

UNION BUDGET 1979-80

An Opportunity for Growth Missed

by

H. P. RANINA



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

1899-1965

**Founder-President
Forum of Free Enterprise**

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All omens were propitious for a really nutritive Budget to be introduced. Our foreign exchange reserves as on 31st January 1979, aggregated to Rs. 5,082 crores which if converted into dollars is equal to 6,000 million. This is the hard currency lying in our coffers. In addition, we have gold and SDRS, i.e., Special Drawing Rights. This reserve of Rs. 5,082 crores remains after repaying all the debts which we owed to the International Monetary Fund. So you can imagine how stable and secure the Indian currency is today.

As far as prices are concerned, again, the economy has done very well. Though there was an increase in national income by 11%, the wholesale price index increased only by 0.9%. Of course, the consumer price index increased by 14 points but that was mainly due to the increase in price of pulses and cereals. Apart from that, we have maintained relative price stability. Turning to the other aspects, the most important ones are that we have registered an industrial rate of growth of 8%, and our foodstocks stand at the impressive figure of 20 million tonnes. Therefore, taking an overall view, this is really a year when the economy has reached the take-off stage and the Finance Minister should

* Mr. Ranina is a noted authority on taxation and author of several books on the subject. This text is based on the lecture delivered by him under the auspices of the Forum of Free Enterprise in Bombay on 1st March 1979.

have taken the golden opportunity to make this Budget the key-stone of an economic miracle which has so far eluded India.

All that the Finance Minister has done is to increase the total outlay to Rs. 18,526 crores. The receipts are Rs. 16,551 crores. There is a deficit of about Rs. 2,000 crores. He proposes to raise revenue of Rs. 665 crores, thereby leaving an uncovered gap of Rs. 1,355 crores. He proposes to utilise the foreign exchange reserves to bridge the gap but this is possible only if massive imports of capital goods are undertaken. However, a substantial part of the expenditure which the Government proposes to incur is on agriculture, irrigation and other items where there is no necessity to import capital goods. So it is doubtful whether he will be able to bridge the gap of Rs. 1,355 crores. Inflation will once again rear its ugly head unless we really have a very good monsoon and the Government is able to cover the gap by borrowings and taking loans from the public.

Out of the total expenditure of Rs. 18,526 crores, Rs. 12,551 crores are earmarked for the Plan outlay. Out of this Plan outlay, Rs. 1,811 crores are for agriculture, Rs. 1,754 crores are for rural industries, and Rs. 1,488 crores for irrigation. So there has been a distinct shift in allocation of resources from the industrial sector to the agricultural sector. Frankly, one can have no quarrel with the Finance Minister on this point. We would be very happy if he can bring about an increase in the level of income of the rural masses and if he can really alleviate their poverty. But what the Finance Minister has done is to reduce the excise duty on fertilisers by 50%, thereby giving up revenue of Rs. 105 crores. Will this benefit the rural masses? It will not make an iota of difference to the poor farmers who still use the bullocks and the wooden ploughs and cow-dung as manure. The only people who are going to benefit are the

rich landlord farmers who have vast holdings of lands in **benami** names. Land reforms have been in force for many years. We have abolished the zamindari and jagirdari systems. But there are people in India who own more than a thousand acres of land, all in fictitious names. There are smugglers, black-marketeers and politicians who have invested their ill-gotten wealth in agricultural lands held in **benami** names. And what do they do ? They hire labour, pay them Re. 1.50 per day as wages and make them slog from morning to evening and make bumper profits.

These are mostly the people who will benefit by the reduction in excise duty on fertilisers and these are the people who have not contributed their mite to the national economy ; for the last 30 years they have not paid a single Rupee as income-tax.

Thus what the Budget has done is a shift from the urban poor and the urban middle-class to the rural rich, because the shortfall in revenue on account of reduction in excise duties on fertilisers, light speed diesel oil, power tillers, etc., will be made good by recovering more taxes from the urban dwellers on basic necessities of life. One could have understood if the shift were for the benefit of the rural poor.

