RECENT CHANGES IN LAWS AFFECTING BUSINESS AND INDUSTRY

Based on a Symposium Organised by the Forum of Free Enterprise

With a Foreword by
N. A. Palkhivala

popular prakashan, bombay

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POPULAR PRAKASHAN, BOMBAY

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FOREWORD

Recent changes in the laws affecting business and industry have been so many and so complicated that even experts find it difficult to keep pace with them, and for the layman the task of keeping abreast of the changes is well-nigh impossible. To amend Company Law and Taxation Laws twice a year has almost become a holy ritual.

In the following pages different speakers have dealt with the kaleidoscopic changes in the main laws which affect industry in India. The main defects of the ceaseless spate of legislation in the field covered by this pocketbook are absolute uncertainty engendered by amendments to fiscal burdens and controls which are as unpredictable as they are frequent; complexity which verges upon incomprehensibility; excessive and cumulative burdens which make dishonesty immeasurably more rewarding than integrity and hard work; injustices inherent in fatuous laws and arbitrary provisions which stem from individual whims and are not based on any discernible principle of sound jurisprudence. If you further take into account the element of careless and hasty drafting, which makes it not uncommon to have new sections which lend themselves to four and more different interpretations, you have a fairly accurate picture of the difficulties facing honest endeavour and enterprise in our country to-day.

October 19, 1965 N. A. PALKHIVALA

INTRODUCTION

The essence of democracy, it is rightly said, is the Rule of Law. All citizens are equal before the law and none, including the Government, is above the law. In the economic sphere also, the operation of the rule of law is very important. Business and Industry have to contribute to public welfare by maximising production within the framework of laws which are required in social interest and which are administered in an impartial manner.

Good and simple laws will help the smooth functioning and growth of the economy. Impractical and complex laws will have the contrary effect. In a newly independent, developing country like India, it is but natural that a certain amount of experimentation is done in the legislative sphere. But if this process goes too far, it will result in creating a climate of uncertainty which will hamper the smooth functioning of the economy.

There have been many changes in our laws in recent years. In conformity with its practice of educating people in business and industry as also the general public and the authorities in various facets of our economic life, the Forum of Free Enterprise had arranged a series of talks on recent changes in laws affecting business and industry. In addition to indicating the

changes, the eminent speakers made constructive suggestions to improve the law. As there was a great demand for the text of these talks, it has been arranged to publish them in the form of a pocketbook which will readily be available to students of economics, business men and industrialists, executives, legislators and others interested in current economic problems.

I wish to congratulate Messrs Popular Prakashan for publishing this pocketbook in a handy form, and at a price designed to suit the pocket of the common man. Incidentally, this is the fifth pocketbook sponsored by the Forum of Free Enterprise. The others are (i) "The Role of Joint-Stock Companies in India's Economic Progress", (ii) "Democracy in India", (iii) "Elements of Modern Enterprise", and (iv) "Towards Greater Production and Productivity".

I hope the reader will find this book interesting and useful, and its publication will lead to re-thinking on some of the present measures which are complex and frustrate the objective of rapid and large-scale economic development of the country in a democratic framework.

A. D. SHROFF
President
Forum of Free Enterprise

Sept. 30, 1965

CONTENTS

Chapter *Page*

1. Few aspects of computation of Business Profits under Income-tax Act *S. P. Mehta* 1
2. Recent changes in Mercantile Law *Mrs. Khorshed D. P. Madon* 15
3. Company Law *H. B. Dhondy* 34
4. Recent Trends in Legislation pertaining to Foreign Exchange *S. R. Vakil* 62
5. The Sales Tax Law *N. C. Mehta* 101
6. Recent Changes in Corporate Taxes *S. V. Ghatalia* 125

FEW ASPECTS OF COMPUTATION OF BUSINESS PROFITS UNDER THE INCOME-TAX ACT

S. P. Mehta*

Taxes, said Mr. Justice Holmes, are what we pay for civilised society. In good old days of no "civilisation" there were no taxes. With the progress in civilisation there has been progress in taxes. One sometimes wonders whether it may be preferable to be less civilised and pay less taxes than style oneself more civilised and be surrounded by taxes on all sides. In India, at present, unlike the Six Hundred soldiers in the march of the Light Brigade, a man is surrounded on all sides by the taxes. There is a tax on the income you earn. If one is spendthrift, there is a tax on the expenditure he makes. If one is conservative, there is a tax on the wealth he saves. If he is generous enough to part with such wealth during his own life-time by way of gift, there is a gift tax. If for some reason he cannot be so generous, there is an Estate duty on the estate he leaves behind — of course, to be paid by the heirs and not by himself.

In these circumstances, the importance of tax in the human life can hardly be exaggerated.

* The author is an eminent advocate who has specialised in income-tax law.

There is hardly any step which a man can take without properly considering the tax implications of his arrangement. A wrong step would mean waste of all the efforts, while a right step would mean a great difference.

As the main source of income would normally be a business, it is very important to know what the concept of business is under the Income-tax Act and to examine a few aspects affecting the computation of business income under the law.

As is well-known to many, the word "business" under the Act, is not exhaustively defined. The categories of business are never exhausted. As the Supreme Court has put it, the word "business" is to be interpreted in the widest possible manner. The word "business" is defined as including "any trade, commerce or manufacture and includes any adventure or concern in the nature of trade, commerce or manufacture". It also includes a vocation or an occupation carried by the individual. There is an interesting case decided by the Supreme Court in Krishna Menon vs. Commissioner of Income-Tax, Madras, wherein a Vedanta Philosopher was held liable to pay tax on moneys deposited by a foreign disciple of that philosopher in his bank account. There was no stipulation for the payment which was entirely spontaneous. The Supreme Court held that his

pursuit of Vedanta philosophy was in one form or another a pursuit of wealth and that, accordingly, the receipt from his disciple constituted his income from vocation liable to be taxed in law. If a Vedanta philosopher can be regarded as pursuing business, an average human being would certainly be regarded as carrying on business if what he does is with the intention to earn profit; and, obviously there are many instances in our life where we work with the hope of earning money though there may be many occasions where with all the best intentions, the efforts prove unsuccessful.

Not merely normal activities carried on with a view to earning profit are treated as business, but under the Income-Tax Law, activities of a mutual association, for example, trading association, are, in certain cases, treated as business activities and the results therefrom are taxed as income from business. The legislature has gone even a step further and what is admittedly not income from business is by fiction of law deemed to be such income; for example, in the case of a Managing Agent, the manager or an agent, any receipt on termination of his contract of employment is made liable to tax notwithstanding the fact that what they receive is in lieu of their source of income and not income from their source. This is only an illustration of the legislature ultimately succeeding in the tug-o'-war be-

tween a tax-payer and tax-gatherer. Instances are not uncommon where in all such cases, it is the State which has succeeded and the tax-payer has always been fighting a loosing battle.

Such income profits and gains from business have always to be computed in accordance with the method of accounting regularly employed by the assessee. The choice is of the tax-payer — once he exercises his choice, the Income-Tax Officer is bound to compute the income from business in accordance with such method and it is not open to him to compute the income otherwise, save and except when he finds that the method is such that it is not possible to compute the income properly. There is no doubt about the statutory provision, but the cases are not uncommon where the power to reject the books of account has been exercised on flimsy grounds. There are always in actual life various units of business, some far above the marginal lines and large number of them just bordering on the marginal line. What the units at the top can afford would not always be afforded by the units at the bottom. For one or other reason, the results shown by the marginal units are rejected and, thereafter, such units are compared with the units at the top and the income from the business is computed.

What is quite often overlooked is that even though equality is a fundamental right under the

Constitution, in life there can be actually no equality. All persons engaged in the same business cannot necessarily be treated alike irrespective of the circumstances in which they are placed and in which they are carrying on business. No doubt, if an assessee has been playing a foul game with the Revenue, his activity should be stopped and he should be brought to book. But merely because he is not in a position to maintain his accounts as efficiently as the best unit in the business, does not mean that he is suppressing his business income.

Sometimes one wonders whether the income-tax authorities can accept advice of a business or trade association and in consultation with them adopt a fair margin of return in various businesses. Today new businesses are being set up and new kinds of industries are being developed. The problems of such new organisations are new and even people engaged in these businesses or industries are to a certain extent handicapped. In these circumstances, it would not be proper to assume that an Income-Tax Officer, always trying to keep pace with the fast changing legislation, could be in a position to determine the income of such new businesses or industries. In the circumstances, the necessity of determining the proper income from business cannot be obviated. It may be advisable to set up various trade associations in consultation with

the income-tax authorities so that there may be a fair estimate of income from business.

There is another problem which also requires consideration. Today an industry requires fairly vast capital and the setting up of the plant also takes pretty long time. There are expenses which can be allowed provided they are of revenue character and have been incurred only after the business is set up. In other words, all the expenses of any kind whatsoever incurred prior to the commencement of the business will be treated as preliminary expenses. During that period, expenses in the nature of interest on borrowed capital, salary of the staff, legal charges and travelling expenses have to be incurred, and instances are not uncommon where such expenses are treated as preliminary expenses and disallowed.

Normally, such expenses, to the extent to which they can be linked with the cost of acquisition of asset, should be allowed to be capitalised and added to the cost of that asset. Where, however, such expenses are not capable of being capitalised, the same would be disallowed. However, there is an interesting point from the point of view of the tax-payer. Suppose instead of incurring such cost he enters into a contract with a third party for setting up a plant for a lump sum, the third party would include all such ex-

penses in determining his cost of construction of the plant, and accordingly, the assessee would be entitled to claim depreciation on the entire amount paid by him on the ground that the same represents to him the cost of that plant. There is lot of substance in the claim of the assessee and it is fair and proper that the claim of the assessee should be considered and accepted.

Even after the business is set up, and has started running, there are numerous cases where there are small points of disputes between the assessee and the Revenue.

There is an obvious case of the remuneration paid by a Company to the Director or to a person substantially interested in the Company or to a relation of either of them. Under the Act, a very wide power is given to the Income-Tax Officer to sit in judgment over any benefit given by a Company to any such person and he is empowered to disallow such payment, if in his opinion, the payment is not justified on grounds of commercial expendiency. The principle behind such power is very laudable but one sometimes wonders whether in actual exercise of such power such a principle is always remembered. There are no doubt many cases where the persons are given some remuneration from a Company not by virtue of their merit but by virtue of their relationship with the people controlling the

Company. Nobody would dispute the disallowance of payment to such persons. However, there are equally numerous cases where remuneration to persons, who on their own merit would draw the same and in some cases even more remuneration in another company, is being disallowed merely because they are connected with the people controlling the Company. The relationship cannot alter the merit of an individual. It would be fair and proper that the exercise of power is restricted to cases where the interests of the Company are overlooked.

Equally in dispute is the travelling expense incurred by the persons carrying on business or the Director of a company or partners of the firm. Today with the distances being reduced to nothing in point of time, the persons are required on grounds of business to travel and visit developing organisations in other countries. Such expenses are normally treated as capital expenditure. One can understand where the persons are sent abroad before the business is set up, in which case the cost of such travel could be regarded as capital expenditure and a part of the cost of acquisition of the asset. However, the persons are sent abroad after the business is set up and has commenced, with a view merely to get themselves acquainted with the latest methods of business or production. Even then such expenses are treated as capital expenses and

accordingly, disallowed. Sometimes a portion of such expenses is treated as personal expenditure and disallowed. It would be fair that to an assessee such expenses should be always allowed because by sending anybody abroad no capital asset will be acquired. It is true that the knowledge of that individual is improved, but that does not mean that any capital asset has been acquired. At best, it is an improvement of the capital asset, if an employee or an individual can ever be regarded as a capital asset; and mere improvement of a capital asset is not, in law, a capital expenditure. The fact that some part of the expenses could be regarded for the personal benefit of that individual does not mean that *quae* the business, expenditure is personal. If an individual goes abroad, he cannot ignore his person and some expenses are bound to be personal in nature, but the same have been incurred only on account of the business requirements and not for personal pleasure or benefit of that individual.

There is another interesting question which also requires consideration, that is the question about royalty. There are numerous businesses in the country where for the purposes of acquiring stock-in-trade, some kind of royalty has to be paid, mainly to the Government. The payment of royalty is a very common feature in the mining industry. The matter has been agitated

in numerous courts. The Supreme Court in the cases of Pingle's Industries Ltd. and Abdul Kayoom, by a majority of two to one, held that the royalty is capital expenditure not allowable as a deduction. This view has very serious consequences. Accepting the judgments of the Supreme Court as the law of the land as it should be, the question which the State has to consider is whether there should be an amendment to overcome that judgment. The Supreme Court has interpreted the law and there are even numerous cases where Parliament has intervened and superseded the judgment of the court of law. Nobody can point out that without payment of royalty, the stock-in-trade of that business can ever be procured. Nobody can also dispute that cost of acquiring stock-in-trade should always be allowed in computing the income of a business. Ultimately, whatever be the process of law, the attempt of every legislature is to determine the real profit a businessman makes in his business. If for one reason or another, the law is found to be lacking in this requirement, the obvious answer is to amend the law and meet with the legitimate need.

There is equally an interesting aspect which crops up in numerous cases. In quite a few cases, the income-tax authorities have held some or other arrangement by an assessee as being in violation of one or other law of the land, and

accordingly, any payment made under that arrangement is held to be unlawful and accordingly, disallowed. The Revenue relies mainly on a judgment of the Supreme Court in the case of Haji Aziz & Bros and Abdul Shakoor where the Supreme Court held that penalty paid for breach of the Sea Customs Act by importing goods in the country in violation of the law of the land is not allowable as a deduction because to break the law of the land cannot be regarded as a part of a business of an assessee. That judgment has to be accepted as it is; but to extend that judgment to other cases is somewhat dangerous. In the case decided by the Supreme Court, the price paid by the assessee in respect of the smuggled goods was not even disputed as being disallowable and in determining the profit made by that assessee on sale of the smuggled goods, the price of the goods must have been allowed. If the arrangement made by an assessee is in violation of the law of the land for example, payment to a Selling Agent or payment to an associate of a Managing Agent,—remuneration paid by the Company to such person is still payment made for remuneration for services rendered by that person. Can it be said that the remuneration paid for such services should not be allowed merely because for some or other reason for which payment is made is in violation of law of the land? In law, even income tainted with immorality or

illegality is taxable as income. There is no reason why any payment under an arrangement found to be in contravention of any law should be disallowed as illegal. The payment is made for the purpose of business, and if otherwise the payment is *bona fide* and genuine, there is no reason why such payment should be disallowed.

These are a few aspects which arise in course of carrying on business.

There is another interesting aspect about the loss suffered in course of business. Normally, income from two businesses is to be aggregated under the head: "Profits and Gains of Business", under Section 28 of the Income-Tax Act. If there is more than one business, the profit under one is to be set off against loss under another and the final result is to be set off against income under other heads. To this general rule, there is an exception in cases of speculative transaction. A speculative transaction is defined as meaning any transaction of purchase and sale wherein delivery is not ultimately given. This definition was inserted in the legislation in the light of the prevalent practice of buying Havala losses to reduce the legitimate income from business. The practice was so prevalent that even courts of law have taken judicial notice thereof. Nobody can doubt the principle and the purpose underlying that legislation. However, in practice, the defi-

nition of speculative transaction has created more room for speculation. It is difficult to say what exactly speculation means. A proviso to that definition makes the matter further complicated. For example, hedging is always recognised as outside the scope of pure speculation. There have been cases where the damages paid for breach of contract have been held to be loss from speculative transaction. There are also cases where loss suffered in hedging transaction has been treated as speculative loss and treated accordingly. One wonders whether the legislature intended that to be so. Anyway, that is a matter which does require some kind of reconsideration.

There is another interesting feature about losses in non-Public Companies. Normally a losing Company is a bad proposition. But the ingenuity of the tax-payers being what it is, such losing Companies acquire importance. People who were making good profits in their normal business found it profitable to acquire such business and bring their own profit-making business in that Company so that the losses of that Company could be set off against that profit and thereby reduce the incidence of taxation. However, the ever vigilant tax-gatherer detected that device and now there is Section 79 of the Income-Tax Act whereby losses suffered by such Company will not be allowed to be carried for-

ward and set off against profits in subsequent years if in those subsequent years shareholding is different by more than 50%.

One more interesting aspect is the liability of the Directors of a non-Public Company. Till recently a Director is regarded as separate and distinct from a Company and the Company alone was held liable in law for the payment of its taxes. There is a departure from that theory and under the new law, a Director of such a Company is made liable for the undischarged liability of the Company unless he can show that it is not on account of his negligence and default that the taxes have remained unpaid. It is a dangerous departure and cuts at the very concept of the legal entity of a Company. Normally, the person who is liable to pay the tax is the person on whose income the taxes are determined and there is no reason why a Director of a Company should be made liable when the income does not belong to him. The only justification can be that many persons completely identify themselves with the Company so much so that the legislature had to accept the position and follow it to its logical conclusion.

These are a few aspects relating to the computation of business profits under the Income-Tax Act. They only go to show how necessary it is to plan one's affairs.

RECENT CHANGES IN MERCANTILE LAW

Mrs. Khorshed D. P. Madon*

The task of keeping up-to-date with recent changes in law is like the repair of Bombay roads—never ending. Just like the task of repairing Bombay roads, the task of law reform has been spasmodically undertaken. The result is that the law is as patchy and uneven as the road's surface and as full of loopholes as our roads are full of potholes. Attempts made to plug the loopholes in business legislation provide the business man with the same perpetual obstacle race that a motorist on the Bombay streets has to run every day.

