UNION BUDGET 1968-69

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FORUM OF FREE ENTERPRISE

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

—Eugene Black

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By

N. A. PALKHIVALA*

This year will go down in India's economic history as the year which witnessed the evolution and successful experimentation of what may be called "the pre-Budget technique". For several weeks before the Budget, speeches from the highest quarters assiduously conditioned the public mind to expect and anticipate heavier doses of taxation. So when the Budget came, in which the crushing levels of taxation were maintained but not increased, it was welcomed in some quarters with a sigh of relief.

Every budget has legal effect for only one year, but its economic consequences endure for years. A nation continuously moulds and shapes its future as it lives through the present and meanders from one budget to another. The crucial question is — what is there in this year's Budget to inspire confidence and hold out hope for a brighter economic future?

As many as 3.5 million unemployed are today on the registers of the 437 Employment Exchanges in India. The total figure of the unemployed would be really more than 7 million. Since there are 16 million people employed in both the private and public sectors, there is one disappointed job-seeker for every two persons employed; and unemployment grows at the rate of more than one lakh a month.

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* Mr Palkhivala, well-known authority on taxation, is a Vice-President of the Forum of Free Enterprise. The text is based on a talk delivered under the auspices of the Forum in Bombay on March 4, 1968.

The future of India, in any event the future of democracy in India, depends upon industrial expansion and vast increase in production in both field and factory. There is nothing in this year's Budget to bring about even the requisite minimum rise in the gross national product.

The rates of individual and corporate taxation will be substantially the same this year as they were in the Budgets of the last two years. If those two Budgets did not revive the economy and did not give a stimulus to industrial expansion, it is difficult to see how this year's Budget can achieve that result. "Triumph of hope over experience" was Dr. Johnson's terse comment on the remarriage of a friend whose married life with his first wife had been very unhappy. These words aptly describe the approach of the Finance Ministry to India's economic problems.

No doubt, the Budget has merits. It has the merit of not having imposed additional disincentives in the form of higher levies, despite an estimated deficit of Rs. 290 crores. It has the further merit of having conceived of liberal incentives for export trade. Moreover, it has given the quietus to the Annuity Deposit Scheme which passes out of our fiscal system unhonoured and unsung.

The Finance Minister was, on the whole, right in preferring deficit financing to the two other alternatives—"massive mobilisation of resources" (which in plain language means lethal instead of crippling taxation) and undue curb on that type of governmental spending which helps the economy. A sum of Rs. 1,859 crores set aside for Plan expenditure would sustain the engineering and other industries. Even during the Second Plan (1956-61), deficit financing reached the total figure of Rs. 954 crores, but because of the 25 per cent increase in agricultural and industrial production during the same five-year period the national economy took the deficit in its stride.

There were, however, four other alternatives before the Finance Minister which, if adopted, would have opened a new chapter in the economic history of the country.

Frist, a vigorous and determined attempt should have been made to cut unproductive governmental expenditure which is increasing apace. Expenditure on civil administration amounted to Rs. 107 crores in 1964-65 and is now estimated at Rs. 186 crores in the Budget this year. The total number of employees in the Central and State Governments has reached the staggering figure of 6½ millions. The estimate that more additional floor space is brought into use for official paper work than the new acreage brought under cultivation may, however, be rejected as slightly exaggerated.

Secondly, there is no reason why the entire nation should continue to pay for the monetary indiscipline of certain States. Last year the Centre gave Rs. 113 crores to some States to clear their unauthorised overdrafts with the Reserve Bank as at the 31st March 1967. Rs. 50 crores is provided for in this year's Budget by way of further gratuitous assistance to the States which choose to live beyond their means.

Thirdly, the Public Sector, which was heralded amidst immense flourishes of trumpets as the harbinger of an era of economic progress and general well-being, must stop being a positive drag on the nation's development. On a total investment of about Rs. 2,100 crores in the running units in the Public Sector, the net return is only about Rs. 12 crores, i.e. 0.57 per cent. Political ideology has blinded us far too long to the abysmal inefficiency in the area which is supposed to represent the commanding heights of the national economy.

