Rural Development Allowance

(Section 35CC of the Income-Tax Act, 1961)
A Review

H.K. SONDHI
J.V.M. SARMA

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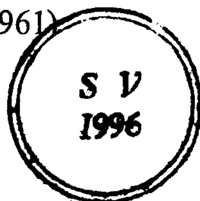
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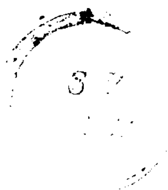

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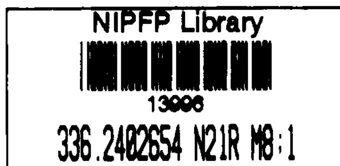
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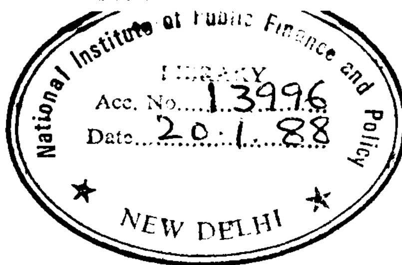
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PREFACE

The National Institute of Public Finance and Policy is an autonomous non-profit organisation carrying out research and imparting training in the field of public finance and related policy.

The present study on Tax Concession for expenditure on Rural Development incurred by companies and cooperative societies under section 35CC of the Income-tax Act was undertaken at the instance of the Central Board of Direct Taxes in June, 1984. The report has been delayed primarily because of the sudden demise of Dr. V.G. Rao, to whom the study was originally entrusted. After his demise, the study was carried out by Shri H.K. Sondhi, Senior Consultant in consultation with Shri J.V.M. Sarma, Senior Economist and Shri K. Srinivasan, Senior Consultant. The report has been written mostly by Shri H.K. Sondhi.

The study seeks to evaluate the cost and benefit of the incentive provided through the income tax system to achieve a "non-tax" objective. Though the tax benefit under section 35CC has since been withdrawn, it is hoped that the results of the study will be of use to the Government in an appraisal of the impact of tax incentives in general and also in designing such an incentive in future.

The Governing Body of the Institute does not take responsibility for the views expressed in the report. This responsibility belongs to the Director and staff of the Institute, and more particularly to the authors.

AMARESH BAGCHI
Director

ACKNOWLEDGEMENTS

The Institute is grateful to a number of individuals and organisations for assistance and cooperation in carrying out this study. Thanks are particularly due to the Commissioners of Income-tax, who furnished particulars of the rural development programmes approved for purposes of section 35CC, as also to the assessing officers who filled in the proforma giving assessment details of the assessees claiming tax relief on this account. The Chief Commissioners of Income Tax, Bombay, West Bengal, Delhi and Andhra Pradesh and their officers and staff rendered very valuable asssistance to the study team in extraction of the requisite data. On being approached, a number of assessees also readily gave information as to the extent to which this incentive had been availed of by them.

Research assistance for the study was provided by Sarvashri S. Pavamani, Gautam Naresh and Diwan Chand. Sarvashri K.K. Atri, A.K. Halen and K.R Subramanian gave computer and word processing support. Shri R. Periannan provided stenographic assistance. Thanks are due to all of them.

AUTHORS

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1. INTRODUCTION

General

Incentives to promote socially desirable activities are not uncommon in tax systems all over the world. The Indian income tax also contains numerous provisions intended to influence allocation of resources according to Plan programmes and promote activities ranking high in the priorities of social and economic development. Among the various socio-economic objectives sought to be supported through concession in tax is the development of rural areas.

Since nearly three-fourths of the country's population live and work in rural areas, the bulk of them at low levels of income and consumption, development of these areas has naturally been a cornerstone of our planning strategy right from the inception of planning in the country. Massive outlays in the public sector on irrigation, rural electrification, communication and creation of financial infrastructure for the growth of agriculture and rural industries have been the principal instruments of this strategy. The tax system has also been used in various ways to lend support to this strategy. For instance, protection and development of handlooms has been a major element of our textile policy and products of cottage and village industries have in general been exempted from excise duties. On the direct taxes side, income of Khadi and Village Industries Commission and other government or non-profit agencies engaged in the development of khadi and village industries is exempt from income tax. In 1974 a scheme of tax holiday or partial exemption of the profits of new industrial undertakings was introduced specially for backward areas, most of which are of a rural character (section 80HH of Income-tax Act, 1961, hereinafter referred to as "the Act"). An alternative concession for newly established small-scale undertakings in rural areas was given under section 80HHA which was introduced in the Act in 1977. The provision of Tax Credit Certificates for shifting of indus-

trial undertakings from urban areas introduced in 1965 was also in a way a measure towards industrialisation of rural areas. Apart from these, a few provisions of a distinctive character were introduced in the Act in 1960s and 1970s which were designed to promote the development of rural areas through application of modern technology in agriculture and spread of social services. These were the agricultural development allowance (section 35C), the rural development allowance (section 35CC) and the deduction for funding of rural development programmes through approved associations and institutions (section 35CCA) inserted in the Act in 1968, 1977 and 1978 respectively.

The distinguishing feature of the latter provisions was that unlike the tax holiday or exemption related to the source of income, these were linked to the use or application of income in the desired directions, irrespective of whether these happened to be within the fields of business activity of the taxpayer concerned. Agricultural development allowance permitted manufacturers (companies and cooperatives) using products of agriculture, animal husbandry, dairy or poultry farming as raw material to claim a deduction (weighted deduction of 120 per cent for and upto the assessment year 1983-84) from their taxable income for expditure incurred by them in providing goods, services and other facilities to cultivators, growers and producers to raise their productivity. While the rural development allowance provided for deduction of expenditure incurred by companies and cooperative societies in undertaking approved rural development programmes, under section 35CCA any taxpayer carrying on a business or profession could claim deduction in respect of funding of approved programmes of rural development or training of personnel for their implementation through approved associations and institutions. In addition, by section 80GGA inserted in the Act in 1979, donations for the above purposes by assessees not carrying on a business or profession also became entitled to tax relief.

While all these provisions subserved the objective of rural development, a feeling grew that there was considerable overlap among them. Also, doubts were felt about their efficacy *vis-a-vis* their cost in terms of revenue forgone, and the attendant complication in tax law. Hence, in line with the policy of

simplifying the tax laws and removing ineffectual or wasteful incentive provisions, the agricultural development allowance, rural development allowance and the deduction for funding of programmes through approved associations and institutions have since been withdrawn. Only contributions or donations made by taxapayers to the National Fund for Rural Development set up in 1984 are deductible in computing taxable income.

In order to evaluate the costs and benefits of incentives of this nature, the present study was commissioned by the Central Board of Direct Taxes (CBDT) in respect of one of the incentives for rural development, *viz.*, rural development allowance provided under section 35CC of the Act. The study was to ascertain:

(*a*) How far the underlying purpose of the incentive was achieved, qualitatively and quantitatively,
(*b*) Cost in terms of revenue,
(*c*) Whether there has been abuse of the provision, and
(*d*) Problems of implementation: Whether there have been difficulties in operation and if there have been problems arising from disputes over interpretation, court rulings and/or audit objections.

