6

Problems of Implementation

Matters of Interpretation

DATA furnished by the assessing officers for purpose of this study as to claims for investment allowance and their disposal are summarised in Table 6.1. This shows that in respect of the assessees in the selected sample for whom information was received, out of 553 completed assessments involving total claims of Rs 16,870 lakh for deduction under section 32A, in 413 assessments (74.7 per cent) claims of Rs 12,863 lakh (76.2 per cent) were accepted at the assessment stage. In the remaining 140 assessments (25.3 per cent) (claims: Rs 4007 lakh) there were full or partial disallowances amounting in all to Rs 335 lakh (1.99 per cent of total claims).

The above data show that although some disallowance of claim for deduction under section 32A was involved in over 25 per cent of the assessments in which such claims were made, the amount disallowed was only about 2 per cent of the total claims. Many terms and expressions used in section 32A are to be found in section 32 (depreciation), section 43 (definition of certain terms relevant to income from profits and gains of business of profession) and section 80J/80I (tax holiday). Although section 32A differed in material respects from section 33 (development rebate) which was operative till May 31, 1974, much of their terminology was similar. Over the years, sections 32, 33, 43 and 80J have been the subject matter of considerable litigation, and judicial pronouncements thereon have assisted in interpreting the provisions of section 32A, thus reducing disputes on its account.

Table 6.2 gives a classification of the disallowances according to reasons. Of the disallowances totalling Rs 215.15 lakh made in 79 assessments for which reasons inducing the dis-

TABLE 6.1

Disposal of Claims for Investment Allowance at the Assessment Stage

	(*Rs lakh*)
1. Total number of assessees for which data received	156
2. Number of assessees out of (1) in which cases one or more assessments involving claim(s) for investment allowance had been completed	149
3. Number of completed assessments involved in (2)	553
4. Total amount of claims involved in (3)	168,70
5. Number of completed assessments out of (3) in which claims fully accepted at the assessment stage	413[1]
6. Amount of claims involved in (5)	128,63[1]
7. Number of completed assessments out of (3) in which claims were partly or fully disallowed	140
8. Amount of claims involved in (7)	4007
9. Amount disallowed out of (8)	335

Note: 1. Includes 14 completed assessments in which as against claims of Rs 367 lakh, claims allowed amounted to Rs 381 lakh.

Source: Income tax assesment records : data furnished by assessing officers: For modus of drawing study sample, refer page 33 (Summary, Ch. 3) of this study.

allowance were reported, disallowances of Rs 113 91 lakh (53 per cent), and Rs 32.32 lakh (16 per cent), pertained respectively to claims of investment allowance on assets found ineligible for the allowance and the government subsidy against capital investment not taken into account in determining the actual cost of the machinery or plant for working out the allowance. Other disallowances were on account of refusal of the higher rate of investment allowance, computation errors by the assessees, machinery not installed during the year, carry forward of the allowance due to the total income being determined at a loss, failure to create the requisite reserve, leasing of machinery, etc.

Subject to the fulfilment of certain conditions, investment allowance was available for new ships, new aircraft and specified new machinery or plant. To an eligible industrial undertaking the allowance was admissible with reference to the actual

TABLE 6.2

Reasons for Disallowance of Claims for Investment Allowance at the Assessment Stage

(*Rs lakh*)

Reason for disallowance	*Number of assessments in which disallowance made*	*Amount of investment allowance claimed*	*Disallowance out of (3)*
1. Ineligible assets[1]	38	1471.23	113.91
2. Government subsidy received against capital investment not taken into account in determining actual cost of the machinery or plant	15	992.21	33.32
3. Higher allowance (35%) due for indigenously developed technology refused; allowance restricted to 25%	7	112.79	14.64
4. Computation mistakes	5	34.62	6.61
5. Machinery not installed during the year	3	22.75	17.73
6. Total income determined being less, investment allowance carried forward	3	5.98	5.98
7. Requisite reserve not created	3	1.44	1.44
8. Machinery not used for the assessee's business (leased)	1	18.88	18.88
9. Want of evidence	1	0.04	0.04
10. Miscellaneous	3	101.00	2.60
	79	2760.94	215.15
11. Not reported	61	1245.82	119.65
TOTAL	140	4006.76	334.80

Note: 1. E.g. machinery or plant producing articles or things listed in the Eleventh Schedule; office appliances; old machinery items where whole cost allowed as deduction by way of depreciation or otherwise.

