

A DRASTIC BUDGET

by

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

**—Eugene Black
President, World Bank**

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IT would be no unfair comment on the Union Budget just presented to Parliament to say that it is the most drastic Budget India has ever had within living memory. When the Budget proposals were first announced, several persons started expressing their views and opinions without caring to study what precisely the proposals and their repercussions were. On second thoughts, which were not only better but also sadder, most people have come to the conclusion that the Budget makes the most depressing reading. It is a Budget which militates against the very basis of the avowed financial policy of the country, viz., sound development of the national economy and capital formation. Many of the proposals are not only ill-conceived, but are drafted with unabashed negligence and indifference.

The Finance Minister announced in his speech introducing the Finance Bill that he had tried to simplify the tax structure. But a careful study of the various amendments proposed to be made, particularly in the Expenditure-tax Act, would leave no doubt that for every step taken towards simplification of the tax structure, there are two or three steps taken towards further complexity. Thus on the whole the nation is worse off than before.

Let us start with the amendments proposed to be made to the Indian Income-tax Act. For the last many years foreign income has been exempt from tax to the extent of Rs. 4,500/- if it is not received in or brought into India. By the new Finance Bill this exemption is sought to be taken away. The taking away of the exemption will hardly make any appreciable difference to the total collection of income-tax. There seems no rational reason why this exemption should now be abolished. The item is comparatively small but it shows how the whole trend of recent tax legislation is towards making one microscopic section of the public pay more and more tax without the slightest consideration of justice or fairplay.

The most drastic amendment sought to be made in the Income-tax Act by the new Budget is the abolition of the principle of the grossing-up of dividends. It is surprising how few persons, even among the leaders of the country in and outside Parliament, understand the precise implications of the proposed change. The proposed change requires to be considered at some length because it affects a very large number of middle-class people who have made investment in shares. Since the commencement of the Indian Income-tax Act in 1922, the law has been that any income-tax paid by a company is deemed to be paid by the shareholders. This is the principle embodied in Sections 16(2), 18(5) and 49-B of the Indian Income-tax Act. But for those sections, the shareholders could not get credit for the tax paid by the company since the company is a legal entity independent of and distinct from the shareholders. Since the profits of the company ultimately find their way into the pockets of the shareholders, it would virtually result in double taxation if income-tax is recovered both from the company and from the shareholders. With a view to avoiding double taxation, the law wisely and reasonably provided that income-tax paid by the company was to be deemed to have been paid by the shareholders, with the result that the shareholders did not pay income-tax over again on those dividends which were

declared out of profits on which the company had already paid income-tax. If the shareholder's income was below the minimum taxable limit or was not assessable at the maximum rate, he got full or partial refund of the income-tax paid by the company. The new proposal is that this principle of credit being given to the shareholders for the income-tax paid by the company should be done away with. The result would be that the yield on shares will now be reduced and the company and the shareholder between them will be paying more by way of tax than they used to pay so far.

My first objection to this drastic change in the law is that it is proposed to be made by the Finance Bill which never goes to a Select Committee, instead of being made by a proper Amending Act which should receive full consideration at the hands of a Select Committee. If a Bill goes to a Select Committee, there is scope for various points of view being duly canvassed and some reasonable solution being arrived at to meet the conflicting points of view. It is very typical and characteristic of the way in which "democracy" works in this country that most of the important amendments with the most far-reaching consequences in the field of taxation have been made year after year by the Finance Bills which do not go to a Select Committee. The far-reaching changes are brought in, so to speak, by the back-door. Public opinion is treated with utter contempt by the powers that be and even in Parliament there is hardly a reasonably adequate opportunity of debating the pros and cons of the proposed changes, thanks to the terrific spate of legislation.

