CHAPTER - III

CORPORATE TAX STRUCTURE IN INDIA

3.1. INTRODUCTION:

It is generally accepted that the ultimate aim of economic policy of any Government is to increase the national income of the country and there is no gainsaying that the Corporate Sector plays a very important role in this respect. National income largely depends upon the volume of investment prevailing in a country and that may be treated as the function of the rate of interest and the marginal efficiency of capital. Such functions can be substantially regulated by the Government. If the return on investment is reduced through high rate of effective tax, the marginal efficiency of capital is likely to decline, resulting in adverse effect on national income. Effective corporate tax depends upon its tax-structure. Corporate tax-structure includes rates of diversified tax imposed on companies; levels of exemptions; and different categories of deductions, rebates, reliefs and allowances allowed for the purpose of computation of tax liabilities. This again depends upon nature of companies.

There are different types of companies for the purpose of taxation. In "Company Law", companies are classified as public limited and private limited but for the purpose of taxation, companies are grouped as "widely held" and "closely-held" and again "industrial" and "non-industrial." The Company Law is mainly interested in the sound management of the companies and in ensuring the rights and privileges of the investors; whereas, income-tax legislation has to consider many other additional factors, like, equity and distribution of income and wealth, revenue requirements of the government, administrative convenience of collecting revenue, safe-guarding against tax evasion and avoidance.[1] That is why, the corporate tax-structure has undergone many changes, innumerable number of times, since the tax legislation in India started in 1860.

In this chapter we shall attempt to analyse the existing corporate tax structure and try to assess how far the tax structure is consistent with the goal of quick industrialisation.

3.2. CLASSIFICATION OF COMPANIES:

Section 2 (7) of the Income-tax Act, 1961 says that an "assessee" will pay tax, and 'assessee' means any 'person' by whom any tax or any other sum of money is payable under this Act. Section 2 (31) includes a "company" within the definition of a

1. Ambirajan, S. - 'The taxation of corporate income in India', Asia Publishing House, Bombay, 1964 p. 128.

'person'. According to Section 2 (17) of the Income-tax Act 1961, a Company means:

(i) any Indian Company, or

(ii) any body corporate incorporated by or under the laws of a country outside India, or

(iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income tax Act, 1922 or which is or was assessable or was assessed under the Income tax Act, 1961 as a company for any assessment year upto 1970-71, or

(iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Central Board of Direct Taxes to be a company and shall be deemed to be a company only for such assessment year or years as may be specified in the declaration.

Companies have been classified according to (i) domestic nature; (ii) ownership in holding; and (iii) economies in activity.

'Domestic Company' under Section 80B (2) means an Indian Company or any other company which, in respect of its income liable to income - tax under the Income - tax Act, has made the proper arrangements for the declaration and payment within India of the dividends (including dividends on preference shares) payable out of such income in accordance with the provision 194 of the Companies Act. Non-domestic company is that company which is not a domestic company. In this connection, the term 'Indian Company' is defined under section 2 (26) of the Income tax Act, 1961 as a company formed and registered under the Companies Act, 1956 including:

(i) a Company formed and registered under any law relating to companies formerly in force in any part of India other than the state of Jammu and Kashmir and the Union territories, specified in (iii) below;

(ia) a corporation established by or under a Central, State or Provincial Act;

(ib) any institution, association or body which is declared by the 'Board' to be a company under section 2 (17);

(ii) & (iii) in the case of the State of Jammu and Kashmir, and for the Union territories, a company formed and registered under any law for the time being in force in that State or Union territory.

For all the above cases, the company must be registered or, as the case may be the principal office of the company, corporation, institution, association or body must be situated in

India.[2]

Non domestic company is taken as a foreign company.

On the basis of ownership holding, the companies are classified as 'Companies in which the public are substantially interested' (widely - held domestic companies) and the 'companies in which the public are not substantially interested' (closely-held domestic companies).

A company is to be treated as widely-held company under section 2 (18):

(a) if it is not a private company under the Companies Act, 1956 and (b) Shares (other than preference shares) were as on the last day of the relevant previous year listed in a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 and any rules made thereunder, or

(c) its shares other than preference shares carrying at least 50% (40% in case of industrial company) of the voting power have been unconditionally allotted to or acquired by, and were throughout the relevant previous year beneficially held by Government or corporation, under the Central, State or Provincial Act, or any widely held company or any of its subsidiary or the public; the said shares were freely transferable; and the affairs

2. Bhattacharya, S. - 'Indian Income tax - Law & Practice', Nababharat Publishers, Cal. 1976 p. 9.

of the company, or the shares carrying more than 50% (60% in case of industrial company) of its total voting power were at no time, in the relevant previous year, controlled or held by five or less persons.

For the computation of five or less persons, no account shall be taken of the Government or any Statutory Corporation or any other widely-held company or any subsidiary thereof and relatives of one another or nominees of any existing shareholders, and that will be treated as a single person.

The domestic companies which are not widely-held companies are termed as closely-held domestic companies.

On the basis of activities of the companies, they can be broadly classified as 'industrial companies' and 'non-industrial companies'.

Industrial company means a company which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining and the income attributable to any of the aforesaid activities included in its gross total income of the previous year is atleast 51% of gross total income. - Sec. 2 (7)(c).

Companies which do not satisfy the above conditions may be termed as non-industrial companies.

For the purpose of additional income-tax, non-industrial companies are further classified as Investment-companies, Trading-companies, Consultancy-service Companies and other companies.

Investment company means a company whose gross total income attributes at least 51% to the income chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources". Sec. 109 (ii)

Trading company means a company whose business consists mainly (at least 51% of its gross total income) in dealing in goods or merchandise manufactured, produced or processed by some one else. Sec. 109 (iia)

Consultancy service company means an Indian company whose business consists wholly in the provision of technical know-how, or in the rendering of services in connection with the provision of technical know-how, to other persons.[3] Sec. 109 (ib).

3.3. RATES OF TAXATION:

I. Basic Tax.

Under the existing structure for the A. Y. 1981-82, there are several rates of income-tax, depending on:

(a) Whether the company is 'widely held' or 'closely held';

3. Lakhotia, R. N. - 'Elements of Indian Income Tax,' Asha Publishing House, Cal. 1979, pp. 396-405.

(b) Whether it is mainly engaged in industrial activities or in other activities like trading, investment, etc.;

(c) Whether the taxable income exceeds a certain limit or not;

(d) Whether the company is domestic or foreign.

A. Domestic Company :- 1. Widely-held company having income not exceeding Rs. 1,00,000. ... Income-tax @ 45%.

2. Income exceeding Rs. 1,00,000 ... Income-tax @ 55%

B. Domestic Company :- 1.a) Closely-held industrial company having income not exceeding Rs. 2,00,000 ... Income tax @ 55%

b) and income exceeding Rs. 2,00,000 ... Income tax @ 60%.

2. Closely-held non-industrial company ... Income-tax @ 65%

C. Non-domestic Company:-

(a)(i) royalties or fees for technical services received from an Indian concern in pursuance of an agreement after 31.3.61 but before 1.4.76 / after 29.2.64 but before 1.4.76, respectively, approved by the Central Government ... Income tax @ 50% and

(ii) agreements entered into after 31.3.76 but before 1.4.81 and approved by the Central Government ... Income tax @ 20%,

(iii) royalties or fees for technical services on agreement, not approved by the Central Government ...
Income tax @ 40%

(b) income by way of dividend ... Income-tax @ 25%

(c) on the balance, if any, of the total income ... Income tax @ 70%

Of course, there are provisions of 'marginal relief' for all the above cases.

Sur-charge is also levied @ 2.5% for domestic companies and 7.5% for non-domestic companies in the computed income-tax liabilities.

II. Additional Income - Tax

There is a provision of additional income-tax under sections 104-109, on 'insufficient distribution' or non-distribution of profits as dividends by companies where public are not substantially interested. The rates of tax depend upon the nature of activities of such companies, like, investment company ... @ 50%, trading company ... @ 37% and any other company ... @ 25%, calculated on the 'distributable income' of the company as reduced by the amount of the dividend actually distributed, if any, during the previous year concerned. Therefore, to escape the levy of such penal tax, the closely-held company, i.e. the company where public are not substantially interested, is to distribute the dividend, which is to be worked out with reference to the "statutory percentage" on the "distributable income".

The "distributable income", under section 109 of the Income-tax Act, 1961, is computed by deducting the following items from the gross total income of the non-industrial closely-held company:

(a) the amount of income-tax payable by the company in respect of its total income, but excluding the additional income-tax payable under Sec. 104;

(b) the amount of any other tax levied under any law by the Government, or by a local authority, in excess of the amount, if any, allowed in computing the total income;

(c) any amount paid as charitable donations, actually allowable under Sec. 80G;

(d) losses relating to long-term capital assets;

(e) amount of accrued foreign income, not permitted to be remitted in India;

(f) in the case of a banking company, the amount actually transferred by it to its statutory reserve fund under section 17 of the Banking Companies Act, 1949;

(g) any expenditure actually incurred for the purposes of the business, but not allowed as a permissible deduction under the head 'profits and gains of business or profession' under sections 30-37 of the I.T. Act;

(h) any expenditure incurred wholly and exclusively for the purpose of making or earning any income (other than profits and gains etc. on business income head) included in the gross total income but not allowed to be deducted in computing such income, if that results in the creation of an asset or enhancement in the value of an existing asset;

(i) the amount payable, if any, as sur-tax by the company under section 4 of the Companies (Profits) sur-tax Act, 1964.