Fourthly, this year afforded a great opportunity for revitalising the moribund economy by reducing the rates of corporate and individual taxes. Such a reduction, coupled with the cut in the Bank Rate from 6 to 5 per cent and the hundred-million-tonne food crop, would have really stimulated industry. Income-tax on companies will yield Rs. 324 crores, while income-tax on other assessees will yield Rs. 305 crores. If the corporate rates were reduced from 55 and 60 per cent to 50 and 55 per cent respectively, and if the 10 per cent surcharge on personal income-tax were removed, the theoretical total loss to the Exchequer would only be Rs. 57 crores. More than half of this loss would most probably have been easily made up by larger collections of excise, income-tax and other levies which grow with the economy. In any event, Rs. 57 crores represents about 1 per cent of the total governmental expenditure of Rs. 5,400 crores which is the subject-matter of the Budget. Rs. 57 crore reduction in direct taxes would have been an insignificant price to pay for reviving the economy.

The abolition of the "Dividend Tax" will benefit only a few companies, in view of the large number of bonus shares issued in the recent past. Again, the reduction of surtax from 35 to 25 per cent will mean little relief to the corporate sector. This is proved by the fact that the total loss of revenue involved in corporate taxes, as a result of the Budget proposals, is only Rs. 4 crores.

As regards individuals, the discontinuance of the Annuity Deposit Scheme is a most welcome measure. That Scheme will no longer be in operation from the assessment year 1969-70 onwards, but its body will remain embalmed in the unrepealed sections of the Income-tax Act and will help to silence any controversy at a future date as to which was the most cumbersome scheme of compulsory saving ever devised by the wit of man.

The abolition of the separate surcharges and the proposal to tax earned and unearned incomes at the same rates, would mean a positive relief in income-tax in respect of unearned income, but this will be fully offset by the increase in wealth-tax rates. The proposal to have a Public Provident Fund Scheme is a step in the right direction, with the three benefits of tax exemption in respect of the voluntary contributions made by self-employed assessees, exemption from wealth-tax, and exemption from income-tax when the amounts are paid back out of the Fund. Likewise, the other Scheme of Five-Year Deposit carrying $4\frac{1}{2}$ per cent tax-free interest would also result in some fiscal benefit. But it is important to note that these two Schemes will not release any savings for industry.

The total corporate and individual savings for the Private Sector, which would be released under the Budget, would be only about Rs. 25 crores. This is a small figure, as compared to the money resources of Rs. 1,500-2,000 crores which are estimated to lie with agriculturists as a result of the fantastic rise in foodgrain prices.

There are different ways in which nations deal with economic crises. Some nations pursue such policies that a crisis is not allowed to start at all. Others pursue the policy of averting an impending crisis after it has started brewing. We pursue the policy of waiting till a crisis has overtaken us and completely engulfed the national economy. This is proved by our dogged refusal to give any fiscal relief even when the textile industry and the engineering industry are in a condition of such acute distress. This is also borne out by our refusal to give proper incentives for export till our export earnings have reached a critically low ebb. Our jute exports declined during the same period that Pakistan's exports registered a steep increase, while the small island of Ceylon could export more tea than this huge sub-continent.

The export incentives now proposed are very belated, but not the less welcome for that reason. However, it is a grave indictment of our economic policy that it takes us more than a year and a half after the devaluation of the rupee on the 6th June 1966, to take the first concrete measures towards reaping the fruits of devaluation. "The diagnosis which pointed to the need for appendectomy in the form of devaluation was not wrong. The expectation that the surgeon would stay awake through the operation and not fall asleep with the scalpel in his hand, was."

The eminent economist, Dr. P. S. Lokanathan, has observed in a recent Report published by the National Council of Applied Economic Research: "There is not the slightest doubt that the major factor responsible for the poor shape of the capital market is the Government's fiscal policy.... The continued sluggishness of the market in India has no parallel in other countries; it is something special to India and reflects Indian policies and Indian performance."

The depressing fact is that even after this "mild" Budget, India will still remain the Highest Taxed Nation, so far as direct taxes are concerned. When the Government tries to refute this case, one is tempted to say that just as no taxation without representation is one principle of democracy, the other is—no taxation with misrepresentation. The maximum marginal rate of income-tax will now be 82.5 per cent on earned as well as unearned income, in addition to wealth-tax which will be up to 3 per cent. The maximum marginal rate of personal income-tax is only 45 per cent in France (on earned income), 53 percent in Germany, 65 per cent in Sweden and 70 per cent in U.S.A. There are several socialist countries in the world, but India is the only country where income-tax and wealth-tax can together amount to more than 100 per cent of the total income.