Source: Income Tax Assessment Cards: Data furnished by Assessing Officers.

cost of the new machinery or plant installed therein initially as also later by way of renewal, replacement or expansion. However, for an assessee engaged in the operation of ships or aircraft, eligibility for the allowance was restricted to the initial investment in the ship or aircraft and did not extend to renewals, replacements and additions. This was anomalous as both ships and aircraft have a number of independent work systems whose installation or replacement may markedly step up efficiency. The scheme of the new section 32AB avoids this anomaly. 'Ship' has not been defined in the Act. Even a non-self-propelled vessel has been held to be a 'ship' and thus entitled to development rebate.[1] This would also hold good for investment allowance and investment deposit account scheme.

For an industrial undertaking other than a small-scale one, the investment allowance was initially restricted to new machinery or plant installed for the business of construction, manufacture or production of any one or more of the articles or things specified in the list in the Ninth Schedule (priority industries). But, from April 1, 1978 new mahinery or plant installed and used *mainly* for construction, manufacture or production of any article or thing not specified in the Eleventh Schedule List (low priority goods) became eligible.[2] In other words, the test for eligibility shifted from a positive to a negative one. This had the effect of considerably enlarging the area of eligibility for investment allowance, e.g., the machinery for packing a popular brand of malted milk and the x-ray machine of a consulting radiologist were found entitled to it.[3] It would also seem that the condition as to the use of the installed machinery or plant for production *mainly* of the non-Eleventh Schedule goods needed to be satisfied only with respect to the year for which investment allowance was claimed. There was no provision for withdrawal of the allowances once granted, if in subsequent years the machinery or plant was utilised mainly or wholly for production of the Eleventh Schedule goods. Pruning of the Eleventh Schedule list in 1982 widened its scope still further and the machinery or plant, whether installed in a small-scale undertaking or not, manufacturing sophisticated consumer articles like household furniture, cutlery, chinaware and the like also became eligible for investment allowance. Thus, through statutory amendments and judicial pronounce-

ments, the scope of what was originally intended to be a special incentive for industries considered important from the point of view of national development was widened considerably. However, large-scale manufacturers of some articles of daily mass, commercial and industrial use such as ordinary soap, typewriters and cork, rubber and polyethylene fittings remained outside its ambit.

Litigation had ensued following rejection of claims for investment allowance in respect of (*a*) computers installed in offices on the view that these constitute office appliances which are among the items specifically barred from investment allowance, and (*b*) machinery manufacturing computers on the ground that as a computer processes the data fed into it, it is nothing but a data processine machine and thus comes within the purview of item 22 of the Eleventh Schedule.[4] The controversy regarding (*a*) will not arise so far as section 32AB is concerned as it specifically prohibits a computer being considered as an office appliance with a stipulation that the term 'computers' does not include calculating machines and calculating devices. To avoid disputes regarding (*b*) computers may have to be specifically excluded from operation of item No. 22 of the Eleventh Schedule. This item would also need a review on another account. Looking to the functions performed by data processing machines, it has been held that these cannot be equated with office appliances and denied the benefit of development rebate.[5] This decision will also hold for investment allowance and the new incentive under section 32AB. And, if the benefit of section 32AB cannot be withheld from data processing machines, it may be invidious to deny it to the manufacturers thereof on the plea of their being hit by item No. 22. Following the removal of distinction in the Central Excise Tariff between aerated waters using synthetic essence and 'blended flavouring concentrates', the Comptroller and Auditor General has pointed out the desirability of suitably amending item 5 of the Eleventh Schedule.[6]

Except when engaged in generation of power or repairs to powered craft, it was construction, manufacture or production of an article or thing that made an industrial undertaking eligible for investment allowance. Judicial opinion has been in favour of the view that for an activity to constitute 'manufac-

ture' or 'production', it should entail preparation or fabrication of a new product. Thus 'cold storage' which helps to prolong the useful life-span of a perishable commodity, and 'processing' which envisages a change in some properties of an existing natural or man-made product, are not 'manufacture' or 'production'. But, to determine whether a particular activity amounts to 'manufacture' or merely constitutes 'processing' has sometimes presented difficulty, e.g., while retreading of tyres and photo-developing have been considered by the Appellate Tribunal as 'manufacture', the courts have expressed divergent opinions on the question whether ginning of cotton is 'manufacture' or 'processing'.[7]