The essential features of section 35CC incentive provision were:[1]

(*i*) Only companies and cooperative societies could avail of the incentive. The interested company or cooperative society had to draw up specific programme(s) of rural development for one or more rural areas.[2]
(*ii*) To secure a deduction of the expenditure incurred on a rural development programme in computation of total income, the programme had to be approved by the prescribed authority before incurring any expenditure thereon. From 1.9.1977 till 31.5.1979 the prescribed authority was a Central inter-ministerial committee with the Secretary, Union Department of Agriculture as its chairman. To expedite clearance of schemes of rural development, the work relating to

approval of programmes was decentralised from 1.6.79 and entrusted to State-level committees consisting of the Commissioner of Income Tax exercising jurisdiction over the State/Union Territory in which the programme was to be carried out, as the chairman, and the concerned Secretary of the State government/Union Territory as a member.[3]

(*iii*) "Programme of rural development" was defined as including any programme for promoting the social and economic welfare of, or the uplift of, the public in any rural area. The Central inter-ministerial committee drew up an illustrative list of 15 categories of programmes that would be considered by it for approval.[4] This illustrative list was also followed by the State-level committees. Following the amendment of section 35CC by the Finance Act, 1983, w.e.f. 1.4.1983 the prescribed authority could approve only those programmes which fell within the classes or categories of programmes specified by the Central government.[5]

(*iv*) While according approval to a programme, the prescribed authority laid down the period during which it had to be implemented. Ordinarily, the implementation period was from the date of approval by the prescribed authority till the close of the accounting year of the assessee commencing next after that date. Before approving an extension, the prescribed authority could monitor the programme to satisfy itself that it was being implemented properly.

(*v*) If the programme involved construction or acquisition of any building, machinery or plant or furniture, the assessee had to divest itself of the owership of the asset in favour of the village panchayat or other local authority. On its failure to do so, it was not entitled to a deduction in respect of the expenditure incurred thereon and could only get depreciation on the cost of the asset, as if it was a business asset.

(*vi*) A claim for deduction under section 35CC was admissible only if the assessee furnished a statement of expenditure in a prescribed form (Form No. 3AA) duly

signed and verified by a qualified accountant. This statement was to be filed along with the return of income for the assessment year in respect of which the deduction was claimed.

Data Base and Methology

In evaluating the efficacy of the provision in question in terms of cost and benefit, information was required on various aspects of its operation, e.g., the number of cases in which the concession was availed of, nature of the programmes actually undertaken and the financial outlay thereon. None of these data was readily available. Section 35CC figures neither in the annual statistics brought out by the Income-tax Department nor in the Annual Reports on Direct Taxes issued by the Comptroller and Auditor General. The CBDT also could not furnish any information readily in this regard.

The Commissioners of Income Tax were accordingly requested to furnish particulars of rural development programmes approved under section 35CC in their respective jurisdictions during the period 1.9.1977 to 31.3.1984. The information furnished by them was supplemented with that contained in the answer to the Lok Sabha Unstarred Question no. 655 dated 23.2.1979 and further gathered by the team entrusted with the present study from the registers of the prescribed authorities for Maharashtra, West Bengal and Andhra Pradesh. This showed that during the period 1.9.1977 to 31.3.1984, 263 approval orders were issued by the Central and State-level prescribed authorities to 140 companies.

The Income Tax Officers/Assistant Commissioners assessing the above companies were requested through their respective Commissioners of Income Tax to furnish information in a proforma as to the amounts of deduction claimed and allowed under section 35CC over the assessment years 1978-79 to 1982-83, reasons for variation between the two, and the subsequent appeal, revision petition and audit history, if any. As assessing authorities, they were requested to indicate, along with their suggestions, the difficulties experienced in the administration of this provision including the lacunae in the law and administration procedures that might have come to notice. Filled-in proformae were received in respect of 43 companies.

Of the 140 companies carrying 263 approvals upto 31.3.1984, 93 companies with 182 approvals happened to be assessed at the three metropolitan cities, namely, Bombay (58 companies with 119 approvals), Calcutta (21 companies with 32 approvals) and Delhi (14 companies with 31 approvals). In May-June, 1985 the Institute's study team scrutinised the income-tax assessment records of the companies concerned available at these places, to extract the relevant assessment details wherever these were not furnished by the assessing officers. The team found that out of 93 companies assessed at these places 69 had claimed deductions under section 35CC for and upto the assessment year 1984-85 in 188 assessment proceedings. In all, information about deductions claimed under this section *vis-a-vis* the total income returned, became available in respect of 92 companies in 223 assessment proceedings. The team found that of the 69 companies assessed at Bombay, Calcutta and Delhi which had claimed deductions under section 35CC, only 56 companies had filed the prescribed Form No. 3AA in support of their claims. The team scrutinised these forms to extract information as to the programmes content actually implemented, nature of capital assets created, if any, and their divestment.

The provisions of section 35CC evoked considerable interest in official and business circles and a number of seminars and workshops were held over the years to evaluate their merits and shortcomings. Their proceedings brought out in sharp relief the views on the subject, of the CBDT, Commissioners of Income Tax, trade associations, the corporate sector including the large industrial houses, voluntary agencies and others interested in rural development. The views expressed in these seminars provided valuable material for this study.

Plan of the Report

Chapter 2 indicates the corporate sector's response to the incentive provided through section 35CC of the Act, and the cost thereof in terms of revenue forgone. It also attempts to indicate how far the underlying purpose behind the objective was achieved. Chapter 3 deals with the problems of implementation. Chapter 4 contains the conclusions and recommendations.

Cooperative Sector

In the nature of things, a cooperative's capacity to spare funds and human resources for a project which is not an essential part of its day-to-day operations, is very limited. Cooperatives making substantial profits enjoy many tax concessions and their contribution to income tax is relatively small. Their response to the incentive of the type offered by section 35CC, therefore, cannot but be muted. The study team's scrutiny of the registers of the State-level prescribed authorities for Maharashtra, West Bengal, Bihar and Orissa did not show any response of the cooperative sector to this incentive. The only information available is that a few cooperative societies got their programmes approved in other States and one of them implemented a modest programme. It was, therefore, no surprise that proceedings of the various seminars which discussed the problems arising out of the working of section 35CC at considerable length are silent on the role of cooperatives and the difficulties, if any, faced by them in this regard. The study is, therefore, confined to the corporate sector.

