

THE ECONOMIC IMPLICATIONS OF
THE UNION BUDGET, 1970-71

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By

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An analysis of the economic implications of the Union Budget for 1970-71 must begin with a clear picture of the state of the Indian economy in the year preceding the Budget. For this purpose attention must be drawn to a few salient features of the economy as they have prevailed in recent years. The national income at constant prices which fell by 5.6 per cent in 1965-66, rose only by 0.9 per cent in 1966-67, and recorded a rise of 8.9 per cent in 1967-68, but again rose marginally by 1.8 per cent in 1968-69. In 1969-70, the national income at constant prices is estimated to have risen by around 5.5 per cent. Thus, the economy which had become stagnant in the periods of drought in 1965-66 and 1966-67 has slowly resumed its forward march. The Fourth Plan targets for a growth rate of 5 to 5.5 per cent in national income and it is to be hoped that this minimum rate of growth can be achieved.

* The author is a well-known authority on taxation. This article, reproduced with kind permission of the Editor, from "Commerce" of March 14, 1970, is based on a public lecture delivered under the auspices of the Forum of Free Enterprise in Bombay on March 3, 1970.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—EUGENE BLACK

On the agricultural front, the new agricultural strategy has enabled the country to emerge from the two years of unprecedented drought in which the food production fell to 72 million tonnes in 1965-66 and to 74 million tonnes in 1966-67. In 1967-68, foodgrains production was estimated at 95 million tonnes and in 1968-69 it was estimated at 94 million tonnes. During 1969-70, it is estimated to have exceeded 100 million tonnes. During the past year the only gloomy aspect of the agricultural picture was the fall in commercial crops' production of certain items such as jute and oilseeds.

Industrial production which had grown between 1961-65 at an annual rate varying between 8 to 9 per cent slumped precipitously to a record low level of minus 0.8 per cent compared with the previous year in 1966 and to minus 0.7 per cent in 1967. But in 1968, the growth rate of industrial production was 6.4 per cent and for the period January to August 1969 industrial production has grown by about 7.2 per cent indicating that industrial recovery has been spurred by the improvement in agriculture. A rather ominous sign on the industrial front is that after having years of excess production capacity in most items shortages have now begun to appear in key items such as steel, staple fibre and aluminium, necessitating an immediate thrust in industrial expansion if such shortages are not to grow and result in inflationary pressures in the economy.

The picture of industrial investment is somewhat confused. The corporate profits and news about their working results have been very good. But the figures of capital issues and capital raised during the current year indicated stagnancy

in respect of the previous years which might have been due to the psychological aftermath of the recession in the entrepreneurial activity. However, the number of applications for industrial licence during 1969 was much larger than in 1968 and the number of letters of intent given in 1969 was double the number in 1968 indicating a revival in industrial investment.

Savings

The rate of domestic savings which was estimated at 8 per cent of the national income in 1968-69 has risen to 9 per cent in 1969-70. However, the ratio of public savings to the national income has been around one per cent. Since the Fourth Plan requires a rise in the ratio to 3.8 per cent in 1975-76 and to 6.2 per cent by 1980-81 in the subsequent Plan, a substantial tax effort is implied in our development planning. If these targets are to be achieved the tax effort as a percentage of the national income which is 13 per cent today will have to rise to 15 per cent by 1973-74 and to 18.5 per cent by 1980-81. The stock markets during the past year staged a most encouraging revival with the index of variable securities having risen from 81.7 per cent in 1968-69 to 93.5 in the period April to December 1969. The price situation, an index of inflationary pressures, has been substantially under control. Thus, the index of all commodities which rose by 11.9 per cent in 1966 and 15 per cent in 1967, actually fell by half per cent in 1968 and has risen by only 2.1 per cent in 1969. However, there has been a renewed upward pressure on prices since November 1969, which is an ominous sign.

On the monetary front, during the period March 31 to January 10, the money supply rose by Rs. 96 crores in 1968-

69, but by as much as Rs. 326 crores in 1969-70 during the same period. A cheap money policy was followed during the period with selective controls on credit. The nationalisation of the 14 major banks which occurred in 1969 is likely to lead to changes in credit and monetary policies in the coming year. The balance of payments of India turned favourable during the past year on account of lower imports and spur in exports.