"Statutory percentage" under section 109 (ii) of the income-tax Act, 1961, refers to the percentage of 'distributable income' that a company is required to distribute dividends in order to escape levy of additional income-tax.[4] For purposes of fixing the 'statutory percentage', companies have been divi-

4. Mohsin, Mohammad - 'Rationalisation of Corporate Tax Structure', Three Way Printers, Aligarh, 1973. p. 9.

ded into four broad categories. Such categories and the 'statutory percentage' of required distribution of profits are shown hereunder:[5]

(1) Consultancy service company.	...	45%
(2) Investment company other than an investment Co., which falls under the sub-clause (3) below.	...	90%

(3) Indian Co., a part only of whose gross total income consists of profits and gains attributable to the business of consultancy service, or of industrial activities:

(a) in relation to that part of income as related to consultancy service.	...	45%
(b) income relating to industrial activities.	...	Nil
(c) in relation to the remaining part:		
(i) if it is an investment company which satisfies the conditions of the following sub-clause 4(a)	...	90%
(ii) in any other case	...	60%

ok. ~~(4) In the case of any other company not referred to above.~~[5]:

(a) Where the accumulated profits and reserves of a trading Co. (including depreciation reserves and any amount capitalised from the earlier reserves) exceed either the aggre-

5. Bhattacharya, S. - 'Indian Income - Tax. - Law & Practice', Nababharat Publishers, Cal. 1976. p. ~~9~~. 582.

gate of the paid-up capital of the company and any loan capital which is the property of the shareholders or value of the fixed assets as shown in the books, whichever is greater ... 90%

In the case of a non-trading company when such profits and reserves exceed twice the aforesaid limit, the rate being same as 90%

(b) in any other case 60%

However, opportunity to make supplementary distribution in special cases within a specified period immediately following the relevant previous year and reduction in the 'statutory percentage' of declaring dividend for the specific cases for 'inadequate distribution' against advance payment in business, may be allowed by the Central Board of Direct Taxes on application, under section 105 (1) and 107A of the Income-tax Act, 1961.

III Sur - Tax

Every company earning 'chargeable profits' exceeding 'specified limits' has to pay sur-tax under section 4, at the rates given in the Companies (Profits) Sur-tax Act, 1964.

'Chargeable profits' corresponding to the previous year, is computed under section 2 (5) of the Sur-tax Act, 1964, as the total income under the Income-tax Act to be reduced by the following amounts:

(i) Capital gains ; (ii) compensation chargeable as business income under Sec. 28 (ii); (iii) profits and gains of any business of life insurance; (iv) balancing charge under Sec. 41 (2); (v) interest on tax-free government securities; (vi) chargeable donations actually allowable to the company under Sec. 80G; (vii) dividends received from a domestic company; (viii) royalties received from Government or a local authority or any Indian concern; (ix) interest or technical service fees received from Government or a local authority or any Indian concern by a foreign company; (x) in the case of a banking company, any amount transferred to the statutory reserve fund during the previous year.

The balance of total income remains after making the above deductions shall be further reduced by (i) the amount of income-tax, including sur-charge, (excluding the amount, if any, payable as additional income-tax under Sec. 104); (ii) the amount of foreign taxes paid after allowance of every relief due under the foreign laws, provided the company produces evidence of the fact of the payment of the aforesaid tax in that country.

'Specified limits' as mentioned earlier, is to be reckond with 'standard deduction' based on 'capital employed' in the business.

Under Sec. 8 of the Sur-tax Act, 1964 as amended upto date, 'capital employed' by a company will consist of its entire paid up share capital and other reserves (excluding the "current liabilities and provisions" as per part I of Schedule VI to the Companies Act, 1956, given in the Balance Sheet). Capital employed will be computed on the first day of the previous year, subject to adjustment for any increase or decrease of such capital during the course of the said year on a proportionate basis according to the number of days.[6]

'Standard deduction' allowed to be made from 'chargeable profits', to get 'chargeable amount' for sur-tax purposes, is 15% of 'capital employed' in the business or Rs. 2,00,000, whichever is greater, and tax is calculated @ 25% on chargeable amount, not exceeding 5% on the 'capital employed' and 40% on the balance.

3.4. AN APPRAISAL ON 'CLASSIFICATIONS' AND 'RATES'[+]:

The complexities in the corporate taxation have developed over a short period of quarter century. We would like, therefore, to examine whether the considerations which led to the different complexities in the existing tax structure still pre-

6. Mohsin, Mohammad - Op.cit. 'Rationalisation of Corporate Tax structure', p. 7.

+ Pande, D. P. - 'Rationalisation of Corporate Tax Structure' based on the paper submitted in the technical session in All India ~~n~~ Commerce Conference, Burdwan, 1981 and published (summary) in the Indian Journal of Commerce, 1982.

vail or not and even if they do whether other and better ways can be found to meet these. If it is seen that the considerations are still prevailing and no other better means are available to safeguard such interests still then it might also be necessary to look into the problem of rationalisation of tax structure. This is because the criticisms levelled against the corporate tax structure by different writers are so long confined mainly to the role of corporate tax in the creation of proper investment climate, but the question like rationalisation has hardly been analysed by most of the writers. The question of rationalisation is very important in this context.

The original reasons for differential treatment for the purpose of rates of taxation between 'widely-held' and 'closely-held' companies was the desire to restrict certain forms of tax avoidance. At that time when such differentiation was introduced in the Finance Act, 1955, under the recommendations of the Taxation Enquiry Commission, headed by Dr. John Mathai; an individual had to bear a highly progressive rate of taxation on unearned income, whereas a company was charged to tax at a flat rate on its aggregate income, which was much lower than an individual, specially at high income brackets. Shareholders of companies who had 'controlling interest' could easily bring down their tax - liability by not distributing substantial amount of distributable income as dividend to the shareholders. Hence, the Income-tax Act, 1961 provided some provisions preventing unjustifiable advantage to certain persons having 'controlling interest' in the companies by levying discriminating tax rates and also by imposing additional income-tax for inadequate distribution or non-distribution of profits to the shareholders.

But such distinction not only creates innumerable ticklish problems to the administration but also leads to prolonged uncertainty in the case of many companies as to their tax liability on the basis of their nature of activities. As there may be a continuous change of shareholdings, the tax authorities will have to decide each year about the nature of companies - whether 'closely-held' or 'widely-held'; 'industrial' or 'non-industrial' which will lead to prolonged uncertainty. The present tendency of minimising rates of taxation on individuals may also point out that there is little justification of classification of companies.

Therefore, it would be better to dispense with this complicated process of 'classification'.

Again, in the structure it is seen that the rates of income-tax is higher in case of closely-held companies in comparison with the widely-held companies. At the same time there is further provision of additional income-tax for closely-held companies. It is necessary to analyse whether there is a case for further levy of such penal tax under sections 104 to 109 of the Income-tax Act, 1961.

Following the recommendation of the Taxation Enquiry Commission, mentioned in the second chapter, additional income-tax was imposed by the Finance Act, 1955 for inadequate distribution of distributable income among the shareholders.

The question of declaration of dividend and adequacy of dividend should not be considered in isolation. Whether in a particular year dividend should be declared or not should be judged by business considerations, such as the previous losses, the present profits, and needs for ploughing back of profits for future development and extension of trade and commerce. The provisions under Sec. 2 (22) of the I.T. Act, 1961 is already there to bring an effective check on the use of companies' profits for private purposes, where it is given in clause (e) .... any payment made by a company, not being a company in which the public are substantially interested, or any sum (whether as representing a part of the assets of the company or not) by way of advance or loan to a shareholder, being a person who has a 'substantial interest'[*1] in the company or any payment by any

*1 beneficial owner of shares, not being shares entitled to a fixed rate of dividend, carrying not less than 20% of the voting power -- Sec. 2 (32).

such company on behalf or for the individual benefit, of any such share-holder, to the extent to which the company in either case possesses accumulated profits, shall be treated as dividend in the hands of such shareholder.

If one goes through the above clause, Sec. 2 (22) (e), along with other clauses under Secs. 2 (22) in connection with the definition of 'Dividend' for income-tax purposes, there is no doubt of the fact that this 'Section' is sufficient to check on the companies' resources, used for private purposes. Therefore, it is suggested by some that ~~this~~ provision of such 'penal tax' should be done away with.

Discontinuance of the provisions U/SS 104 to 109 regarding additional income-tax had been suggested by Mr. Bhoothalingam in his report -- 'Rationalisation and simplification of the Tax Structure', submitted in 1967, where he observed ... "total avoidance is in any case impossible because of the provision that any kind of distribution of assets under any name including on liquidation are brought into the tax net. Thus, when profits of a company are not distributed, the value of the shares increases correspondingly and the net wealth of the shareholder is consequently increased on which wealth tax is levied. If the shares are transferred without consideration, the gift tax is attracted. If they are transferred with consideration, capital gains tax becomes payable. On death, the value is calculated for estate duty. With all this it would be well worth-while to consider whether the time has not come to leave distribution of profits to the judgement of the management."[7]

The same suggestion has also been given in Wanchoo Committee's Report on Direct Taxes, submitted in 1971 where Mr. Wanchoo, the Chairman of the said Committee observed ...." the provisions of section 104 of the Income-tax Act are intended to plug avoidance of tax by shareholders of closely-held companies. In practice, however, the provisions do not seem to have achieved their intended purpose. .... We therefore, recommend that section 104 of the Income-tax Act be omitted."[8]

While appreciating the provision exempting closely-held industrial companies from the ambit of section 104, introduced by the Finance (No. 2) Act, 1977, Mr. Choksi, in his interim Report on Direct Tax Laws, submitted in December, 1977, observed that ... " there is likewise justification for excluding the other categories of companies as well, in as much as trading companies and service companies do contribute to economic growth and employment and supplement the role of individual companies in this regard. These companies provide feeder services to industrial companies and there is hence a case for

7. Government of India : 'Final Report on Rationalisation and Simplification of the Tax Structure', 1967, p. 36.

8. Government of India : 'Final Report of Direct Taxes Enquiry Committee', 1971, pp. 123-4.

excluding such companies also from the operation of sections 104 to 109".[9]

But, unlike Mr. Bhoothalingam and Mr. Wanchoo, Mr. Choksi was in favour of continuing such penal tax in the case of closely-held investment companies. He was of opinion that .... "these companies enjoy a concessional tax treatment in relation to their main source of income, namely, dividend income, where the tax rate is around 27% (Nil in certain cases) against the rate of 68.25% applicable to the other income of such companies in general. This should be viewed in comparison with the personal rate of tax which reaches upto 69%."[10]

The distinction between 'industrial' and 'non-industrial' companies would seem prime-facie valid because of the economic policy of the Government where impetus is given to the industrial sector of the economy. Some writers are not in favour of such distinction based on differential treatment in taxation rates. A straight deduction from the computed tax may be made, recognising national priority, keeping the tax structure as simple as possible. The main tax structure thus remains the same while it may be still responsive to the changing needs of the economic policy.

