THE UNION BUDGET 1999-2000

Positive Measures and Innovative Policies

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"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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by

H. P. RANINA*

The Finance Minister has made serious attempts to restore macro-economic balance to a fiscally disoriented economy. His primary balancing act has been in the field of indirect taxation by rationalising customs and excise duty structures. While the Finance Minister is optimistically betting on growth, his second budget is a model of realism and restraint.

He has formulated some innovative measures which, if implemented effectively, will substantially change the growth pattern of Indian industry. These measures include setting up of a hundred industrial clusters every year in rural areas and provide additional credit to the food processing and agro-based industry. This will have a salubrious effect in increasing the employment potential and in reversing the migratory trend to urban centers.

The Finance Minister is determined to raise atleast Rs.10,000 crore by disinvestments in public sector units. The important point is that his concept of strategic disinvestment will not only bring in a substantial amount to the Exchequer but it will help in reviving the capital market as these shares will be offered to the private sector and the public in general. The Government, therefore, looks upon privatisation as a measure to increase efficiency of these units by inculcating the

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* The author is a noted tax expert. The text is based on a talk delivered at a public meeting arranged by the Forum of Free Enterprise jointly with other organisations in Mumbai on 28th February 1999.

principles of corporate governance which a private enterprise would instill when it takes over the management of another company.

The greatest thrust of the Finance Minister's strategy has been to keep the fiscal deficit in check, allocate higher resources for agriculture, irrigation and rural development and give additional benefits to his constituency of small scale entrepreneurs. His objective of empowering the Gram Panchayats is laudable but adequate safeguards have to be ensured so that there is no misuse of powers or leakage of expenditure meant for uplifting the plight of the rural masses.

While the surcharge on corporate tax will not result in a heavy burden for industry, the Finance Minister could have rewarded companies with a growth record by reviving the investment allowance provision and offering this incentive at the rate of 20% to high priority and infrastructure companies.

In view of the lean patch that the corporate sector is going through, the strong demand for facilitating corporate restructuring needs to be met. It is now an acknowledged fact that mergers and acquisitions (M&A) is the preferred route to building globally powerful corporations. To make M&A attractive, easy to structure, quick to implement, and devoid of legal and procedural ambiguities, sections that govern M&A provisions in various laws were expected to be made consistent with each other. But this has not been done.

The containment of fiscal deficit will ultimately be the acid test to determine the success of his budget strategy. His optimism at containing the deficit figures stems from certain positive assumptions of economic revival and growth which would be translated into buoyancy in customs and excise revenues. To some extent, the rationalisation of the excise

structure by reducing the duty rate to 8%, 16% and 24% and the removal of zero customs duty with imposition of 5% rate would certainly make revenue collection target easier to achieve. Ultimately, the introduction of value added tax would be the real answer to ensuring industrial growth with commensurate increase in revenues.

The Finance Minister should have considered the difficulties faced by employees who subscribe to sweat equity. Perquisite value is proposed to be taxed when the employee exercises the option. This would impose a tax burden on an employee at the time when he does not have the funds to pay the tax, having invested his savings in acquiring the shares. The simplest and best way to promote employee participation in management which is the object of this scheme would be to tax only the capital gains by deducting the indexed cost of acquisition from the sale price.

The issue of gold bonds which would be interest-bearing and which would enable individuals to make use of funds by taking loans against such security will permit businessmen to encash their unproductive asset and use funds for the purpose of their business. This scheme if imaginatively implemented will help the small businessmen to an immeasurable extent and permit them to step up their business activities by diversifying into new areas of investment.

PROPOSALS AFFECTING INDIVIDUALS

Several provisions have been made in the Finance Bill, 1999, which will have a direct bearing on individual and personal taxation. In this article, some of the salient features of these proposals are discussed.

Section 17(2)(iii-a) of the Income-tax Act, 1961 seeks to include in the definition of perquisites, the value of any specified security allotted or transferred, directly or indirectly, by any person free of cost or at concessional rate to an individual who is or has been in employment of that person in the year of exercise of option of such shares.

The Explanation to the proposed sub-clause (iii-a) defines the expression "cost", "specified security", "sweat equity shares" and "value" used in that sub-clause.

Deduction of interest on borrowed capital in the case of self-occupied property is proposed to be increased from Rs.30,000 to Rs.75,000. This would apply only where the property is acquired or constructed with capital borrowed on or after 1st April, 1999 and where the acquisition or construction is completed by 31st March, 2001.

