Union Budget 1990-91 Will Not Solve Economic Problems

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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

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Mr. Madhu Dandavate, the Union Finance Minister, has presented the first budget of this decade, showing his skill as an astute politician who can levy a heavy dose of taxation on the corporate sector and yet create a euphoria among stock brokers and investors. He is the first Finance Minister in India who has learned the art of raising taxes with cheer, though it is apparent that tax-payers have not understood the true effect of the budgetary policies announced in Parliament on 19th March, 1990.

There is no doubt that the Finance Minister has done his best, given the circumstances prevailing today. His greatest achievement is that he has restricted the budgetary deficit to Rs.7,206 crores for the fiscal year 1990-91 despite the rise in the defence expenditure and administrative costs. However, he has optimistically assumed that non-development expenditure will be restricted and the various Ministries will be able to absorb the liability on account of additional instalments of dearness allowance.

The author is a well-known tax expert. The text is based on a talk delivered by him on "The Union Budget 1990-91" under the auspices of the Forum of Free Enterprise and several other organisations in Bombay on 21st March, 1990.

As in the past, the Government has come up with a promise of evolving a long-term fiscal policy. A document on this will be presented in Parliament. However, the Finance Minister has acknowledged the desirability to keep the basic structure of the Income Tax Law stable. He has accepted this principle by continuing with the policies announced by the last Government and he has been magnanimous enough not to depart from them just because the Goverment has changed. The Budget exercise needs to be lauded on the following three counts:-

1. There has been no additional burden of taxation on individuals. However, businessmen who run non-corporate entities will be adversely hit in view of the withdrawal of Investment Allowance and relief for small scale units.

2. The Government has acknowledged the fact that a substantial part of black money is generated by "leakages" from public expenditure and Government projects. The economic survey mentions that stringent measures are called for to prevent leakages at every level.

3. Zero-based budgeting is on the anvil and the Government is conscious of the need for looking at each project de novo.

Mr. Dandavate has rightly abolished the controversial Gold Control Act, which has been acclaimed by all, including the architect of this statute, Mr. Morarji Desai, who is known for his strong beliefs.

However, the main drawback of this year's budget is that a heavy dose of taxation is sought to be imposed on industry in various forms and no fresh incentives have been given for encouraging exports, apart from a reduction in the rate of customs duty on import of capital goods. The Government has also not proposed any measure for containing inflation or for bolstering the foreign exchange reserves in a meaningful way by giving incentives to non-resident Indians.

The burden on the corporate sector will go up by a staggering figure of Rs.800 crores in direct taxes. This is done by not increasing the rates of taxation, in fact,the rates have been reduced, but by withdrawing some of the most significant tax concessions which have been on the statute book for the past many years to promote industrialisation.

The withdrawal of the Investment Allowance, the Investment Deposit Scheme, the benefit for setting up new industrial units in the backward areas and new small scale units in the rural areas, will have the effect of increasing the rates of income-tax for such units from 16.2% to 43.2% (including surcharge), a whopping increase of 27%.

This budget will, therefore, not motivate the corporate sector to improve its performance and no additional amount will be available for declaration of dividends to shareholders. The only beneficiaries of this change will be some of the multinational companies which are selling consumer goods, having a fairly high level of profit.

Such companies will continue to pay tax at the rate of 40% without having to set aside 20% of their taxable profits as deposit with the Industrial Development Bank of India. While the consumer goods industry needs to be encouraged, specially in the rural and semi-urban areas, medium scale and large scale industries are necessary in the core sector and the abolishing of the Investment Allowance is, therefore, a retrograde measure which is deleterious to Indian industry.

Even the amendment pertaining to inter-corporate dividend relief under section 80-M will leave companies worse off than before because if the dividend received by a company from another is not distributed by the receiving company to its shareholders, the whole of such inter-corporate dividend will be liable to tax, as the present relief of 60% stands withdrawn.

The Finance Minister could have given heed to the suggestions made by almost every stock exchange and shareholders' association for abolishing the tax on dividends. The loss of revenue on this account would have been no more than Rs.90 crores, but the advantages of doing so would have been far greater, as not only would the savings of the rural masses be, to some extent, diverted to the productive sector, but substantial funds in foreign exchange would have flowed from non-resident Indians.

This budget is also not savings oriented as it is made out to be. The benefit of section 80-C which is to be deleted, is introduced in a different form by a new section 88 which seeks to give the rebate directly from tax at the rate of 20% on such savings, subject to a maximum of Rs.10,000 per annum. In other words, there is virtually no additional incentive for saving, but the upper income group will have to save

Rs.10,000 more to get the same benefit they are enjoying at present.