For purposes of section 32AB, construction, manufacture or production of the Eleventh Schedule goods by an industrial undertaking other than small-scale is not an 'eligible business'. It may, therefore, be argued that 'processing' of such goods is an 'eligible business'. Thus, the question whether a particular business amounts to 'manufacture or production' or is 'processing' will continue to crop up under section 32AB (and other provisions of the Act, which employ the expression 'manufacture or production', e.g., sections 80HH and 80I). While specifically denying the benefit of an incentive to construction, manufacture or production of an article, it may be inappropriate to make its availability for the 'processing' thereof a subject matter of argument. To avoid litigation, it may be desirable to clarify whether for purpose of 32AB(2)(*i*)(*a*), 'processing' comes within the ambit of the expression "manufacture or production".

It has been held that construction of dams and bridges does not amount to manufacture or processing of goods for allowing super tax rebate (since abolished) and the section 80HH backward area allowance.[8] And, the end products of execution of construction contracts are not "articles" for section 80HH and 80J purposes.[9] However, rigs and compressors for drilling bore wells, machinery for blasting, concrete lining and preparation of steel structures for tunnels and other water conductor systems employed in dam construction have been considered eligible for investment allowance by various branches of the Appellate Tribunal.[10] It is argued that sinking of a bore well, excavating a tunnel or building a dam amounts to construction of

an article or thing and further that the article or thing prepared may be for internal consumption and not for sale.

The question whether a contractor undertaking a government contract for dam construction becomes an industrial undertaking entitled to investment allowance has been answered by the Tribunal in the affirmative by relying on an Orissa High Court decision in a section 80HH case which referred to the definition of 'industrial undertaking' for the purpose of the Industrial Disputes Act, 1947.[11] A similar view has been taken by a different bench of the Tribunal in respect of a contractor constructing water tunnels, etc., for the Government by applying the ratio laid down in a High Court judgement which dealt with the intepretation of the definition of 'industrial undertaking' contained in the Wealth-tax Act for the limited purpose of section 45(*d*) of that Act.[12] Controversy has also developed whether a hotel can be considered an industrial undertaking for grant of investment allowance.[13] Except for section 33B (Rehabilitation allowance) which became non-operative since the assessment year 1985-86, the expression, 'industrial undertaking' has not been defined anywhere in the Act although it is used in a number of provisions besides section 32A such as sections 10A, 80HH, 80HHA and 80I. Each provision separately lists the conditions which an 'industrial undertaking' has to fulfil for its purpose. The new section 32AB merely adopts the definition of a 'small-scale industrial undertaking' based on the aggregate value of the installed machinery and plant, contained in section 80HHA. In order to ensure a uniformity of approach, it would be appropriate to insert a definition of 'industrial undertaking' in section 2 which defines various terms and expressions commonly used in the Act. To the extent modification of the common definition contained therein is required for purposes of a particular provision, it may be indicated in the latter.

The term 'machinery' is not defined in the Act and section 43(3) merely gives an inclusive definition of 'plant', viz., 'plant' includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of the business or profession. It has been held that having regard to the fact that articles like books and surgical instruments are expressly included in the definition, the word 'plant' has to be given a wide mean-

ing.[14] This gives rise to frequent disputes on whether an impugned item constitutes 'machinery or plant', e.g., the courts have expressed divergent views on whether a road in a factory constitutes a plant entitled to depreciation and development rebate.[15] The fencing round a refinery has been held to be 'plant' deserving development rebate.[16] The factory shed for accommodating turmeric dolls in polishing turmeric and x-ray machines of a radiologist have been considered by the Tribunal as plant and thus entitled to investment allowance which has been denied, however, to the laboratory equipment of a clinical biochemist.[17]

An generally understood, while 'machinery' is synonymous with a mechanical contrivance, 'plant' connotes a self-contained assembly of machinery items designed to produce a specific object. 'Plant' as defined in section 43(3) would also include technical know-how acquired in the shape of drawings, designs and charts, etc., necessary to put the machine assembly to work.[18] For the purpose of giving an incentive for increased investment in selected assets, some countries use the expression 'machinery or equipment'. Considering, however, that many judicial pronouncements from Indian courts are available explaining the meaning of the expression 'machinery or plant', it may be appropriate to continue with the said expression. If it is found that an incentive is being allowed on the authority of judicial pronouncements on a particular type of asset frustrating its objective, the appropriate remedy would seem to be to suitably enlarge the excluded categories of assets for the incentive.