Law has been defined as "a system that protects anybody who can afford to hire a lawyer", while a lawyer has been defined by a wit as "a learned gentleman who rescues your estate from your enemies for himself" or "one who is willing to go to Court and spend your last paisa to prove he is right." No lawyer knows all the law—even a judge is not supposed to know the law—and that is why a Court of Appeal is provided to correct him. Only the Supreme Court is supposed to know the law for the simple reason that there is no higher court to tell the Supreme

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Court that it is wrong! In spite of this as citizens of India we are expected to know the law of our own country because of the maxim, "Ignorantia Juris Non Excusat", i.e., ignorance of law is no excuse although "Ignorantia Facti Excusat", i.e., ignorance of fact may be excused.

Mercantile law is the law of the merchant. It developed from the ancient Lex Mercatoria, a dynamic system of law evolved by the exigencies of trade and commerce ever expanding with the changing needs of the merchant. It grew up naturally among the merchants instead of being forced on them by an outside authority. Lex Mercatoria was a collection of principles and practices which had been accepted by the merchant adventurers of the past, as sound, reasonable, practical principles, endorsed by public opinion.

These principles and practices were recognised by the courts in England because they had the sanction of the mercantile community. Originally these principles were administered in the Courts held at medieval fairs where most of international commerce took place. The sanction behind these principles was the force of public opinion. Strictly speaking, lex mercatoria was not law but usage. But later it acquired the sanction of law as these usages were recognised and enforced by the law courts.

Mercantile law has evolved through the centuries and is still trying to keep pace with the growing needs of trade and commerce. Although it is part of the general law of the land, it is given a distinct separate name mainly by text-book writers and examining bodies. There are hardly any recent changes in the topics usually covered by books on Mercantile law but as this special name, Mercantile Law, reflects the business frame of mind it is necessary to look at mercantile or commercial law as seen through the eyes of a business man. Although the business man, like other citizens, is also concerned with other aspects of law such as matrimonial or family law, land law and revenue law, it is industrial law, commercial law and company law which is of the most substantial business interest to him.

This article is, however, confined to commercial law. The real changes in mercantile law have been in the concepts brought about partly by changing modes of transacting business and partly by the increasing volume of control orders.

There are many branches of mercantile law such as the sale of goods, negotiable instruments, agency, partnership, indemnity and guarantee, bailment, insurance, carriage of goods by land, sea and air, etc. It is not possible to deal with

all aspects of mercantile law within such a small compass. I shall, therefore, concentrate on changing concepts in the law of contracts particularly the law involved in the transaction of sale. This is because the fundamental relationship of mercantile law revolves around the contract of sale as buying and selling are the very sinews of trade and commerce. Without a sale there can be no transaction to be financed and no goods to be carried or to be insured. Letters of credit, bills of exchange, bills of lading, warehouse receipts and all similar customary instruments of merchants are incidental in some way or other to a contract of sale.

The law relating to the sale of goods is governed partly by principles common to all contracts in general and partly by the principles which are peculiar to itself. In India the law of contracts is codified in the Indian Contract Act of 1872. Originally the law of the sale of goods formed a chapter of the Indian Contract Act. In 1930 that chapter was repealed and replaced by the Indian Sale of Goods Act of 1930, as the simple rules which had been enacted half a century ago were found inadequate. Nevertheless as indicated by Sections 3 and 66 of the Indian Sale of Goods Act many of the provisions of the Indian Contract Act have to be considered in relation to a contract of sale.

Let us, therefore, briefly consider some of these provisions.

1. *Proposal + Acceptance = Agreement*: In the earlier days merchants came together either at market fairs or on their travels and after some haggling, prolonged or brief depending on temperament and habits, struck a bargain and a contract was made. But today's agreements, marital or mercantile, are not as simple as that.

In modern modes of communication, the buyer and seller no longer come together to bargain over the goods which are spread out before them. That is a thing of the past. Great distances intervene and negotiations must be conducted by correspondence through post, telegraphs, cable, telex and telephone.

According to the general principles of the law of contracts, an agreement is made at the moment of time an offer is accepted and the agreement becomes binding on the offeror according to Indian law as soon as the acceptance is put in a regular course of transmission so that where the post is the mode of transmission, the agreement would be binding as soon as the letter of acceptance is properly posted.

In the case of a telephonic communication, i.e., when an agreement is made by telephone or

by the even more recent system of telex, it has been held in a recent English case [Entores Ltd. v. Miles Far Eastern Corporation (1955) 2A. E.R. 493] that the parties are treated in all respects as if they were in each other's presence and therefore there is a binding contract as soon as notice of the acceptance is received by the offeror.

For example, take the case of two people making a contract over the telephone. A merchant makes an offer by telephone and while the other party at the other end of the line is giving his reply the line goes dead so that his words of acceptance are not heard by the offeror. The words are actually spoken but the offeror has not heard them. Therefore, in such a case there is no contract.

If the line revives and the words of acceptance are heard by the offeror the contract is deemed to be made only the second time when the offeror actually hears the words.

Or perhaps the line does not go dead but the words are so indistinct that the offeror asks the offeree to repeat the words. In such a case it is not the first time when the offeror does not hear but only at the second time when he does hear that the contract is complete. If the words are not repeated there is no contract. In

other words the contract is only complete when the offeror has the answer accepting the offer.

Thus it will be seen that contracts by instantaneous communication such as telephone or telex are treated on the same principle as those made between parties in each other's presence.

This rule has been applied in India where the Contract Act is not exhaustive and in such a case it is permissible to apply English principles in dealing with such matters. (Kanhaiyalal v. Dineshwarchandra, 1959 M.P. 234).

2. *Consideration*:- Every agreement must be supported by consideration, i.e., each side to an agreement must give and receive something as a one-sided undertaking is not binding at law for want of mutuality. There is an increasing tendency today for companies to have their own elaborate printed agreement forms with several clauses in the company's own favour, e.g., the right to cancel the agreement. Sir D. Mulla held in Chhotalal v. Chamsey (24 Bom. L.R. 877) that such power can be exercised only for a valid reason and not arbitrarily; otherwise the agreement would be void for want of mutuality. In *Keshavlal Lallubhai* v. *Lalbhai Mills* [60 Bom. L.R. 948 (S.C.)], the Supreme Court has held that extension of time should also be by mutual agreement, not unilaterally.

3. *Illegality*:- Sections 23 and 24, 57 and 58 of the Indian Contract Act which deal with the legality of consideration and objects apply also to a contract of sale. An agreement the object or consideration of which is unlawful is void and unenforceable at law. For example, agreements for the sale of an obscene book or illicit liquor are unenforceable at law.

Contracts for the sale of goods in which the buyer and seller know that the goods will be put to some illegal use, for example, for house-breaking, are also unenforceable, so that if such goods are not delivered the buyer will not be able to recover them by action in court and if he has already delivered them the seller cannot recover the price from the buyer. If, however, the parties are not in *pari delicto*, i.e., not equally at fault, for example, where the seller does not know that the goods are to be put to an unlawful use, the buyer will not be able to defend himself by pleading his own illegal purpose for "no man shall set up his own iniquity as a defence any more than as a cause of action". Where of course both the parties are in *pari delicto*, that is, equally at fault, the illegality can be relied upon by the party sued.

4. *Impossibility*:- Impossibility may exist *ab initio*, i.e., at the time of making the agreement, or it may be the result of a supervening

event beyond the contemplation of the parties which makes the agreement impossible of performance. In the latter case, the contract is said to be "frustrated" by supervening impossibility.

The word "frustration" has been described by Lord Wright in Twentsche Overseas Trading Co. Ltd. v. Uganda Sugar Factory Ltd. [(1945) 1 M.L.J. 417 P.C.]: "The word frustration is a sort of shorthand; it means that a contract has ceased to bind the parties because the common basis on which by mutual understanding it was based has failed. . . .that there has been a failure of what in the contemplation of the parties would be the essential condition or purpose of the performance."

An example of frustration is Government action as for example banning the import of a particular type of goods or requisitioning under the Defence of India Act. For example, a contract to transport goods by means of motor trucks which are subsequently requisitioned under the Defence of India Act would frustrate the contract. (1945 Nag. 473).

Frustration must be distinguished from *mere commercial impossibility*, i.e., unexpected difficulty of performance, e.g., strikes, lockouts, abnormal fall or rise in prices, or a sudden depreciation of currency.

To safeguard against this, modern forms of contracts increasingly provide for what is known as a *"force majeur"* clause.

5. *Contractual Capacity*:- There can be no contract unless the parties to the contract have the capacity to contract. So far writers of legal text-books have been males and they treat the subject of "incapacity to contract" unchivalrously under the heading, "Infants, Married Women and Lunatics".

A person's capacity to contract may be limited either through mental deficiency or on account of status. These classes of persons are minors, lunatics, drunkards, corporations, married women, aliens.

Minor—According to the Indian Majority Act, a minor is a person who is under the age of 18. This age stands extended to 21 if a guardian has been appointed of the person or property of the minor before he has completed the age of 18.

A minor is regarded as the spoilt child of law and agreements made with minors have no binding force.

Mentally Deficient—The position of lunatics, drunkards and other mentally deficient persons is the same at law.

Corporation—A corporation is given a personality by law and is, therefore, a legal person. It has been said that a corporation has "no body to be kicked and no soul to be damned". As early as 1245 the Pope had said that the corporation could not be excommunicated as it has neither mind nor soul, and it cannot sin. In a recent case the Supreme Court has held that a corporation is not a "citizen" under Article 19 of the Constitution and, therefore, cannot claim fundamental rights (S.T. Corporation of India, Ltd. v. Commercial Tax Officer A.I.R. 1963 S.C. 1811).

This does not mean that contracts of sale or otherwise cannot be made with a corporation. Apart from these natural or formal limitations, the contractual capacity of corporations is limited by the documents which define their sphere of activity or state their purpose or objects for which they are created.

For example, corporations registered under the Companies Act have full capacity to contract subject to the limitations placed on them by the objects clause of their memorandum of association and also by the provisions of the Companies Act.

There have been drastic changes in the law affecting corporations, particularly the management of corporations.

Married Women—The question that arises in connection with married women is of vital interest to everyone because those who are not married already either hope or dread to be! This question is, "Should Husbands Foot the Bill"?

Popular saying has it that while it is the woman who pays with tears and heartache the debts of love, it is the man who pays with his earnings the debts of his wife. Like most popular sayings, this is a half-truth.

Formerly in England by a legal fiction, husband and wife were regarded as one person and as law was man-made it is easy to understand why on marriage it was the wife's property which became her husband's and not *vice versa.*

This provided the popular theme of half the Victorian melodramas in which the villain with his oily smile and waxed moustachios, burning the candle of seduction at both ends, laid matrimonial traps for the unsuspecting heiress.

As the wife had no property left after marriage, it was only fair to make the husband responsible for his wife's debts. Today the law has changed considerably in this respect and a married woman has full capacity to contract. Instances where husbands are even today compelled by law to pay their wives' debts do happen. In such

cases, the husband's liability depends on the principles of agency. An agent is a person who is authorised to act on behalf of another.

The husband is only liable if he either by words or action induces others to regard his wife as his agent. For example, Mrs. X has been in the habit of buying expensive clothes and jewels from "Charms Ltd." Mr. X has so far paid all the bills with great patience and indulgence, a habit calculated to make any marriage a success. One evening he wakes up from his masculine absentmindedness and realises what a sap he has been to encourage such unending extravagance. Having fortified himself with courage, he puts down the proverbial foot and forbids his spouse to buy any more of such fripperies without first consulting him, emphasising again and again that he will not pay any such bills in future. Mrs. X turns her back on what she considers to be unreasoning male idiosyncrasy, while her husband congratulates himself for having mastered an awkward situation without the usual tearful outburst.

On returning home from office one evening he finds an all too familiar envelope on his writing desk with the challenging words, "Charms Ltd." printed in bright colours. On opening it, he finds a bill for a pair of diamond earclips bought that very day.

What is the husband's responsibility in such a case? Can he snatch the jewels from his obstinate spouse and return them to the jeweller together with the unpaid bill and give himself another pat on the back? Or is he to go through the office hours with the perpetual dread of finding an innocent looking bill, the symbol of male thraldom, waiting for him at the end of the day?

The husband is bound to pay the jeweller for the price of those jewels. This is not because he merely happens to be the buyer's husband but because, whether the buyer was his wife, mistress or sister, he had, by his own actions in paying similar bills run up in his name at that particular shop, induced the shopkeeper to deal with her and give her credit.

Warning the woman alone is not enough. The husband remains liable until he has actually informed the tradesman concerned that he will not pay such bills any more.

If a wife is living apart from her husband in circumstances justifying her in doing so, as where the husband is ill-treating her, she has a right to claim maintenance from him. If he does not provide her with maintenance, she has a right to provide herself with the necessaries of life and claim that her husband foot such bills.

Thus the wife's right to make her husband foot her bills depends upon whether she can be said to be her husband's agent for the purchases made or whether such purchases come in the category of necessaries for her maintenance which her husband has failed to provide.

Alien—Alien Enemy. Although on the general principles of the Law of Contracts there can be no objection to agreements between an Indian citizen and a foreigner as long as the two countries are at peace, for the purpose of conserving foreign exchange as well as in the interest of keeping Indian industry largely in the hands of Indians, a number of controls have been introduced such as the Capital Issues (Control) Act, 1947, the Imports and Exports Control Act, 1947, the Foreign Exchange Control Act, 1947, which empower the Central Government and the Reserve Bank of India to control and regulate all transactions in foreign exchange, directly or indirectly.

An Indian entrepreneur, therefore, who wants to start an industry with foreign collaboration, either through technical assistance, foreign investment or import of plant and machinery would like to know the government's policy and the control measures affecting such foreign collaboration.

The Government of India's policy is to encourage foreign investment consistent with the Five-Year Plans i.e., foreign investment in the shape of buying of shares or technical participation etc. is encouraged by the Government, (a) where the activity relates to manufacturing, and (b) where adequate capacity does not already exist in the country.

Normally, the Government is not in favour of foreign investment in trading or commercial activities or in plantations or in already well-established fields such as banking and insurance.

As early as April 16, 1948, the Government issued its Industrial Policy Resolution which was clarified by the then Prime Minister in the Parliament on April, 1949, to the effect that the investment should be of such a nature as to eventually contribute towards strengthening of the country's economy, through the production of commodities which would lead to increased efficiency in the field concerned.

The tendency of the Government nowadays is to prefer the issue of free equity shares against the supply of technical know-how rather than royalty payments.

The setting up of various financial institutions such as the Industrial Finance Corporation of India and the various State Aid to Industries

Acts have provided aid to industries by widening the loan market and enabling companies to raise capital from sources other than the owners of capital.

It has also made possible changes in the management structure of business and industrial organisations by providing a strong answer to the argument in favour of continuing the managing agency system as a source for providing or guaranteeing finance to corporations.

Thus during the last half century, conditions in India relating to trade and business have undergone material changes. As methods of business have largely altered, the simple rules enacted more than 50 years ago are no longer adequate.

The *laissez faire* policy which left the business man free to play his business games according to business ethics has given place to the "socialistic pattern" policy with mounting controls and regulatory measures.

The changing concept of the law relating to merchants is a necessary result of the revolutionary changes introduced in modern modes of doing business and increased government control. The contracting merchants may be residents of different countries accustomed to deal with each other in different currencies.

Many a contract is built around a catalogue or an item in a stock inventory or by a trade description. Very often there is a definite interval between the making of a contract and the manufacture of the subject matter and even more time between the date of the shipment of the goods to the final receipt of them by the purchaser.

Various control orders have considerably taken away the freedom of contract. A manufacturer in such cases can supply only to holders of a permit or authorisation as in the case of commodities such as cement, steel etc.

Foreign trade brings in its trail a host of complicated problems in the shape of foreign exchange regulation, import and export control orders.

In short, the recent trends in mercantile law have kept the business man truly busy running a perpetual obstacle race punctuated with time-consuming but profitless form-filling.

The bright sunny climate for the very enjoyable business game has certainly changed and a certain number of restrictions are of course, necessary but the skies are not as overcast as the Government seems to think and the Government should bear in mind that discretion is the better part of controls.

A nation is the individuals who belong to it. If a nation wishes to enjoy freedom, it must create a climate in which the individual is not subordinated to or manipulated by any power outside himself, be it economic or political.

True liberty begins with a belief in people, in respect for the individual and the institutions he holds dear to his heart, in an understanding of his weaknesses and in faith in his sense of responsibility, in a recognition and encouragement of a society where the spirit and conscience of mankind are no less important than material things.

The evidence of true democracy is the expression of the people's respect for law and a steady awareness of their responsibility.

COMPANY LAW

H. B. Dhondy*

The head of one of the largest and most successful business corporations in the world, (Mr. Greenewalt, Chairman of the Board of Directors of Du Pont's), has said: "Sociey can profit most through emancipation of the individual from all forms of power — economic, political or social — which impose unnatural restraints against his full development..... All organisations, nations, societies and civilisations will prosper and advance only to the extent that they can encourage common men to perform uncommon deeds."

The sovereign Legislature of our land, in its wisdom, does not share this belief. That, in sum, appears to be the clear conclusion that an objective assessment of the trend in recent changes in Company Law leads one to.

