DIRECT TAXES ENQUIRY COMMITTEE
FINAL REPORT DECEMBER 1971

CHAPTER 2: BLACK MONEY AND TAX EVASION

INTRODUCTORY

Section 2.1 deleted.

2.2 It was during the Second World War that the terms 'Black market' and 'black money' came into vogue. Due to imposition of various controls on distribution and prices, a clandestine market had sprung up in which things were still available, but at prices higher than the controlled ones. The term 'black money' became current to describe the money received or paid in such 'black market' deals. Since disclosure of these deals, which were entered into in violation of rules and regulations, would have invited severe penalties, these were naturally not entered in the regular books of account and, consequently, remained concealed from the gaze of the tax authorities as well. Afterwards, though black market in the commonly understood sense of the term became rare with the lifting of several controls, transactions still continued to be carried on by the unscrupulous elements in trade and industry outside their books of account, as this practice helped the parties concerned to evade, or substantially reduce, the payment of taxes thereon. With the passage of time, 'black money' acquired a wider connotation - wider than its association with black market transactions alone.

2.3 Today, the term 'black money' is generally used to denote unaccounted money or concealed income and/or undisclosed wealth, as well as money involved in transactions wholly or partly suppressed. Some consider only that as black money which had its origin in clandestine transactions and is currently in circulation. There are others who assert that this is taking too narrow a view of black money. According to them, black money denotes not only unaccounted currency which is either hoarded or is in circulation outside the disclosed trading channels, but also its investment in gold, jewellery and precious stones made secretly and even investments in lands and buildings and business assets over and above the amounts shown in the books of account.

2.4 As mentioned above, tax evasion and black money are closely and inextricably inter-linked. While tax evasion leads to the creation of black money, the black money utilised secretively in business for earning more income inevitably leads to tax evasion. While all tax-evaded income represents black money in a broad sense, all black money does not necessarily originate in tax evasion. Black money is also made through surreptitious use of 'white money'. In this sense, the proliferation of black money derives an additional impetus from the inter-mixing of 'black income' and 'white income'. This phenomenon arises essentially from the dual nature of the national economy. Thus, there is the "official" economy functioning on the basis of the official monetary system, involving open transactions financed through identifiable sources of funds, generating ascertainable income and wealth, and operating generally in conformity with government rules and regulatory and the levy system. But there is another economy, a 'parallel' economy, operating simultaneously and competing with the "official" economy. This parallel economy has ramifications which go beyond one's imagination. It derives its nourishment, strength and support from a secretive, defiant, and an unscrupulous element in our society; it is based not on the official monetary system, but on a secret understanding, and involves a complex range of undisclosed deals and transactions pushed through secretly with unaccounted sources of funds, generating, in the process, income and wealth which escape enumeration or cannot be easily ascertained.

Section 2.5 deleted.

2.6 With the surge of planned expenditures came large government orders, massive industrial outlays, defence programmes, construction and other investments, all creating a boom psychology - one which gave a further thrust to illegal cuts, commissions and transactions and the generation of more black incomes. To mention one example, the cost of land and buildings went up resulting in new rackets; property dealings thus became a significant avenue of illegal deals, with

ratios of 'white' and 'black' payments being freely mentioned. In Bombay, for example, during the period of our enquiry, the commonly quoted ratio was 60:40, that is to say that 40 per cent of the total amount for land or buildings had to be paid in 'black', and receipt might be issued only for 60 per cent of the payment. In some cases, the ratio may have been 50:50 or 40:60. Consequently, a significant portion of the payment remained concealed at both ends and even wealth-tax dodged. In the worst days of inflation, the artificial element of shortages has always been large; but as black money multiplied, the area of artificial shortages seems to have grown. Even otherwise, the distortions in the industrial economy, the periodic foreign exchange crisis and the rigorous import curbs have all provided a fertile field to anti-social elements to ensure that their parallel economy is kept flourishing. In an environment such as this, the smuggling of foreign goods, gold and gems, speculation in commodities and land and properties, and surreptitious money lending have by now become the main props of the black money economy.

Section 2.7, 2.8 & 2.9 deleted.

2.10 Black money and tax evasion, which go hand in hand, have also the effect of seriously undermining the equity concept of taxation and warping its progressiveness. Together, they throw a greater burden on the honest taxpayer and lead to economic inequality and concentration of wealth in the hands of the unscrupulous few in the country. In addition, since black money is in a way 'cheap' money too, because it has not suffered reduction by way of taxation, there is a natural tendency among those who possess it to use it for lavish expenditure and conspicuous consumption. The existence of black money has, to a large extent, been responsible for the inflationary pressures, shortages, rise in prices and economically unhealthy speculation in commodities. Part of black money, which is not utilised in lavish consumption, goes into the purchase of bullion, precious stones and other valuable articles. This in turn, encourages large-scale smuggling of gold, etc., into the country, causing considerable strain on its already tight balance of payments position. Further, by keeping their ill-gotten gains outside the country as deposits in foreign banks or with their own associate concerns, whether earned in deals abroad or transferred out of India through clandestine channels, the tax evaders deprive the country of a part of its wealth which could have been put to productive use here. Besides, the leakage of foreign exchange makes our balance of payments rather distorted and unreal. There is also the oddity that a country, where capital and more particularly foreign exchange resources are scarce, becomes a *de facto* lender of aid and capital to economically advanced and wealthier nations, with the concealed outflow of funds.

Section 2.11 deleted.

2.12 Black incomes and tax evasion defeat Government's economic policies and at the very least make the implementation of the policies ineffective; for example, in the field of credit and investment. Monetary policy involving severe restrictions or a curb on disbursement of credit comes straight in the face of a parallel economy functioning outside the purview of the authorities. When a dear money policy is pursued or the Government desires to impose selective control on disbursement of finance to certain sectors, the black money economy can frustrate this by opening up alternative sources of credit at 'free market' rates. This source of credit is available even to what the Government may consider as the non-priority sectors on whom the credit squeeze is to be applied. One of the reasons why the Government's management of credit and money in recent years has been ineffective is the proliferation of black money and rampant tax evasion which provide a free access to surreptitious funds to those who desire them. The impact of this may be somewhat less when the curbs are officially relaxed. It is our view that black money and tax evasion are even otherwise encouraging over-financing of business which is as dangerous as under-financing. These trends add further to the inflationary pressures in the country. They can undo also some of the major investment targets and objectives of Government's planning. Apart from the fact that this situation results in an

under-estimation of resources available in the country, thereby inhibiting investment planning, there is reason to believe that the operation of the black money economy has already upset the momentum of our development and distorted the pattern of saving and investment in India.

2.13 Black money and tax evasion have an adverse economic effect in yet another sense, in that they divert the energy of taxpayers and their advisers from productive activities to the non-productive object of manipulation of accounts, creating camouflage around their deals and devising all sorts of facades to escape their legitimate tax liability. In the process, they also compel the administration to spend a lot of its time and resources on tackling their devious ways of tax evasion - time and money which could have been put to more purposeful use.

Section 2.14 deleted.

Extent of Black-Money and Tax Evasion

2.15 Before considering measures for fighting tax evasion, we felt that we should have an idea of the extent of black money and tax evasion in the country as it would help us gauge the dimensions of the problem. While tax evasion in the country is believed to be substantial, the estimates furnished in the course of replies to our Questionnaire varied widely from Rs 100 crores to Rs 15,000 crores. We are fully conscious of the inherent, difficulties involved in attempts to quantify tax evasion. The Taxation Enquiry Commission had observed that "..... the quantum of the evasion which actually takes place and goes undetected could rightly be estimated at a very high figure indeed." An estimate was made in 1956 by Nicholas Kaldor. According to him, the income-tax loss through tax evasion was of the order of Rs 200 to Rs 300 crores in 1953-54. As against Kaldor's estimate, the Central Board of Revenue, as it then was, expressed the opinion that tax evaded in the year 1953-54 could not have exceeded Rs 20-30 crores. The Direct Taxes Administration Enquiry Committee (1958-59) also considered the extent of tax evasion in the country and observed that the quantum of tax evasion, though undoubtedly high, was not of the magnitude indicated by Kaldor.

2.16 Research work on tax evasion in this country is extremely limited; ..... we were able to obtain some data for 1961-62 from the Directorate of Inspection (Research, Statistics and Publications). An exercise on the basis of these data is given in Table I.

TABLE I. SECTOR-WISE DISTRIBUTION OF ASSESSABLE NON-SALARY INCOME FOR 1961-62 (ASSESSMENT YEAR 1962-63)

(Rs Crore)

Sector	National income*		Assumed proportion of non salary income above exemption limit	Assessable non-salary income
	Total salary income Rs	Non-salary income Rs	(%)	Rs
1. Mining and Quarrying	60	89	60	53
2. Manufacturing (a)	1,247	1,523	60	914
3. Railways and Communications	286	67	..	..
4. Other transport	151	151	60	91
5. Trade, Hotels and Restaurants	278	1,111	70	777
6. Banking and Insurance	134	49	100	49
7. Public Administration and Defence	475	118	100	118
8. Miscellaneous (b)	..	1,369	50	684
Total	2,631	4,477	..	2,686
9. Agriculture	1,030	6,025		
GRAND TOTAL	3,661	10,502		

Note: (a) Includes large-scale, small-scale, construction, electricity, gas, water supply, etc.
(b) Includes real estate ownership and other services.
* Source: Estimates of National Product (Revised Series) - March, 1969.

Assessed non-salary income referable to the year 1961-62 (Assessment Year 1962-63).

Income referable to assessment year 1962-63 was assessed during the financial year 1962-63 to 1966-67. The break-up is as under:

(Rs Crore)

1962-63	1,022.9
1963-64	373.3
1964-65	155.8
1965-66	168.0
1966-67	507.7
Total	2,227.7
Deduct-salary income assessed during the financial year 1962-63	352.6*
Non-salary income of financial year 1961-62 which was actually assessed to tax	1,875.1

* This is assumed to represent the salary income of financial year 1961-62.

2.17 This study is based on an adoption of the Kaldor method with suitable modifications bearing in mind the structural changes in the economy and certain other developments. The conclusion of this study is that the assessable non-salary income and the actually assessed non-salary income for the financial year 1961-62 were Rs 2,686 crore and Rs 1,875, crore respectively. Accordingly, the income which escaped tax for that year would appear to be of the order of Rs 811 crore. In order to ascertain the position for the financial year 1965-66 (assessment year 1966-67), being the latest year for which detailed revenue statistics are available we arrived at the assessable non-salary income for that year, on the basis that was adopted for 1961-62 financial year, at a figure of Rs 4,027 crore (vide Table II). Applying the ratio of evaded income to the assessable non-salary income of 1961-62 to the assessable non-salary income of 1965-66, the evaded income for 1965-66 works out to Rs 1,216 crore. However, we should like to qualify these estimates for three reasons:

TABLE II. SECTOR-WISE DISTRIBUTION OF ASSESSABLE NON-SALARY INCOME FOR 1965-66 (ASSESSMENT YEAR 1966-67)

(Rs Crore)

Sector	National income*		Assumed proportion of non salary income above exemption limit (%)	Assessable non-salary income
	Total salary income Rs	Non-salary income Rs		Rs
1. Mining and Quarrying	94	140	60	84
2. Manufacturing (a)	1,890	2,310	60	1,386
3. Railways and Communications	416	97	..	..
4. Other transport	223	222	60	133
5. Trade, Hotels and Restaurants	445	1,784	70	1,249
6. Banking and Insurance	245	90	100	90
7. Public Administration and Defence	1,040	260	100	260
8. Miscellaneous (b)	..	1,651	50	825
Total	4,353	6,554	..	4,027
9. Agriculture	1,575	8,271		
GRAND TOTAL	5,928	14,825		

Note: (a) Includes large-scale, small-scale, construction, electricity, gas, water supply, etc.
(b) Includes real estate ownership and other services.

(i) The income which can be related to the assessment year 1966-67 does not fully represent the income generated in or related to the financial year 1965-66. Accounting years and on varying dates and a certain backlog is also involved in the routine assessments. Larger income cases needing more scrutiny may not always be completed within the relevant years and many such cases may have been carried forward.

(ii) The national income figures cannot be strictly compared with incomes assessed because the Income-tax Act allows a large number of exemptions and deductions (for

example, casual and non-recurring receipts, income of new industrial undertakings and priority industries, and deduction for development rebate, etc.). No adjustment is possible in the case of such exemptions and deductions.

(iii) No adjustment has been made in respect of certain incomes which are subject to income-tax twice due to provisions of the income-tax law. For example, the income of a firm suffers tax not only in the hands of the firm, but also in the hands of its partners. Due to lack of data, no adjustment has been made in respect of such items also.

Even after taking all these limitations into account and after making rough adjustments on the basis of information available, the estimated income on which tax has been evaded would probably be Rs 700 crore and Rs 1,000 crore for the years 1961-62 and 1965-66, respectively. Projecting this estimate further to 1968-69 on the basis of the percentage of increase in the national income from 1961-62 to 1968-69 (during which period the national income increased nearly by 100 per cent), the income on which tax was evaded for 1968-69 can be estimated at a figure of Rs 1,400 crore.

2.18 As regards the extent of tax evasion, we find that the average rate of tax on the income assessed for 1965-66 was around 25 per cent. But considering that the size of the problem of black money and tax evasion has grown over the years and tax evasion is more widely practised at higher levels of income, it would be appropriate to adopt the rate of tax applicable to evaded income at not less than 33-1/3 per cent, for 1968-69. On this basis, the extent of income-tax evaded during 1968-69 would be of the order of Rs 470 crore, being one-third of Rs 1,400 crore. The money value of deals involving black income may, therefore, be not less than Rs 7,000 crore for 1968-69. We would, however, wish to emphasize that the amount of tax-evaded income for 1968-69 is only a justmate based on certain assumptions about which substantial difference of opinion exists for want of adequate data. In addition, we would also like to dispel a possible impression that the tax-evaded income is all lying hoarded which can be seized by the authorities; much of it has been either converted into assets or spent away in consumption or else is in circulation in undisclosed business dealings.

Avenues for Black Money

2.19 The multiplicity of avenues in which black money in the country gets channelised is matched only by the ingenuity of the devices through which it is earned. It is found widely used for conducting business transactions in 'Account No. 2', smuggling of gold, diamonds and luxury articles, indulging in unauthorised transactions involving foreign currency and purchasing scarce commodities for the purpose of hoarding, speculation, profiteering and black-marketing. It is also spent in purchasing illegally quotas and licences at premia, financing secret commissions, bribes, litigation, etc., giving 'on-money' in business transactions, buying industrial peace, financing election expenses and giving donations to political parties. Black money is also utilised in call deposits, bogus hundi loans, acquisition of movable and immovable assets, *e.g.*, jewellery, tax-free Government securities, deposits in Indian and foreign banks in 'ghost' or benami accounts and land and buildings purchased in real or benami names, often with 'on-money' payments. Not infrequently, contributions to charity in anonymous and pseudonymous names also come out of black money. Behind the vulgar display of wealth which is evidenced by ostentatious living and lavish expenditure on weddings, festivals, etc., is this scourge of black money.

Causes of Tax Evasion, Creation of Black Money and its Proliferation

2.20 To be able to suggest remedial measures, we considered it necessary to be clear in our minds as to the causes which have led to this malaise of black money and tax evasion..... The following are said to be the major factors responsible for this evil:-

(a) High rates of taxation under the direct tax laws

We had posed the question whether tax evasion is dependent on the rates of taxation and whether it increases with the increase in the tax rates. An overwhelming majority of the persons, who responded to the Questionnaire, have voiced the opinion that tax evasion is dependent on the rates of taxation and rises with increase in the rates. When the marginal rate of taxation is as high as 97.75 per cent, the net profit on concealment can be as much as 4,300 per cent, of the after-tax income. The implication of 97.75 per cent, income tax is that it is more profitable at a certain level of income to evade tax on Rs 30 than to earn honestly Rs 1,000. We will not be surprised that placed in such a situation, it would be difficult for a person to resist the temptation to evade taxes.

(b) Economy of shortages and consequent controls and licences

The Indian economy before the Second World War was not marked by any significant shortages. This was so not because production was plentiful but because demand in an economy, which was stagnant, was small. During the War, however, things began to change. The Government had to incur vast expenditure on defence and had to divert the existing inadequate resources to meet the urgent and pressing needs of the War. As a result, imbalances in the economy and acute shortages of various goods developed. Shortages had to be regulated by imposing controls on distribution and prices. Controls led to abuse, black-marketing, profiteering and tax evasion.

Shortages and controls did not however, end with the War. With the advent of Independence, to fulfil its promises to the people, the Government had to launch various economic schemes in order to achieve planned progress. With the ever-increasing population and the scarce resources position, it became inevitable for the Government to regulate foreign exchange, imports and exports, to control distribution of scarce commodities and to resort to licensing of industry in order to achieve planned development. In spite of the vigilance exercised by the Government, controls and regulations came to be used by the unscrupulous for amassing money for themselves. Since considerable discretionary power lay in the hands of those who administered controls, this provided them with scope for corruption - 'speed money' for issuing licences and permits, and 'hush money' for turning a blind eye to the violation of controls. All this gave rise to trading in permits, quotas and licences, malpractices in distribution and, in the process, it generated sizable sums of black money. As the transactions in violation of statutory restrictions had to be entered into secretively, these had necessarily to be kept back from the tax authorities. In consequence, evasion of tax on incomes thus made illegally followed inevitably.

(c) Donations to political parties

It has been represented before us that the political climate in India is none too conducive to checking black money transactions. Rather, it is contended that it provides opportunities for generation of black money. In this connection, it has been pointed out that large funds are required to meet election expenses and it is common knowledge that these are financed to a great extent by wealthy persons, with lots of black money. According to some, this is not the cause but an outlet for black money. The situation is stated to have been further aggravated by the ban imposed recently on donations by companies to political parties.

(d) Corrupt business practices

Many of the corrupt practices in business seem to lead to an ever increasing need for keeping on hand funds in black. Payments of secret commission, bribes, on-money, pugree, etc., in a variety of situations have ben referred to us in this connection. It has been particularly mentioned that the manufacturers of popular goods which are in short supply not only exact from parties large sums initially for appointment as selling agents, but also demand recurring secret commission on

the sale of goods. Undoubtedly, such corrupt practices are responsible to a considerable extent for the creation of 'black money' in the economy.

(e) Ceilings on, and disallowances of business expenses

It has been represented that the Income-tax Act either completely disallows or imposes ceilings on certain expenses which are required to be incurred on principles of commercial expediency, with the result that such expenses, though actually incurred, are not allowed to be deducted in arriving at the taxable income. It has been pointed out that this artificial limitation adds to the tax burden, particularly in the context of the present day high rates of taxation. The examples usually cited in this regard are those relating to expenses on entertainment, advertisement, guest houses, travelling and perquisites to directors.

(f) High rates of sales-tax and other levies

Many of those who sent replies to our Questionnaire or who appeared before us were of the view that the high rates of Central and State imposts, other than income-tax are contributory factors to evasion of income-tax in the country. It was stated that the high rates of sales-tax, stamp duty, excise duty on certain items, octroi, cess and the like, induce many persons to avoid recording the transactions altogether and in the process they evade income-tax as well. We concede that there are persons who find evasion of these taxes to be quite attractive and profitable, as evasion of one tax offers them relief from the burden of another.

(g) Ineffective enforcement of tax laws

Yet another important cause of tax evasion is said to be the lack of an effective enforcement machinery. It is pointed out that the income-tax administration has not been able to achieve a major breakthrough in fighting evasion for certain technical as well as administrative reasons. In this connection, some have even pointed out that tax administration is not able to function independently and also that the set-up of the Department itself is not quite conducive to effective enforcement of laws. There are others who feel that taxation laws and administrative policies themselves have certain loopholes which water down their efficiency. It is contended that frequent resort to voluntary disclosure schemes to net in untaxed income, absence of an effective intelligence machinery in the Income-tax Department and lack of a vigorous prosecution policy for the offences provide encouragement to tax evaders to carry on with their nefarious activities with impunity in the belief that the Department will not detect them. We agree with this view substantially and do feel that there is need and scope for more vigorous enforcement of tax laws.

(h) Deterioration in moral standards

Another important cause of tax evasion which has been mentioned is the general deterioration in moral standards of our people, lack of tax consciousness and the absence of social stigma against tax evasion. There has been lately a marked tendency towards putting greater premium on material values and, consequently, a growing craze for getting rich quick, by resorting to all possible means - fair or foul. This naturally tempts people to resort to violation of tax laws, for the most obvious means of retaining more money is by not paying tax thereon. In such an atmosphere, no wonder evasion of taxes is not considered by many as undesirable or unethical. Not infrequently one comes across persons who boast privately of their 'achievements' to the field of tax evasion. The lack of social stigma against tax evaders plays an important contributory role in this over-all lack of tax consciousness. Sharing this general atmosphere of moral laxity, it is not surprising that even some tax advisers do not hesitate to lend their support in shielding, and even assisting the tax dodgers.