It will be seen that the Indian economy had emerged from the years of drought and industrial recession and has resumed its growth at a moderate rate during the past year. The aim of the Budget is to accelerate the growth of the economy and give it a forward thrust so as to spur development. The Budget should therefore be assessed in the context of this background. The Budget has been presented by the Prime Minister who is also the Finance Minister of the country. With the Budget papers, the Prime Minister has circulated a paper called "Towards Growth with Social Justice." It proposes certain changes in Indian planning and development which must be mentioned in view of their importance in future thinking on planning.

It has been stressed that measures to help small farmers and agricultural labour through various means as the provision of credit facilities, cheap fertilisers, rural improvement etc. would have to be given a high priority in the coming years. The expansion of employment opportunities in the rural areas through activities such as dry farming, dairy development, rural works, and small-scale industries has also been set out as goal of highest priority. Nutritional programmes for children are to be launched on a modest scale and the

Budget provides Rs. 4 crores for this purpose. The problem of urban development and housing for lower income groups is to be tackled through a finance corporation. Rural water supply schemes in order to provide fresh drinking water are to be launched. Social security measures for industrial workers and government employees who die prematurely to provide for their widows and children are to be introduced. These are all worthwhile measures which over a period of time will go to make the country more prosperous and politically stable.

The Budget provides for an increase in the plan outlays of the Centre and the States of Rs. 400 crores during the coming year indicating a substantial step-up in the development outlays. In order to achieve the various goals of the Plan and the other priorities outlined above the Prime Minister has had to frame a delicately conceived budget where the tax net has been spread widely over all the sections of the community. Yet a substantial deficit has been left uncovered.

The budgetary position of the Government of India was that the overall deficit for 1969-70 had risen from the Budget figure of Rs. 254 crores to Rs. 290 crores as per revised estimates. At current levels of taxation, the overall deficit for the coming year was estimated at Rs. 350 crores, after taking into account the Rs. 15-crore surplus on the revenue account. The Prime Minister has proposed to cut this deficit by Rs. 124 crores through additional taxation which will yield Rs. 170 crores in the coming year of which the share of the States will be Rs. 45 crores so that the Centre's net yield from the additional taxation is Rs. 125 crores as proposed in the Budget. This will leave an overall deficit of around Rs. 225 crores

uncovered. Thus, taxation will tackle only a minor portion of the overall budgetary deficit which has been necessitated by the needs of the Plan and the economy. Of the total taxes proposed in the Budget during the coming year amounting to Rs. 170 crores as much as Rs. 155 crores is sought to be raised through indirect taxes and only Rs. 15 crores will come through the changes proposed in direct taxes during 1970-71.

Customs and excises

The Prime Minister has proposed a series of changes in customs and excise duties. Some of the major changes may be analysed here. The export duty on jute canvas and manufactures has been reduced from Rs. 500 to Rs. 200 per tonne and export duty on tea has been abolished although excise duty on tea has also been imposed to spur exports. The reduction in export duties involves Rs. 9.75 crores loss in revenue, but should contribute handsomely towards export drive of the country. Import duty on machinery (excepting for new projects and substantial expansion) has been raised from 27.5 to 35% and should spur import substitution. There are other minor changes in customs duties. The net gain in revenue from customs duties as a result of the Budget changes is placed at Rs. 20 crores.

The excise duties proposed by the Prime Minister are estimated to yield Rs. 135 crores of which the share of the States will be Rs. 35 crores. The excise duty on cigarettes has been raised in order to yield an additional Rs. 13.5 crores. This is a purely revenue measure which also will have an inflationary impact insofar as the prices of cigarettes are bound to rise to the extent of the duty. Increases in excise

duty on motor spirit, to yield Rs. 21.36 crores, on superior kerosene to yield Rs. 9.20 crores and on furnace oil to yield Rs. 9 crores have been proposed. These levies will undoubtedly push up transportation costs and industrial costs, although their effect will be spread thinly throughout the economy. The *ad valorem* duty on various types of sugar has been raised in order to yield Rs. 28.50 crores. However, it may not be possible for the sugar industry to pass on this duty to the consumer fully because sugar is in a glut and a rise in prices may not be feasible at least in respect of free market sugar. Thus part of the duty, if not the whole of it, is likely to come out of the profits of the sugar manufacturing industry.