The Budget has increased excise duties on petrol and diesel which will fetch Rs. 279 crores. Prices of petrol and diesel have already gone up by 50 paise per litre. Taxi drivers are clamouring for higher taxi fare ; they have already raised the fare. Bus operators will naturally ask for more. Not only has the Finance Minister raised the duty on petrol but he has increased the excise duty on motor cars which will now cost about Rs. 50,000. He has increased the excise duty on certain spare parts which are replaced with great regularity like tie-rod ends, brake linings, etc. These are spare parts which are to be replaced very often. Thus,

not only will petrol prices go up, but the cost of maintaining a car will go up if you can afford to buy one now.

The other effect would be on transport industry. Needless to say, every single article or commodity has to be transported some time or the other from one place to another. So the increase in transportation costs will be reflected in the cost of the final products and, therefore, there will be an all-round rise in the price level.

Coming to other industries on which heavy imposts have been levied, they are tooth paste, tooth brush, soap, and other items of day-to-day use. According to the Finance Minister, all these items, which are really meant for personal hygiene, are luxury products. He has increased excise duties on pressure cookers, steel furniture, locks and keys and other consumer items like electrical goods. He has also increased the duties on radios, television sets, refrigerators, etc. A refrigerator cannot be considered to be a luxury at all in a poor country like India where we have warm weather, because a refrigerator helps to preserve foods which otherwise would be wasted. Refrigerators are a necessity and by no stretch of imagination can they be considered a luxury. The most cruel thing that the Budget has done is that in the International Year of the Child it has increased excise duty on biscuits, butter and confectioneries.

Thus the effect of Budget proposals has been to transfer resources from the pockets of the poor and middle-class urban citizens to the pockets of the rural rich. It has taken sweets and biscuits out of the mouths of children and passed on the revenue to the rural rich. In fact, a general rise in the price level will affect not only urbanites but even poor agriculturists. It will have a very adverse effect on the national economy apart from the fact that it will bring about as some newspapers say, a needless confrontation between the urban and rural population.

The time has come when urbanites should assert themselves. The reason why in each and every Budget the urbanites have been subjected to heavy imposts is that we do not have a base in the sense that urbanites are in a minority in India, and are not effectively organised.

Another aspect is the class of people who live in urban areas. They are all the educated and literate people. In fact, most of the people who were formerly in rural areas moved into urban areas the moment they got education and literacy. So the real effect of the budget proposals is to levy a tax on education, on literacy, on growth, on progress.

Let us now turn to the proposed amendments in the Finance Bill, 1979. A Committee, headed by Mr. C. C. Chokshi, had been appointed by the Government of India in 1977 to make recommendations on the Direct Taxes. Unfortunately, only those recommendations of the Chokshi Committee, barring one, which are in favour of the revenue have been accepted. One such is under section 10. At present a foreign technician enjoys tax exemption under Section 10(6) (vii-a) upto Rs. 4,000 per month for four years. A technician is defined to mean a foreign citizen who is engaged in the manufacture of goods or articles. There are specialists in various fields who do not strictly fall within this definition. Hence, the country is not able to take advantage of their expertise. An amendment is, therefore, proposed to enable the Central Government to include certain specialists in the definition of technicians.

The second amendment which is a salutary provision made in the Finance Bill is for revival of the export market development allowance. Last year, Mr. H. M. Patel as the Union Finance Minister had withdrawn this export market development allowance which is a weighted deduction of one and one-third times the expenditure incurred on promoting exports. Mr. Patel had withdrawn this and made it

available only to certain consultancy service companies. This allowance has now been revived and it has been provided that any expenditure on advertisement and publicity outside India will also be eligible for this allowance.

At present, there is a provision (Section 35CCA) which enacts that if a company makes any contribution to an approved association which is set up for agricultural or rural development, the amount would be allowed as a deduction to the company. A new provision is now made which allows deduction in respect of a contribution made to a school or institution which trains people for conducting rural development programmes. This is an admission of the fact that we do not have sufficient people in this country to carry out such development programmes and that is why the Finance Minister proposes to encourage the setting up of training schools and institutions so that such people can be trained in the method of conducting rural development programmes.

The next provision made in the Finance Bill relates to deduction of bad debts by banks. There is a telltale story behind it. The provision is that a bank which has a branch in a rural area can now claim as a deduction one and one-half percent of its total advances as a provision for bad debt. Today under the income-tax law you cannot claim a bad debt unless it has actually become irrecoverable in the accounting year. In other words, you cannot claim a provision for bad debt as a deduction. Since banks are giving large amounts of credit to the rural masses which they are unable to recover, a provision is now made that a bank can write off one and one-half percent of the loans given by rural branches.