Steps taken in the past to unearth black money

2.21 Though tax evasion and black money assumed significant dimensions in our country only during and after the Second World War, the problem as such has always been there and has

continuously engaged the attention of the Government. As far back as 1936, the Ayers Committee reviewed the Income-tax system in India in all its aspects, and large-scale amendments to the law were made in 1939 to give effect to its recommendations which, it was claimed, were 'designed to secure the fairest possible treatment of the honest taxpayer and at the same time to strengthen the Department in dealing with fraudulent evasion and what is known as 'legal avoidance'.' For dealing with the mounting tax evasion during the war period, the Income-tax Investigation Commission, was appointed in 1947 to investigate individual cases of tax evasion referred to it and also to report on the state of the law and administration and to suggest measures for its improvement with a view to prevent tax evasion. The Taxation Enquiry Commission (1953-54) also went into the question of tax evasion and recommended several legal and procedural changes. In 1956, Nicholas Kaldor made a specialised study of the Indian tax system, particularly with reference to personal and business taxation and the prevalence of tax evasion. The years 1957-58 witnessed several amendments and new legislation based on his report. The Direct Taxes Administration Enquiry Committee, which was appointed in 1958 to advise the Government on the administrative organisation and procedures necessary for implementing the integrated scheme of taxation with due regard to the need for eliminating tax evasion and avoiding inconvenience to the public, also made substantial contribution to the reorganisation of the legal and administrative set-up. In 1968, a Committee of Departmental officers was constituted by the Government to undertake a study of the problems of tax evasion and to suggest ways and means of tackling it. The Administrative Reforms Commission, based on a study of the problem of tax evasion made by the Working Group, suggested certain measures in its report submitted in January, 1969.

2.22 Consequent on the recommendations of these various Commissions, Committees and experts, several changes have been made in the law dealing with tax evasion. The scope of provisions relating to the reopening of past assessments has been progressively widened. Penalties have been made stiffer and deterrent provisions for criminal prosecutions and for awarding exemplary punishment have been introduced. The administrative powers of the authorities for securing information have been enlarged and officers of the Department have been given the powers of search and seizure, and also of spot survey. Simultaneously, the secrecy provisions in the law have been relaxed and greater publicity is now given in respect of tax offences. Several other legislative measures for curbing certain malpractices resulting in evasion or avoidance of tax have also been introduced.

2.23 There have also been changes from time to time in the administrative set up of the Department and its procedures to gear it up to the changing role it has to play in tackling tax evasion. For a detailed and thorough investigation of difficult cases of tax evasion, Central Charges were created at Bombay in 1939 and at Calcutta in 1941 on the basis of the recommendations of the Ayers Committee in 1936. In 1940, the Directorate of Inspection (Income-tax) was set up, and in 1943-44 a Special Branch was set up under the direction and control of that Directorate to do investigation and collation work in connection with the assessment of contractors who were making colossal profits during the war time. The Directorate of Inspection (Investigation) was set up in 1952 for undertaking and coordinating investigation in difficult and complicated cases of tax evasion. This Directorate was later entrusted with the Special Investigation Circles. Following the decision of the Supreme Court which struck down the Taxation on Income (Investigation Commission) Act, 1947, as *ultra vires*, the Directorate of Inspection (Special Investigation) was formed in 1954 to take over and complete the work of the Investigation Commission. In 1966, an Intelligence Wing was created and placed under the charge of the Directorate of Investigation. Special Investigation Branches, which function at the headquarters of the Commissioners for collection, collation and dissemination of information, and survey units have been reorganised from time to time to improve the quality of internal and external survey. On the assessment side, group charges were created to facilitate better investigation and

assessment under the guidance of senior officers. More recently, the functional scheme and the small income assessment scheme have been introduced to release the time and energy of senior and experienced officers for the more important work of investigation and tackling of tax evasion.

2.24 Apart from these legal and administrative measures meant to curb evasion of tax, certain steps were also taken to tackle the black money built up out of past evasions. In 1946, just at the close of the war, high denomination notes were demonetised so as to bring into the tax net black money earned during the war. A voluntary disclosure scheme was announced in 1951 to facilitate the disclosure of suppressed incomes. The penal provisions of the law were suitably relaxed for the purpose. After the lapse of nearly a decade and a half, a second scheme of voluntary disclosure was introduced by section 68 of the Finance Act, 1965. This scheme, popularly known as the '60-40 Scheme', enabled the tax evaders to pay 60 per cent of the concealed income as tax and bring the balance of 40 per cent thereof into their books. Closely on the heels of the scheme, came another under section 24 of the Finance (No. 2) Act, 1965, popularly known as the 'Block Scheme', according to which tax was payable at rates applicable to the block of concealed income disclosed, and not at a flat rate as under the '60-40 Scheme'.

Measures for unearthing black money

2.25 Despite the aforesaid steps taken by the Government from time to time, the twin problems of black money and tax evasion have, if anything continued unabated. It was in this background that we were called upon to recommend remedial measures, both legal and administrative, to unearth black money and to prevent its proliferation through further evasion.

Section 2.26 deleted.

Voluntary disclosure scheme

2.27 We had in the Questionnaire issued by us posed the question whether it would be desirable for the Government to announce another scheme of general amnesty for the declaration of black money. Majority of the persons who have replied to the Questionnaire do not favour another scheme of voluntary disclosure. The general feeling is that such schemes place a premium on fraud and are unfair to the honest taxpayers. Majority of the Departmental officers and some chambers and other representative bodies of the trading community have expressed themselves categorically against the introduction of any further disclosure schemes. A large number of the persons who appeared before us also echoed similar sentiments.

2.28 The principal argument against the introduction of another disclosure scheme is that the results of the three earlier schemes have been disappointing. The total income disclosed in all the three schemes put together was a mere Rs 267 crore which, to say the least, is only a small fraction of even the most modest estimate of concealed income for the period of 15 years from 1951 to 1965. As against this, it was stated that the concealment detected by the Department in the ordinary course during a period of 5 years from 1965 to 1969 was Rs 161 crore and the taxes and penalties in respect of such concealed income worked out to Rs 105 crore or about 65 per cent of the income detected. Moreover, much of the income disclosed during the course of the three schemes had been either already detected or was about to be detected and the schemes did not make any real contribution to bringing to surface concealed incomes. The taxes realised out of the disclosures were even more unimpressive. The 60-40 scheme produced only Rs 30.80 crore. The other two schemes yielded tax of hardly 15 per cent, of the disclosed income. The total tax yield of all the three schemes put together was a mere Rs 61.23 crore.

2.29 All the three earlier schemes were found defective in one respect or another. They were more or less schemes for converting black money into white on payment of what turned out to be in most cases, a small amount of conscience money. Disclosures made in the names of minors, ladies and benamidars have, on the other hand, contributed to perpetuating evasion, and rendered investigation in many a case of suspected tax evasion difficult or even futile. The fact that in

the last of these three schemes, namely, the block scheme, as many as 1,64,226 disclosures were from persons not previously assessed to tax would bear ample testimony to the misuse of the scheme. We were informed by the Central Board of Direct Taxes that there were several instances of the same set of persons taking advantage of all the three disclosure schemes, which would belie the theory that such schemes help to rehabilitate the repentant tax evader who is desirous of mending his ways.

2.30 An argument usually advanced in the favour of announcing another disclosure scheme is that it would help, to broaden the base of investment and accelerate the growth rate. This proposition is, in our view, based on the erroneous assumption that the amounts which disclosures bring out are not already invested. As happens in most cases, the disclosed amounts are already invested surreptitiously in business or property through various devices, and the contribution of disclosure schemes as such to fresh investment is hardly worthwhile.

2.31 We consider that a disclosure scheme is an extraordinary measure, meant for abnormal situations such as after a war or at a time of national crisis. Resorting to such a measure during normal times, and that too frequently, would only shake the confidence of the honest taxpayers in the capacity of the Government to deal with the law breakers and would invite contempt for its enforcement machinery. *We are convinced that any more disclosure schemes would not only fail to achieve the intended purpose of unearthing black money but would have deleterious effect on the level of compliance among the taxpaying public and on the moral of the administration. We are, therefore, strongly opposed to the idea of the introduction of any general scheme of disclosure either now or in the future.*

Settlement machinery

2.32 This, however, does not mean that the door for compromise with an errant taxpayer should for ever remain closed. In the administration of fiscal laws, whose primary objective is to raise revenue, there has to be room for compromise and settlement. A rigid attitude would not only inhibit a one-time tax-evader or an unintending defaulter from making a clean breast of his affairs, but would also unnecessarily strain the investigational resources of the Department in cases of doubtful benefit to revenue, while needlessly proliferating litigation and holding up collections. We would, therefore, suggest that there should be a provision in the law for a settlement with the taxpayer at any stage of the proceedings. In the United Kingdom, the 'confession' method has been in vogue since 1923. In the U.S. law also, there is a provision for compromise with the taxpayer as to his tax liabilities. A provision of this type facilitating settlement in individual cases will have this advantage over general disclosure schemes that misuse thereof will be difficult and the disclosure will not normally breed further tax evasion. Each individual case can be considered on its merits and full disclosures not only of the income but of the *modus operandi* of its build-up can be insisted on, thus sealing off chances of continued evasion through similar practices.

2.33 To ensure that the settlement is fair, prompt and independent, we would suggest that there should be a high level machinery for administering the provisions, which would also incidentally relieve the field officer of an onerous responsibility and the risk of having to face adverse criticism which, we are told, has been responsible for the slow rate of disposal of disclosure petitions. *We would, therefore, recommend that settlements may be entrusted to a separate body within the Department, to be called the Direct Taxes Settlement Tribunal.* It will be a permanent body with three Members. The strength of the Tribunal can be increased later, depending on the work-load. To ensure impartial and quick decisions, and to encourage officers with integrity and wide knowledge and experience to accept assignments on the Tribunal, *we recommend that its members should be given the same status and emoluments as the members of the Central Board of Direct Taxes.*

Any taxpayer will be entitled to move a petition before the Tribunal for settlement of his liability under the direct tax laws. We do not think that it is necessary to provide for cases being referred to the Tribunal by the Department. However, *we wish to emphasise that the Tribunal will proceed*

with *the petition filed by a taxpayer only if the Department raises no objection to its being so entertained.* We consider that this will be a salutary safeguard, because otherwise the Tribunal might become an escape route for tax evaders who have been caught and who are likely to be heavily penalised or prosecuted. Once a case is admitted for adjudication, the Tribunal will have exclusive jurisdiction over it and it will no longer be open to the taxpayer to withdraw the petition. The Tribunal will take a decision after hearing both the assessee and the Department. The Tribunal should be vested with full powers as regards discovery and inspection, enforcing the attendance of any person, compelling production of books of account or any other documents and issuing commissions. It should also have the power to investigate cases by itself or, in the alternative, to have investigation carried out on any specific point or generally, in any case through the Income-tax Department. The terms of the award will be set down in writing and it will be open to the Tribunal to determine not only the amount of tax, penalty or interest but also to fix date or dates of payment. The quantum of penalty and interest will be in the discretion of the Tribunal. Similarly, the Tribunal may also in its discretion grant immunity from criminal prosecution in suitable cases. The award will be binding both on the petitioner and on the Department. The application of its decisions on questions of law will, however, be confined to the case under settlement and will not in any way interfere with the interpretation of law in general. No appeal will lie against the decision of the Tribunal by the petitioner or the Department, whether on questions of fact or of law.

Bearer bonds

2.35 Another suggestion that has been made to bring out black money and canalise it into productive channels is a scheme of 'bearer bonds'. In brief, the suggestion is that the Government should issue long term bearer bonds carrying a low rate of interest, say, 3 per cent. Bearer bonds are normally transferred by delivery but these bonds will be negotiable only by endorsement and thereafter they will cease to be bearer bonds. The Government should give the assurance that the source of moneys invested in such bonds by the original holder, so long as they are not endorsed, will not be questioned. The advantages claimed for the scheme are that persons who have unaccounted money, will find it a safe avenue of investment, while at the same time the country will stand to benefit by the utilisation of such black money for development projects. The low rate of interest which the Government would pay on the investment is claimed to represent an indirect levy of tax on the money invested and, as in all disclosure schemes, the Government would realise the tax on the amounts disclosed, though indirectly and at somewhat concessional rates. For the investor, the investment would offer anonymity, security and liquidity. He can borrow against the investment or sell it in the market. By providing that after endorsement the bonds will cease to be bearer bonds, the scheme ensures that it does not invite a chain of black money investments. It is contended by the protagonists of the suggestion that the anonymity which the scheme offers would encourage tax evaders to come out with their cash hoards without fear, proliferation of black money will be checked, inflationary tendencies will be curbed and productive investments will get a fillip.

2.36 We have carefully considered the pros and cones of this suggestion. The Bearer Bond Scheme is a poor substitute even for a disclosure scheme, as it can cover only black money which is not invested and is lying in cash. Further, the investments of black money in such bonds will not connect it up with any particular source of income, and as such, it does not offer to the investor immunity from investigation and proper assessment of the income from that source and the penal consequences. The investor cannot also remain completely anonymous from the Income-tax Department when he sells the bonds or raises loans on their security or offers the interest from such bonds for taxation. These aspects will militate against the success of the scheme even within the limited sphere of persons having unaccounted cash. Making the interest tax-free would tantamount to allowing high rate of interest and would defeat the very purpose of offering a low yield on the investment. On the

other hand, if the interest is taxable, the chances are that most of the investors taking advantage of their anonymity would not disclose the interest income and the scheme might in fact lead to further evasion and build up of black money. The possibility of transfer of bearer bonds from hand to hand in violation of the stipulation of endorsement cannot be ruled out and in that event, the bearer bonds will become a parallel currency. It may be that in view of the low rate of interest, the market value of a bond of Rs 100 comes down to Rs 50 or Rs 60. But the difference accrues only to the buyer and not to the Government which will eventually have to redeem the bonds at their full face value. We will not be surprised, if after the expire of the issue period, which will be limited, these bonds start selling at a premium or being lent as short-term accommodation for a consideration, to enable tax evaders to explain away the concealments which might be detected by the Department in their cases. The more we think of it, the more *we feel convinced that the so-called benefits claimed for the bearer bond scheme are illusory.*

Swiss type bank accounts

2.37 Bank accounts of the 'Swiss type' have been advocated as another means of channelising 'black money' now circulating almost as a parallel currency in the country with all its consequent deleterious effects on the economy. Swiss banks with their stringent rules of secrecy have in recent years become known as repositories of black money owned by tax evaders in various countries. The argument is that if India were to offer similar facilities, the Government might be able to mobilise substantial deposits of unaccounted moneys, both from inside India and from abroad. We are not convinced by this argument. Switzerland occupies a unique position - geographically, historically, politically and economically. There is now a growing concern among many countries that the manner in which the Swiss banks operate provides facilities for tax evasion by the nationals of other countries and this tends to facilitate the flight of capital to Switzerland. To combat the threat posed by the system, countries like the U.S.A. have in their tax treaties with Switzerland included clauses for exchange of information for countering fiscal evasion. Recently, the Federal Tribunal, Switzerland's highest court, authorised Swiss federal authorities to give information to the Internal Revenue Service in Washington about an American citizen's account with a Swiss Bank. The Federal Tribunal ruled that Switzerland was obliged under its double taxation agreement with the United States to give competent U.S. authorities information to prevent or detect crime or fraud. They also said that the 'Swiss Banking Agency' - enshrined in the Swiss code since 1934 - protected a bank's customer from routine enquiries about possible tax evasion but not if there were grounds for suspecting more serious offences of tax fraud. In this context, *we do not consider it worthwhile to experiment with the Swiss type of bank accounts in India.*

Canalising black money into certain specified fields

2.38 It has been suggested that black money floating in India could be canalised into social and desirable fields of activity by giving immunity from rendering any explanation about the sources of investment. Such desirable fields of activity could be building water works, roads, bridges, etc., in rural areas which may be thrown open to private initiative and enterprise, and the construction of tenements for slum dwellers in the cities..... It is unlikely that persons who were unwilling to pay a portion of their income as taxes would volunteer to give away the whole of it for a purpose of general public utility. *We are, therefore, of the view that sponsoring official schemes for canalising black money into specified fields will not be desirable.* Elsewhere we have suggested that public conscience should be roused against the evil of tax evasion, and that tax evaders should be made to feel like social outcastes. It will be highly inconsistent with such an attitude and approach if tax evaders were to be allowed to assume in the public eye the role of benefactors.

Searches and seizures

2.39 *Increased use of power of search and seizure* ..... Searches form a necessary and powerful adjunct to investigation as they bring to light assets and information, which would otherwise be beyond the reach of the Department through its normal channels of enquiry and examination of accounts. We consider the power of search under the Income-tax Act as a potent instrument in the hands of the Department to provide direct and clinching evidence about tax evasion and the existence of black money. Searches not only lead to unearthing of black money in kind, but also to getting hold of hidden books of account which would clearly show that what has been disclosed is only part of what has been earned, invested or accumulated. That searches have been found to be useful in the fight against tax evasion is apparent from the following information supplied to us by the Central Board of Direct Taxes:

Year	No. of searches and seizures conducted	No. of successful searches	Amount of assets seized (Rs lakh)
1	2	3	4
1964-65	397	393	147
1965-66	306	293	130
1966-67	189	186	58
1967-68	109	106	90
1968-69	81	79	59
1969-70	170	169	95
1970-71	195	192	120
	1,447	1,418	699

We recommend that the Department should make an increasing use of its powers of search and seizure in appropriate cases.

2.40 In their memoranda as well as statements before us, several persons have pointed out some glaring anomalies in the existing provisions and have also marked out certain problem areas. We have carefully considered the various suggestions made in this behalf. *We recommend below changes, which we would like to be made, so as to render this instrument more effective.*

(a) Commissioner's power - Sub-section (1) of section 132 of the Income-tax Act, 1961, empowers a Commissioner of Income-tax to authorise searches and seizures only in respect of assessees who are within his jurisdiction. Moreover, the search is to be confined to the premises mentioned in the search warrant. It has been brought to our notice that considerable difficulty is being experienced in cases with all-India ramifications when during the course of conducting the search at places in the jurisdiction of another Commissioner of Income-tax, the 'authorised officer' finds it necessary to search some other premises of the same assessee not mentioned in the search warrant. He cannot readily obtain another warrant from the Commissioner of Income-tax who is available locally as the latter has no power under sub-section (1) of section 132 to authorise a search in respect of the proposed premises since they are not connected with any assessee in his jurisdiction. This results in the postponement of the search of such other premises till a warrant can be obtained from the Commissioner of Income-tax who had originally authorised the search. As time is of the essence in these matters, this delay quite often defeats, wholly or partially, the purpose of the search. As the difficulty pointed out is genuine, *we recommend that a Commissioner of Income-tax should have power to authorise search and seizure, irrespective of whether the taxpayer is assessed in his jurisdiction or not.*

Inspecting Assistant Commissioners to have power of Search - We have also considered the desirability of empowering Inspecting Assistant Commissioners to authorise searches and seizures. As the headquarters of the Commissioners of Income-tax are at quite some distance from Income-tax Offices, particularly in mofussil charges, and as the success of a search and seizure lies in secrecy and prompt action, *we recommend that the power of authorising searches and seizures should be available to the Inspecting Assistant Commissioners as well.* In fact, the power to authorise searches and seizures is available under the Customs Act, 1962 and Foreign Exchange Regulation Act, 1947 to officers who are lower in rank than an Assistant Commissioner of Income-tax. We do not apprehend that empowering these officers would result in any harassment to tax-payers. However, an Inspecting Assistant Commissioner should have this power only in respect of cases falling within

his jurisdiction.

(b) Search to cover persons, vehicles and vessels - Premises of any person who is suspected to have concealed income or items of wealth can be searched in pursuance of a search warrant issued under section 132 of the Act. We understand that there have been several occasions when searches of persons, vehicles and vessels became inevitable, and yet nothing could be done due to the non-availability of powers of search in this regard. We appreciate that on certain occasions the lack of power to search persons, vehicles and vessels can be a serious handicap. We find that similar powers are available to officers of the Customs Department under sections 100, 101 and 106 of the Customs Act, 1962. *We recommend that the existing powers of search under the Income-tax Act be extended to cover persons, vehicles and* vessels.

(c) Period for making order for retention of seized assets - In case of seizure of an asset, the Income-tax Officer is required to estimate the undisclosed income in a summary manner to the best of his judgement and pass an order under sub-section (5) of section 132 within ninety days of the seizure. Such an order can be made only with the previous approval of the Commissioner of Income-tax after affording the reasonable opportunity to the persons concerned of being heard and making an enquiry as prescribed under Rule 112A of the Income-tax Rules, 1962. It has been represented to us that this period of ninety days is too short because the assessees, whose premises are searched, generally adopt dilatory and obstructionist tactics in order to stall the enquiry contemplated before passing such an order. This period is also stated to be inadequate for scrutiny of important materials vital for the enquiry. We agree that placed in such a situation, any conscientious officer would find it an exasperating experience to adhere to this time-limit. On the one hand, he is expected to make a well-reasoned order which should stand the test of assessee's appeal to the Board, and on the other, he has to reckon with the tactics of a a recalcitrant assessee. *We recommend that the period for making an order under sub-section (5) of section 132 may be extended from the present ninety days to one hundred and eighty days.* As the enquiry proceedings for the purpose of making an order under sub-section (5) of section 132 have to be commenced within fifteen days of the seizure, the tax administration is already committed to initiate proceedings without delay. In a way, this change would also be useful to the assessees as they will have enough time and opportunity to vindicate their stand-point in the matter satisfactorily.

