UNION BUDGET 1981-82 WILL NOT STIMULATE ECONOMY

by

H. P. Ranina

FORUM OF FREE ENTERPRISE
PIRAMAL MANSION, 235 DR. D. N. ROAD,
BOMBAY 400 001.

"**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

UNION BUDGET 1981-82 WILL NOT STIMULATE ECONOMY

H. P. Ranina*

That our economy continues to go through distressing times has been made amply clear by the "Economic Survey" presented by the Finance Minister in February. These figures in black and white represent the myriad lights and shades of India's economy.

Except for the comfortable position on the agricultural front, industry continues to stagnate on account of the power crisis and shortages of basic items like steel and cement. Though the number of man-days lost has come down, industrial strife continues to plague the key sectors of the economy as admitted by the Government itself.

The high import bill of oil has widened the trade gap to such an extent that the Government has thrown up its hands in desperation and pronounced its inability to do anything about it. Imports are likely to reach Rs. 11,300 crores whereas exports will remain at the low figure of Rs. 7,100 crores.

Inflation continues to eat into the vitals of the economy, inspite of the highest ever food production so far. With the increase in the budgetary deficit, inflation in the coming year would not be less than 15%.

---

* Mr. Ranina, an authority on taxation, is author of popular books on the subject and a regular contributor to the press. This text is based on a lecture delivered under the auspices of the Forum of Free Enterprise in Bombay on 2nd March 1981.

In fact, the budgetary deficit of Rs. 1,539 crores announced by the Finance Minister is likely to be much higher because the Government will not be able to mop up Rs. 800 crores, as estimated by it, from the sale of Special Bearer Bonds.

Hence, the budgetary deficit is bound to pierce the Rs. 2,000 crores mark and add further fuel to the fire of inflation. The increase in **ad valorem** Custom Duty by 5% on most imported goods and the recent hike in railway freight will make it impossible for the Government to keep the inflationary pressures under check.

The snowballing effect of these increases is bound to be felt by the common man, resulting in a winter of discontent. A thick cloud of uncontrolled inflation will settle upon the entire economy.

The budget has been greeted with euphoria from every quarter only because no new fiscal levies or heavy imposts have been announced. Most people have forgotten that the crying need of the hour is to take potent measures to galvanise the economy and revitalise industry and this requires positive action and not mere abstention from negative action.

Much has been said in and outside Parliament about the increase in the initial exemption limit from Rs. 12,000 to Rs. 15,000 per annum. This increase was long overdue in view of the fall in the purchasing power of the Rupee due to inflation. However, the Finance Minister has sought to nullify to a great extent the effect of increasing the exemption limit by hiking up the marginal rates of income-tax on income between Rs. 15,000 and Rs. 30,000.

The continuance of the Compulsory Deposit Scheme for another two years, which otherwise would have lapsed, is another blow to middle-class citizens who will have no

respite from the pressures brought in by rising prices on the one hand and the continuing burden of taxation and compulsory deposit on the other. Therefore, there can be no doubt that the common man will be worse off than before.

Apart from reducing the surcharge on companies from $7\frac{1}{2}\%$ to $2\frac{1}{2}\%$ on the income-tax payable by them, no concession whatsoever has been given to industry. A few low priority industries manufacturing consumer goods would now be entitled to the investment allowance and the relief for new industrial undertakings.

But this is no panacea for raising industrial growth from 4% to 8% as envisaged by the framers of the Sixth Five-Year Plan. In order to have that rate of growth, what is needed are measures by way of accelerated depreciation, incentives for plough-back of profit and inducement to people to channelise their resources towards the industrial front.

Depreciation is still granted in this country on the archaic basis of historical cost. Most progressive countries have now adopted replacement value as the basis for depreciation or they allow free depreciation permitting even a 100% write off in the very first year.

Mr. William Miller, Chairman of the Federal Reserve Bank of the United States, has pointed out that there are various ways to stimulate investment but you get the biggest bang for the buck with faster depreciation.

While India is the fourth largest producer of foodgrains and the tenth largest manufacturer of industrial products, it has only about 0.5% of the world export market. With a view to give a boost to exports and export-oriented units, the Finance Minister has proposed granting a tax free

holiday to new industrial undertakings for a period of five years.