During the course of a series of Lectures that I was invited to deliver at Madras in September 1963, I had occasion to discuss the role of Government in the planning of industrial development in India in our times, and some of

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the key instruments available to it for this purpose. After considering some developments in the field of fiscal measures which then, to me, seemed to hold out hope for some improvement in that direction, I turned to the field of Company Law. I then said on this subject:

"On this faintly optimistic note, I leave the field of Taxation and step into that of Company Law. Almost at once, all trace of optimism is rubbed off and replaced by a sense of stunned bewilderment. Our Companies Act already has the doubtful distinction of being among the most verbose and complicated of such pieces of legislation anywhere in the world. During a brief business visit to the United States last September, I had occasion to participate in a most stimulating discussion with eminent accountants and business men from over a dozen of the leading industrial nations. I was surprised at the strength and vigour of their expressions of disapproving astonishment at the scope of its detailed coverage of matters which, almost without exception, in their countries are left to the good sense of the owners and managers of the companies concerned. Most of them who had had occasion, through their Indian business collaborations, to make a closer acquaintance with some of the ramifications of our Company Law and its administration, had difficulty in conceal-

ing their feelings of irritation and frustration at the tremendous emphasis placed in the administering of this law on what they considered to be mere technicalities and trivialities."

I had hoped that perhaps this was a passing phase in the early years of the working of this Department. When one's experience of a new field is limited, and the subject is vast and complex, it is understandable that, in the actual work, especially at lower levels, there should be a tendency to play safe and concentrate on the letter of the law, and possibly on technicalities, lest, in taking a broader view, we trip up over matters of detail. But, surely, by now sufficient time has passed to allow a review of the actual experience of administering the law; to assess its results on the corporate sector of industry objectively; and to chalk out the directions in which emphasis should be concentrated in future.

Not satisfied with the formidable labyrinth already built up in 1956, and amended and enlarged substantially since, in 1960, our Parliament is reportedly on the point of considering further substantial additions including, no doubt, many more "Do's" and "Don'ts." When is this constant tinkering about with a basic piece of legislation going to end? And if merrily continued, where is it going to lead us?

It is good and right to legislate, wisely and after mature thought, for conditions and defects

which are known to be widely prevalent, and which are amenable to improvement by legislation. But it is not good to legislate for *all* on the basis of the misdeeds of a *few,* and on wild and unproved allegations that such misdeeds are widespread throughout the Private Sector. The havenots will always be envious of those who have, and only too ready to malign them. Black sheep in any large flock, no doubt, there are, and always will be. But must we be so colour blind that we can only see black sheep?

The existing law, if adequately and properly administered, provides more than enough ammunition to attack and severely punish known and notorious wrong-doers. But has this been done? Instead, after years and even decades of dilly-dallying with so-called investigations in isolated cases, the punishment hardly fits the crime. At the same time, members of good, honestly-run, small companies are asked to show cause why they should not be prosecuted for failing to file in time a return of some immaterial information, which, in any case, would only add to the masses of paper dumped in a Government office until there is no more space in that building, and so another fine and imposing building at the cost of a few more crores of rupees of public money has to be planned and financed as part of a poor country's industrial development.

The Company Law Administration has had to face an undoubtedly formidable and challenging task. It has, in certain directions, acquitted itself very creditably indeed. I have, from some personal knowledge of them, the highest regard for many of its senior officers. They are men of integrity and are endowed with a sense of fairness. But good intentions, regrettably, are not enough.

I intend to examine the trend of the more important amendments already made to the Act and those under consideration.

It could legitimately be argued that, in the history of a basic commercial law, such as the Companies Act, a decade is relatively a very short period of time to consider. And yet, in less than ten years, there has been a complete rewriting of our Company Law and the introduction of a whole new code and "philosophy" of Company legislation by the monumental Act of 1956, which an entire series of lectures would barely suffice to cover adequately. But even a reasonable familiarity with the complex provisions of that voluminous piece of legislation as originally enacted would hardly serve for a claim to up-to-date knowledge on Indian Company Law.

In the brief span of the last five years (or less), we have witnessed the labours of a Company Law Amendment Committee, a learned

Commission of Inquiry, and a Special Committee consisting of two legal luminaries, not to mention a succession of changes in organisation of the administrative limb of Government dealing with Company Law. All these prodigious efforts have resulted in major amendments to the 1956 Act, first in 1960, then again in 1963, and now the pending amendments. In between, we have had some relatively minor amendments, made by two Ordinances, which were duly replaced by Amending Acts, and a Notification amending one of the important Schedules to the Act, not to speak of a host of General Statutory Rules and Orders and a flood of Circulars, Press Notes and the like, all purporting to "clarify" the provisions of the Act, and, not infrequently, serving to add to the general confusion!

The Act of 1956 had 658 sections and 12 Schedules and came into force on 1st April 1956. By the Amendment Act of 1960, with effect from 28-12-1960, 193 of these sections and 3 of the Schedules were changed (including a total repeal of 5 sections), and 20 more sections and a Schedule were newly added. Schedules V, VI and X of the principal Act have been amended by Government Orders several times on dates between 21-12-1956 and 21-3-1961. One new section each were added by the Amendment Acts of 1962 and 1964, with effect from 3-11-1962 and 5-7-1964 respectively. Seven sections were

amended substantially and a round dozen added by the Amendment Act of 1963 which was brought into force from 1-1-1964, except for section 8 thereof which took effect from 1-12-1964. Thus, the Companies Act of 1956 had a total tally of 687 sections and 13 Schedules in force on 31st December 1964, of which one section (293B) is to remain in force only during the official period of the present National Emergency. Even this final count is, of course, subject to the changes proposed by the Second Amendment Bill of 1964, which comprise 51 major and 29 minor amendments to existing sections, including the proposed repeal of 8 sections, one welcome amendment to a Schedule (IA), and 10 new sections proposed to be added. Indeed, the Companies Act threatens to outpace the Income-tax Act — which hitherto was indisputably the notorious leader in this respect — for rapidity and frequency of amendment! What better proof could there be that we do indeed live in a dynamic, planned economy?

A quick and very brief look back to the historical retrospect of Indian Company Law may perhaps assist us to understand and review the recent changes in proper perspective. Company legislation in India started well over a hundred years ago with the Joint-stock Companies Act of 1850. A major landmark was the Indian Companies Act of 1913, which, with substantial amend-

ments in 1936 and 1951, remained the major Company Law enactment for a period of well over forty years. Right down to the 1950s, the Indian law was, by and large, based on the prevailing English law relating to Companies.

Extensive upheavals in corporate activity and management took place during the years of the Second World War and immediately thereafter. Public attention was increasingly attracted to the operation of businesses in Company form. In the U.K. the Cohen Committee was appointed in the late 1940s and, based largely on its Report, after an enquiry spread over two years, the Companies Act of 1948 eventually found its place on the Statute book. In India, a similar awakening of interest took place and the Government successively appointed two eminent company lawyers from Bombay and Madras to advise on the broad lines on which the Indian Companies Act should be revised. Their views were considered departmentally and the Government's tentative thinking was formulated and circulated in a Memorandum to the general public for eliciting opinion.

Late in 1950, the Bhabha Committee was appointed by the Government to go into the entire question of the revision of the Indian Companies Act, with particular reference to its bearing on the development of Indian trade and industry. This Committee reported in March 1952. A Bill

based largely on this Report was introduced on 2nd September 1953, referred to a Joint Select Committee in May 1954, reported on by that Committee in May 1955 and passed in November 1955. This was the Companies Act of 1956, which, as I have said before, came into force on 1st April 1956.

In one major respect at least, the Bhabha Committee's recommendation was deviated from in the Act. The Committee had recommended, after mature deliberation, that a statutory authority, at the Centre, to be called "Corporate Investment and Administration Commission", should be set up under the new Act for administering the Company Law as well as for the discharge of other related functions. The Act resulted instead in a Department of Company Law Administration, within the Government, to carry out the duties and responsibilities visualised for the Statutory authority. The Statement of Objects and Reasons stated: "It is, however, proposed that the question of conferring statutory status on this Organisation if so necessary be considered after this Central Organisation has been set up and functioned for a reasonable period." As we know, not only has the change not been effected to date, but the latest Amendment Bill proposes abolishing of the Advisory Commission set up by section 410 of the Act. This is one trend running unmistakeably through

most of the recent changes in our Company Law —the taking on of more and more powers by the Government and doing away with the moderating influence of independent expert outside bodies.

Even before the voluminous enactment of 1956 had been fully considered, understood, and attempted to be worked by business and industry the Government appointed what has come to be known as the Sastri Committee on 15th May 1957, to consider amendments to the Act—(1) "in the light of its working" to: (a) overcome practical difficulties; (b) remove drafting defects and obscurities; and (c) ensure better fulfilment of the purposes underlying the Act; and also (2) to consider changes in its form or structure to simplify the Act. The Committee took the view that any reassessment of the considerations of general economic or social policy on which the Act was based was outside the ambit of its enquiry. In the words of the Committee's Report: "We have tried to plug loopholes, supply omissions, clarify ambiguities, correct mistakes, remove inconsistencies, omit unnecessary or otiose provisions and add others conducive to the smooth and effective working of the Act."

The labours of the Sastri Committee resulted in over 200 amendments effected by the Act of 1960 out of which mention may be made of

the following: (1) By section 43A, newly inserted in the principal Act, private companies in which one or more bodies corporate held 25% or more of the share capital were deemed to be public companies. Certain exceptions have been provided to the general rule, to which more are proposed to be added by the latest Bill, but predictably involving Government approval. (2) The numerous provisions of the principal Act regarding Managerial Remuneration were sought (—though only with partial success—) to be made more lucid, and, at the same time, more stringent in so far as concerned disclosure of perquisites, etc., included in such Remuneration. (3) The deduction of Depreciation|Past Losses from out of the current year's Profits before declaration of Dividend therefrom was made compulsory (Section 205). (4) Books of Accounts were required to be preserved for at least eight years and amendments were made as regards the form and requirements as to disclosure in the Annual Accounts (Schedule VI). (5) The Board's Report was required to include references to post-Balance Sheet date changes of material nature and to any capital commitments entered into (Section 217). (6) Private non-subsidiary, or wholly-owned subsidiary Companies were required to file their Balance Sheet and Profit and Loss Account with the Registrar of Companies, though the Profit and

Loss Account was not open for inspection by non-members (Section 220). (7) Provision was made for compulsory audit of the accounts maintained at Branches (Section 228). (8) The powers of Inspectors were increased so as to make Investigations more effective. (9) Disclosure of Donations for political purposes in the Profit and Loss Account was made compulsory (Section 293A).

The Amendment Act of 1962 introduced section 293B, with effect from 3rd November 1962, and for the duration of the Emergency, to empower Boards of Directors of Companies to contribute to the National Defence Fund or other Government-approved Funds for the purpose of national defence, regardless of the restrictions and limits on the Board's powers under the existing provisions of sections 293 and 293A, but subject to disclosure in the Companies' Profit and Loss Accounts of the amounts so contributed during the financial year. This is the sort of amendment to which no right-thinking shareholder, who is also a patriot, can raise serious objection.

The same praise can hardly be bestowed on some of the changes under the next Amendment Act, that of 1963. These may be considered under a few broad groups as follows: The first of these groups of changes is aimed at strengthening Government's powers to interfere and remove

Managerial personnel for malpractices, etc. Sections 388 B to E and 635A were newly added, and sections 397, 398 and 408 were amended for this purpose. In a very lucid article in the "Economic Times," of December 27, 1964, Mr. Matthew J. Kust, a good friend of India, has written as follows about these provisions: "It appears to this observer that one reason for the unsettling 1964 budget may have been the use of the tax—also the company—laws to accomplish an ulterior purpose which was to strike at undue family concentration of wealth. Here the unfortunate timing of the Bose Report may have unwittingly had a damaging effect. Although the Bose Report is a compendium of corporate and other malpractices by a particular industrial group, these acts transpired prior to 1956 and would have been mostly illegal under the reformed Companies Act of 1956. Yet the impression created by the Bose Report, which was nearly ten years overdue, was that such corporate malpractices were still extant. It spurred the 1963 Companies Amendment Act which added further and, perhaps, unnecessary restrictions on companies. The new section 388B can only disaffect the private sector. Whether it was necessary can be seriously questioned. It is interesting to note that the Government is proceeding under the old sections 397 and 398 in the Bennett-Coleman case and not under the new section 388B, which would tend to lend credence to the

conclusion that sufficient powers already existed prior to December 1963 in the Companies Act to deal with corporate malpractices. If so, the 1963 Amendments appear like a vote of no confidence in the private sector." Coming, as they do, from a staunch friend of this country, who has consistently championed our cause abroad, and tried to explain to critics in his country the rationale behind, and the reasonableness of, our tax and economic laws, controls and restrictions, these words are a timely warning of the gravely harmful effects on our economy—unintended, no doubt, but not the less damaging therefor—, of frequent, hasty and ill-thought-out amendments to our basic commercial laws.

But if this first group of changes under the 1963 Act appears to Mr. Kust to be "a vote of 'no confidence' in the private sector", I wonder how much more so must seem the totally unjustified and grossly inequitable provisions empowering the Government, "if in its opinion it is necessary in the public interest so to do", to unilaterally direct conversion of Loans given by Government,—or Debentures issued to Government,—into capital of the company, "on such terms and conditions as appear to that Government to be reasonable in the circumstances of the case". By rejecting the Select Committee's recommendation that this power of conversion should be available to the Government with re-

trospective effect only in cases of default by the borrowing company, has not Government provided ground for charges of breach of contract, and of faith, which do it no good? And for what reason has this been done? The Statement of Objects and Reasons gives no reason, beyond the haughty assertion that "it is considered necessary that the Government should have the power...." This is one of the most disturbing and dangerous trends becoming increasingly more pronounced in the recent past, and also the proposed, changes in Company Law. This way, looms threateningly, the possibility of subjugation of the individual to the oppressive tyranny of an all-powerful State.

This same disturbing trend is emphasised by yet another group of changes made by the 1963 Act, empowering the Government, — without there having been any proved, or even suspected malpractice, — to deprive all Trustees of their legal right to vote as shareholders of Companies, and to transfer this right to a Public Trustee appointed by the Government. Such deprivation, without offering any reason, without recourse to a Court of Law for justice or redress, hardly appears to be a model law for a free and democratic society. Is it too late to remind ourselves that bad laws make bad citizens?

Not only are these provisions (Sections 153A and 187B) unfair and inequitous, but they

are also ambiguous and badly drafted. This will be apparent when it is noted that, even before the power conferred under section 8 of the 1963 Act on the Public Trustee came into force on 1-12-1964, the Government itself has included in the Companies (Second Amendment) Bill 1964, (introduced in the Lok Sabha on 21st September 1964) in Clause 16 a redraft of the language of section 153B(4), which, in its anxiety to gloss over the position, it has referred to in the Notes on Clauses as "an explanation"....which .... "makes the position clear." This so-called explanation is in reality a substantive amendment, because it introduces a yardstick of the paid-up value in cases not provided for by the previous language employed. Even in making this amendment, there seems to have been a slip, whereby the words "or debentures" appear to have been inadvertently left out at the end of the sentence. This speaks eloquently for the unseeming haste and poor drafting of the recent frequent changes in our laws.

The most recent change already effected in the Companies Act, 1956, is the introduction of section 635B by the Companies (Amendment) Act, 1964, (No. 32 of 1964, which received the President's assent on 9th October 1964 and was gazetted on 12th October 1964), with effect from 5th July 1964. This section prohibits companies, bodies or persons whose affairs, etc., are being

investigated under sections 235, 237, 239, 247, 248, or 249, or against whom proceedings under Chapter IVA of Part VI are pending from discharging or punishing employees without prior notice to, and, indirectly, consent of the Company Law Board. A right of appeal to the Tribunal against the Board's decision has been provided for. The provision is not to prejudice any other law for the time being in force. It is intended to protect employees who assist the Government in investigation of suspected misdeeds and prosecution of the wrong doers, from victimisation by their employers. How real this protection will prove to be, time will tell in certain specific instances which received a certain amount of publicity not so very long ago.

The Companies (Second Amendment) Bill, 1964, may also be considered as it contains changes which may be effected into law shortly.

According to the Statement of Objects and Reasons, it would appear that the principal object of the Bill is to implement the recommendations of the Commission of Inquiry on the administration of Dalmia-Jain Companies (which has popularly come to be referred to as the Vivian Bose Commission) and the Daphtary-Sastri Committee, which, at the instance of Government, examined the learned Commission's Report and made some suggestions of its

own for amending the Companies Act. "Opportunity is also being taken (i) to strengthen the provisions relating to investigation into the affairs of companies and to provide for more effective audit in dealing with cases of dishonesty and fraud in the corporate sector, and (ii) to simplify some of the procedural requirements which are at present burdensome to the companies without being of corresponding advantage to the Government".

As regards the principal object of the Bill, implementation of the Bose Commission's recommendations, little remains to be said. I have already quoted Mr. Kust's remarks to the effect that most of the malpractices referred to in the Commission's Report are already guarded against adequately under the law as it stands today. Even the learned members of the Commission themselves, share, and have given expression to, this view. On balance, the need for the further amendments proposed appears, to say the lesat, hardly imperative.

