THE UNION BUDGET 1995-96

Bypassing Parliamentary Select Committee

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By

Nani A. Palkhivala *

The last four budgets were framed by Dr. Manmohan Singh, the technocrat. The fifth budget introduced this year is by Dr. Manmohan Singh, the politician.

The earlier four budgets marked the turning point in the way Indians thought about their economy — less like a tortoise and more like a tiger. They were watershed budgets which marked the transformation of the arthritic economy into an athletic economy.

The best thing one can say about the budget presented this month is that it continues the trend which Dr. Manmohan Singh started in his first four budgets — lower taxes, liberalization and globalization. There is no retracing of the steps, no going back on any of the ideals which made those budgets so epoch-making. The justified criticism is that the Finance Minister has not taken any step forward in any of the new directions.

It is a total misconception to think that in the State elections the people rejected the new policy of

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* The author is President, Forum of Free Enterprise. The text is based upon the Plus Channel presentation on Doordarshan Main Channel on 18th March 1995, and the subsequent articles on the subject in several leading newspapers.

liberalization and globalization. The clear message is that the people were disgusted with the prevailing corruption and the inefficiency of the men in power.

They voted for change, and that is why in the States where the Congress party was in power they returned non-Congress candidates, and in the States where a non-Congress party was in power they returned the Congress party.

One would have expected the Finance Minister to make a reference to his earlier proposal to abolish the surcharge on corporate tax and give reasons why he was not implementing the idea this year.

Equally, one would have expected the Finance Minister to give concrete proposals for the deregulation of the insurance sector, which he had rightly referred to in his 1993 Budget Speech as one of the urgent tasks of liberalization. The Malhotra Committee was appointed and it made a very balanced, well-thought-out report, as one would expect from a man of the calibre of Mr. R. N. Malhotra. After that Report, the Finance Minister in his Budget Speech in 1994 again reiterated his proposal to deregulate the insurance sector and to create a competitive and financially strong insurance industry functioning under an independent regulatory authority.

This year there is no specific announcement about the opening of insurance (Life and General) to the private sector. There is only a reference to a proposal "to establish an independent regulatory authority for the

insurance industry" with a promise that "necessary legislation will be introduced shortly". Kingsley Amis was not wrong when he said, "There is always a gap between an idea and its execution, but in India it is the widest". Is the momentum of liberalization and globalization being lost in the clash of political ideologies?

The threshold of personal taxation is proposed to be increased from Rs. 35,000 to Rs. 40,000. But this is wholly inadequate, having regard to the erosion in the value of the Rupee. The exemption limit was fixed in 1981 at Rs. 15,000 which is equivalent to Rs. 51,450 today. Equity and justice are on the side of those parties who are pressing for the exemption limit to be raised beyond Rs. 50,000. The Chelliah Committee Report recommends that the top rate of 40 per cent should be made applicable to income over Rs. 2,00,000, whereas in the Budget this year it is proposed to be made applicable at Rs. 1,20,000.

The present rate of inflation of 11 per cent is likely to increase in the next financial year. One of the factors which will push up the inflation is the growing volume of Non-Plan expenditure by the government. The fiscal deficit is likely to exceed the target of 5.5 per cent of the gross domestic product. In the Finance Minister's Speech are mentioned the new authorities, schemes and programmes which would have to be paid for out of the public exchequer. As Mr. Rajiv Gandhi discovered for himself, when he was the Prime Minister, hardly 18 per cent of the expenditure incurred for the welfare of

the poor trickled down to the targeted section of the population.

The Finance Bill contains a proposal to amend Section 80-IA with a view to allowing a tax holiday in respect of profits and gains from industrial undertakings engaged in development of infrastructure. The Explanatory Memorandum rightly mentions that industrial modernization requires a massive expansion of, and qualitative improvement in, infrastructure and that our country is very deficient in infrastructure such as expressways, highways, ports and rapid urban rail transport systems. Additional resources are needed to fulfil the requirements of India within a reasonable time-frame. In other countries, BOT (Build, Operate and Transfer) or BOOT (Build, Own, Operate and Transfer) concepts have been utilized for developing new infrastructure. It is, therefore, proposed to provide a five-year tax holiday for an enterprise which builds, maintains, and operates infrastructure facilities. The five-year tax holiday is proposed in respect of income derived from the use of the infrastructure facilities developed by them.