Though this tax free holiday may seem to be attractive, it is not really so considering the fact that provisions are made in section 10-A to deny the incentives which are given in the normal course to other industrial undertakings. Sub-section (4) to this section provides that an industrial undertaking set up in a free trade zone would not be entitled to unabsorbed depreciation allowance, unabsorbed investment allowance, unabsorbed deduction for Scientific Research, unabsorbed losses and the deficiency under section 80-J for the five assessment years during which the tax holiday is granted.

Further, no tax benefit would be allowed under section 80-HH (for setting up the unit in a backward area) or under section 80-HHA (for putting up a small scale undertaking) or under section 80-I (for setting up a new industrial undertaking) where the industrial undertaking has begun to manufacture or produce articles during any previous year relevant to the tax holiday period.

In case of most capital intensive units and in case of units which are likely to make a profit only after four or five years, it would be preferable not to set up the unit in the free trade zone because in such cases, the tax holiday is meaningless if no profits are to be made immediately. In fact, it would be prudent to avail of the normal tax incentives available under the Law.

The only other concession given to industry is that certain industries which were earlier listed in the Eleventh Schedule are now excluded from such Schedule. These are mainly industries which manufacture consumer goods, like

television sets, radios, electric fans and other appliances, house-hold furniture, pressure cookers, table-ware, hardware, chinaware, etc.

The advantage of this amendment is that the industrialist manufacturing these items would now be entitled to claim the investment allowance and the relief under section 80-I for new industrial undertakings. Further, shareholders who subscribe to the shares of these units, would be entitled to a deduction under section 80-CC to the extent of the amount invested in such industries upto the prescribed limits.

The Electronics Industry has been included in the list of priority industries, given in the Ninth Schedule to the Income-tax Act because this industry has considerable employment potential and substantial scope for increased exports. This industry includes manufacture of electric components, computer and peripherals, communication equipment, process control, instrumentation, etc.

The advantage of including this industry in the Ninth Schedule is that corporate shareholders which invest in this industry will secure complete tax-free dividends. However, this concession is available only to an Indian company which invests in another Indian company, which sets up an Electronic Unit.

The other advantage is that a wealth-tax payer would not pay wealth-tax for five years in respect of the value of equity shares purchased by him in a company which sets up such an unit. However, such shares must form part of initial issue of equity share capital and the exemption is for five successive assessment years commencing from the assessment year next following the date on which such shares were first issued.

The definition of a Small Scale Industry is sought to be liberalised so as to include an industrial unit where the total value of the plant and machinery is less than Rs. 20 lakhs on the last day of the relevant previous year. In respect of existing industrial undertakings, they would be regarded as small scale if the aggregate value of the machinery or plant installed as on the last day of the previous year ending after 31st July, 1980, does not exceed Rs. 20 lakhs.

Where an industrial undertaking was not eligible for this tax concession in view of the investment in machinery or plant exceeding Rs. 10 lakhs but less than Rs. 20 lakhs in any earlier years, such undertaking would be eligible for the benefit of the tax concession for the unexpired portion of the 10-year period.

A small Scale Undertaking gets the following tax reliefs:

(1) investment allowance even if it is engaged in the business of manufacturing a low priority item specified in the list in the Eleventh Schedule;

(2) deduction of 20% of the profits set up in a rural area under section 80-HHA; and

(3) deduction under section 80-I of 20% of its profits or 25% of its profits, if it is a company.

The Finance Minister proposes to make one important change governing foreign collaborators who give the benefit of their know-how in the field of oil exploration and production. At present, off-shore companies which carry on the business of oil exploration outside the territorial limits of India are not liable to income-tax.

Therefore, foreign collaborators who are assessed, also escape tax. It is proposed to extend the Income-tax Act and the Companies (Profits) Surtax Act to the off-shore areas.

Secondly, it is proposed to amend the Income-tax Act and the Surtax Act to enable the Central Government to provide, by a Notification in the Official Gazette, for exemption/reduction in rate or other modification in respect of income-tax or surtax in favour of any class of persons engaged in the business of mineral oil and gas in association with the Central Government.

It is also proposed to amend section 42 of the Income-tax Act which makes special provision for deduction in the case of business of prospecting for or extraction or production of mineral oils so as to extend the scope to cover cases where the Government itself does not participate in such business but participates through any person authorised by it.