More than 80% of the capital of limited companies is held by middle-class people. To the middle-class man one percent more yield or less yield on his investments in shares is of very vital importance. The result of the abolition of the principle of grossing-up of dividends would be that the aggregate yield on investments in shares will be appreciably reduced in many cases. At a time when the Government should strive hard to induce

taxable income must suffer deduction of tax at the full rate when he gets the dividend from the company. This is an absurd anomaly and deserves to be remedied before the proposed amendments are passed into law.

Let us turn to another provision which shows how incessantly and insensately our taxing provisions are changed from year to year without rhyme or reason. Companies to which Section 23A of the Indian Income-tax Act applies are required to declare a certain percentage of their net profits by way of dividend. Under the last year's Budget certain companies to which Section 23A applied were required to declare 45% of their net profits by way of dividend and for others the percentage was 60. This 45% is proposed to be changed to 50%, and 60% is proposed to be changed to 65%. Although nothing has happened during the last twelve months which can conceivably afford the slightest justification for a change in the percentage, a change is still proposed to be made. We are a "dynamic" society, our laws are "progressive" and, therefore, we must keep on chopping and changing our laws as frequently as possible. If you protest against these ill-digested and ill-conceived perennial changes in the law, you will be branded as a "reactionary". At the risk of being called a "reactionary", I shall express my firm conviction that one of the worst and the least defensible characteristics of the tax laws of India is that they are not stable at all. The taxing laws are changed every year needlessly, gratuitously, and without the slightest consideration for the enormous inconvenience caused to the public. The changes are so many, so illogical, and so badly worded that even the greatest expert in the field of the law would find it difficult to tell you off-hand what the legal position on many topics was at a given point of time; much less can the average member of the public even understand anything about the perennial stream of legislative changes and the gathering avalanche of amendments in the taxing statutes. Since all the taxing proposals relate back for one year, it is most essential that no changes should be made

except for compelling reasons. During the last few years the percentage of dividend which Section 23-A companies have to declare has been changed at least half a dozen times for no comprehensible reason whatever. This may make the Budget Session exciting and mysterious, but it deprives the law of two of its most essential requisites, viz., stability and certainty. The Indian Penal Code was drafted by Lord Macaulay between 1834 and 1838. It has stood for 120 years with hardly ten amendments. Is there one important piece of legislation enacted during the last ten years which has not suffered at least one amendment every year? The very foundation of our Government — the Constitution of India — has been amended seven times between 1950 and 1956. These are not the indicia of a 'dynamic' society. These are rather the hallmarks of a careless Government, legislating without any consideration for the stability of the law or for public convenience. It was said of the old Greeks that they passed their laws when they were drunk and considered them when they were sober. The future historian will not have many complimentary things to say about the taxing laws of India today.

Let us come then to the proposed changes in the Wealth-tax Act. You will find an increase of half a per cent proposed in the rates of wealth-tax at every slab. The half per cent looks innocuous but in practice it imposes a most severe burden. Take, for example, a man who earns one lac of rupees per year by his ability and hard work in any profession, employment or business. Any income that he derives from investments, over and above that earned income of Rs. 1 lac, would attract income-tax and super-tax at the maximum rate of 84%. If he has a fixed deposit with a Bank and earns 4% interest thereon, he would be left with 16% of such interest after paying 84% by way of income-tax and super-tax. Now, the wealth-tax is 1% at the lowest slab. One percent of the capital would come to 25% of the yield, if the yield is at the rate of 4% on the capital. Thus the assessee would have to pay 84% by way of income-tax and super-tax and 25% by

way of wealth-tax, i.e. 109% in all, on his investment income, and this would be the position even if his wealth is just a little over two lacs of rupees since the rate of 1% wealth-tax applies to the first slab of taxable wealth above Rs. 2 lacs. Is it at all rational and just that a man with a capital of only Rs. 2 lacs should have to pay 109% by way of income-tax, super-tax and wealth-tax on his investment income? Is India the only Welfare State in the world? Are there not other countries whose Governments have the welfare of the people at heart as much as the Indian Government? Why is it that no other Government of the world has resorted to the fantastic type of direct taxation exceeding 100% of the income?