Again, the present corporate tax structure shows an element of progression in case of basic income - tax and sur-tax

9. Government of India : 'Report of Direct Tax Laws Committee', (Interim), 1977, p.22.
10. Ibid., p.22.

rates. The rates of income-tax differ in case of incomes upto Rs. 1,00,000 and above for widely-held company and upto Rs.2,00,000 and above for closely-held industrial company. The problem of ~~or~~ progression of tax rate is extremely debatable issue in any country. However, in most of the "welfare state" progression of tax is accepted as the norm of the State.

The progression in rates may have been argued with the intention or desire to help small business organisations and to act as a disincentive to the growth of large business houses which may lead to concentration of economic power. In this perspective it can be said that most of the small-scale business organisations are managed either in the form of partnership or proprietorship, and not at all suggested to run such business houses, specially industrial concerns, in the form of companies as they may become uneconomic. To help small business houses resorts may be taken, like liberalisation in the granting of licence, methods of financing, product marketing, etc., without continuing the concessional rate of tax. Particularly, when there is a provision of 'carry forward of business losses', one should think seriously whether there is further need of differentiation in tax rates.

So far as 'restraining the growth of large business houses' and to avoid the 'concentration of economic power' arguments, it is suggested sometimes that 'largeness' or 'smallness' of a company should be measured in terms of its paid-up capital and not in terms of profits, which is dependent on many internal and external factors like efficiency in management and risks involved with the nature of business. Concentration of economic power is also not the inherent result of uniform tax rates. Size of a company may not have got essential correlation with the income of its shareholders, who may be the cause of concentration of economic power. Small companies may be owned by a few wealthy share-holders, whereas large companies may be hold by a large number of small shareholders. So, there may not be a conclusive decision as to bring a relationship between 'economic power' and 'progressive rates' of corporate taxation. Therefore, it is suggested by some that there should not be any discriminatory tax rates on different levels of corporate income.

The remarks made by Mr. Bhoothalingam in his Report on 'Rationalisation and Simplification of the Tax structure' regarding 'progression' in corporate taxation is worthwhile to remember, where he observed: "The principle of progression is relevant, indeed fundamental, in the case of personal taxation but it can have no place in company taxation. Companies are only juristic personalities and it is only to the ultimate beneficiaries, viz., the share-holders the principle of progression should be applied."[11]

Now let us consider the 'rates' at which companies should be taxed. In this connection we may recall the luncheon address, as reported in press, given by Mr. N.A. Palkhivala, for-

11. Bhoothalingam Committee's Report - op.cit p.19.

mer Ambassador to the U.S.A. and renound tax expert, in the Annual Conference of the Federation of Indian Chambers of Commerce and Industry in New Delhi on November 14, 1981, where he dismissed the argument that the reduction in tax rates would adversely affect Government revenue, rather he emphasized that tax reduction would lead to greater collection. He warned that taxation beyond 50% would be counter - productive, leading to malpractices.[12]

Mr. Bhoothalingam, in his report, said ... "it is necessary to see that the revenues of the state, which is engaged in the hard task of economic development, are not inconveniently diminished. Taking all these practical considerations into account, I would recommend a low rate of one per cent on all capital (owned and borrowed) and ..... ~~to~~ the standard rate of tax on the profits of corporations should be forty-five per cent."[13]

Mr. Wanchoo, the Chairman in Direct Taxes Enquiry Committee, reported ... "a uniform rate of income tax of 55 per cent be prescribed for all domestic companies, whether public or private, widely-held or closely-held, and industrial or non-industrial."[14]

Often Government may justify the high rates of corporate taxation on the grounds that numerous reliefs are provided to the corporate-assessee. But it is to be remembered that most of the reliefs available to the corporate assessees are in

12. The Statesman, Calcutta, dt. 16.11.81.
13. Bhoothalingam Committee's Report - op.cit. p.33.
14. Wanchoo Committee's Report - op.cit. p.124.

the formative years and neither a corporate unit does establish itself anew every year nor it acquires new plant and machinery every now and then to obtain the benefit of such reliefs. Consequently, when initial allowances are exhausted, the tax liability goes up. Shri K. C. Khanna, in his article - Impact of the Budget, said ... "apart from discouraging the generation of internal resources, high corporate taxation hampers corporate growth, distorts the debt-equity ratio, encourage corporate extravagance, erodes integrity and shifts the corporate tax burden; thereby muleting the consumer and fanning the flames of inflation".[15]

Considering all these arguments it is suggested by some for the abolition of unnecessary classification of domestic companies as 'closely-held' and 'widely-held', 'industrial' and 'non-industrial' and a uniform rate of income-tax, say at 50%, including sur-charge for all domestic companies. At the same time, companies may be urged upon, by suitable legislation, to plough back a certain portion of their disposable income in a way, as desired by the Government in the perspective of national economic policy. There may not be a full support to divert a portion of corporate-disposable income in the government-desired channels, which are mostly unremunerative, the alternative process may be that the companies may be asked each year to deposit a portion, say 25 per cent of their disposable income, on a fixed term on

15. The Statesman, Calcutta, dt. March 16, 1982.

which interest at a nominal rate may be allowed. The amount so transferred would be directly deducted to compute tax liability. The interest income should however be considered for tax purposes. After the expiry of the fixed term, the companies may be allowed to withdraw the fund, which should be subjected to tax in the year of withdrawal.

However, the distinction between domestic and non-domestic, i.e., foreign companies had been favoured, rather recommended to continue, by Mr. Bhoothalingam in his report, submitted in 1967. In his opinion, such distinction may be continued, 'not so much for any reasons of principle, but solely for administrative grounds.' The shareholders are diffused throughout a vast area, national and international, and it may not be an easy task to realise personal taxes from the recipients of such distributed profits, on the basis of 'ability to pay' principle. So, there is no other alternative but to levy a higher rate of tax on companies, which would otherwise have been paid by the shareholders.

Some have supported the views of Mr. Bhoothalingam on the grounds of administrative difficulties and firmly in favour of such distinction as 'domestic and foreign' with higher rates of income tax on foreign companies in comparison with domestic companies. But, the present tendency of the Government of India, specially after 1976 to bring down the rates of income-tax on specific sources of income earned by foreign companies, should be seriously viewed in the perspective of our national growth.

Regarding 'Sur Tax' on companies, which was imposed in 1964, replacing super profits tax, conflicting recommendations by different expert committees as to its eliminition or retention make us puzzled.

Mr. Bhoothalingam, in his report on Rationalisation and simplification of the Tax Structure 1967 made a comment - "The Sur-tax in effect introduces the progressive principle which, while eminently appropriate in the case of individuals as reflecting both capacity to pay and social justice, is completely inappropriate in the case of impersonal organisations. The base of the Sur-tax corresponds pretty closely to capital effectively employed. A higher discriminatory rate of taxation, therefore, penalises the more effective use of capital. Surely, the more important economic and social objective should be to secure the best and most productive use of capital. This is particularly important in a developing country which needs quick development and in which the scarcity of capital is likely to persist for a long time. In fact ..... the corporation tax system ..... should encourage efficient, fruitful and progressive ways of utilising capital and positively discourage and even penalise inefficient, wasteful or prodigal use of what is perhaps our most scarce resource". He finally concluded with his observation as "I am convinced that the Sur-tax in its present form or in any minor variant of it can not appropriately constitute a part of the long term tax structure."[16]

Quoting the observations made by Mr. Bhoothalingam, Mr. Wanchoo, in his final report on Direct Taxes, in 1971 also came to the same conclusion ... "After careful consideration, we recommend that Sur-tax on companies be abolished."[17] But Mr. Chokshi, in his final report on Direct Tax Laws, 1978, not only recommended its continuance but also tried to establish the validity of this type of tax on companies. Of course, he criticised the 'procedure' of computing 'chargeable profits', 'Capital employed' in the business and the 'rates' of such tax and recommended some measures to rationalise the Sur-tax structure. He observed ... "The basic objective underlying a levy like sur-tax is to mop up the excess profits of corporate enterprises. In a developing economy, a more so in a planned economy, such as ours, there are certain sectors where unduly large profits are generated. This is particularly so in some of the more sophisticated industries which may be developed and established through the system of liensing and operate in a protected and, virtually, captive market. This large level of profits cannot wholly be said to be brought about by mere efficiency in the management of the corporate enterprise or in the management of the funds of the corporate enterprise. The high return on capital employed in such industries is to some

16. Bhoothalingam Committee's Report - op.cit., pp. 20-21.

17. Wanchoo Committee's Report - op.cit. p. 124.

extent fortuitous in that it is brought about not so much by any positive effort of the management as by the general economic climate resulting from Governmental policies."[18]

The above observations have got some merits no doubt but it should be remembered that Government policies are directed towards a particular industry, as mentioned by Mr. Choksi, not to a particular company, where large profits are generated. In the same industry, if magnitude of profits substantially differ in a particular company in comparison with the other, though both of them are working under the same regulated economy, the argument for excess profit due to some extra benefits does not stand. There is no reason but to explain that such excess profit is mainly due to comparative efficiency in management and better utilisation of capital. So, Sur-tax has got a direct hearing on the efficiency in management resulting higher profits, and it acts as punitive measure. Some other better means may be thought of by the Government to squeeze some consideration from the 'favoured' industry, not from a particular company in the form of sur-tax as a plea of excess profits earned due to Governmental measures.