The duty on polyester fibre has been raised by Rs. 4 per kg to yield Rs. 1.60 crores. The present specific duty of 7.8 paise per sq. metre on fabrics made from synthetic fibres has been changed to *ad valorem* excise duty ranging from 3 to 10 per cent estimated to yield Rs. 12.18 crores. It is doubtful whether this excise duty will be inflationary because the synthetic fibre manufacturers were selling their fabrics at the highest price which the market could bear and it is therefore likely that duty will fall on the profits of the manufacturing industry producing these fabrics causing minimum inflationary effects.

A 10 per cent *ad valorem* excise duty has been imposed on many items such as office machines, metal containers, stainless steel, safe deposit vaults to yield altogether Rs. 10.40 crores. These imposts will have different inflationary effects in the case of different items depending on their supply and demand position over the next year.

Levies on food items

A 10 per cent *ad valorem* duty has been unfortunately levied on a wide range of preserved foods including items like biscuits, vegetable juices, cocoa powder, aerated water, glucose, instant coffee etc. This levy is bound to push up the prices of these items because the profit margin of the manufacturers are quite slender, and cannot possibly be absorbed even partially. It is unfortunate that at a time when there is an urgent need to encourage the preservation of foodstuffs in India and spur the growth of processed foods industry, the Prime Minister has sought to impose these levies on food items.

Certain other changes in excise duties may be noted. Excise duty on calcium carbide, bleaching powder and sodium hydrosulphite has been levied at the rate of 10 per cent *ad valorem*. The excise duty has been raised from 5 to 10 per cent on caustic soda and soda ash, and a duty of Rs. 350 per metric ton on synthetic rubber. These duties are estimated to yield Rs. 5.3 crores and are likely to have inflationary effects in respect of the prices of these chemicals and on industrial products. The excise duty on refrigerators and airconditioners has been raised presumably on ideological grounds. Similarly, the excise duty on sanitarywares has also been increased.

The net result of these changes in excise and customs duties is an additional revenue of Rs. 155 crores budgeted for 1970-71. These are likely to have a certain inflationary push in the economy, but because they are spread over a wide range of items they have been made palatable and their impact is not likely to be felt by ~~the consumer~~ in respect of

any particular item on a marked basis. The Prime Minister has raised the postal and telegraphic rates of various items in order to get Rs 8.22 crores. These are expected to meet the deficits of these departments and yield a nominal surplus of Rs. one crore. Successive budgets have been pushing up postal and telegraphic rates for **making** up the deficits of these departments. It is time that steps were taken to make these departments more efficient in their **working**. The average person thinks upward changes in postal and telegraphic rates imposes a continuous burden on him and pushes up the cost of living perhaps without justification.

Direct taxation

The proposals for levying additional direct taxation in the Budget are estimated to yield in 1970-71 only Rs. 15 crores of which the States will get Rs 10 crores. In 1971-72, the yield will be Rs. 36 crores of which the States will get Rs. 13 crores. This is due to the fact that most of the proposed changes are prospective and are therefore applicable only during the financial year 1970-71 or the assessment year 1971-72. Initially, the yield from the direct taxes in 1970-71 are largely through collections on account of advance taxes and deduction of tax at source. The healthy tradition set in the past few budgets of changes in taxes being prospective and not retrospective has been followed in respect of most of the budget proposals for direct taxes.

The Prime Minister has proposed substantial changes in the income tax levied on individuals and Hindu undivided families with effect from the assessment year 1971-72 (or financial year 1970-71). The present exemption limit for income tax purposes applicable to individuals which varied

from Rs. 4,000 to Rs. 4,800 depending on their marital status and, the number of children has been raised to a flat sum of Rs. 5,000. As a result of this simplification it is anticipated that about 500,000 assesseees will be excluded from payment of income tax. It should result in substantial reduction of the work load of the tax administration. However, the limit should have been raised to a higher figure of around Rs. 7,500 as recommended by the Bhoothalingam committee. This would have eliminated almost 1,700,000 assesseees and would have involved only a loss of around Rs. 7 crores to Rs. 8 crores a year. Thus it would have left within the income tax net only 1.1 million assesseees whose assessment the tax officials would have been able to pursue more effectively and diligently.