(d) Tax liability to include interest and penalty - Under clause *(ii)* of sub-section (5) of section 132 the assets seized in the course of a search can be retained for the purpose of meeting the tax liability on the estimated undisclosed income. However, the existing provision does not permit retention of assets in order to satisfy the liability on account of interest and penalty that might be determined on such undisclosed income. This appears to us to be an omission and *we recommend that the law may be amended to permit retention of seized assets in order to meet the liability of interest and penalty, in addition to the tax, that may become due on the estimated undisclosed income.*

(e) Definition of 'authorised officer' - Under sub-section (8) of section 132 of the Income-tax Act, 1961, account books and documents seized in the course of search cannot be retained by the 'authorised officer' for a period exceeding one hundred and eighty days unless he records the reasons in writing for the retention, and obtains approval of the Commissioner of Income-tax in this behalf. We are told that this requirement has led to some practical difficulties. Usually the 'authorised officer', *i.e.*, the officer authorised to conduct search and seizure, hands over the seized material to the Income-tax Officer having jurisdiction over the assessee's case. Thereafter, the authorised officer is in no position to decide whether or not the seized records should be retained beyond 180 days. The practice obtaining at present is that the assessing Income-tax Officer records the reasons for retention and requests the 'authorised officer' to endorse the proposal for retention before the same is forwarded to the Commissioner of Income-tax for approval. In many a case, it so happens that the person who acted as an 'authorised officer' goes out on transfer to a far off station or is otherwise not readily available to sign the retention proposal. In

some cases, the 'authorised officer' may not be available with the Department, having either retired or resigned, with the result that it becomes impossible to comply strictly with the provision of sub-section (8) of section 132 of the Act. To resolve these difficulties, *we recommend that the law be amended to provide that the 'authorised officer' and/or the Income-tax Officer having jurisdiction over the case may apply for retention of the seized material beyond the period of 180 days. Similarly, sub-section (9) of section 132, which contemplates copies, etc., of seized documents being made in the presence of the 'authorised officer', or any other person empowered by him in this behalf, may be suitably amended.*

(f) Year of concealment - We learn that in several cases of substantial cash seizures, assessees took the plea that the seized assets were referable to the income of the year of seizure and would accordingly be explained or offered for tax in the return to be filed for the relevant assessment year. This opens up an escape route and gives them an opportunity either to cook up evidence during the remaining portion of the year to explain the possession of the seized assets, or to avoid the penal consequences under the Income-tax Act by including the amount in the return of income as unexplained earnings of the year in which the cash was seized. This loophole naturally waters down the efficacy of the powers of search and seizure, which are intended to act as a deterrent. To remedy this situation, *we recommend that the law may be amended to raise a presumption to the effect that, unless proved to the contrary by the assessee, the assets which are seized in the course of a search will be deemed to represent the concealed income and wealth of the previous year/valuation date immediately preceding the date of the search.*

(g) Onus of proof - At present, the onus is on the Department to prove that the assets, account books or documents found at the premises of an assessee in the course of a search relate to the assessee. In the very nature of things, it is often difficult for the Department to get independent evidence to prove that the assets, account books and documents found at the assessee's premises belong to him and relate to his affairs. After all, this is a matter within the exclusive and personal knowledge of the assessee himself. Our attention has been drawn to section 2A of the Foreign Exchange Regulation Act, 1947, which provides for certain presumptions as to the documents seized in the course of a search. The absence of an analogous provision in the Income-tax Act is stated to be causing considerable difficulty to the Department. We agree that when an asset, account book or document is found at the premises of an assessee, it would only be reasonable to presume that it belongs to the assessee and relates to his affairs. The onus, in these circumstances, should be on the assessee to prove that it is not so. *We recommend that the law may be amended to provide a rebuttable presumption both for estimating the undisclosed income, and also for prosecution of an assessee or an abettor.*

2.41 *Need for cautious approach* - Having recommended more powers of search and seizure and their extensive use by the Department, we would be failing in our duty if we were not to add a word of caution here. Several persons, who appeared before us, complained against the arbitrary and high-handed manner in which some of the searches were conducted. It was also repeatedly pointed out that whenever a search takes place, there is always inordinate delay in completing the assessment. We have looked into the statistics furnished by the Department and we are satisfied that even after making allowance for the dilatory tactics which the assessees may adopt in such cases, and to which we have referred earlier, there is considerable truth in the representations made to us in this behalf.

We would like the Department to ensure that the actions of its officers in the matter of searches and seizures do not leave any room for complaint and whenever any officer is found, in his misplaced enthusiasm, to err and over-step the limits of reasonableness, he should be promptly and adequately dealt with. With a view to avoiding hardship to the assessees as also to safeguard the interests of revenue, *we consider it to be of paramount importance that assessments in cases where seizures have been made in the course of searches are finalised expeditiously and are not allowed to drag on unnecessarily.* Any avoidable delay not only places impediments in the conduct of even the normal business of the taxpayers but

also considerably dilutes the desired impact of searches on tax-evaders and gives them more time to invent fresh explanations.

Section 2.42 deleted.

Measures to fight tax evasion

2.43 Having discussed measures for unearthing black money and for bringing it out into the open, we now proceed to make suggestions which seek to tackle the causes that lead to the evasion and creation of black money. While doing so, we propose to deal with the problem both in its legal as well as administrative aspects.

Section 2.44 deleted.

Reduction in tax rates

2.45 The present combination of high rates of taxation and widespread evasion has created a vicious circle. With the additions made to the returned income on account of estimates of profit or disallowance of expenses, statutory and otherwise, the tax can conceivably exceed the returned income. Even without such additions or disallowances, the effective marginal rate of tax, taking income-tax and wealth-tax together, may well exceed 100 per cent of the income. After all, levy of wealth-tax even at the rate of one per cent, is equivalent to 10 per cent yield. In these conditions, tax evasion almost gets elevated to the status of a defensive weapon in the hands of taxpayers. If public conscience is to be aroused against tax evasion and if tax evaders are to be ostracized by the society at large, the public needs to be convinced that tax evasion is anti-social. This objective is difficult to achieve so long as the marginal rates of taxation are confiscatory.

Section 2.46 & 2.47 deleted.

2.48 Another objection to the high marginal rates of taxation is that they can erode the capacity and sap the incentive to save and invest. This is relevant to our present economic situation where the need to encourage savings and investment has assumed greater significance than ever before for stepping up production and for providing larger employment opportunities.

2.49 Besides, high marginal rates of taxation tend to promote wasteful consumption expenditures. Apart from the fact that evaded income is more often spent than invested, there is the tendency to spend more when expenses are allowable in the computation of income and are in effect heavily subsidized by the Government on account of the high tax saving. Grant of tax free or nominally taxed perquisites to employees is another instance of avoidance developing under the pressure of high rates of taxation. This encourages excessive spending and thereby generates inflationary tendencies.

2.50 We are convinced that high marginal rates of taxation are a powerful contributory factor towards evasion inasmuch as they make the fruits of evasion so attractive that a less scrupulous person would consider the incidental risks worth taking. In addition, the high rates of taxation create a psychological barrier to greater effort, and undermine the capacity and the will to save and invest....

2.51 We do not consider it advisable, for another reason, for our country to resort to such high rates of taxation in normal times. The country has to leave some tax potential in reserve for an emergency. The present high level of taxation leaves the Government with little scope for manoeuverability for raising additional resources in times of emergency.

2.52 Having considered the matter in all its aspects, *we recommend that the maximum marginal rate of income-tax, including surcharge, should be brought down from its present level of 97.75 per cent, to 75 per cent. We further recommend that some reduction in tax rates be also given at the middle and lower levels. In order to create an impact, the reduction in the rates of taxation should be at one stroke. We give below a rate schedule which we would recommend for adoption by the Government:*

Income slab	Rate of tax
0-5,000	Nil
5,001-10,000	10%
10,001-15,000	500+15%
15,001-20,000	1,250+20%
20,001-25,000	2,250+25%
25,001-30,000	3,500+35%
30,001-40,000	5,250+45%
40,001-50,000	9,750+50%
50,001-60,000	14,750+55%
60,001-70,000	20,250+60%
Over-70,000	26,250+65%

Surcharge @ 15% in respect of incomes over Rs 15,000.

2.53 We would like to state here our reasons for keeping the highest marginal tax rate at 75 per cent. The alternatives before us were *(a)* a fairly low rate of tax with no exemptions and deductions, and *(b)* not so low a tax rate but a structure of rates incorporating some incentives for savings and investment, and for giving direction to the economic development of the country. After careful consideration of the pros and cons of the alternatives, we came to the conclusion that, in the context of the existing economic conditions, it was advisable to adopt the latter course. Looking at the rate structure of income-tax, we feel that at no stage of income, however high, should a taxpayer be left with less than 25 per cent, of the additional income after payment of income-tax.

Next, we gave our careful consideration to the level of income at which the maximum marginal rate should apply. Not so long ago, this level was Rs 70,001 in 1967. Recently, under the Finance (No. 2) Act, 1971, the maximum salary and perquisites allowable as deduction in the computation of business income have been fixed at Rs 5,000 p.m. and Rs 1,000 p.m. per employee. Even in Government the maximum salary is Rs 5,000 plus free residential accommodation. Taking into consideration all these factors, we felt that it would be appropriate to fix Rs 70,001 as the level of income at which the maximum marginal rate should apply.

Section 2.54 & 2.55 deleted.

Minimisation of controls and licences

2.56 Controls and black money constitute a vicious circle. Even as controls generate black market, black market generates black money and tax evasion. Controlled goods carry a premium and the premium is always given and demanded in cash to escape detection. Not only goods but certain entitlements and rights in the form of licences and permits command a premium on the sly. In fields like import licences, the practice of paying unofficial premium is so widespread and common that commercial circles have given recognition to it by having the rates regularly quoted in some newspapers. Rent controls have given rise to the 'Pugree system' where a substantial sum is received in cash before the premises are let out at controlled rent. The clandestine deals and undisclosed investments arising from black money have caused a serious problem of tax evasion which increases in geometric progression as black money generates more black money and evasion breeds further evasion.

Section 2.57 deleted.

2.58 What appears to be necessary now is a comprehensive review of the existing controls so that those which are ineffective, redundant or irksome might be eliminated or modified to suit the needs of the changed situation. There is also scope for streamlining some of the controls to make them more effective and to ensure a fairer deal to the common man, and for modifying some of the procedures so as to eliminate the irritants, bottlenecks and above all scope for abuse. For instance, there appears to be need for modifying the import control regulations to eliminate certain malpractices such as the sale or transfer of licences, without adversely affecting the interests of the actual user. Perhaps, import entitlements which are offered as incentives for export performance could be replaced by cash subsidies. Elimination of unwanted and ineffectively enforced controls would considerably reduce the area of black money and tax evasion. *We would recommend that a committee of experts be appointed to enquire into the utility of all existing controls, licensing and permit systems, and suggest elimination of such of these as are no longer considered necessary. This committee may also suggest changes in law and procedures so as to ensure that the controls which are absolutely*

essential for *the health of the economy are administered more effectively and with the least harassment to the public.*

Regulation of donations to political parties

2.59 Political parties and elections are a necessary adjunct to a democratic step-up. A majority of the persons who sent replies to our Questionnaire, and those who appeared in person before us, stated that political factors were also responsible to a considerable extent for the generation and proliferation of black money in the country. In this context, one item which was particularly criticised by them was the incongruity existing between the present ban on donations to political parties by companies on the one hand and the enormous funds required to meet election expenses on the other. This ban on donation to political parties by companies was imposed only in 1969 by an amendment to the Companies Act, 1956, since it was considered that such contributions "tended to corrupt political life to adversely affect the healthy growth of democracy in the country". We recognize the need to keep political institutions free of corruption. We are, therefore, not in favour of the ban on donations by companies to political parties being removed, particularly when the shares of many companies are held by public institutions like the Unit Trust of India, Life Insurance Corporation, nationalised banks, etc.

2.60 Nevertheless, it is an accepted fact of life that in a democratic set-up, political parties have to spend considerable sums of money, and that large sums are required for elections..... *We are of the opinion that in our country also, the Government should finance political parties. We recommend that reasonable grants-in-aid should be given by the Government to national political parties and suitable criteria should be evolved for recognizing such parties and determining the extent of grant-in-aid to each of them. For according recognition to a political party for this purpose, it should be necessary, inter alia, that it is registered under the Societies Registration Act, 1860 and its yearly accounts are audited and published within a prescribed time. Irrespective of the decision of Government on the question of* financing *political parties, we recommend that the parties be required to get their accounts audited and published annually.*

2.61 Inasmuch as the grants-in-aid by the Government may not meet fully the requirements of political parties, they will have to look for additional contributions from other quarters. The considerations which weigh against large donations by big industrial and trading units in the corporate sector do not, however, apply to smaller donations by individuals. *We, therefore, recommend that donations by taxpayers, other than companies, to recognized political parties should be allowed as a deduction from the gross total income, subject to certain restrictions. The maximum amount eligible for deduction on account of donations to political parties should be 10 per cent, of the gross total income, subject to a ceiling of rupees ten thousand. The deduction to be allowed should be 50 per cent, of the qualifying amount of the donation.*

Creating confidence among small taxpayers

2.62 There is a widespread belief that much of the tax evasion of lower levels of income is due to fear of the Income-tax Department, or because of lack of confidence in its fairness. This is generally attributed to the practice of estimating income in small cases, pitching up estimates of income almost as a matter of routine, and disallowing expenses indiscriminately. It is stated that many assessees return lower incomes as a cushion against higher estimates of income and disallowance of expenses by the Department. Similarly, it is mentioned that many taxpayers avoid filing of returns of income for fear of harassment by departmental officers.

2.63 Whether such fears and mistrust have any real basis or not, it is amply clear from the evidence given before us that many taxpayers do genuinely apprehend unfair treatment at the hands of departmental authorities. The practice of being too meticulous in small cases, where no worthwhile revenue is involved, has done much to damage the image of the Department in the public eye. The initiative for undoing the damage lies with the Department. One concrete step suggested for restoring public confidence is to dispense with

detailed scrutiny in small income cases and accept the returns of income in such cases in large numbers.

2.64 It is not that the Department itself has not been alive to this issue. The small income scheme was introduced, following the recommendations of the Direct Taxes Administration Enquiry Committee. However, in the actual formulation of the scheme several 'ifs' and 'buts' were introduced with the result that it did not achieve any significant success. The scheme did not evoke any great enthusiasm among tax payers, and the assessing officers' reluctance to take the responsibility for accepting any return stood in the way of its success. Subsequently, some improvements were made in the scheme and this helped in reducing the pendency of assessments in small cases to some extent. However, the position in law remained unchanged that a return could be accepted only if the Income-tax Officer was satisfied that it was correct and complete. Thus, the small income scheme lacked legal sanction.

2.65 Recently, the law has been amended so as to facilitate assessments being made on the basis of returns without the requirement that the Income-tax Officer should be satisfied that the return is correct and complete. Such an assessment can be re-examined either at the instance of the assessee or where the Income-tax Officer considers it necessary or expedient to verify the correctness and completeness of the return by requiring the presence of the assessee or the production of evidence in this behalf. In the latter case, the Income-tax Officer has to obtain the previous approval of the Inspecting Assistant Commissioner.

2.66 Following this amendment of the law, the small income scheme, as it existed, has been scrapped with effect from 1st April, 1971 and the Central Board of Direct Taxes have issued fresh instructions on the new procedure for making assessments in small income cases. We have looked into these instructions. They make a bold departure from the past and are likely to achieve more significant results than the earlier small income scheme. *While broadly approving the general principles underlying these instructions, we have to observe that we see no reason why* assessees in certain income groups at some *places should be given a preferential treatment by having their returns accepted under section 143(1), whereas elsewhere assessees in these income groups will have to face annual scrutiny. We feel that the basic criteria for selecting cases for annual scrutiny should be uniform throughout the country.* While selecting cases for scrutiny out of those already disposed of summarily, varying percentages might have to be adopted depending on the workload and manpower available. *We would suggest that the work be so programmed, and the manpower supplemented, if necessary, as to ensure that at the end of each financial year the carry over of work should not be more than what can be disposed of in the next four months.*

2.67 We find that it is proposed to discontinue the procedure of issuing notice under sub-section (2) of section 139 in every case. *We suggest that, notwithstanding this change in procedure, the Department should mail the return forms together with instructions for filling them to all existing taxpayers on the general index registers in the first week of May every year.* This would serve as a timely reminder to the taxpayer of his obligation under the law to file his return of income, would save him the time and trouble in obtaining the form, and would facilitate prompt filing of returns. .....

Allowance of certain business expenses

2.68 While discussing the causes of tax evasion we had referred, *inter alia,* to disallowances and ceilings on certain expenses which are required to be incurred in view of commercial expediency. We had mentioned that this unduly adds to the tax burden on the assessees when such expenses, though actually incurred, are not allowed to be deducted in arriving at the total income. The expenses commonly mentioned in this connection are those relating to entertainment and maintenance of guest houses.

We consider that certain curbs on lavish entertainment are necessary and certain restrictions are also desirable to prevent the unscrupulous amongst the assessees from claiming deduction for personal or non-business expenses. However, a blanket disallowance of entertainment expenses appears to us to be an unduly stringent measure

not warranted by a realistic appraisal of commercial considerations. Business is a highly competitive venture and it cannot be denied that occasions do arise when a person carrying on business has to provide food, drinks and other hospitality to prospective buyers or persons otherwise helpful in promoting his business. Such expenses have to be incurred in the ordinary course of business out of sheer commercial expediency, particularly when they relate to overseas customers. Any prohibition of such expenditure has the effect of driving it underground to re-appear in more acceptable forms. In the ultimate analysis, it is only the honest taxpayer who suffers.

2.69 ..... *We recommend that entertainment expenditure which is incurred primarily for the furtherance of the taxpayer's business and is directly related to its active conduct should be allowed to be deducted, upto the ceiling prescribed under sub-section (2A) of section 37 of the Income-Tax Act, 1961.* Of course, the deduction should be allowed only if the taxpayer proves by adequate evidence not only the actual expenditure incurred but also the business purpose of the expenditure and business relationship of the person entertained to the taxpayer.

2.70 Notwithstanding sub-section (1) of section 37 of the Income-tax Act, 1961, which provides for deduction of expenses which are incurred wholly and exclusively for the purpose of business, the Income-tax law imposes certain restrictions in respect of maintenance of guest houses by assessees having income from business or profession. These restrictions were first imposed in 1964. From 1st April 1964, expenses on the maintenance of guest houses incurred by an assessee were to be disallowed unless the expenses were within the prescribed limits and fulfilled certain specified conditions. In 1970, the law in this regard was tightened. By the Finance Act, 1970, it was provided that no allowance shall be made in respect of any expenditure incurred by an assessee on the maintenance of any residential accommodation in the nature of a guest house and also in respect of depreciation of any building or asset used for the purpose of a guest house. The second proviso to sub-section (4) of section 37 of the Income-tax Act, 1961, however, provides an exception to such restrictions in respect of any guest house maintained as a holiday-home for the exclusive use of employees while on leave. We feel that it will also be reasonable to give the benefit to guest houses maintained in the nature of transit houses for employees on duty. *We, therefore, recommend that the exception contained in the second proviso to sub-section (4) of section 37 of Income-tax Act, 1961 should be made applicable to guest houses maintained in the nature of transit houses for employees on duty, provided the stay is temporary and rent is charged. Where no rent is charged,* the daily allowance admissible to *the employee should be restricted on the same lines as for Government servants.*

Changes in penal provisions

2.71 As the number of taxpayers increases, the tax administration has of necessity to rely more and more on voluntary compliance of tax laws by the assessees. Appropriate penal provisions form a necessary complement to this approach as they impel compliance with the tax laws by imposing additional monetary burden on those who happen to go astray either inadvertently or by design. It is in this context that we have considered it necessary to review the penal provisions in the direct tax laws.

Iniquity and severity of penal provisions

2.72 Considerable criticism of the existing penalty provisions has been voiced before us. Our attention has been drawn particularly to the fact that the law provides for levy of interest and penalty, and also prosecution for the same default. Similarly, objection is taken to the penalty for concealment being levied with reference to income or wealth concealed, instead of the tax sought to be evaded. The main criticism levelled is that these provisions are unrealistic and iniquitous, especially from the point of view of small taxpayers. It has been urged that instead of aiding the administration in the enforcement of tax laws, these draconian provisions compel a taxpayer to go underground or practice undercover operations.

2.73 Under clause (c) of sub-section (1) of section 271 of the Income-tax Act, 1961, a person who has concealed the particulars of his income or furnished inaccurate particulars thereof, is liable to pay a minimum penalty equal to the concealed income and maximum penalty of twice that amount. This provision has been the subject of widespread criticism both in the replies to the Questionnaire as well as in the statements made before us. It has been pointed out that apart from the penalty itself acting very harshly on the taxpayers, its severity is enhanced by the Explanation to sub-section (1) of section 271 which is to the effect that where the income returned by any person is less than eighty per cent of the assessed income, he will be deemed to have concealed the particulars of his income or furnished inaccurate particulars thereof, unless he can prove that the failure to return the income as assessed did not arise from any fraud or any gross or willful neglect on his part.