Therefore, there is a scope of rethinking on the continuance of Sur Tax.

A study group, headed by Dr. C. Rangarajan, Deputy Governor of the Reserve Bank of India and consisting of representatives from the ministries of finance, industry, financial institu-

18. Choksi Committee's Report - op.cit., p. 94.

tions, the Planning Commission and the National Institute of Public Finance and Policy also noted the same view regarding sur tax. Recommending on the financing of private corporate investment to the Planning Commission, to make the corporate sector self reliant in the mobilisation of resources, the study group suggested among other things the immediate abolition of sur-tax on company profits.[19]

3.5. PROVISIONS FOR DEDUCTIONS AND ALLOWANCES :

Allowances and Deductions in computing the taxable income of a company can be grouped under three specific categories, such as:

1) relating to the cost of earning which are allowed to be deducted from the gross earnings in computing taxable income under the head "Profits and gains of business or profession";

2) deductions granted for offsetting losses in the current year, as well as sustained in one year against income in the following years;

3) deductions granted to promote certain specified objectives.

Here it is not discussed all types of allowances and deductions which are allowable in computing the net taxable income

19. The Telegraph, Calcutta, Saturday, 21 May, 1983.
Study Group submitted its report to the Planning Commission in Nov. 1982 and made available to the press on 20.5.83.

of a corporate body and to prescribe some ideal policies for such deductions and allowances which will be effective for the purposes for which these were granted. The objective is to show the present forms of all types of allowances and deductions allowed to a corporate body and to analyse the utility and effectiveness of a selected items in the broad categories.

Allowances : Deductions expressly allowed : Secs. 30 to 35.

1. Expenses in respect of business premises. Sec. 30
2. Repairs and Insurance of Machinery, Plant and Furniture. Sec. 31.
3. Depreciation on fixed assets. Sec. 32.
4. Investment Allowance. Sec. 32A.
5. Development Rebate. Sec. 33.
6. Development Allowance. Sec. 33A.
7. Rehabilitation Allowance. Sec. 33B.
8. Expenses on Scientific Research. Sec. 35.
9. Expenses on Acquisition of Patent Rights and Copy Rights. Sec. 35A.
10. Export Market Development Allowance. Sec. 35B.
11. Agricultural Development Allowance. Sec. 35C.
12. Rural Development Allowance. Sec. 35CC.
13. Expenditure by way of Payment to Associations and Institutions for carrying out Rural Development Programmes. Sec. 35 CCA.
14. Amortisation of certain Preliminary Expenses. Sec. 35D.

15. Expenses for Prospecting etc. for certain Minerals. Sec. 35E.

Other deductions like interest on borrowed capital, employer's contribution to provident fund, bad debts etc. are also expressly allowed under section 36. Deductions in special cases are also given in sections 42 and 43A, over and above the list of general deductions under section 37.

The provision of set-off and carry forward and set-off of business losses is provided in Secs. 70 to 73, 74A and 79.

The other deductions, to companies, which are mostly allowed to promote certain specified objectives, are contained under Secs. 80 HH to 80 VV of the Income tax Act, 1961:

1. Profits and Gains from newly established industrial undertaking or hotel business in backward areas under Sec. 80-HH, before a certain date, @ 20% on such income for a number of years subject to fulfilment of certain conditions;

2. Profits and Gains from newly established small-scale industrial undertakings in certain rural areas under Sec. 80-HHA, @ 25% on such income for a number of years subject to fulfilment of certain conditions *2 ;

*2 Increased from 20% to 25% by the Finance Act, 1982.

3) Profits and Gains from foreign projects to be deducted @ 25% provided the consideration for the execution of such project/such work is payable in foreign currency; - Sec. 80-HHB;[*3]

4) Profits and Gains from newly established industrial undertaking or ships or hotel business after a certain date in certain cases under Sec. 80-I, @ 25% on income arising out of such activities for a number of years subject to fulfilment of certain conditions. The benefit of Tax Holiday under Sec. 80-J has been replaced by this section of 80-I with effect from 1st April, 1981.[*4]

5) Deduction in respect of profits and gains from business of Livestock Breeding or Poultry or Diary Farming, subject to maximum Rs. 15,000 effective from the assessment year 1981-82, under Sec. 80-JJ;

6) Deduction in respect of profits and gains from business of Growing Mushrooms, subject to maximum Rs. 10,000, effective from the assessment year 1980-81, under Sec. 80-JJA;

7) Dividends from Tax-holiday profit of new industrial undertaking or ship or hotel business @ 100% received by the shareholder, under Sec. 80-K;[*5]

8) Deduction in respect of certain inter-corporate dividends at different rates depending upon varied circumstances, under Sec. 80-M;

*3 newly introduced by the Finance Act, 1982.
*4 introduced by the Finance Act, 1981.
*5 withdrawn after March 31, 1976.

9) Deduction in the case of an Indian company in respect of royalties, commissions, fees for rendering technical know how etc., received from any concern in India, @ 40% under Sec. 80-MM;

10) Deduction @ 100% on dividends received by an Indian company from certain foreign companies on such shares in convertible foreign exchange in India or outside India, is brought into India, against shares alloted in consideration of technical know-how or technical services under an agreement approved by the Board of Direct Taxes, under Sec. 80-N;

11) Deduction @ 100% in respect of royalties, fees, commissions etc., received from certain foreign enterprises or a foreign Government and brought into India by the assessee or on his behalf in accordance with any law for the time being in force, for regulating payments and dealings in foreign exchange, on agreements approved by the Board of Direct Taxes, under Sec. 80-O;

12) Deduction in respect of profits and gains from the business of publication of books, @ 20% on incomes arising on such publication. This provision under Sec. 80-QQ is applicable upto the assessment year 1985-86;

13) Deduction in respect of moneys borrowed to pay taxes under Sec. 80-V;

14) Deduction in respect of expenses incurred in connec-

tion with proceedings before the Income - tax authorities, under Sec. 80-VV.

A. <u>Capital consumption allowances</u> : 1. Depreciation + :-

One of the most vexatious problems connected with the determination of business income is the treatment of capital expenditure in the form of depreciation as a cost of production for the purpose of taxation.

In the absence of any conflict between the ideas behind the aims and objectives of determining business income in financial accounts and accounts for tax purposes, there would have been little need to interfere by the Taxation Authority to recast the Revenue Accounts, vis-a-vis the treatment of capital expenditure in the form of depreciation. Depreciation allowance in financial accounts is mainly aimed at the replacement of the asset concerned in future, but for taxation purposes, the main idea behind such capital consumption allowance, is to correlate it with the revenue earnings of the state and to give some impetus to further investment for the growth and extension of the business.

However, the word 'depreciation' has not been defined in the Income tax Act. Therefore, it has to be understood in its usual commercial sense. It is taken for all practical purposes as 'diminution in the value of an asset due to its wear and tear or by obsolescence.' The Income-tax Act permits the deduction of

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\+ Pande, D. P. - 'Depreciation in corporate taxation-Rationalising the Rates' -- Business Standard, Cal., Sept. 10, 1981.

capital expenditure, incurred for the business or profession, mainly in the form of depreciation under Sec. 32 (1), subject to fulfilment of certain conditions, at the prescribed rates given in Rule 5 Appendix I of Part I of Income-tax Rules 1962, on the actual cost price in the case of ocean going ships and in all other cases of depreciable assets, on the written-down value. Over and above this normal depreciation, certain other forms of depreciation allowances are also allowed under certain circumstances like (a) Extra shift allowances; (b) Additional depreciation under Sec. 32 (1) (iia), (c) Initial depreciation under Sec. 32 (1) (iv) (v) (vi), (d) Terminal depreciation under Sec. 32 (1) (iii) [and also balancing charge u/s. 41 (2)]. There is also a provision for set-off and carry forward of unabsorbed depreciation under Sec. 32 (2).

Before submission of the Report on Rationalisation and Simplification of the Tax structure by Sri S. Bhoothalingam in 1967, there were numerous rates for normal depreciation on different types of assets. Mr. Bhoothalingam observed ... "Rates of depreciation have essentially to be derived from a judgment of the life of the assets. In the nature of things such judgement can relate only to the average and cannot possibly be true in all cases. .... I must emphasise that there is really no need to attempt a meticulous judgement of the probable life of assets in order to build up a structure consisting of numerous depreciation rates. .... I would recommend, therefore, that a few broad categories will be sufficient to serve the essential purpose of depreciation".[20]

Based on the recommendation of Mr. Bhoothalingam, a few broad categories of assets have been made of Buildings; Furniture and Fittings; Machinery and plant and ships; where the rates of depreciation vary from 5 to 20% on 'written down values' of all the types of assets except in case of ocean-going ships, depreciation base is taken as 'actual cost.'

On the basis of recommendations made by Income - tax Enquiry Committee in 1936, though 'written down value' method of charging depreciation was introduced from the assessment year, 1940-41, it was argued by Mr. Bhoothalingam ... "all that will happen is that a little less tax will be paid in earlier years and correspondingly more in later years."[21] In an inflationary condition he recommended sufficient amount of depreciation on all physical assets for their replacement provision and that would be possible if more than the original cost is provided for in the form of total depreciation. Specifically he recommended total depreciation of 20% more than the original cost assuming 10 to 15 years average life of the assets and average rise in prices as 2% p.a.