The next amendment is in Section 37 which relates to advertisement expenses. Certain percentage of the advertisement expenses is sought to be disallowed as a deduction. There was a rule that if you advertised in a newspaper which

had a circulation of less than 15,000, in that case the full amount of advertisement charges was deductible provided you furnished a certificate from the Audit Bureau of Circulation. This requirement has now been removed and it is no longer necessary to produce a certificate from the Bureau. You can straightaway claim the full amount as a deduction if you say that the circulation does not exceed 15,000.

The next provision of the Finance Bill is in respect of the controversial Section 54E which the previous Finance Minister, Mr. H. M. Patel, had introduced in 1977 in his first Budget. The purpose of Section 54E was that black money transactions would be reduced by inducing people to declare the full sale consideration. It was thus provided that if the money from sale of capital assets was invested in specific securities for a period of three years, no capital gains tax would be payable. This indeed was a salutary provision and in fact the price of property not only came up but almost 80 to 90 percent of the consideration was fully disclosed. This provision is now sought to be deleted. The effect of this would be that if you make a transaction as on today and hereafter, then you will not get the capital gains tax exemption. One question which arises immediately from the Budget proposal is what happens when you have already asked your broker to sell the shares but the actual transfer has not taken place in the sense that the company has not registered the buyer of the shares as the shareholder? If you have transferred the shares till yesterday, the transfer would be complete in the sense that the broker had recorded in his books the sale of shares. That may be sufficient to show that the transfer of the assets has taken place. But this is a matter which will lead to litigation as the Income-tax Department will dispute this point. But there are cases, genuine cases, where a company may not transfer the shares to the name of the buyer immediately. It takes at least two to three months and, therefore, such honest transactions should not be taxed.

It is only necessary to show by a broker's note that the consideration has already been paid. Thereafter you have six months to invest the sale proceeds in the specified assets. This is important. All that is necessary is that the transfer should have taken place as on yesterday. You will still have six months upto 31st August 1979 to invest the sale proceeds and if you do so, you will be entitled to the exemption.

Another provision made in the Budget which is extremely unjust is that even if in respect of a transaction which had taken place one or two years ago, if there was some dispute as regards the consideration to be received and a higher consideration is now awarded by a court of law or by an arbitrator, then any consideration received after 28th February 1979 would not be eligible for exemption under Section 54E even though the transfer of the asset has already taken place one or two years before. It is extremely unjust that such additional consideration should be denied exemption and the higher consideration should be made liable to tax. This is one point on which Chambers of Commerce and stock exchanges should take up the matter with the Government and see to it that this injustice is not perpetrated.

The next amendment is the one proposed to Section 64. The cynical view taken by some people that the Chokshi Committee should never have been appointed, because though they have made some excellent recommendations, those recommendations would never see the light of the day but only those recommendations which are favourable to the Government would be implemented is fully justified by the amendment proposed to Section 64. The Chokshi Committee had recommended that where there is a partnership firm having a husband and wife as partners, one of whom is represented by a trustee, the provision for clubbing of income should be made applicable. There is nothing illegal or wrong about such an arrangement. It has been judicially

recognised that every assessee has the right so to arrange his affairs as to attract the least amount of tax. So if instead of making the wife a partner with the husband in the firm if you settled the property upon trust and the trustee became a partner in the firm, the provision for clubbing in Section 64 does not apply at present. The Chokshi Committee recommended that in their opinion this was wrong as this led to tax avoidance. The Government has promptly agreed to this recommendation and an amendment is made with effect from the assessment year 1980-81 to provide that in all cases where the trustee is a partner on behalf of a spouse, the provision for clubbing of income should be made applicable.

A similar law has been made for minor children, i.e., if the minor children are represented by a trustee and the trustee is a partner in the firm, the provision for clubbing would apply even if the parent is not a partner in the same firm. So if a minor child through a trustee is entitled to the benefits of partnership in any firm, the share of profit of the minor would be clubbed in the hands of the parent whose income is higher.

The third amendment is a clarificatory one. The question is whether income includes loss. The law says that income would be clubbed in the hands of the transferor. There was a controversy on the point whether income includes loss and whether the loss is also to be clubbed in the hands of the transferor. This controversy has now been settled and it has been provided that the loss made by a transferee, i.e., the wife or a minor, would also be clubbed in the hands of the transferor.