NOTES

1. Government of India, Ministry of Finance (Department of Revenue) Circular No. 231 (F. No. 203-201/77-ITAII) dated November 14, 1977 contains the guidelines for approval of programmes of rural development for purposes of Section 35CC: *Direct Taxes Circulars*, Taxmann, 1985, Vol. 1, pp. 318-322.
2. "Rural area" as defined in clause (b) of the Explanation to sub-section (1) of Section 35CC: Notification issued under sub-clause (ii) thereof: No. S.O. 691 (E) dated September 29, 1977, *ibid.* p. 323.
3. Central Board of Direct Taxes: Notification No. S.O. 327 (E) dated May 31, 1979 (1979), for States and Union Territories having more than one commissioner of income tax, Central Board of Direct Taxes: Notification No. S.O. 327 (E) dated May 31, 1979: (1979) 118 *I.T.R.* 28-29 (St).
4. Government of India, Ministry of Finance (Department of Revenue) Notification No. GSR 47 (E), dated 28.1.1984, as amended by GSR 720 (E), dated 12.10.1984, *Direct Taxes Circulars*, Taxmann, 1985, Vol. 1, p. 322.

2. RESPONSE TO THE INCENTIVE

As indicated in the preceding chapter, the expenditure incurred only on a rural development programme approved by the prescribed authority was allowed to be deducted under section 35CC in the computation of the assessee's taxable profits. This section was inserted in the Act with effect from September 1, 1977 and programmes could be approved thereunder upto March 16, 1985. Thus the provision was in operation for a period of a little over seven years and six months. As mentioned already, information gathered for this study showed that in six years and seven months till March 31, 1984, the prescribed authority issued 263 approval orders to 140 companies. Table 2.1 gives the year-wise break-up. It will be seen that the number of approvals rose from 42 in the operative seven months of 1977-78 to 65 in 1978-79, and thereafter fell to 44 in 1979-80, 47 in 1980-81, 32 in 1981-82, 28 in 1982-83 and 5 in 1983-84. Table 2.1 also gives the number of approval orders for new programmes, *i.e.*, programmes which were not continuation/extension or programmes approved earlier. The number of approvals for new programmes also registered a steady decline after going up initially. The number which stood at 42 in 1977-78, and 59 in 1978-79 came down to 14 in 1982-83 and nil in the following year. The work relating to approval of programmes was decentralised with effect from June 1, 1979. While the Central prescribed authority gave 107 approvals in $1\frac{3}{4}$ years from 1.9.1977 to 31.5.1979 the State-level prescribed authorities could accord only 156 approvals in $4\frac{3}{4}$ years from 1.6.1979 to 31.3.1984.

The number of companies borne on the registers of the Income-tax Department as on March 31, 1983 was 48,597.[1] Only the relatively more prosperous of them could be expected to take on the burden of rural development. The total number of companies which got their programmes approved under section 35CC may be estimated at 155.[2] This works out to 5.3

per cent of 2,928, the number of companies with income above Rs. 5 lakh.[1] Even allowing for the fact that a large number out of 2,928 companies would be enterprises with operations entirely restricted to urban areas with little interest in villages, it is evident that the corporate sectors's initial response to this incentive was lukewarm. And, it became indifferent over the years. The poor response to the scheme is evidenced also by the fact that the total expenditure involved in the programmes in the $7^1/_2$-year period is estimated at Rs. 875.56 lakh or Rs. 9 crore and the tax revenue forgone at Rs. 497 lakh or roughly, Rs. 5 crore[3] forming only about 0.35 per cent of the income tax collected from companies during the period.

Programmes under section 35CC were generally approved for implementation within a two-year period from the approval date. The year of completion of a programme was the year for which the attendant tax relief could be obtained. Not all the 140 companies which got programmes approved till March 31, 1984 undertook their implementation, e.g., of the 83 out of 86 companies which secured approvals before June 1, 1979 for which the requisite information was available, as many as 16 did not implement the approved programmes.[3] This gives a drop-out rate of about 20 per cent. Further, out of 92 companies for which information regarding deductions claimed under section 35CC could be gathered, as many as 32 companies claimed deduction for one year only during the first three assessment years, *viz.*, 1978-79, 1978-80 and 1980-81 and deductions claimed by 28 companies did not exceed Rs. 2 lakh each. This, in effect, means that about one-third of the companies which availed of the incentive lost interest in it after implementing a relatively modest programme. In other words, their initial enthusiasm tapered off.

Out of Rs. 688 lakh, the total amount claimed as deductions under section 35CC for which company-wise breakup is available, Rs. 595 lakh or 86.5 per cent of the total was claimed by 60 companies which belonged to one or the other of the Large Industrial Houses or were Single Large or Dominant Undertakings (Table 2.2). In terms of expenditure on rural programmes, the houses who account for a significant share are Mafatlal, ACC, Dalmia, Tata, ICI, Birla and Ramakrishna groups. Their combined expenditure constituted 78 per cent of

the total. Mafatlal alone accounted for over 38 per cent of the total.

Incidentally, the business houses which showed relatively more interest in section 35CC programmes were generally those which had involved themselves in rural welfare and uplift even before this section came on the statute in 1977, e.g., "a large industrial house" of western India with extensive interest in textiles has been associated with a research-hased foundation set up in 1967 which has done considerable work in cattle development and propagation of high quality and low cost cattle feeds. Another was a leading cement manufacturing company with factories in isolated and backward rural areas in various States believed to have commenced rural development activities in 1952. Another large industrial house had set up its own social welfare board in 1953 for rural uplift in selected areas. A steel manufacturing company belonging to this house had been showing interest in Adivasi welfare from 1974. So far as these houses were concerned, the only change brought about by section 35CC was that to the extent such financial outlay could not be claimed as businesss expense, it allowed them 100 per cent deduction in computation of taxable income of the companies concerned as against the 50 per cent deduction already available under section 80G for donations to house trusts etc., to undertake similar work.

Table 2.3 shows that out of the 86 companies about which equity capital information was readily available, 32 companies accounting for over Rs. 1.9 crore of the deductions claimed under section 35CC belonged to the size-group of Rs. 1 crore to Rs. 5 crore range, and 21 companies accounting for Rs. 2.7 crore deductions belonged to Rs. 5 crore to Rs. 10 crore range. Thus most of the companies belonged to the paid-up capital-size group ranging from Rs. 1 crore to Rs. 10 crore range. Their combined share in the total deduction under section 35CC was 67.6 per cent. The other major contribution of 23.6 per cent came from the seven companies accounting for Rs. 1 6 crore deductions, each having paid-up capital above Rs. 20 crore. Thus, only large companies displayed initiative in the 35CC programmes.

Table 2.4 shows section 35CC deduction claimed *vis-a-vis* total income for the year. This classification also shows that

only the relatively prosperous companies came forward to undertake the rural programmes. Roughly 50 per cent of the expenditure on such programmes came from companies whose returned income was above Rs. 1 crore each in each of the assessments in which the claim was made. Another interesting point is the Rs. 214 7 crore deduction claimed in 44 assessments in which total income declared was a loss which forms 31.2 per cent of the total deduction. In these cases, the absence of profit for the relevant year was not a restraining factor as the expenditure on section 35CC programmes was paltry.

