

3. PROBLEMS OF IMPLEMENTATION

There has been no adverse comment on the working of section 35CC in the annual reports of the Comptroller and Auditor-General for the years 1977-78 to 1984-85¹. Enquiry from the Central Board of Direct Taxes and the Directorate of Inspection (Income-tax and Audit) has not brought out any error of omission or commission pointed out by the Department's internal audit organisation in this regard. No court rulings on disputes pertaining to the provisions of Section 35CC have been reported. Absence of audit objections and court litigation would suggest that section 35CC has been relatively easy to administer in so far as the Income-tax department is concerned.

As regards this study, the problems of implementation of section 35CC are viewed from two aspects: proceedings before the prescribed authority for obtaining approval of a programme and proceedings before the assessing officer to secure tax relief in respect of expenditure incurred on implementing the approved programme.

Proceedings before the Prescribed Authority

Till May 31, 1979 the prescribed authority for approving the rural development programmes under section 35CC was the Central Inter-Ministerial Committee. With effect from June 1, 1979 the work relating to approval of programmes was decentralised to expedite clearance of schemes for rural development put forward and companies and cooperative societies and entrusted to State-level committees.² However, this did not accelerate the pace of disposal of applications and there were frequent complaints of delay.³ The decentralisation also did not result in widening the response to the incentive.⁴ It was therefore, no surprise that revival of the prescribed authority at the Centre began to be thought of.⁵

The study team looked into the files of the State-level prescribed authorities for Maharashtra and West Bengal. It

was found that out of 40 and 8 applications disposed of during the period June 1, 1979 to March 16, 1985 in Maharashtra and West Bengal respectively, only 21 and 1 applications were disposed of within three months (vide Table 3.1). Consequent to the amendment of section 35CC by the Finance Act, 1985 no programme could be approved thereunder after March 16, 1985. At that time, 7 applications were pending in Maharashtra (5) and West Bengal (2) with 4 (2 each in Maharashtra and West Bengal) pending for more than 24 months. Table 3.1 indicates the reasons for their pendency. Although some applications were disposed of by circulation, scrutiny of the applications, absence of full particulars therein necessitating further correspondence, eliciting clarification as to the programme content and time taken to connect the earlier papers and in convening meetings of the approval committee were the factors retarding the disposal rate. After March 31, 1983 the prescribed authority could approve a programme only if it fell within the classes or categories of programmes specified by the Central Government. But the notification specifying such classes or categories came to be issued on January 28, 1984. This also contributed to the delay and partly explains the sharp slump in the number of approvals given during the financial year 1983-84 as compared to the earlier years (Table 2.1).

In view of the statutory stipulation of prior approval of a programme by the prescribed authority, for an assessee to be entitled to the incentive, the date on which the prescribed authority approved a programme was generally made the commencement date of its implementation period. This would have worked satisfactorily were the applications disposed of promptly. Delay in disposal created a problem particularly if there was pressure for urgent implementation of a programme due to various reasons. This led to representations that the approval should be effective either from the date requested by the assessee or from the date it made the application. To get over the difficulty, the State-level prescribed authorities made their approvals retrospective wherever considered necessary. Legally, this was open to question as the statute required the assessee to obtain the prescribed authority's approval of the programme before he incurred expenditure thereon. However, this was a practical way out of the difficulty.⁶

Programmes were generally approved for implementation by the end of the assessee's accounting year commencing after the date on which the prescribed authority accorded its approval. In the case of on-going programmes, the system of according approval for one year at a time proved unnecessarily restrictive. Except for calling a report from the assessee as to the work done, the records of the prescribed authorities seen during the study, showed little of actual monitoring. While it was desirable that a programme once approved should get implemented without any avoidable delay, the necessity for a taxpayer to knock repeatedly at the door of the prescribed authority seeking an extension/renewal for a continuing project could have been avoided. This seems to have been appreciated, and at later stages the prescribed authorities did allow in some instances an extended period for implementation of an approved programme.