Treatment of Machinery etc. taken on Hire-purchase/Lease

While depreciation under section 32 is given *inter-alia* on machinery or plant (including a ship and aircraft) owned by the assessee and used for the purposes of the business or profession, investment allowance under section 32A (and before it, development rebate under section 33) was allowed on a new ship, aircraft, machinery or plant owned by the assessee and wholly used for the purposes of the business carried on by him. In a credit or instalment sale, wherein the seller has merely the right to sue for arrear instalments but no right to recover the asset, the ownership is at once transferred to the purchaser.

But, under a hire-purchase transaction, while possession of the goods is delivered to the hirer and he has an option to purchase them, the property in the goods passes to the hirer only on completion of the purchase in the manner provided in the agreement. In the interregnum, the hirer is not the owner of the assets and strictly speaking not entitled to depreciation, development rebate or investment allowance.[19] However, under executive instructions, the Department has been allowing depreciation and development rebate in the first year, to the hirer on the full initial value of the asset if under the agreement it shall eventually become his property or he has the option to purchase it.[20] The courts have endorsed this pragmatic view treating a hire-purchase agreement as an agreement for sale or rather a sale to the 'hirer' with the facility of paying the purchase consideration in instalments on the security of the asset.[21] These instructions and court rulings should also hold for investment allowance. With the problem of 'ownership' out of the way, a 'hirer' under a hire-purchase agreement would be entitled to investment allowance as he has no difficulty in satisfying the other criterion, viz., use of the asset wholly for purposes of the business carried on by him.

The essential nature of a lease is that of a bailment, i.e., delivery of goods by one person to another for the latter's use during the term of the lease. Unlike a hire-purchase agreement, there is no option to purchase and the ownership of the goods remains with the lessor. Depending upon facts and circumstances of the case, commercial exploitation of an asset through leasing amounts to a business carried on by the lessor and his entitlement to depreciation is no longer in question. But, his claim for investment allowance meets resistance because of the dispute whether the criterion of the asset being wholly used for the purpose of his business is satisfied. The Tribunal benches have given conflicting decisions on the point. On the view that the word "wholly" does not mean "exclusively", a special bench of the Tribunal has found that the benefit of investment allowance cannot be denied to the lessor.[22] The matter is stated to be pending with the Madras High Court. For the purposes of section 32AB, leasing and hiring of machinery or plant has been made an eligible business except to the extent any machinery or plant is leased or hired to an industrial undertaking,

other than small-scale, engaged in producing Eleventh Schedule goods.

'Lease' is an all-embracing term including in its ambit a 'lease in perpetuity' which from the tax angle is as good as a sale to the lessee. An ostensible lease may in effect be a conditional sale. Section 43 of the Act defines terms like 'actual case', 'paid' and 'speculative transaction' for the purposes of determination of taxable income from business or profession. To enable hire purchase and equipment leasing play their due role in the country's economy uninhibited by tax uncertainties, it may be appropriate to insert in section 43, provisions stating the circumstances in which a hirer/lessee may be deemed to be the owner of the asset, as also when the asset may be deemed to be wholly used for purposes of the lessor's business. To prevent abuse and artificial manipulation of profits which is possible if the parties to a hire purchase/lease are subject to common control and the transaction is not done at arm's length, 'transfer pricing' provisions similar to sub-sections (6) and (7) of section 80HH (backward area allowance) and sub-sections (8) and (9) of section 80I (tax holiday) may be incorporated.