The Prime Minister has also introduced a very stiff rise in the rates of income tax in the slabs above Rs. 40,000 per annum income. Thus, the income tax including surcharge payable on the slabs of income of individuals above Rs. 40,000 will be as follows: from Rs. 40,001 to Rs. 60,000—66 per cent, from Rs. 60,001 to Rs. 80,000—77 per cent, from Rs. 80,001 to Rs. 1,00,000—82.5 per cent, from Rs. 1 lakh to 2 lakhs—88 per cent and Rs. 2 lakhs and above 93.5 per cent. Thus, the maximum rate of income tax has been raised from 82.5 per cent to 93.5 per cent which involves a substantial rise in the tax burden.

Harsh rise

Such a stiff increase in personal income tax levels is likely to have strong disincentive effects on the incentives to work, savings and investment in the coming years. Indeed, it makes the earning of income above Rs. 40,000 unattractive

and the earning of income above Rs. 1,00,000 almost meaningless. The proposed increases in the rates of income tax appear somewhat excessive and harsh and should be reconsidered over a period of time.

However, to stimulate savings and investment it has been provided that effective from the financial year 1970-71 income tax assesseees will be entitled to a deduction of Rs. 3,000 from their total income in respect of income from securities, debentures of co-operative societies and approved institutions, shares in Indian companies and the units of the Unit Trust of India, certain deposits under government schemes and deposits with banks. Hitherto such concessions were available only in respect of Rs. 1,000 as dividend from Indian companies and Rs. 1,000 income from the units of the Unit Trust. By giving a consolidated deduction of Rs. 3,000 in respect of income from these sources for each assessee and by allowing assesseees a free choice between the various alternative investments for generating such income exempted from tax the Prime Minister has given them a wide range of alternatives from which to choose for this purpose. Taking into account the highest marginal slabs of income it should be stressed that the exemption of Rs. 3,000 is tantamount to having gross income of Rs. 30,000 to Rs. 40,000 gross per annum for those in the highest marginal slabs of income tax. The concession should also stimulate people to take active interest in investing in shares and other items covered by the concession.

Loopholes plugged

The Prime Minister has sought to plug certain loopholes which have enabled legal avoidance of taxes by wealthy in-

dividuals. It was found that the exemption from income tax of religious and charitable trusts was often used by wealthy individuals to set up such trusts, accumulate part of their income and use the capital and accumulated income of the trusts for various business purposes and other purposes of personal benefit for themselves and their relatives. Accordingly, the Budget has now sought to plug this loophole for tax avoidance by providing that income accumulated of a trust and not used for its purpose during its financial year or three months thereafter will be brought to tax. Also where the trust's funds are used for personal benefit of the founder or his relatives income tax exemption will be lost. Investments in companies controlled by such founders or their relatives will also result in a loss of the income tax concession above a certain limit. These are steps in the correct direction, especially in view of the widespread abuse made of the income tax concession applicable to charitable and religious trusts.

The Budget also provides for changes in the scheme of taxation of private discretionary trusts. The private discretionary trusts are those trusts in which the shares of the beneficiaries of the income are indeterminate, that is they are not specific. Such discretionary trusts were charged to income tax as a single unit or association of persons. This enabled the reduction in income tax liability by wealthy individuals by transferring property to one or more trusts and giving the trusts the power to accumulate the income and apply the same for the benefit of one or more beneficiaries at their will and choice. Wealthy individuals created a multiplicity of such trusts so that each trust had a low income and the incidence of tax of each of the trusts was at a low rate.

In order to curb the proliferation of discretionary trusts for tax avoidance, the Budget has proposed that such trusts will be taxed at the flat rate of 65 per cent or the higher rate of tax applicable to them as associations of persons. Thus it is sought to prevent tax avoidance through the method of discretionary trusts. However, genuine discretionary trusts are not covered by these provisions because all the following types of discretionary trusts are exempted from them : (a) trusts where all the beneficiaries of the trust have no income chargeable to tax; (b) trusts created by will and (c) trusts created by non-testamentary instruments before March 1, 1970 provided that the income tax authorities are satisfied that the trust was created exclusively for the benefit of the dependents of the settlor. Thus Trusts which are genuine and not created specifically for tax avoidance, will be charged to tax as if they are associations of persons.