But it may be said that the flat increase of 20% will not definitely correspond to actual increase in prices in most of the cases of allowable depreciable assets. Again the provi-

20. Bhoothalingam Committee's Report - op.cit., pp. 24.25
21. Bhoothalingam Committee's Report - op.cit., p. 25.

sion of investment allowance has already been introduced by the Finance Act, 1976 (to be discussed later on) serving more or less the same purpose of giving an extra capital allowance over the actual cost. So, one should think whether there is further scope for extra depreciation in this context.

Regarding extra shift allowance which has been granted, since the assessment year 1940-41, to compensate the extra wear and tear of plant and machinery in a factory, @ 50% and @ 100% of the normal depreciation for double and triple shift of working respectively, computed in proportion in which the number of double shift/triple shift working days bear to the normal number of working days[*6] in the previous year. Mr. Bhoothalingam also opined in the same line that it is nothing but the deferred tax liability and should be abolished as that will not help to replace the asset concerned in future.

Initial depreciation allowance is also an allowable deduction in respect of buildings newly erected after 31st March, 1961, (if such buildings are solely used for the residence of the low paid employees or are mainly used for the welfare of such employees like establishment of hospital, library, canteen etc.), @ 40% on the actual cost of the building. This allowance is also allowed in case of hotel building owned by an Indian company @ 25% subject to fulfilment of certain conditions.

*6 actual working days or 180 days in case of seasonal factory, 240 days in case of non-seasonal factory, whichever is greater.

The provision of additional depreciation under Sec. 32 (1) (iia) has also been introduced by the Finance Act, 1980, which is permissible @ 50% on normal depreciation in respect of new plant and machinery installed after 31st March 1980 but before 1st April, 1985.

It is known that Sec. 34 (2) (i) of the Income-tax Act, 1961, provides that the aggregate of all types of depreciation allowances provided year after year should not exceed the original cost of the asset concerned. In that case it can be said that all these extra allowances are nothing but deferring of tax liabilities and may be treated as short-term "bribe" against long-term "handicaps". Once the provision of investment allowance has been implemented as extra capital grant, the Government should think if there is any further need of allowing extra depreciation which is neither based on any rational thinking nor based on the true longivity of the assets. Rather, the arena of such capital allowance, viz., investment allowance should be extended and the business houses should be allowed full freedom of charging depreciation in one or more years of its choice.

In international experience, recently, it is seen in many countries the different type of policy effort involving mainly the introduction of various forms of accelerated depreciation for capital cost recovery.

In the United Kingdom, the budget submitted in March, 1981, contains a proposal to raise from 50 per cent to 75 per cent the initial deduction for industrial buildings purchased since March, 1981. The most far reaching change has been proposed in the United States under the programme for Economic Recovery, unveiled by the Administration in February, 1981. The proposal envisages replacing the existing asset lives by the so-called 10-5-3 "accelerated system of cost recovery plan" and applying a combination of double declining balance and sum-of-the-years-digits methods of depreciation over the new lives. These lives are three years for motor vehicles, five years for other machinery and equipment, and ten years for most industrial buildings. The other proposals may be mentioned as Ullman bill which groups all machinery and equipment into four classes with lives of 3-6-9-12 years; and the Finance Committee bill proposed a system similar to Ullman but with shorter lives of 2-4-7-10 years.[22] But in France industrial corporations are allowed to charge depreciation allowance every year in equal instalments which is adjusted according to current index price.[+]

The startling and phenomenal progress made in the last decade in many industries leads to the abnormal unforeseen obsolescence of fixed assets and the need arises to replace the asset

22. Kopits, George, F. - 'Industrial Countries : Increase Their Use of Tax Incentives to stimulate Investment'. I.M.F. Survey, October 27, 1980; April 20, 1981.

\+ Pande, D.P. - 'Living with inflation - Indexation for tax payers' Business Standard, Cal. March, 30, 1982.

concerned, not because its pre-estimated physical life has been exhausted but because the continuance of the same may lead to an uneconomic proportion, e.g., changed production methods may require different types of fixed assets, improved machines may render existing machines quite uneconomic in the sense that it produced better quality of goods or increased number in the same quality or involved lesser amount of complementary costs in comparison with the value of services obtained.[23] After all it is a management problem and the policy to be pursued by them should not be dictated or directed by different provisions under the Income - tax Act as to the quantum of depreciation to be provided and the real life of the asset to be presumed.

Mr. C. C. Chokshi, Chairman of Direct Tax Laws Committee, recommended in his Interim Report, submitted in December, 1977, the maximum rates of depreciation, within which the tax payers should have liberty to operate. The logic putforward as regards ceiling on depreciation rates is (1) innumerable number of choice regarding rates may crop up and it may be impossible on the part of Income-tax Authorities to maintain the prescribed particulars of assets concerned; (2) the budgetary position of the Government may be grossly disturbed if unlimited choice of rates in different years, limited to 100%, is offered to the tax payers. So for the sake of

23. Batty, J. - 'Management Accountancy', The E.L.B.S. and Macdonald & Evans Ltd., London, 1970, pp. 670-71. Meij, J.L. (ed.)- 'Depreciation and Replacement Policy.' North-Holland Publishing Company, Amsterdam, 1961, pp. 1-14.

administrative difficulties and government's uncertainty in budgetary provision, limitation in depreciation rates is desirable.

Mr. Choksi, in his report brought the concept of 'block of assets' and recommended the limiting rates on the basis of such blocks, as under:

Buildings including roads, culverts, bridges etc.	10%
Furniture and Fixture	20%
Plant and Machinery	40%

The lumpsum amount of depreciation for the entire block of depreciable assets in each of the categories would be provided. At every state of addition of new assets, cost of the new assets should be added up with the W.D.V of the existing block of assets and the realised amount due to sale, damage or destruction of any asset in the form of sale proceeds, scrap or salvage moneys realised from insurance companies should be deducted from the W.D.V of the block of assets concerned. In the opinion of the Committee, the matter of 'terminal depreciation' or 'balancing charge' should only arise in connection with the entire block and not of individual asset.[24]

The very concept of 'block of assets' is more complicated than the concept of individual asset. Strictly speaking, depreciation is the proportionate amount of wear and tear of

24. Chokshi Committee's Report - op.cit., pp. 10-15

assets and all assets in the same 'block' as suggested, are not subject to the same proportion of wear and tear. Sot it would be better to continue the idea of 'individual assets' rather than the 'block of assets'. However the idea of 'limit' in the depreciation rate might be favoured by the tax experts on the ground that 'free choice' would grossly disturb the budget estimates of any country. In this connection it could be mentioned that 'free depreciation method' was adopted in Sweden in the year 1938, which continued upto 1954. In 1955 the system was abandoned in favour of a more definite method with the argument that the 'free method' would not be equitable as it might result in deliberate tax deferral in many cases with the consequential undesirable fluctuations in government revenues. Therefore it is suggested by some experts that there should be some limit in the rates of depreciation within which the companies may be allowed to operate.

Sometimes, another argument is put forward in favour of 'individual assets' concept as against the concept of 'block of assets' favoured by Mr. Chokshi. It is mentioned in the said report of Mr. Chokshi that when the realised value of the individual block of assets exceeds the block's original cost, the excess value to be treated as ordinary profits. Under the existing provisions, profits arising out of 'transfer' of capital asset is treated as capital gains and capital gains (long-term) is subjected to tax, which is substantially less than the basic rates of income -tax applicable to revenue profits. So it is advised by many, not to deny the assessees of distinct tax advantage by treating the 'excess amount' as revenue profits in place of capital profits. However for simplification of structure, it is suggested that all other depreciation allowances, like initial depreciations, additional depreciation, extra shift allowances, terminal depreciation and the like might not be considered except the 'normal depreciation'.

2. Investment Allowance+ :

The Finance Act, 1976 has replaced the scheme of initial depreciation allowance in respect of plant and machinery, granted earlier under section 32 (1) (vi) of the Income - tax Act, 1961 by a scheme of investment allowance. As the scheme of initial depreciation had been regarded unanimously by industrial circle as no substitute of development rebate, discontinued earlier, Mr. Subramaniam, the then Finance Minister, had to introduce an investment-oriented scheme, viz., investment allowance under a new Sec. 32A effective from the A.Y. 77-78, with the object of encouraging investment in new plant and machinery, accelerating production and extending the scope of employment.

The benefit of this allowance is available @ 25% of the cost of acquisition of new plant and machinery installed in an industrial undertaking after March 31, 1976 producing articles

+ Pande, D. P. - 'Practical utility of Investment Allowance', The Management Accountant (I.C.W.A.I) Cal. Dec. 1978.

or things not listed in the XI schedule*7 or new ship or new aircraft acquired after March 31, 1976 or new plant and machinery installed after March 31, 1976. But small scale industrial undertaking*8 producing any article or thing comes under the perview of Investment allowance. In all the cases the following conditions must be fulfilled:

1) the assessee must be the owner of such ship, aircraft, machinery or plant [Sec. 32A (1)];

2) the prescribed particulars on such assets, as per Rule 5AA of the Income Tax Rules, 1962, have been furnished by the Assessee [Sec. 32A (4) (i)];

3) a reserve styled as "Investment Allowance Reserve Account" should be created by debiting seventy-five per cent of the investment allowance actually allowed in the previous year to the Profit and Loss Account and crediting the said Reserve Account (50% in case of ships) [Sec. 32A (4) (ii)];

4) such reserve should be utilised 'within a period of ten years' immediately succeeding the previous year in which the ship or aircraft was acquired or the plant or machinery was installed, to acquire new ship, aircraft, machinery or plant for the

*7. List of specified articles or things, not entitled to Investment Allowance in case of industries other than small-scale industrial undertaking, w.e.f. A.Y. 78-79.