The most expensive hobby of Indians is work. Comparative data, some of which are collected in the Seventeenth Report of the Public Accounts Committee published recently, establish beyond doubt that, on the whole, we impose heavier tax on honest enterprise and endeavour than any other country.

Likewise, corporate taxation in India is heavier than in any other country, barring countries like Indonesia and Burma which have substituted opaque ignorance for economic policy and are content to stand on the verge of ruin. In no other developed or developing country does the maximum rate of tax on resident companies soar beyond 54 per cent of the total income; whereas in India it can go beyond 70 per cent and the total incidence of tax as between the company and the shareholder can pierce the 94 per cent barrier.

In physics there is the absolute zero of temperature, known as Kelvin zero, which is reached at — 273.16°C.; nothing can, even in theory, be colder. As far as rates of taxation are concerned, India has almost reached Kelvin zero in its treatment of corporate profits.

It is well recognised that a high level of taxation in a developing economy is not disinflationary but positively inflationary, because if the solution to the problem of inflation is more production, then a very high level of taxation which reduces the margin of saving and the amount available for investment is a potential inflationary force. Further, it destroys all cost-consciousness as it destroys all ethics consciousness: a company has as little incentive to economise when 70 per cent of its expenses are met by the Government, as a citizen has to be honest when it is more profitable to evade tax on Rs. 20 than to earn Rs. 100.

Pakistan has successfully used the technique of fiscal incentives and has doubled its industrial production during its last Plan. The following are the main features of income-tax on individuals in Pakistan:

(i) The limit for exemption from income-tax is Rs. 6,000, as against Rs. 4,000 in India.

(ii) Apart from a personal allowance of Rs. 2,000, there is an education allowance of Rs. 300 per child upto a maximum of Rs. 900.

(iii) Earned income relief takes the form of exempting 20 per cent of the taxable earned income of non-salaried assessees, up to a maximum of Rs. 4,000, and 25 per cent in the case of salaried employees, up to a maximum of Rs. 6,000.

(iv) There is an investment allowance, which is much more generous (both in point of percentage of income and of the ceiling) than what is permitted in India in respect of provident fund contribution and insurance premium.

(v) The maximum rate of income-tax is 70 per cent as against 82.5 per cent in India.

(vi) Interest up to Rs. 500 on deposits in a savings account in any scheduled bank is exempt from tax.

vii) Dividend income is totally exempt from tax up to a ceiling of Rs. 5,000, as against only Rs. 500 in India.

viii) Whereas our Budget proposes to take the retrograde step of charging capital gains at the full income-tax rates if the asset is sold within two years, Pakistan has the following scheme of capital gains tax which affords a much better fiscal incentive to investment. If an asset is disposed of within six months, then alone it is treated as a short-term capital asset and the capital gains are charged at ordinary income-tax rates. If the asset is disposed of after six months but within five years, two-thirds of the capital gains or Rs. 10,000, whichever is the greater, is deducted from such gains and only the balance is charged at ordinary income-tax rates. If the asset is disposed of after five years, five-sixths of the capital gains or Rs. 20,000, whichever is the greater, is deducted from such gains and the balance is charged at ordinary income-tax rates.

The burden of taxation on resident companies in Pakistan is also appreciably lower. The rates range between 40 and 50 per cent, coupled with the added advantage that, on that portion of the corporate profits which is distributed as dividends, the tax is reduced by 10 per cent. Further, inter-corporate dividends are totally exempt from tax if they are derived from a subsidiary operating in another area. There is no scheme of development rebate, but the complete tax holiday for a number of years is, in several cases, more beneficial than our scheme of development rebate and partial tax holiday for five years.

India can hardly afford to lag behind Pakistan in industrial expansion or in the rate of growth of the gross national product. The Budget should have been balanced by getting a higher return from the Public Sector. Direct taxes should not have been allowed to remain at the level where they obstruct effort, deflect enterprise and constrict growth.

The claim has been made by successive Finance Ministers during the last five years that their Budget proposals have "simplified" Income-tax law. The truth of the matter is that the actual calculation of tax was considerably simplified by the Finance Act, 1965, and was further simplified by successive Finance Acts; and this process of simplification in the matter of tax calculation is proposed to be carried further by the Finance Bill, 1968. However, the substantive provisions of the Income-tax Act, 1961, are today more complicated than they were ever before, and will become further complicated by the amendments proposed in the Finance Bill.