Agricultural land taxed

The inequitable situation under which the so-called agricultural lands in urban areas were exempt from tax on capital gains arising from their sale is sought to be remedied by the Budget. It has been provided that capital gains tax will apply in respect of agricultural land situated in urban areas in respect of all transfers made of such land after March 1, 1970. The urban area is defined as an area within the limits of a municipality or town having a population of 10,000 persons or an area within 8 km distance from the limit of such municipalities in cases where the urban area was growing towards such limits and so notified by the Government. These changes will also remedy an inequitable situation under which certain types of land were sold in urban areas and escaped the normal law of capital gains tax,

The plugging of loopholes which have resulted in substantial tax avoidance in the past in the Budget is to be welcomed for introducing a measure of fairness and equity in the taxation structure of the country.

Corporate taxation

The taxation of income of companies and businesses has been left more or less untouched except for two minor changes. It has been provided that entertainment expenses incurred after February 28, 1970 will be disallowed totally in computing the taxable income. Further, the expenses on maintenance of guest houses by businesses incurred after February 28, 1970 will also be disallowed unless the guest house is a holiday home for the benefit of the employees of an assessee employing more than 100 people. These are minor changes whose burden will be a token rise in the tax payable by businesses and companies. By leaving the structure of corporate tax intact the Prime Minister has infused tremendous confidence and enthusiasm in the minds of businessmen and has also revived the stock market which depends on corporate news and corporate taxation. The revival of the capital market after the Budget should help in creating conditions under which new entrepreneurs can raise capital from the stock markets of the country and help spur industrial growth. The Budget also contains a few other minor changes in respect of taxation of income which have little economic significance.

The Budget has provided for a substantial step up in the rate of wealth tax payable by individuals and Hindu undivided families. The rates of wealth tax are stepped up thus: on net wealth between one lakh and five lakh, the rate

is increased from half to one per cent; on net wealth between five and ten lakhs, the rate is increased from one to 2 per cent; on net wealth between Rs. 10 lakhs to Rs. 15 lakhs the rate is raised from 2½ to 3 per cent; on net wealth between Rs. 15 lakhs and Rs. 20 lakhs, the rate is raised from 29 to 4 per cent and on net wealth in excess of Rs. 20 lakhs the rate is raised from 3 to 5 per cent. This constitutes a substantial increase in the normal rates of wealth tax payable by individuals. These increases in the wealth tax rates coupled with the increase in the income tax mentioned earlier result in a penal and confiscatory pattern of taxation in respect of individual wealth and unearned income above a slab of wealth around Rs. 8 lakhs to Rs. 10 lakhs, which can be estimated to yield an earning income of around Rs. 70,000 to Rs. one lakh.

Indeed, the Prime Minister has correctly mentioned that as a result of the Budget proposals there would also be an effective ceiling of Rs. 25,000 in respect of net residue left out of unearned income after payment of income tax and wealth tax by individuals. This ceiling is reached around levels of wealth between Rs. 8 lakhs to Rs. 10 lakhs coupled with levels of income between Rs. 70,000 and Rs. one lakh. Beyond the limits of income and wealth, the wealth tax as proposed in the Budget will exceed the net residue from income after payment of income tax and so will ensure a continuous confiscation of wealth and capital in the case of the individuals. These are harsh changes proposed in the Budget, because in effect they are confiscatory and constitute a capital levy on wealth above certain relatively modest limits. These modifications could therefore affect adversely the ability of individuals to save and invest in the coming years and indeed

they are likely to do so. It is suggested that these proposals **should** be reconsidered so as to lay down that the total of wealth tax and income tax payable by an individual should not exceed a reasonable percentage of his income per year in order to retain a minimum measure of incentive for savings and growth.