Other Problems of Interpretation

'Actual cost' which forms the basis for allowance of depreciation and investment allowance (and its precursor, development rebate) has to be construed with reference to clause (1) of section 43. According to the said clause, as amended by the Finance Act, 1986, 'actual cost' means the actual cost of the asset to the assessee (excluding interest paid or payable in connection with the asset's acquisition as is relatable to the period after it is first put to use) reduced by that portion of the cost, if any, as has been met directly or indirectly by any other person or authority. Subsidies are granted by the Central and the State Governments against capital investment in industries set up in backward areas. In the context of the "10 per cent Central Outright Grant of Subsidy Scheme, 1971', the CBDT have been advised that as the subsidy is related to various assets, provisions of section 43(1) are attracted.[23] In many instances, the assessee's claim for government subsidy is not admitted by the appropriate authority by the time the relative income tax assessment is decided. This leads the assessee to claim invest-

ment allowance on the unreduced cost on the plea that even in the mercantile system of accounting, he cannot take credit for the subsidy till its sanction. It has been pointed out by some assessing officers that absence of a specific provision in section 155 authorising rectification of the deduction given by way of investment allowance as necessitated by the 'actual cost' undergoing a change on account of a subsidy received in a subsequent year, is creating difficulty and an enabling provision in this regard would be in order. Indeed, the assessees have generally objected to such subsidies being considered at all in computing the 'actual cost' of the asset. The Appellate Tribunal has opined that these subsidies cannot be taken into account as these are not granted specifically to meet cost of the asset and the fixed capital investment is only taken as a measure for determining the amount of subsidy.[24] To avoid repetitive litigation in instances in which determination of actual cost of an asset is material, it would be desirable to obtain an early authoritative court ruling as to whether such subsidies are to be taken into account in determining 'actual cost' under section 43(1) of the Act and if the answer is in the affirmative, to provide for corrective action in the event of their belated receipt. In the alternative, the controversy may be set at rest through a clarificatory amendment. The issue will continue to be relevant even "where a deduction is claimed for purchase of new machinery, etc., in terms of section 32AB(1)(*b*)."

As in the case of development rebate, sale or transfer of an asset within the prohibited period entails withdrawal for investment allowance except when the sale or transfer is to the Government or statutory corporations etc., or subject to prescribed conditions or is in connection with amalgamation of the available company with another company or on succession of the availing firm by a company. Disputes on whether conversion of a sole proprietory concern into a partnership or allotment of assets to co-owners on partition of a Hindu Undivided Family amounts to 'transfer' necessitating withdrawal of development rebate under section 33 have been taken to the Supreme Court.[25] Such disputes are likely to arise in respect of the new section 32AB as well. It may therefore be desirable to obtain the Supreme Court rulings early in the context that a subsequent transaction by the partnership of the co-owner within

the prohibited period, which is admittedly a sale or transfer, may also not result in recapture of the allowance on the ground that under the statute the sale or transfer has to be by the assessee who availed of the allowance.[26] In the alternative, the relevant provision in section 32AB may be amended to clearly spell out the correct acceptable official position.

The stipulation for creation of reserve in order to obtain a deduction under section 32A follows a similar precondition for allowance of the erstwhile development rebate. It is now fairly settled that (*a*) an omission to create an adequate reserve or any reserve at all may be rectified by the time the relevant assessment is framed by the assessing officer even by debit to the profit and loss account of a subsequent year if the accounts of the relevant year stand finally adjusted and closed, and (*b*) the requisite reserve need not be created in the year of installation of machinery or plant if there are no book profits or the assessed income is nil or loss. To avoid withdrawal of the investment allowance, the investment allowance reserve has also to be utilised within a period of 10 years for acquisition of a new ship or a new aircraft or new machinery or plant for purposes of the business of the undertaking in which the asset wherefor the allowance was availed of has been installed. If the undertaking is closed meanwhile, the allowance is liable to be withdrawn either on sale or transfer of the asset following the closure or at the outside on expiry of the ten-year period. However, if the assessee itself ceases to exist meanwhile except by amalgamation or succession referred to in subsections (6) and (7) of section 32A, the investment allowance reserve cannot obviously be utilised in accordance with the scheme of section 32A leaving no scope for application of section 155(4A)(*b*) for withdrawal of the allowance.[26] Similar situations may arise under section 32AB except on succession of a firm by a company covered by clause (*ii*) of the proviso to sub-section (7) thereof. If through operation of law or by act of parties, a depositor assessee ceases to exist before making any withdrawals from the designated account or after making a withdrawal but before expiry of the period prescribed for utilisation of the amount withdrawn for specified purposes, there may be no occasion to fasten any income tax liability as envisaged under sub-section (6). Such situations should be provided for in the Investment

Deposit Account Scheme, 1986.