We think this criticism is not without merit. Penalty serves its purpose only so long as it is within reasonable limit. Once it crosses that limit, it is more likely to increase the rigidity of a taxpayer's recalcitrance than to reform him. If a tax evader is really unable to pay a heavy penalty, he would prefer to go underground and start business in benami names. Unduly harsh penalties thus breed only defiance of the law and have to be eschewed. No other country in the world appears to have adopted such a basis for levying penalty for concealment. A penalty based on income instead of tax hits the smaller taxpayers more harshly. The iniquity of this provision is evident from the fact that while the minimum penalty is over nine times the tax sought to be evaded in the case of a taxpayer with income upto Rs 10,000, it is just about equal to the tax in the case of a person with income above Rs 2 lakh. In the desire not to let off the fraudulent tax evaders lightly, it is not correct to penalise the small taxpayer more harshly. The objective can be better served by prosecuting tax evaders in higher income brackets, which would be far more effective than loading everyone with heavy penalties. Later in this report, we have ourselves recommended a vigorous prosecution policy to be adopted by the Department. The purpose of penalty should, however, be only to bend and not to break the taxpayer. *We recommend that the quantum of penalty impossible for concealment of income should be with reference to the tax sought to be evaded, instead of the income concealed. Moreover, the minimum penalty impossible for concealment of income should be the amount of tax sought to be evaded and the maximum penalty impossible should be fixed at twice the said amount. It may also be clarified that 'tax sought to be evaded' in this context means the difference between the tax determined in respect of total income assessed and the tax that would have been payable had the income other than the concealed income been the total income.* This would ensure that taxpayers are not made to pay penalty in respect of certain additions to income, which are not in the nature of concealment but are made only for certain technical reasons.

2.74 We are not unaware that linking concealment penalty to tax sought to be evaded can, at times, lead to some anomalies. *We would recommend that in cases where the concealed income is to be set off against losses incurred by an assessee under other heads of income or against losses brought forward from earlier years, and the total income thus gets reduced to a figure smaller than the concealed income or even to a minus figure, the tax sought to be evaded should be calculated as if the concealed income were the total income.*

Explanation to sec. 271(1)(c)

2.75 Several persons who appeared before us urged the need for deleting the Explanation to clause (c) of sub-section (1) of section 271 of the Income-tax Act, 1961 for various reasons. The primary objection against this Explanation is that it is being invoked indiscriminately and penalty proceedings are initiated in all cases where the income shown in the return is less than eighty per cent of the assessed income.

The Explanation was introduced in order to cast on the assessee the burden of proving that the omission to disclose true income did not proceed from any fraud, or gross or wilful neglect. A similar Explanation was also introduced in the Wealth-tax Act, 1957. This was a sequel to the

recommendation made by the Direct Taxes Administration Enquiry Committee (1958-59), based on a similar provision in the United Kingdom law. We understand that in a number of cases that came up on appeal, the appellate authorities were not inclined to uphold the penalties imposed on the basis of this Explanation, since they were of the view that the Department was still under obligation to prove the concealment. The difference between the assessed income and the returned income can be due to a variety of reasons - some technical, like estimate of gross profit and others purely arithmetical - and in our opinion, it would not be correct to initiate proceedings in every case where the difference exceeds twenty per cent. In the United Kingdom itself, the provision on which this Explanation was based has now been dropped. In any event, if past experience is any indication, we feel that this Explanation has failed to serve any useful purpose. On the other hand, it has resulted in unwarranted harassment to the taxpayers, and too much of paper work caused by indiscriminate initiation of penalty proceedings and consequent appeals.

We recommend that Explanation to clause (c) of sub-section (1) of section 271 of the Income-tax Act, 1961 and also Explanation 1 to clause (c) of sub-section (1) of section 18 of the Wealth-tax Act, 1957 may be deleted.

2.76 While we are of the view that penalties should not be draconian, we also strongly feel that those who are tempted to resort to concealment of income should not be allowed to get away with tenuous legal interpretations. We would recommend the following changes in the Income-tax Act in this regard:

(a) Presumption of concealment where explanation found false - Several officers of the Department invited our attention to the Supreme Court's decision in the case of Commissioner of Income-tax, West Bengal *vs.* Anwar Ali (76 ITR 696). It has been held by the Court that penalty for concealment of income cannot be imposed merely because the explanation given by an assessee is found to be false. While this decision was given in the context of clause (c) of sub-section (1) of section 28 of Indian Income-tax Act, 1922, it is not reasonably certain that it would not apply to penalties under the Income-tax Act, 1961. *We would, therefore, recommend, as a measure of abundant caution, that an Explanation to sub-section (1) of section 271 of the Income-tax Act, 1961 may be inserted to clarify that where a taxpayer's explanation in respect of any receipt, deposit, outgoing, or investment is* found to be false, the *amount represented by such receipt, etc., shall be deemed to be income in respect of which particulars have been concealed or inaccurate particulars have ben furnished, within the meaning of clause (c) of sub-section (1) of section 271 of the Income-tax Act, 1961.*

(b) Intangible additions - Additions to income are frequently made by the Income-tax Officers for purely technical reasons, *e.g.*, application of a presumptive rate of gross profit or of yield, or on account of estimated disallowance of certain expenses, shortages, wastage, etc. These are commonly referred to as 'intangible additions' and normally no penalty is levied - and rightly so - for want of adequate material to establish that these additions represent the taxpayer's concealed income. We are, however, informed that these intangible additions are exploited by some taxpayers as a means of escape from tax and penalty in assessments pertaining to subsequent years. Instances are said to be common when a taxpayer, confronted with the need to explain the source of some of his funds, assets, etc., takes the plea in the absence of any other evidence, that the said funds, assets, etc., had emanated from income represented by intangible additions made in earlier assessments. Such explanations also find favour with appellate authorities, with the result that the taxpayer gets away with admitted utilisation of concealed income without paying any penalty. We do not consider this to be justifiable. *We recommend that law should be amended to provide that where intangible additions made in earlier years are cited by an assessee as the source of his funds, assets, etc., in a subsequent year, the said funds, assets, etc., would be deemed to represent the assessee's income, particulars in respect of which have been concealed within the meaning of clause (c) of sub-section (1) of section 271 of the Income-tax Act, 1961, and the quantum of penalty would be determined with reference to the total income of*

the said, assessment year, which shall be *computed for this limited purpose by including the* value of such funds, assets, etc., to the extent they are claimed to be out *of past intangible additions.*

(c) Presumption of concealment in case of failure to file the return - Tax evasion can be attributed to acts of either commission or omission of an assessee. A taxpayer may file his return but may not disclose his income in full. On the other hand, he may decide not to file the return at all, thereby concealing all his income. As stated earlier, penalty is impossible under clause (iii) of sub-section (1) of section 271 of the Income-tax Act, 1961 if an assessee has, in the return filed by him, concealed particulars of his income or furnished inaccurate particulars thereof. Where, however, an assessee does not submit the return of his income, though he had taxable income and this fact is established on assessment, no penalty for concealment of income is leviable under the law. At best, the income-tax officer can levy penalty under clause (i) of sub-section (1) of section 271 of the Act for assessee's failure to submit the return of income. While the maximum penalty under clause (iii) of sub-section (1) of section 271 is twice the concealed income (which we are recommending to be changed to twice the tax sought to be evaded), the maximum penalty for filing of return or non-filing of return is 50 per cent, of the tax payable on assessment. We consider it to be highly unsatisfactory that a complete concealment of income should entail a lighter punishment than partial concealment. *We accordingly recommend that where an assessee does not file a return of income within the normal period of limitation for completion of assessment, and the Income-tax Officer establishes that he had taxable income, the assessee should be deemed in law to have concealed his total income for the purpose of clause (c) of sub-section (1) of section 271 of the Act, notwithstanding that he has subsequently, in response to notice under section* 148, filed a return stating his *correct income. This will apply only to those who have not hitherto been assessed.*

Other Penalties

2.77 In regard to other penalties under section 271, which do not relate to concealment of income, our recommendations are as under:

If an assessee fails to furnish his return of income under sub-section (1) of section 13 of the Income-tax Act, 1961 within the prescribed time, he is liable to pay penal interest and penalty for the period of default, apart from being liable to be prosecuted, in certain circumstances, under section 276C of the Income-tax Act, 1961. We consider that the policy of levying interest and penalty, in addition to making the assessee liable to prosecution is not warranted in all such cases. In our opinion, assessees who furnish returns of income, though belated, should be treated more leniently than assessees who do not furnish returns of income at all. Similarly, the treatment to be meted out to a case of failure to file return of income where no notice under sub-section (2) of section 139 of the Act has been served should be less severe than that to a case where such a notice has been served. Accordingly, we make the following recommendations:

(i) Where a return of income is filed under sub-section (1) of section 139 of the Income-tax Act, 1961, after the prescribed time-limit but within the period of limitation for completion of assessment, the assessee should be liable to pay only interest at the rate of 1 per cent per month on the tax due for the period of delay. There should be no liability for penalty or prosecution.

(ii) Where a return of income is filed beyond the time prescribed under sub-section (2) of section 139 or section 148, but within the time allowed, if any, by the Income-tax Officer, the assessee should be liable to pay interest at the rate of 1 per cent, per month on the tax due for the period of delay.

(iii) Where a return of income is filed beyond the time prescribed under sub-section (2) of section 139 or section 148 and also beyond the time allowed, if any, by the Income-tax Officer, the assessee should be liable to pay interest at the rate of 1 per cent per month, and, in addition penalty at the rate of 1 per cent, of the tax due for every month during which the default continued.

(iv) Where a person fails to submit a return of income in response to a notice under sub-section (2) of section 139 or section 148 and on assessment his income is found to be above taxable limit, he should be liable to pay interest at the rate of 1 per cent per month and, in addition, penalty at *the rate of 1 per cent, of the tax due for every month during which the default continued. He should also be liable to prosecution.*

(v) Where a person fails to submit a return as required under sub-section (1) of section 139 but submits it in response to a notice under sub-section (2) of section 139 or section 148, he should be liable to pay interest at the rate of 1 per cent, of the tax due for every month during which the default continued.

In the case of a person not hitherto assessed to tax, where the failure has continued beyond the normal period of limitation for completing the assessment under section 143, he should, in addition to interest, be liable to a penalty under clause (c) of sub-section (1) of section 271 as recommended earlier, as also prosecution.

(vi) For the purpose of levy of interest at the rate of 1 per cent., the period of delay or default should always be counted from the due date for filing the return of income under sub-section (1) of section 139, notwithstanding the extension of time, if any, granted by the Income-tax Officer.

Penalties under Wealth-tax Act

2.78 Now coming to the penalties under the Wealth-tax Act, 1957, we find that the quantum of penalty for defaults under sub-section (1) of section 18 and the nature of punishment for offences under sub-section (1) of section 36 of the Wealth-tax Act, 1957, substantially differ from those of the Income-tax Act, 1961, even though the nature of default or offence sought to be penalised is more or less the same. To illustrate, the penalty under clause (i) of sub-section (1) of section 18 of the Wealth-tax Act, 1957 for failure to submit the return of net wealth within the prescribed period is one-half per cent, of *the net wealth* for every month of default, subject to a *maximum of an amount equal to the net wealth,* whereas the penalty prescribed under clause (i) of sub-section (1) of section 271 of the Income-tax Act, 1961, for a similar default is two per cent, *of the tax,* for every month of default, subject to a *maximum of fifty per cent of the tax.* We consider this position to be anomalous. *We, therefore, recommend that the provisions in clauses (i) and (ii) of sub-section (1) of section 18 and clauses (a), (b) and (c) of sub-section (1) of section 36 of the Wealth-tax Act, 1957 should be respectively brought in line with the corresponding provisions* of the Income-tax Act.

As regards clause (iii) of sub-section (1) of section 18 of the Wealth-tax Act, 1957, the minimum penalty for concealment of wealth is equal to the concealed wealth and the maximum penalty is twice that amount. Explanation 1 to sub-section (1) of section 18 of the Wealth-tax Act, 1957, which we have elsewhere recommended for deletion, further provides that where the value of any asset returned is less than seventy five per cent, of its value as determined in the assessment, or where the value of any debt returned exceeds the value of such debt as determined in the assessment by more than twenty five per cent., the assessee shall be deemed to have concealed his wealth to the extent of under-valuation of asset or over-valuation of debt, unless he can prove that the failure to return the value as determined in assessment did not arise from any fraud or any gross or willful neglect on his part. Apart from the quantum of penalty itself being quite harsh, we consider that this Explanation makes it all the more stringent. *We recommend that penalty for concealment of wealth should be restricted to only those cases where there is a total omission to include an asset in the return of net wealth. Further, in order to avoid gross under-valuation, the Government may be given the power to acquire the properties, which are considered to be grossly under-valued, on payment of the value put by the assessee plus 15 per cent, thereof by way of compensation.*

Regarding the quantum of penalty on concealment of wealth, we do not approve of the existing provision linking it to the amount of wealth concealed as it leads to inequitable and intolerably oppressive results. For example, if an assessee wants to disclose an asset worth Rs 50,000, which he had not done earlier, he will be liable to

minimum penalty of Rs 50,000 and maximum penalty of Rs 1,00,000 under the Wealth-tax Act, apart from penal consequences under the Income-tax Act. If the omission had occurred in returns of net wealth for more than one year, this penalty will get multiplied by the number of years. Thus, omission to disclose an asset worth Rs 50,000 for three years would entail minimum penalty of Rs 1,50,000 and maximum penalty of Rs 3,00,000. In addition he will be exposed to the threat of prosecution. All this, we think, is likely to prompt a taxpayer to remain underground rather than make a clean breast of the whole affair and start paying taxes honestly. In line with our earlier recommendation with regard to the penalty for concealment of income under the Income-tax Act, *we recommend that the penalty for concealment of wealth should be linked to the amount of tax sought to be evaded instead of the concealed wealth.* However, we would prefer a minor departure from our earlier recommendation in so far as the maximum penalty leviable for concealment of wealth is concerned. We consider that maximum penalty equal to twice the tax sought to be evaded may not make the penal provision as effective under the Wealth-tax Act as under the Income-tax Act. *We recommend that the minimum penalty for concealment of wealth under the Wealth-tax Act, 1957 should be equal to the tax sought to be evaded and the maximum penalty should be five times the tax sought to be evaded.*

Penalties under Gift-tax Act

2.79 Under clause (i) of sub-section (1) of section 17 of the Gift-tax Act, 1958, if a person fails to furnish his return of gifts which he is required to file, he is liable to pay penalty equal to two per cent of the tax for every month during which the default continued, but this is subject to a ceiling of fifty per cent of the tax due. Filing of gift-tax return is a very simple matter, unlike the filing of the return of income under the Income-tax Act, 1961, which has to depend on various factors, including the accounts being written up-to-date. Moreover, filing of gift-tax returns will assume far greater importance with the introduction of the provision for aggregation of gifts recommended by us elsewhere. We consider, therefore, that the delayed submission of return of gifts under the Gift-tax Act, 1958 should be subject to a higher penalty than the penalty prescribed for the belated filing of the return of income. Accordingly, *we recommend that while the present rate of penalty at 2 per cent per month prescribed under clause (i) of sub-section (1) of section 17 of the Gift-tax Act should continue, the ceiling of fifty per cent of the tax due should go.*

Mitigation of penalties and interest

2.80 Another aspect to which our attention was invited by several persons who appeared before us related to the need for mitigating the rigors of the penal provisions, which instead of encouraging a one-time tax evader to come back to the path of rectitude, drive him to become a confirmed tax dodger. Even sub-section (4A) of section 271 of the Income-tax Act, 1961, under which Commissioner of Income-tax has the power to reduce or waive penalty, does not cover all the penalties impossible under the Act. Even the reduction or waiver of penalty impossible under clauses (i) and (iii) of sub-section (1) of section 271 of the Act is subject to certain conditions. Some of the conditions are that the assessee should have made voluntary and full disclosure of income *before* the notice calling the return of income was issued to him, and that in cases of liability to penalty under clause (iii) of sub-section (1) of section 271 of the Act, his voluntary disclosure of income should have been made *prior* to the detection of concealment by the Department. There is a similar provision in the Wealth-tax Act, 1957 as well.

Apart from the scope of this provision being very limited, the conditions required to be fulfilled for getting its benefit may not be fully satisfied in certain cases, though facts and circumstances may otherwise justify mitigation of penalty. We consider that it would be advantageous to have a comprehensive provision under which mitigation or remission of penalties is made possible, where facts and circumstances of the case so warrant. We find that a similar provision exists in the Taxes Management Act, 1970 of the United Kingdom. *We recommend that the existing provisions for waiver and reduction*

of penalties *may be deleted and, instead all the direct tax laws should contain a provision enabling the Commissioner to mitigate or entirely remit any penalty, or stay, or compound any proceedings for recovery thereof, in cases of* genuine *hardship*. However, this power should be available only in respect of cases other than those which are the subject of settlement proceedings before the Direct Taxes Settlement Tribunal.

2.81 Notwithstanding our recommendations for a comprehensive provision enabling the Commissioner to mitigate penalty in appropriate cases, we consider that there is need for a provision which would mitigate the impact of penalty and interest of belated returns in respect of small income cases at the level of Income-tax Officer himself *suo motu. We, therefore, suggest that where a return of income is filed belatedly by an assessee and his income in no year during a period of four years immediately preceding the year exceeded Rs 15,000, the Income-tax Officer should be under a statutory obligation to consider waiver or reduction of both penalty and interest and should record a note giving reasons for the decision taken by him in the matter.*

Minimum penalty

2.82 In view of the comprehensive mitigation provision recommended by us, we do not consider it necessary to delete, as suggested by some, the statutory minimum prescribed for levy of penalties under the direct tax laws, or to have fixed but graded penalties only for various kinds of defaults. *We are of the opinion that the present policy of having a statutory minimum for penalties has, on the whole, had salutary effect and it should, therefore, continue.*

Vigorous prosecution policy

Need for vigorous prosecution policy

2.83 In the fight against tax evasion, monetary penalties are not enough. Many a calculating tax dodger finds it a profitable proposition to carry on evading taxes over the years, if the only risk to which he is exposed is a monetary penalty in the year in which he happens to be caught. The public in general also tends to lose faith and confidence in the tax administration once it knows that even when a tax evader is caught, the administration lets him get away lightly after paying only a monetary penalty - when money is no longer a major consideration with him if it serves his business interests. Unfortunately, in the present social milieu, such penalties carry no stigma either. In these circumstances, the provisions for imposition of penalty fail to instil adequate fear of the law in the minds of tax evaders. Prospect of landing in jail, on the other hand, is a far more dreaded consequence - to operate *in terrorem* upon the erring taxpayers. Besides, a conviction in a court of law is attended with several legal and social disqualifications as well. In order, therefore, to make enforcement of tax laws really effective, we consider it necessary for the Department to evolve a vigorous prosecution policy and to pursue it unsparingly.

Section 2.84 deleted.

2.85 For a successful enforcement programme, it is not enough that adequate number of cases are taken to court every year. In selecting cases for prosecution, the Department should ensure that these represent a cross-section of the society and are picked up from different regions and all walks of life, viz., persons in employment, profession, trade, industry, etc. *While the power to compound offences presently available to the Department under sub-section (2) of section 279 of the Income-tax Act, 1961 may continue, we recommend that it should be used very sparingly. We also wish to emphasise that flagrant cases of tax evasion, particularly of persons in the high income brackets, should be pursued relentlessly.*

Person behind tax evasion to be prosecuted

2.86 We have examined the adequacy of section 277 of the Income-tax Act, 1961, which deals with prosecution for false statement in declaration, etc. We consider that this provision is not adequate to bring to book those persons who are in fact responsible for false returns being furnished to the Department. Section 140 of the Act authorises the return of income being signed in the case of a

company by its 'principal officer'. Clause (35) of section 2 defines a 'principal officer' as the secretary, treasurer, manager or agent of the company or any person connected with the management of administration of the company upon whom the Income-tax Officer has served a notice of his intention of treating him as the principal officer. Section 277 as it stands at present contemplates prosecution of that person only who knowingly makes a false statement in any verification under the Act. In the case of a company, the return is usually signed by the secretary who is merely an employee and thus it is he who can be prosecuted under section 277 of the Act. The managing director and other directors who are in fact the persons in charge of running the concern, and in that capacity are normally responsible for commission of tax offences, escape prosecution. Similarly, in the case of partnerships, the managing partner escapes prosecution if the return is signed by a partner who does not actively participate in managing the business. In order to get at the persons who are really responsible for tax offences, *we recommend that the definition of 'principal officer' for the purpose of signing of the return should be amended so as to provide that the return of income of a limited company should be signed by the person mainly responsible for the management or administration of the affairs of the company. In other words, the liability for signing the return should be fixed primarily on the managing director, failing which on the working director. Similarly, in the case of a partnership, the responsibility to sign the return should rest on the managing partner or the partner in charge of the financial affairs of the firm.*

2.87 Cases may, however, still crop up where a person in charge of, and responsible to, a company for the conduct of its business may have managed to avoid signing the return. It will be desirable to bring him also within the reach of the long arm of the law. Section 140 of the Customs Act, 1962, contains a useful provision to meet such a situation. It provides that where a company commits an offence, every person who, at the time the offence was committed, was in charge of, and was responsible to the company for the conduct of its business, shall be held guilty of the offence and be liable to be prosecuted. It further provides that if the offence is found to have been committed with the consent, connivance or negligence of any director, manager, secretary or other officer of the company, the said person shall also be liable to be prosecuted. *We recommend that a provision analogous to section 140 of the Customs Act, 1962 be incorporated in the Income-tax Act. Further, it should also cover the case of a partner who is really responsible for the tax offence of the firm, although he has not signed the return himself. We would like that choice of person who should be proceeded against to be left to the direction of the Commissioner of Income-tax.*

Scope of sec. 277 to be widened

2.88 The present section 277 of the Income-tax Act, 1961 is very limited in its scope inasmuch as it deals only with cases of signing false verification and delivering false accounts or statements and does not make tax evasion itself an offence punishable under the Act. We examined the proposal to have a comprehensive legislative provision within the Income-tax law in order to deal effectively with tax evasion and attempts to evade or defeat taxes. There are provisions to this effect in the East African Income-tax (Management) Act, 1958. In the United States of America, tax offences committed with criminal intent are treated as felony under section 7201 of Internal Revenue Code which reads as under:-

> "Any person who wilfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution."