Additional wealth tax

The Budget has also proposed introduction of extremely harsh additional wealth tax in respect of urban properties, which are not used for business purposes by the assessees. It has been provided that in respect of urban properties held by individuals and Hindu undivided families which are not used for business purposes, an exemption of up to Rs. 5 lakhs would be given and thereafter an additional wealth tax will be payable on them will be at the rate of 5 per cent on the net value of the property between **Rs. 5 lakhs to Rs. 10 lakhs** and at the rate of 7 per cent on the value of property above Rs. 10 lakhs. A provision has been introduced to ensure that individuals cannot avoid this penal wealth tax by transferring their properties to companies or partnerships. This provision provides for the taxation of such properties held by partnerships and private companies in the personal tax assessments of their partners or shareholders. Thus in respect of urban property above Rs. 5 lakhs the total rate of wealth tax payable will be 7 per cent and the rate then will rise up to 12 per cent of the net wealth. The burden of such taxes will be so high as to ensure that individuals will find it extremely uneconomic to own urban property in excess of Rs. 5 lakhs and this is tantamount to introducing a ceiling on urban property over a period of time through confiscatory tax measures. The new proposals will therefore lead to **frag-**

mentation of urban property as well as depreciation in the values of urban property held by large landlords who will be compelled to sell their property over a period of time merely to pay wealth tax on them.

In the context of sharp increases in wealth tax rates, the Prime Minister has introduced a new exemption from wealth tax up to a limit of Rs. 1.5 lakhs in respect of investments in the following types of assets: government securities, shares of Indian companies, debentures of co-operative societies and approved institutions, deposits in companies and units of the Unit Trust. Assesseees will be able to deduct up to Rs. 1.5 lakhs of their assets invested in such forms of investment for computing their net wealth provided that these assets are held for more than six months before the date of their wealth tax valuation. This exemption of Rs. 1.5 lakhs will encourage people to invest in these types of assets and in view of their high marginal rates of wealth tax it will make investments in such assets more attractive. The provision also gives an individual a fairly generous choice of investment alternatives. It is likely to induce investors to invest in shares of companies and thus accelerate the recovery of share prices on the stock markets. The exemption of Rs. 1.5 lakhs is only in respect of certain assets mentioned above and will continue the scope for individuals to secure further exemption from wealth tax by investing in shares of new companies by subscribing to their initial issues, and through various other exemptions formerly available such as exemption of Rs. one lakh for a house used for a residual purposes which is sought to be now made uniformly applicable for all assesseees as per the Budget proposals. High marginal rates of wealth tax will now necessitate careful planning by **invest-**

ing all their assets in order to take the maximum advantage of the various exemptions from wealth tax given under the Wealth Tax Act. These exemptions can thus be used as a powerful instrument to direct investment activity in such diverse fields as the Government considers desirable. The taxation of discretionary trusts under the wealth tax is now sought to be done at one and half per cent or the higher rate applicable to individuals to prevent the avoidance of wealth tax by the proliferation of such trusts by small capital value duty.

The rates of gift tax applicable during the financial year 1970-71 have been stepped up to make them similar to those of estate duty and the exemption under the gift tax is to be reduced from Rs. 10,000 to Rs. 5,000. This will involve an additional tax burden.

Heavy price

The imposition of heavy and indeed harsh and confiscatory direct taxes as proposed in the Budget involves a very heavy price which individuals are now asked to pay in order to contribute towards the development effort in the **Five-Year** Plans of the Government. If the development efforts are successful the price which is now sought to be extracted by the imposition of direct taxes may be worth paying. But if on account of administrative failures and other causes the country's development effort fails or succeeds only partially then the price of harsh direct taxation imposed by the Budget on individuals will be excessive and even lead to economic maldistribution of investments and savings of the country. A closer look should therefore be given to the proposals for direct taxation as contained in the Budget with

a view to making the rates of income tax and wealth tax more reasonable or impose a ceiling on the total tax liability of individuals as a percentage of their gross income.

To sum up, the Budget has proposed substantial increases in taxation for the financing of the Plan and the various other governmental activities sought to be undertaken in the coming years. The direction of the development effort appears to be sound. But the direct taxes proposed in the Budget appear to be excessively harsh in the context of the development effort. The country is poised for accelerated economic progress in the coming years. It will be achieved only if sound economic policies are followed, taxation is maintained at reasonable levels and the political fabric of the country remains sound and healthy.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise.

**"Free Enterprise was born with man and shall
survive as long as man survives."**

—A. D. SHROFF

(1899-1965)

Founder-President,
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