It is also proposed to increase the rate of depreciation from 10% to 30% on machinery or plant installed for manufacturing renewable energy devices and systems. Depreciation on renewable energy devices and systems used for a business or profession will also be allowed at the enhanced rate.

Amendment is also made to section 33-A to give higher Development Allowance to the Tea Industry where expenditure is incurred on plantation of tea bushes in any new area or on any land which has been previously abandoned. Fifty per cent of the total expenditure deductible and the expenditure qualifying for such deduction is proposed to be increased, having regard to the nature of the area.

At present, surtax is payable by companies only when the assessment is made, either provisionally or otherwise. In order to recover more revenue expeditiously, it is now proposed to provide that surtax would be payable in advance at the same time when advance-tax is payable by companies.

It is important to point out that though the Government has reduced the surcharge from $7\frac{1}{2}\%$ to $2\frac{1}{2}\%$, the expeditious recovery of the surtax would compensate for the loss of revenue if at all that is suffered on account of the reduction in the surcharge. There is no likelihood of loss of revenue on account of such reduction.

Two important amendments made to the substantiate Law are in respect of tax liability of Oral Trusts and Associations of Persons. At present under section 164, a discretionary trust is liable to tax at the highest marginal rates of income-tax. This provision, however, applies only in respect of a trust declared by a duly executed instrument in writing, whether testamentory or otherwise.

Therefore, some taxpayers have created Oral Trusts so that the provisions of section 164 would not apply even if the beneficiaries of such trusts are indeterminate and unknown. As a result, the trustees of the Oral Trusts would be charged to tax as an Association of Persons at the normal rates applicable to individuals.

Therefore, by creating a large number of Oral Trusts, the income of each such assessable entity is brought down and the lower marginal rates of income-tax are attracted. This has effectively reduced the tax liability.

Under the amendment which comes into effect from the assessment year 1981-82, a trustee, appointed under an Oral Trust. would be regarded as a representative assessee in respect of income received by him on behalf, or for the benefit, of any person. An Oral Trust will be regarded as Trust declared by a duly executed instrument in writing if a statement in writing is signed by the trustees setting out the purpose of the trust, the particulars about the trustees, the beneficiaries and the trust property. These have to be

furnished to the Income-tax Officer within the specified time limit.

Where the trust has been declared before 1st June, 1981, the specified time limit would be the period of 3 months from that date and in any other case, 3 months from the date of the declaration of the trust. If no such declaration is made, the trust would continue to be treated as an Oral Trust.

The effect of these amendments is that an Oral Trust will be chargeable to income-tax at the maximum marginal rate in all cases. However, if the terms thereof are recorded in writing and intimated to the Income-tax Officer in the specified manner, the income would be chargeable to tax at normal rates, if the shares of the beneficiaries are specified and the beneficiaries are known.

On the other hand, in respect of an Oral Trust, where the shares of the beneficiaries are indeterminate or unknown, the maximum marginal rate of 66% would be applicable. Since these provisions come into effect from the assessment year 1981-82, it follows by implication that for the preceding assessment years, the provisions of section 164 did not apply to Oral Trusts.

The next amendment made in the substantive provision relates to Association of Persons. At present, the Law is that an Association of Persons is a separate assessable entity and pays tax at rates applicable to an individual.

In the case of a member of an Association of Persons, no tax is payable on any portion of amount which such member is entitled to receive from the Association of Persons, on which income-tax has already been paid by the association. Such portion is, however, taken into account for determining the rate of tax in the case of a member.

In view of these advantages, some taxpayers have created multiple associations of persons, where the shares of the members are indefinite and unknown. Thus, the income-tax liability is spread over several assessable entities.

Further, no part of the income of the association is taxed in the hands of its members when their shares are indeterminate or unknown and during the life of the association, the members do not receive any income. Thus, income-tax is payable by the association only on the income accruing to it at the normal rates.

In order to dissuade the creation of multiple Associations of Persons, where the shares are undefined, it is proposed to amend section 86 and insert a new section 167-A. Under these new provisions, Associations of Persons would be liable to tax at the maximum marginal rate, where the individual shares of the members are indeterminate and unknown.

Where, however, the shares of members of the association are not specified in relation to only a part of such income, such part which is not so specified will be chargeable to income-tax at the maximum marginal rate. The rest of the income in which the shares of the members are specific, would be chargeable to tax at the normal rates.