Table 2.5 shows the classification of 35CC companies by their major manufacturing activity. *A priori* it is difficult to reason out why some industries showed more initiative than others in such activities. Ordinarily, industries which depend on agricultural inputs or other local raw materials or human inputs could be expected to show a higher degree of initiative than others. However, the empirical support is weak for such a conclusion. The major contributions to activities supported by 35CC came from the textile industry (37 per cent), chemical and chemical products industry (28.9 per cent), cement industry (11.6 per cent) and paper industry (5.6 per cent).

Gains to the Economy

(*a*) *Regional spread of rural programmes*

According to information culled from the prescribed authority files, 263 rural development programmes were approved during the period 1977-78 to 1983-84. These programmes covered over 1100 villages spread over 13 States.

The State-wise distribution of the programmes and their outlays are shown in Table 2.6. The table shows that rural programmes approved and undertaken for section 35CC were concentrated in Gujarat, Maharashtra, Uttar Pradesh, Andhra Pradesh, and Karnataka. About 60 per cent of the 263 programmes were located in these five States, involving 73 per cent of the total expenditure. Also, over two-thirds of the 1100 villages covered belonged to those five States. Among the States which received scant attention, the prominent ones were Assam, West Bengal, Bihar and Tamil Nadu.

(*b*) *Activities covered by rural development programmes*

We made an attempt to find out what type of activities received support from the companies undertaking rural development programmes. The 263 approved programmes are classified under 15 categories. These include schemes relating to self-employment generation, provision of medical facilities, educational facilities, infrastructure such as roads and drainage, drinking water projects, rural electrification, housing, minor irrigation, supply of seeds, fertilisers and pesticides to small and marginal farmers, supply of farm equipment, animal husbandry, technical assistance in developing cottage industries as well as facilities of repairs and maintenance of farm equipment (Table 2.7).

Many of these approved programmes were of a mixed character, touching various aspects of rural development. Out of the Rs. 532.12 lakh outlay for which information was available, Rs. 404.32 lakh (76 per cent) was found to have been spent on multi-activity programmes. This indicates a desire on the part of the sponsors to benefit the selected area in a comprehensive manner in tune with the approach of the national Integrated Rural Development Programme (IRDP). Further, it is also not surprising that the choice of the programme and the location was guided by enlightened business interest or sentimental affinity of persons in control to certain areas. For example, two companies executed programmes (Rs. 3.40 lakh) in areas with which the persons in control had a sentimental affinity. A well-known pilgrim centre attracted considerable outlay (Rs.32.60 lakh) from companies belonging to a large industrial house.

Among the single-category programmes, more popular were the schemes for setting up of educational and vocational centres (Rs. 39.97 lakh), rural electrification (Rs. 36.88 lakh), setting up of dispensaries, medical centres, etc. (Rs. 17.74 lakh), assistance in setting np rural industrjes (Rs. 13.29 lakh) and animal husbandry were more popular.

(*c*) *Extent of fixed asset creation*

Table 2.8 shows the value of fixed assets created under the rural development programmes in different States. Out of the total outlay of Rs. 688.05 lakh, information on fixed asset crea-

tion is available in respect of programmes involving Rs. 532.12 lakh. Expenditure on fixed assets was Rs. 131.33 lakh (25 per cent). The proportion of expenditure on fixed assets in the total expenditure varied among the States. For example, in Andhra Pradesh, fixed assets formed 96 per cent of the total expenditure for which programme-wise details are available. The share was 45 per cent in Orissa, 29 per cent in Madhya Pradesh, 27 per cent in Haryana, and so on. Further, buildings constituted a major portion (74 per cent) of the expenditure on fixed assets.

An Evaluation of Section 35CC

(a) Underlying purpose

In 1976, well before the enactment of section 35CC, the Union Minister of Agriculture and Irrigation emphasised the need for industry to help develop appropriate technology and transfer of necessary skills for the benefit of small farmers.[4] However, this concept was not strictly followed in defining the programme of rural development" for purpose of section 35CC on its enactment in 1977. The definition was made much wider to include any programme for promoting the social and economic welfare of, or uplift of the public in any rural area. Thus, the definition rested on two concepts: welfare (relief of distress) and uplift (eradication of poverty). The 15-category illustrative list of programmes for rural development to be considered for approval by the prescribed authority for purposes of section 35CC included many categories of programmes with more "welfare" than "uplift" content, e.g., establishment and running of dispensaries, maternity, child and family welfare centres; nutrition programmes for school children, construction and maintenance of village streets, pavements and drainage, construction and maintenance of drinking water projects, such as wells, tubewells, etc., and cleaning of wells and ponds, assistance to weaker sections in constructing houses on sites provided in rural areas by government and village panchayats, etc. Thus a large portion of funds made available under section 35CC went towards welfare programmes involving little transfer of skills.

On it becoming clear by 1979, that there was going to be no large-scale direct involvement of the corporate sector in rural development, it was emphasised that it was not so much the

financial expenditure of the companies which was important, but efforts had to be made to have managerial inputs and expertise of the companies in management of the rural development projects [5] To quote Dr. M.S. Swaminathan, Member, Planning Commission:

> "On an overall approach, what we call rural development has three major aspects: the minimum needs programme, the rural infrastructural programme and the employment generation programme. Business houses and industrial houses can also play a role in the minimum needs programme like drinking water supply, rural health care and sanitation, elementary education and a wide variety of other ancillary programmes put under the minimum needs programme. They can also play a part in terms of infrastructure in certain cases. But, I think business houses should concentrate on this single purpose which was identified by Mr. Guzder: how do we really increase the family income in rural area ? If one can have that as a single major target instead of getting diversified, if one can have a single focus and thrust instead of chasing too many butterflies at the same time, one can also measure what impact that contribution has made. Putting an ocasional drinking water well here or there is important. These are generally classified as philanthropic activities. The most important and the most meaningful contribution one could make is to increase the family income in rural areas so that the stigma that 48 per cent of our people are below the poverty line could be removed as quickly as possible."[6]

The above approach did not lead to a redrawing of the illustrative list of categories of programmes that could be approved for the purposes of section 35CC. Section 35CC was amended in 1983 to provide that the prescribed authority could approve programmes only out of the classes or categories of

programmes of rural development as might be specified by the Central Government in this behalf. However, the notification of 28th January, 1984 which specified seven categories or classes of programmes included three categories which Dr. Swaminathan would have considered as predominantly philanthropic or social in nature, *viz.*, construction and maintenance of drinking water projects, hospitals and dispensaries and family planning centres and rural link roads, village streets, pavements; drainage and sanitary latrines, etc. Thus the classes and categories of programmes which were approved under section 35CC included many programmes which were essentially of a "welfare" nature, and only a fraction of the very limited response to this incentive was channellised for its real purpose, *viz.*, deployment of corporate skills of management and expertise for raising village family incomes.