Development rebate remaining unadjusted due to lack of adequate profits could be carried forward for eight assessment years. It has been held that for set-off of the brought forward development rebate the business for which it was originally allowed need not be in existence in the year of set-off.[27] As the relevant provision for carry forward and set-off of investment allowance is similar, the above decision is likely to be followed in investment allowance cases as well. Although the scheme of the new section 32AB does not envisage any carry forward, the benefit of carry forward and set-off of the unabsorbed portion of the investment allowance will continue to be admissible even if the taxpayer claims the benefit of investment deposit account under section 32AB in subsequent year.

With the repeal of the investment allowance, there is no need to go into the following propositions for its modification, viz., that (*i*) in the absence of adequate profits, it may be allowed to be carried forward indefinitely instead of only for eight years; (*ii*) in the matter of set-off it should be given precedence over the brought forward depreciation which can be carried forward indefinitely, and (*iii*) in the event of competition between set-off of brought forward loss (also subject to 8-year time limit) and brought forward investment allowance, an earlier year loss or investment allowance should get precedence. These questions do not arise under the new funding provision of section 32AB which follows a different pattern.

Audit Objections

The statutory audit organisation of the Comptroller and Auditor General (C & AG) and the internal audit set-up of the Department have pointed out a number of errors on the part of the assessing authorities in acceptance of the claims for investment allowance. As to C & AG's annual audit reports, while Table 6.3 gives a year-wise break-up of the objections, Table 6.4 indicates the grounds of objection. Upto 1984-85, objections have been raised in cases of 83 assessees (114 assessments) involving excessive investment allowance amounting to Rs 370.71 lakh resulting in short levy of tax of Rs 208.18 lakh. By the time the respective annual audit reports were made, the Ministry had accepted objections is respect of 52 assessees. For

TABLE 6.3

Statutory Audit Objections—Year-wise Break up (1976-77 to 1984-85)

(*Rs lakh*)

C & AG Report for the year	*Number of assessees*	*Number of assessments*	*Investment allowance wrongly allowed/ carried forward/not withdrawn*	*Short-levy of tax*[1]
1976-77	—	—	—	—
1977-78	—	—	—	—
1978-79	1	1	6.85	3.95
1979-80	—	—	—	—
1980-81	—	—	—	—
1981-82	3	3	7.15	3.97
1982-83	13	16	26.26	16.37
1983-84	19	28	128.51	69.59
1984-85	47	66	201.94	114.30
TOTAL	83	114	370.71	208.18

(*i*) No. of assessees* in whose cases objections were accepted by the Ministry by the time the respective annual reports were made	52
(*ii*) No. of assessees* in whose cases the Ministry's replies were awaited	37
(*iii*) *a*. No. of assessees* in whose cases the objections were not accepted by the Ministry	4 (6 assessments)
b. Excessive investment allowance induced in (*iii*) *a*	Rs 17.08 lakh
c. Short levy of tax in (*iii*) *a*	Rs 10.91 lakh

Notes: *For a number of assessees, objections related to more than one assessment. By the time the respective annual audit reports were made, objections had been accepted by the Ministry in a few cases for some of the assessments, while its replies were awaited in respect of objections for other assessment.

1. As indicated in the audit paras; wherever not indicated: 50 per cent of the investment allowance wrongly allowed, etc.

Source: Government of India, Annual Reports of the Comptroller and Auditor General of India (C & AG), Union Government (Civil) Revenue Receipts Vol. II—Direct Taxes.

TABLE 6.4

Statutory Audit Objections—Grounds of Objection

(Rs lakh)

Ground of objection	*Number of assessees*	*Number of assess-ments*	*Investment allowance wrongly allowed/ carried forward/ not withdrawn*	*Short levy[1] of tax*
1. Ineligible Assets[2]	23	29	154.75	89.09
2. Incorrect determination of "actual cost" (government subsidies against capital investment not taken into account)	10	17	28.14	15.21
3. Allowance given for a year which was not the year of installation/ the immediately succeeding year in which the plant or machinery first used	5	5	17.80	9.24
4. Machinery or plant not employed in an "industrial undertaking"				
5. Industrial undertaking not engaged in "manufacture or production"	16	23	58.01	33.26
6. Machinery or plant not wholly used in the assessee's own business (leased)	2	4	17.25	7 09
7. Higher rate (35%) wrongly allowed	2	2	15.12	8.92
8. Non-creation of reserve or creation of inadequate reserve; investment allowance allowed not withdrawn on non-utilisation of the reserve during the specified period	5	7	18.63	11.12
9. Investment allowance allowed to registered firm allocated amongst partners instead of being carried forward in the firm's case	2	4	3.89	1.45
10. Incorrect carry forward should not have been carried forward	4	4	24.57	12.45

(Contd.)