*8. Where the aggregate value of plant and machinery on the last day of the P.Y. does not exceed Rs. 20,00,000, effective from the P.Y. ending after July 31, 1980.

purpose of business of the undertaking [Sec. 32A (4) (ii) (a)] and it can not be utilised for distribution of dividends or for remittance of profits outside India or for the creation of any asset outside India during the said period of ten years; [Sec. 32A (4) (ii) (b)]

5) Such asset should not be transferred or sold at any time before the expiry of eight years from the year of acquisition or installation, except to the Government, a local authority, statutory corporation or Government company or in connection with amalgamation or succession [Sec. 32A (5), 32A (6)]

All the conditions aforesaid must be complied with and in default of any one of such conditions, investment allowance once granted to be withdrawn [Sec. 32A (5), (6)] by rectifying the original assessment under section 155 (4A) of the Income tax Act, 1961.

Sub-section (2B) has been added with Sec. 32A in the Finance Act, 1977 giving a higher rate of investment allowance of 35% on plant or machinery installed after June 30, 1977 and before April 1, 1982*9 for the purpose of assesse's business, if the business uses any technology or process or know-how, developed or invented in a laboratory owned or financed by the Govern-

*9 another five years, upto March 31, 1987, extended by the Finance Act, 1982.

ment of India or owned by a public sector company in India or a University etc.

To combat the challenge of scarcity of capital and abundant supply of labour which resulted in aggravation of far reaching socio-economic malady, 'development rebate'[+], as one of major tax incentives, came to be introduced under Sec. 33 in the year 1955. Since then a number of changes has been made by different Finance Acts from time to time with the main object of availability of capital to the selected industries which are unlikely to be developed in the hands of the private entrepreneurs without special stimulus.

In practice, such tax free benefit created a tendency among entrepreneurs to use capital more liberally, even wastefully, in capital equipment than it was justified from the point of view of economic necessity. Mr. Bhoothalingam, formerly Secretary in the Ministry of Finance, Government of India, observed in his report on Rationalisation and Simplification of the tax structure, that the requirement of creation of Development Rebate Reserve to the extent of 75% of the amount of rebate actually allowed, which should not had been used for purposes other than 'business purposes', could not curtail the freedom of companies to use their resources as they would think fit if they had other reserves. Therefore he recommended for its withdrawal, of course before its withdrawal he firmly opted for rationalising the depreciation

+ Pande, D. P. - 'Development Rebate - A Retrospect' - Management Accountant (ICWAI), Cal. June, 1976.

system as a pre-condition. The system of 'development rebate' for plant and machinery installed after May 31, 1974 was withdrawn following resolutions made in the budget session for 1971-72. It was recalled that timely delivery of plant and machinery might not be assured due to unforeseen circumstances like availability of shipping space, uncertainty in international market, shortage of power etc., the benefit of development rebate was extended upto June 5, 1975 in selected cases. In pursuant to the demand for some other fiscal measures to provide continuous incentive for investment, initial depreciation under section 32 (1) ($_{iv}$), @ 20% on the actual cost of plant and machinery installed after May 31, 1974 was introduced in selected industries in the budget 1973-74. But the scheme of initial depreciation had been unanimously regarded by industrial circle as not the proper substitute of development rebate, as the former was the part and parcel of overall depreciation and the later was like a capital grant. So, 'investment allowance' was introduced by the Finance Act, 1976. The purview of the scheme has been extended and the rates, and benefit structure have been rationalised.

This allowance including depreciation enables an industry an allowable deduction of at least 125 per cent of cost of new plant or machinery with a view to compensate skyrocketing capital costs in recent years.

In the case of an existing company it may be possible to se-off current depreciation, investment allowance etc. over and above unabsorbed business loss, if any, against current year's profits and still may be in a position to declare normal dividend to its shareholders. But in the case of newly floated company it may take three to four years to reach a level of subsistence and further three to four years may lapse to set-off unabsorbed business losses. Considering these circumstances it can be said that it will be difficult to obtain risk capital from investors as they will have to wait six to eight years for getting any dividend on their investment. At the same time they may be influenced to invest their investable funds with the existing companies or in long-term bank deposits, particularly if there is a climate of price stability, where the assured income is exempted from tax upto a certain limit. So, sometimes it is said that investment allowance will not help a newly floated company in its growth of capital.

Investment allowance may not help also to create opportunities for unemployed persons. The Government has been experimenting with capital linked fiscal incentive schemes for the last several years but available evidence might show that growth of employment has lagged far behind than the capital employed in the business houses. How can one expect from the industrialists to employ men rather than machines when they are sure to get attractive fiscal benefits if they employ machines but no benefit if they employ men? So, it is high time to think if there is any scope of linked up capital investment scheme with the volume of employment. Investment allowance induces capital intensive production systems and quick turnover of capital goods which sometimes becomes unjustified on technological considerations specially in a developing country like India where employment and output levels are more endowed with labour resources rather than capital.

The higher rate of investment allowance, viz., 35% on plant and machineries for the manufacture of articles with the help of indegeneous know-how is supposed to be encouraging and should be continued to enrich India's own technology. The General investment allowance might only be granted with strict discretion in a very selected fields for specific purposes but overall capital investment allowance is suggested to be linked up with different allowances creating more employment.

3. Development Rebate:

On the basis of the recommendations of The Taxation Enquiry Commission, 1953-54; headed by John Mathai, Development Rebate was introduced in 1955 with the provision of 'carry forward' from 1958. The Commission observed and recommended that for industries of national importance which are unlikely to be developed in the hands of the private entrepreneurs without special stimulus, a rebate in the name of 'development rebate' is to be introduced replacing 'initial depreciation' and the concession should be confined to the producers goods and capital goods industries and the benefit should be available for all purchases of fixed assets, whether for replacement or for expansion of industries. In practice, such tax-free benefit did not serve the purposes for which that was allowed initially (already referred to). That is why Mr. Bhoothalingam in his Report criticised the 'allowance' vehemently and recommended for its abolition. On the basis of such recommendations, this 'allowance' virtually ceased to exist with effect from May 31, 1974.

4. Amortisation of Preliminary Expenses:

A new section 35D was added by the Taxation Laws (Amendment) Act, 1970 providing for the amortisation of qualifying amount of certain preliminary expenses incurred after March, 1970 by an Indian company. Such expenses may be related with the before or after commencement of the business. The expenditure, incurred after the commencement, ~~but~~ must be in connection with the setting up a new industrial undertaking or extension of the existing industrial undertakings. The deduction is allowed with reference to the qualifying amount*10 in 10 equal instalments beginning with the previous year in which the business commences or extension took place or production begins.

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*10. $2\frac{1}{2}\%$ of the cost of the project (aggregate of all fixed (assets) or $2\frac{1}{2}\%$ of the capital employed in the business, at the discretion of the company assessee.

The provision can be explained with an illustration:+

The company in our example is supposed to be an Indian company and its business commenced from February 1, 1981 when the factory started production. It is further assumed that the expenses grouped under 'preliminary expenses' are not claimed or allowed for under any other provision as limited under Sec. 35D (6) and all the expenses were incurred before the commencement of the business. The aggregate amount of qualifying items of expenditure is taken to be Rs. 1,60,000. The actual cost of fixed assets as at 31.12.81 is Rs. 50,00,000 and capital employed in the business is Rs. 55,00,000 (aggregate of paid up share capital, debentures and long-term borrowings from the Government/financial institution/person outside India, not repayable before 7 years, on the last day of the p.y.). All the stated fixed assets and capital employed were in connection with the setting up of that new industrial unit.

The qualifying amount may be computed as 2½% of Rs. 50,00,000 = Rs. 1,25,000; and 2½% of Rs. 55,00,000 = Rs. 1,37,500 and surely the company will claim the greater one at its discretion and Rs. 13,750 will be allowed for amortisation in each of the successive ten years beginning with the assessment year 1982-83.

+ Pande, D.P. - 'Capital in Business for Tax-purposes'. The Management Accountant, (I.C.W.A.I) Cal., Feb., 1981.

There is a strong support that all types of capital expenditure, in proportionate amount, whether in the form of depreciation or amortisation, which is incidental to or connected with the business should be allowed but regarding computation of amortisable amount with qualifying limitation is a subject of controversy.

The Income-tax is concerned with computation of capital base for four different purposes, viz., (i) for amortisation of preliminary expenses under Sec. 35D; (ii) for allowing tax holiday benefits in business of newly constructed industrial undertakings, hotels or ships under Sec. 80J; (iii) in the perspective of additional income-tax under Sec. 104-109 for closely-held companies; and (iv) for imposition of Sur-tax under the Sur-tax Act. Although each of the computations is based on the same set of facts, they are calculated differently for different purposes. In the case of 'amortisation', only the paid up share capital, borrowings and loans on the last day of the previous year have been taken into account, whereas for the purpose of 'tax holiday', to be discussed later on, the concept of net assets as on the first day of the previous year has been brought into play, so also 'capital' is conceived in another way for the purpose of Sec. 109. In the case of sur-tax only the owned capital, i.e., paid up capital and reserves, have been taken into account.

