UNION BUDGET : 1997-98

FOUNDATION FOR AN INDIAN ECONOMIC MIRACLE

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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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The Finance Minister has come up with a historical path-breaking Budget which will, at one stroke, make India an attractive investment destination not only for its own people but for foreigners and non-resident Indians as well. By doing so, Mr. P. Chidambaram will go down in History as one of the architects of modern India.

While the insurance sector has been opened up cautiously and selectively to enable L.I.C. and G.I.C. to have joint ventures with Indian companies in the field of pension business and health insurance, the insurance sector is bound to be exposed to the forces of competition in the very near future.

One of the great merits of the Budget proposals is that a comprehensive incentive package has been framed for oil exploration at a time when domestic

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*The author is an eminent authority on taxation. This text is based on a lecture delivered at a public meeting on 1st March 1997 in Mumbai under joint auspices of Forum of Free Enterprise, Bombay Industries Association and several other organisations.

production has plummeted to dangerously low levels. The framing of the petroleum tax code needs to be done in the shortest possible time since foreign investment in this sector is the crying need of the hour.

The containment of the fiscal deficit and the discontinuance of the ad-hoc treasury bills will certainly rein in inflation. This will not only help the common man but will also restore structural stability to the fiscal regime.

Bonanza for Individuals

Never in the fiscal history of India have the rates of tax been brought down for individuals to a low of 30%. In fact, this rate of personal taxation makes India one of the tax havens of the world if one compares it with the rates prevailing in the European countries, U.S.A., Japan and some of the East Asian countries.

The Finance (No.2) Act, 1996 amended section 88 of the Income-tax Act, through a new clause (xvi), to include investments in debentures of, and equity shares in, a public company engaged in infrastructure including power sector for rebate under this section. By investing in such shares or debentures, a maximum rebate of Rs.14,000 can be claimed.

The Bill proposes to include subscription to equity shares and debentures of a public company for the purpose of providing telecommunication services, (whether basic or cellular) also, forming part of eligible issue of capital for availing the tax rebate under clauses (xvi) and (xvii) of the section.

Under section 193 of the Income-tax Act, tax deduction at source (TDS) is made in respect of interest payable on any income by way of interest on securities. With a view to attract investment in Government securities, the Finance Bill proposes to fully exempt interest payable on any security of the Central Government or a State Government from the requirement of tax deduction at source.

One of the possible ways by which a larger number of persons can be brought under the tax net is to identify potential tax-payers through certain economic indicators. There could be a number of such economic indicators which could be employed for this purpose. It would be a reasonable presumption that any person who satisfies the requirement of ownership/use/expenditure on the following four indicators should be a person having taxable income :

(i) Ownership/lease of a motor vehicle;
(ii) Occupation of any category or categories of immovable property as may be specified by the Board by notification, whether by way of ownership or tenancy or otherwise;
(iii) Foreign travel; or
(iv) Subscription of a telephone.

The Finance Bill proposes to amend section 139 in order to provide that any person who fulfils any two of the four conditions mentioned above should be required to file a return of his income. It is proposed to levy a penalty of Rs.500 in cases where the return of income is not furnished although required on the basis of the above indicators. Initially, these provisions will be applicable to only some selected cities to be notified.

The proposed amendment will take effect from 1st April, 1997 and will, accordingly, apply in relation to the assessment year 1997-98 and subsequent years.

In order to mobilise resources and to channelise funds into priority sectors of the economy, and to offer an opportunity to persons who have evaded tax in the past, to declare their undisclosed income, pay a reasonable tax and in future adopt the path of rectitude and civic responsibility, a voluntary disclosure of income and wealth scheme is proposed to be introduced. The scheme will have the following salient features :

(i) The scheme will cover all persons, corporate or non-corporate. The tax payable on the disclosed income will be 30% in the case of individuals and 35% in the case of other declarants viz. corporates and firms. The tax on the voluntarily disclosed income or wealth would have to be paid before making the declaration, and proof of such payment must be attached alongwith the declaration. However, where tax is paid within three months of the filing of the declaration, interest at the rate of two per cent for every month or part of a month will become chargeable. If such tax is not paid within three months of the filing of the declaration, it will be deemed to be void.

(ii) The person making a disclosure would have to file a declaration in a prescribed form before the Commissioner of Income-tax. The Commissioner shall, on an application made by the declarant, grant a certificate to him setting forth the particulars of the voluntarily disclosed income and the amount of income-tax paid in respect of the same. A person may make a declaration in respect of any income chargeable to tax for any assessment year prior to the assessment year 1998-99 -

(a) for which he has failed to furnish a return under section 139 of the Income-tax Act.

(b) for which he has failed to disclose in a return of income furnished by him under the Income-tax Act before the date of commencement of the Act.

