The term 'company' embraces within its definition 'any institution', association or body, whether incorporated or not. The expression 'Indian Company' is defined in section 2(26) as meaning, in short, a company registered under the Indian Laws. The concept underlying this provision is that even a non-resident shareholder should be made liable to tax in respect of dividend distributed by the Indian company, by deeming such entire dividend as 'accruing' or 'arising' in India, though paid in the country where the non-resident resides.

The 1961 Act, in reproducing Explanation 3 of section 4(1), Income Tax Act, 1922 omits the words 'to the extent to which it (the dividend) has been paid out of profits subjected to income tax in the taxable territories'. These words have been omitted for the reason that they have no meaning after the amendment by the Finance Act, 1958, making all Indian companies as companies 'resident' in India. The term 'company' includes a foreign corporation which has been declared by the Board to be a company. It is not necessary that a company must be formed for the purpose of carrying on a business. In other words, companies without commercial or profit making motive have also

1. Clause (iv) of section 2(17) of the Income Tax Act, 1961 defines the term 'company' as under:

   "Any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Board to be a company..."

2. Section 4A(c) of the 1922 Act corresponds to section 6(3) of the 1961 Act. Obviously, once the Indian Company is regarded as a 'resident' company, the retention of the words quoted above becomes superfluous and meaningless.

3. Heckett Engineering Co. v. CIT (1979) 120 ITR 417(Fat).

to be assessed as such under the Income Tax Act.

On the other hand, the 'corporate veil' has been lifted for the sake of revenue or to do away with perpetration of fraud. Professor Gower states that only trusted creditor in whose favour Salomon rule has been substantially mitigated is the revenue$. The learned author quotes Bankvoer Handel en Schepvaart N.V. v. Slatford, where Devlin, J observed:

"No doubt, the legislature can forge a sledge hammer capable of cracking open the corporate shell, and it can, if it chooses demand that the courts ignore all the conceptions and principles which are at the root of company law".

b) KINDS OF COMPANIES UNDER THE TAXATION LAWS

Broadly speaking, there are two types of companies under the Income Tax Act, 1961.

i) companies in which the public are substantially interested,

ii) companies in which the public are not substantially interested.

Companies in which the public are substantially interested are popularly known as 'widely-held' companies. Such 'widely-held' or 'non-controlled' companies are not necessarily equivalent to 'public companies' as understood in company law. The object of the legislature being to hit at 'controlled companies', certain attributes are mentioned in section 2(18) for a 'widely-held' company. The Finance Act, 1983 lays down a much wanted condition, defining a 'company in which the public are substantially interested'. It states that a company whose shares are not listed in recognised stock exchange in India in accordance with the Securities Contracts (Regulations) Act, 1956 and any rules made thereunder will not be treated as

5. Upper India Chamber of Commerce v. CIT (1947) 15 ITR, 263 (All).
a company in which the public are substantially interested.

In order to find out the nature of the company, both ordinary and preference shares would be taken into account where, under the articles of association of the company, the preference shareholders have exactly the same voting rights as the equity shareholders for instance, a shareholder's holding 99% of the equity shares would still be regarded as a member of the public if he has no controlling interest in the company because of the fact that the preference shareholders are also having the same voting rights as the equity shareholders. Thus the holding of equity shares would be treated as 'holding' by the public.

Besides the broader classification, the tax legislation differentiates companies on the basis of their nature of activities. The incidence of tax is dependent on such a classification, since many incentives or allowances are provided on the basis of such categories, as well as the rates

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8. Section 2(18), Income Tax Act, 1961 further states that unless the shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 50% of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by:

a) the government, or

b) a corporation established by a central, state or provincial act, or

c) any company to which this clause applies or any subsidiary company of such company if the whole of the share capital of such subsidiary company has been held by the parent company or by its nominees throughout the previous year.

of taxes are also different. One of these categories is an

10. These categories are:

a) Domestic company - a company which has made the prescribed arrangements for declaration and payment of dividends in India, including dividends on preference shares (section 80B(2), I.T. Act, 1961).

b) Foreign company - a company which is not a domestic company (section 80B(4), I.T. Act, 1961).

c) Trading company - a company whose business consists mainly in dealing in goods manufactured produced or processed by a person other than that company.

d) Investment company - a company whose gross total income consists mainly of income which is chargeable under the heads 'interest on securities', 'income from house property', 'capital gains' and 'income from other sources' (section 109(ii), I.T. Act, 1961). The decision of the Calcutta High Court in CIT v. L.M. Sen & Sons (P) Ltd. (1980) 121 ITR 664 (Cal) is no longer good law where it was held that where the holding of assets by the company consisted mainly of house property, it would not by itself make the company an investment company.

e) Consultancy service company - an Indian company whose business consists wholly in the provision of technical know-how, or in the rendering of services in connection with the provision of technical know-how to other persons (Section 109(1b) I.T. Act, 1961).