Evidently, this provision has a much wider scope than section 277 of the Income-tax Act, 1961 and covers all situations of attempts to evade or defeat taxes, or the payment thereof. *We have no doubt in our minds that a provision on the lines of Section 7201 of U.S. Internal Revenue Code will be extremely helpful in countering devices of tax*

evaders, and we recommend that such a *provision should be incorporated in the Indian tax laws also.*

Probation of Offenders Act not to apply to tax offences

2.89 It has been pointed out to that the Probation of Offenders Act, 1958, has proved a stumbling block in the way of the Department securing conviction under section 277 of the Income-tax Act, 1961. Under section 3 of the Probation of Offenders Act, an offender can be released by the court on probation of good conduct, or even otherwise after due admonition if, *inter alia*, the offence committed is punishable with imprisonment for not more than two years. This provision is stated to have set at nought certain prosecutions launched by the Department under section 277 of the Income-tax Act, 1961, as the offence mentioned in this section is punishable with imprisonment for not more than two years. A suggestion has been made that in order to get over this difficulty, section 277 of the Income-tax Act, 1961 should be amended by suitably enhancing the sentence of punishment to a period which is more than two years. We consider that the remedy for this situation lies elsewhere. *We recommend that section 118 of the Probation of Offenders Act, 1958 should be suitably amended to include all* the direct tax laws among the *statutes which are saved from the operation of the Probation of Offenders Act.*

Fines for certain offences by department officers

2.90 Offences of various kinds are at present committed with impunity in the course of proceedings before the Income-tax Officers, since cognizance of these offences can be taken only by resorting to the Indian Penal Code and complying with the attendant formalities. A suggestion has been made before us that provisions corresponding to some of the relevant sections of the Indian Penal Code should be incorporated in the Income-tax law itself so that the Income-tax Act is made comprehensive enough to deal with such offences. We have examined the feasibility of the suggestion. We are of the opinion that this suggestion is fraught with certain far-reaching consequences and we, therefore, do not approve of it. Nonetheless, there are certain offences, such as those specified in sections 179 and 180 of the Indian Penal Code, which can be incorporated in the Income-tax law itself. Section 179 of the Indian Penal Code makes it an offence for a person to refuse answering a question put to him by a public servant authorised to record statement, and section 180 of the Indian Penal Code relates to punishing a person who refuses to sign any statement made by him before a public servant. We also find that the Customs Act, 1962 contains a comprehensive residuary penalty provision in section 117, which is to the effect that if any person contravenes any provision of the Customs Act or abets any such contravention or fails to comply with any of its provisions, he shall be liable to a penalty not exceeding Rs 1,000 in case no express penalty is elsewhere provided for such contravention or failure. *We recommend that similar provisions should be incorporated in Chapter XXI of the Income-tax Act, 1961 and these contraventions be made liable to a penalty only.* We consider that these changes in law would strengthen the hands of a Department and also relieve the officers of the need of going to the courts and complying with the attendant formalities.

In this connection, we also considered the provisions of section 276 of the Income-tax Act, 1961, which prescribed only monetary fines for the offences specified therein. We see no reason why the Department itself should not be empowered to impose penalties in such cases. *We recommend that the present section 276 of the Income-tax Act, 1961, may be deleted from Chapter XXII dealing with 'Offences and Prosecutions' and may be incorporated with suitable amendments in Chapter XXI of the Income-tax Act, 1961, dealing with 'Penalties impossible'.* We may mention that a provision enabling the imposition of penalties by the officers of the Department would not be a new one. Sub-section (2) of section 131 already empowers an Income-tax Officer to impose penalty, though the word used there by oversight is 'fine' and not 'penalty'.

2.91 *We recommend that the penalties suggested*

by us above should be imposed by *officers not below the rank of Inspecting Assistant Commissioner*. If the defaults in question are committed in the course of any proceeding or enquiry before the Income-tax Officer, the penalty should be imposed by the Inspecting Assistant Commissioner of Income-tax on the basis of a complaint made by the Income-tax Officer. However, if these defaults are committed before an Inspecting Assistant Commissioner, or Appellate Assistant Commissioner, or Commissioner of Income-tax, as the case may be, the penalty may be imposed by the Inspecting Assistant Commissioner, or the Appellate Assistant Commissioner or the Commissioner concerned. *The orders imposing penalty may be made appealable to the Appellate Tribunal by suitably amending section 253 of the Income-tax Act, 1961.*

Exclusion of prosecution period for limitation

2.92 At present, a prosecution can be commenced either before or after the completion of assessment proceedings. Normally, a person is proceeded against only after the assessment has been completed. However, cases do arise where documents seized in the course of a search or discovered during assessment proceedings clearly indicate that a taxpayer has suppressed certain receipts, sales, purchases or expenses. There are also cases where materials obtained show that the taxpayer has altogether failed to disclose a particular source of income. Any delay in launching prosecution can provide opportunity to a taxpayer to temper with the evidence, to cook up fresh evidence or to tutor witnesses. In such a case, it becomes desirable to launch prosecution even before the completion of assessment, and soon after the relevant evidence about the commission of an offence has been collected. Since prosecution proceedings are generally time-consuming, filing complaints during the pendency of assessment proceedings would present considerable difficulty to tax authorities in the matter of completion of assessments within the period of limitation prescribed under section 153 of the Income-tax Act, 1961. *We, therefore, recommend that the law be suitably amended to exclude the time spent on prosecution, from the* institution of the complaint to its final disposal, *from the period of limitation prescribed for making on assessment or re-assessment.*

Section 2.93 to 2.97 deleted.

Background and existing set-up of Intelligence Wing

2.98 Prior to the constitution of the Intelligence Wing, the Directorate of Inspection (Investigation) was expected to meet effectively the challenge of big tax evaders. In the field of formations, there were Special Investigation Circles and Central Circles to which cases of suspected tax fraud were specifically assigned. The role of the Directorate was to give guidance in individual cases and to lay down broad lines of investigation. In addition to this Directorate, there was a 'Special Investigation Branch' in each Commissioner's charge. But this was primarily meant to collate and disseminate routine information for verification in the course of assessment proceedings. This set-up was not found to be adequate to undertake any intelligence work. Intelligence Wing was, therefore, set up in 1966 to fill up this gap. Broadly, the functions of this Wing are collection and dissemination of information regarding tax evasion, study of techniques of tax evasion prevalent in various trades and industries, locating concealed assets, forestalling fraudulent transfers to defeat taxes and processing specific cases for prosecution.

2.99 The methods of work adopted by the Intelligence Wing are stated to be maintenance of contact with informers, scrutiny of anonymous and pseudonymous petitions, maintenance of liaison with allied agencies and other Government Departments, conducting *suo motu* enquiries, initiating survey operations under section 133A of the Income-tax Act, 1961 and organising and conducting searches independently of, or in association with, allied agencies.

2.100 Although the Intelligence Wing has only been in existence for five years and can thus be said to be in its infancy, the achievements to its credit are not inconsiderable. Its units have reported concealment of income/wealth in 826 cases during the period from 1966 to 1969. These

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include 150 cases involving concealed income of approximately Rs 42 crore and the tax sought to be evaded in each of these cases exceeds Rs 10 lakh. The searches conducted by the Wing have led to a breakthrough in several rackets involving wide inter-State remifications, e.g., customs clearance permits, hundi hawalas, etc. In addition, a sum of Rs 95 lakh had been seized upto 1969. The four main Intelligence units at Calcutta, Bombay, Madras and Delhi have launched 38 cases of prosecution for concealment, out of which convictions have been secured in 13 cases. Prosecutions were also launched under the Indian Penal Code in four cases, two of which have resulted in convictions.

2.101 It has been stated before us by a number of senior officers of the Department that the Intelligence Wing, though it has done some useful work, is yet far from achieving the objectives. This is said to be so because the officers of the Intelligence Wing have kept themselves largely confined to their own offices, receiving information from outsiders, mostly informants, or scrutinising anonymous or pseudonymous complaints about tax evasion. They have not yet taken the initiative to venture out into the din and bustle of the market-place or to try to enter the inner sanctuaries and the closed precincts of big tax evaders, wherein all the nefarious schemes of evasion are hatched and practised with impunity in the confident belief that the Income-tax Department is incapable of reaching and detecting them. We, therefore, consider it necessary to analyse the causes and to suggest measures which will enable the Intelligence Wing to pay a more dynamic and effective role.

Proposed set-up

2.102 A major criticism against the Intelligence Wing relates to its organisational pattern. It is said that the guidance and control emanating from the top is itself neither adequate nor effective. Another shortcoming stressed by the officers of the Department is that the functioning of the Wing is seriously impeded by duality of control over the Wing exercised by Commissioners of Income-tax and the Director of Inspection (Investigation). We have considered the merits and demerits of the various suggestions offered in this behalf. At the outset, we may observe that the Member, Central Board of Direct Taxes, who is in charge of Intelligence and Investigation is saddled with multifarious other duties. *We are of the opinion that intelligence and investigation should receive exclusive attention of a senior Member of the Central Board of Direct Taxes, and we accordingly suggest that the Member concerned should be freed of all other work. This Member should be designated as a Member (Intelligence and Investigation). He should lay down the policy in matters relating to intelligence and investigation, indicate the lines on which efforts of the officers working in these fields should be directed and provide them with overall guidance and supervision. He should also be responsible for (a) developing expertise generally for handling investigation concerning different trades and industries; (b) collecting and disseminating information regarding commercial and industrial trends, economic malpractices, tax evasion techniques; (c) keeping liaison with the various investigating agencies at Delhi; and (d) giving publicity to the Department's performance in the field of detection of concealments. He should, however, be assisted by two senior officers of the rank of Additional Commissioners. They may be designated as Director (Intelligence) and Director (Investigation). In addition, he should be assisted by a group of specialists for developing expertise, as recommended by us later in this Chapter.* As for eliminating the duality of control by the Director of Inspection (Investigation) and Commissioner of Income-tax, we suggest that *the present Directorate of Inspection (Investigation) should be abolished* in view of our recommendation for an exclusive Member in charge of intelligence and investigation. *As regards the organisational pattern at the Commissioner's level, the ideal position according to us would be to create a separate division for intelligence and investigation under each Commissioner of Income-tax. However, in major cities like Bombay, Calcutta, Delhi and Madras, looking to the workload involved, the intelligence and investigation work should be assigned to Commissioner of Income-tax (Central).* All the Commissioners of

Income-tax, whether of Central charges or otherwise, should be assisted by appropriate number of Inspecting Assistant Commissioners of Income-tax to exclusively look after intelligence and investigation work, the number varying according to the needs of each charge. They may be designated as Inspecting Assistant Commissioners (Intelligence) or Inspecting Assistant Commissioners (Investigation), according to the work handled by them. The Income-tax Officers working under them will be similarly designated Income-tax Officers (Intelligence) and Income-tax Officers (Investigation), depending upon the duty allotted.

Section 2.103 deleted.

Functions of Income-tax Officers (Intelligence)

2.104 The functions to be assigned to the Income-tax Officers (Intelligence) may be divided broadly into three groups. Firstly, one or more Income-tax Officers (Intelligence) should be put on the job of procuring general information likely to be useful in detecting concealment. They should maintain liaison with the field formations of the allied agencies like Directorate of Revenue Intelligence, Central Bureau of Investigation and Special Police Establishment. These officers should further keep a vigilant eye on the malpractices prevailing in the commercial word. They may study the latest tax evasion techniques adopted by evaders in a particular business or locality. They may also obtain and pass on information regarding property deals and constructions, transfer of concerns, issue of big licences and permits, large loans and advances by financial organisations, speculation, concerning of shares, etc., other unusual happenings in the business world and fresh avenues for sudden abnormal profits.

2.105 The second group of Income-tax Officers (Intelligence) should devote themselves exclusively to specific cases of tax dodgers. Not only will they follow up the information received through informants and anonymous petitions, but also collect information pertaining to the particular cases from all possible sources. They will also resort to surveillance so as to shadow the suspect tax evaders, discover their clandestine financial operations and keep track of any large expenditure, for example, on marriages, entertainment, holiday travel and foreign tours. The duty of conducting searches and seizures in specific cases will also be assigned to them.

2.106 The third group of Income-tax Officers (Intelligence) will follow up the leads in cases suspected of serious tax fraud, process them for prosecution and pursue them till the stage of conviction. We may add that *where an Income-tax Officer (Intelligence) has made elaborate enquiries in a particular case over a long period, the jurisdiction for assessment over such a case may also be assigned to him.*

Powers of Income-tax Officers (Intelligence)

2.107 We have been told that at present the Assistant Directors of Inspection (Intelligence) are not able to make proper investigations as they lack statutory powers of compelling attendance, production of accounts and documents, etc. We can well visualize the occasions when it becomes necessary for an Income-tax Officer (Intelligence) to do so. *We, therefore, recommend that* the Income-tax Officers (Intelligence) should be *given the requisite powers under sections 131 and 133A of Income-tax Act, 1961 to enable them to work up cases effectively. This power should be available to them in respect of all the cases falling within the jurisdiction of the Commissioner of Income-tax under whom they are posted, and not only in respect of assessees, whose cases are specifically allotted to them for assessment.*

Section 2.108 to 2.110 deleted.

Workload

2.111 It has been mentioned that the efficiency of Investigation Circles is hampered by the heavy workload assigned to the Income-tax Officers (Central). It is stated that the officers of these circles have usually a large number of cases on hand which are about to get time-barred, and they are constantly goaded into fulfilling certain informally prescribed heavy quotas. All this

deters them from undertaking the work in the right spirit and embarking upon thorough and detailed investigations. ....

Section 2.112 & 2.113 deleted.

Specialists at Central office

2.114 The nature of income-tax investigation work is so intricate and its range so wide, that an investigating officer is expected to know many more things than what he is normally able to gather in the course of his day to day work. Methods of tax evasion are also becoming so ingenious and skilful that they vary from business to business and person to person. In these circumstances, the needs of the investigation officers cannot be fully met by training alone. *We, therefore, recommend that a group of senior and capable officers may be constituted under the Central Board of Direct Taxes to act as specialists for guiding investigation in various important business and industries*, e.g., iron and steel, engineering, mines and minerals, textiles, banks, paper, cement, sugar, chemicals and pharmaceuticals, speculation, import/export, trade agencies, etc. They should possess thorough knowledge in their respective fields of specialisation about the working processes, stages of operations, proportions of yields, wastages and by-products, major technical, commercial and administrative difficulties, the ways adopted by assessees to solve them and their financial implications. They should also be in the know of the peculiar accounting methods pertaining to particular business and the special tax dodging devices prevailing therein. These officers should be encouraged to visit the industrial and commercial establishments to acquire first-hand knowledge and to undergo advanced courses of study in their respective spheres. They should keep abreast of all the technical advances, current trends in the particular business/industry and prepare monographs, issue general instructions and guidance to the officers handling investigation cases. *We recommend that the specialists should work under Member (Intelligence and Investigation) and should be selected from among* officers who *have handled assessments of a* particular *business or industry over a long period of time and have acquired special ability in that field.*

Role of informers

2.115 .... *We recommend that provisions of section 182 of the Indian Penal Code be invoked in flagrant cases of informers furnishing false information.* We also recommend *that the existing reward rules should be made more flexible. While there should be no fixed percentage for payment of rewards, the rules may stipulate that if information furnished by an informer is correct and leads to additional tax, or is otherwise useful in checking tax evasion, the Commissioner of Income-tax, and the Central Board of Direct taxes may, in their discretion, pay rewards upto Rs 5,000 and Rs 25,000 respectively....*

Section 2.116 & 2.117 deleted.

2.118 While discussing intelligence, we have recommended certain facilities to be provided to the officers working in that Wing for increasing their efficiency. For similar reasons, *we recommend that the officers working in Investigation Circles should also be given facilities regarding staff assistance, staff car, air travel and residential telephones.*

Publicity

2.119 Lastly, we would like to emphasize that the deterrent impact on tax evaders can be considerably enhanced by giving adequate publicity to the achievements of the intelligence and investigation division. We find that publicity is not at present given to several cases where searches and prosecutions have been conducted by the Department successfully. This is said to be due to the provision in sub-section (2) of section 287 of Income-tax Act, 1961, which is to the effect that penalties imposed and convictions secured in respect of tax offences cannot be published by the Department unless, the time for first appeal has expired without an appeal having been presented or the appeal, if presented, has been disposed of. *We recommend that the*

Department *should widely publicise in newspapers, by way of paid advertisements if necessary, factual details of searches, seizures and* prosecutions, without waiting for the result of appeals; and *for this purpose, the law may be suitably amended.*

Section 2.120 & 2.121 deleted.

Taxation of agricultural income.

2.122 Agricultural income, which is at present outside the Central tax net, offers plenty of scope for comouflaging black money. In recent years agricultural farms, vineyards and orchards have been acquired by many film artistes, industrialists and others, not for the love of agriculture, but to convert their black money into 'white' money. Instances abound where income-tax payers, confronted with the need to explain certain deposits, investments or expenses not converted by their incomes disclosed to the Department for tax purposes, resort to explaining them as entirely or partly financed from their agricultural income. Even where the tax-payer does not have any agricultural income of his own, he manages to find some agriculturists ready to lend their names, for a consideration or otherwise, for explaining deposits, etc. The explanation that agricultural income is the source of such deposits, etc., is offered readily for two reasons. Firstly, the Department finds it difficult to rebut the assessee's claim on account of inadequate means of verification. Secondly, and more importantly, the persons professing to possess considerable agricultural income expose themselves to no liability to tax on that account as there is no tax on agricultural income in several States and even where there is one, the exemptions available are large.

2.123 There is urgent need for agricultural income being subjected to a uniform tax more or less on par with the tax on other incomes so as to eliminate the scope for evasion of direct taxes imposed by the Union Government. Since agriculture is an item falling under the State List of our Constitution, levies pertaining to agricultural income or holdings have baffling variations from State to State and there is no uniformity regarding the tax base or the rate structure. Many State Governments are gradually abolishing even the existing land revenue. There is also a great inequity between the incidence of tax on agricultural income and that on the non-agricultural one. Although agriculture accounts for nearly half of India's national income, the taxes contributed by it are around Rs 113 crore only, whereas the contribution by the non-agricultural sector is over six times as much. In fact, tax burden on the urban income is relatively so high that a taxpayer having urban income of Rs 10 lakh is left after paying income-tax with almost as much income as another person having an agricultural income of Rs 1 lakh only. There is no justifiable reason for this vast disparity between the tax burden on the two sectors, particularly when, as a result of the 'green revolution' and the price-support policy of the Government, income from agricultural holdings has been progressively rising in recent years. In the wake of planning, the urban taxpayers have been subsidizing agricultural income by bearing the full burden of the agricultural development schemes and also sustaining high prices of foodgrains, raw materials and other agricultural produce. Consequently, there has been a one-sided flow of resources from the urban economy to agriculture. In view of the larger objective of achieving a self-sustaining economic growth, there is pressing need for larger and larger resources, and this is another good reason why agriculture should also contribute to the national Exchequer in much the same way as the other sectors are doing.

2.124 The present system of land revenue or tax on agricultural income is neither uniform nor rational. Besides, the benefits of the 'green revolution' have intensified inequalities of income and wealth in the rural sector.

We consider that uniform and progressive taxation of agricultural income is urgently necessary for the purpose of ensuring that agricultural income ceases to offer any scope for tax evasion, and also on grounds of equity and distributive justice.

2.125 The main difficulties and objections generally advanced against the suggestion for uniform and progressive agricultural income-tax are as under:-

(a) The tax on agricultural income will act as a positive disincentive to increased agricultural production. This may not be desirable at present, when the country is just beginning to have a break-through in agriculture.

(b) The per capita income of rural population is very low, and it will only add to poverty of the rural folk.

(c) Maintenance of accounts by the rural population is very difficult.

(d) Such a change cannot be brought about unless the Constitution is suitably amended.

However, on analysis, these difficulties do not seem to us to be insurmountable.

2.126 As the net fiscal burden on the agricultural sector is small at present, we consider that the levy of a uniform income-tax on agricultural income will not adversely affect the production in the farm sector. In fact, a tax on agricultural income, as any other tax, is likely to motivate farmers to increased agricultural production, by the adoption of improved technology for augmenting their income to meet the tax liability.