It is proposed to insert section 44-AD(6) to enable an assessee to claim lower profits and gains than the deemed profits and gains specified in sub-section (1) of that section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44-AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44-AB.

Section 44-AE(7) is proposed to be inserted to enable an assessee to claim lower profits and gains than the deemed profits and gains specified in sub-sections (1) and (2) of that section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44-AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44-AB.

Section 44-AF(5) is proposed to be inserted to enable an assessee to claim lower profits and gains than the deemed profits and gains specified in sub-section (1) of that section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44-AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44-AB.

The new section 46-A provides that any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares or other specified securities held by such shareholder or holder of other specified securities, shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the holder of securities or by the shareholder, as the case may be, as capital gains. The computation of capital gains shall be made in accordance with the provisions of section 48.

Under sections 80-O, 80-R, 80-RR and 80-RRA, permission of the Chief Commissioner of Income-tax was necessary to be obtained where there was a delay of more than six months from the end of the financial year in bringing the convertible foreign exchange to India. It is now necessary to obtain the necessary approval of the Reserve Bank of India or such other regulatory authority which may be notified.

The new section 115-ACA seeks to provide that in the case of a resident employee, the income-tax payable shall be the aggregate of (i) ten percent of the income by way of dividends in respect of Global Depository Receipts of an Indian company purchased in foreign currency in accordance with such employees' stock option scheme as the Central Government may, by notification in the Official Gazette, specify

in this behalf, if any, (ii) ten percent in case of long-term capital gains arising from the transfer of the aforesaid Global Depository Receipts, if any, and (iii) the amount of income-tax on the total income as reduced by the income from the said Global Depository Receipts.

Sub-section (2) of the new section seeks to provide that in the case of the aforesaid resident employee, no deduction shall be allowed under any provisions of the Act where the gross total income consists only of income from Global Depository Receipts. However, where the gross total income includes income from Global Depository Receipts, the deduction under any provisions of the Act shall be allowed as if the gross total income does not include the income from Global Depository Receipts.

Sub-section (3) of the new section provides that the first and second provisos of section 48 relating to the computation of capital gains shall not apply in case of transfer of Global Depository Receipts of an Indian company purchased by the resident employee in foreign currency.

Under the existing provisions contained in section 139(1), a person who fulfils certain conditions specified in that sub-section is required to furnish his return of income and one of such conditions is that he is the owner or lessee of a motor vehicle as defined in Explanation 3.

It is proposed to exclude two-wheeled motor vehicles whether having any detachable side car having extra wheel attached to such vehicles or not from the purview of "motor-vehicle".

Under the existing provisions contained in sub-section (6) the return of income in the prescribed form requires the

assessee to furnish the particulars of income exempt from tax, assets of the prescribed nature and value and belonging to him, expenditure exceeding prescribed limits incurred by him under prescribed heads and such other outgoings. It is proposed to provide that the return of income as prescribed shall also require the assessee to furnish particulars of his bank account and credit card held by him.

Under the existing provisions, if any tax is payable on the basis of any return required to be furnished under section 139 or section 142 or section 148, the assessee is liable to pay such tax alongwith interest payable under the Act before furnishing the return and the return should be accompanied by proof of payment of such tax and interest.

It is proposed to provide that any person before filing of the return under section 158-BC shall also be liable to pay tax and interest in accordance with the provisions contained in sub-section (1) of section 140-A.

It is further proposed to provide that after a block assessment under section 158-BC has been made, any amount paid under sub-section (1) of section 140-A shall be deemed to have been paid towards the block assessment under section 158-BC.

Under 143 there is a procedure for processing the return, making prima facie adjustments and raising additional tax, wherever necessary and sending intimation to the assessee in all cases.

It is proposed to provide that if any tax or interest is found due on the basis of return filed under section 139 or in response to a notice under sub-section (1) of section 142, after adjustment of any tax deducted at source, any advance tax

paid, any tax paid on self assessment and any amount paid otherwise by way of tax or interest, then, without prejudice to the provisions of sub-section (2), an intimation shall be sent to the assessee specifying the sum so payable, and such intimation shall be deemed to be a notice of demand issued under section 156 and all the provisions of the Income-tax Act shall apply accordingly. If any refund is due on the basis of such return, it shall be granted to the assessee.

It is also proposed so substitute the existing provisos by new provisos to provide that the acknowledgement of the return shall be deemed to be the intimation under sub-section (1) where either no sum is payable or no refund is due. The intimation under this sub-section shall not be sent after the expiry of two years from the end of the relevant assessment year.