Finance Act, 1983 explains the provision of technical know-how. This amendment is consequential to the omission of section 80MM by virtue of the Finance Act, 1983.

f) Industrial company - a company mainly engaged in the manufacture or processing of goods etc. (Section 104, I.T. Act, 1961).

The expression 'processing of goods' refers to a wide category of activities. The leading pronouncement on the subject, as to the test for determining an industrial company remains the Kerala High Court's judgment in CIT v. Casino (P) Ltd. (1973) 91 ITR 289, where the point involved was as to whether a hotel could be considered to be an industrial company. The Delhi High Court in Ad CIT v. Kalsi Tyres (P) Ltd. (1981) 131 ITR 635, 640 (Del) following Casino (P) Ltd. held:

"...activities of a nature which might not amount to manufacture, but which would result in the doing of something to the goods to change or alter their form might be taken in by the term 'processing'. But they did not so the purposes of the case before them consider the scope of the term in full, because they were of opinion that having regard to the four categories of companies..." Th

was clearly a contrast intended between manufacturing concerns on the one hand and trade concerns on the other. They were of opinion that a hotel was mainly intended for trading and not for production or manufacture."
'investment company'. The principle object, for which such a company is formed is to enable persons desiring to invest their money to avail themselves of what is called the 'doctrine of average'—that is to say, if a large number of different independent securities of a hazardous description are held together, the loss upon some will be compensated by the gain upon others so that a tolerably uniform rate of interest will be maintained. It was held as back as in 1957, in Oriental Investment Co., Ltd. v. CIT, Bombay that the question whether a company is an investment company or is a finance company, is a question of law.

The leading pronouncement on the test for determining an investment company remains the Supreme Court's decision in Hawn Estates (Pvt.) Ltd. v. CIT. The expression 'investment company' has been defined in section 372 (11) of the companies Act, 1956 corresponding to section 87(f) of the Indian Companies Act, 1913, where it is laid down that an investment company is one whose principal business is the acquisition and holding of shares, debentures, stocks or other securities. This definition, the Supreme Court pointed out, does not apply for purposes of Income Tax because of its limited scope and application to matters pertaining to company law only. The Supreme Court held:

"The term 'investment' is not a term of art and resort should be had not to its technical meaning but to its popular meaning".

In CIT v. Aloc Investment Co., (Pvt.) Ltd. after bringing out the significance of the changes made by virtue of the Finance Act, 1966 in the definition of investment company the Bombay High Court laid down three tests in order to determine whether a company is an investment company, as under:

1) whether any investments as contemplated by the definition have been made by the company as a matter of fact;

13. Ibid.
ii) whether the company could be regarded as holding investments attributable to those assets, and

iii) whether the business of the company consisting wholly or mainly in the holding of such investments.

The real myth of an 'investment company' came up before the Calcutta High Court in Great Pyramid Insurance Co., Ltd. v. CIT, the court held:

"The mere fact that a company had in the past been carrying on the business of holding of investments would not by itself be adequate to treat the company as investment company in the subsequent years as well... what is most essential is the nature of the company's activities and the intention with which the different activities are carried on as part of its business during the accounting year relevant to the assessment year in question".

The Calcutta High Court further observed:

"Where the legislature speaks of the business of holding of investments, it refers to real, substantial or systematic or organized course of activity of investment carried on by the assessee for a set purpose such as the earning of profits".

Thus, this Calcutta High Court's judgment in Great Pyramid Insurance Co., Ltd. v. CIT brings out an important proposition that in the case of an investment company, its nature of activities shall have to be determined with respect to each assessment year. Even the Supreme Court's decision in Western States Trading Co., Pvt., Ltd. v. CIT supports the reasoning given by the Calcutta High Court that the nature of activities and the intention with which different activities are carried on, will determine the nature of the company.