Let us look at another provision of the Wealth-tax Act. The Revenue in computing your wealth will give you no allowance for your tax liability which has not crystallised in an assessment order at a valuation date. The absence of an assessment order may be due to no fault of your own. You may have knocked at the door of the Income-tax Officer twenty times during the year and still no assessment may have been completed. But because the assessment order is not passed, you are not to get a deduction in respect of your tax liability in computing your net wealth. This is obviously unfair. It is surprising that after levying taxes at such crushing rates the Government should further be unfair enough to deny to the citizen a legitimate deduction in respect of a tax liability even if it is clearly due as a liability, merely because an assessment order is not passed at the valuation date. This is one more instance of how the administration of taxing laws in this country is divorced from all considerations of justice and fairplay.

There is another provision which is sought to be introduced by the new Budget. Even if an assessment order is passed, if your taxes are in arrears for twelve months, those tax liabilities would not be allowed to be deducted in computing your net wealth. The Wealth-tax Officer may put a very generous value

on your immoveable property, he being under no obligation either to buy it at that price for himself or for the Government he represents. You may find no buyer for the house and you may have no other funds out of which to pay your wealth-tax. Likewise, you may be taxed under Section 9 of the Income-tax Act in respect of the *bona fide* annual value of your house property which may actually bring you no income in fact. Instances can be multiplied where an assessee may be *bona fide* in arrear so far as his tax liability is concerned; yet, even in a *bona fide* case, such arrears of tax liability which have not been discharged for one year are not allowed to be deducted in computing the assessee's net wealth. This is another crying injustice sought to be perpetrated by the new Budget.

Let us now come to the proposed changes in the Expenditure-tax Act. When the Expenditure-tax Bill was first presented to Parliament in 1957, its provisions were very drastic. The Bill went to a Select Committee which consisted of the members of the ruling party as well as the members of the Opposition, including the Independents. The Select Committee suggested certain proposals which were implemented and incorporated in the Act as ultimately passed by Parliament. Many of those very changes, proposed by the Select Committee and adopted by Parliament, are now sought to be torpedoed by the new Budget. No democracy can function on the right lines if the recommendations of a Select Committee, made after mature consideration and deliberation, are to be jettisoned within two years for no explicable reason except the "dynamic" urges of a Government impervious to public opinion. This is the very negation of democracy. It is Oligarchy. Why go through the farce of a Select Committee and waste the valuable time of important members of Parliament if the Government is to set at naught their considered proposals in just two years' time?

Kaldor had said that income-tax, wealth-tax and expenditure-tax between themselves should not exceed 100% of the income.

One would have expected some relaxation in the Expenditure-tax Act or alternatively reduction in the rates of income-tax and wealth-tax. But, on the contrary, in the new Budget whereas the income-tax rates remain the same, the wealth-tax rates have been appreciably increased and the Expenditure-tax Act has been made much more drastic. In the entire history of fiscal legislation, the Expenditure-tax Act, after the amendments sought to be made by the new Budget, will remain as one of the most unjust and most unreasonable taxes ever devised by the wit of man, in the context of the high rates of income-tax and wealth-tax.

Looking at the provisions of the Expenditure-tax Act, one would think that to spend your own money is the greatest anti-social offence you could commit. Formerly the State looked with disfavour on citizens who spent other people's money. Now it looks with disfavour on those who spend their own.