The amendment proposed to section 86(v) is to the effect that in the case of an Association of Persons, in which the shares of the members are indeterminate or unknown, the shares of all members will be deemed to be equal and the amount so ascertained will be included in the assessment of the members of the association for rate purposes. For this purpose, the shares of members of the association will be regarded as indeterminate or unknown if such shares are not ascertainable at the time of the formation of association or at any time thereafter.

These amendments are also to come into effect for the assessment year 1981-82. Therefore, in a way, it will have a retrospective effect because the amendments pertaining to Oral Trusts and Association of Persons would apply to income already earned.

This would also mean that such associations would have paid less advance-tax for the assessment year 1981-82 and hence provisions should be made to exempt them from any penalty or interest for short payment of advance-tax. Similar provisions have been made in the Wealth-tax Act.

An Oral Trust, the terms whereof are not recorded in writing and intimated to the Wealth-tax Officer, would be chargeable to Wealth-tax at the rate applicable to an individual or at the rate of 3%, whichever is higher. Even if the terms of the Oral Trust are recorded in writing, the aforesaid rates will apply in case the shares of the beneficiaries are indeterminate or unknown.

However, where the shares of the beneficiaries are determinate or known and the trustee of the Oral Trust records in writing the terms of the trusts and intimates them to the Wealth-tax Officer, the rate of tax applicable would be the normal rates applicable to the beneficiaries.

Likewise, amendment has been made in the Wealth-tax Act to provide that where the shares of members of Association of Persons are indeterminate or unknown, the rate of wealth-tax applicable would be the normal rates applicable to an individual or the rate of 3%, whichever is higher.

The other provisions of the Finance Bill applicable to individuals is regarding the extension of Compulsory Deposit Scheme for two more assessment years, 1982-83 and 1983-84. It is unfortunate that the Government goes on extending the Compulsory Deposit Scheme and shows no inclination to give up this source of revenue.

The only liberalising amendment made in this respect is that where the person has reached the age of 70 years in a financial year, the balance standing to his credit in the Compulsory Deposit Account will, at his option, be repayable to him on the expiry of such financial year.

Where the person has already crossed the age of 70 years before 1st April, 1981, the amount standing to his credit in the Compulsory Deposit Account would be repayable to him on 1st June, 1981.

The best proposal of the Finance Minister for which no provision has been made in the Finance Bill is in respect of Estate Duty. Not only is the initial exemption limit proposed to be raised from Rs. 50,000 to Rs. 1,50,000 it is to be provided that one residential house would be valued for Estate Duty purposes on the same basis as for the purposes of Wealth-tax.

A Bill to give effect to these proposals would be introduced after the State Legislatures have granted their approval.

Under Rule 1-BB of the Wealth-tax Rules, 1957, the value of a house used for residential purposes is to be arrived at by multiplying the net maintainable rent by twelve and a half times. The net maintainable rent means the standard rent of the house as reduced by expenditure on taxes, ground rent, insurance premium and the standard deduction for repairs.

The Finance Minister has to be complimented on these wise moves because the artificial increase in property prices on account of inflation has put a considerable burden so far on middle class citizens in urban areas whose forefathers had purchased small properties at very low prices.

In the current Bill, less than 10 amendments are made of which only two or three have a bearing on the substantive Law. This is in addition to two important changes made

for giving relief to industry which have already been discussed.

The first amendment governing individuals is that in respect of standard deduction available to employees. At present, the standard deduction is equal to 20% of first amount of Rs. 10,000 of salary and 10% of the excess amount, subject to maximum of Rs. 3,500 per annum. The Bill proposes to grant a deduction of 20% of the salary on a flat basis or Rs. 5,000 whichever is less.

The implication of this amendment is that employees will continue to avail of the deduction upto salary of Rs. 25,000 per annum. Since the initial exemption limit has now been increased to Rs. 15,000, it would mean that an employee drawing upto Rs. 20,000 per annum by way of salary will not be liable to income-tax in view of the standard deduction and the deduction by way of Provident Fund contribution under section 80-C of the Income-tax Act.

However, if such an employee has other income on which tax is deducted at source, for example dividends, he may still have to file a return of income to claim refund of tax.