The clauses of the Bill aimed at simplifying some of the numerous procedural requirements scattered over the six hundred and odd sections of the principal Act are to be indeed welcomed, so far as they go. To the vast majority of reasonably-efficiently and honestly managed companies, the working of the Act in the eight years since its enactment in 1956 has

meant a not insignificant incurring of time, effort and expense in attempts to comply with not only the spirit, but also the letter of the various technical requirements of the law. Not all company managements shared the Company Law Administration's belief that all these requirements were really necessary and not just a waste of time and scarce managerial resources which might otherwise have been employed in more productive pursuits in the interests of the nation's economic development. Chambers of Commerce and other spokesmen of business and industry in the corporate sector had, from time to time, made representations to the Authorities regarding the desirability of curtailing purely procedural technicalities. The Institute of Chartered Accountants of India, too, communicated its suggestions for certain amendments to the law in this regard. It is gratifying to note that a number of our suggestions have been found reasonable and acceptable to the Government, and are sought to be effected by appropriate amendments to the Act. It was even more gratifying for me to read in the newspapers on Christmas Eve that, in its 8th Annual Report, (placed on the table of the Rajya Sabha a day earlier), the "Company Law Board has reported a significant shift in its policy and procedure" regarding the prosecution of companies for "offences of a serious nature", and that "the Board is also condoning the small

technical offences of the companies and is not proceeding against them, provided such offences are rectified by them on the advice of the Regional Directors of the Board". This is an overdue change in approach which I had publicly suggested over fifteen months ago. I trust the experience of company managements over the last year's working bears out the justification for the Board's claim. If it does, the Government need to be indeed congratulated on this.

It is those provisions of the Bill which attempt to fulfil the remaining one of the three objectives set out in its Statement of Objects and Reasons, namely, those aimed at providing "for more effective audit in dealing with cases of dishonesty and fraud in the corporate sector", which will need the closest and most careful attention. This was perhaps to have been expected, because it is here that the proposed changes attempt to surge forth into fresh fields and pastures new, such as have perhaps not been essayed by company legislation in most other countries, not excluding those reputed to be among the most advanced industrially.

In their pre-occupation with other more widely-publicised provisions of the Bill (such as those of clause 13 relating to the curbing of the abuses inherent in the system of blank transfers, clause 43 amending section 309 to bring directors' remuneration for services other than *qua*

director within the purview of the section, and clause 46 amending section 370 to make the restrictions on inter-company loans even tighter than those on such investments), business and industry have not found adequate time to consider the serious difficulties and dangers implied in the proposals affecting Accounts and Audit. Clauses 21, 22 and 24 of the Bill, amending sections 209 and 227 and introducing a new section 233B, are those by which company managements, no less than Auditors, are likely to be most affected in their daily work.

"The proposed section 227(1A) contains certain clauses, the drafting of which could have been considerably improved, and the precise implication whereof is far from clear. Clause (b) is possibly the worst offender in both regards. This clause requires every auditor of a company to inquire "whether transactions of the company which are represented merely by book entries conform to normal business practices accepted by established principles of accountancy". This provision seems to be the product of considerably confused thinking.

I am particularly unhappy about the reference to "transactions of the Company which are represented merely by book entries." One can understand what is intended to be conveyed by this expression. It is the sort of cases cited by

the Bose Commission, where large amounts were simultaneously shown in the books of account as received and paid in cash, and shares allotted "for cash consideration", whereas, in fact, there was neither a receipt nor a payment of the amount. In those cases, it will be appreciated, there never was in fact any transaction of the company, but only a fraudulent entry in the books of accounts as if such a transaction had actually taken place. However, in the first place it is not at all clear as to precisely how the Courts will interpret the words: "transactions represented merely by book entries." The transactions of a company are matters of fact. Either a particular transaction does take place, or it does not. The purpose of all "book entries" is to record correctly in the books of account, in monetary terms, such transactions as do in fact take place. If book entries are made purporting to record transactions which in fact never took place, accounts built up from such entries could never disclose a true and fair view of the company's affairs, as the law requires them to do. It will be readily conceded that, if the auditor deliberately refrains from reporting on entries in the books of accounts which purport to record material transactions of the company which, to the auditor's knowledge, never in fact took place, he would be clearly at fault, having failed in his duties under the law, even as it is today. Therefore, it would seem altoge-

ther unnecessary to insert Clause (b) solely to make an auditor inquire into such cases, because there is no doubt that he is already required to do so. The words "transactions which are represented merely by book entries" have been used by the learned draftsmen of the Daphtary-Sastri Report. However, with respect to these eminent persons it is to be pointed out that, if an opportunity is given to them to reconsider this matter in the light of the observations in the Institute's Memorandum and the foregoing remarks, they would be frank enough to admit that they had not intended this expression to be adopted verbatim into the statute.

In the second place, "established principles of accountancy" lay down the correct "book entries" for specific classes of transactions. These principles do not, and cannot, "accept" or reject what are in fact the transactions of a company, irrespective of whether these transactions do, or do not, conform to what has been referred to as "normal business practices". Established principles of accountancy afford guide-lines for truly recording all business transactions, normal or abnormal, prudent and proper or otherwise. Therefore, it is difficult to appreciate how the question of normal business practices being "accepted" or "not accepted" "by established principles of accountancy" can arise.

After considerable thought on this point, I have come to the conclusion that what is intended to be conveyed in Clause (b) is that the auditor should inquire, in the case of transactions of the company for which the main evidence is merely the entry recording the transaction in the books of account, whether such transactions had in fact taken place, and further whether such entry is in accordance with accepted principles of accountancy.

One of the most objectionable provisions of the Bill, — possibly *the* single most objectionable proposal in principle — is that in Clause 22(b), seeking to insert a new sub-section (4A) in section 227. This would empower the Government to direct, by general *or special* orders, that, in specified cases, the auditor's report should contain a statement on such matters as the Government may choose to specify in each case. I consider this power not only, in effect, an unnecessary duplication of existing similar powers to direct a special audit under section 233A, but, more important, an indefensibly excessive delegation of authority to the Executive on matters which should be fully and clearly spelt out in the statute itself.

It will be noted with regret by Chartered Accountants, no less than by the general public, that two groups of amendments which had been

suggested by the Institute are conspicuous by their total omission from the Bill. Of these, the first group sought to rectify shortcomings in Accounting matters noticed in the Act. Amendments to sections 211 and 350 and to Schedule VI had been suggested for this purpose.

The second group of suggested amendments had sought to correct somewhat the existing position, whereby adequate differentiation is not made, either in the statute, or in its administration, between the scope and extent of the regulatory provisions applicable, on the one hand, to companies in which the public has a substantial interest, and, on the other, to non-subsidiary private companies, most of which are small "family" concerns, where no question of the public interest arises. Exemption of the latter category of companies from some of the numerous procedural provisions at present applicable as much to them as to public companies had been urged by the Institute, with a view to encouraging the growing new class of small-scale entrepreneurs to adopt the corporate form of business organisation for their ventures. Thus, for example, it had been suggested that sections 292, 297, 301 and particularly section 314, should not apply to private, non-subsidiary companies. Not only does the Bill omit to provide for this, but an added require-

ment has been imposed—possibly inadvertently—by the proposed amendment of section 370 by clause 46. The Vivian Bose Commission had suggested that inter-company loans should be made subject to the same restrictions at present applicable to inter-company investments and contained in section 372. While clause 46 seeks to amend section 370 accordingly, in fact the draft amendment makes the position much more stringent in the case of loans than for investments. This is because no parallel has been provided in section 370 for the exemptions to section 372 specified in sub-section (14) of that section. Since this apparently never was the intention, it has been suggested that provision for similar exemptions be inserted in section 370. The deletion of the words "or an advance" appearing in section 370(3) has also been recommended, so as not to unduly restrict trade advances, e.g., to suppliers against orders, which are commonly required to be made in the course of normal business activities.

The ideas underlying this review of the trend of recent changes in Company Law affecting Business and Industry may be summed up in the words of the Jenkins Committee's Report thus:

"It is no doubt necessary for the protection of shareholders, creditors and intending investors that the activities of companies and those responsible for their management should be

subject to a considerable degree of statutory regulation and control. But controls and regulations carried to excess may defeat their own object; and we share the views expressed by the Greene and Cohen Committees as to the undesirability of imposing restrictions which would seriously hamper the activities of honest men in order to defeat an occasional wrongdoer, and the importance of not placing unreasonable fetters upon business which is conducted in an efficient and honest manner.

"Accordingly, in our consideration of proposals to impose further statutory restrictions and requirements on companies or their directors, we have asked ourselves whether the new restriction or duty proposed would, if it was made law, improve *to an extent worthy of legislation* the position of the investors or creditors it was designed to protect; *and if so whether its implementation would to any significant extent hamper or impede the company in the efficient conduct of its legitimate business, thus perhaps operating to the detriment of those very persons.*" And again — "The risk (which must not be exaggerated) that dishonest directors may abuse the trust reposed in them must be accepted if business is to go on."

This is the spirit in which changes in our Company Law should,—but I regret have not—been considered and effected.

It has been said that Darwin taught us that evolution is the best kind of change to breed stayers. What we need more than leaders are followers who know where they ought to be led. The followers must be convinced the trip is worth all the fuss and bother. "Far more dangerous than fanatical leaders, are *rabid followers* who put all their faith in a leader, because they have so little faith in themselves."

RECENT TRENDS IN LEGISLATION PERTAINING TO FOREIGN EXCHANGE

S. R. Vakil*

"Now as always, noble and eager schemers for the reorganisation of society have painted beautiful pictures of life as it might be under institutions which their imagination constructs easily. But it is an irresponsible imagination in that it proceeds on the supposed assumption that human nature will, under the new institutions, quickly undergo changes such as cannot reasonably be expected in the course of century, even under favourable conditions. If human nature could thus be ideally transformed, economic chivalry would dominate life."

Marshall—"Principles of Economics," VI, XIII 15.

The Attorney-General of India, Mr. C. K. Daphtary, whilst addressing a meeting of lawyers in Bombay, under the auspices of Western India Advocates Association on 17th June, 1965, observed that law in India was developing without real planning, that laws were being made as whims struck Ministers and not as part of a co-ordinated system....The Legislatures had become law factories. Laws were made and made and made. They were developing like cities of Delhi or Bombay where localities

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sprang up without roads or other conveniences and buildings rose to 20 floors without much space in between!

Acquisition of Foreign Exchange:

No remarks would apply more aptly than the above to the recent trend of amendments in the law relating to Foreign Exchange and Customs. The Foreign Exchange Regulation Act, an emergency measure of 1947, has been amended and amended and amended, the latest by the Central Act LV of 1964 which came into force on 1st April, 1965. The Government, not being content with these amendments, had to invoke the assistance of the Defence of India Rules in between. Rule 132A of the said Rules came into effect on 21st January, 1964, which prohibited acquisition of foreign exchange *in any manner* except through an authorised dealer. The acquisition of foreign exchange whatever the manner of acquisition, whether by way of inheritance, settlement, gift or remuneration for services rendered, scholarship or stipend from a Charitable Trust, was prohibited by the said Rule since 21st January, 1964. If any professional man accepted foreign exchange for services rendered from a non-resident client, he contravened the provisions of the said Rule.

The Government realising, but refusing to admit, as usual, the utter absurdity of such a

prohibition, which *ex facie* violated the fundamental rights guaranteed under Article 19 of the Constitution, made a half-hearted attempt to incorporate similar provisions in section 4 of the Foreign Exchange Regulation Act by prohibiting acquisition of foreign exchange in any manner except from an authorised dealer. The amendment effected by the substantive provision of the section has, however, been nullified by an exemption issued by the Reserve Bank of India.

The Reserve Bank of India realised that such prohibition far from doing any good to the country or its citizens, would act as a deterrent to the legitimate earning of foreign exchange. It has, therefore, issued a notification on 1st April, 1965, being the date on which the Act came into force exempting acquisition of foreign exchange from certain sources. This notification supersedes the provisions of Rule 132A of the Defence of India Rules. Rule 132A as it stood was clearly violative of the fundamental rights guaranteed under Article 19 of the Constitution being an unreasonable restriction "to acquisition holding or disposal of property"—a restriction neither in the interest of the Government nor the citizens.

Under the notification general permission is granted for acquisition of foreign exchange by way of—

(1) Scholarship or stipend, from a Charitable trust or educational institution, foundation or from a foreign Government;

provided the recipient makes a report within 30 days of acquisition of such foreign exchange.

(2) (i) remuneration for services rendered whether in or outside India;

(ii) income on assets held outside India;

(iii) settlement of any lawful obligation; or

(iv) inheritance settlement or gift: provided the amount so acquired is surrendered within 30 days of its receipt to an authorised dealer against payment in rupees. This obligation, however, is relaxed in case of persons resident outside India to the extent of foreign exchange owned by them when they cease to be persons resident outside India.

Prior to 1st April, 1965, under the Foreign Exchange Regulation Act (apart from the restrictions imposed by the Defence of India Rule

132A), the only prohibitions in respect of dealings in foreign exchange were (a) buying; (b) borrowing; (c) selling; (d) lending or (e) exchanging with a person other than an authorised dealer. On a careful consideration of the notification, it would appear that the restrictions imposed by the amendment of the Section are set at nought by the Reserve Bank notification. It is difficult to conceive of any legitimate modes of acquisition of foreign exchange other than those set out in the notification.

This notification, *inter alia,* permits acquisition of foreign exchange by way of remuneration for services rendered outside India, provided that, such foreign exchange is offered or caused to be offered for sale to an authorised dealer against payment in rupees within 30 days of its receipt. Section 5(2) of the Act specifically provides that nothing in sub-section (1) thereof shall render unlawful, the making of any payment, out of foreign exchange earned by way of salary or other payment for services, not arising from business in or anything done while in India. Under section 5(2) of the Act, therefore, it is in order for any person to make payment to any person resident outside India, out of foreign exchange received by way of salary or remuneration for services rendered outside India, e.g. payment of hotel bills abroad, or payment to any non-resident abroad for ser-

vices rendered, or payment for purchase of any articles.

The notification issued under section 4 of the Act is, to the extent that it imposes an obligation to surrender the entire foreign exchange earned outside India, by a person resident in India, whilst he may be temporarily abroad, is clearly inconsistent with the express provisions of section 5(2) of the Act. Notwithstanding the provisions of the notification, it will be lawful for any person resident in India receiving remuneration for services rendered outside India, whilst temporarily abroad, to make any payment out of such foreign exchange to any person resident outside India and the obligation to surrender or offer for sale shall only be restricted to the balance left in his hands when he returns to India.

The gravamen of the notification is that it casts an obligation to sell or cause to be offered for sale foreign exchange earned by you within 30 days after receipt; which foreign exchange is not restricted to any country, whether it is a freely convertible currency allowing such repatriation or a dictatorially controlled currency where for an attempt to repatriate death is decreed. The notification issued under section 4, the substantive provisions of section 5(2) and the notification issued under section 9 of the

Act, provide a glorious example of experimental legislation "full of sound and fury" introduced in "vacant or in pensive mood". They exhibit callous disregard to consistency and reflect total misapplication and supreme indifference of the minds of the draftsmen and legislators who seem to be under the impression that they are governing a flock of forty crores of bleating sheep and not human beings. The Attorney-General has rightly observed "we have lost initiative and adopted the attitude of looking to the Government to do everything for us."

Emigration facilities

The next aspect which I shall deal with is grant of emigration facilities.

Prior to 1st July, 1957, Indian nationals (including persons domiciled in India) emigrating to a Sterling Area country were allowed to transfer their assets in full at the time of emigration. After 1st July, 1957, upto 12th March, 1960, Indian nationals emigrating to Sterling Area countries were only allowed to transfer a sum not exceeding Rs. 2,00,000|- in the case of each family at the time of their departure. The remaining assets were to be held in India but remittance of income on such assets was allowed in full.

On 12th March, 1960, the Reserve Bank of India reduced the limit of the transfer of capi-

tal assets to Rs. 50,000|- and with immediate effect from the said date Indian nationals including persons domiciled in India who wished to emigrate to any country outside India were allowed to transfer a sum not exceeding Rs. 50,000|- in the case of each family at the time of their departure. Any assets remaining in India in excess of Rs. 50,000|- were blocked and remittance of income on such assets was allowed in full but no further transfer of capital was permitted. As from the said date, viz. 12th March, 1960, accounts of Indian nationals including persons domiciled in India who had already migrated from India were blocked—even if the actual amount transferred by such emigrants was less than the emigration quota of Rs. 50,000|-.

By a circular dated 3rd October, 1962, the Reserve Bank of India intimated authorised dealers that all emigration facilities granted up to the said date to Indian nationals including persons domiciled in India were withdrawn "at present".

The position today is that no emigration facilities are available to anyone who wishes to emigrate. The Reserve Bank will not allow transfer of capital or transfer of income if anyone chooses to emigrate. Obviously, circumstances prevailing in the country have proved

too adverse for emigration concessions to remain in force. Bad internal administration, severe inflation within the country and large-scale surreptitious smuggling of gold, wrist watches and other articles of luxury have denuded it of external resources, with the result that the country can hardly find sufficient foreign exchange with which to pay for its minimum essential purchases abroad and is quite unable to find foreign currency required to meet financial remittances for emigration.

Gold Control

The next aspect which I propose to touch is gold control. Whilst the Foreign Exchange Regulation Act prohibits import of gold in any form in India (except to a limited extent in respect of jewellery made wholly or mainly of gold), the Gold Control Order prohibits possession of gold in any form other than jewellery unless it is declared before the appropriate authorities.

The net effect of the Gold Control Rules has been:

(a) steady increase in surreptitious smuggling of gold throughout the length and breadth of the country;

(b) continuous unemployment of artisans and goldsmiths;

(c) diversion of black market money which was invested in gold to real properties with unprecedented rise of prices in lands throughout the country;

(d) unheard of black market in lands and commodities particularly in big cities like Bombay, Calcutta, Delhi and other commercial centres;

(e) steady fall of rupee and rise in value of foreign currency in black market;

(f) flight of capital from India to other countries like Switzerland;

(g) destruction of rural credit;

(h) creation of a new bureaucracy, new forms of corruption and new expenditure, and loss to the public exchequer revenue, lakhs of rupees in the way of sales tax and income-tax which would have come to the country from the earnings of honest goldsmiths and gold dealers of this country.