Such diversified definitions of 'capital employed' would necessarily lead to complications and unwanted exertion on the part of companies, tax authorities and tax planners. That may result also in litigation as to specific meaning of certain terms relating to computation of 'capital'. 'Borrowed' money or 'debts'; 'owed' or 'due'; 'reserve' or 'provision' are some of the areas where legal conflict may arise as a matter of conflicting meaning.[25]

To avoid such unnecessary complications an uniform definition of 'capital employed' in a business in relation to a company for the purpose of taxation should be considered. For all purposes, 'capital' may be defined to mean the aggregate of paid up share capital; reserve as appropriation of profits having the same meaning as in Part III of Schedule VI of the Companies Act, and debentures and other long-term borrowings, which are repayable after a certain period, say 5 or 10 years, on the last day of the previous year. That will help to avoid unnecessary litigation and will simplify and rationalise the provisions of law.

As regards the 'qualifying amount' @2½% of the cost of project or capital employed in the business, no reason or justification for such ceiling may be found when the principle of allowing certain specific pre and post-incorporation expenses has been accepted. Therefore, it is often suggested by many

25. Santhanam, R. - 'Choksi Committee on Sur-tax', Chartered Secretary, - (I.C.S.I.) V. VIII No. 10, New Delhi, January, 1979.

to remove such 'ceiling' on prescribed preliminary expenses for the purpose of amortisation.

B. Set off and carry forward of losses:

In Chapter VI of the Income - tax Act, sections 70 to 80 deal with the provisions of set off and carry forward and set off of losses. To reduce the risk of investment in different sectors and to induce additional investment in the business undertakings, the present provisions under sections 70 to 80 are reasonably clear and settled. According to the scheme, losses arising from different heads of income can be adjusted against any source of income of the assessee in the same year in most of the cases except in case of losses arising from speculative business; long-term capital gains; lotteries, cross-word puzzles, card games and other games of any sort of gambling or betting; and horse races. In case of carry-forward of such loss, that can be set off against the same captioned head of income within a stipulated period in the respective cases but inter-head adjustment is restricted almost in all cases and the allowable period of carry-forward also varies for different sources of income. For this study it is dealt with the provisions relating to the losses arising under the head 'Business (other than speculative) or profession or vocation' and to study if there is any scope of rationalising and simplifying the provisions regarding business loss.

It is given, loss arising from non-speculative business or profession or vocation can be set off against the profits and gains of another 'business' of the same assessee, including speculative business [Under Sec. 70 (1)] in the same year, then against any other head of income in the same previous year [Under Sec. 71]. Loss to the extent not set off within the same year can be carried forward and set off against the profits and gains (including speculative one) of any business, profession or vocation for subsequent eight assessment years following the assessment year for which the loss was first computed [Under Sec. 72] provided the business, profession or vocation in which such loss was sustained, continued to be carried on by the same assessee (who claims such set-off) subject to certain exceptions.

The scheme is reasonably clear and acceptable. But a few comments may be added in this regard:-

Gross income of a company is computed by aggregating net incomes arising from all the different sources and taxable income is ascertained by deducting certain other allowable expenditure thereon. Therefore, it does not appear as a sound principle when restriction is imposed for setting off of losses in inter-heads of income in certain cases. So it is argued by some that loss under one head of income should be allowed to be set-off against any head of income in the current year as well as in future years in case of carry forward of such losses.

Without adjusting unabsorbed business loss and loss under any other head, if any amount remains unabsorbed after the expiry of the stipulated period, tax imposed on the company assessee does not reflect the true tax burden. So some are not in favour of 'restriction' on carry forward of unabsorbed business loss and loss under any other heads of income for an indefinite period to be adjusted in successive years against any source of income forming part and parcel of total taxable income.

When there is a provision of set-off and carry forward of losses in a business under-taking some do not find any reason of further allowing such advantage to certain other expenses and allowances, like depreciation, investment allowance etc., which are deductable and automatically adjusted to find out profits or losses of the business undertaking for the purpose of taxation. They argue that the present practice should be dispensed with in favour of greater rationalisation.

C. Deductions allowed to selected industries:

1. To ensure balanced economic growth Sec. 80 HH had been introduced, where 20 per cent profits and gains derived from an industrial undertaking or the business of a hotel in backward areas, as per Schedule Eight, which started functioning after March 31, 1973, is allowed to be deducted for each of the 10 successive assessment years, provided certain conditions

are fulfilled. The period of ten years to be reckoned with the assessment year relevant to the previous year in which the business was first started.

2. To prevent regional imbalance, Sec. 80 HHA had been introduced where 20 per cent (25% w.e.f. the A.Y. 1983-84)[*11] profits derived from the profits and gains of newly established small scale industrial undertaking[*12] in any rural areas, is allowed to be deducted from the gross income to find out total income of the company for 10 successive assessment years beginning with the assessment year relevant to the previous year in which such small-scale undertaking begins to manufacture or produce articles, subject to fulfilment of certain conditions. If the deduction is claimed and allowed in relation to the same industrial undertaking under both the sections 80 HH and 80 HHA, either of the two may be granted at the option of the assessee.

3. A new section, viz., 80 HHB has been added by the Finance Act, 1982 where 25% of profits arising from specified projects undertaken by an Indian Company in foreign countries has been allowed to be deducted provided the consideration for the execution of such project/work is payable in foreign currency.

4. To promote the general climate of industrial development in the country, capital-based deduction, popularly known as 'tax holiday benefit', was allowed under section 80-J

*11 rate enhanced by the Finance Act. 1982.

*12 When the aggregate value of machinery and plant installed therein is on the last day of the P.Y. does not exceed Rs.20 lakhs (Finance Act, 1981) as against Rs. 10 lakhs.

in computing the total income of the company deriving from industrial activity or the business of a hotel or the operation of a ship and the rate of such deduction was 6% p.a. upto March 31, 1976 and 7½% p.a. after that date on the amount of 'capital employed' in the business with further provision of carry-forward of defficiency if any for a number of years.[26+]

Sec. 80-J has become redundant after March 31, 1981 and being replaced by Sec. 80-I from the financial year 1981-82.

5. This incentive under Sec. 80-I becomes operative after March 31, 1981[*13] and applicable to new industrial undertakings (including cold storage plants), approved hotels and ships. The rate of deduction is 25% of profits p.a. deriving from the aforesaid activities and is allowed for the first eight assessment years, popularly known as 'tax holiday period', relevant to the previous year in which the industrial undertaking begins to produce articles outside the non-priority list of Eleventh Schedule[*14], or to operate its cold storage plants or the business of hotel starts functioning or the ship is brought into use. This deductable allowance is subject to the fulfilment of certain conditions given in sections 80I (2), (3) and (4).

26. I.I.M., Cal. 'Decision' V.I. No. 2. Nov. 1974.
+ Pande, D.P. - 'Capital in business for Tax-purposes'. The Management Accountant, Cal. Feb. 1981.
*13 Introduced by the Finance Act, 1981.
*14 The benefit is applicable to small scale industrial undertaking, even if it manufactures or produces articles specified in the Eleventh Schedule. The Eleventh Schedule has been introduced with effect from the A.Y. 1978-79.

6. When the gross total income of a domestic company includes any income by way of dividends from another domestic company, which is engaged mainly in the manufacture or production of specified items[*15] and which is formed and registered after the 28-2-1975, in respect of such income of the company the whole of the amount (100%) is allowed as straightway deduction in computation of the total income of the receiving domestic company. In respect of dividends received from any other Indian company, the rate of deduction is 60% (Sec. 80M).

7. Where the gross total income of the Indian company includes dividends on shares issued by foreign companies in exchange of technical know-how or technical services rendered or agreed to be rendered, on the basis of agreement made and approved by the Board of Direct Taxes[*16] and if the dividends are received in convertible foreign exchange,[*17] the whole of such dividend is allowed to be deducted under section 80-N.

8. Any income of an Indian Company by way of royalty, commission, fees etc. received from any concern in India as consideration for the provision of technical know-how in the specified fields or for rendering services in connection with the

*15. Items listed in the IXth Schedule, w.e.f. April 1, 1982 electronic components and raw materials; computers and peripherals etc. have been included.

*16. The power of approval was vested with the Central Government upto March 31, 1972 and since after the Board of Direct Taxes.

*17. Recognised by the Reserve Bank of India for regulating payments and dealings in foreign exchange.

provision of such technical know-how, under an approved agreement made after 31st March, 1969, is subject to a deduction of 40% on such income under Sec. 80-MM.

Economic development of any country largely depends upon its industrialisation and industrialisation is based on many aspects. The broader aspects may be mentioned as

(i) technological development in the processes;

(ii) setting up of new industrial units in different regions and boosting up of production and

(iii) increase in exports to pay for essential imports.

The governments of all the countries of the world take many incentive schemes for the development of all such productive stages and India is no exception in this regard. So far as corporate tax is concerned, sections 80-HH and 80-HHA have been introduced as tax incentives for industrialisation in rural and backward areas of the country; Sections 80-J and 80-I for general industrialisation and Sections 80M, 80N and 80 MM in connection with inter - corporate dividends, royalties and commissions as considerations of the provisions of technical know-how received in terms of foreign exchange; Sec. 80 HHB and 89A[*18] are

*18. u/s 89A for export turnover exceeding 10% over the last year, tax deduction at specified rate, to be notified by the Govt. of India, from the total tax payable on such excess turnover (F.A. 82).

meant for earning foreign exchange.

All these deductions are mostly welcome as incentive measures but the nature and ways on which such measures are allowed, are not beyond criticism and well subjected to the scope of rationalisation.

To remove regional imbalances there should be proper incentives to start or shift industrial units in rural areas. But if one looks at the industrial map of India, it may be seen that industrial development is noticeable mainly near metropolitan cities. In terms of Income-tax Act, certain deductions are allowed in the income of units set up in backward areas. In 1968, the National Development Council constituted two Working Groups -- one under the Chairmanship of Mr. B. D. Pande, Secretary, Planning Commission and the other under Mr. N. N. Wanchoo, Secretary, Ministry of Industrial Development and Company Affairs. The former group, headed by Mr. Pande, was entrusted to evolve criteria of 'backwardness' and the later group headed by Mr. Wanchoo was entrusted to evolve nature of 'concessions' to be extended to attract industrialists to such backward regions. As formulated by the first Working Group, areas having 25% below the national average, based on per capita income, per capita consumption of electricity, length of roads and railways, etc. were identified as 'backward'. Wanchoo - Group formulated financial and fiscal concessions to be allowed for attracting industries to such identified backward regions.