It is common knowledge that the investment companies are one of the best conduits for tax avoidance. In order to curb this practice, it is submitted, such investment companies may be allowed to operate only if they convert themselves into widely-held companies within the meaning of section 2(18) Income Tax Act, 1961.

16. Ibid.
17. (1971) 80 ITR 21 (SC).
Tax Act, 1961, so as to ensure that their shares are quoted in the stock exchange.

c) INCONGRUITIES IN THE PRACTICE UNDER COMPANIES ACT AND INCOME TAX ACT.

By virtue of this fact that the definition of the term 'company' has a wider scope under the Income Tax Act in contradistinction to the Companies Act, certain incongruities arise by implication. Few of the incongruities are as under—

1) Provisions regarding balance sheet

Notes given in the balance sheet are meant to convey such additional information as is considered necessary to keep the shareholders informed of the state of affairs of the company. However important such information may be for the purposes of company legislation, both the trading receipts or capital receipts are to be evaluated in their substance, under the fiscal legislation.

The Supreme Court had to analyse such a question in Panjab Distilling Industries Ltd. v. CIT, Simla. The assessee was a distillery company manufacturing liquor. It charged the purchasers the price of the bottles in which the liquor was filled, apart from the price of the liquor itself, and it undertook to refund the price of the bottles on the return of the bottles to it under a 'buy-back' scheme. The sums received from the purchasers in respect of the price of the bottles were entered by the assessee in his books in a separate ledger termed 'Empty bottles return security deposit account'. These monies were returned as and when the bottles were returned to the assessee. It was held that the balance standing to the credit of this account was a trading receipt as the bottles were as much sold as the liquor. The circumstance that the price of the bottles would be refunded on their return did not affect

18. The form in which the balance sheet is to set out is enumerated in part I and the particulars to be shown in the profit and loss account are set out in part II of schedule VI to the companies Act.

the character of the receipt.

A very important principle of law emerges from the above-mentioned decision of the Supreme Court. An assessee may credit to capital account or revenue account, but the general principles concerning profit computation, which are a part of the substantive law of Income Tax shall have to be observed. The House of Lords accepted this principle in one of the leading judgments, Glenboig Union Fireclay Co. Ltd. v. CRA where the assessee-company entered in its books the compensation which it received for sterilization of its assets in its revenue account, included the same in its profit and loss account, and distributed, accordingly, dividends out of the same. The House of Lords held that the mode of book-keeping followed by the company was not conclusive of the true character of the receipt, which was capital in nature.

In deciding, whether an item of expenditure is of a capital or revenue nature, accountancy evidence is, of course, relevant but not crucial. In Heather v. P.E. consulting Group Ltd., Lord Denning, M.R. stated:

"...The Courts have always been assisted greatly by the evidence of accountants. Their practice should be given due weight; but the courts have never regarded themselves as being bound by it. It would be wrong to do so. The question of what is capital and what is revenue is a question of law for the courts. They are not to be deflected from their true course by the evidence of accountants, however eminent".

The extent to which the ascertainment of profits is a question of fact was summarised by Lord Haldane as follows:

"It is plain that the question of what is or is not profit or gain must primarily be one of fact, and of fact to be ascertained by the tests applied in ordinary business. Questions of law can only arise where some

References:
20. 12 TC 427, 432 (HL).
21. (1972) 48 TC 293.
22. Ibid, 322
express statutory direction applies and excludes ordinary commercial practice, or where, by reason of its being impracticable to ascertain the facts sufficiently some presumption has to be invoked to fill the gap".

In general, therefore, the obviating power is vested in the court to disregard accountancy practice, where that practice appears to be based on a mistaken view of the law. In Peter Merchant Ltd. v. Stedeford evidence by accountant that a contingent liability to replace customer's equipment was a proper item of deduction in the trading account was disregarded by the Court of Appeal because his opinion was founded on an erroneous view of the liability. Similarly, in Southern Railway of Peru v. Owen, evidence by accountants that a contingent liability under Peruvian law to pay compensation to the employees in the event of their dismissal of service was a proper item of deduction in the trading account was disregarded by the House of Lords, as the amount of the deduction claimed had not been sufficiently and accurately ascertained.