Last month the Institute of Chartered Accountants in U.K. made a representation to the Treasury that the tax law of that country had become so confusing that it was difficult even for professional men to interpret the law and to offer sound advice to their clients. The position is much worse in India. The utter waste of intelligence, labour and time on the part of both the public and the Department, entailed by the complexity of, and unending changes in, our fiscal laws, is really beyond belief.

The Finance (No. 2) Act, 1967, started the practice of having two sets of amendments, one for the relevant assessment year and the other for the subsequent year. This practice has again been followed in the present Finance Bill. This practice only adds to confusion and to the difficulty of ascertaining the law at a given point of time.

Some of the important provisions of the Finance Bill which seek to amend the Income-tax Act, 1961, may now be considered.

Two changes are proposed to be made in respect of income from house property. Under the existing law the owner of house property of which the construction was completed after the 31st March 1950 and which is let out to a tenant, is entitled to a deduction in respect of only one-half of the total amount of the taxes levied by a local authority. This provision is patently unfair, and the injustice is sought to be redressed by an amendment to Section 24 which will permit a deduction in respect of the full taxes levied by any local authority.

The other proposed amendment is to Section 24. That section, as it stands today, permits a deduction in respect of the interest on any mortgage or capital charge created on house property; and it also provides that where the property is subject to an annual non-capital charge, the amount of such charge is allowable as a deduction. The result is that any owner of house property can, under the existing law, voluntarily create a charge on his own property in favour of any friend or relative and claim a deduction in computing his income from house property. This loophole will be plugged by the proposed amendment to Section 24, and charges created voluntarily by an assessee on his house property will no longer qualify for a deduction.

It is proposed to insert Section 35-B in the Income-tax Act with the object of granting "export markets development allowance". Specified categories of expenditure will qualify for a deduction of a sum equal to one and one-third times the amount of such expenditure. All the specified categories of expenditure pertain to operations outside India except expenditure on "obtaining information regarding markets outside India for such goods, services or facilities". Even if the expenditure is incurred in India for obtaining information locally regarding foreign markets, such expenditure would seem to fall within the proposed section. The new provision will apply only in respect of expenditure incurred after the 29th February 1968.

The proposed Section 35-C deals with "agricultural development allowance" and entitles a company to a deduction of a sum equal to one and one-fifth times the amount of expenditure incurred after the 29th February 1968 on agricultural inputs and other services to a cultivator, grower or producer in India of the agricultural raw materials used by the company. The extra allowance is available where the expenditure is incurred directly by the company and also where it is in incurred through an approved body or association.

The proposed Section 40A will have a very far-reaching effect. Sub-section (2) of that section provides that where the assessee incurs any expenditure in respect of which payment is made to a relative or to an associate concern, so much of the expenditure as is considered by the Income-tax Officer to be excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by him, shall not be allowed as a deduction. This section will result in more litigation and a larger crop of appeals than any other amendment of the Income-tax Act, 1961.

It is indisputable that any expenditure which is incurred out of family feeling or for extra-commercial considerations should not be allowed as a deduction. But for that purpose the existing law is quite adequate; and it not only permits but enjoins the Income-tax Officer to disallow any such expenditure. What the new section aims at doing is to substitute, in place of objective facts, the subjective opinion of the Income-tax Officer as to whether the expenditure is excessive or unreasonable. Such a provision is unfair both to the assessing Officer and to the tax-payer. It assumes omniscience on the part of the assessing Officer and attributes to him the capacity to evaluate accurately a variety of goods and services for which there is no market quotation.

Of recent years the administration of tax laws has run down very considerably. Unnerved by the perpetual talk of corruption in public life, and by excessive control and undiscerning criticism from the top, the officials are reluctant to shoulder responsibility and to proceed under their own steam. The Income-tax Officers are given more and more powers, and allowed less and less initiative and independent judgment. The environment and set-up are highly conducive to the general tendency to record conclusions adverse to the assessee and let the law take its course—its painfully prolonged and tiring course. The prick of official conscience is assuaged by the knowledge that the wronged assessee has the right of appeal and reference.