2.127 Again, in examining the feasibility of subjecting agricultural incomes to income-tax, considerations of per capita income have very little relevance. At present, 18.36 per cent of the number of operational holdings have under their control 61.75 per cent of the total area under cultivation in the country. The agricultural income is concentrated in the hands of a small section of the farmers in India. An attempt to tax only the richer farmers cannot be said to promote poverty among the rural folk. To allay lurking fears, if there be any, we suggest that a higher exemption limit should be provided for agriculturists. We consider that an additional deduction of Rs 5,000 may be given for agricultural income. Thus, in the case of an agriculturist, no tax will be payable where his income does not exceed Rs 10,000. It may also be provided that, in any event, no income tax will be charged on agricultural income if the total agricultural holding of an assessee does not exceed five acres (2.01 hectares). As a result of these exemption limits, all small agriculturists will be excluded from the purview of income-tax.

2.128 As regards the difficulties relating to maintenance of accounts, it may be observed that with the basic exemption limits as suggested above, only assessees having large agricultural holdings will be called upon to prove the extent of their agricultural income. We feel that there should be no difficulty for these persons in maintaining accounts. In any case, if no proper accounts are produced, assessments can be completed on the basis of local information regarding crops and prices. Such presumptive assessments of agricultural income are being made in other countries like Chile, Ceylon and France.

2.129 Now, as regards the constitutional difficulty, the Parliament has exclusive power to make laws with respect to taxes on income other than agricultural income by virtue of Article 246(1) of the Constitution read with Entry 82 of the Union List. Similarly, Article 246(3) of the Constitution read with Entry 46 of the State List empowers a State Legislature to make laws with respect to 'taxes on agricultural income'. Thus, these two entries are to be read as complementary to each other. It would, therefore, follow that if agricultural income is to be taxed, in the manner we desire it to be done, two main courses are open to the Government. Either the Central Government should itself assume the power to levy tax on agricultural income, or request the State Governments to levy agricultural income-tax in accordance with a common code duly drawn up by the Central Government. We are, however, of the opinion that though the alternative to Central administration of tax on agricultural income seems, at first sight, to be easy and attractive, it may pose serious difficulties in persuading all the State Governments to adopt a common pattern of taxation of agricultural incomes. *We, therefore, recommend that in the interest of uniformity and stability, the Central Government should assume the power to levy and administer tax on agricultural income.*

2.130 Towards this end in view, we suggest that the Government may choose any of the following courses, as it deems feasible:

(a) The Constitution may be amended by deleting the words 'other than agricultural income' appearing in Entry 82 of the Union List. Entry 46 of the State List which empowers the State Governments to legislate on matters concerning 'Taxes on agricultural income' may also be deleted. Such a constitutional amendment will unambiguously empower the Union Government to impose taxes on agricultural income.

(b) The Union Government may impose income-tax on agricultural income, provided State Legislatures empower the Union Government in this behalf by necessary resolution in accordance with the provision of Article 252 of the Constitution. It would be pertinent to mention here that estate duty has been extended to agricultural lands in certain States by resorting to this procedure.

(c) Article 269 of the Constitution may be amended to include taxes on agricultural income in the list of taxes levied and collected by the Union, and the taxes so collected may be assigned to the States in accordance with the procedure outlined therein. The advantage of this course of action is that the State Governments are more likely to agree to concede the power to impose tax, as their financial interests will be statutorily protected.

Unexplained expenditure

2.131 Under section 69, 69A and 69B of the Income-tax Act, 1961, any unexplained money or value of any unexplained investment, bullion, jewellery or other valuable article, or the amount of any investment, etc., not fully disclosed in the books of account of an assessee is deemed to be his income for tax purposes. At present, the law does not expressly stipulate that when any expenditure incurred by a taxpayer is not recorded in the books of account, or is only partly recorded, and the source of such expenditure remains unexplained, the amount of such expenditure would be treated as the income of the assessee. We had, therefore, included a question in our Questionnaire whether such a provision was necessary. In the replies received, divergent views have been expressed in this behalf. While some are of the view that such provision would be clarificatory, reasonable and logical, there are others who feel that the taxability of such expenditure is implicit even otherwise in section 4 of the Act and there is, therefore, no need for a new provision to bring to tax such expenditure. There are still others who apprehend that such a provision might be misused by the tax authorities, resulting in harassment of the taxpayers.

2.132 We have carefully considered the pros and cons of having such a provision in the income-tax law. We feel that though the income out of which the 'unexplained' expenditure has been incurred, is intended to be taxed under the present law, the existing legal provisions do not make this quite clear. In the context of the ostentatious living that we see around, made possible mostly due to the availability of black money, we consider that there should be a specific provision in law which will assist the tax authorities in effectively tackling this problem. Apart from being supplemented to the existing sections 69, 69A and 69B of the Act, such a provision would highlight the need to examine expenditure. It would give statutory recognition to the existing practice of treating 'unexplained' expenditure as income from undisclosed sources. Further, it would also fix by statute the financial year in which such income is to be assessed. *We recommend that a separate legal provision, analogous to sections 69, 69A and 69B, be made in the Income-tax Act, 1961, which would enable the tax authorities to bring to tax the amount of 'unexplained' expenditure.* It would, however, be necessary for the administration to ensure that this provision is not used to harass the small taxpayers by making them explain petty items of expenditure.

Substitution of sales-tax by excise duty

2.133 In our country, evasion of income-tax is closely linked with evasion of sales-tax. Though differences of opinion are bound to be there

whether evasion of income-tax is the cause or consequence of evasion of sales-tax, it is generally true that since both the purchaser and the seller stand to gain, transactions in many a case are kept out of records.

2.134 Sales taxation in our country has taken multitudinous forms and it has generally "tended to become excessively complex". The present assorted systems of sales-tax in the country thus provide ample opportunities for evasion of sales-tax and, in turn, lead to evasion of income-tax as well. We consider that more revenue with broadly the same incidence of tax can well be secured by the substitution of sales-tax by excise levy in respect of many more items. *We are, therefore, of the opinion that the best way to get over the problem posed by the existing sales-tax systems would be to replace sales-tax levy on various commodities, as far as possible, by additional duty of excise, but in the selection of commodities, care should be taken to minimise the cascading effect on prices.* We consider that such a measure is desirable for tackling evasion of both income-tax and sales-tax. As sales-tax will still continue to be levied on some commodities, *we feel that there should be greater co-ordination between the income-tax authorities and sales-tax authorities in the matter of exchange of information, collection of intelligence about evasion of these taxes and also in taking preventive measures for checking tax evasion.*

Compulsory maintenance of accounts

2.135 One of the devices which tax dodgers often adopt to escape proper liability to tax and penal consequences is to take shelter behind the plea that no accounts have been maintained. The law no doubt provides for 'best judgement' assessments on estimated income in such cases but this provision can hardly be considered as a deterrent, and instances are not wanting where taxpayers, particularly traders and persons in profession, invite best judgement assessments year after year on such a plea. Similarly, the tax dodgers, when confronted with the prospect of a probe, often advance the plea of having no accounts. Even taxpayers with substantial incomes, such as contractors executing large contracts, take the stand that no accounts are maintained. In these circumstances, cross verification of important items of receipts, sales, purchases or expenses becomes difficult and this defeats the object of detailed scrutiny. In cases where the Department strongly suspects that some accounts must in fact exist, it finds itself quite helpless as even powers of search can be exercised only when the Commissioner has, in consequence of information in his possession, reason to believe that books of account exist but will not be produced, if summoned.

2.136 If maintenance of accounts is made a statutory obligation, it would be a potent weapon in the fight against circulation of unaccounted money. Maintenance of faithful accounts at least by some would offer a starting point for uncovering unaccounted money in other cases. While the absence of a legal requirement to maintain accounts enables tax evaders to escape proper assessment and punishment for concealment, it impedes the introduction of a real self-assessment system on others. Compulsory maintenance of accounts would facilitate acceptance of returns, eliminate the evil of arbitrary 'best judgement' assessments and would contribute to improving the relationship between the taxpayers and the taxation department.

2.137 The question of compulsory maintenance of accounts was examined by the Income-tax Investigation Commission, but it did not favour the suggestion in the face of overwhelming public opinion that no such legal obligation should be imposed, particularly in the context of widespread illiteracy in the country. Two decades have since passed and there has been considerable improvement in the standards of literacy. A distinct change in public opinion is also visible. Many persons, who answered a specific query on this subject in our Questionnaire, have expressed themselves in favour of compulsory maintenance of accounts. We feel that the grounds on which the Income-tax Investigation Commission rejected the idea are no longer valid.

2.138 Today, any person earning a worthwhile income from business or profession maintains some sort of accounts as he would like to know whether he is losing or making a profit. Where

such a person is assisted by others in his business or profession, he needs accounts all the more as he has also to make sure that he is not being cheated by his associates or assistants. These days even a petty trader running a one-man show is quite often required to make purchases or sales on credit and he has necessarily to maintain some records. Thus, it is reasonable to presume that accounts are by and large maintained in most cases of business and profession, but in the absence of a provision in law requiring maintenance of accounts, it becomes difficult to deal with the plea, when advanced, that no accounts are actually maintained. In most cases, the legal requirement will not cast any additional burden on the taxpayers but will help to bring out in the open the accounts already maintained.

2.139 As regards the argument of widespread illiteracy in our country, it is to be noted that income-tax payers constitute less than one per cent of the population. The mere fact that there is widespread illiteracy does not mean that most of the taxpayers are also illiterate. The exemption limit which is fairly high in comparison with the per capita income eliminates the possibility of any sizable section of the taxpayers being illiterate. This argument of illiteracy is patently inapplicable to professional men many of whom do not at present maintain accounts or at any rate claim that they do not. As regards businessmen, they are already subject to a variety of requirements under various laws for maintaining records, registers and for filing frequent periodical statements. The excise laws and municipal laws are a case in point. The Sales-tax law in some of the States requires compulsory maintenance of accounts. A requirement for maintenance of accounts under the Income-tax law should not by itself cause hardship to the public or pose any insurmountable problems.

Section 2.140 deleted.

2.141 In the initial stages, the form in which accounts are to be maintained and the type of books and records that are to be kept may be left to the discretion of the taxpayers, the Department merely exercising a broad check to ensure that the assessee's income and claims for deductions, exemptions, etc., are correctly and faithfully recorded. In due course, the Central Board of Direct Taxes might settle the form of accounts for different types of businesses and professions in consultation with the Institute of Chartered Accountants, bar associations, medical associations, etc.

2.142 We feel that a provision for mandatory maintenance of accounts might not itself serve the objective in view, unless it is also supplemented by a provision requiring their preservation for a minimum period. The U.S. Canadian and New Zealand laws contain such a provision. *We recommend that the law should provide that ledgers and cash books should be preserved for a period of 16 years and other accounts and records for 8 years.*

2.143 There might be difficulties in enforcing the statutory requirements regarding compulsory maintenance of accounts and their retention for a minimum period unless any failure to comply with them involved penal consequences. Both the Canadian and U.S. laws carry penal sanctions which can be invoked against any taxpayer who wilfully fails to maintain books and records required by law. *We recommend that monetary fines should be provided in the law for failure to maintain accounts in the manner required or to preserve them for the prescribed period.* In the initial stages, the Department should mount a massive publicity programme to educate the public in this behalf. A mild and conciliatory approach will be needed for some years to come and the penal provisions should be invoked only in flagrant cases of deliberate failure to maintain books or records or to preserve them.

Compulsory audit of accounts

2.144 We think it would facilitate the administration of tax laws to a considerable extent if, simultaneously with the compulsory maintenance of accounts, there is a statutory provision for their mandatory audit, at least in the bigger cases. Audit would ensure that the books and records are properly maintained, and that they reflect faithfully the taxpayer's income (as shown in the books of account) and claims for deductions. Audit would also help in the proper presentation

of the accounts before the tax authorities, thereby making assessment proceedings more meaningful. Further, in a vast majority of cases, it would save considerable time of the assessing officers which is at present spent on carrying out routine verification, like correctness of totals and whether purchases and sales are properly vouched or not. The time thus saved could then be utilised for attending to more important investigational aspects of a case. The information which the auditor could be required to furnish with his certificate would also enable building up of information exchange for purposes of cross verification which will be invaluable in detecting tax evasion and spotting new assessees. Audit would also help to check fraudulent practices such as concoction of accounts at later dates, maintaining duplicate sets of accounts, etc.

2.145 In his report, Nicholas Kaldor had expressed the view that malpractices like the presentation of false and misleading accounts could be checked to a great extent if it were made compulsory for taxpayers to present audited accounts in all cases in which income or property exceeded certain limits. The idea of compulsory audit of accounts in large income cases has found support even in quarters which were not otherwise quite favourably inclined towards the suggestion of compulsory maintenance of accounts. The Income-tax Investigation Commission, while not favouring the imposition of a legal obligation on all to maintain accounts, was of the view that compulsory audit in the case of business with large incomes would be desirable. The Direct Taxes Administration Enquiry Committee also recommended that in the interest of expeditious and proper assessment of taxpayers in higher income group, audit of accounts in all cases of business, profession and vocation, where the total assessed income in any one of the last three years exceeded Rs 50,000, should be made compulsory by law and that audit should also be made compulsory in those cases of business, profession and vocation where the returned income for the first time exceeds Rs 50,000. The Working Group of the Administrative Reforms Commission also favoured compulsory audit by Chartered Accountants of cases with income over Rs 50,000. However, the Administrative Reforms Commission, while agreeing that audit by qualified Chartered Accountants would be helpful in relieving the assessing authority of the need to make routine checks and enabling him to concentrate on the broader aspects of determination of the assessees correct liability, felt that the number of Chartered Accountants being limited, it may not be possible for all assessees to secure their services except at heavy cost and that the requirement of compulsory audit might delay the submission of returns. The Commission, therefore, recommended only an amendment of the provisions of rule 12A of the Income-tax Rules, 1962, so as to provide for furnishing of certain additional information in all cases in which the returned income from business exceeds Rs 50,000 and the returns are prepared by Chartered Accountants.

2.146 In the Questionnaire issued by us, we had specifically elicited views on this subject. Most of the departmental officers, who appeared before us, welcomed the suggestion and there was near unanimity among them that this would also go a long way in fighting tax evasion. Even among taxpayers, we found a sizable support for the measure, which they felt would smoothen proceedings before the income-tax authorities. Some of the persons who appeared before us have, however, expressed their fears that a provision for compulsory audit of accounts might put an undue burden on the taxpayer. We concede that this may no doubt be true in the case of small business or professional men or persons deriving income from other sources. We are, therefore, of the view that such persons should not be required to get their accounts audited. The requirement of compulsory audit of accounts should be applicable to persons engaged in business or profession where the income or turnover/receipts exceed certain specified limits.

2.147 Doubts have also been expressed whether enough qualified auditors will be available for undertaking audit in all case where it is mandatory. Companies are already statutorily required to get their accounts audited. We feel that if suitable limits are prescribed for the non-corporate sector, the work-load may not be too great to be tackled by the existing professional accountants. We understand that the number of

Chartered Accountants has increased from eight thousand in April, 1967 to over twelve thousand in October, 1971. Further, during the same period the number of Chartered Accountants solely in practice has risen significantly from 2,900 to 5,400. From the concern voiced from time to time in the press and elsewhere about a few well-known firms of Chartered Accountants monopolising bulk of the audit work relating to the corporate sector, it appears that there is a considerably large number of practising Chartered Accountants who can undertake additional work-load of audit in the non-corporate sector without much difficulty.

2.148 .... *We, therefore, recommend that a provision be introduced in the law, making presentation of audited accounts mandatory in all cases of business or profession where the sales/turnover/receipts exceed Rs 5 lakh or the profit before tax exceeds Rs 50,000. We further recommend that a form of audit report be prescribed taking due note of the manner in which documents, records and books are maintained in the non-corporate sector. Auditor's report should include, among other things, pertinent information like the following:*

1. *Scope of examination - whether full check, test-check or mere reconciliation - in order to satisfy that purchases, sales, income and expenses are properly accounted for and balance-sheet is properly drawn up.*

2. *Nature of security offered for obtaining secured loans. Particulars of security not recorded or accounted for in the books to be stated.*

3. *Computation of admissible allowance by way of depreciation.*

4. *Brief particulars of expenditure on entertainment, advertisement, guest house, etc., and the amount, if any, disallowable under section 37 of the Income-tax Act, 1961.*

5. *Particulars of expenses in respect of which payments have been made to directors, partners or persons substantially interested in the concern and their relatives. The amount, if any, not deductible under sections 40 and 40A of the Income-tax Act, 1961.*

6. *Particulars of amounts, if any, chargeable as profits under section 41 of the Income-tax Act, 1961.*

7. *Particulars of payments in respect of which income-tax has not been deducted at source and paid in accordance with the requirements of sections 192-200 of the Income-tax Act, 1961.*

The Government may also, in due course, evolve a proforma of information to be furnished by the auditors which would facilitate completion of assessments.

Section 2.149 deleted

2.150 The question of introducing permanent account numbers has engaged the attention of several experts, and expert bodies in the past Nicholas Kaldor and in his report, while suggesting the introduction of a comprehensive reporting system in respect of all transactions in property, stressed the need to allot a code number to every taxpayer and every other person entering into such transactions. S. Bhoothalingam has in his final report, while dealing with the problem of tax arrears, recommended that each taxpayer should be assigned a distinctive and permanent number. The Administrative Reforms Commission has also recommended that steps should be taken to introduce a system of registration of assessees in an all-India list on the lines suggested by the Working Group. Some of the experts engaged by the Government had also conducted studies in this behalf and made recommendations, e.g., Staunton Calvert, an American expert. All these experts and expert bodies were unanimous in their view that the Department should introduce a permanent code for identifying the taxpayers all over the country. Notwithstanding such unanimity of views and the fact that the earliest of these recommendations was made some 15 years ago, no progress had been made in evolving and implementing a scheme of allotting permanent

account numbers or identification codes to all taxpayers. We felt that the absence of a simple but suitable code and the attendant administrative and procedural problems had perhaps stalled the adoption of a measure about the advantage of which there were no two opinions. We had, therefore, drawn up a scheme for the allotment of permanent account numbers, devoting considerable attention to the various problem areas. We had the blueprint of a workable scheme ready when we learnt that the Central Board of Direct Taxes have also been developing a scheme on their own and have decided to introduce it in a few charges with effect from 1st October, 1971. We are glad to note that steps have at last been taken to fulfil a long-felt need....

2.151 While selecting a suitable type of code which would meet the requirements of the Income-tax Department, we have kept in mind the following factors:

(a) The length of the code should be minimal. Unduly long codes are likely to lead to serious errors in reproduction, particularly in the existing manual system.

(b) The system should, however, be capable of covering the entire section of the population which it is intended to cover and also provide sufficient room for expansion over the projected useful life of the code.

(c) The code should be permanently assigned to an entity to provide historical continuity and to facilitate data processing operations.

(d) The code should have a fixed numbers of characters so that, while being suitable for manual processing, it could be adopted without change when machine processing is widely introduced.

Sections 2.152 to 2.159 deleted.

The law should require all persons carrying on business, where the turn-over in a year is likely to exceed Rs 30,000, to apply for allotment of permanent account numbers within the prescribed time - if they are not already taxpayers. The law may also provide that any subsequent change in the business name should be forthwith intimated to the concerned authorities. To save any hardship to the public arising out of delay in allotment of permanent account numbers, it could be provided that if a proper application for allotment of a number has been made within time, entering into transactions even before allotment of the permanent account number will not entail penal consequences.

Section 2.160 deleted.

2.161 While commending the scheme, we would like to make it clear that we are not unaware of the limitations of the system and the problems it might throw up, e.g.,

(i) Some persons might intentionally quote wrong numbers and may not be traceable at all.

(ii) Some persons might not intimate changes in their addresses or might intimate wrong addresses so that it becomes well-nigh impossible to get at them later, after they have obtained a permanent account number.

(iii) Statutory requirement to quote the permanent account number in the documents relating to certain transactions might contribute to increasing the volume of unrecorded or unaccounted transactions, thus breeding further evasion of tax.

(iv) The reporting systems might so increase the volume of information available to the Department that a discriminate use thereof becomes difficult.

Nonetheless, we are convinced that a system of permanent account numbers will be useful and will help the Department to deal with tax evasion more effectively and also improve the accounting and maintenance of records. The system is not a substitute for a vigilant and watchful administration but an aid to make its efforts more rewarding.

Power of survey

2.162 Under Section 133A of the Income-tax Act, 1961, an Income-tax Officer or any Inspector of Income-tax authorised by him, may enter any premises in which a business or profession of an

assessee is carried on. He can inspect such books of account or other documents as may be available there. Besides, he is empowered to place marks of identification on such books of account or documents, and to take extracts, if considered necessary. The main purpose of this provision is to enable the Income-tax Officer to make surprise checks at the business premises of the assessee, especially when he suspects the existence of incriminating documents or books of account. This also enables the Income-tax Officer to ensure that the books of account which are currently in use are produced at the time of assessment.