Lord Mac Dermott of the House of Lords observed:

"...As a general proposition, it is, I think right to say that in computing his taxable profits for a particular year, a trader, who is under a definite obligation to pay his employees for their services in that year an immediate payment and also a future payment in some subsequent year, may properly deduct, not only the immediate payment, but the present value of the future payment, provided such present value can be satisfactorily determined or fairly estimated".

On the other hand, it is not necessary that there should a debit entry in the books of accounts in order to be entitled to claim a deduction in respect of a liability.

11) ARTICLES NOT DECISIVE ON THE POINT

As already mentioned, incidence of tax depends upon the kind of 'company' and the nature of activity being pursued by it.

24. (1948) 30 TC 496 (CA)
25. (1957) AC 334 (HL)
26. Ibid, 345
27. J.K.woollen Manufacturers (P)Ltd. v. CIT 65 ITR, 237.
The important question arises as to how far articles of association of a company may be helpful in determining such a nature. The Courts are, in general, of this opinion that articles are not decisive on the point.

On the other hand, the majority judgment of the Delhi High Court in CIT v. Bharat Development (P)Ltd. laid stress on the articles of association of the company being decisive on the matter. The facts were that certain companies were amalgamated with the petitioner company. The shareholders of the amalgamating companies were allotted shares for the face value amounting to less than the value of the net assets taken over and in the process a surplus resulted which was carried to the amalgamation account. Upon these facts, Ranganathan, J., and Kapur, J., held that such a surplus taken to amalgamation account would not constitute a revenue receipt.

Khanna, D.R., gave a dissenting judgment. His Lordship held as under:

"Normally the mere purchase of merchandise does not result in income. Profit thereto arises only at the time of sale. But to purchase other companies or to embark upon amalgamations with other companies in the form of trading activity is rarely a business adopted by people. Such acquisition or amalgamations of companies does not render them as commodities which are readily marketable."

It is submitted that the majority judgment raises serious doubts as regards the undue significance given to the articles in order to determine the nature of a receipt.

28. The Supreme Court held in Krishna Agency Ltd. v. CIT (1971) 82 ITR 372 (SC) that shares cannot be said to be not freely transferable by the holder to other members of the public, merely because the articles of association of the company empower the directors to refuse without assigning any reason whatsoever, to register a transfer of shares. In another Supreme Court case Pilani Investment Corporation Ltd. v. CIT (1973) 89 ITR 53 (SC) it was held that it has to be proved that the director had been exercising such a right or power freely, as a result of which shares were not freely transferable.

29. (1982) 135 ITR 456 (Del)

30. Ibid, 470.
iii) MEMORANDUM NOT DECISIVE ON THE POINT

In the same way, the objects of an incorporated company, as laid down in the memorandum of association, are not conclusive of this question whether the activities of the company amount to carrying on of business.

iv) HOLDING AND SUBSIDIARY COMPANIES

Though for the purposes of taxation too, a subsidiary company is separate and distinct assessable unit from its parent company, but the Income Tax Act, 1961 acknowledges 'fusion' for some purposes, and then again made a departure from such a fusion. Nevertheless, much belatedly, the Finance Act, 1965 inserted Explanation 6 to sections 43(1) and Explanation 2 to section 43(6), the total sum of these Explanations is that no balancing charge or 'deemed profits' would take place on account of transfer of assets between a holding company and its wholly-owned subsidiary.


32. In Odham's Press Ltd. v. Cook 23 TC 233 (H.L.) Odham's Press Ltd. owned all the shares in 'coming fashions' Ltd. The business of coming fashions Ltd. was that of compiling and issuing for sale of a periodical 'Every Women's'. Odham's Press printed and published the periodicals on commercial terms for coming fashions Ltd. Thereby coming fashions incurred liabilities to Odham's Press on trading account. In the year of account, coming fashions owed Odham's Press £10,118. Out of this, Odham's Press wrote off £2,927 so as to reduce the amount owing by the subsidiary for printing charges, because coming fashions made a loss on its trading operations in that year. The House of Lords held that the finding of the General Commissioners being that the expenditure was not incurred wholly and exclusively for the business of Odham's Press, expenditure was not allowable.

33. Section 47(iv), Income Tax Act, 1961 exempts the transactions from holding company to its wholly-owned subsidiary or from wholly-owned subsidiary to holding company, from capital gains tax.