Proceedings before Assessing Officer

On an average, a company implementing rural development programmes under section 35CC sought tax relief for two to three assessment years. Table 3.2 summarises the data gathered in respect of deductions claimed on this account in returns of income filed by the time of study. Out of 223 assessment proceedings (92 companies) with total claims for deductions of Rs. 688.05 lakh, 162 proceedings (78 companies) involving claims of Rs 459.52 lakh had been completed. Claims amounting to Rs. 369.53 lakh (80.4 per cent) made in 128 proceedings were fully accepted by the assessing officers. Claims of Rs. 89.22 lakh (19.6 per cent) in the remaining 34 proceedings were partly or fully disallowed to the extent of only Rs. 23.77 lakh (5.2 per cent of Rs. 459.52 lakh). As tax incentives go, it also shows a relatively smooth working of this particular provision.

Filing of the prescribed statement in form No. 3AA along with the return of income was mandatory for obtaining a deduction under section 35CC. 145 assessments completed at Bombay, Calcutta and Delhi involving claims of Rs. 411.88 lakh were seen by the study team. Table 3.3 shows that while a majority of the claims allowed were supported by statements in form No. 3AA (80 claims; amount Rs. 253.76 lakh), a large number of claims were allowed without the statements having

been filed (30 claims for Rs. 64.57 lakh including one claim partly allowed). Only 9 claims for Rs. 8.21 lakh were rejected due to non-filing of the prescribed statement. Evidently, some of the assessing officers did not realise the importance of the statement and disposed of the claims in a routine manner. In one case involving two assessments, claims for deduction of Rs 0.86 lakh were rejected by the assessing officer as the statements although filed in the course of the assessment proceedings, were not furnished along with the returns of income. On the Commissioner (Appeals) considering this as sufficient compliance with the statutory requirement, the Department preferred appeals to the Appellate Tribunal against his orders.

There is an interesting case of a manufacturing company which secured approval under section 35CC for a number of rural development programmes in various States over a period of years and implemented them. However, for allowance of the expenditure incurred, it did not prefer claims under section 35CC. Forms No. 3AA were also not filed. Instead, it claimed deductions therefore under section 37 of the Act, *i.e.*, as expenditure incurred wholly and exclusively for the purposes of the business. These claims were disallowed by the assessing officer in three of the four assessments completed by the time of the study, on the ground that the expenditure was not incidental to business [Table 3.3, item (v)]. But, the Commissioner (Appeals) deleted the disallowance for two years by relying on an appellate order in this very case for the assessment year 1975-76, observing *inter alia* that the company had amended its objects clause in the Articles to include welfare of society and the local people and that the facilities had been provided to the employees and their families as also the local population. The appeal for the third assessment year was pending.

Under section 37 of the Act, deduction of expenses laid out wholly and exclusively for a business is subject to two conditions :

- (i) The expenditure should not be in the nature of capital expenditure.
- (ii) It should not be expenditure of the nature described in sections 30 to 36 and section 80VV.

In respect of the expenditure on rural development of the nature described in section 35CC and more so when it is incurred after obtaining an approval of the requisite prescribed authority, the restriction at (ii) above applies. Except to the extent the rural development and social welfare expenses can be considered to promote staff welfare, it will seem to be unduly stretching the ambit of section 37 to equate and identify all rural development programmes with employees' welfare schemes and claim deduction under section 37. Expenditure for acquisition of capital assets is also hit by the restriction at (i). Inclusion of social welfare, etc., in the objects clause only assists the company in forestalling the shareholders' and creditors' objections, if any, against the expenditure thereon. It does not entitle the company to claim a deduction under section 37, except as provided for therein.

It must be recorded that on being requested by the study team, the company readily furnished copies of the prescribed authorities' orders under section 35CC approving its rural development programmes in various States as also the immediately available particulars of divestment of the ownership of the capital assets. It was stated that the various branch officers of the company had directly obtained approval of their rural development programmes from the prescribed authorities of their respective States. They had also got the necessary statements in Form No. 3AA prepared, but had omitted to transmit them to the head office, with the result that these could not be filed before the assessing authority. Though the interests of the revenue may not be prejudiced and there is no reason to suspect mala fide in the matter, this appears to be an instance of an inadequate appreciation of the relevant provisions of the law on the part of both the assessee and the Department.