(c) which has escaped assessment in terms of section 147 as it stood prior to 1.4.1989 and thereafter.

(iii) The amount of voluntarily disclosed income shall be allowed to be credited by the declarant in the books of account, if any, maintained by him for any source of income or any other record. The credit so made should be intimated to the Assessing Officer. The voluntarily disclosed income will not be included in the total income of the declarant for the purpose of assessment for any year under the Income-tax Act. There will be no assessment proceeding in respect of the disclosed income and the tax liability in respect of such income will be finally settled on payment of the tax under the scheme. Where the voluntarily disclosed income is represented by any cash, bullion, investment in shares or any other assets, wealth-tax shall not be payable by the declarant in respect of such assets.

(iv) All particulars contained in a declaration will be treated as confidential and no Court or authority will be entitled to require any public servant or the declarant to produce before it any such declaration or part thereof or to give any evidence in this regard.

Furthermore, nothing contained in any declaration shall be admissible in evidence against the declarant for the purposes of any proceeding relating to imposition of penalty or the purposes of prosecution under the Income-tax, Wealth-tax, Foreign Exchange Regulation, and Company Laws.

Corporate Reforms

The tax rates have been made extremely competitive and are comparable to those prevailing in all industrially advanced countries. The reduction in the rate of corporate tax from 43% (including surcharge) to 35% has astounded captains of industry who expected that the maximum cut would be of 5%. This, coupled with the abolition of tax on dividends in the hands of shareholders, will galvanise the capital market and once again make it possible for industry to raise equity from the public by tapping the primary market.

One of the proposals which has so far gone unnoticed is the provision which has been made in the Finance Bill, 1997 to exempt from tax capital gains made on sale of land by a sick industrial company which is managed by a workers' co-operative. This will not only make it possible for such units to become financially viable but will also give a boost for workers' participation in management.

After almost 35 years, the demand of industry has been met to delete provisions which disallow legitimate business expenses. Year after year, memoranda were sent to the Government by various Chambers on this very point but the demand fell on deaf ears.

While the Finance Minister has not abolished the Minimum Alternative Tax, he has bowed down to the demands of the corporate sector to allow credit for the tax so paid to be set-off within five years when the company becomes liable to taxation in the normal course. Moreover, exempting exporters from M.A.T. will create the right psychological climate for accelerating the growth rate in exports which has come down during 1996-97.

The Finance Bill proposes to insert a new section 115-JAA to provide a tax credit scheme by which MAT paid can be carried forward for set-off against regular tax payable during the subsequent five-year period subject to certain conditions, as under :

1) When a company pays tax under MAT, the tax credit earned by it shall be an amount which is the difference between the amount payable under MAT and the regular tax. Regular tax in this case means the tax payable on the basis of normal computation of total income of the company.

2) MAT credit will be allowed carry forward facility for a period of five assessment years immediately succeeding the assessment year in which MAT is paid. Unabsorbed MAT credit will be allowed to be accumulated subject to the five-year carry forward limit.

3) In the assessment year when regular tax becomes payable, the difference between the regular tax and the tax computed under MAT for that year will be set off against the MAT credit available.

4) The credit allowed will not bear any interest.

The rationale for allowing credit in respect of taxes paid under MAT in the aforesaid manner is that a company should always pay a minimum tax. The above method will ensure that the company will always pay a minimum tax even while offsetting the MAT credit against regular tax.

In order to give fillip to the telecom sector in addition to tax holiday, the Bill proposes to insert a new section 35-ABB in the Income-tax Act. The section seeks to provide that any capital expenditure incurred and actually paid by an assessee on the acquisition of any right to operate telecom services by obtaining licence will be allowed as a deduction in equal instalments over the period for which the licence remains in force.

It further seeks to provide that where the licence is transferred and proceeds of the transfer are less than the expenditure remaining unallowed, a deduction equal to the expenditure remaining unallowed as reduced by the proceeds of transfer, shall be allowed in the previous year in which the licence has been transferred. It also seeks to provide that if the licence is transferred and proceeds of the transfer exceed the amount of expenditure remaining unallowed, the excess amount shall be chargeable to tax as profits and gains of business in the previous year in which the licence has been transferred.

The section also provides for amortisation of unallowed expenses in a case where a part of the licence is transferred. The restrictive provisions of this section will not apply in relation to a transfer under a scheme of amalgamation whereby the licence is transferred by the amalgamating company to the amalgamated company, the latter being an Indian company.

Under the provisions of section 80-IA of the Income-tax Act, a five-year tax holiday and a deduction of 25% (30% in the case of companies) in the subsequent five years is allowed to an undertaking engaged in the business of generation, or generation and distribution, of power or to an industrial undertaking set up in backward states/districts.