34. Therefore the judgment of the Bombay High Court in Ginners & Pressers Pvt. Ltd. v. CIT (1978) 113 ITR 616 (Bom) is no longer good law wherein it was held that the transfer between the parent company and its wholly-owned subsidiary would involve balancing charge. Similarly the judgment of the Madras High Court in CIT v. Stanes Motors Ltd. (1976) 105 ITR 289 (Mad) is also no longer good law, wherein it was held:
Much to the Chagrin of Revenue, the courts have held the holding-subsidiary alliance as one and the same. In brief the tax legislation has recognised the importance of 'pyramiding' of companies, thus encouraging the holding-subsidiary alliance. Once it is accepted that it is beneficial to the revenue as well, it equally helps in certain respects in the effective application of labour laws, for example Industrial Dispute Act, Payment of Bonus Act, Payment of gratuity Act, for the simple reason that the application of all these legislations depend upon the particular nature of problems faced by each industry, having regard to their nature of business activities.

In fact, the question arises as to when the 'fusion' of holding-subsidiary alliance is acknowledged to this extent, then is it not an appropriate case to set off the losses or allowances (e.g. depreciation or investment allowance) by the holding company? It is submitted that having regard to a positive and dynamic approach to industrialization, suitable amendments may be made in this direction in section 72A by amending its marginal heading and inserting specific provisions in regard thereto. Is it irrational that 'amalgamation' and 'splitting-up' of companies should have parity, for this matter, in tax treatment?

The conditions laid down under section 72A, in order to avail the privilege of carry forward and set off of accumulated losses and unabsorbed depreciation allowance by the amalgamated company have been already hit upon, much adversely, by the Supreme Court in CIT v. Mahindra & Mahindra.

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34 contd. "A reading of sections 41(2) and 50 of the Act showed that the balancing charge and capital gain cannot overlap, and it is only the amount which is in excess of the balancing charge that will be attracted to capital gains tax under section 50".

It is submitted, that only one condition namely (b) the amalgamation was in the public interest subserves the entire purpose.

The writer is of this opinion that the holding-subsidiary alliance would have to be viewed in an integral perspective. The question of grants-in-aid or subsidy to the subsidiary companies from holding companies has assumed importance, as to whether such grants-in-aid or subsidy constitutes revenue receipt in the hands of the subsidiary. In a recent case of the Delhi High Court, CIT, Delhi v. Handicrafts & Handloom 36, (1983) 14 Taxmann 11(SC) affirming Delhi High Court's decision in Mahindra & Mahindra Ltd. v. Union of India (1983) 141 ITR 174. The Supreme Court has held in the instant case as under:

"The financial non-viability of a sick company in terms of clause (a) of section 72A(1) is to be equated with the 'sickness' of such undertaking and obviously, in the context of its revival by a sound undertaking, the sickness must be of a temporary character and not any basic or permanent sickness. An undertaking which is basically or potentially non-viable will ordinarily be incapable of revival and would face a closure; in other words, the financial non-viability spoken of by the section must refer to sickness brought about by temporary adverse financial circumstances that disables the unit to stand and work on its own. Moreover, the concept of financial non-viability, as understood by men of business, commerce and financial institutions, is that where all the three parameters - profitability, liquidity and solvency- show the negative figure, the unit is 'sick'. Accordingly, the specified authority as well as the Central Government were not justified in equating financial non-viability with basic non-viability".

The first condition is enunciated in section 72A(1) as under:

"(a) the amalgamating was not, immediately before such amalgamation, financially viable by reason of its liabilities, losses and other relevant factors".

The third condition is:

"(c) such other conditions as the Central Government may, by notification, which would facilitate the rehabilitation or revival of the business of the amalgamating company".
Export's Corporation, the assessee-company was a subsidiary of the State Trading Corporation, a government company. During the previous years relevant to assessment years 1965-66 and 1966-67, the assessee company received certain grants-in-aid from the government, which were treated as income in the accounts. Even thereafter the assessee-company was left with a substantial loss which was reimbursed by the parent company.

The Tribunal held that the grant-in-aid given by the government for export efforts was meant to reimburse the expenditure incurred by the assessee and clearly related to trading account. As regards the reimbursement of the loss by the STC, there was no contractual obligation to reimburse the loss and the reimbursement was intended to remedy the erosion of capital caused by the loss.