The last provision is in respect of Hindu undivided families. At present the law is that if you transfer self-acquired property by impressing it with the character of a joint family

property, the income arising from the transfer would be clubbed in the hands of the transferor. But the Supreme Court recently held in the case of **J. G. Shah** that if instead of impressing the property with the character of Hindu undivided family property you gift it to the H.U.F., then the provisions of Section 64 do not apply because there is a difference between impressing property with the character of H.U.F. property and gifting it. Now to undo the law laid down by the Supreme Court and to supercede its decision, it has been provided that even if you make a gift, the provision for clubbing would still apply. Again, this is on the basis of the Chokshi Committee Report.

This brings us to the Chapter relating to deductions. The Finance Minister had made a provision which is indefensible in law and in economic wisdom. Section 80C allows you to claim as a deduction any contribution to the Public Provident Fund or to a recognized provident fund or by way of insurance premium paid in respect of an insurance policy. At present the rebate is 100% of the first Rs. 5,000, 50% on the next Rs. 5000 and 50% of the balance amount of Rs. 20,000. In other words, you can make a contribution aggregating to Rs. 30,000 per annum, or 30% of the gross total income whichever is less. For the first time, a Finance Minister has reduced the tax incentive for saving. The first Rs. 5,000 is eligible for the 100% deduction. On the next Rs. 5,000 he has reduced the rebate from 50% to 35%, and on the balance amount he has reduced it from 40% to 20%. So far if a taxpayer could save Rs. 30,000, he got a deduction of Rs. 15,500 and that resulted in a tax rebate of Rs. 10,695. Now the effect would be that the deduction would be reduced from Rs. 15,500 to Rs. 10,750 and the actual tax rebate would be restricted from Rs. 10,695 to Rs. 7,740 i.e. a difference of Rs. 2,955. So the extra amount will now have to come out of your own pocket. This is unjust because people have already committed themselves

on the basis of a particular provision of law since when the higher rebate was given, assessee took out a higher insurance policy and paid more premium, which means that a commitment was made for all times to come until the maturity of the policy. This amendment will not only affect self-employed people, it will also affect all employees because provident fund is compulsorily deducted from salary of employees. What would be the net effect so far as executives are concerned? First, they are threatened with ceiling on managerial remuneration. Secondly, surcharge on income-tax is increased by 5%. Thirdly, the tax rebate has been reduced. Fourthly, the prices will increase in view of the general increase in excise duties.

Hence, on the one hand, there are increased taxes and on the other there are increased prices. Executives are squeezed between the two. Brain drain from India will increase more than ever before.

The next amendment is the introduction of a new section, Section 80GGA, which provides that you can now make a donation to an approved scientific research association and you can also make a donation to an approved institution which is for rural development. At present there are Sections 35 and 35CC and these provisions are available only to those who have income from business or profession. Those who have income from salaries or income from other sources or income from house-property or capital gains, are not entitled to this deduction at present. So in order to extend the benefit and induce an assessee to make contributions to scientific research associations and institutions for agricultural development, Section 80GGA is being introduced so that whatever donation you make would be deductible from your taxable income. However, one difference will still persist between those who have business income and those who have non-business income. If you have business

income and you give a donation higher than your income, then the higher amount would be your loss and you can carry it forward for a period of eight years and set it off against business income in future years.

Under Section 80GGA you cannot have a loss, because Section 80A enacts that the total deduction under that Chapter cannot exceed the gross total income. So whereas a professional or businessman can give a higher donation and claim a set-off of the loss, a non-businessman would not be able to do so. This discrimination will exist.

Another proposal, which is outrageous, is the amendment proposed to Section 80J. This section is the only provision which allows you an incentive if you set up a new industrial undertaking. The relief is 7.5% of the capital employed for five years. This would mean that you get 37.5% of the capital employed over a period of five years. It has now been provided that a new industrial undertaking commencing production after 31st March 1979 will not be eligible for relief under Section 80J if that industry falls within the Eleventh Schedule to the Act which comprises of industries that are non-priority ones in the opinion of the Government.