The experiment has been a dismal failure but the Government will never admit its failure. The economy of the country has been dwindling to such an extent that a parallel Government in cash dealing which is a real jeopardy to the country is gathering momentum. A new wave of rising prices has swept over India where the

Honourable the then Union Finance Minister expected hopeful return to currency stability. Under the impact of so-called prosperity, wages have increased and taxes have risen as also prices of all products and the purchasing power of the Indian Rupee has been coldly reduced. The mournful truth (which will never be confessed by the Government) remains that gold continues to be smuggled into India on an unprecedented scale — most of the smuggling being conducted under the barter system, in exchange for supply of commodities like opium, cloth, tea, kirana and Indian coins of the denominations of 50 Paise and 25 Paise.

The price of a gold Sovereign today is Rs. 100|-. Correspondingly, the Sterling is quoted at Rs. 25 and USA dollar at Rs. 9.25P. What good gold control has achieved lies hidden in official pigeonholes and confidential portfolios of the Government of India. The experiment has proved a miserable failure in the context of the country's economy and peoples' outlook towards the yellow metal, where hoarding thereof is personal and traditional and the illiterate as well as the educated desire to have an insurance against national currency failing.

Holding of Foreign Exchange

The next aspect which I propose to deal with is the aspect relating to restrictions in respect of

holding of foreign exchange by Indian Nationals. There are three distinct landmarks:

(i) 25th March, 1947, to 25th September, 1958: Under Notification No. 12(13)F1|47 dated 25th March, 1947, the only obligation which was cast upon a person was to surrender the currency of the United States of America and Philippine Islands of which a person was or became owner to authorised dealers specified in the Notification No. FERA|10|47-RB of even date. The notification was limited in its operation so far as currency was concerned, viz., it only applied to the currencies of the United States of America and the Philippines, i.e., dollar balances. There was no obligation cast upon any one to surrender foreign exchange of any other country acquired in any manner until the promulgation of the notification dated 25th September, 1958, with the result that between 25th March, 1947, and 25th September, 1958, it was perfectly legitimate for anyone to utilise foreign exchange, other than U.S. Dollars, acquired by him in any manner he pleased.

(ii) 25th September, 1958, to 6th April, 1960: Under the Notification dated 25th September, 1958, as originally enacted, it was obligatory upon all persons who became owners of foreign exchange or who owned foreign exchange, of the categories specified in the Schedule, to surrender

the same within one month. Under the 4th provision to the said notification, however, "any sum held in an account expressed in pounds sterling provided that such account was in existence prior to 8th July, 1947" was exempted. What was exempted under the said notification was any amount provided the account was in existence prior to 8th July, 1947, viz., a pre-zero account. Since the said notification exempted an account, and not any particular amount, the Reserve Bank of India realised that the notification was likely to be abused by people who had pre-zero accounts.

(iii) 6th April, 1960 to date: On 6th April, 1960, the aforesaid exemption was modified so as to exempt only "any sum held as on 8th July, 1947, in an account expressed in pounds sterling and existence prior to that date". The effect of the amendment is, therefore, to modify or restrict the exemption to the extent of the amount held as on 8th July, 1947. What is exempted now is the amount held on 8th July, 1947, as distinct from what was originally exempted, viz., the account.

I shall now deal with the mode of enforcement of Exchange Control laws. For the purpose of gathering facts, power is conferred upon the Government and the Reserve Bank of India to issue Directives. The substantive provisions are contained in section 19(2) of the Foreign Ex-

change Regulation Act. If the Central Government or the Reserve Bank of India consider it necessary or expedient to obtain and examine any information, book or other document either in possession of a person, or in the opinion of the Central Government or the Reserve Bank it is possible for such person to obtain and furnish, the Central Government or the Reserve Bank of India may, by an order, in writing, require such person to furnish, or obtain and furnish, to the Central Government or to the Reserve Bank or any person specified in the order, such information, book or other document. It is to be remembered that the Central Government or the Reserve Bank can, not only call upon a person to furnish information, book or document in his possession, but also call upon him to obtain and furnish information, book or other document if they are of opinion that it is possible for such person to obtain and furnish the same. A person upon whom a valid order or direction under this section is issued is obliged to comply with the same and on his failure to comply, he will be liable to be prosecuted and punished under section 23(1A) of the Act, the punishment being imprisonment for two years or unlimited fine or both. Prior to 1st April, 1965, if a person failed to comply with an order or direction issued under section 19(2), the maximum punishment was a fine of Rs. 2,000|- after prosecution.

Does Section 19(2) offend the provisions of Article 20(3) of the Constitution?

Article 20(3) of the Constitution provides that no person accused of any offence shall be compelled to be a witness against himself. The question which would require serious consideration is whether the provisions of section 19(2) amount to testimonial compulsion by a person accused of an offence. This section may be invoked at any of the following six stages:

(a) prior to investigation of an alleged offence;

(b) in the course of investigation of an alleged offence;

(c) after the issue of a search warrant under section 19D;

(d) after the search of a person suspected of an offence under section 19A;

(e) at any stage after such search warrant or arrest before preferring a charge in a Court of Law or issue of a notice proposing to adopt adjudication proceedings;

(f) after a person is arrested under Section 19J.

It would appear that once an accusation is preferred against a person in a Court of Law or otherwise or adjudication proceedings against him commence, Article 20(3) of the Constitution would apply and the provisions of Section 19(2) of the Act seeking compulsory production of documents or information from such person would be violative of the rights guaranteed under the Constitution inasmuch as enforcement of any direction or order under the circumstances would tantamount to testimonial compulsion. *

Enforcement Officers

The next aspect which I propose to deal with pertains to conferment of police powers upon Enforcement Officers.

The Amendment Act of 1964 has conferred police powers upon Enforcement Officers. By putting the Enforcement Officers practically on the same level as police officers for enforcement of the provisions of the Act, one more Police Establishment has been added to the already

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* The above view is now fortified by the Judgement of the Supreme Court reported in AIR 1965, S. C. (August Issue) page 125.

existing State Police, Special Police Establishment, Central Investigation Bureau, Customs, Central Excise, Income-tax and Sales-tax. Here also the draftsman blindly copied the provisions of the Customs Act without realising that some of such powers were already in existence. The changing pattern is a vivid reminder of the immortal words of Nigeria's President Nnamali: "If independence means substitution of indigenous tyranny for alien rule, then those who struggled for independence have not only desecrated the cause of freedom but have betrayed their people".

The Supreme Court, by a majority judgment (Kapoor and Raghubar Dayal, J. J. Subbarao J. dissenting) held that a Customs Officer was not primarily concerned with the detection and punishment of crimes committed by a person but was mainly interested in the detection and prevention of smuggling of goods and safeguarding the recovery of customs duties. He was more concerned with the goods and customs duty than with the offender. They further held that the duties of Customs Officers were very much different from those of Police Officers and their possessing certain powers which may have similarity with those of Police Officers, for the purpose of detecting smuggling of goods and persons

responsible for it would not make them Police Officers merely because similar powers in regard to detection of infractions of Customs Laws have been conferred on Officers of Customs Department as are conferred on Officers of Police and that a statement made before a Customs Officer was not a statement made before a Police Officer within the meaning of Section 25 of the Evidence Act.

Mr. Justice Subba Rao in a dissenting judgment, however, held that the reasoning which excluded the one from evidence would apply equally to the other, if both statements are made under similar circumstances. After analysing the various provisions of the Sea Customs Act, Mr. Justice Subba Rao came to the conclusion that a Customs Officer was a Police Officer *qua* his police functions and that a confession made to him could not be proved against a person accused of an offence. This judgment was followed in Soni Vallabhdas v. Assistant Collector of Customs, 1965, 1 S.C.J. p. 208.

The question again arose in the Supreme Court in Rajaram Jeswal v. State of Bihar (A.I.R. 1964 Supreme Court, page 828) whether an Inspector or Sub-Inspector of Excise empowered to

investigate any offence punishable under the Bihar and Orissa Excise Act was a Police Officer. Mr. Justice Subba Rao and Mr. Justice Mudholkar by a majority judgment came to the conclusion that since powers of investigating into offences which a Police Officer enjoys are conferred upon Inspectors and Sub-Inspectors of Excise by the Bihar and Orissa Excise Act, they were Police Officers and any statement made before such an Officer was inadmissible in evidence. Their Lordships further held that it is the power of investigation which establishes a direct relationship with the prohibition enacted in section 25 of the Evidence Act. This judgment was delivered on 4th April, 1963. Unfortunately, the fact that the Sea Customs Act, 1878, was repealed by the Customs Act, 1962, and was no longer in force and the new Customs Act, 1962, had come into force on the 1st February, 1963, was not brought to the notice of the Learned Judges, the Act having received the assent of the President as far back as 13th December 1962. The Learned Judges further held that unlike the Customs Officer under the Sea Customs Act on whom powers of a limited character which were analogous to those conferred upon Police Officers, powers conferred on an Excise Officer were wider. The reasoning of the Learned Judges is that the existence of the power to grant bail in an officer-in-charge of a Police Station itself enables him to exercise authority over the arrested person and

influences his conduct if he so wishes. Their Lordships further held that the Customs Officer had power to seize anything liable to confiscation but was liable on demand of the person in charge of the thing so seized to give him a statement in writing of the reason for such seizure. On a consideration of the above provisions, Their Lordships came to the conclusion that the powers of investigation into offences which a Police Officer enjoys were not conferred upon a Customs Officer.

As stated above, it was unfortunate that the fact that the new Customs Act was already in force was not brought to the notice of the Learned Judges or probably when the matter was argued, the Act was not in force. The New Customs Act confers upon a Customs Officer the power of arrest under section 104(1) and under section 104(3) an Officer of Customs who has arrested a person, he shall for the purpose of releasing such person on bail or otherwise have the same powers and be subject to the same provisions as the officer-in-charge of a Police Station has, and is subject to, under the Code of Criminal Procedure, 1898. Moreover, under section 110 of the new Customs Act, there is no obligation upon the Officer to give reasons for seizure.

If, therefore, the test laid down by the Supreme Court in Rajaram's case applies, there is

no doubt that Customs Officers under the new Act are Police Officers and any statement made to them would be hit by section 25 of the Evidence Act as statements made to Police Officers.

Applying the aforesaid test, the powers conferred upon an Enforcement Officer under the Foreign Exchange Regulation Act are:

(a) power to search suspected persons (Section 19A);

(b) power to arrest a person (Section 19B), clause (1);

(c) power to release on bail or otherwise subject to the same powers as an officer-in-charge of a Police Station under the Code of Criminal Procedure [Section 19B(3)];

(d) power to stop and search conveyances (19C);

(e) power to search premises (19D).

On a proper consideration of the aforesaid provisions, as well as powers conferred upon Officers of Enforcement under the Defence of India Rules, there is no doubt that the position of an Enforcement Officer so far as offences under the Foreign Exchange Regulation Act are concerned, is not different from that of an officer in charge of a Police Station. As regards these

offences, there is no distinction in the nature of the powers he exercises and those which a Police Officer exercises in relation to offences which it is his duty to prevent and bring to light. It would, therefore, be logical to hold that a confession recorded by an Enforcement Officer during an investigation into an exchange control offence cannot reasonably be regarded as anything different from a confession to a Police Officer, for, in conducting investigations, he exercises all the powers of the Police Officer including a power to arrest and release him on bail. The Enforcement Officer is subject to the same provisions as the Officer in charge of a Police Station is and is subject to the provisions of the Code of Criminal Procedure, 1898, even though he does not belong to the police force constituted under the Police Act. The test would be whether the powers which are conferred are such as would tend to facilitate the obtaining by him of a confession from a suspect or a delinquent. If they do, then it is unnecessary to consider the dominant purpose for which he is appointed or the question as to what other powers he enjoys.

On a proper appreciation of the relevant provisions of the amended Act, it will be difficult for a court to hold that an Enforcement Officer is not a Police Officer within the meaning of that term as used in section 25 of the Evidence Act

and any confession made to him should be considered inadmissible in evidence.

Penalties for offences

The next aspect to be noticed pertains to penalties for offences. The Amendment Acts of 1957 and 1964 effect radical changes relating to procedure for adjudication and penalty. Prior to the amendments any contravention of the provisions of the Act, rules or directions attracted a prosecution and the maximum punishment was two years' imprisonment and unlimited fine. The result of the amendments is:

(a) In cases of contraventions of provisions of sections 4, 5, 9, 10, 12(2), 17, 18A, 18B or any rules, notifications or directions made thereunder, adjudication proceedings can be held by the Director of Enforcement resulting in penalty to the extent of three times the value of the foreign exchange in respect of which the contravention has taken place or Rs. 5,000|- whichever is more as may be adjudged by the Director of Enforcement.

(b) Alternatively, a discretion is vested in the Director of Enforcement to file a complaint in a Court having jurisdiction.

(c) In the event of failure of payment of the penalty which may be imposed,

under section 23F, a complaint can be filed to the Court having jurisdiction and the defaulting party convicted and sentenced to two years' imprisonment or fine or both. It is curious that the Act prescribes no mode for recovery of penalty that may be adjudicated by the Director of Enforcement. A provision analogous to section 142 of the Customs Act ought to have been introduced in the Act.

(d) In cases of contravention of any of the provisions of the Act, rule, direction or order other than those referred to above, the party can be prosecuted and punished after a complaint is filed in an appropriate Court having jurisdiction in the matter.

Unfettered discretion is vested in the Director of Enforcement to decide at any stage of the proceedings to stop the adjudication and refer the matter to a Court of Law.

The question then is: Does the amended section violate the provisions of Article 14 of the Constitution? There were two possible views on this aspect before the judgment of the Supreme Court in Shanti Prasad Jain's case.

The first view: The section violates the provisions of Article 14: It appears that naked

arbitrary and unfettered discretion is vested in the Government and the Director of Enforcement to decide as to which cases would be adjudicated upon and which cases would be referred to a Court of Law. At any such stage, the Director has a right to stop adjudication proceedings and refer the matter to a Court of Law. He is not bound to record any reasons for a reference and he has authority to pass a peremptory order stopping adjudication proceedings without any warning. After all, for whose benefit was the Constitution enacted? What was the point of making all this pother about fundamental rights? A constitution is not for the exclusive benefit of the Government and States. It is not only for lawyers and politicians and officials and those highly placed but it also exists for the common man, for the poor and the humble, for those who have business at stake, for the "butcher, the baker and the candlestick maker". It lays down for this land a rule of law as understood in the free democracies of the world. The heart and core of a democracy lies in the judicial process and that means independent and fearless judges, free from executive control, brought up in judicial traditions and trained to judicial ways of working and thinking. The main bulwarks of liberty and freedom lie there and it is clear that uncontrolled powers of discrimination in matters that seriously affect the life and properties of people cannot be left to executive or quasi-execu-

tive bodies even if they exercise quasi-judicial functions because they are then invested with an authority that even Parliament does not possess. In a democracy functioning under the Rule of Law, it is not enough to do justice or to do the right thing; justice must be seen to be done and a satisfaction and sense of security engendered in the minds of the people at large in place of a vague uneasiness that Star Chambers are arising in this land — (A.I.R. 1956 Supreme Court, pages 485, 486).

The second view: The amendment does not violate the provisions of Article 14: The provisions of Section 23 no doubt confer an absolute and unfettered right on the Government and the Director of Enforcement to decide whether a particular case should be adjudicated upon departmentally or should go to a Court of Law. At any stage of the inquiry after the adjudication proceedings start, the Director of Enforcement has an authority to make a complaint in writing to the Court if he is of opinion that having regard to all the circumstances of the case, the penalty which he is empowered to impose would not be adequate. If an executive authority or a quasi-judicial authority were to be given the right to determine these matters to their subjective satisfaction, a serious doubt arises whether there is any meaning of the fundamental rights, for the Courts would then be powerless to interfere and

determine whether those rights have been infringed. It is arguable that the section is not violative of Article 14 of the Constitution. If there is any abuse of power, it can be remedied by appropriate action either under Article 226 or under Article 32 of the Constitution and what can be struck down is not the provisions in section 23 of the Act but the order passed thereunder which may be *mala fide* or violative of these fundamental rights. It may be argued that though discretionary powers have been given to the Government and the Director of Enforcement, nevertheless they have to be exercised in a manner which is not discriminatory. No rules or directions having been laid down in regard to the exercise of that power in particular cases, the Government and the Director have to determine what are the proper cases in which such power should be exercised having regard to the object of the Act and the ends to be achieved. The cases of suspects which come for adjudication before the Director of Enforcement are of various types and no one case is similar to another. There are complications introduced by the very nature of the provisions of the Act, e.g., section 20, sub-clauses (d) and (e). There may be difficulty in proving in a Court of Law due to stringent laws of the rules of evidence an offence beyond reasonable doubt. The Director has to exercise his discretion with due regard to the scope and object of the Act. Even if there is a possibility of

a discriminatory treatment of persons falling within the same group or category, such possibility cannot necessarily invalidate the piece of legislation. It is also to be remembered that this power is vested not in minor officials but in the Director of Enforcement. This power may be discretionary and not necessarily discriminatory. An abuse of power cannot be easily assumed. Discretion is vested in a high Official. There is moreover a presumption that public officials will discharge their duties honestly and in accordance with the Rules of Law. This presumption however cannot be stressed too far. It cannot be held that there must be some undisclosed or unknown reason for subjecting certain individuals or corporations to hostile and discriminatory treatment. There may be cases where improper execution of discretion will result in injustice to the party. However the possibility of such discriminatory treatment may not necessarily invalidate the legislation and where there is an abuse of such power, the parties aggrieved are not without ample remedies under the law. What will be struck down in such cases will not be the provision which invests the authorities with such power but the abuse of the power itself. Though the burden of proving an abuse of power lies on the party averring so, such burden is not by way of proof to the hilt. If in a particular case, a party seeks to impeach the order of reference to the Court as an abuse of power

pointing out circumstances which *prima facie* and without anything more would make out the exercise of the power discriminatory *qua* him, it will be incumbent upon the Director of Enforcement to explain the circumstances under which the order has been made. The Court will in that event scrutinise these circumstances having particular regard to the object sought to be achieved by the Amendment Act and come to its own conclusion as to the *bona fides* of the order and if it is not satisfied that the order was made in *bona fide* exercise of the powers vested in him by the Director of Enforcement, it will certainly quash the same. The standard of satisfaction which would have to be attained will necessarily depend on the circumstances of each case and the Court will arrive at the conclusion one way or the other having regard to all the circumstances of the case disclosed in the record. The Court will certainly not be powerless to strike down the abuse of power in appropriate cases and an aggrieved party will not be without redress. Even though the Director of Enforcement may purport to act under the Act, his action will be subject to scrutiny in the manner indicated above and will be liable to be set aside if it was found to be *mala fide* or discriminatory *qua* the aggrieved party. It may further be argued that an offender has no fundamental right to call upon the Director to adjudicate and not refer the matter to the Court.