The Delhi High Court held as under:

"The view taken by the Tribunal was the correct view. The assessee had incurred a trading loss. If there had been a profit and that had been transferred to the parent company, it could not have been said that the profit had been wiped-off. Similarly, it cannot be said that the loss had been wiped off by the reimbursement."

It is submitted that this Delhi High Court judgment raises serious doubts. Would it imply that if there is no contractual obligation to reimburse the loss by the holding to the subsidiary then it constitutes a capital receipt. The Supreme Court has explained the concept of real income in CIT v. Sitaldas Tirathdas in the following words:

"In our opinion, the true test is whether the amount sought to be deducted in truth, never reached the assess as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of

39. (1981) Tax 63(3) 192 (Del)
40. Ibid, Headnote
41. (1961) 41 ITR 367, 374 (SC).
the assessee where, by the obligation, income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second."

In other words, it can only be a capital receipt if the nature of the obligation calls upon diversion of such an income before it reaches the assessee. It is submitted that no such obligation could be inferred in a holding-subsidiary alliance. To conceive such an obligation would give rise to one of the best conduits for tax avoidance.

Just the very next year, the same petitioner, Handicrafts & Handloom Export Corporation of India v. CIT again came to the Delhi High Court. Being a 100% subsidiary of the STC, a sum of Rs. 11.7 lakhs was received by the assessee-company from STC as financial assistance in view of the losses incurred by the assessee. The only material difference, as compared with the previous case, was that in the earlier years such payments took the form of reimbursement of the entire loss, in the year under reference the payment was made as a percentage of the turnover of the assessee-company.

Ranganathan, J., speaking for the Delhi High Court held as under:

"This was a case of a cent per cent holding company coming to the rescue of its subsidiary which had incurred losses and of its enabling it to recoup them and that the method of calculating the amount to be reimbursed would not make any difference".

It is submitted that perhaps in these two judgments rendered by the Delhi High Court, the court became impressed with this fact that the assessee-company was 100% subsidiary of the holding company. As regards, the grants-in-aid or subsidy, the courts have been unanimous in holding that they constitute

42. (1962) Tax 65(3)-134 (Del).
43. Ibid, Headnote.
44. (1981) Tax 63(3) 192 (Del); (1982) Tax 65(3)-134(Del).
taxable receipts.

The Delhi High Court pointed out asunder:

"There is in our opinion, a basic difference between grants made by a government or from public funds generally to assessee in a particular line of business or trade, with a view to help them in the trade or to supplement their general revenues or trading receipts and not earmarked for any specific or particular purpose and a case of a private party agreeing to make good the losses incurred by an assessee on account of a mutual relationship that subsists between them. The former are treated as trading receipts because they reach the trader in his capacity as such and are made in order to assist him in the carrying on of the trade".

In essence, Surrey and Warren states:

In the absence of any precise general formula, the concept of income has become an uncontrolled discretionary zone of legislative, administrative and judicial free-play.

45. The Supreme Court held in Meenakshi Achi v. CIT (1966) 60 ITR 253 (SC) affirming the decision of the Madras High Court in CIT v. Meenakshi Achi (1962) 50 ITR 206 (Mad), that the amounts paid as grants-in-aid by the government, on the basis of the Rubber produced and expenditure incurred by the assessee-company would be income receipts to the assessee.

In Ratna Sugar Mills Co. Ltd. v. CIT (1958) 33 ITR 644 (All) the subsidy paid by the U.P. Government to the Sugar Mill to compensate for the loss of profits resulting from the government orders to pay wages at an enhanced rate, was held in the nature of income to the assessee. The Punjab & Haryana High Court has also held in Ludhiana Central Cooperative Consumer's Stores v. CIT (1980) 122 ITR 942 that the government subsidy to recoup revenue expenditure incurred by an assessee will be in the nature of income.

46. (1982) Tax 65(3)-134,139 (Del.).