When I was speaking to an audience of Non-resident Indians in Muscat and Dubai two years ago, I found them bluntly asking the question — can we trust the Government of India? If we start an undertaking on the strength of a tax holiday proposed in a particular Budget, can we be sure that the basis on which we decide to embark on the venture will continue to be the law of India at the time when the tax holiday begins, say, three years later? The majority of the chartered

accountants practising in the Arab countries are Non-resident Indians themselves and they have full knowledge of what has been happening in India in the recent past.

Prior to the Finance Act, 1986, the then existing Section 32A(8) of the Income-tax Act provided that the Central Government might notify the discontinuance of investment allowance in respect of any ship or aircraft acquired or any machinery or plant installed after a specified date "not being earlier than three years from the date of such notification". The Finance Act, 1986 discontinued investment allowance without the three years' notice which was mandatory under the law, by the simple expedient of omitting the statutory words which required three years' notice, Indians have no option but to submit to such strident injustice. But Non-resident Indians and other foreigners who can venture in any part of the world are understandably averse to investing in a country where a sense of honour has become totally anachronistic.

A similar breach of faith was involved in the abolition of relief by the Finance Act, 1990 which dealt with certain provisions of the Income-tax Act. It abolished, without notice, reliefs under Section 33A (development allowance for tea bushes planted in new fields); Section 80HH (establishment of new industrial undertakings or hotels in, or shifting of existing units from cities to, backward areas); and Section 80HHA (establishment of small-scale industrial undertakings in rural areas). Those sections had been in operation for a long time — ranging

from 13 to 25 years. The government refused to consider the palpable injustice entailed as regards schemes which had been in the process of implementation and which had been undertaken by trusting taxpayers on the basis of existing law.

The question may be asked — how can any finance minister ensure that such breaches of faith are not committed by his successors? In Mauritius they amended the Constitution and provided that changes in certain policies could not be made without a special majority needed to amend the Constitution. India need not go to that length. There is a simple expedient to deal with the situation. The government should declare its economic and fiscal policy for the remaining term of its office. It should apologize for the breaches of faith committed in the past and publicly avow that its policy hereafter would be to ensure that those who act on the faith of the existing law would be protected. Such a solemn assurance would give rise to the doctrine of "promissory estoppel" which, in jurisprudence, means that the government is estopped from going back on its promises. The equity of promissory estoppel can be enforced in the High Courts and in the Supreme Court by any aggrieved citizen or foreigner.

I cannot help thinking that Dr. Manmohan Singh is the right person who can start the healthy tradition of giving the type of assurance which would amount to promissory estoppel and which would safeguard those Indians and foreigners who act on the basis of our existing enactment.

There are three important proposals in the Finance Bill which should not be there at all and can only be adequately dealt with by Parliament as a subject-matter of a separate amendment bill which, in normal course, would have to be referred to a Select Committee of both the Houses. There is a growing tendency for the wayward barons of bureaucracy to usurp the functions of Parliament and make laws which can be made by the people's representatives only in the legislature. The proposed changes in the Income-tax Act are of such far-reaching effect and are so controversial in nature that they cannot possibly be dealt with adequately by Parliament as parts of a Finance Bill.

First, the proposed amendment of Section 145 of the Income-tax Act. Under the existing Section the profits and gains of business or profession and income from other sources are to be computed in accordance with the method of accounting regularly employed by the assessee. The substance of the present Section 145 has been the law of India for more than a hundred years. This year's Finance Bill proposes to amend Section 145 to provide that business or professional profits and income from other sources shall be computed in accordance with either cash or mercantile system of accounting; and no other system like the hybrid system, can be adopted by the taxpayer. Many honest and law-abiding assessees follow the hybrid system, in the sense that for some categories of transactions they find the cash system preferable, while in respect of other types of transactions they follow the mercantile system as better suited. It is certainly a

possible view that to ban the hybrid system of accounting altogether, as a rule of law, would be in violation of the fundamental right to carry on business.