No doubt, vast talent, high administrative ability, and capacity to do full justice between the State and the citizen, are all there in the Income-tax Department. But their possessors are the victims of a pernicious system which prefers that such fine qualities should be kept latent and which breeds the feeling that it is dangerous to use initiative or discretion in favour of the tax-payer. At a time when the administration is in such a poor state, it is wholly wrong to insert a provision like Section 40A which will only result in endless disputes between the public and the Income-tax Department and further embitter the relations between them.

Under the present law an assessment must be completed within four years if the case does not involve any concealment of income. The proposed amendments to Sections 153 and 239 of the Income-tax Act, which will apply from the assessment year 1969-70 onwards, require the assessment in such cases to be completed, and the applications for refund to be filed, within two years. This is a step in the right direction and should help to accelerate the process of assessment.

Last year the Central Board of Direct Taxes issued a totally misconceived Circular to the effect that even if shares stand *bona fide* in the name of a bank but belong to the bank's constituent, the beneficial owner of the shares cannot get credit for tax deducted at source or tax relief in respect of dividends from newly established undertakings. This Circular has resulted in considerable injustice and hardship to honest tax-payers. This injustice will be removed by the proposed amendments to Sections 80K and 199.

Section 271 deals with penalty for concealment of income. The present provision is that the penalty should not be less than 20 per cent, or more than 150 per cent, of the amount of tax sought to be avoided. Under the proposed amendment, a penalty would be leviable even if no tax is payable at all under the assessment and, further, the penalty should not be less than, and should not exceed twice, "the amount of the income in respect of which the particulars have been concealed or inaccurate particulars have been furnished".

The most objectionable feature of the proposed amendment is that it will apply even to cases where the assessee may not be guilty of concealment in reality and yet by a fiction of law he is deemed to have been guilty of concealment. This is the effect of the existing Explanation to Section 271(1) which provides that where the total income returned is less than 80 per cent of the total income assessed (reduced by the expenditure incurred *bona fide* but disallowed as a deduction), "such person shall, unless he proves that the failure to return the correct income did not arise from any fraud or any gross or wilful neglect on his part, be deemed to have concealed the particulars of his income or furnished inaccurate particulars of such income". The result of the Explanation is that the tax-payer is presumed to be guilty unless he proves himself to be innocent, and oversight or negligence is equated with deliberate concealment. The new penalties virtually amount to confiscation, not only of the income but, in the discretion of the Income-tax Officer, also of an additional sum equal to the income. Further, the new provision does not even give discretion to the Income-tax Department to levy a penalty less than the amount of the entire income which is the subject-matter of dispute.

The most savage provision for penalty is, however, to be found in the proposed amendment to Section 18 of the Wealth-tax Act. Whereas under the existing law the minimum penalty for concealment is 20 per cent, and the maximum is 150 per cent, of the wealth tax sought to be avoided, now the penalty is proposed to be not less than the value of the wealth sought to be concealed, and not more than twice that value. In other words, if the wealth-tax is levied at the rate of 1 per cent, the minimum penalty is one hundred times the tax sought to be avoided. The really outrageous provision is that if there is a difference between the valuation of an asset or a debt shown in the Wealth-tax Return and the valuation determined by the Wealth-tax Officer, the assessee is deemed by a fiction of law to have been guilty of concealment. The gross injustice of such a provision becomes apparent when one considers that a large number of items chargeable to wealth-tax have no precise market value, e.g. lands, houses and shares of private companies. It is imperative that the proposed amendment should be recast to make it clear that the difference in valuation would be treated as amounting to concealment only if the assessee's valuation was done with the deliberate intent to evade wealth-tax.

It is extremely doubtful whether the proposed confiscatory provisions in the Income-tax and Wealth-tax Acts would be constitutionally valid, inasmuch as they will apply even in cases of honest tax-payers who are deemed to be guilty of concealment by a fiction of law.

Severe punishment is no doubt called for in the case of dishonest tax-payers whose nefarious evasion of tax increases the burden on their fellow citizens. But the problem arises as to the attitude of the law and of the administration towards those who are basically not dishonest but who expect the law to treat them fairly. With all the newly added powers, the Department will find it easy to strike fear in the heart of the tax-payer. Any administration can do that. It is much more difficult to inspire confidence and to evoke response and co-operation. If that is to be accomplished, the proposed changes in the law will have to be characterised by a more scrupulous regard to justice and fairness, and a higher public morality, than is evident in the Finance Bill.

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

— A. D. Shroff
(1899-1965)
Founder-President,
Forum of Free Enterprise.

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