(*b*) *Reasons for poor initial interest and declining response*

Non-implementation by a significant number of the companies which had got their programmes approved by the prescribed authority indicates the inability or unwillingness on the part of many companies to tackle the managerial and other problems involved in executing a rural development programme on their own. This explains the lukewarm interest in this incentive on the part of the corporate sector, the virtual monopoly of the implemented programmes by the bigger companies and the preponderant role of the Large Industrial Houses. Only they have the requisite administrative infrastructure to undertake obligations not immediately connected with the income-earning process.

Second, the Finance Act, 1978 inserted a new provision in the Act, *viz.*, section 35CCA, to enable tax payers to contribute to rural development. This provision allowed a company (along with other categories of assessees) to obtain full deduction in the computation of its taxable business profits, of the sum paid by it to an association or institution approved for the purposes of section 35CCA and undertaking approved rural development programmes. Section 35CCA became operative from 1.6.1978. As could be expected, section 35CCA became popular at the expense of section 35CC. In fact, a number of companies after getting their programmes approved under

section 35CC, preferred to drop them and to make payments covered by section 35CCA. It is, therefore, not surprising that as early as in November, 1980 the Chief Commissioner of Income Tax, Bombay, reported that while 12 applications with proposed financial outlay of Rs. 146 lakh had been approved under section 35CC, the number of applications approved under section 35CCA was 66 involving outlay of Rs. 475 lakh.[7]

It would be inappropriate to view the financial outlay made by industry in implementation of programmes approved under section 35CC (more than half thereof met by the Government as tax forgone) in isolation. There were other tax incentives for the industry to provide funds for rural development as such, *viz.*, section 35CCA (payments to approved associations and institutions for carrying out approved rural development programmes), section 80GGA(2)(b) (deduction in respect of donations for rural development) and section 80GGA(2)(d) pertaining to National Rural Development Fund. A large number of charitable funds and institutions participate in the work of uplift and advancement of poor rural folk, donations to which entitle the donor to tax relief under section 80G of the Act. For an idea as to the total contributions made by the industry for rural development, outlays spurred by all these incentives have to be taken into account. The proper perspective to view section 35CC would be to see it as a new instrument devised to involve industry directly in the cause of rural development. For various reasons, it failed to arouse much enthusiasm.

NOTES

1. Government of India, *Report of Comptroller and Auditor General of India for the year 1982-83*—Union Government (Civil) Revenue Receipts—Vol. II, Direct Taxes, pp. 6-7.
2. Assuming that the number of companies which got approval for the first time in 1984-85 upto March 16, 1985 was about the same which obtained approval for the first time annually during 1981-82 (12) or 1982-83 (14), the total number of companies obtaining approval during the entire period in which approvals could be given, i.e., 1.1.1977 to 16.3.1985 comes to [number of companies obtaining approval upto 31.3.1984: 140 plus estimated number of companies obtaining approval for the first time from 1.4.1984 to 16.3.1985: (15) =155]. For our present purpose, 1983-84 is ignored when the number

of companies securing an approval for the first time was nil. That may be ascribed to the fact that consequent to amendment of section 35CC, effective April 1, 1983, the notification specifying the classes and categories of programmes from which the prescribed authority could accord approval, came to be issued on January 28, 1984.

3. See Appendix.
4. Government of India, Ministry of Agriculture and Irrigation (Department of Rural Development). *Brochure on Rural Development Programmes*—participation of Industrial/business houses (1979). Inaugural address by Shri Jagjivan Ram, Union Minister of Agriculture and Irrigation at the Seminar on Industries Participation in Agricultural & Rural Development, at Ranchi—21st August, 1976.
5. 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 S. 35CC/35CCA held on 28th December, 1979, p. 4, para 18 (i).
6. Proceedings of Seminar on Rural Development: Involvement of Business and Industry, jointly organised by the Indian Merchants' Chamber, Bombay Management Association and Bombay Chamber of Commerce and Industry, 22-23 November, 1980, p. 6.
7. *Ibid*., p. 90.

Table 2.1

Approval of Programmes by Prescribed Authority for Section 35CC (1977-78 to 1983-84)

Financial year	*Number of approval orders*	*Number of companies granted approval for the first time*	*Number of approval orders out of (2) for new programmes, i.e., programmes which were not continuation/extension of programmes approved earlier*
(1)	(2)	(3)	(4)
1977-78 (1.9.77 to 31.3.78)	42	42	42
1978-79	65	44	59
1979-80	44	15	34
1980-81	47	13	35
1981-82	32	12	19
1982-83	28	14	14
1983-84	5	nil	nil
TOTAL	263	140	203

Note: The number in column (3) is less than in column (2) for the reason that a number of companies obtained approval orders for (*i*) more than one programme in one year, (*ii*) for new programme(s) in subsequent year(s) and (*iii*) continuation/extension of programme(s) approved earlier.

Source: Data furnished by Commissioners of Income Tax, reply to Lok Sabha Unstarred Question No. 655 on February 23, 1979 and information gathered by the study team at Bombay, Calcutta, and Hyderabad.

Table 2.2

Expenditure Incurred on Rural Development Programmes under Section 35CC of Income-tax Act by Large Business Houses

Name of business house	*Number of companies claiming deduction*	*Total deduction claimed (Rs lakh)*	*Relative share in the total (per cent)*
(1)	(2)	(3)	(4)
1. ACC	2	19.52	13.30
2. Bajaj	1	4.13	0.60
3. Bangur	1	6.33	0.92
4. Birla	5	32.96	4.79
5. Dalmia	2	75.92	11.03
6. ICI	3	31.23	4.54
7. JK	1	4.44	0.65
8. Mafatlal	10	263.68	38.32
9. Modi	3	16.93	2.46
10. Ramakrishna	1	16.69	2.43
11. Tata	19	39.96	5.81
12. Walchand	2	0.60	0.90
13. Government companies	1	10.70	1.56
14. Others	41	92.96	13.51
TOTAL	92	688.05	100.00

Source: Income Tax Records.

Table 2.3

Expenditure Incurred by Companies on Rural Development Programmes under Section 35CC of Income-tax Act by Size of Paid-up Capital

Size class of paid-up capital (Rs crore)	*Number of companies obtaining approvals for rural development programmes (estimated)*	*Number of companies claiming deduction*	*Deduction claimed (Rs lakh)*	*Per cent share*
(1)	(2)	(3)	(4)	(5)
Below 1	24	17	33.47	4.86
1— 5	36	32	190.17	27.64
5—10	22	21	274.97	39.96
10—20	12	9	18.95	2.75
Above 20	11	7	162.50	23.62
Unclassified	50	6	7.99	1.16
TOTAL	155	92	688.05	100.00

Source: As for Table 2.2

Table 2.4

Expenditure Incurred by Companies on Rural Development Programmes under Section 35CC of Income-tax Act by Size of Income

(*Rs lakh*)

Size of income as per return	*Number of assessments*	*Total deduction claimed*	*Per cent share*
(1)	(2)	(3)	(4)
Loss	44	214.70	31.20
Below 1	—	—	—
1— 5	6	7.99	1.16
5—10	2	0.12	0.02
10—50	22	49.27	7.16
50—100	10	22.59	3.28
Above 100	118	343.62	49.94
Unclassified	19	49.76	7.23
TOTAL	221	688.05	100.00

Source: As for Table 2.2.