It is also proposed to omit the provisions in respect of levy of additional income-tax on account of prima facie adjustment.

Under the existing provisions of sections 234-A and 234-B, an assessee is liable to pay simple interest at the rate of two percent for every month or part of a month for default in furnishing the return of income specified in the said section.

The proposed amendment seeks to reduce the rate of interest from two percent to one and one-half percent for every month or part of a month, as the case may be.

MEASURES TO TONE UP INDUSTRY

Since a section of industry feels that not enough has been done in this year's budget proposals to revitalize Indian

industry, it is necessary to bring into focus specific measures which would enable business and industry to achieve a better rate of growth than what has been in the last two financial years.

Before the budget, a notification was issued on 8th January allowing higher rates of depreciation for commercial vehicles. The first concession was to allow full 40 percent rate of depreciation even for vehicles purchased and used for less than 180 days during the financial year 1998-99.

The next proposal was to enhance the full rate to 60 percent in case of new commercial vehicles acquired between 1st October, 1998 and 31st October, 1999 or in replacement of vehicles of over 15 years of age. The full rate of 60 percent would apply for vehicles acquired during 1999-2000 in substitution of old ones which are over 15 years of age, provided these vehicles are purchased before 1st October, 1999; otherwise the rate applicable would be 30 percent.

The object of giving the higher rate of depreciation is to ensure that the demand for vehicles goes up immediately and that the automobile section gets a boost not only as a result of increase in output of the manufacturers but also increase in turnover of thousands of automobile ancillary units. Further, the replacement of old vehicles would to some extent reduce the problems of environmental pollution which is mainly contributed by fuel emissions from obsolete vehicles.

The main thrust of the Finance Minister's proposals covered by the Finance Bill, 1999 pertains to business restructuring measures. It is generally believed that Indian industrial houses operate at a very low rate of economic value addition (EVA) which is the rate of return on investments in excess of the opportunity costs of funds. Thousands of

industrial units work at negative rates of EVA when they earn a return on investment which is less than the opportunity cost of funds.

The crying need of the hour is undoubtedly corporate restructuring. This would involve selling off a unit or hiving off an undertaking to another entity which could be infused with additional capital and technology. Such act of spinning off a unit tantamounts to demerger. Under the proposed section 2(19-AA) of the Income-tax Act, 1961, demerger in relation to companies is defined to mean transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to the resulting company in the following manner:

(i) all the property and liabilities transferred by the demerged company should become the property of the resulting company;

(ii) the property and liabilities of the undertakings being demerged, should be transferred at book value;

(iii) the resulting company should issue shares to the shareholders of the demerged company on a proportionate basis as consideration for demerger;

(iv) shareholders holding not less than three-fourths in value of the shares in the demerged company, other than the shares already held therein, should become shareholders of the resulting company;

(v) the transfer of the undertaking should be on a going concern basis;

(vi) the demerger should be in accordance with the conditions, if any, notified under sub-section (5) of section 72-A.

In the case of such demergers, all the tax benefits and concessions which were earlier available to the demerged company would continue to be availed of on the transfer of the undertaking to the resulting company. The expression "resulting company" is defined by section 2(41-A) to mean one or more companies to which the undertaking of the demerged company is transferred in a demerger and as a consideration whereof, the resulting company issues shares to the shareholders of the demerged company. The resulting company would include any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

The incentives under the tax law which the resulting company can continue to avail of are as follows :

1. The benefit of section 35-A in respect of acquisition of patent rights and copyrights which were acquired before 1st April, 1998;

2. The benefit of amortising lumpsum technical know-how fees under section 35-AB where the expenditure was incurred prior to 1st April, 1998;

3. Deduction under section 35-ABB in respect of capital expenditure incurred to acquire any right to operate telecommunication services, such capital expenditure being non-depreciable in view of a new sub-section (8) proposed to be inserted with retrospective effect from the Assessment Year 1996-97.

4. Benefit of amortisation of preliminary expenses under section 35-D;

5. Any expenditure incurred by an assessee for the purpose of demerger is allowed to be amortised over five years under the new section 35-DD;

6. The benefit under section 35-E of amortising expenditure on prospecting for certain minerals, or in prospecting for mineral oil under section 42;

7. Under section 47(vi-b) it is proposed that the provisions of section 45 attracting capital gains tax will not apply to any transfer or a capital asset in a demerger by the demerged company to the resulting company, if the resulting company is an Indian company.