Under Section 3 of the Expenditure-tax Act, the Act did not apply to you till last year, if your net income after paying income-tax and super-tax was less than Rs. 36,000/-. In deciding whether your net income was Rs. 36,000/- or less, your own income alone was taken into account. Under the amendments proposed by the new Budget, your income, the income of your wife, the income of all your minor children and the income of any major child or any other person who is wholly or mainly dependent on you, are clubbed together in determining whether the figure of Rs. 36,000/- is reached or not. An idea of how the new Budget makes complicated laws still more complex is afforded by the fact that the Finance Bill proposes that in computing the said sum of Rs. 36,000/- there should be included any sum in money or money's worth spent for the benefit of the assessee out of the income of the Hindu joint family, where the assessee is a member of a Hindu joint family. How is anyone to compute the value of money's worth spent by the joint family for the benefit of an individual member? Under the Expenditure-tax Act as it stood so far, it was easy enough to calculate whether the

assessee's net income exceeded Rs. 36,000/- or not. Now it would be infinitely difficult to determine that question, because all kinds of disputes would arise between the Department and the assessee as to the value of money's worth spent for the benefit of the assessee by the joint family of which he is a member. This is typical of the "simplification" of the tax structure which is supposed to be brought about by the new Budget.

Now I come to a most important point, namely, the careless way in which the Notes on Clauses are drafted. The Notes on Clauses appear as a part of every Bill which is before Parliament. They are supposed to indicate to the members of Parliament the objects which are sought to be achieved by the proposed changes. It must be a matter of deep regret to every citizen that as the years go by, the Notes on Clauses, which were formerly just negligently drafted, are now so drafted as to be positively misleading. For instance, under Section 4 of the Expenditure-tax Act any expenditure incurred by a person other than the assessee in respect of any obligation or personal requirement of the assessee was includible in the assessee's own expenditure provided the expenditure was such that "but for the expenditure having been incurred by that other person, it would have been incurred by the assessee" himself. In the new Budget it is proposed that the words, "which, but for the expenditure having been incurred by that other person, would have been incurred by the assessee", should be omitted. Now, these are crucial words which make all the difference, because under the existing law if the expenditure is such that you would not have incurred it yourself if it had not been incurred by the other person, it is not to be included in your total expenditure, whereas after the proposed amendment even such expenditure of another person would be taxable in your hands. But amazingly enough the Notes on the Clauses say that these crucial words are omitted because they "appear to be unnecessary". If a student appearing for the First LL. B. Examination was asked to state whether the proposed omission of the words made any

change and he stated that the words proposed to be omitted were unnecessary, he may, I daresay, fail in his examination. If a clerk getting a salary of Rs 200/- per month prepares the minutes of a meeting on the basis that the omission of the words aforesaid would make no difference to the point at issue, he may be promptly sacked. Here is the contrast between the degree of care and intelligence which a citizen is required to show in his personal affairs and the degree of care and intelligence which is shown by those who deal with the affairs of this sub-continent. This is to my mind a most serious matter. Surely, those who are entrusted with the task of drafting the laws of this country must realise their responsibility and take at least elementary care about what they put in the Notes on Clauses. It is better to have no Notes on Clauses than to have Notes which are so grotesquely misleading.

An illustration would make clear the difference between the old law and the law after the proposed change. Suppose somebody buys a carpet or a piece of furniture for you exceeding Rs 5,000/- in value. The article may be to meet your personal requirement but it may be such that you would not have yourself incurred the expenditure in buying it if it had not been gifted to you. Under the old law you paid no expenditure-tax in respect of such an item, but after the proposed change you would have to pay expenditure-tax. Is it rational that a man should be asked to pay expenditure-tax in respect of a gift made by another person in such circumstances? It must be remembered that the person making the gift would have to pay gift tax in addition to the expenditure-tax payable by the donee.

Look, again, at clause (ii) of Section 4 of the Expenditure-tax Act as proposed to be amended by the new Finance Bill. Under the proposed amendment, any expenditure incurred by the wife, minor child or any major child or other person dependent on the assessee out of any income or property transferred, directly or indirectly, to the dependant by the assessee would be included

in the assessee's taxable expenditure. Thus, even if the properties were transferred many years ago when expenditure-tax was not even dreamt of, the expenditure of the entire family would be clubbed together and taxed at rates which go quickly up to 100%.