It is submitted that in Explanation 1 to section 28 the words 'subsidy or grants-in-aid' may be inserted so as to plug the measure which does not only encourage tax avoidance, but promotes differential treatment between the public sector and private sector. The concept of mixed economy ensures a balance between public and private power.

v) ACCOUNTS OF COMPANIES

The Income Tax legislation makes deep inroads into the machinations of company legislation, that 'in fact each branch of a business can be a separate source of income. An assessee having a head office and a branch office can have two previous years, one for the head office and the other for the branch, even though the business may be the same at both the places'. The importance of locating the previous year lies in this fact that the liability varies according to the rates of income tax declared in yearly Finance Acts. In an important judgment of the

48. Interestingly enough, the Delhi High Court (Ibid, 139) compared the holding-subsidiary alliance at par with father-son that "the amounts given by the father will be only in the nature of gifts or voluntary payments motivated by affection or personal relationship and not stemming from any business considerations. The position is similar here".

49. Friedmann states in his pioneering work 'The State and the Rule of Law in a mixed economy', as under(95)

"The proposition that the rule of law in modern Democracy is incompatible with any kind of economic planning by the state or to take another of Hayek's formulations (Hayek, the Road to Serfdom (1944) Ch.6), that the planned state 'commands people which road to take', whereas the rule of law only provides "signposts" is of course incompatible with the reality of any contemporary democracy. It would be a useless exercise for us to attempt to define the rule of law in a way that bears no relation to the minimum functions of social welfare, urban planning, regulatory controls, entrepreneurship and other essential functions of the state in a mixed economy. But, no less essential to a 'mixed economy' democracy, is the maintenance and protection by the law, of a balance between public and private power".

Allahabad High Court J.K. Synthetics Ltd. v. ITO, the ITO allowed the change of the accounting year, subject to the following two important conditions:

i) the change should not be on account of the fact that there would be profit in the first twelve months, against which the loss in the next 6 months would be set off and,

ii) the change should not result in a reduction of tax liability including surtax.

The Allahabad High Court held that the first condition was a 'palpably illegal condition'. As regards the second condition, the court held that it was an 'ambiguous condition and wholly superfluous'. The court held that to consider the previous year of eighteen months was in itself a condition.

vi) CHARGE OF DEPRECIATION

Depreciation is a first charge on the profits in order to arrive at the true profits and gains of a business or profession. This principle is embodied in section 205 of the Companies Act, 1956, which requires the creation of a provision for depreciation before dividend is declared to the shareholders. There is only one exception to this rule, that section 72, Income Tax Act, 1961 requires the unabsorbed business losses to have precedence over the unabsorbed depreciation allowance, for the simple reason that whereas the former is a time-limit deduction, the latter is timeless. The only condition stipulated, as held in CIT v. Virmani Industries (P) Ltd. by the Allahabad High Court, is, that 'the assessee must carry on some business in the succeeding year in which the set off of unabsorbed depreciation is claimed'.

52. 97 ITR 461 (All).
vii) PROVISION FOR TAXATION

Section 530 (1)(a), Companies Act, 1956 and section 178(6) deal with the same aspect—the priority in respect of arrears of tax owed by a company in liquidation, as compared to the interests of other persons. There is a recent authority on this point, as to the priority of tax dues, in a Andhra Pradesh High Court judgment, ITO v. Official Liquidator. The court held as under:

"Now, if section 530(1)(a) of the Companies Act is in any manner contrary to the provisions of section 178 of the Income Tax Act, then according to sub-section (6) of section 178, the said section will have overriding effect. But is there any contrariety? In our view, there is. While section 530(1)(a) of the Companies Act restricts the preferential claim of tax due and payable within 12 months next before the winding-up order, section 178 of the Income Tax Act puts no such restriction on the claim, preferential or otherwise in regard to the amount of tax due from the company in liquidation. It directs the whole amount due and payable to be set apart."

Thus, the liquidator is bound under section 178 to set apart the amount equal to the amount notified by the ITO under sub-section (2) of that section. Thus, any amount becomes due on account of the tax, irrespective of the provisions of section 530(1)(a) of the Companies Act, whether the amount has been due and payable within 12 months next before the date of the winding-up order.

The Andhra Pradesh High Court further held:

"When once the effect of section 178 is held to be that the tax amount so set apart shall be utilised for the purpose of payment of the tax by the liquidator, then the limited right of preferential payment conferred on the ITO really gets merged in the wider right which section 178 confers on the ITO."

It is therefore, abundantly plain that section 178 is a provision which is contrary to section 530(1)(a) of the Companies Act in the sense that it legislatively directs the

53. (1975) 101 ITR 478 (AP)
54. Ibid, 473.
55. Ibid, 474-75.
Therefore, it is that Section 178(6) prevails over Section 530(1)(a) of the Companies Act.