8. Under section 47(vi-c), it is proposed that the provisions of section 45 will not apply to any transfer in a demerger of a foreign company in respect of capital assets being shares held in an Indian company to the resulting company if atleast seventy-five percent of the shareholders of the demerged foreign company continue to remain shareholders attract tax on capital gains in the country in which the demerged foreign company is incorporated. It is further proposed that the provisions of sections 391 to 394 of the Companies Act, 1956 shall not apply in such a case.

9. Under section 47(vi-d), it is proposed that the provisions of section 45 will not apply to a transfer or issue of shares in a demerger to the shareholders of the demerged company by the resulting company.

10. Under section 49(2-C) it is proposed that the cost of acquisition of the shares in the resulting company would be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

    It is also proposed to insert a new sub-section (2-D) to provide that the cost of acquisition of the original shares held by the shareholders in the demerged company would be deemed to have been reduced by the amount so arrived at under the proposed sub-section (2-C).

11. Under section 72-A it is proposed that where there has been a demerger of an undertaking, the accumulated loss and the unabsorbed depreciation directly relatable to the undertaking transferred by the demerged company to the resulting company would be allowed to be carried forward and set off in the hands of the resulting company. If the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, the same will be apportioned between the demerged company and the resulting company in the same proportion in which the value of the assets have been transferred.

It is further proposed that the provisions of section 79 would not apply to any change in the shareholding of an Indian (closely-held) company which is a subsidiary of a foreign company arising as a result of amalgamation or demerger or a foreign company subject to the condition that fifty-one

percent of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

As far as the benefit of tax holiday is concerned, section 80-1A is amended to provide that where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger, (a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and (b) the provisions of this section shall, as far as may be, apply to the amalgamated or resulting company as they would have applied to the amalgamating or demerged company as if the amalgamation or demerger had not taken place.

Similar provision has been made under the new section 80-1B which relates to new industrial undertakings set up in backward districts. This new provision also applies to ships, certain hotels, companies carrying on scientific research and development, refineries, certain real estate development companies and undertakings which own and operate a cold chain facility for agricultural produce.

Turning to the issue of amalgamation of companies, section 72-A is proposed to be amended to provide for the following :

a) the amalgamated company holds at least three-fourths in value of assets of the amalgamating company acquired as a result of amalgamation, for a period of five years from the effective date of amalgamation;

b) the amalgamated company continues the business of the amalgamating company for atleast five years. The Central Government may notify such other conditions as may be necessary. It is further proposed to provide that in case the above specified conditions are not fulfilled, that part of the carry forward of losses and unabsorbed depreciation remaining to be utilised by the amalgamated company shall lapse and such loss or depreciation as has been set off shall be treated as the income in the year in which failure to fulfil the conditions occurs.

The law has also been amended to deal with tax implications of an undertaking being sold. In such a case, the profits will not be bifurcated between revenue profits and capital gains. The new section 50-B provides that any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Any profits and gains arising from such transfer of one or more undertakings held by the assessee for not more than thirty-six months would be deemed to be short-term capital gains.

The net worth of the undertaking or the division, as the case may be, would be deemed to be the cost of acquisition and the cost of improvement for the purpose of sections 48 and 49 in relation to capital assets of such undertaking or division transferred by way of such sale and the provisions contained in the second proviso to section 48 would be ignored.

Every assessee in the case of slump sale should furnish in the prescribed form along with the return of income, a report of an accountant indicating the computation of net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section.

Several innovative provisions have been made to permit business restructuring. The Finance Minister has now thrown a challenge to Indian industrialists to reorganise their businesses so that they may sharpen the competitive edge and be ready to face the challenges of the 21st century.

Industrialists should, therefore, rise to the occasion and make their industrial enterprises competitive by putting through such restructuring strategy as may be necessary. Thus, mergers and acquisitions, demergers and sale of loss-making units will be the only answer for Indian industrial houses to build globally powerful corporations.

To conclude, the 1999-2000 budget proposals of Finance Minister Yashwant Sinha reflect economic realism mixed with political sensitivity. The Finance Minister will create history if he can ensure a consistent rate of growth of around 8% every year emanating from his budget proposals. Unless India grows at a minimum rate of 8 percent per annum for the next 20 years, there is no hope of dramatically reducing the extent of mass poverty and economic deprivation.

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

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

– Eugene Black

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