Likewise, the Equity Linked Savings Scheme is not an additional benefit which will be available to investors to invest on the stock market, because this scheme is meant to replace the present deduction under section 80-CC which is given for investment in shares of new companies.

While the Finance Minister has paid lip service to the need for promoting exports, no further benefit is sought to be given except for reducing the customs duty on imported capital goods to 25%, provided an export commitment is given for earning three times the value of the imported capital goods by way of export turnover within a period of four years.

The Finance Bill seeks to treat as revenue the cash compensatory assistance, export subsidies and duty drawback received by exporters. This amendment will supersede several decisions of Courts, in which it was held that such amounts are capital receipts which are outside the purview of taxation. All these amendments are made retrospectively, so that past completed assessments of exporters will be reopened.

While Indian exports have recorded a substantial increase during the current year, by recording a growth rate of 38% which is an all time high, as a percentage of world trade, the country's contribution is not even 1%. In fact, with the debt-service obligations increasing, the Government has to ensure that Indian exports increase dramatically in the coming months both in the traditional sector like cotton textiles and commodities as well as in the non-traditional sector like chemicals and engineering goods.

Likewise, while the Finance Minister has acknowledged the contribution of non-resident Indians in bolstering the foreign exchange resources of the country, no new positive measures have been suggested by him to further encourage investments by non-resident Indians. With the abolition of the Gold Control Act, the least that the Government can do is to permit non-resident Indians to legally import gold subject to a reasonable rate of customs duty being levied. This will also make smuggling of gold less attractive and the price of gold in the domestic market will come down.

For the first time, the Government has admitted that one of the major causes for the generation of black money is the public expenditure incurred by various Government agencies. In the economic survey it has been categorically stated that there is an imperative need for carrying out a very strict audit of such expenditure, both at the technical and financial levels.

The problem of black money has to be tackled on every front. Not only do controls have to be liberalised and eradicated, but the public distribution system has to be geared up to avoid any shortages which lead to black marketing and profiteering.

The Finance Minister is on the right track when he suggests that black money and unaccounted wealth could be channelised to productive uses by permitting small scale agro-based units to be set up in rural areas. The scheme for unearthing black money by construction of new houses in rural areas and for slum clearance, is also to be welcomed though no details have been given about the nature of the schemes or the method of their implementation.

However, a flat rate of tax on the amount invested in such schemes is to be imposed and only the after-tax income would be available for investment. There would be immunity provided to the investor from being questioned about the source of the funds.

The abolition of the Gold Control Act, permitting citizens to now keep gold even in a primary form, will, to some extent, divert resources from the capital market, as investors, in times of inflation when the capital market is not buoyant, would be inclined to invest in gold rather than shares and other financial securities. Hence, the demand for gold is going to increase and the Government should, therefore, actively encourage importation of gold either through its own agencies or through non-resident Indians or both.

The revamping of the Gift-tax Law is only of a cosmetic nature and will have no effect on tax collection. In fact, this Law needs to be repealed considering the fact that only Rs.9 crores are collected by the Exchequer.

The Government has sought to change the gift-tax structure by making the tax payable by donees rather than donors. This is sought to be justified on the ground that it will curb ostentatious consumption, specially on such occasions like weddings.

In this context, it is relevant to point out that there is already a provision, namely, section 69-C of the Income-Tax Act, which seeks to tax any unexplained expenditure where the source of the funds cannot be proved to the satisfaction of the Income-Tax Officer. Hence lavish expenditure on festive and other occasions can be controlled by adequate administration of the law.

No useful purpose would be served in merely shifting the burden of gift-tax from the donor to the donee. In fact, if this provision is introduced, it would lead to greater evasion of tax as more and more transactions would be undertaken illegally.

To illustrate, if a parent gives a heirloom to the son or daughter at the time of marriage, which 50 years ago may have been worth Rs.1,000 but which may now be worth over a lakh, there would be a tax liability on the son or daughter because several other presents would also be received at the time of marriage.

While an exemption of Rs.1 lakh is sought to be given for gifts received at the time of marriage, this is totally inadequate considering the present price of gold ornaments and jewelleries. The tax on such gifts would be so high that the donee would be totally disuaded from declaring the amount of gift received. Therefore, there would be greater avoidance of declaration of gifts received than at present.