The statements in Form No. 3AA verified by accountants as statutorily required, filed by the assesseees in support of their claims for deduction under section 35CC, seem to have been generally accepted by the revenue authorities without question. The accountant's verification therein is based on the assessee's accounts and the information and explanations given by him. In none of the cases seen during the study was any independent monitoring or evaluation report before the assessing officer. The fact that the expenditure claimed was within the monetary

limit fixed by the prescribed authority might have weighed with the officers in refraining from any scrutiny or inquiry and no instance of misuse of the provisions was found. Disallowances as called for on the particulars furnished in these statements were, however, duly made if not already added back by the assessee themselves in computing their taxable profits (Table 3.3, item vi). Reasons for the various disallowances made by the assessing officers are indicated in Table 3.4; twelve of the sixteen disallowances being on account of incidental administrative expenditure (9), pre-approval expenses (2) and non-divestment of the ownership of the capital asset within the mandatory period (1).

Initially, in the absence of a specific approval for consultancy and managerial expenses by the prescribed authority, only the direct expenditure incurred on implementation of a programme was being allowed to be deducted in computation of the taxable income. However, it was soon realised that for a programme of any magnitude, some administrative overheads were inevitable. The problem seemed to have been satisfactorily resolved by the prescribed authorities beginning to specify in their approval orders the percentage of the approved outlay within which the administrative expenses might be incurred. Retrospective approvals stopped disallowance of pre-approval expenses.⁷

Table 3.4 shows only one disallowance (Rs 0.04 lakh) due to non-divestment of ownership of a capital asset within the year of its creation. In twelve other assessment proceedings, the assessee obviated the need for the assessing officers to make disallowances on this ground by refraining to claim deductions in respect of non-divested capital assets (Rs 5.73 lakh). In all these instances, the assessee did not suffer any tax loss. As provided in sub-section (2) of section 35CC, the capital assets were deemed to have been used for the purposes of the assessee's business and due depreciation was claimed and allowed for the year of their creation/acquisition and subsequent years. These assets became a part of the capital stock of the assessee and, so to say, lost their identity. In the absence of evidence to the contrary, it may be taken that these were in fact put to use in the assessee's business. In this context, it needs to be mentioned that in instances of delay in execution

of a project, on being requested the prescribed authorities extended the implementation period to enable the assessee to complete the programme and divest itself of the ownership of the capital asset created thereby, within the extended period.

By adopting a practical approach, the prescribed authorities made welcome efforts to see that the assessee's claims for tax relief under section 35CC did not suffer on legalistic and technical grounds.

NOTES

1. Government of India, *Reports of the Comptroller and Auditor General of India*, Union Government (Civil) Revenue Receipts, Vol. II (Direct Taxes).
2. Union Budget Speech, 1979 (February 28, 1979), para 90.
3. Government of India, Ministry of Rural Reconstruction—Summary Record of the meeting of Chairman and Members of the State Level Committees of Income Tax Concession under section 35CC/35CCA to companies, cooperatives, associations and institutions, held on 8th December, 1979, para 5.
4. See opening para of Chapter 2; Table 2.1. above.
5. Government of India, Ministry of Rural Reconstruction, *Annual Report 1980-81*, p. 52.
6. In this context, the Hyderabad Tribunal Branch decision in *Vazir Sultan Tobacco Co. Ltd. v. ITO* (1984) 8 ITD 511 may be mentioned. It was held therein that the prescribed authority could lay down any particular date in the relevant accounting year from which the approval would be effective and the expenditure incurred during the accounting year even prior to the date of the approval was allowable subject to the extent it was certified by an Accountant. This decision should be taken as confined to the peculiar facts of that case.
7. See section 2, third para.

Table 3.1

Time Taken for Disposal of Applications for Approval of Programmes under Section 35CC during the period June 1, 1979 to March 16, 1985

<i>Time taken</i>	<i>Number of Applications disposed of</i>	
	<i>Maharashtra</i>	<i>West Bengal</i>
One month	2	Nil
Three months	19	1
Six months	12	3
Twelve months	3	4
Over twelve months	4	Nil
TOTAL	40	8

Applications Pending on March 17, 1985

Maharashtra: Number of applications pending: 5

<i>Period of pendency (months)</i>	<i>Reasons for pendency</i>	
1	3	Details awaited
2	6	The proposed programme considered by the Committee was not covered by the guideline;; reference made to the Board in February 1985.
3	17	Full details regarding the earlier approved programme not furnished.
4	29	The earlier approved programme not fully implemented.
5	38	Details called for not fully furnished.