Next, there is Section 5 of the Expenditure-tax Act which provides for certain exemptions. Under the existing law any expenditure on the repairs, maintenance or improvement of any immoveable property is exempt from tax. Under the changes proposed to be made by the new Budget all expenditure on repairs, maintenance or improvement of any immoveable property is sought to be charged to expenditure-tax. The result of the proposed change would be that even if you are compelled by a notice issued by the Municipality to repair a building which you have let out to tenants, you would still have to pay expenditure-tax in respect of the cost of such repairs. Amazingly enough, the Notes on Clauses say that the proposed change "removes an exemption allowed in the case of certain expenditure in relation to owner-occupied properties because the expenditure in such cases is really in the nature of personal expenditure." There is not a syllable in the proposed amendment to suggest that the amendment applies only to owner-occupied properties. On the contrary, the proposed amendment would make it clear beyond the shadow of a doubt that repairing properties let out to tenants would still not qualify for exemption from expenditure-tax. This is again another instance showing how absurdly misleading the Notes on Clauses are. What public cause is the Government serving by providing a further disincentive to landlords to repair buildings let out to tenants? As it is, it is difficult enough to get landlords to repair buildings, having regard to the high cost of repairs and the freezing of rents under the Rent Control Act. How are the requirements of a Welfare State promoted by penalising a landlord who is decent enough or law-abiding enough to effect repairs for the benefit of his tenants? Not only repairs, but even ordinary maintenance of any immoveable property is liable to

expenditure-tax; e.g., white-washing of the building or keeping the electrical fittings or the lift in good trim would attract expenditure-tax. Likewise, taxes paid to a Municipality in respect of a house property in the occupation of the owner or any of his dependants, which were exempt from expenditure-tax so far, are now sought to be made liable to expenditure-tax. This is truly fantastic. There is no rational basis for levying expenditure-tax on the amount of tax paid by a man to the State or a public authority. No doubt, the expenditure-tax affects only a small section of the nation. But a law does not cease to be iniquitous and oppressive because it affects only a small section of the people.

What after all is the justification for this unparalleled crushing burden of tax? It is said that this type of taxation is necessary to finance the successive Five-Year Plans. Economists have calculated that even after twenty years of planning, the national income will only be double of what it is now and even then we will be among the poorest nations of the world. A very substantial part of the huge amounts raised by crushing a section of the people really goes down the drain. It is amazing how many scandals in the public sector, how many instances of utter waste of public funds, how many examples of sheer extravagance in administering the country are allowed to occur year after year without any proper enquiry or any conscientious effort to prevent their recurrence. In the meanwhile, the burden of taxation keeps on mounting higher, the cost of living goes up, the poor man is dissatisfied, the middle-class man is dissatisfied and the rich man is dissatisfied. The old nation still rolls groaning along its way with increased burdens every year. There is a seething discontent in the public mind. History records how top-heavy taxation has resulted in the overthrow of nations and of Governments. When you realise that even in the premier communist country, Russia, the maximum level of income-tax is 11%, when you realise that no other nation of the world has resorted to direct taxes aggregating more than 100% of the income, although many foreign

nations are truly Welfare States, you realise that there must be something radically wrong with either the doctrinaire ideology of our Government or the quality of their administration.

Men of vision and knowledge would readily realise that a system of taxation which breeds widespread discontent, which is administered without understanding or sympathy and which breeds a nation of tax-dodgers is not particularly conducive to the economic progress of the nation; that to bleed the nation white today in the hope of giving it nourishment tomorrow is neither fair nor reasonable; that doctrinaire planning is good, but a realistic appraisal of human nature and the practical needs of a contented society are infinitely better; and that a Welfare State which denies to a citizen the fruits of his own labour is a contradiction in terms.

The views expressed in this Booklet do not necessarily represent the views of the Forum of Free Enterprise.

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

—A. D. Shroff

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