The Supreme Court's view: The Supreme Court has in Shanti Prasad Jain v. The Director of Enforcement (A.I.R. 1962 S.C. 1764) held that the section does not violate the fundamental rights guaranteed by Article 14 of the Constitution. According to the Supreme Court, foreign exchange has features and problems peculiarly its own, and it forms a class in itself. A law which prescribes a special procedure for investigation of breaches of foreign exchange regulations will, therefore, be not hit by Article 14 as it is based on a classification which has a just and reasonable relation to the object of the legislation. The vires of Section 23(1)(a) of the Act is accordingly not open to attack on the ground that it is governed by a procedure different from that prescribed by the Code of Criminal Procedure. There is no difference in the legal position by reason of the fact that Section 23D provides for transfer by the Director of Enforcement of cases which he can try, to the Court. Section 23D confers authority on the very officer who has power to try and dispose of a case to send it on for trial to a court, and that too only when he considers that a more severe punishment, than what he is authorised to impose, should be awarded. In a Judicial system, in which there is a hierarchy of Courts or Tribunals, presided over by magistrates or officers belonging to different classes, and there is a devolution of powers among them graded according to their

class, a provision such as Section 23D is necessary for proper administration of justice. Thus, power conferred on the Director of Enforcement under Section 23D to transfer cases to a Court is not unguided or arbitrary, and does not offend Article 14 and Section 23(1)(a) cannot be assailed as unconstitutional.

The fact remains that the power which is vested in the Government and the Director of Enforcement is an arbitrary power, unfettered, unguided or uncontrolled so as to enable them to pick and choose one offender out of those similarly circumstanced subjecting him to discriminatory treatment as compared with others who fall within the same category. The subjective test, viz., a penalty which he is empowered to impose would not be adequate, is no safeguard. If the proceedings are taken before a Court, the Court has in respect of such proceedings the powers of a Magistrate of the First Class in relation to criminal trials and has to follow in all respects the procedure provided for trials before such Magistrate in the Code of Criminal Procedure, 1898, but in passing a sentence of fine it has unlimited powers. An accused person, so proceeded against, may, if convicted, be punished with imprisonment which may extend to two years or with unlimited amount of fine or with both. If, on the other hand, the proceedings are taken before the Director of Enforcement, the

offender cannot be required to pay as penalty a sum exceeding three times the value of the foreign exchange involved in the offence committed or rupees five thousand, whichever is more, and there can be no sentence of imprisonment. There is no procedure prescribed for recovery of penalty. From a closer examination of the relative provisions governing each of the two modes, the situation that emerges is:

(1) That for offences under Sections 4, 5, 9, 10, 12(2), 17, 18A, 18B or any rule, direction or order made thereunder, an offender can be proceeded against either in a Criminal Court under the ordinary law or before a Director of Enforcement.

(2) When proceeded against under the ordinary law, the sentence on conviction may be that of imprisonment, and of fine in any amount.

(3) If the accused is proceeded against before a Director of Enforcement, he cannot be sentenced to imprisonment and the maximum penalty that can be imposed upon him cannot exceed three times the value of the foreign exchange involved in the commission of the offence or rupees five thousand whatever is more. The language of the penal section is to be noted, for in offences under Sections 5, 9, 10, 12(2), 17, 18A and 18B if the Indian currency is involved, whatever may be the amount involved, the maxi-

mum penalty would be Rs. 5,000|- for the "Yardstick" of three times only applies to foreign exchange.

(4) Whether a person is to be tried under the ordinary law or placed before a Director of Enforcement depends on the will of the Central Government, i.e., the Finance Department which administers this branch of Law.

(5) The Central Government itself has an uncontrolled, unfettered and unrestricted power to decide how each offender has to be dealt with.

(6) Under the proviso to Section 23D(1), the Director of Enforcement has absolute uncontrolled and unfettered discretion, if he is of opinion that having regard to the circumstances of the case, the penalty which he is empowered to impose would not be adequate, instead of imposing any penalty, himself, to make a complaint in writing to the Court.

(7) Section 23 expressly permits that a person accused of a contravention of the Act may be proceeded against under the ordinary law or before the Director of Enforcement. On a true construction of this section, both the Court and the Director of Enforcement were intended by the Act to function side by side in respect of similar offences against offenders similarly placed. If the intention had been of conferring

exclusive jurisdiction on each of these two authorities in a particular class of cases, Section 23 would not have been worded as it is and such jurisdiction would either have been stated or permitted to be stated by rules and not made to depend on the mere will of the Central Government or the Director of Enforcement.

(8) If these authorities are functioning simultaneously, the result cannot but be discriminatory, because while a person who is proceeded against before a Director of Enforcement escapes merely by paying a penalty the maximum of which is limited to three times the value of the foreign exchange involved, or rupees five thousand, whichever is more, a person placed before a Court will, if convicted, receive a sentence of imprisonment and|or may be ordered to pay fine in any amount, or may not get a sentence of imprisonment at all.

(9) If, therefore, the Act is administered in its true spirit, discrimination must result from the action taken by the Director of Enforcement, which action is not subjected to rules or restrictions and is the result of the mere will of the Government or Director of Enforcement. Indeed, it may well be said, in the word of Derbyshire, C.J. of the Supreme Court of Pakistan, that the Central Government makes procedural "legislation *ad hoc* for the man's case".

(10) The contention that it could not be said that discretion had not been exercised in a fair and reasonable manner by the Government in electing to send certain cases to a Court, on the allegations that the cases were of a serious character, and merited severe punishment, the mischief of the Act is, however, not susceptible of so simple a cure. The Act confers discretion of a very wide character upon the Director to act in relation to subjects falling within the same class in two different modes varying greatly in severity. By furnishing no guidance whatsoever in regard to the exercise of this discretion, the Act, on the one hand, leaves the subject, falling within its provisions, at the mercy of the arbitrary will of the authority concerned and, on the other hand, clearly makes the fundamental right to equality of treatment under the Constitution illusory.

(11) The Constitution declares in Article 14 that the State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India. The duty of declaring a law as void, for violating a fundamental right defined rests on the Courts. That duty cannot be performed, so as to ensure that a law operates equally in relation to all persons within its mischief, if the law itself provides for differential operation in relation to such persons, not in accordance with any principle ex-

pressed or implicit in the law, not on the basis of any classification made by or under the law, but according to the unfettered discretion of the Director of Enforcement constituted as a statutory authority.

(12) Here, not only is there unfettered discretion in the Director of Enforcement, whether he will proceed at all against any member of the class concerned, viz., offenders against the Act, but there is also an unfettered choice to pursue the offence in any one of two different modes which vary greatly in relation to the opportunity allowed to the alleged offender to clear himself, as well as to the quantum and nature of the penalty which he may incur. In the absence of any discernible principle guiding the choice of forum, among the two provided by the law, the choice must always be, in the judicial viewpoint, arbitrary to a greater or less degree. The Act, as it is framed, makes provision for discrimination between persons falling, *qua* its terms, in the same class, and it does so in such a manner as to render it impossible for the Courts to determine, in a particular case, whether it is being applied with strict regard to the requirements of Article 14 of the Constitution.

(13) The section has the effect of doing indirectly, i.e., by leaving the discrimination within the unguided and unfettered discretion of statutory authorities, what it could not do directly,

i.e., to treat unequally, persons falling within the same class, upon a basis which bears no reasonable relation to the purposes of the law. The Act is, therefore, in relation to its discriminatory provisions, inconsistent with the declaration of equality in Article 14 of the Constitution.

(14) If the question had arisen in the United States of America, the section would undoubtedly have been held violative both of the "due process" clause and the "equal protection of the law" clause of the Constitution.

However, the judgment of the Supreme Court is final and binding and lays down the law of the land.

Appeal to the Court

Another highlight of the Amendment Act is the introduction of Section 23EE by conferring upon an aggrieved party a right of appeal to the High Court from the order of the Foreign Exchange Appellate Board on a question of law. The amendment does not specify the "High Court" to which the appeal would lie nor the period of limitation. This is another classical example of legislation introduced in a vacant mood.

The position in short is that it is conceded by the Government that our Foreign Exchange position is critical and, therefore, the laws are being tightened up.

Mr. T. T. Krishnamachari, the Union Finance Minister, in the second week of June, 1965, observed that as long as he was in power, the country would not be insolvent. *Res ipsa loquitor.*

Mr. Lal Bahadur Shastri, our Prime Minister, in the course of his speech to Indian students at Church West, Westminister, on the 20th June, 1965, said that although India would be depending on foreign loans to finance her fourth plan, he was optimistic that in *less than* 15 *years*, these debts would be paid off and the country would be economically stable. Mr. Shastri further stated "if you want progress, the country will have to make a sacrifice and our generation will have to give up something of themselves to build up the future generation in India".

Mr. Shastri appears to be extremely optimistic. He probably is not aware of the actual figures and his statement is an eyewash to those who are not aware of facts and figures.

At the time of partition, out of foreign balances which undivided India had, viz., Rs. 1,800 crores, Rs. 1,300 crores were allotted to India and Rs. 500 crores to Pakistan. By 1951, we had lost not only our entire Rs. 1,300 crores in foreign exchange but we began our First Plan with a foreign exchange debt of Rs. 57 crores. This increased to Rs. 140 crores at the end of the First Plan and in the last year, our foreign obligations repayable in foreign currency to non-nationals

amounted to Rs. 2,041 crores. By the end of the Third Plan, this foreign debt will exceed Rs. 2,500 crores if not more. Whilst this foreign assistance was most essential in the context of economic development, it is significant that 60% of this assistance came from U.S.A. and 7½% from Russia and her satellites. It has been said that more than 60% of the borrowing from the World Bank has been employed in the Public Sector projects. If the Government is genuinely honest to stand by the aforesaid optimism of Mr. Shastri, what is most essential at this stage is to set up a Commission of Inquiry of impartial observers about the capacity of these projects to bear the interest charges and instalment repayments of foreign exchange, rather than hold out a bare pious hope of paying off all debts in 15 years.

A Government that cannot realise its errors can never have either a chance or opportunity to rectify the same.

In the words of Alexander Pope, "A man should never be ashamed to say he has been in the wrong, which is but saying in other words, he is wiser today than he was yesterday." May we, who claim to be human beings — have the moral courage to own our mistakes and to undo our wrongs — before it is too late — and thereby admit that we are wiser today than what we were yesterday!

THE SALES TAX LAW

N. C. Mehta*

Sales tax has come to stay. It is getting a more and more important place in the armoury of State revenues, firstly, because it has proved to be the most lucrative source of revenue and, secondly, because it is the most elastic source. By *minor adjustments* in the nature of upward revision of rates or restriction of the categories of exempted goods and sales and lowering down of the minimum turnover limit for the fixation of a dealer's liability, the desired revenue is obtained. Again, with the ever-increasing volume of internal trade, the yield from this tax has ever been on an increase.

Figures available from the Reserve Bank of India's reports are for the revenue from taxes on commodities and services such as state excise, entertainment tax, electricity duties etc. State-wise yields from taxes on commodities are not available. However, they still afford a good comparison. Figures are in percentage of the total tax revenue.

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State	1961-62 (Accounts)	1962-62 (Accounts	1963-64 (Revised)	1964-65 (Budget)
	%	%	%	%
Andhra Pradesh....	62 100	59 116	61 134	62 140
Assam. ...	57 100	56 115	57 137	57 156
Bihar. ...	54 100	54 127	61 148	62 163
Gujarat. ...	63 100	70 117	72 135	72 143
Jammu & Kashmir.	49 100	70 201	69 219	73 273
Kerala.	67 100	71 125	75 159	75 169
Madhya Pradesh....	57 100	62 125	64 158	67 181
Madras. ...	64 100	71 123	71 148	73 159
Maharashtra. ...	74 100	72 123	74 155	77 133
Mysore. ...	65 100	68 126	65 147	69 156
Orissa. ...	58 190	69 166	69 194	70 204
Punjab. ...	62 100	64 125	68 158	70 162
Rajasthan. ...	51 100	58 143	63 176	69 186
West Bengal. ...	68 100	67 115	69 135	69 139
Uttar Pradesh. ...	52 100	55 122	55 155	59 143

If we compare revenue of all the States together from general sales tax, the position is as follows:

	1961-62 (Accounts)	1962-63 (Accounts)	1963-64 (Revised)	1964-65 (Budget)
	%	%	%	%
Percentage of revenue from general sales tax as compared to total tax revenue.	25 100	21 115	26 145	27 155

Maharashtra State:

1960-61 (Accounts)	1961-62 (Accounts)	1962-63 (Accounts)	1963-64 Revised Estimates	1964-65 Budget Estimates
Lakhs	Lakhs	Lakhs	Lakhs	Lakhs
32,15	35,03	40,57	53,01	55,56
79,94	73,99	91,19	1,12,53	1,15,31
40%	47%	43%	47%	48%

Though the revenue-yielding profiability of sales tax in India and outside world has been recognised only recently, it would be of interest to note that even in ancient times sales tax was not unknown. In India itself, references to the use of sales tax can be traced back to the days of Mauryas as is found in Kautilya's "Artha Shastra". In Europe, in Roman times general sales tax was introduced by Augustus. In France, first experiments with sales taxation were made in 1465 A.D. But both these experiments were temporary and had to be abandoned. It was only

in Spain that sales tax was levied for a long time. During World War I, sales tax was adopted by none of the neutral European countries but it was adopted by all the European belligerents except Great Britain. During Second World War, even Great Britain levied a mild form of sales tax called the purchase tax. Today, sales tax has spread to all the continents and countries of the World not excluding the U.S.S.R.

Sales tax in *modern India* was first introduced in *Madhya Pradesh* in 1938 when a tax on the retail sales of motor spirit and lubricants was introduced. Since then, taxation of motor spirit has usually been the subject matter of a separate legislation in our country. That is why motor spirit is exempted from levy under the general sales tax law as distinct from the selective sales tax law. It was the then *Madras* Province which was the pioneer in the field of general sales tax law. A multiple levy was introduced in that Province in 1939. *Bengal* was next to follow which introduced a single-point system in 1941. In that year *Punjab* too had a sales tax law which was broadly based on the multi-point model. In 1944, *Bihar* followed the single-point system of Bengal.

Then Bombay, Assam, Madhya Pradesh and Orissa adopted single-point general sales tax law and Uttar Pradesh had a multiple law with important modifications. This was all before 1st

April, 1948. Since that date most of the former Part B States introduced a sales tax legislation to augment their revenues. Multiple system of the Madras model was adopted by Mysore, Travancore-Cochin and Hyderabad States. Other States had a single-point levy, some on a large variety of goods and some on a very few items. Today all States in our country have a sales tax law, the last entrants to the field being Goa, Daman and Diu.

Types of Levy

Broadly speaking, there are two main systems of sales tax levy: multiple point and single point. Under the former, tax is levied at successive stages of sales in a series of transactions. Under the latter, tax is levied only at one stage, either at the stage when the goods are for the first time sold in the State or at the stage when the goods ultimately reach the consumer or the unregistered dealer. As under the multiple system, some goods bear tax at more than one stage, to reduce its cumulative incidence, rate is kept low while under the single point levy the rate of tax is high.

Bombay was the first State to introduce what is called a double-point levy of tax, the tax being levied at the first as well as the last stages in the chain of transactions taking place within the State. This system was first introduced for

a selected number of items which were declared essential for the life of the community under the former Article 286(3). This was along with multiple levy for other goods and was in force for seventeen months during 1952 to 1954 — Since 1st April 1954 till 31st December 1959. This double point levy was extended to all goods with certain exceptions, of course. Since 1st January 1960, we have a mixture of single-point levy for a large variety of goods and a double-point levy for Schedule E goods. It may be noted that since the enforcement of section 15 of the Central Sales Tax Act, "declared goods", are taxable under a State law only at one stage and that too at a rate not exceeding two per cent. Therefore, so far as declared goods are concerned, there is a uniform law throughout the country.