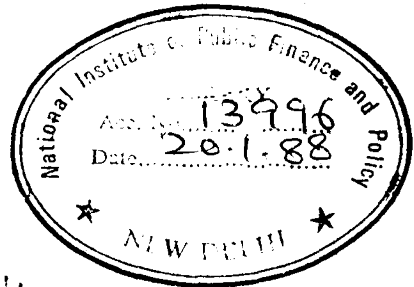

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Table 2.5

Expenditure Incurred by Companies on Rural Development Programmes under Section 35CC of Income-tax Act by Type of Industrial Activity

Type of industrial activity	*Number of companies obtaining approvals for rural development programmes (estimated)*	*Number of companies claiming deduction*	*Deduction claimed (Rs lakh)*	*Per cent share*
(1)	(2)	(3)	(4)	(5)
1. Tea	6	4	3.80	0.55
2. Food products	10	4	8.00	1.16
3. Textiles	18	13	253.69	36.66
4. Paper & products	7	5	38.67	5.59
5. Rubber & products	4	4	7.65	1.11
6. Chemicals & products	35	31	200.20	28.93
7. Metal & products	9	1	26.00	3.76
8. Cement & products	9	6	80.10	11.57
9. Engineering	24	10	18.06	2.61
10. Transport equipment	7	3	15.63	2.26
11. Power generation & supply	6	4	5.67	0.82
12. Services	8	6	22.68	3.28
13. Unclassified	12	4	7.90	1.72
TOTAL	155	92	688.05	100.00

Source: As for Table 2.2.

Table 2.6

Distribution of Approved Rural Development Programmes, Proposed Outlay and Expenditure—Statewise

State	*Number of companies claiming the deduction under Sec. 35CC*	*No. of programmes*	*Approximate no. of villages covered*	*Proposed outlay (Rs. lakh)*	*Total deduction claimed*	*Per cent share in total deduction*
1. Andhra Pradesh	32	54	313	121.44	52.54	7.64
2. Assam	2	3	22	4.35	2.08	0.30
3. Bihar	1	1	—	n.a.	8.90	1.29
4. Gujarat	12	35	344	252.11	173.66	25.24
5. Haryana	9	24	25	40.35	41.42	6.02
6. Karnataka	3	4	9	78.25	44.48	6.46
7. Madhya Pradesh	11	17	156	83.04	41.08	5.97
8. Orissa	5	10	13	50.00	42.69	6.20
9. Maharashtra	16	33	130	185.25	98.52	14.32
10. Rajasthan	5	19	23	n.a.	31.24	4.54
11. Tamil Nadu	4	17	7	n.a.	10.01	1.45
12. Uttar Pradesh	10	33	69	n.a.	132.00	19.18
13. West Bengal	6	13	9	37.45	9.43	1.37
TOTAL	116**	263	1100	852.24*	688.05	100.00

Notes: (1)* Approximate figure. (2)**Some companies had programmes in more than one State, thus making the total more than the sample number of 92. (3) n.a.=Not available.

Source: As for Table 2.2.

Table

State-wise Distribution of Expenditure under

	All States	*Andhra Pradesh*	*Assam*	*Bihar*	*Gujarat*
1. Assistance in setting up of rural industries	13.29	—	—	—	2.72
2. Dispensaries, etc.	17.74	—	—	—	0.86
3. Nutrition programmes for children	n.a.	—	—	—	—
4. Educational (vocational) centres	39.97	—	2.08	—	—
5. Road, drainages etc.	n.a.	—	—	—	—
6. Drinking water facilities	0.61	—	—	—	—
7. Rural electrification	36.88	36.88	—	—	—
8. Housing for weaker sections	2.14	—	—	—	—
9. Minor irrigation	n.a.	—	—	—	—
10. Supply of seeds	n.a.	—	—	—	—
11. Supply of fertilizers	0.69	—	—	—	—
12. Supply of plant protection equipments	n.a.	—	—	—	—
13. Animal husbandry	10.18	—	—	—	—
14. Poultry farming, horti-culture, pisciculture	0.88	—	—	—	—
15. Servicing and repairing equipments	5.42	—	—	—	3.25
16. Multi-activity programmes	404.32	0.42	—	8.90	144.07
TOTAL	532.12	37.30	2.08	8.90	150.90

Source: As for Table 2.2.

2.7

Section 35CC According to Activity

Haryana	*Karnataka*	*Madhya Pradesh*	*Maharashtra*	*Orissa*	*Rajasthan*	*Tamil Nadu*	*Uttar Pradesh*	*West Bengal*
—	—	—	1.20	3.87	—	—	—	5.50
—	—	14.44	—	—	—	2.44	—	—
—	—	—	—	—	—	—	—	—
—	—	—	1.51	36.38	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	0.61
—	—	—	—	—	—	—	—	—
—	—	—	—	2.14	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	0.06	—	—	—	—	0.63
—	—	—	—	—	—	—	—	—
4.29	—	—	—	—	—	—	5.89	—
—	0.88	—	—	—	—	—	—	—
—	—	—	2.17	—	—	—	—	—
4.94	—	17.98	72.16	—	27.85	2.93	122.39	2.68
9.23	0.88	32.42	77.10	42.39	27.85	5.07	128.23	9.42

Table 2.8

Value of Fixed Assets created under Approved Rural Development Programmes by Category of Assets—Statewise

(*Rs. lakh*)

State	*Amount of expenditure in respect of which programme-wise details are available*	*Buildings*	*Plant and machinery*	*Furniture*	*Others**	*Total fixed assets*	*Share of the fixed assets in total expenditure (%)*
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1. Andhra Pradesh	37.30	36.08	0.42	—	—	36.50	(96.36)
2. Assam	2.08	—	—	—	—	—	—
3. Bihar	8.90	—	—	—	—	—	—
4. Gujarat	150.90	1.27	0.82	0.44	2.56	5.09	(3.37)
5. Haryana	9.23	1.85	—	0.47	0.15	2.47	(26.76)
6. Karnataka	0.88	—	—	—	—	—	—
7. Madhya Pradesh	32.42	5.04	1.09	—	3.08	9.21	(28.41)
8. Orissa	42.39	18.85	0.08	—	—	18.93	(44.66)

9. Maharashtra	77.10	3.58	0.05	1.29	1.21	6.13	(7.94)
10. Rajasthan	27.85	2.85	0.15	—	—	3.00	(10.77)
11. Tamil Nadu	5.07	0.74	0.09	0.04	—	0.87	(16.20)
12. Uttar Pradesh	128.28	5.97	0.82	6.79	—	13.58	(10.59)
13. West Bengal	9.42	—	0.63	—	—	0.63	(6.69)
Unclassified	—	20.31	6.82	—	7.79	34.92	—
ALL STATES	532.12	96.54	10.97	9.03	14.79	131.33	(24.65)
Share of each asset in total expenditure on assets (%)		(73.50)	(8.35)	(6.88)	(11.23)	(100.00)	

Notes:* Information on 'others' is not separately provided in form No. 3AA, as sub-section (3) of section 35CC referred only to buildings, machinery plant and furniture. However, claims for deduction of expenditure on 'other' capital assets have been claimed and allowed; the 'other' assets being mobile (medical) vans, jeeps, etc. As provided in Rule 5 of the Income Tax Rules, 1962, these 'other' assets should be taken to fall under 'Machinery and Plant'.