The other objectionable feature of the proposed amendment of Section **145** is that it is sought to empower the Central Government to notify in the Official Gazette from time to time the accounting standards to be followed by any class of assessees or in respect of any class of income. Today it is the Institute of Chartered Accountants of India which prescribes the accounting standards in conformity with the prevailing standards in other parts of the world. The proposal is that instead of the professional body which the Institute of Chartered Accountants is, it would be the bureaucrats in the Finance Ministry who will prescribe the accounting standards — a change of far-reaching importance and far-reaching effect, unparallelled, to the best of my knowledge, in any other part of the world.

Secondly, the Finance Bill proposes to insert Section **194J** in the Income-tax Act to provide for deduction of tax at source from fees paid for professional services or technical services. It is worth recalling that this is the fourth attempt at making a provision for deduction of tax at source from fees paid for professional services.

The first attempt was made by the Finance (No. 2) Bill, 1967 and that proposal was withdrawn. Twenty years later, the second attempt was made by the Finance Bill, 1987 and again the proposal was withdrawn. The third attempt was made by a Circular of the Central

Board of Direct Taxes dated 8th March 1994, but the relevant portion of the Circular was struck down by the Bombay High Court on 14th July 1994. The attempt is now repeated by the new Finance Bill. The proposal bristles with difficulties and complexities. An attorney in Bombay or Calcutta gets fees from clients which include fees of the counsel appearing in the case and which is payable by the attorney. Likewise, in Delhi and in other cities the fees of an Advocate-on-Record include fees which are payable by him to senior counsel who appear in court. The fees payable to a hospital include fees which are payable by the hospital to the physician or surgeon who is attached to the hospital. From whose income is the deduction of tax at source sought to be made?-I have no doubt in my mind that the proposed Section 194J will only increase the number of cases where payments will be demanded and received in cash, in order to avoid the bother and the inconveniences involved in compliance with the new Section 194J. Is it right that a matter of such importance and complexity, which has engaged the attention of our lawmakers for almost thirty years, should now be repeated as merely a part of the Finance Bill where it can hardly get more than a fraction of the attention it deserves?

Thirdly, the Finance Bill proposes that when bonus shares are sold, their cost should be taken as nil for the purposes of computing the capital gains made on the sale. The Supreme Court has laid down that where bonus shares are issued in respect of the existing shares held in a company by the assessee, their real cost to

the **assessee** cannot be taken to be nil or their face value. Their cost should be determined by the process of averaging, **i.e.** by spreading the cost of the old shares to the shareholder over the old shares and the new bonus shares taken together. The present law laid down by the Supreme Court has worked admirably for more than thirty years and it is fair to both the taxpayer and the revenue. It is now sought to be changed thoughtlessly. A chaotic situation will arise as a result of the proposal to change the law from 1st April **1996.** Law-abiding companies have cast their accounts on the basis of the existing law; and in several cases where the old shares were sold in the past, the capital loss or capital gain was computed on the basis of the Supreme Court decision. On that basis, capital gains tax was paid on the sale of old shares, in a larger amount than the amount which would have been chargeable if the original cost of the shares sold had been taken into account and not reduced by being spread over the bonus shares. Those assessments have become final and there is no provision in the Act to get a refund of the excess tax paid.

Further, the new Central Depository is the novel, modern method of dealing in shares on the stock exchange, without using any scrip and the Finance Minister proposes to introduce it in the course of the year. The officers in the Finance Ministry did not draw the attention of the Finance Minister to the incontrovertible fact that when the new system comes into operation, it will operate in such a way that it will not make a distinction between old shares and bonus

shares and, therefore, in a given case nobody will know whether the shares sold are old shares or new bonus shares.

The perennial error of our times is to mistake amendment for improvement and change for progress. A stable fiscal policy is to a nation what a stable family life is to an individual. But stability is anathema to the North Block.

The time has come to consider the desirability of a two-year budget. There would be tremendous saving in time and energy, cost and public inconvenience, if we adopt the system of a Union Budget for a period of two years at a time. It would make for greater stability in place of the insensate annual changes to which we are accustomed. As many as 21 States of the United States of America have adopted the practice of two-year budgets. President Clinton has publicly said that he intends to introduce the practice of two-year budgets from October 1996. Though we may not be enamoured of the attitude of Americans towards India in some areas, we should learn from them the way of saving the nation's time, effort and energy.

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