The other benefit given to individuals is the increase in the deduction under section 80-D from Rs. 2,400 to Rs. 4,800 in respect of medical expenses incurred by him for a person who is a relative of the individual and who is dependent on him and where such person is suffering from a physical or mental disability. It must be noted that this benefit is allowed only in respect of expenses incurred by an individual on his handicapped relatives and not if the expenditure is incurred on himself. A relative is one who is defined in section 80-B-(h).

The further irrationality of this provision is that the deduction of Rs. 4,800 per annum would be available only where the handicapped dependent has, for a period of 182 days or more during the previous year, been admitted in a hospital or a nursing home or a medical institution. It is obvious that if a person has to spend more than six months in a hospital, the deduction of Rs. 4,800 would perhaps be adequate to cover just the cost of food, and not any medical expenses.

If a handicapped dependent has spent less than six months in a hospital or if he has not been to any hospital, the deduction allowable is Rs. 1,200 per annum. If the assessee has the misfortune of having more than one handicapped dependent, the deduction is allowed only with reference to any one.

It is indeed unfortunate that the Finance Minister has not thought of giving a similar deduction for expenses incurred by the individual on his own medical treatment. Every progressive country of the world allows personal medical expenses as a deduction upto certain limits or the whole of the amount exceeding the specified limits.

For example, in U.S.A., where adequate health insurance is taken out by each tax-payer, deduction is allowable if the medical expenses of a taxpayer exceeds 3% of his income. In other words, upto the first 3% of income, medical expenses are to be borne by the taxpayer himself but the excess amount is fully deductible from his taxable business income.

The next provision relates to the extension of the concession given to publishers. Under section 80-QQ, 20% of the profits of publishing are exempt from tax. This concession was to have lapsed after the current assessment year

1980-81. Hence, it is sought to be extended for another 5 years to encourage printing and publication of books in India.

The Finance Minister has ended his Budget Speech by showing an uncovered deficit of Rs. 1,539 crores. This has been done by taking credit for a highly exaggerated estimate of subscription to Special Bearer Bonds. This is because the Bearer Bond Scheme does not grant immunity to the tax evaded income even when it is invested in bonds. A taxpayer who is found guilty of concealment, would be liable to tax, penalty and interest even if he has already invested his concealed income in the bonds.

Hence, the overall budgetary gap would be more than Rs. 2,000 crores which would add fuel to the raging fire of inflation. It cannot be forgotten that the effect of the recent increase in oil prices and the railway freight will exert further pressures on the economy and accelerate the tempo of cost-push inflation.

It is difficult to believe that the Finance Minister has not even mentioned about the need for economies in Government expenditure. Though the Sixth Plan has emphasised that there is stringent need for economies which have to be effected by the Government, the only way in which to curb the yawning budgetary gap is to cut down unproductive expenditure.

Mr. H. V. R. Iengar, former Governor of the Reserve Bank of India, had made a public statement that generally 40% of the Government's expenditure was wasted.

It would not be out of place to point out here that the very first step taken by President Reagan on assuming office in the United States was to sit down with his Secretaries and make drastic curtailment of expenditure. In fact, in every

country of the world, there is overspending, a poor country like India can ill-afford this luxury especially where the effect of imported inflation cannot be restricted and when industrial production is at a low ebb.

Taking an overall view of Mr. Venkataraman's second budget, one cannot help coming to the conclusion that he has missed one more golden opportunity for raising the nation from the economic morass in which it has been since 1979. A man of his calibre and experience could certainly have taken bolder and more imaginative measures which would have triggered off an economic miracle which has so far eluded India.

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**

414

Have you joined the Forum?

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.

Membership is open to all who agree with the Manifesto of the Forum. Annual membership fee is Rs 15/- (entrance fee, Rs. 10/-) and Associate Membership fee, Rs. 7/- only (entrance fee, Rs. 5/-). Graduate course students can get our booklets and leaflets by becoming Student Associates on payment of Rs. 3/- only. (No entrance fee).

Write for further particulars (state whether Membership or Student Associateship) to the Secretary. Forum of Free Enterprise, 235, Dr. Dadabhai Naoroji Road, Post Box No. 48-A, Bombay-400 001.

Published by M. R. PAI for the Forum of Free Enterprise, "Piramal Mansion", 235 Dr. Dadabhai Naoroji Road, Bombay-1 and printed by B. D. Nadirshaw at Bombay Chronicle Press, Sayed Abdulla Brelvi Road, Fort, Bombay-1.

11/April/1981