Further, if gifts are received other than in cash, from where is the donee going to pay the gift-tax which could be as high as 40% on the value of gifts exceeding Rs.2 lakhs? Therefore, if at all the Gift-Tax Law is to be amended, it should be made applicable only to cash gifts which would enable the donee to discharge his tax obligations. Any gift in monies worth or in the form of immovable property, would not be accepted by the donee as he would find it impossible to pay gift-tax.

Further, this new amendment to the Gift-Tax Law should not be made applicable to any charitable or religious trust. All public trusts, whether of a charitable or religious nature, irrespective of the date of their being set up or whether they are communal or non-communal, should be exempted from paying gift-tax on gifts or donations received from the public.

The Finance Minister is earnestly requested to consider all the implications in great detail before the Amending Bill is introduced in the current session of Parlament. Further, representations from various charitable trusts should be considered and given due weightage before the Amending Bill is introduced in Parliament.

While 49% of the resources are proposed to be spent on the rural sector, there will be no appreciable increase in the agricultural output in the near future but it could well decline if the monsoon this year is not as good as in the recent past.

No positive measure has been proposed to tackle the problem of growing unemployment specially among the educated youth. The Employment Guarantee Scheme will not even scratch the surface of the problem because it is to be introduced only in the drought-prone areas. The Government has failed to realise the fact that unless new small scale and medium scale industries are set up in the rural and semi-urban areas, the problem of unemployment will increase.

In fact, the problem is becoming so acute that the very political stability of the country may be jeopardised. Apart from the 12 million unemployed during 1987-88, as stated by the Finance Minister, there are atleast a hundred million people who are so underemployed that they are far below the poverty line.

Thus, not only is it necessary to induce people to set up small scale industries in the rural areas, but agriculture should itself be made a profitable occupation by ensuring due return on sale of crops. The Finance Minister has rightly pointed out that investment in irrigation, land development and soil and moisture conservation are the focal points of the agricultural strategy of the new Government.

While the debt relief to farmers is proposed more as a result of an electoral promise given by the Government, it would have been better if the same benefit could have been confirmed in a different form. This would have been possible by giving a more remunerative price to farmers and ensuring that a part of that amount is used for repayment of the loan.

Such a step would have added dignity to the issue of writing-off loans due by farmers. Apart from that, it would have sent a message to the rural sector that any scheme for their benefit has to be linked with their performance. This is the only way in which there would have been increase in productivity in the agricultural sector, which is considered necessary by the Finance Minister, as stated in paragraph 32 of his Budget Speech.

The Finance Minister's announcement for reintroducing the Central Investment Subsidy of 15% for small scale units in rural areas and backward regions, is a cause for cheer. However, the subsidy has to be properly utilised and the Government should take adequate steps to ensure that the project for which it is meant is expeditiously set up so that there are no cost overruns.

The public sector has to be made much more profitable than in the past if it is to contribute substantially to the national exchequer. While stock option schemes have to be carefully conceived, it has to be emphasised that mere labour participation in management may not bring the desired results.

It is possible that such schemes may be counter-productive, as worker participation in management could also lead to greater demand for wages. What is more important is that public sector enterprises should be given a certain amount of autonomy from the concerned Ministries and professionalism has to be injected at every level.

On the indirect tax front, the Finance Minister has merely made cosmetic changes depending on his own preferences. He has shown himself as a "kill-joy" by increasing the excise duty on ice-cream. On the other hand, he has exempted pickles which are bad for the health of the people. While increasing the excise duty on air-conditioners and refrigerators, the Finance Minister has failed to appreciate the fact that refrigerators are not a luxury, but are necessary in a hot and humid country like India for the preservation of food, specially for the poor and lower middle class citizens.

The combined impact of increase in the railway freight and the price of petrol and diesel, will spur inflation as the entire transport sector will be heavily burdened. This is a retrograde measure which needs to be condemned. India has the dubious distinction of having the highest price of petrol in the world. The fact that two-wheelers and autorickshaws have been spared from the increase in excise duty, will not help the common man because the cost of fuel has gone up immediately after the budget.

There is no indication of the Government's desire to control non-productive, non-plan expenditure which continues to show a rising trend and gobble up almost two-thirds of the total revenue of the Government. However, the increase in outlay for the Central Plan by 14.2% is welcome, though it is doubtful whether the full amount of Rs.39,329 crores will in fact be spent since almost Rs.22,000 crores are to be mobilised through the internal sources of public sector enterprises.

It is indeed disheartening that non-plan expenditure continues to increase drastically, interest itself absorbing Rs.20,850 crores and defence Rs.15,750 crores. The total plan expenditure, on the other hand, is only Rs.30,192 crores. No measures are proposed by the Finance Minister to curtail unproductive, administrative and other expenses.