Source: As for Table 2.2.

APPENDIX

Estimates of Total Financial Outlay by the Corporate Sector and Revenue Forgone on account of Programmes Approved under Section 35CC

(Rs. lakh)

	From 1.9.77 to 31.5.79	*From 1.6.79 to 31.3.84*	*Total*
(*i*) Number of companies which as per information available obtained approval of a programme for the first time during the period	86	54	140
(*ii*) Number of companies out of (*i*) for which information is available that they did not implement the approved programme	4	3	7
(*iii*) Number of companies out of (*i*) for which no information could be gathered about implementation or otherwise of the approved programme	3	7	10
(*iv*) Number of companies out of (*i*) which did not claim any deduction under section 35CC. In computation of total income for the assessment years for which information is available:			
upto assessment year 1982-83	3	16	
upto assessment year 1984-85	9	3	
	12	19	31
(This includes 5 companies in whose cases the last date for implementation of the approved programme fell after the close of the accounting year relevant to the latest assessment year for which information is available)			

(*v*)	Number of companies out of (*i*) for which information regarding deduction(s) claimed for one or more assessment years is available: (*i*) minus [(*ii*) plus (*iii*) plus (*iv*)] This includes 11 companies for which information regarding deductions claimed is available only for the part of the prescribed period for implementation of the approved programme	67	25	92
(*iv*)	Amount of deductions claimed by 92 companies vide item (*v*) for the assessment years for which information is available.			688.05
(*vii*)	Estimated amount of deductions that may be claimed by 11 companies included in item (*v*) above for the assessment years for which information is not available, on the assumption that the approved programmes were implemented fully.[1]			59.35
(*viii*)	Estimated amount of deductions that may be claimed by 5 companies included in item (*iv*) above, in whose cases the last date for implementation of the programme fell after the close of the accounting years for which no deduction was claimed, on the assumption that the approved programmes were fully implemented with an estimated 20 per cent drop-out rate.[2] (See Ch. 2, Section 1)			10.00
(*ix*)	Estimated amount of deductions that may be claimed by 10 companies vide item (*iii*) above on the assumption that the approved programmes were implemented with an estimated 20 per cent drop-out rate.[3]			23.55
(*x*)	Estimated amount of deductions that may be claimed in respect of the estimated number of 30 approvals accorded during the period 1.4.1984 to 16.3.1985.[4]			89.61
	THUS, ESTIMATED TOTAL OUTLAY			875.56

(*xi*) Estimated tax forgone in respect of (*iv*).[5]	394.51
(*xii*) Etimated tax forgone in respect of (*vii*), (*viii*), (*ix*) and (*x*) above (Rs. 875.56 lakh minus Rs. 688.05 lakh= Rs. 187.51 lakh @ 55 per cent)	103.13
	———
ESTIMATED TOTAL TAX FORGONE	497.63
or, say	500.00
	———

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1. In instances where the total financial outlay approved by the prescribed authority is available: Total financial outlay approved minus the financial outlay claimed for the assessment year(s) for which information is available. In instances where the total financial outlay approved by the prescribed authority is not available: by adopting the annual average deduction claimed for the assessment year(s) for which information is available.
2. Due to absence of information regarding financial outlay approved by the prescribed authority: estimated by adopting the annual average deduction claimed by particular class of companies, e.g., companies belonging to Large Industrial Houses, Public Sector Undertakings, other companies in which the public is substantially interested, private companies.
3. Approved financial outlay wherever available, otherwise by adopting the annual average deduction claimed by the particular class of companies.
4. By adopting the average financial outlay per approval, i.e., [(*vi*)+(*vii*)+(*viii*)+(*ix*)] divided by 263 being the number of approvals accorded upto 31.3.1984. The number of approval orders issued during 1981-82 and 1982-83 was 32 and 28 respectively. The number of approval orders issued during the period 1.4.1984 to 16.3.1985 is estimated at their mean, *viz*., 30. 1983-84 is ignored for the reason stated in Note 2 at page 16.
5. Tax forgone has been calculated by applying the marginal rate for the relevant assessment year to the amount of deduction claimed. The same basis has been adopted for the assessment years for which the total income returned was a loss. This has been done as in many instances the assessment year in which the loss (as determined at the assessment stage) was actually set-off is not known. It has been assumed that the loss carried forward for one or more assessment years should be fully adjusted against profits of subsequent assessment years within the statutory period for carry forward and set-off of losses.

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 1984-85[1]. 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. Legalistically, 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 develoment 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 statament. 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 omittted 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 assessees 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 assessees 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 assessees obviated the need for the assessing officers to make disallownces on this ground by refraining to claim deductions in respect of non-divested capital assets (Rs 5.73 lakh). In all these instances, the assessees 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 assessees' claims for tax relief under section 35CC did not suffer on legalistic and technical grounds.

NOTES

1. Government of India, *Reports of the Comproller 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

Time taken	*Number of Applications disposed of*	
	Maharashtra	*West Bengal*
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

	Period of pendency (months)	*Reasons for pendency*
1	3	Details awaited
2	6	The proposed programme considered by the Committee was not covered by the guidelines; 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 sec- 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

	Number of completed assessment proceedings	*Deductions claimed (Rs. lakh)*
A. Claims fully allowed:		
(*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
B. Claims partly or fully rejected:		
(*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 tne 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)

Note: (1)

	Number of completed assessments	*Deductions claimed* (Rs lakh)
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

Reason for disallowance	*Number of assessees*	*Number of assessment proceedings*	*Total deductions claimed*	*Total disallowances*	*Remarks*
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.