The country requires large investment in the telecommunication sector, both basic and cellular. In order to encourage investment in this sector, it is proposed to grant 100% deduction from the profits and gains of an assessee engaged in the business of providing telecommunication services for the initial five assessment years. It is also proposed to provide a deduction of 25% (30% in the case of companies) from such profits and gains for a further period of five years. The deduction will be allowed to an undertaking which begins to provide the telecommunication services at any time during the period beginning on 1st April, 1995 and ending on 31st March, 2000.

The proposed amendment will take effect retrospectively from 1st April, 1996 and will, accordingly, apply in relation to assessment year 1996-97 and subsequent years.

As mentioned above, under the provisions of section 80-IA of the Income-tax Act, a five-year tax holiday and a deduction of 25% (30% in the case of companies) in the subsequent five years is allowed to an undertaking engaged in the business of generation, or generation and distribution, of power or to an industrial undertaking set up in backward states/ districts.

The Bill proposes to extend the tax holiday to industrial parks notified for this purpose in accordance with any scheme to be framed by the Central Government. This tax holiday is expected to encourage investments in industrial infrastructure. Those industrial parks which start operating during the period beginning on 1st April, 1997 and ending on 31st March, 2002 will be eligible for 100% deduction for the initial five assessment years followed by 25% (30% in case of companies) deduction from profits for the next five years.

Under section 35 of the Income-tax Act, certain deductions are allowed in respect of expenditure on scientific research.

The Bill proposes to introduce a new sub-section (2-AB) to allow a company, a deduction of a sum equal to 1-1/4th times the sum paid in respect of any expenditure incurred by a company on scientific research including an expenditure of capital nature related to the business. This deduction will be available to companies having in-house Research & Development facility approved for the purpose of the section by the prescribed authority and engaged in the business of manufacture or production of any drugs, pharmaceuticals, electronic equipment, computers, telecommunication equipment, chemicals or any other article or thing notified in this behalf.

It is also proposed that no deduction shall be allowed in respect of expenditure on land and building, and that the company shall enter into an agreement of co-operation and audit with the prescribed authority before approval of the research and development facility.

Indirect taxes

The reduction in excise and customs duties will also help industry substantially and the additional burden on the steel industry caused by the increase in railway freight will, to some extent, be balanced by the reduction in input cost of raw materials as a result of such reduction.

It was widely expected that the Finance Minister would raise excise duties on luxury items, notably motor-cars, specially those which have diesel engines. This has not happened and the automobile sector will, therefore, continue to maintain its growth rate.

The reduction in the rate of excise duty on several consumer items should result in benefit to consumers in view of the competitive environment which has been created over the last six years. However, the service tax on various agencies may result in higher cost for end users.

Other noteworthy proposals

Some of the other highlights of the Budget proposals which are worthy of note are :

a) the granting of administrative and financial autonomy to public sector units;
b) further liberalisation of the infrastructural sector;
c) a new regime for the telecom industry;
d) liberalisation measures for oil, gas and power projects;
e) review of the Urban Land (Ceiling and Regulation) Act, 1996; and
f) additional incentives for scientific research.

While the policy decision on capital account convertibility has been deferred depending on the report of the group set up by the Reserve Bank of India, there is no doubt that the goal of full convertibility will be reached much sooner than expected. Once certain economic parameters have been achieved, the Rupee will emerge much stronger, making it one of the prime currencies of the world.

The capital market will continue to gain vigour and may possibly become even stronger in view of the report of the Expert Group appointed by the Government to draft a new Income-tax Law. These recommendations are expected to be incorporated in the new Income-tax Law which will come into force from the financial year 1998-99. Investors may not only have the benefit of tax-free dividends but also adequate tax shelter in respect of long-term capital gains.

In the fiscal year 1998-99, Indian industry will perform even better if Mr. Chidambaram and his other colleagues continue with the reform process and State Governments continue their competitive bid for attracting foreign investment. The recent example of Maharashtra will undoubtedly be emulated by other Governments.

It does not require an astrologer to predict that with the aforesaid budget proposals announced this year, the manufacturing sector of Indian industry will easily achieve a rate of growth of 14% in 1997-98. As a result, the gross domestic product is most likely to rise to 7.5% as against the average of 7% in the preceding three years and 6.8% in the current financial year.

Conclusion

It takes one man to trigger an economic miracle with bold and imaginative policies, emanating from a futuristic vision. Chancellor Ludwig Erhard laid the foundation for the German economic miracle in the early fifties, and Prime Minister Lee Kwan Yew did it for Singapore. When India emerges as one of the front-line nations of the world, the name of P. Chidambaram will be etched in History as the architect of India's economic miracle.

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

596

FORUM OF FREE ENTERPRISE

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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