2.163 It has been pointed out that the power available under section 133A of the Act is subject to certain serious limitations. For example, the existing provision does not authorise the Income-tax Officer to check cash, stocks or other valuables. Besides, the present power of survey is exercisable only at the premises where business or profession is carried on. It is not uncommon for businessmen to keep stocks, books of account and cash at residential premises also where strictly speaking no business is carried on. It may be argued that in such cases, the Department should use the powers of search available to it under the law. But it has to be noted that a search under the Income-tax law can be authorised only if certain pre-conditions are fulfilled and that, in any case, it can be authorised only by the Commissioner of Income-tax. We consider that the power of survey, though limited in scope, is, all the same, a useful tool in the hands of the Income-tax Officer to enforce compliance with tax laws. *We recommend that a new provision may be introduced as an adjunct to section 133A of the Income-tax Act, 1961, to enable the Income-tax Officer to visit any premises of an assessee for the purpose of counting cash, verifying stocks, and inspecting such accounts or documents, as he may require and which may be available there. He may also obtain any additional information and record statement of any person who is found at the premises, in respect of matters which would be relevant for making a* proper *assessment.* In order to ensure that this provision does not give room for harassment, we would like this power to be exercised only by an Income-tax Officer and not any lower official. *We also recommend that the law may be amended to confer powers of survey on the Inspecting Assistant Commissioners as well.*

Increasing survey operations

Section 2.164 & 2.165 deleted

2.166 Considering the importance of survey for fighting tax evasion, a special survey drive for discovering new cases was launched by the Income-tax Department in 1964, but these operations were suspended in 1966 in view of the huge pendency of assessments. It was later decided by the Central Board of Direct Taxes in 1969 that external survey should be resumed only on a selective basis. During the last two years, the number of effective cases discovered as a result of survey was only 48,073 and 53,942 respectively. The total number of income-tax assessees on the register of the Department in 1970-71 was 30,13,676 only in a population of 55 crore, which is a mere 0.6 per cent. It is thus obvious that survey has not received the attention it deserves. In our opinion, 'survey circles', even where organised, have not been able to give the desired results because of the faulty system of control and the lack of adequate work programming. With a view to making external survey really effective, *we recommend that adequate number of survey circles should be set up to ensure comprehensive and continuing survey on rotational basis. Further, an officer, of the rank of Assistant Commissioner should be placed in over-all control of survey operations in each Commissioner's charge and he should also hold charge of the Special Investigation Branch.* As he would have materials with him coming from different sources in regard to new assessees, he should be in a position to draw up, and also implement, a well-planned programme of general and selective survey. Besides, *in the bigger cities like Delhi, Bombay, Calcutta and Madras, a survey Range should be created under an Inspecting Assistant Commissioner who will have a contingent of survey circle Income-tax Officers and the necessary complement of Inspectors under him. In other mofussil towns, the survey squad should be*

under the local Inspecting *Assistant Commissioner*, who will have one or more Income-tax Officers for survey operations and adequate number of Inspectors for this work. He should be in overall control of the survey programme so as to ensure that every town and locality in his Range is properly surveyed. The Inspecting Assistant Commissioner will also have to ensure that survey reports submitted by the Inspectors are promptly processed and acted upon so that there is no loss of revenue due to departmental delays. He should review the performance of the survey circles every month and report to the Commissioner of Income-tax.

2.167 *The Income-tax Officer in charge of a survey circle should have territorial jurisdiction* and he should be in complete control of the team of Inspectors working under him. To improve the quality of survey, these Income-tax Officers should frequently go out in the localities surveyed by the Inspectors and make test-checks in a fairly large number of cases with a view to ensure the reasonableness of the estimates made by the Inspectors and the comprehensiveness of the survey. *It should be the responsibility of these Income-tax Officers to ensure that all persons having taxable income/wealth within their respective jurisdictions are brought on the registers of the Department.*

Sections 2.168 to 2.171 deleted.

Collection, collation and dissemination of information

2.172 An efficient machinery for collection, collation and dissemination of information is a *sine qua non* for an efficient tax administration charged with the function of collecting taxes and countering tax evasion. At present, a separate cell, called the Special Investigation Branch, functions under each Commissioner of Income-tax for the purpose of collection, collation and dissemination of information. The work programme of this branch is quite impressive. The branch is expected to deal with anonymous petitions, payment intimation slips, newspaper cuttings, information received from other departments like Sales-tax, Central Excise, Registrar of Immovable Properties, Director-General of Supplies and Disposals, Transport authorities, Chief Controller of Imports and Exports, Reserve Bank, Life Insurance Corporation of India, etc. In addition, Income-tax Officers in the field are required to collect data from the statutory information returns furnished by the assessees and also from the account books of the taxpayers.

2.173 The Special Investigation Branch functions under the direct control of the Commissioner of Income-tax, but the Commissioner himself being loaded with multifarious duties can devote little or no time to the work of the branch. The result is that the work is carried on mostly by junior officers or at times, by Inspectors. We understand that there is no system of regular inspection of this work either. Small wonder then that the work is in a state of complete neglect. This branch is neither doing any investigation nor is there anything special about it; it is even a misnomer to call it Special Investigation Branch.

2.174 At the lower levels in the field formations, it is very rarely that the Income-tax Officer effectively utilises the information received from various sources. Information slips received from the Special Investigation Branch are very often not recorded, though a register is required to be maintained for the purpose, and even if they are recorded, they are not promptly verified with the result that such slips go on piling up in the office to be summarily disposed of by the Inspector at a later date. The Income-tax Officer's half-hearted efforts in this direction are stated to be mainly due to lack of time at his disposal and lack of proper emphasis by the senior officers on this aspect of the work.

2.175 The Administrative Reforms Commission has adversely commented on the performance of the Department in this field. It recommended *inter alia* that the Special Investigation Branches should be strengthened and their energies should not be dissipated on work other than collection, collation and dissemination of information. It suggested that these branches should be placed under the immediate supervision of an Inspecting Assistant Commissioner, who will also be in charge of Internal Audit Department, and that their work should be periodically inspected by the

Director of Inspection. The Public Accounts Committee obviously felt unhappy at the working of the Special Investigation Branches when in its 117th Report, it observed as under:-

"There are Special Investigation Branches in Commissioners' charges which are responsible for collecting information from Government agencies, municipalities and other organisations like banks, financing companies, etc., so as to discover new assessees or sources of income not disclosed by existing ones. The Administrative Reforms Commission reported that the working of these Special Investigation Branches is 'unsatisfactory' due, amongst other things, to lack of adequate supervision and their being saddled with items of work not relevant to their main functions. These defects in the working of these branches should be removed. The Committee feel that if all the available information is collected from these sources and systematically analysed and promptly processed in each Commissioner's charge it would lead to the discovery of most of the persons liable to assessment".

Section 2.176 deleted.

2.177 While the ultimate goal for the Income-tax Department should be to develop an information matching programme which fully covers all aspects of the economic activities of the country, it would not be expedient, and it may also not be practicable, to set up such an all embracing machinery all at once. We consider that it would be better to first set up a moderately sized organisation and as it starts running efficiently and is perfected, it should be feasible to build gradually a sound, systematic, efficient and comprehensive machinery for this purpose. The routine and off-hand manner in which the job is handled at present has to give place to a systematic approach. *We recommend that the Central Board of Direct Taxes should lay down each year a programme and specify targets for collection, collation and* dissemination of information. *It should also ensure that the programme is strictly adhered to* and efforts are made to reach the targets fixed. The *sources to be tapped every year should be* decided at the national level by the Board at the *beginning of each year, to be followed and implemented strictly at all levels. Different types of information may be collected in different years so as to keep an element of surprise.*

Section 2.178 deleted.

2.179 With a view to securing efficient functioning of the set-up, *we recommend that standards of work and performance should be laid down, without which it would not be possible to judge the requirements of manpower nor to measure the adequacy or otherwise of the output given by the persons at various levels. The Special Investigation Branches, to be renamed as Central Information Branches, should be suitably strengthened and they should be placed under the* supervision of the Inspecting Assistant Commissioner in charge of survey operations as suggested by us elsewhere. *They should be located at the stations where the headquarters of the Commissioners are but should not form part of* their offices. The work of the Special Investigations Branch should be *inspected at least once a year by the Commissioner of Income-tax himself.*

Co-ordinations between banks and the Income-tax Department

2.180 It has been brought to our notice that the banking channels are utilised for putting through transactions calculated to evade taxes largely because the bank authorities do not insist on proper identification of parties and, in many cases, do not even preserve adequate information on record to enable the Income-tax Department to ascertain the identity of the parties to these transactions. There is need for a better liaison between the banks and the Income-tax Department from the point of view of fighting tax evasion. We have recommended elsewhere in this report a system of permanent account numbers for all taxpayers to facilitate collation of information to help investigation in cases of tax evasion. One of the important ways in which this system can be profitably utilised is to make it obligatory for all taxpayers to quote permanent account numbers in their financial transactions

through banks. This will help connect the transactions to the relevant parties. *We accordingly recommend that the legal provisions under which the system of permanent account numbers is introduced should also include that taxpayers should quote their permanent account numbers in applications for bank drafts, mail transfers, telegraphic transfers, etc., if the amount involved in such transactions exceeds five thousand rupees.* Where a party to such transaction has no permanent account number, it should be required to state so specifically. This will limit the scope for benami transactions and clandestine dealings.

2.181 The second point which has engaged our attention concerns banking transactions which are *prima facie* of a suspicious nature, because they are either inconsistent or incommensurate with the customary conduct of the business, industry or profession of the person or the organisation concerned. In the United States of America, the Code of Federal Regulations contains provisions under which banks are required to report unusual and suspicious transactions to revenue authorities *suo motu*. The existing position in our country on the other hand protects the privacy of the transactions with the result that even if the banks come to know that all is not well with certain transactions, they do not bother to alert the Income-tax Department. Such a position permits tax evaders, foreign exchange violations and black marketeers to continue their activities without the fear of being caught. *We accordingly recommend that a suitable provision be introduced in the Banking Regulation Act, 1949, by which all banking institutions coming within the purview of that Act should be under a statutory obligation to report to the Reserve Bank of India all financial transactions in cash over twenty-five thousand rupees which, in the judgment of the banking company concerned, are suspicious or unusual.* The Reserve Bank of India may also be enabled to report all these transactions to the Central Board of Direct Taxes, to be followed up by the officers of the Intelligence Wing of the Department.

Sections 2.182 to 2.192 deleted.

2.193 .... *We would, therefore, suggest that the Government should seriously consider the expediency of prescribing a uniform accounting year for all taxpayers. In that case, the accounting year should coincide with the budget year.*

Whatever might be the objections to the prescription of a uniform accounting year for all taxpayers, we are absolutely no justification for the same person being allowed to adopt different accounting years for different businesses carried on by him. *We, therefore, recommend that, in any event, the law should permit adoption of only one 'previous year' in respect of all businesses carried on by one person.*

Checking under-valuation of immovable properties

2.194 Evasion of direct taxes in our country is closely linked with the practice of undervaluation of properties by the taxpayers, whether in the transfer documents relating to immovable properties, or in their returns of net wealth, or when explaining the source of cost of construction. The absence of a proper valuation machinery in the Income-tax Department helps the tax dodgers in more than one way. It facilitates utilisation of unaccounted money in investments. It also provides scope for reduction of liability to direct taxes, whether on income, capital gains, wealth or gifts. Due to the opportunities available for understating the value of assets in the guise of honest difference of opinion, tax dodgers are able to evade the penal consequences and merrily continue their game of tax evasion.

2.195 There are no two opinions that correct valuation of assets can contribute to an effective administration of income-tax and other direct taxes. Proper valuation of assets also seems necessary for the purpose of effectively implementing the levy of additional wealth-tax on urban properties.

Section 2.196 deleted.

2.197 In our interim report to the Government, we had recommended compulsory acquisition of

immovable properties in cases where the sale deeds did not reflect their fair market value. This recommendation has since been accepted and legislation has been introduced in the Parliament. However, the problem of under-valuation is not limited only to understatement of sale consideration in the transfer deeds. Considering the scope for tax evasion through understatement of cost of construction of property by the taxpayer, we examined whether the recommendation made by us earlier in the interim report for compulsory acquisition of immovable properties should be extended to such cases also. *We are of the opinion that it would be expedient for the Government to assume powers to acquire immovable properties in cases of understatement of cost of construction as well. However, as this would be an extension of our recommendation in the interim report, we feel that the Government should consider such extension only after it has had some experience of acquisition of immovable properties in cases of understatement of sale consideration.*

2.198 In this context, we considered the adequacy of the proposed provisions relating to acquisition of immovable properties, as contained in the Taxation Laws (Amendment) Bill, 1971, introduced in the Parliament. However, there may still be certain cases where it may not be expedient to follow the procedure laid down in the Bill. In order to meet this situation, the Land Acquisition Act, 1894 may be invoked and the property acquired for specific public purposes. To avoid unnecessary controversy on the question of valuation of the property, *we recommend that the Land Acquisition Act, 1894 may be amended to the effect that where an immovable property to be acquired under the Act, was the subject matter of a transfer within one year preceding the notification under section 4 of the Land Acquisition Act, 1894, the sale consideration stated in the transfer deed relating to that property will be deemed to be the market value for the purpose of determining compensation under section 23 of the Land Acquisition Act, 1894.*

Section 2.199 deleted.

Ownership flats

2.200 With the increasing pace of urbanisation in the country and the consequent pressure on housing, the system of having what are commonly known as 'flats on ownership basis' or 'ownership flats' has become very popular, especially in bigger cities. Such flats are often constructed through the medium of co-operative housing societies. A person desirous of owning a flat becomes a member of such a society and the purchase of a specified number of shares of the society entitles him to a flat. The flat is transferable by the mere transfer of the shares. Thus, what is acquired or transferred in case of these flats is not the ownership of the flat as such, but the ownership of the shares of the housing society. These transfers are, therefore, not treated as transactions in immovable property and are consequently not required to be registered under the Indian Registration Act, 1908. Even where such flats are purchased from an entity other than a co-operative society, e.g., a limited company, the rights acquired are described as merely rights of occupancy in respect of a tenement. The position regarding requirement of registration under the Indian Registration Act, 1908, therefore, remains the same. For this reason, these transactions will also be outside the purview of the proposed legislation for compulsory acquisition of immovable property in case of understatement of consideration for the transfer.

2.201 The absence of a statutory requirement of registration of these transactions, coupled with the increasing demand for such flats, has led to considerable opportunities for tax evasion and proliferation of black money. Receipt of 'on-money' on transfer of flats, holding flats in bogus and benami names, deriving unaccounted rental therefrom, and ante-dating transactions in them to thwart tax recovery proceedings, etc., have thus become quite common.

2.202 The Maharashtra Government had noticed that consequent on the acute shortage of housing in several areas, certain malpractices and difficulties relating to construction, sale and transfer of flats taken on ownership basis had cropped up. The State Government, therefore, appointed a Committee in 1960 to enquire into these matters and advise the Government. On the basis of the

recommendations of this Committee, the Maharashtra Ownership Flats (Regulation of the Promotion of Construction, Sale, Management and Transfer) Act was passed in 1963. This Act provided, *inter alia*, that where a person constructs such flats for sale, he must enter into a written agreement with the intending buyer before accepting any advance or deposit from him and the agreement should be registered under the Indian Registration Act, 1908. Recently, the Government of Maharashtra has enacted another statute, viz., The Maharashtra Apartment Ownership Act, 1970. The preamble states that the Act has been enacted in order to provide ownership rights to persons who buy apartments in a building and also to make such apartments heritable and transferable property. Each apartment owner can avail of these benefits if he executes the prescribed documents and gets them registered under the Indian Registration Act, 1908. No doubt, these enactments are likely to be of some help in checking tax evasion in Maharashtra State, but in our opinion, even these do not go far enough. As indicated above, the first enactment covers only agreements with the promoter and not the subsequent transactions. So far as the second enactment is concerned, it does not apply to co-operative societies, which hold a large number of such flats. Secondly, it leaves non-residential flats out of its purview and, what is more, the option to be governed by this Act is left wholly to the discretion of the owners of the apartments.

2.203 We consider that evasion of taxes through transactions in ownership flats can be checked only if there is all-India legislation providing that such transactions shall be treated as transactions in immovable property and shall consequently have to be registered under the Indian Registration Act, 1908. Such a measure would also be of considerable help to the Department even in the matter of collection of taxes. It will extend the scope of section 230A of the Income-tax Act, 1961 to the flats and will also enable such property being attached in certificate proceedings for recovery of taxes.

We, accordingly, recommend that it may be provided by law that ownership flats, whether acquired through the medium of co-operative housing societies or *otherwise, would be deemed to be immovable property for purposes of the Transfer of Property Act, 1882 and that transfer of such flats shall be required to be registered under the Indian Registration Act, 1908 in the same manner as any other immovable property.*

'Pugree' payments

2.204 'Pugree' is a premium paid at the time of change of tenancy of premises and this payment, being illegal, is made outside the account books and usually out of unaccounted money. The system of 'pugree' payments has its origin in rent control legislation in force in the various States. Rent control was introduced mainly to curb the practice of charging exorbitant rents. Consequently, the various Rent Control Acts put a prohibition on claiming or receiving any sum as premium or pugree, in addition to rent. In spite of the prohibition, 'pugree' system is widely prevalent, particularly in the bigger cities, and leads to tax evasion and circulation of black money.

2.205 .... At present, rent control applies to both residential and non-residential premises. This would mean that doing away with all rent control would result in lifting control in respect of residential buildings also. We are convinced that in view of the larger social objectives, there is justification for protection against exorbitant rents to continue in respect of residential tenancies. No such considerations, however, prevail in the case of non-residential premises. Moreover, any higher rent charged by landlords for letting out non-residential premises is an admissible deduction in computation of income from business or profession. *We recommend that the present legislative control on rent which operates in respect of both residential and non-residential premises be amended so as to restrict its operation to residential premises only.*

Tightening provisions of the Stamp Act

2.206 A convenient device frequently adopted for secretly utilising black money is to invest it in immovable property by understating the purchase consideration. This not only saves stamp duty but

also results in evasion of income-tax and wealth-tax in the hands of the investor, while the vendor escapes his proper liability to capital gains tax. In addition, it creates a fresh nucleus of black money in the hands of the vendor, which leads to its proliferation in the economy. It was for this reason that we had recommended in our interim report, a detailed scheme for the take-over of immovable properties by the Government in cases of understatement of purchase consideration. We had stated, *inter alia*, that this measure would act as an effective deterrent and curb the tendency to understate the consideration in documents relating to transfer of immovable properties. While recommending this measure, however, we had ourselves made it clear that it will have to be applied only to cases of substantial under-statement. It is in this context that we recommend below another measure to help deter investment of black money in immovable property.

2.207 We think it will go a long way to achieve this objective if adequate machinery is provided under the Stamp Act for valuation of properties which are the subject of transfer. The Indian Stamp Act, 1899, no doubt provides for impounding instruments not duly stamped and for levy of penalty for the insufficiency of stamps. However, the stamp duty payable on an instrument has to be determined with reference to the terms of the document and the court is not entitled to take into consideration evidence *de hors* the instrument itself. Even where a deed relating to a property is impounded by an authority under section 33 of the Indian Stamp Act, and proceedings are started by the Collector under section 40 of the Act for judging the sufficiency of the stamps and levying penalty where necessary, the Collector has no power to embark upon an enquiry regarding the market value of the property and to require payment of further stamp duty according to the valuation arrived at by him. It is true that a penalty can be imposed under section 6 in case of fraud but, in the very nature of things, it is easier to allege fraud than to establish it, with the result that the provision of section 64 have almost become a dead letter.

Section 2.208 deleted.

2.209 We find that in 1967 the then Madras State Government had introduced certain measures to curb the evil of understatement of purchase consideration. By an amendment to the Indian Stamp Act, 1899, the Registering Officers, within Madras State were empowered to refer cases of suspected understatement of market value in the deeds requiring registration, to the District Collector, for determining the market value of the property mentioned therein. We are of the opinion that it would be advantageous to have similar machinery in other States also. *We recommend that the Indian Stamp Act may be suitably amended in this behalf on the lines of the Madras enactment.*

2.210 Another change we would like to recommend, with a view to checking tax evasion, is in relation to the sale of stamps and stamped papers. At present, the stamps are sold only by licensed stamp vendors who are required to maintain a register of sales showing name and address of the purchaser and the date of sale. These details are also required to be recorded by the vendors on the back of the stamped paper at the time of sale. This entry on the stamped paper is an important means of verifying the genuineness of the transaction sought to be evidenced by the document. However, this procedure is open to considerable abuse. Unscrupulous persons obtain illegitimate tax advantages or defeat certain controls and regulations imposed by other legislation by antedating certain transactions. The entry regarding the name of purchaser and the date of sale is not enough to prevent such ante-dating manoeuvres. Stamped papers of earlier dates can still be used for such purposes because details regarding the nature of transaction sought to be recorded on the stamped paper and names of the parties to the transaction, are nowhere mentioned at the time of purchase of the paper. In view of the widespread misuse of the stamped papers to evade taxes, *we recommend that in addition to indicating the date of sale and name and address of the purchaser, the stamp vendors may be required to state on the stamped paper the purpose for which the paper was purchased and also the names of the parties to the transaction sought to be recorded thereon, except in the case of an agreement or a memorandum of agreement under article 5 of schedule*

I of the Indian Stamp Act, 1899, and power of attorney under *article 48 thereof*. Such a change in the procedure with regard to sale of stamped papers would render it difficult to record on stamped paper a transaction not contemplated at the time of its purchase.