TABLE 6.4 (Contd.)

11. Sale/transfer of the asset within the prohibited period	8	10	14.95	8.97
12. Ministerial lapses (arithmetic mistakes, etc.)	2	2	5.27	3.60
13. Miscellaneous	1	2	6.38	3.74
GRAND TOTAL	83	114	370.71	208.18

Notes: 1. 50 per cent of the investment allowance wrongly allowed, etc.

2. *Ineligible assets*:				
(*a*) Assets used in manufacture or production of non-9th schedule goods/11th schedule goods; office appliances or machinery or plant installed in office premises or loose tools, etc.	18	23	67.75	42.98
(*b*) Assets whose actual cost or 100% depreciation allowed as deduction in one year	3	3	25.71	15.15
(*c*) Machinery or plant not new	2	3	61.29	30.96
TOTAL (*a*+*b*+*c*)	23	29	154.75	89.09

Source: Government of India, Reports of the Comptroller and Auditor General of India, Union Government (Civil) Receipts Volume II—Direct Taxes: for the years 1979-77 to 1984-85.

four assessees involving excessive investment allowance of Rs 17.08 lakh with short levy of tax of Rs 10.91 lakh, objections were not accepted by the Ministry.

Objections pointing out excessive investment allowance of Rs 240.90 lakh in the case of 49 assessees were on three counts: (*a*) incentive allowed on ineligible assets (23 assessees; excessive allowance Rs 154.75 lakh); (*b*) government subsidies not taken into account in determining 'actual cost' of the asset (10 assessees; Rs 28.14 lakh) and (*c*) the industrial undertaking not engaged in manufacture or production (16 assessees; Rs 58.01

lakh). Other objections related to the allowance being given for a year which was neither the year of installation nor the immediately succeeding year; allowance in excess of that warranted by the reserve created; allocation of the allowance among partners of the assessee registered firm instead of its being carried forward in the firm's case; allowance not withdrawn on sale or transfer of the machinery within the prohibited period, arithmetical mistakes, etc. The four audit objections not accepted by the Ministry hinge around admission of investment allowance claims in respect of a freight barge and a cold storage plant, provision of adequate reserve and the question whether the blending of various oils to form a lubricant amounts to 'manufacture'.

Similar mistakes have been observed by Internal Audit, the majority of them pointing out investment allowance having been given on ineligible assets. As in the case of statutory audit, other internal audit objections related to allowance in excess of that warranted by the reserve created, allowance for a year in which the machinery was not put to use; allowance not withdrawn in spite of the sale or transfer within the prohibited period, etc. Objections in a few cases related to claims for investment allowance being allowed without the requisite particulars having been brought on record.

Only a few of the audit objections involve questions of interpretation. The questions which are of wide and continuing interest for purposes of the new section 32AB and other provisions of the Act have been dealt with earlier in this chapter. Most of the objections point to administrative lapses in giving effect to the statutory requirements of section 32A.

Abuse of the Incentive and Administrative Aspects

Abuse of a tax incentive like investment allowance may arise either on an assessee claiming tax relief in respect of an ineligible asset and getting away with it or on his availing of the concession and continuing to enjoy it without fulfilling all the prescribed conditions. This may be possible by legal subterfuge or through giving incomplete or misleading information to the assessing authority. In none of the cases of the selected sample for this study, for which information was furnished by the respective assessing officers, was any penal action reported for

furnishing false or inaccurate particulars in respect of a claim for investment allowance. However, on the data furnished by the assessees, a number of claims for investment allowance were found by the assessing authorities to be inadmissible, partly or wholly, as indicated in the first three paragraphs of this chapter. As in the case of audit objections, a large majority of claims disallowed by the assessing officers on their own were claims in which the prescribed conditions were indisputably not fulfilled properly and the claims were patently untenable. Only in respect of a few of the disallowances, there could be an honest difference of opinion necessitating the thrashing out of the matter by the appellate authorities. There was some public criticism about the provisions of section 32A being complicated and cumbersome. Some of the assessing officers echoed this criticism by saying that such incentives tend to shift the focus of departmental energies from tax investigation to tax litigation. All the same, it is evident that most of the post-assessment work (appellate or corrective) thrown up by section 32A, was a direct result of inadequate scrutiny of the claims for investment allowance at the initial assessment stage.