The Andhra Pradesh High Court reached the same conclusion by another approach too, as under:

"Section 530(1)(a) of the Companies Act gives a limited priority to the government. It, by implication, means that the government should stand in the queue with other unsecured creditors to receive the pari passu distribution of the assets of the company. Section 178 of the Income Tax Act which is a subsequent legislation on the same subject, however, casts an obligation on the liquidator to set aside not only the restricted amount of tax referred to in Section 530(1)(a) of the Companies Act, but the entire amount of tax due for the purpose of its payment. The subsequent legislation, therefore, submerges the effect of Section 530(1)(a) of the Companies Act."

It is submitted that in order to do away with such a predicament the words 'which had become due and payable within 12 months next before the date of the winding-up order' may be inserted in sub clause (b) of sub section (3) of Section 178 after the words '...shall set aside an amount equal to the amount' before the words 'notified...'. The prevailing position of law on this aspect is really inscrutable in as much as the workers of the company would have anything left over, only after the taxes have been made safer.

d) THE NATURE, SCOPE AND OBJECTIVES OF THE PROJECT

While inflation was not a phenomenon of the recent origin, the inflation of recent years is distinctly different from that of the past because of the high rate as well as the cause. This was no more a supply-demand equation controllable through fiscal management, but was caused deliberately by activity that pushed up the cost of energy and consequently of all commodities throughout the world. It could, therefore, be reasonably assumed that the upward trend in costs might not abate in the foreseeable future.

The planning process in the country had involved a deliberate raising of planned investment above the level of voluntary savings and such a situation was covered neither by
the classical nor by the Keynesian theory. The familiar theory and policy of 'mixed economy' could not help the country in evolving proper methods of demand management. There is, therefore, an imperative need to differentiate India's mixed economy from the Keynesian mixed economy.

The Achille's heel of the economy appears to be industrial production. At the same time it is not desirable to totally check the inflation. To check the inflation beyond a manageable level would tantamount to closing down of many industrial units. The only sure and safest way to curb the rate of inflation are increased production, reducing the production cost, improving efficiency, better capacity utilization, economic use of existing resources, austerity in consumption expenditure.

Taxation has occupied an important position in our economic planning. The assessee has started recognising the importance of integrating taxation with business planning. The most dominant factors in this context are:

a) companies which are economically viable aim at not merely the maximising of profits but also maximising profits after taxation;

b) perhaps the charge of income tax is the only major business expenditure, of course, neither personal nor capital in nature, which is not admissible for computing the amount of income tax;

c) taxation forms part of the major cash expense, thus the tax saved is an interest free loan from the government, which may not be repaid.

The tendency to give retrospective effect to the charge of tax through legislation, particularly to supersede the court's decisions is inscrutable. Ad-hocism has become very liberal with the direct tax laws, in particular with the Income Tax Act, 1961. The cautionary note struck by the Taxation Enquiry Committee about three decades ago is perhaps more valid today.

Resort to deficit financing rather than taxation, particularly direct taxation of individual and corporate business may maintain the buoyancy of conditions in the private sector as reflected in the rates of profitability and of capital formation. But such buoyancy will not necessarily lead to proportionate formation of real assets or greater productive capacity. Experience of conditions in this country, as in other underdeveloped countries, emphasises the importance of restraining inflationary tendencies not only in the interest of healthy development, but also that of achieving any substantial real development, or else, speculative elements are liable to gain ascendancy and distort the pattern of development and of capital formation itself. Considerations of both the quality and pace of healthy development thus underline the need to keep the rate of deficit financing within proportions which will not jeopardise economic stability.

Substantive law is the product of inter-action between economic policies, development needs, social compulsion and revenue requirements. Its simplification and rationalisation involves the balancing of a variety of forces, which is a never-ending process. The code of direct taxes having an elastic canopy by its very nature is evolutionary in its character. If the historical retrospect could be any guide, the attempt at simplification of substantive law invariably leads to an 'amendment-to-amendment' approach and fails to yield efficacious results. Whenever a meaningful attempt was made, the results were extremely gratifying, for example, the discontinuation of the practice of grossing-up dividends had its own salutary effect.