Development of a sales tax law

The Provinces in the British India started with levy of tax on sales. Prior to the inauguration of our present Constitution, tax was levied on nexus basis. Thus, a sale could be taxed under more than one Provincial laws. With the inauguration of the present Constitution, Article 286 imposed far-reaching restrictions on the states' power to levy tax on a sale or purchase of goods. The nexus theory to sustain the fiscal jurisdiction of the state no more survived as held by the Supreme Court in its later judgments. A sale could not be taxed if it took place outside

the state. It took place where the property in the goods passed. Even if a sale took place within the state, it could not be taxed if it took place in the course of export-import trade of the country. If it took place in the course of inter-state trade or commerce, it could not be taxed after the 5th September 1955. Of course, since 1st July 1957 inter-state sales are subject to tax under the Central Sales Tax Act.

While initially sale aspect of a transaction was aimed to be hit by a state law, gradually purchases too were looked upon for the tax levy. Today, under a good number of state laws tax is being levied on purchases, though on a selective basis. Gujarat perhaps is the only state which has a levy of tax on purchases generally. Of course, where sales against prescribed declarations are exempted from tax, in the event of the contravention of the recitals of such declarations, tax is levied on the purchase value of the goods, by addition thereof to the sales turnover of the dealer or by way of purchase tax itself as under the Maharashtra or the Gujarat sales tax law. Addition of such purchase value to the taxable turnover of a dealer being by way of a safeguard against the misuse of the exemption, is being provided under the sales tax law since long.

The two most important aspects that were agitated before the highest Court of the land

were: what could be taxed under a state law and when could a sale be taxed. The Supreme Court has held that a state could tax only a concluded sale and not merely an agreement to sell. This was the position prior to the inauguration of the Constitution also. The Court has further held that that transaction could be taxed by a State under its law which was a sale under the general law relating to the sale of goods. Thus a building contract, a hire-purchase transaction (whereunder the property in the goods did not pass to the hirer), self-consumption or a compulsory acquisition of goods could not be taxed by a State. While these restrictions apply to a State, they do not come in the way of the Union to extend its taxing net to such transactions.

Present Structure

Broadly speaking, the present structure of a sales tax legislation in our country is this:

Andhra Pradesh—has a multiple levy with a single first point tax on selected items covered by the First Schedule—Purchase Tax is levied on the items covered by the Second Schedule. It has also a turnover tax on all goods, except of course, the declared goods.

Assam—has a single point levy at the last stage but on certain goods tax is levied under a different enactment, namely, the Assam Finance (Sales Tax) Act, 1956, at the first stage.

Bihar—Special Sales Tax is levied at the last stage. General Sales Tax is a multi-point tax. Then there is a Special rate of tax which is levied instead of Special or General Sales Tax but on specific transactions only.

Delhi—Single point system at the last stage.

Gujarat and Maharashtra—A single point levy at the first stage for Schedule BI and Schedule C goods, a single point levy at the last stage on Schedule BII and D goods and a double point levy on Schedule E goods.

Kerala—Single point sales tax at the first stage on some goods, single-point purchase tax at the last stage on some other goods and multiple tax on the rest. Single-point sales tax is reduced to one per cent. on sales of component parts.

Madhya Pradesh—First-point tax on certain goods and last point tax on others. Purchase tax provided under specific circumstances. Raw materials are taxed at one per cent.

Madras—General multi-point tax but the first point sales tax on specified goods and first or last point purchase tax on a few items.

Mysore—General multi-point levy with first-point sales tax on certain goods and first or last point purchase tax on specific goods.

Orissa—Single-point system at the last stage.

Punjab—Single-point levy at the last stage but purchase tax on certain goods.

Rajasthan—Single-point system at the stage notified by the Government. Purchase tax under certain circumstances.

Uttar Pradesh—Combination of single-point and multiple levies. Purchase tax on specific goods.

West Bengal—Single point tax at the last stage.

Applicability of Sales Tax Laws

As is well known, under a sales tax law usually a dealer is liable to pay tax on his turnover either of sales or of purchases or of both. A dealer is usually defined as a person carrying on business and the concept of business underlines a profit motive though in practice the same may not be realised. But days would not be far off when the profit motive is dispensed with so that the transactions undertaken even without a profit motive are brought in the taxing net. Amendment to the U.P. and the Madras Sales Tax Acts is the point in instance. State law provides for artificial definitions of "dealer" and the same have to be reckoned with.

A sales tax law also provides for a minimum turnover which a dealer has to reach before he can be held liable to pay tax under the Act. But exceptions are found with regard to agents of non-resident dealers, transactions in respect of goods purchased in the course of inter-state trade or commerce against C form declarations, casual traders, importers, etc. There has been a tendency to lower down the minimum turnover so that more and more dealers are brought under the charge. Again, sales tax laws provide for different turnovers for different types of dealers such as importers, manufacturers, resellers, co-operative societies, etc.

Usually a State law provides for compulsory registration of a dealer liable to pay tax under the Act, which in effect lays down the same turnover limit both for liability to pay tax and for liability for registration. But certain southern states have laid down lower turnover limits for registration. Some laws have provided for voluntary registrations which is not the case under the Bombay Act.

The state laws also lay down as to what types of transactions should be included in the turnover of a dealer for the purposes of his liability for tax and registration. Certain State laws have provided that a dealer exclusively

dealing in tax-free goods need not be registered under the law. The Bombay Act has extended this concession and has exempted a dealer from liability to pay tax as well as obtain registration certificate if the turnover of taxable goods is less than Rs. 2,500|- during a year.

It may be noted that the minimum turnover for the liability and|or registration has to be calculated strictly in accordance with the provisions of the relevant sales tax law. For example, if the State law provides for the calculation of such turnover during a financial year, the same has to be calculated accordingly even if the dealer might be keeping his accounts according to a different year, say, a calendar year or a *Samvat* Year.

Under a sales tax law, a person carrying on the sale or purchase transactions is liable to pay tax and obtain registration whether or not the transactions are his own or the same are effected on behalf of someone else. Thus selling or purchasing commission agents are liable as dealers even though they effect transactions on behalf of their principals.

The liability under a law being based on the total turnover of a dealer, the dealer has to club together his turnover at his different places of business in the State if he carries on business at more than one place. A dealer once liable to

pay tax under an Act attracts liability for the payment of tax right from the first sale or purchase that he effects at his newly opened place of business. Again, the turnovers of different businesses have to be aggregated, whatever the type of business, if they are under the same ownership.

Most of the laws have now provided that a dealer is liable to pay tax on his local sales of goods purchased by him against C form declarations or on his sales of goods in the manufacture of which he might have used the goods purchased by him against C form declarations. In such a case, the minimum turnover laid down under the local law to attract liability for the payment of tax is not applicable. Under the Bombay Act such a dealer is treated as a registered dealer for various provisions of the Act even though he is not required to obtain registration certificate. When a dealer effects such sales he is liable to pay tax thereon and he is equally entitled to collect tax thereon. As, however, he is not a registered dealer for all the provisions of the Act, his vendee is deemed to have purchased goods from an unregistered dealer and hence when in his turn he sells goods, he is again liable to pay tax thereon. To avoid this double taxation, such a dealer should either be treated as a registered dealer for all the provisions of the Bombay Act or he should

be allowed to obtain registration certificate voluntarily. In fact, all sales tax laws should provide for voluntary registration certificate as it facilitates the newly setup trade.

Administration of sales tax laws

It would not be out of place to note a few observations on administration of a sales tax law, for, the dealers are concerned more with the administration of a sales tax law than with the provisions thereof. It is true, as Edmund Burke said, that, "To tax and to please, no more than to love and to be wise, is not given to man".

The Taxation Inquiry Commission has also observed that "It is true that all taxes are unwelcome and that no tax can be rendered popular by good administration, but few taxes can be rendered so unpopular by bad administration, as the sales tax. The point has to be firmly grasped that sales tax system which is avoidably unwelcome is to that extent avoidably inefficient. The sales taxes of different states can be rendered less unwelcome in proportion as legislation is less ambiguous, regulation less complex, assessment less dilatory and, in more general terms, administration at various points less open to charges of inefficiency and corruption. We are convinced that a considerable part of the opposition of the trade and industry to the sales tax levies in every State is a result of

the methods of administering the tax. We cannot wholly discount the allegations made to us in several states that there was corruption in the administration of the tax or that evasion was on the increase; and have evidence to show that assessments have not been prompt and that arrears are on the whole mounting. It is perhaps hardly necessary for us to point out firstly, that corruption penalises the honest person and tends to demoralise him; secondly, that the person who pays the sales tax is, by and large, the trade; and thirdly, that in this class, as indeed among others, the honesty that is present needs careful nurture, rather than persistent discouragement, even if only in the interests of the exchequer."

These observations of the Commission made in 1953-54 still hold good except perhaps with regard to assessments. Those who have anything to do with sales tax assessments how very well that corruption is on the increase. The principles of good administration are too well known to be reiterated. A few points that have a bearing on the subject, keeping in mind the administration in Maharashtra particularly need to be noted.

Production of Declarations: Under a sales tax law, exemption, partial or whole, is granted to a seller subject to the production of prescribed declarations from the customers. It is a

matter of practical experience that such declarations are not always easily forthcoming or are not complete in all respects. The dealer, therefore, very often has to make good the deficiency at the time of assessment and sometimes he is able to produce such declarations, original or duplicate, only at the appeal or the revisional stage. However, the declarations so produced are not accepted and the sales are taxed. It has been found that even the Government or semi-Government concerns are not prompt enough to issue such declarations in time. There is no valid reason to shut out such evidence either at the assessment stage or at the higher stage. But the same is not allowed to be so produced with the result that a dealer finds it 'economical' to 'arrange', at the verification stage, to see that deficiencies in this respect are not brought on record.

Solution of Grievances at Higher Stages: A perusal of departmental orders in appeal or revision would convince anyone that the appeal or revision provisions under the Act are a matter of empty formality only, without any effective exercise of the powers and duties thereunder by the authorities concerned. The appellate and the revisional authorities, in most of the cases, confirm what the lower authorities do, which reminds one, of the famous observations of Beaumont, C.J., in C.I.T. v. Edulji F. E. Dinshaw.

He observed: "I have been hearing income-tax references in this Presidency for the last thirteen years and I would say that in at least ninety per cent of the cases which have come before this Court the Assistant Commissioner has agreed with the Income-tax Officer, and the Commissioner has agreed with the Assistant Commissioner, however complicated and difficult the questions may have been. But although that may have been the result in practice of giving a right of appeal to superior Income-tax Officers, I apprehend that that was not what was in the contemplation of the Legislature when they gave the right of appeal. I have no doubt they contemplated that superior officers would exercise their powers in a judicial spirit and consider on merits the cases which came before them." [1943 I.T.R., 340, 347-8].

While it seems that the position today of income-tax administration is not as bad as found by the Chief Justice of the Bombay High Court, sales tax administration seems to endeavour to stand by the observations, nay, perhaps endeavouring to raise the percentage upwards. It is self-evident that under this state of affairs, a dealer would find it tempting to have a "compromise" at the lowest level so that he has no occasion to approach the higher authorities for the solution of his grievances which may be full of risks.

Lack of Guidance: Maharashtra has had a sales tax law for the last more than 18 years but under the present enactment, the Department has adopted a policy not to guide the dealers in understanding the provisions of the law which for no fault of the dealers is getting more and more complicated. Initially the Public Relations Officer issued two bulletins clarifying a number of entries in the various Schedules to the Act. But issue of such bulletins was stopped perhaps under the belief that a Sales Tax Commissioner has merely to administer the law without any duty to guide the public. As sales tax impinges on a larger number of people and a larger number of interests than most other taxes, day-to-day guidance to the dealers is a 'must'. That makes the dealers know their position clearly and with a certainty and as tax is usually expected to be passed off to the customers, they are not caught unaware at the time of assessment by unanticipated demand. This helps to reduce corruption to a great extent. In this respect, observations of Shultz and Harris, in their "American Public Finance" (6th Ed.) are relevant:

> "The alert administration must turn missionary when some new tax is levied. He becomes a sales executive with a new 'commodity' to sell, and he must advertise its virtues. The new tax can be publicised

through press releases, through special articles and question-and-answer columns in trade newspapers, magazines, and the general Press, and through speeches before civic organisations and tax-payers' associations...." They go on to observe: "No wise administration is arbitrary or bureaucratic in the actual administration of a new tax. Where conciliation and compromise are warranted, he conciliates and compromises. Obstinate insistence on his personal interpretation of a detail would arouse tax-payer resentment and induce avoidance or evasion or even resort to litigation costly to both parties. Because of the great expense of taking a disputed point to Court, the great mass of tax-payers are largely at the mercy of the tax official when a question arises. A tax administration supervising the imposition of a new tax must be referee, standing between the State on the one hand and the taxpayer on the other, with the sole idea and desire of seeing that both get a square deal" (page 229).

This is one of the principles of good administration. The position in Maharashtra seems to be different. Direct communication with the dealers on interpretation of mute provisions of the complicated law or the public circulars are

now a matter of the past. There has been an increasing tendency to take shelter under the principle of "no estoppel against law" and thereby shake off the responsibility for the consequences flowing from the departmental interpretation, publicly made known in the past, when the same turns out to be unfavourable to the department. More dangerous than this is the policy of a recent development to catch the dealers unaware at the time of their assessment, completely over-looking earlier public clarifications. For instance, the Maharashtra Sales Tax Commissioner had by a public circular, perhaps following a judgment of the Bombay High Court, clarified that casual sales are not taxable in the hands of a dealer. Now on an interpretation of the Supreme Court's judgment in the Abdul Bakshi's case, such sales are being taxed. None could grudge the change in the opinion. But the department has not thought it fit even to make the public know, by a similar circular, that it is not going to follow the earlier circular! Another illustration is with regard to the list of Declared Goods. With the change of opinion of the Central Government, certain items, which were formerly stated to fall under the category of these goods, are now being excluded and consequently liable to be taxed at a higher level. When the Bombay Chamber of Commerce sought clarification on

this subject from the Commissioner of Sales Tax, it was replied that the circular on the lines indicated by the Chamber could not be issued since such a circular would not be according to law. This reply underlines the views of the department with regard to administration of the sales tax law. One hopes that true principles of administration are fully grasped so that the dealers find it easy to comply with the irksome provisions of the law.

I have dealt with only a few aspects of the administration of sales tax law with a view to impressing on those concerned with sales tax administration that unless the law is administered in its right spirit and the administration is based on accepted principles, the confidence of tax-payers in the administration would be shaken, and to use the phrase used by the Income-tax Investigation Commission, it will drive the tax-payer first to non-cooperation, then to hostility and, thirdly, to evasion.

The Taxation Inquiry Commission has observed: "Firmness in securing the interests of the public revenue does not consist in downright disbelief of the dealers' statements, inquisitorial investigation of odds and ends in his accounts and, in general, an attitude of determined discourtesy towards the assessee. Appreciation of the *bona fide* difficulties of traders,

guidance in proper compliance with the requirements of the tax administration and courteous behaviour are certain to go a long way towards making the sales tax department less unpopular than they are at present" (Vol. III, p. 72).

Recommendations

I would like to make the following suggestions to improve Sales Tax laws and their administration.

(1) The Commissioner should have powers to compound the tax liability of dealers and the same should be delegated to the Assistant and the Deputy Commissioners. The powers under the Bombay Act should be extended to even cases not covered by natural calamities. Such powers should be freely used so as to encourage erring dealers themselves to come forward and get their slate clean. It is found that when for one reason or other, tax liability piles up and gets beyond the reach of the defaulting dealer, dubious ways are adopted to get beyond the catch of the department. It should be appreciated that sales tax is payable on all taxable sales whether or not the dealer makes a profit out of them and when the same is not recouped from the purchasers, the dealer has to pay the same out of his pocket, which discourages him to clear up his past liability. But when a dealer is able to keep himself outside the tax records,

he has to keep that up to shield his past liability. It is, however, in the interests of the revenue that such dealers are tempted themselves to come forward for the clearance of their past liability and straighten their affairs.

(2) With the same object in view, a bar of limitation should be provided even for original assessments which is not found under the Bombay Act and a few other Acts. That would also bring about prompt and efficient assessments.

(3) Where no loss of revenue is involved, in genuine cases assessments should not be made only with the sole purpose of getting extra tax. For instance, there is the case of non-resident dealers who import goods at the out-of-State ports and sell the same in the States of import. Such imports have to be made out of compelling circumstances and the dealers in other States should not be made to undergo the formalities under the State law with no real advantage to the State concerned.

(4) In the case of misinterpretation of a particular provision of the law or misunderstanding on the part of the dealers, the department itself should come forward and give complete administrative relief. It should be zealous to guide the dealers in understanding the law and in complying with its provisions. However, it should never make the dealers suffer for the

guidance given by it in the past though it may announce a change in its view to be enforced after sufficient prior notice.

(5) Futile formalities such as enlistment in the Recognition Certificate under the Bombay Act or in the Registration Certificate under the Central Sales Tax Act of the goods required to be purchased by a dealer should be done away with which would save a lot of time and energy of both the dealers as well as the department. Whether or not the dealer has issued proper declarations can be verified with reference to the use to which the particular goods are put to.

(6) There should be complete independence of the appellate cadre so as to inspire confidence in the dealers and give substantial justice to the tax-payers.