A condition precedent for obtaining a deduction under section 32A was that the particulars prescribed in this behalf were furnished by the assessee in respect of the ship, aircraft, machinery or plant. However, the "prescribed particulars for depreciation and investment allowance" vide Rule 5AA of the Income Tax Rules, 1962 were patently inadequate to help decide whether the preferred claim for investment allowance fulfilled all the statutory requirements. The assessee was merely required to indicate the rate and amount of the investment allowance claimed and the investment allowance allowed on existing assets in an earlier year. He was not required to state whether the asset acquired was new or second-hand and if second-hand, why it was claimed as "new" for the purpose of section 32A; the date(s) of its installation and its being first put to use; the amount of reserve created; whether during the previous year there had been any utilisation of the investment allowance reserve created earlier and if the answer was in the affirmative, for what purpose, etc. All this information was left to be furnished *suo moto* by the assessee or to be gathered by the assessing officer. It is, therefore, no surprise that in the

rush of assessment work, one or the other relevant information remained to be gathered or failed to attract due notice of the assessing authority and instances of incorrect deduction allowed under section 32A come to notice year after year. The new section 32AB has its own conditions for obtaining and retaining the tax advantage available thereunder.

It is desirable that simultaneously with the introduction of a new incentive as its subsequent modification, the statutory form of return of income and its prescribed accompaniments are reviewed closely in order that necessary amendments are made therein to clearly bring out how the prescribed conditions for availing of the incentive are fulfilled. Before the ITO can grant relief, there must be clear data on the assessment record sufficient to enable him to consider whether the relief should be granted[28]. Under the new concept of assessment by acceptance of all returns without any prior scrutiny, this becomes all the more necessary. Furnishing of the requisite data in a prescribed form along with the return will assist the assessees in preferring rightful claims and, if a case is subsequently selected for scrutiny by the department, enable it to satisfy itself as to the correctness of the claim without inconveniencing the assessee by calling for the missing details. As stipulated in section 44AB read with rule 60, every person carrying on a business or profession wlth gross receipts etc., above the prescribed minimum has to file an audit report in Form No. 3CD (for business)/No. 3CE (for profession) duly signed and verified by an accountant. It will be in order to also amend Forms No. 3CD and 3CE so as to clearly indicate the amounts of deduction to which the assessee may be entitled on account of the various tax incentives and how the prescribed conditions for grant of each incentive are fulfilled. So far as section 32AB is concerned, the prescribed audit report (Rule 5AB/Form No. 32AA) which is to accompany the return of income, gives the requisite information.

Ready availability of the requisite statistical data is essential if tax policy and administration are to keep pace with a rapidly changing environment. The absence thereof is nowhere felt more keenly than in the field of tax incentives. Simultaneously with the enactment of a tax incentive, an information system to ensure its correct and speedy accounting and feedback of the

essential data to enable proper monitoring and evaluation thereof should be introduced. The Long Term Fiscal Policy announced in December, 1985 has promised a viable tax information system. Data thus available may be supplemented with in-depth analysis and case studies from time to time.

It is seen that the C&AG Reports for the years 1974-75 to 1978-79 indicated the number of assessees availing of some of the tax incentives and the amounts of relief allowed. However, this has been discontinued since 1979-80. As incentives constitute an important facet of tax policy and involve substantial expenditure of public revenue, Revenue Audit may consider reviving the practice of indicating in the annual reports the number of assessees availing of the various tax incentives and the amount of revenue forgone on their irrespective accounts. Indeed, so far as the major tax incentives are concerned, the relevant data could find place in the Union Government Annual Budget Papers as in the budgets of countries like the USA where tax expenditures are shown separately.

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