At the moment, investment allowance is not available in respect of such industries. Hence, for such industries both the investment allowance and Section 80J relief will be withdrawn. It is unfair, because those who had taken this benefit into account while going in for expansion will now be denied the benefit merely because they have not yet been able to set up the new industrial undertaking. So to that extent it will have a retrospective effect and will affect all those who had taken a decision four or five years ago.

In this bleak Budget there is one streak of humour, and that is the introduction of a new section, Section 80JJA,

which lay down that one-third of the profits and gains will be exempt from tax if you do the business of growing mushrooms ! One-third without any limit, i.e. one-third or Rs. 10,000, whichever is higher. For the first time it is “whichever is higher”; it is always “whichever is lower”. But here it is “whichever is higher” in respect of profits from growing mushrooms. On the one hand, the Budget withdraws the relief for industries under Section 80J and on the other it gives an incentive for growing mushrooms. The anti-industry bias of the Budget is thus clearly shown.

The next amendment is in respect of Section 80P. Section 80P is in respect of co-operative societies which are for consumers. They will now be entitled to a deduction of Rs. 40,000 per annum instead of Rs. 20,000 per annum as at present.

The last provision made in this Chapter is in respect of authors who write books in an Indian language, not in English, and such a book is either an encyclopaedia or it is a book which is recognized by a University or an approved educational institution. The rationale behind this is that there are not enough authors, say in the subject of physics, where books are written in Hindi or Tamil or any other language. Incentive is given to such authors who will get 25% of the royalty taxfree for a period of five years commencing with the assessment year 1980-81.

At present, if you go to the Settlement Commission and apply for settlement of your taxes, the Settlement Commission will refer the matter to the Commissioner of Income-tax and if the Commissioner of Income-tax objects to your making an application to the Settlement Commission, the Settlement Commission is debarred from entertaining your application. Now it has been provided that if the Commissioner objects to the application, then the Settlement

Commission will hear both the assessee and the Commissioner, and it itself will decide whether to entertain the application or not.

The last amendment is in respect of appeals to Commissioners. At the moment, a company has to go in appeal to the Commissioner of Income-tax (Appeals) only if the income or loss assessed exceeds Rs. 5 lakhs. That means that some companies go to the Appellate Assistant Commissioners and the larger companies go to the Commissioners of Income-tax (Appeals). The amendment says that all companies, however big or small, can only appeal to the Commissioners of Income-tax (Appeals) and not to the Appellate Assistant Commissioners.

In the Wealth-tax Act, the same amendments are made for the clubbing of wealth as they are made for clubbing of income under Section 64 of the Income-tax Act.

The only other amendment is the increase in the rate of wealth-tax. Between Rupees 10 and 15 lakhs, the wealth-tax rate is increased from 2.5% to 3.0% and in respect of wealth exceeding Rs. 15 lakhs the wealth-tax rate is increased from 3.5% to 5%.

Mr. Charan Singh has ended his Budget Speech by saying that his Budget will promote economic growth, will reduce disparities in income and wealth, and will bring out the best in the people. First of all, economic growth is impossible unless it is in spite of this Budget, because not a single incentive or benefit is given to industries. Just as agriculture needs fertilisers, industries also need fertilisers by way of tax incentives. Not a single incentive is given but instead the surcharge on corporate tax is proposed to be increased from 5% to 7.5%. Though this may be a small amount, it is the proverbial last straw on the camel's back, because today certain companies pay tax at the confiscatory

rate of 84.1% including the surtax, which will now go up to 86%. Moreover, when a company declares dividend, again the shareholders pay tax on the same profits. So the aggregate tax burden well exceeds the 100% barrier. One may well imagine why no foreign company is prepared to come to India.

The Finance Ministry says that his Budget will bring out the skills and the hopes and aspirations of the people. So far as skills are concerned, we will be exporting our skills, because people will be migrating from this country on account of the ceiling on remuneration, high prices and high taxes. So far as hopes and aspirations are concerned, only hopes and aspirations which will be fulfilled are those in the minds of the rural rich.

Taxes are the lifeblood of any economy. But when that blood is taken out of the arteries of the urban sector, it cannot be justified on grounds of economic necessity; it can only be justified on grounds of political expediency.

*The views expressed in this booklet are not necessarily
the views 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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The Forum of Free Enterprise is a non-political and non-partisan organisation, started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions, and other means as befit a democratic society.

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