While the rates of income-tax on individuals have not been increased, the effective burden of tax on businessmen has gone up with the withdrawal of the Investment Allowance and the Investment Deposit Scheme. If the reduction in the rates of corporate tax can be justified on the ground that Investment Allowance and Investment Deposit Scheme are withdrawn, why should there not be a similar reduction in the rates of tax on the profits of businesses which are carried on by sole proprietors, partnership firms, Hindu Undivided Families and Associations of Persons?

Such business entities will now be worse off than limited companies. To remove this discrimination, it is imperative that income-tax at the personal level should also be reduced to 40%.

The only relief sought to be given to industry is the withdrawal of section 115-J, which at present taxes 30% of the book profits in the case of those companies which would not otherwise be liable to tax in view of the depreciation and investment allowances, both current and unabsorbed which are carried forward. The deletion of section 115-J with effect from the assessment year 1991-92 would help only those companies which have a substantial backlog of such unabsorbed amount. It will mainly benefit new capital intensive companies which have a substantial gross block of plant and machinery as they will not be liable to pay tax until the unabsorbed amounts are fully set off.

Under the existing provisions of section 80-HHC of the Income-Tax Act, exporters are allowed a 100 per cent deduction in respect of the profits derived from export of goods or merchandise. Similarly, under section 80-HHD of the Income-Tax Act, persons engaged in the business of a hotel or of a tour operator or travel agent are allowed a deduction of 50 per cent of the profits derived from services provided to foreign tourists and so much of the balance profits as is credited to a reserve account to be utilised for specified purposes. One of the conditions for allowing the deduction under both the above sections is that the receipts should be in convertible foreign exchange.

However, the deductions are allowable even if the foreign exchange is not brought into India. In the absence of such a condition, one of the main purposes of allowing such concessions, namely to augment the foreign exchange earnings of the country is being defeated. It has, therefore, been proposed that for obtaining the deduction under sections 80-HHC and 80-HHD, the taxpayer will be required to bring into India the sale proceeds of goods or merchandise or receipts in relation to services provided to foreign tourists, in convertible foreign exchange within a period of six months from the end of the previous year or within such extended period as the Chief Commissioner or Commissioner of Income-Tax may allow on being satisfied that the taxpayer was prevented from complying with this requirement for reasons beyond his control.

At present, exporters are given export incentives by way of cash compensatory support (CCS), drawback of duty and import entitlement licences. The taxation of CCS has been a subject matter of litigation. The Department's view all along has been the CCS or any other subsidy received by an exporter as an export incentive, is a revenue receipt and hence taxable. To give finality to this view and to end all judicial controversies, it has been proposed that CCS or any other subsidy received by an exporter for exports be included in the definition of income and be taxed under the head "Profits and gains of business or profession".

As regards drawback of duty and profit on sale of import entitlement licences, there are many Court decisions in favour of the Department's stand that these are revenue receipts and liable to tax. To put an end to any litigation which may arise regarding the taxability of these two incentives received by exporters, it has been proposed that they too shall be taxed as revenue receipts under the head "Profits and gains of business or profession".

These amendments will take effect retrospectively, co-terminus with the dates of availability of these export incentives.

In view of the need to promote industrial growth by encouraging the establishing of new industrial undertakings, etc., it is proposed to extend the tax concession under section 80-I for a further period of five years. Accordingly, an industrial undertaking which begins to manufacture or produce articles or things or a ship which is brought into use or the business of a hotel which starts functioning, after 31st March, 1990 but before 1st April, 1995, will also now be eligible for tax concession under section 80-I. The rate of deduction in such cases has also been enhanced as under :-

in the case of a company, thirty per cent; in any other case, twenty-five per cent.

The withdrawal of investment allowance and the relief under sections 80-HH and 80-HHA for new industrial undertakings are retrograde steps. In fact, the investment allowance was restored only three years ago after careful consideration of the imperative need to have this provision.

While the Government may shift its priority from capital intensive industries to labour intensive industries, the investment allowance is still relevant in this day and age because Indian industry needs to be modernised and technologically upgraded. The Finance Minister should therefore restore the investment allowance in the long term interest of the country.

To sum up, the budget proposals will in no way solve the problems of inflation, declining industrial growth and rise in poverty among the masses. While the Finance Minister may have succeeded in making his budget proposals politically seductive, he will unfortunately not go down in history as a man who laid the foundation for a strong industrial India at the turn of this century.

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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