Foreign exchange violations

2.211 In our present economic situation, earning and conservation of foreign exchange are of considerable importance to the development of our country. That foreign exchange violations are of considerable magnitude is perhaps to state the obvious. An official study team appointed by the Government of India has estimated in its report recently submitted that the extent of leakage of foreign exchange is about Rs 240 crore yearly. *Since foreign exchange violations are possible only through clandestine dealings, these necessarily result in evasion of income-tax and other allied taxes. We understand that the Government is examining the report of this study team and is proposing to initiate necessary remedial measures in this regard, including certain amendments to the Foreign Exchange Regulation Act. We expect that the appropriate authorities would deal with this matter effectively.*

Tax treaties for exchange of information relating to tax evasion

2.212 Tax evasion in our country cannot be said to be confined only to transactions taking place within the country; it is closely linked with transactions such as over-invoicing and under-invoicing in import and export business, operations through secret foreign bank accounts and smuggling of valuable articles into and out of India. Moreover, there are cases of taxpayers who thwart the attempts of tax administration to collect tax dues by either retaining their assets abroad, or transferring them secretly outside India. The only answer to these problems appears to us to be to enlarge the field of international co-operation in dealing with tax dodgers, by entering into comprehensive tax treaties with other countries, particularly those with whom we have economic relations and trade on a substantial scale. The United States of America has entered into comprehensive tax treaties with several countries, including Canada and Switzerland.

2.213 We consider that to be of assistance in tackling tax evasion, tax treaties should have a provision for automatic exchange of routine information relating to payment of interest, commission, royalty, rent, etc., to residents of one of the contracting countries in cases where such payments are likely to attract tax liability in that country. The agreements should also provide for exchange of commercial intelligence which is vital for dealing with international tax evasion. This is necessary because it will otherwise be difficult to establish fraud successfully, particularly when it relates to under-invoicing or over-invoicing. The agreements should also facilitate exchange of general information relating to tax laws and fiscal policies. The most important role which such agreements can play is, however, in the field of investigation of specific cases of tax fraud and recovery of tax dues from those who have migrated to the other country or who have assets in the other country, by providing for exchange of information relating to such cases and by making the administrative machinery for investigation and recovery of one country available to the other. The agreements between France and U.S.A. include clauses providing for such mutual assistance. We are of the view that our agreements with other countries should also provide for mutual assistance and should no longer be mere double taxation avoidance agreements as envisaged by section 90 of the Income-tax Act as it stands at present. *We, therefore, recommend that section 90 of the Income-tax Act be suitably amended to enable the Government to enter into agreements with foreign countries not only for the avoidance of double taxation of income, but also for prevention of fiscal evasion. We further recommend that our existing agreements should be revised so as to provide for exchange of routine information and market intelligence as also specific information in individual cases to facilitate investigation of tax evasion and recovery of taxes. The agreements should also enable courts in both the contracting countries to entertain rogatory, commissions or letters of request from the tax*

authorities of the other country for the purpose of *securing the evidence of persons resident therein. The agreements should further provide for mutual* assistance in investigation of tax frauds and *recovery of taxes by making the administrative machinery of each available to the other.*

Tax evasion in film industry

2.214 It is generally said that in the film industry, a lot of 'on-money' is paid to artistes and that this practice leads to a chain reaction in the case of producers, financiers, exhibitors, etc., resulting in evasion of proper tax liability at all levels. We had sought views on this matter through a question in our Questionnaire and an overwhelming majority of persons, who sent their replies, was of the opinion that considerable amount of black money passes in transactions in the film world at different stages. It was, however, pointed out that the peculiar features of the film industry, such as the short and uncertain span of the artiste's working life and the need to preserve his glamour in the public eye, were responsible to a considerable extent for the degree of tax evasion in the film industry.

Section 2.215 deleted.

2.216 There was, however, yet another suggestion which in our opinion should, by and large, meet the plea by film artistes that they should have concessional tax treatment in view of short span of their working life. We learn that the Central Board of Direct Taxes had some time back, in an individual case, approved the principle of taxing the remuneration of a film artiste over a period of years if the film producer, instead of paying the amount directly to the film artiste, purchased irrevocable deferred annuities by an agreement with the Life Insurance Corporation of India and assigned the same in favour of the artiste. It was decided that the artiste would be taxed each year only to the extent of the amount of annuity received. Such tax treatment not only frees the artistes from the burden of paying tax at high rates on the large income earned during a short span of popularity but also ensures that he will have a steady income over a period of years. We consider that if this scheme is statutorily introduced, the film artistes would find it quite useful. Besides, we feel that such a concessional tax treatment would encourage the film artistes to disclose their true incomes. *We accordingly recommend that the law should be suitably amended to provide that where under an irrevocable annuity policy, though taken by the producer in his name but assigned in favour of the artiste, the remuneration is paid to the artiste in the form of an annuity spread over a number of years, the artiste should be taxed only on the amount of annuity received during the year. The present value of annuities due in future should be exempt from wealth-tax. Of course, the producer would be entitled to claim the entire amount paid to the Life Insurance Corporation towards taking out such a policy as a deduction in the year of payment.*

2.217 While on this subject, we also considered the adequacy of the existing system of giving concessional tax treatment to the artistes, etc., under section 80C of the Income-tax Act, 1961, read with rule 11A of the Income-tax Rules, 1962, in the matter of deductions of life insurance premia and provident fund contributions. *We recommend that in view of the enhancement of the ceilings under clauses (ii) and (iv) of sub-section (4) of section 80C of the Income-tax Act, 1961, in recent years, the percentage of gross total income and the qualifying amount prescribed for artistes, playwrights, authors, etc., under rule 11A of the Income-tax Rules, 1962 should also be suitably* enhanced.

2.218 In the course of our enquiry, another suggestion was made that copies of all agreements between film producers and film artistes regarding the latter's remuneration should be required to be sent to the Department within a specified period so as to eliminate the scope for subsequent manipulations and spurious claims. We agree that such a measure will help in checking tax evasion in the film industry. *We, therefore, recommend that where the remuneration payable to an artiste under an agreement exceeds Rs 5,000, both the film producer and the artiste should be under a statutory obligation to*

furnish a copy of the *agreement to their respective Income-tax Officers, within a period of one month from the date of execution of such an agreement.*

Payment by crossed cheque or crossed bank draft

2.219 Sub-section (3) of section 40A of the Income-tax Act, 1961, provides for the disallowance of any business expenditure in respect of which payment is made in a sum exceeding Rs 2,500, otherwise than by a crossed cheque or crossed bank draft. This provision was introduced in order to check the tendency to claim fictitious business expenses. With a view to avoiding genuine hardship to tax-payers and others, certain exceptions to this provision have been notified from time to time. We consider these exceptions to be unduly wide. It is true that insistence on payment by cheques in respect of all business expenses above Rs 2,500 would cause problems, particularly when payments have to be made across the counter and the seller is not in a position to fully rely on the credit-worthiness of the payer. To facilitate transactions of this nature, a possible approach could be that the payer obtains from his bankers a cheque marked 'good for payment'. In practice, however, this may become difficult, partly on account of hesitation on the part of the banker and partly due to the payer not knowing in advance the quantum of payment involved. We are aware of the prevalence of travellers' cheques which normally could be used for this purpose, but in this case also a complication would arise in that the holder of a traveller's cheque would be obliged to sign it in the presence of the receiver: and ordinarily such a receiver has to be either a banker or a person approved by the bank in this behalf. *We, therefore, consider that an endeavour should be made to evolve a new instrument in the form of a Bank Bill of Exchange which is readily transferable but also contains an obligation for it to be encashed through a bank account. A suitable pay order/draft of different denominations may be designed and introduced for this purpose. In brief, this instrument should contain the following three essentials:*

(i) that it is an equivalent of a pay order or draft, without the name of the payee at the time of issue;

(ii) that the name of the payee is entered on the instrument by the payer at the time of payment; and

(iii) that the instrument is marked 'account payee only' by the issuing bank so that it cannot be encashed except through a bank account of the payee.

We recommend that after the introduction of the new instrument as suggested above, the exceptions provided in rule 6DD of the Income-tax Rules may be suitably curtailed.

'Hundi' loans

2.220 Until some time back, 'hundi' loans provided one of the important outlets for profitably investing or utilising black money. As a result of sustained efforts by the Department, the 'hundi' racket is stated to have ben tackled to a considerable extent. *We would, however, recommend that Permanent Account Numbers, which are to be assigned to taxpayers by the Department, should be statutorily required to be quoted on hundi papers and further that advances of loans on hundi and their repayments, including interest, should be made through 'account payee' cheques only. This should serve as an effective check on bogus hundi loans.*

Checking tax evasion among contractors

2.221 What we have said elsewhere about the need for compulsory maintenance of accounts, compulsory audit of accounts, registration of businesses and allotment of permanent account numbers to taxpayers applies to the case of contractors as well. In addition, we have also recommended that in the case of contracts given by Government, local authorities and public sector undertakings or companies, 3 per cent of the amount billed should be deducted as tax from each bill at the time of payment. We have further recommended that tax at the rate of 2 per cent should be deducted by contractors, other than individuals or Hindu undivided families, from payments made to subcontractors in certain cases.

Dealing with compulsory maintenance of accounts, we have observed that in the initial stages the form in which accounts are to be maintained and the type of books and records to be kept may be left to the taxpayers themselves, but that in due course, the Central Board of Direct Taxes might settle the proforma of accounts for different types of businesses, etc., in consultation with the concerned professional or business associations as also the Institute of Chartered Accountants. We would like to add here that *in the case of contractors, including sub-contractors, a register for recording daily receipts and payments would be essential and should be in a prescribed form in due course.* The maintenance of such a register, we think will limit the scope for inflation of expenses by manipulating the account books at a later date. It will, however, have to be ensured that such a register is periodically inspected and signed by the Income-tax Officer or Inspector under the provisions of section 133A of the Income-tax Act, 1961.

2.222 Apart from the practice of inflating expenses, it has been said that contractors try to evade proper tax liability through the device of 'sub-contracts'. This is often resorted to for the purpose of diversion of income, as it enables transfer of a portion of taxable income to a different entity. We feel that tax evasion through sub-contracts can be substantially checked if the contractors are compelled to make payments to sub-contractors only by 'account payee cheques. Such a measure would, in any case, limit the scope for bogus claims of sub-contracts. Accordingly, *we recommend that the income-tax law may be amended to provide that payment to a sub-contractor will not be allowed as deduction in computing the taxable income of the contractor unless it has been made by an 'account payee' cheque.*

2.223 A person undertaking a contract for construction of a building for supply of goods or services in connection with it, for more than fifty thousand rupees, is required under section 285A of the Income-tax Act, 1961 to furnish particulars of the contract to the Income-tax Officer concerned within a month. We see no reason why this requirement should not be made applicable to all contractors generally. *We, therefore, recommend that the scope of this provision should be extended to apply to all contractors.*

2.224 We have elsewhere recommended that Government patronage should be denied to tax evaders. In conformity with that recommendation, we consider it would be necessary to ensure that contractors who are found to have evaded taxes are denied the opportunity to earn profit from Government contracts. *We, therefore, recommend that contractors who have been penalised or convicted for concealment of income/wealth should not be awarded Government contracts for a period of three years. For this purpose, the form of tax clearance certificate applicable to contractors may be suitably amended to include information whether the contractor was penalised or convicted for concealment of income/wealth during the immediately preceding three years.*

Blank transfer of shares

2.225 The system of blank transfer of shares has been in vogue for quite some time in our country. As this has led to considerable abuse, the desirability of continuing this system has become a controversial issue. We are here concerned with this matter as it still provides considerable scope for tax evasion.

2.226 The controversy with regard to the utility of blank transfer of shares has been examined by various expert bodies. In 1923, the Atlay Committee on Stock Exchanges recommended complete abolition of the system of blank transfer of shares and this view was also later endorsed by the Morison Committee in 1937. This recommendation was not, however, implemented by the Government. Shortly after the war, a one-man study team of P.J. Thomas was appointed to recommend proposals for reform of Stock Exchanges. P.J. Thomas defended the system in his report to the Government in 1947. The controversy again came to the forefront with the appointment of Gorwala Committee in 1951. This Committee, however, left the decision to the Government, as there were sharp differences of opinion among the members on the subject. The

Vivian Bose Inquiry Commission had also considered the need for certain restrictions in order to regulate and control the currency of blank transfer of shares and it had made certain recommendations in this regard. Following these recommendations, the Companies Act, 1956 was amended once in 1965 and again in 1966. The present position in law is that every instrument of transfer should be in a prescribed form and, before it is signed by or on behalf of the transferor and before any entry is made therein, it should be presented to the prescribed authority who will be required to stamp such an instrument or otherwise endorse thereon the date on which it is so presented. It further requires that such a blank instrument of transfer should be delivered to the company at any time before the date on which the register of members is closed, in accordance with law, for the first time after the date of the presentation of the form to the prescribed authority or within two months from the said date, whichever is later; this is for shares dealt in or quoted on a recognised stock exchange. In any other case (i.e., where shares are not dealt in or quoted on a recognised stock exchange), the instrument of transfer must be delivered to the company within two months from the date of such presentation to the prescribed authority. However, these restrictions do not apply to shares held by a company or Government corporation in the name of a director or a nominee, and also in respect of shares which are deposited with the State Bank of India, scheduled banks or any other financial institution approved by the Government by way of security for the repayment of loan. While making these amendments, it was made clear by the Government that the object underlying the new provisions was not to prohibit blank transfers altogether but only to restrict their currency.

2.227 We examined the system of blank transfer of shares to see how far it still facilitates tax evasion. It is generally considered that the practice of blank transfer of shares encourages anti-social activities in a variety of ways. Firstly, it facilitates a person with black money to hide his ill-gotten wealth, since blank transfer helps investment in shares anonymously. Secondly, it enables evasion of income-tax since the tax evader can also escape his full income-tax liability in respect of his income from such shares. Thirdly, this system enables persons to obtain control over companies clandestinely by cornering their shares. The companies themselves have the opportunity to reshuffle shares held on blank transfer between their associates with the object of window-dressing their balance-sheets. It also leaves scope for creation of fictitious losses by ante-dating transactions in the books of the companies. While we are not in a position to confirm the extent of these abuses, we are very clear in our minds that they facilitate tax evasion and black money operations.

Section 2.228 deleted.

2.229 .... *We recommend that the law be suitably amended to provide that before an instrument of transfer is presented to the prescribed authority, the transferor should be required to state in the instrument itself his name, the distinctive numbers and value of shares proposed to be transferred, and the instrument of transfer should be duly signed by the transferor and bear the requisite stamp duty. The prescribed authority should be required to cancel the stamps on the instrument of transfer at the time of stamping or otherwise endorsing thereon the date on which it is so presented. The instrument of transfer should be valid for a period of two months only from the date of its presentation to the prescribed authority. However, in order to protect the interest of genuine share-holders who want to borrow funds from banks on the security of shares, we recommend that such blank instrument of transfer should be valid for the period the shares are held by the bank as security for an advance or overdraft to a registered share-holder.*

Benami investments

2.230 The practice of benami investments, which is peculiar to Indian law, has been widely exploited for evasion of taxes. The matter has been receiving attention of earlier Committees. The form of verification appearing in the returns of income and wealth was amended recently to

affirm that the income or *wealth returned covered not only the sources of income or assets held in the name of the taxpayer but also those which were beneficially held for him by others.*

2.231 In pursuance of the recommendation of the Administrative Reforms Commission, the Government has also sponsored legislation through the Taxation Laws (Amendment) Bill, 1971 to discourage benami holding of property. Under the proposed provision which is sought to be inserted as section 281A of the Income-tax Act, 1961, no suit shall be instituted in any court to enforce any right in respect of any property held benami unless the claimant has either disclosed the property in *question or the income therefrom in connection with his wealth-tax or income-tax assessments or given notice to the Income-tax Officer about the particulars of such property in the prescribed form. We consider this to be a step in the right direction.*

Denial of credit facilities to tax evaders

2.232 One of the effective methods of preventing tax evasion would be to choke the flow of finance to tax evaders by denying them credit facilities from banks. We do not deny that such a measure is drastic and it may affect business activity in the country to some extent. But, in the fight against tax evasion, we feel there should be no room for sympathy with tax evaders. This *apart, denial of credit facilities* to tax evaders is also in the interest of *the banks themselves. It is common knowledge that banks generally look to the credit-worthiness* and financial integrity of the person concerned before sanctioning an advance. Since tax evasion is a serious blemish on a person's conduct, it is only in the fitness of things that persons who have cheated the Government in respect of their tax dues are considered unworthy of credit by the banks also. In any case, it is necessary for the Government to ensure that persons who evade taxes do not flourish while persons who pay their taxes correctly suffer due to unfair competition with tax evaders. As the benefits accruing from such a measure would far out-weigh the possible adverse impact that it might have on the extent of business activities, *we recommend that all scheduled banks should be barred from providing credit facilities above Rs 25,000 at any point of time to any person, unless he gives an affidavit to the effect that he has not been subject to any penalty or prosecution for concealment of income/wealth during the immediately preceding three years.* This prohibition shall not, however, apply to cases covered either by sub-section (4A) of section 271 of Income-tax Act, 1961, or by an order of settlement passed by the Direct Taxes Settlement Tribunal proposed by us elsewhere.

Tightening up vigilance machinery

2.233 It is often said that large share of the responsibility for the prevalence of black money and tax evasion in the country should fall on the shoulders of the administration itself which, by its acts of omission, commission and connivance, has allowed such a situation to develop and continue. Tightening up the vigilance machinery so as to tone up administration and deal with its lapses has been suggested as an effective, though indirect, method of tackling black money and tax evasion. We have, while discussing the role of 'controls' in the creation and proliferation of black money, referred to the practice of paying 'speed money' and 'hush money' which creates black money in the hands of the officials administering the controls, as also of the beneficiaries of their actions or inaction. The same is true of many other departments or agencies of the Government, whether they are executing national projects or raising resources for the Government. The Committee on Prevention of Corruption had whole-heartedly endorsed the view that the existence of large amounts of unaccounted black money was a major source of corruption. As black money and corruption go hand in hand, any attempt at tackling black money and tax evasion is likely to yield results only if simultaneously adequate steps are taken to prevent corrupt practices in the administration and also to detect and punish corrupt officials.

2.234 Political corruption is another manifestation of the same disease. We have earlier discussed the question as to how black money, heavy expenditure on elections and contributions to political parties are closely interlinked. Administrative vigilance will not by itself be fully

rewarding without similar vigilance at the political level as well.

The Administrative Reforms Commission recommended the appointment of a Lokpal with the power to investigate an administrative act done by or with the approval of a Minister or a Secretary to the Government. The Commission felt that the answer to the oft-expressed public outcry against the prevalence of corruption, the existence of widespread inefficiency and the unresponsiveness of the administration to popular needs lay in the provision of an institution of the 'Ombudsman' type. The Lokpal and Lokayuktas Bill 1968 was introduced in the Lok Sabha on 9th May, 1968 seeking to give effect to the recommendations of the Commission. In its scope, it differed from the draft Bill as proposed by the Commission in two major respects. It did not extend to public servants in the States. Secondly, it did not confine itself to Ministers and Secretaries alone. The Bill was passed by the Lok Sabha on 20th August, 1969 and transmitted to the Rajya Sabha. However, it lapsed in 1970 on the dissolution of the Lok Sabha. A revised Bill has now been reintroduced in the Parliament which, except for modification of a formal nature, is identical with the one that lapsed.

2.235 Elsewhere in this report, we have given our recommendations with regard to prevention of corruption among Government servants generally and in particular, we have given our views on steps needed for prevention or detection and punishment of corruption in the Income-tax Department. We have stated in that context that the existing requirements under the Government Servants Conduct Rules for submission of annual immovable property returns and intimation of all transactions in movable properties over Rs 1,000 are not adequate. We have recommended that in order to have an effective control in this regard, all Government officers should be required to submit an annual statement of net worth to their respective Heads of Departments. *As regards the question of dealing with corruption at higher levels in public life and redressal of public grievances, we trust that the appointment of* Lokpal and *Lokayuktas after passage of the necessary legislation would take adequate care of the situation.*

Sections 2.236 & 2.237 deleted.

Arousing social conscience against tax evasion

2.238 We consider that if a strong public opinion against tax evasion is to be built up, the Government should take a policy decision that tax evaders will not get any sympathy, patronage, licence or facility from the Government and the public sector undertakings. With this end in view, *we recommend that tax evaders who have been penalised or convicted for concealment of income/wealth should be disqualified for the purpose of getting national awards. The law should also be suitably amended to disqualify such persons from holding any public elective office for a period of six years. In addition, we suggest that Ministers and senior officers of the Government should avoid attending social functions sponsored or organised by known tax evaders.* Elsewhere we have also recommended that such persons should be denied credit facilities by the scheduled banks. *We would like to add that a person who has been penalised or convicted for concealment of income/wealth should not be eligible to be a director of a limited company for a period of six years. The Companies Act, 1956, may be amended accordingly.*

Section 2.239 to 2.243 deleted.