West Bengal: Number of applications pending: 2

1	26	Reference made to the Board in June, 1984 as to eligibility.
2	53	Further details awaited.

Table 3.2

***Assessment Proceedings involved in Claims for Deduction
of Expenditure Incurred on Programmes
Approved under Section 35CC***

1. Number of companies which claimed deduction (under section 35CC or otherwise) in respect of expenditure incurred on rural development programme(s) approved under section 35CC	92
2. Number of assessment proceedings involved in (1) in which claims for such deduction were made	223
3. Total amount of deduction claimed (under section 35CC or otherwise) in (2)	Rs. 688.05 lakh
4. Number of companies out of (1) in whose cases one or more assessment proceedings involving claim(s) for deduction of expenditure incurred on rural development programme(s) approved under section 35CC had been completed.	78
5. Number of assessment proceedings out of (2) completed in the cases of companies shown in (4)	162
6. Total amount of deduction claimed in (5)	Rs. 459.52 lakh
7. Total amount of deduction out of (6) allowed at the assessment stage	Rs. 435.55 lakh
8. Number of completed assessment proceedings out of (5) in which claims for deduction were fully allowed at the assessment stage	128
9. Total amount of deductions claimed and allowed in (8)	Rs. 369.53 lakh
10. Number of completed assessment proceedings out of (5) in which claims for deduction were partly or fully disallowed at the assessment stage	34
11. Total amount of deductions claimed in (10)	Rs. 89.99 lakh
12. Total amount of deductions disallowed out of (11)	Rs. 23.77 lakh

Source: Assessment records: Data furnished by assessing officers and gathered by the study team.

Table 3.3
Analysis of Claims Allowed and Rejected

	<i>Number of completed assessments</i>	<i>Deductions claimed (Rs. lakh) proceedings</i>
<i>A. Claims fully allowed:</i>		
(i) Claims fully allowed, supported by statements in Form No. 3AA	80	253.76
(ii) Claims fully allowed, not supported by statements in Form No. 3AA	29	62.50
TOTAL (A)	109	316.26
<i>B. Claims partly or fully rejected:</i>		
(i) Claims partly allowed, statements No. 3AA not filed	1	3.25
(ii) Claims fully rejected due to non-filing of statements No. 3AA	9	8.21
(iii) Claims fully rejected due to non-filing of statements No. 3AA alongwith the returns of income, although the statements were filed later in the course of the assessment proceedings	2	0.86
(iv) Claims fully rejected due to non-production of the prescribed authority's approval order; statements No. 3AA filed	1	1.12
(v) Claims made under section 37 and partly or fully rejected without reference to the provisions of section 35CC; statements No. 3AA not filed	4	36.87
(vi) Claims partly or fully rejected though supported by 3AA statements	19	45.31
TOTAL (B)	36	95.62
GRAND TOTAL (A+B)	145(a)	411.88(1)

<i>Note: (1)</i>	<i>Number of completed assessments</i>	<i>Deductions claimed (Rs lakh)</i>
Bombay	103	342.17
Calcutta	24	23.40
Delhi	18	46.31
TOTAL	145	411.88

Source: Assessment records of companies assessed at Bombay, Calcutta and Deini, which claimed deductions under section 35CC; information extracted by the study team.

Table 3.4
*Disallowance of Claims Supported by Statements
in Form No. 3AA*

<i>Reason for disallowance</i>	<i>Number of ass-essees</i>	<i>Number of ass-essment proceedings</i>	<i>Total deductions claimed</i>	<i>Total disallowances</i>	<i>Remarks</i>
1. Incidental administrative expenses	9	10	23.78	0.49	
2. Pre-approval expenses	2	3	4.74	0.54	
3. Ownership of the capital asset not divested	1	1	1.24	0.04	
4. Location not covered by the term "rural area" as defined in section 35CC	1	1	9.63	0.95	
5. Deduction u/s 80G allowed pending verification	1	2	0.50	0.50	Matter pending with ITO for verification
6. Payments not covered by approval order	1	2	1.76	0.78	
7. Not clear	1	1	3.66	2.84	Matter referred back to ITO by CIT (A) for passing a clear order
TOTAL	16	19	45.31	6.14	

Source: As for Table 3.3.