(7) A provision should be made under the Central Sales Tax Act for exemption on subsequent inter-State sales even when they are effected to a Government or a Government department. Such an amendment is necessary because of the ever-increasing volume of trade with the Government departments.

The Governments can collect larger revenues, more easily, if the entire system is rationalised. It is also necessary to have model sales tax legislation, with definitions of terms like sale, applicable to all states uniformly.

RECENT CHANGES IN CORPORATE TAXES

S. V. Ghatalia*

Three notable features of corporate taxation in our country are (i) multiplicity of taxes; (ii) recurring changes in the tax system; and (iii) gradual but certain up-grading of the incidence of tax.

In no country of the world, one would find such multiplicity of taxes as in our country. A company is liable to seven different types of taxes, viz. (i) income-tax; (ii) capital gains tax; (iii) additional income-tax; (iv) bonus tax; (v) dividends tax; (vi) Companies (Profits) Surtax; and (vii) gift tax.

According to Hindu Mythology, while creating a woman, God took the *beauty* of the flowers, *song* of the birds, the *colours* of the rain-bow, the *kiss* of the breeze, the *laughter* of the waves, the *waywardness* of the clouds, the *fickleness* of the showers, the *gentleness* of the lamb and the *cunning* of the fox and wove them into a female being and presented her to man as his wife. The pattern of taxes in our country is a combination of taxes imported from abroad

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and the taxes invented by our Finance Ministers. Our tax system includes some features of capitalist countries, some features of socialist countries and some features of communist countries and, unfortunately, the worst features of all the various systems are incorporated in our fiscal system.

Secondly, there are constant and recurring changes in the tax system. Most of these changes are the result of rectification of mistakes originally committed [e.g. section 40(c) (iii)] and in so doing further mistakes and further rectification—so on and so forth. In the last few years, so many changes have been introduced that it has become impossible to predict, like weather, what the corporate taxation is likely to be next year.

Corporate Taxation

The yield from corporate taxation in 1960-61 was Rs. 111 crores and it has risen to Rs. 342 crores in 1964-65 and estimated revenue for 1965-66 is of the order of Rs. 386 crores. The percentage of corporate taxes to total tax on income has increased from 39.88 per cent in 1960-61 to 54.61 per cent in 1964-65. We had in 1962-63, 25,524 companies of which only 40 per cent were liable to tax. The impact of taxation can be judged more precisely when it is realised that out of the total number of com-

panies in this country, about 84 per cent of the companies have capital below Rs. 5 lakhs.

The rising incidence has correspondingly increased the risk of investment, which makes the industrial ventures more speculative than they ought to be. Consequently, a larger rate of return is required to justify the investment, which, in turn, entails a charge of profiteering.

The high rates of taxes have a demoralising effect on company management, because the ultimate loss on account of inefficiency or high cost structure is very much less than what it would be under a reasonable level of taxation. The number of companies in the last five years has remained more or less static which demonstrates the dampening effect of taxation on development of the corporate sector. The incidence of corporate taxes coupled with incidence of personal taxation is so high as to discourage investment in the corporate sector. It is an indisputable proposition that a tax on company is ultimately a tax on the shareholder. The high incidence of tax on investment makes it impossible for the middle class which forms the bulk of the investing population to participate in corporate ventures. The policy of attacking the so-called concentration of economic power has very badly hit a large number of citizens who are outside the sphere of such concentration.

I was recently asked by a journalist as to what improvements could be made in our tax system and I told him that the best improvement that we can make is to discard the entire system and replace it by a new one. The chances of improvement in our tax structure are next to nil unless the basic economic framework which is wrongly conceived, formulated and implemented is radically changed. We are having a mixed economy which means so many things are so much mixed together that one does not know what is what and as a result there has emerged a confused economy which looks like the paintings of Picasso.

Ludwig Erhard in his book, "Economics of Success", states: "As things are to-day, the state must provide the economy with the principles and broad lines of a policy and with objectives designed to guide and regulate its functioning. In this respect the state indisputably has and should have the initiative. But to go further and reduce the independent business man to the status of a mere puppet or servant of the authority's will would be to destroy all the values derived from personality and to rob the economy of its most precious source of inspiration and strength".

Re-modelling of Tax Structure

The previous classification of companies for applying varying rates of taxes is now com-

pletely altered. It must be said to the credit of the present Finance Minister that the re-modelling of the tax structure is no doubt a process of rationalisation. The main features of the changes in the rate structure are:

(1) Distinction between public companies (section 108 company) and controlled companies (non-108 company). In case of public companies the maximum rate of tax is retained at 50 per cent but in the case of controlled companies the rate of tax is increased from 50 to 60 per cent.

(2) A distinction is now made between companies wholly or mainly engaged in industry and other companies. Industrial companies mean companies which are wholly or mainly engaged in the manufacture or processing of goods, or in mining or in the generation or distribution of electricity or any other form of power. A company is deemed to be engaged mainly in such activities if the income attributable to such acivities is not less than 51 per cent of the total income.

(3) The industrial companies are further classified into companies engaged in scheduled industries and those engaged

in other industries. Companies engaged in the business of generation or distribution of electricity (but not any other form of power) or of manufacture or production of articles specified in Part III of the First Schedule to the Finance Act, 1965, are referred to as "Scheduled Industries".

In case of a public company with a total income not exceeding Rs. 25,000|- the rate of tax is 42.5%. In case of other public companies, the income derived from scheduled industry is chargeable at 45% and the balance of total income is chargeable at 50%.

In case of controlled companies, the income from scheduled industry upto Rs. 10 lakhs is liable to be taxed at 45% and the balance of such income is taxable at 54%. In case of a controlled company whose income from scheduled industry and other industry does not exceed Rs. 10 lakhs, the income from scheduled industry will be charged at 45% and the income from other industry will be charged at 50%. In case the controlled company has income exceeding Rs. 10 lakhs, in respect of the income from scheduled in-

dustry; and in respect of income from other industry up to Rs. 10 lakhs, the above rule will apply and on the balance of the income, tax will be payable at 60%. The benefit of lower rate applies to profits and gains attributable to scheduled industry or industry as the case may be.

Inter-corporate Dividends

Section 99 which gave exemption from super-tax in respect of inter-corporate dividends is now deleted, and hence the necessity for enacting Section 85A.

A deduction is granted in respect of dividends included in the total income which is received by a company from:

(i) an Indian company; or

(ii) a company which has made the prescribed arrangements for declaration and payment of dividends (including dividends on preference shares) within India.

A deduction is to the extent of the amount of income-tax calculated at the average rate of income-tax on dividend income (other than dividends on which no income-tax is payable) as exceeds an amount of 25% thereof.

The intention was to give deduction in such a manner that the rate of income-tax on dividends does not exceed 25%. The wording adopted in section 85A does not give this result.

Secondly, deduction from tax is granted in the case of a company: (1) which has not made the prescribed arrangements for declaration and payment of dividends within India, and (2) which receives dividend from an Indian company which is a non-108 company and which is wholly or mainly engaged in priority industries [engaged in business of generation or distribution of electricity or of construction, manufacture or production of articles specified in the list in para 2 of the Third Schedule to the Companies (Profits) Surtax Act, 1964.]

The deduction is to the extent of the amount of income-tax calculated at the average rate of income-tax on dividend income (other than dividends on which no income-tax is payable) as exceeds an amount of 15% thereof.

The intention is to charge such dividend at the rate of 15% but in actual practice the average rate of tax on foreign companies would be less than 65% and therefore the net effective rate will exceed 15%.

Dividend Tax

Formerly, Excess Dividend Tax was being levied but it was discontinued from the assess-

ment year 1960-61. The Finance Act, 1964, imposed dividend tax at 7.5% on dividends on equity share capital. The main features of dividend tax are:

(1) It applies only to companies which are 108-companies or companies referred to in section 104(2)(iii) or companies referred to in section 104(4).

(2) It only applies to dividend on equity shares and does not apply to dividend on preference shares.

(3) The rate of tax is 7.5% on the entire dividend on equity shares except in case of a company, which, since the commencement of its activities, has declared its first dividend during the previous year or any one of the four previous years immediately preceding the accounting year. In such cases, the dividend tax will apply only to the amount of dividend, which exceeds 10% of the paid-up equity share capital.

Bonus Tax

The tax payable by a company on the issue of bonus shares is retained at 12.5 per cent but if the bonus shares are issued wholly out of the share premium account, after 31st March 1964, then the bonus tax is not chargeable.

Under section 45 of the Income-tax Act, 1961, if an assessee, who holds any equity shares as investment, receives any bonus shares, he becomes liable to Capital Gains Tax in respect of such bonus shares as if he had transferred the said shares at the market value, after the expiry of 30 days from the date of issue of such shares. It introduces a new principle of taxing unrealised gains, which cannot be justified under any principle of accounting or by any canon of taxation. Such notional capital gains are taxable as long-term capital gains. Such bonus shares are not chargeable to tax if such shares are included in the stock-in-trade of the assessee or if such shares were allotted before 1st day of April 1964.

Under section 114, the assessment of bonus shares to capital gains is subject to a relief to the extent of 12½% of the face value of the shares or the amount of tax on such bonus shares whichever is less.

Capital Gains Tax

The rates of Capital Gains Tax in case of companies are now as under:

On long-term capital gains: (1) On bonus shares at 12.5 per cent; (2) on land and buildings at 40 per cent; and (3) on other assets at 30 per cent.

Short-term capital gains will be charged at the same rates as are applicable to other income.

Foreign Companies

In respect of companies which are neither Indian companies nor companies which have made the prescribed arrangements for the declaration and payment of dividend within India, the following important changes have been made:

(1) Dividend from controlled companies engaged in scheduled industries will be taxable at 15 per cent and other dividends will be taxable at 25 per cent.

(2) Up till now such companies were subject to tax at 50 per cent on Royalty received under an agreement entered into after 1st day of April 1961, if such agreement was approved by the Central Government. Similar concession is now extended to technical fees. Fees for rendering technical services received from an Indian company under an agreement entered into after 29th February 1964, which has been approved by the Central Government, would become liable to tax at 50 per cent instead of 65 per cent.

(3) Foreign companies will be exempted from tax on income from securities which are approved by the Central Government. Such exemption will extend to income-tax, and surtax. The object of exemption is to attract investment by foreigners in the debentures of companies, etc.

(4) The tax on income, other than the above income, is enhanced from 63 per cent to 65 per cent.

Distribution of Dividend

Under sections 104 to 109 of the Income-tax Act, 1961, the controlled companies are required to distribute a prescribed percentage of distributable income and in case of default they become liable to additional income-tax on the undistributed income at: (i) 50% in case of investment companies; (ii) 37% in case of trading companies; and (iii) 25% in case of other companies.

In these provisions, four important changes have been made: (1) An Indian company, whose business consists wholly or mainly in manufacture or processing of goods or in mining or in generation or distribution of electricity or any other form of power, is excluded from the operation of section 104. (2) Section 104 also does not apply to an Indian company,

the value of whose capital assets, being machinery or plant (other than office appliances or road transport vehicles) as shown in the books of account on the last day of the relevant previous year is Rs. 50 lakhs or more. (3) The Central Government has reserved the power to exempt any class of company from the operation of section 104, if the Central Government is of the opinion that it is necessary or expedient in the public interest to do so. (4) Section 107(A) makes provision for reduction of minimum distribution. Any company except an investment company can apply for reduction in distribution on the ground that having regard to the current requirements for the development of its activities, it will not be possible or advisable to declare a larger dividend than the one already declared or proposed to be declared.

The Central Board of Direct Taxes is empowered to reduce the statutory percentage of distributable income by an amount not exceeding 20 per cent thereof. Until the Board passes an order on the application, the operation of section 104 would remain suspended.

Companies (Profits) Surtax

The Super Profits Tax is abolished and is replaced by a new tax called "Surtax". The Surtax is imposed on the same lines as Super Profits Tax but the rate of tax is lower, the

capital base is little higher and the statutory deduction is larger. Surtax applies only when the chargeable profits of the company exceed ten per cent of the capital base or Rs. 2 lakhs, whichever is higher.

Broadly speaking, a public company up to a profit of Rs. 4 lakhs, and a controlled company up to a profit of Rs. 5 lakhs, will not be liable to Surtax. As against the two-tier system of rates of 50 and 60 per cent under the Super Profits Tax, the Surtax will be leviable at a uniform rate of 40 per cent on the chargeable profits.

The capital base will comprise of the entire paid-up capital, reserves (including development rebate reserves), debentures, long-term loans from Governments, Industrial Finance Corporations or the Industrial Credit & Investment Corporation of India Limited or any other approved financial institution or from banking institutions and monies borrowed from any person in a country outside India, provided such loans are incurred for creating a capital asset in India and the loan agreement provides for repayment during a period of not less than seven years.

Unlike the Super Profits Tax, for the purpose of Surtax, there is no provision for carry forward and set off of deficiency.

The deduction of ten per cent of total income, granted under Super Profits Tax Act, while computing the chargeable income, is deleted.

As a corollary to the inclusion of loan capital in the capital base, the interest payable on the loan capital will be added to the chargeable profits.

At rebate of 20 per cent is granted in respect of profits derived from generation or distribution of electricity or manufacture of articles listed in the Third Schedule to the Act. On such profits the Surtax will be 32 per cent instead of 40 per cent.

Disallowance of Expenditure

In respect of *bona fide* business expenditure incurred legitimately and wholly and exclusively for the purpose of business, there already exist considerable hardships on account of non-deduction of such expenses, like directors' remuneration, technical fees, expenditure for negotiating long-term loans, etc. It is not appreciated that disallowance of *bona fide* business expenditure is tantamount to charging tax on capital. Instead of examining such hardships and remedying them by appropriate amendments, the recent trend is to increasingly restrict the expenditure allowable in computing the business income.

By amending section 37 of the Income-tax Act, a new provision is inserted to the effect that in respect of certain specified expenditure, incurred by an assessee after 31st March 1964, deduction will be granted only to the extent and subject to such conditions as may be prescribed under the Income-tax Rules. The expenses to which these restrictions apply are: (a) Advertisement; (b) Maintenance of residential accommodation including any accommodation in the nature of a guest-house; and (c) Expenditure in connection with travelling by an employee or any other person (including hotel expenses) or allowances paid in connection with such travelling.

This provision applies not only to the companies but to other assessees also.

There already exist sufficient provisions to disallow the expenses which do not relate to the carrying on of a business and, therefore, further restrictions on allowance of expenditure will only hit those expenses which are admittedly incurred *bona fide,* wholly and exclusively for the purposes of business.

Disallowance of Perquisites

The Finance Act, 1963, placed a ceiling on the allowance of expenditure incurred by a company on remuneration and perquisites to an Indian employee at Rs. 60,000 per annum. This

restriction was discriminatory against an Indian employee of a company and has, therefore, been withdrawn.

Instead, proliferation of perquisites to employees is sought to be restricted by limiting the allowance of expenditure on perquisites to the employees whether Indian or foreign.

The recent amendment of section 40(c)(iii) imposes a ceiling on expenditure incurred by a company, after 29th February 1964, in respect of any benefit, amenity or perquisite provided directly or indirectly to an employee. The ceiling is 20 per cent of the salary payable to the employee for any period of his employment after 29th February 1964. The benefit, amenity or perquisite may or may not be convertible into money. The perquisite would include any payment by the company in respect of any legal obligation of the employee. The disallowance to the company would be notwithstanding the fact that the said amount is included in the total income of the recipient. The word "salary" for this purpose shall have the same meaning as it has under clause (h) of Rule 2 of Part A of the Fourth Schedule according to which "Salary" includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

In taking into account benefit, amenity or perquisite, the following amounts are to be excluded: (1) Gratuity: (2) Travel concession or assistance referred to in section 10(5); (3) Passage moneys or value of free or concessional passage referred to in section 10(6)(i); (4) Transferred balances in recognised provident funds referred to in section 17(1)(vii) or sums paid to effect life insurance or annuity referred to in section 17(2)(v); (5) Compensation received on the termination or modification of the terms of employment; (6) Payment from employers other than gratuity or contribution to provident fund; (7) Payment to recognised provident fund, or approved superannuation or gratuity fund referred to in section 36(1)(iv) or (v).

The following points should be noted in connection with this provision: (a) The expenditure on perquisites etc. should be computed with reference to the actual expenditure incurred by the company and not with reference to notional value of the perquisites assessable in the hands of the employee. (b) In computing the amount disallowable, only the proportion of the actual expenditure incurred in providing the

amenity should be taken into account. (c) Bonus, it appears, should not be included in the word 'salary' for the purpose of determining the base for computing the ceiling. Bonus is also not to be taken as a perquisite. It appears that bonus is a different form of payment altogether which cannot be considered either as salary or as perquisite.

However, the restriction of allowance will not apply to expenditure on perquisites of employees whose income chargeable under the head "salary" is Rs. 7,500|- or less.

Conclusion

The uncertain taxation policy has created an unfavourable climate of insecurity and instability of investment which will have a very adverse effect on the capital market. With the confiscatory rates of taxes, personal savings are next to nil, and the available internal finance is becoming smaller and smaller and as a result the private sector is deprived of the finance necessary for its healthy growth and development. Our present taxation policy has impeded industrial growth, puts a premium on dishonesty and inefficiency and leaves no incentive for enterprise and initiative. In the very process of reducing inequality of wealth and income, the

very apparatus of earning income and wealth will be permanently damaged and the economic morale of the people will be broken.

The present policy completely ignores the disastrous social and psychological effects on the citizens of this country. Unless the Government radically changes the basic economic policy and rationalises the taxation system we are likely to face a serious economic crisis.

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