4. CONCLUSIONS AND RECOMMENDATIONS

The striking conclusion that emerges from the study is that, the incentive provided to the corporate sector through deduction of expenditure incurred on approved programmes of rural development under section 35CC of the Income-tax Act did not evoke much enthusiasm. The initial response was lukewarm and it became indifferent over the years. Only 155 companies seem to have obtained approval for such programmes and, out of those who obtained the approval not all went ahead to implement them. In fact roughly one-fifth of them did not implement them. One third of the companies which availed of the benefit of the provision lost interest in it after implementing relatively modest programmes. The total financial outlay on the programmes came to about Rs. 9 crore only and the tax saving (or revenue forgone on their account) was of the order of Rs. 5 crore. It is significant that several of the companies which had claimed deduction under the provision had been running such programmes even earlier. Whether, and if so, to what extent the incentive spurred them to put in further efforts in this direction is difficult to say. However, the fact that the total outlay for which deduction was claimed was no more than Rs. 9 crore indicates that the element of "additionality" in the outlay could not have been significant and at least some of the activities which were supported by the outlay would in all probability, have been undertaken by the companies concerned in any case.

The bigger companies and Large Industrial Houses had a preponderant role in the programmes undertaken under section 35CC. Available information shows that over 86 per cent of the deductions claimed under the section under review were accounted for by companies coming under the purview of the MRTP Act. As much as 38 per cent of the total deduction was claimed by one Large Industrial House. This was perhaps to be expected as the big concerns alone possess the resources to

embark on programmes not directly connected with their business activities. Moreover, inadequacy or absence of profit in a particular year was no constraint on their capacity to run such programmes especially since the size of the outlay was relatively small.

Section 35CC programmes were generally implemented in areas from which the sponsoring companies drew their human or material inputs. A few of the programmes were undertaken in areas with which the persons in control of the sponsoring company had sentimental affinity. There was an uneven geographical distribution of the programmes. The States which saw maximum activity under section 35CC were Gujarat, Maharashtra, Uttar Pradesh, Andhra Pradesh and Karnataka, with Gujarat alone accounting for as mueh as 25 per cent of the total outlay.

The underlying objective of section 35CC was to help develop appropriate technology and transfer of skills to the small farmers. By and large, this object does not seem to have been fulfilled by programmes which were actually undertaken in response. The scope of the provision includes any programme for promoting the social and economic welfare of, or uplift of, the public in a rural area. The accent was on welfare and uplift. Several of the programmes implemented under section 35CC had more of "welfare" than "uplift" in their content. Consequently, only a fraction of the very limited response to this incentive was used in the deployment of corporate skills of management and expertise for raising village farmers' income.

On the face of it the administration of the section does not seem to have posed any serious problem so far as the tax authorities were concerned as audit objections and litigations over the interpretation of the section were few. The claims made by the companies were generally allowed without much interference by the assessing officers. The number of cases involved were also relatively small. However, the study reveals that approval of the schemes involved considerable delay. The procedures evolved were time consuming. In several instances, neither the companies nor the revenue authorities appear to have appreciated all the implications of the statutory provision and complied with them fully.

Another deficiency of the measure was absence of an

effective mechanism for monitoring the implementation of the approved schemes. While prescribed authorities made welcome efforts to see that the assessees' claims for relief under section 35CC did not suffer on legalistic or technical grounds, in none of the cases gone into in the course of the study was any independent monitoring or evaluation report found to have been available to the assessing officer to show whether the programmes had been duly implemented according to the approved plan. Thus once a plan was approved, there was no effective check to ensure that the outlays incurred served to provide the benefits to the extent contemplated under the approved programme.

The experience of the operation of section 35CC as revealed by the present study underlines the need for circumspection in providing incentives for achieving socio-economic objectives through the tax system. First of all, it is unrealistic to expect that taxpayers can be enthused to undertake philanthropic activities totally unrelated to their business merely because of some tax relief. Second, tax benefits tend to be appropriated largely by big resourceful assessees. Also, these tend to support activities which some assessees might have engaged in, any way. Third, the costs of a tax expenditure are unlikely to be commensurate with the benefits unless an effective mechanism for monitoring is also devised. Lastly, tax incentives do not seem to be the right vehicle for motivating private agencies engaged in business activity to take up philanthropic work on their own. The decline of section 35CC with the introduction of section 35CCA shows that gifts to agencies specially equipped to undertake philanthropic or rural welfare programmes are more popular than the idea of taking up such programmes directly. However, whether encouraging contributions for rural welfare indirectly through a tax incentive as embodied in section 35CCA was an efficient method for promoting rural development is another matter not gone into. Evaluation of section 35CCA is beyond the purview of this study.

At present, an assessee interested in rural welfare and uplift along with saving in tax, may make donations to tax-exempt charitable trusts providing voluntary services in rural areas. Subject to the limitations stipulated therein, section 80G of the Act entitles him to 50 per cent deduction of the sum donated.

Alternatively, he may make payments to the National Fund for Rural Development and obtain full deduction under section 35CCA or section 80GGA.[1] If he is carrying on a business or profession, section 35CCA is operative; the payment is not subject to any monetary limit and if part of the business loss for the year, may be carried forward and set off. For assessees not carrying on a business or profession, section 80GGA is applicable and the aggregate of deductions under chapter VIA of the Act including this deduction cannot exceed the gross total income for the year. Were the recommendation of the Economic Administration Reforms Commission for shifting all tax incentives and special deductions not relating to the income activity to a stage after the arriving at of the true income of the taxpayer, to be accepted, the relevant provision of section 35CCA would get shifted to chapter VIA and make for a uniform tax treatment of donations to the National Fund for Rural Development for all assessees. Indeed, it would be desirable to have all provisions relating to tax treatment of donations put together in one section in chapter VIA of the Act.

The collection of requisite data for the study presented much difficulty. Whenever a tax incentive is introduced in future, it may be advisable to simultaneously design an information system to ensure speedy monitoring; special studies being made whenever found necessary. The Comptroller and Auditor General's (C & AG) annual report on Union Government (Civil) Revenue Receipts gives general information as to receipts under various Direct Taxes, variations between budget estimates and actuals, cost of collection, number of assessees, appeals and revision petitions, etc., besides setting out the lapses noticed in the course of Statutory Audit during the year. C&AG's reports for the years 1974-75 to 1978-79 indicated the number of assessees availing of some of the tax concessions under chapter VIA of the Act and the amounts of relief allowed. This information has not been furnished since 1978-79. As incentives constitute an important facet of tax policy and entail substantial expenditure by way of revenue forgone, it would be very helpful if the Revenue Audit reports continued to provide the available data on all the tax incentives item by item on a regular basis.

NOTE

1. The donors to the National Fund for Rural Development may indicate their preference for the area or locality and the rural development programmes for which the donation is to be used as also the voluntary agency through which the programmes may be implemented. The wishes of the donors in this regard will be respected as far as possible: Direct Taxes Circulars, *Taxmann*, 1985, Vol. 1, p. 331.

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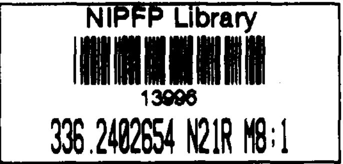

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