So far as tax incentives are concerned, it may be noted that Sections 80 HH and 80 HHA do not reflect the desired results. It might be the reasons that different fiscal incentives including tax, are offered by the Government and Governmental agencies in an uniform manner to all the regions, marked as 'backward' without considering the 'degree of backwardness'. That has resulted concentration of industries in a satellite manner near the metropolis. Therefore, to remove regional imbalances and rural backwardness, the quantum of incentives for industrialisation should be linked up with the degree of backwardness. More the backwardness higher should be the rate of incentives.

But tax is not the primary force in introducing new enterprises in the backward areas. Adequate infrastructure facilities like provision of accessable roads, developed lands, transport, water, power etc. over and above soft loan facility, availability of man power, raw materials and proper assurance of marketing the products are the basic needs of rural industrialisation. It may be suggested to allow all types of expenditures which are incurred necessarily and exclusively for the purpose of such industrial unit and the deficiency of income may be allowed to be carried forward for an indefinite period to be set-off against the total income of the company arising from any of the sources. The present system of allowing deduction at a certain percentage on profits and gains arising out of activities of newly established undertaking for a fixed period is a stringent measure against real benefits, if at all. Tax liability becomes meaningless if there is no privilege of establishment of enterprises in the rural areas at the first instance and specially on those cases where a gestation period, even after establishment, covers not less than five to six years of time. Thus, it may be suggested that this complex system of incentives should be done away with and straight incentives may be given for rural industrialisation.

Regarding incentives for general industrialisation under sections 80 J and 80 I, the system of percentage deduction on profits and gains should also be abolished and in place of that the incentives should be directly related with the level of production and on capacity utilisation as suggested by K. N. Wanchoo in his final report on Direct Taxes Enquiry Committee : "an incentive by way of tax rebate be allowed to companies, engaged in the manufacture or production of specified goods, to reward additional productivity, i.e., increased utilisation of installed capacity and increased production. The rebate may be in the form of a deduction ranging from 5 to 10 per cent of the tax payable for every 10 per cent increase in output."[27] At the same time the deficiency, if any, may be allowed to be carried forward for future set-off, in the line discussed earlier.

What is suggested is not to allow piece-meal incentives in specific cases but to create favourable climate for overall balanced industrial growth and the incentives should be directly

27. Wanchoo Committee's (final) Report -'71 *op.cit.*, p. 123.

related with the purpose for which these are granted.

Inter corporate investment is a powerful instrument for the growth of corporate entities and to hasten the economic growth of any developing country. That is why, in most of the countries in the world inter corporate dividend has been either fully exempted from the purview of taxation in the hands of the investing companies or there may be a substantial tax relief on such income. Prior to 1936, there was no tax on dividend income on their corporate investment in U.S.A. After the date there was nominal tax imposed on such income. Hundred per cent exemption is allowed in Japan, Canada and West Germany. In France graduated relief is allowed. In some other countries like Australia, Newzealand, inter corporate dividend income is outside the tax net altogether. In India also inter corporate dividend is fully exempted in specific cases, as given in sections 80 M and 80 N. It has been observed by Shri S. Bhoothalingam, in his final report on Rationalisation and Simplification of the Tax Structure ... "When an enterprise has or can command surplus funds, it has to make a choice between diverfication within its own structure or the adoption of a different organisation, such as a subsidiary company. Exercise of this choice will certainly be influenced by the taxation of inter-corporate dividends. ... There is no reason to expect that influencing the choice in favour of or against any particular form of organisation will yield any better economic decisions than a free choice."[28] Therefore, from inter-national experience and well

28. Bhoothalingam Committee's Report - 1967, <u>op.cit.</u>, p. 31.

thoughtout practice in India it may not be justified to deny the privilege granted to inter corporate dividend-earning but one can raise caution against this dividend income which may lead to monopoly tendency resulting inequitable distribution of income and wealth.

Inter company investment may help in creating inter-locking directorship and that may operate to the benefit of both the companies, enabling one to inflate expenditure and the other to enjoy high profit. Subsidiary companies may supply rawmaterials and technical services to the investing companies at inflated rate at their choice, who may want the diminution of tax liabilities. The scope of inter company loan at a high rate of interest can not be overlooked also. It has been observed by Shri N. K. Chandra in his article - 'Monopoly Capital, Private Corporate Sector and the Indian Economy : A Study in Relative Growth, 1931-76', "Monopolies in India have generally been able to retain or expand their market power not so much by superior economic efficiency, but by controlling the supply of rawmaterials and intermediates through their intimate links with the state machinery and restrictive selling practices to shut down smaller firms."[29]

Therefore, if the abuses of inter-corporate invest-

29. 'Economic and Political Weekly,' Bombay, August, 1979, Special No.

ment, which may lead to the creation of monopoly business houses, are adequately guarded against, many will favour giving sufficient relief in tax consideration on dividend income on mutual investment; otherwise inter-corporate dividend should be regarded as no different from return on investment of any other kind and should be taxed as such.

The provisions regarding technological development under sections 80 MM and 80 N are important but the provisions, meant for augmenting foreign exchange earnings under section 80 HHB should be related with the quantum of foreign exchange earning rather than to profit earning. Profit earning is dependent on many hexazonous factors including competition on foreign markets on which the company assessee may not have sufficient control.

3.6. SUMMARY:

We have analysed the existing corporate tax structure and some suggestions have been put forward to rationalise and simplify the 'structure' keeping in view the goal of quick industrialisation in India. Corporate tax structure includes the different types of companies on the basis of domestic nature, ownership in holding and economies in activity; different rates of income-tax depending upon the nature of companies and the extent of income; application of additional income-tax for 'insufficient' or non-distribution of profits as dividends by specific type of companies;

sur-tax on companies earning extra profits exceeding a 'specified limit'; and different provisions concerning deductions and allowances relating to cost of earning, promotion of certain specified objectives and setting off different types of losses (3.1).

The reasons for such complicated tax structure have been critically analysed and arguments levelled against such complexities by different writers have been cited in details. Recommendations of different Committees and Commissions, specially those formed after 1955 have been analytically discussed. It has been pointed out that the distinction between 'closely-held' and 'widely-held'; 'industrial' and 'non-industrial' not only creates innumerable problems to the administration but also leads to prolonged uncertainty in the case of many companies as to their tax liability on the basis of their activities. Regarding additional income-tax, imposed by the Finance Act, 1956 in conformity with the recommendations of the Taxation Enquiry Commission, it has been argued that the declaration of dividend and adequacy of dividend should not be considered in isolation. Declaration of dividend by a Company should be judged by business considerations like previous losses, present profits, needs for ploughing back of profits for the extension and improvement of the activities of the company. Again, the provisions under Sec. 2(22) (e) of the Income Tax Act, 1961, as regards 'deemed dividend' is supposed to be sufficient to check on the companies' resources, used for private purposes by the persons having 'substantial interest' with the companies. The progression in rates of income-tax on companies according to their nature and extent of income has also been examined in this Chapter. Doubts have been raised as to the objectives behind such differentiation of rates of income-tax. Sometimes it is argued that for restraining the growth of large business houses and to avoid the concentration of economic power, discriminatory tax rates on different levels of corporate incomes are imposed. It was pointed out that 'largeness' or 'smallness' of a company should be measured in terms of its paid up capital and not in terms of its profits. Size of a company may not have an essential correlation with the income of its share-holders and the income of share-holders may be the cause of concentration of economic power and not of the company. In this connection, remarks made by different Committees have also been quoted. We also tried to criticise the high rates of corporate taxation in India. It is often justified on the ground of numerous reliefs granted to the companies under the Income-tax Act. We have pointed out that most of the reliefs available to the corporate assessees are in the formative years and neither a corporate unit need establish itself anew every year nor it acquires new plant and machinery every now and then to obtain the benefits like investment allowance. Consequently, when initial allowances are exhausted, the tax liability goes up. So, there might be a case for diminishing the existing rate of income-tax on companies.

Regarding sur-tax on companies, which was introduced in 1964, conflicting recommendations by different expert Committees were available. Mr. Bhoothalingam, in his report on Rationalisation and Simplification of the Tax structure, recommended for its abolition, as it penalises the more effective use of capital. Mr. Wanchoo, in his report on Direct Taxes, also maintained the same view. But Mr. Chokshi, in his final report on Direct Tax Laws, not only recommended its continuance but also tried to establish the validity of this type of tax on companies. It has been pointed out by us that if profits substantially differ from company to company under the same industry, though both of them are working under the same congenial economic climate resulting from Governmental policies, 'extra profits' argument due to Government policies, as cited by Mr. Chokshi, may not stand. A recent study Group, headed by Dr. C. Rangarajan, deputy governer of the Reserve Bank of India, also recommended withdrawal of sur-tax on companies to make the corporate sector self-reliant in the mobilisation of resources (3.2, 3.3 and 3.4).

Different provisions relating to deductions, allowances and reliefs under the Income Tax Act, 1961, allowed to a corporate body have been shown in this Chapter. The utility and effectiveness of some of the more important items out of a large number of provisions have been taken for our study. Capital consumption allowances, like, depreciation, investment allowance, development rebate, and amortisation of preliminary expenses; deductions granted under Secs. 70 to 80 in Chapter VI of the Income-tax Act. regarding set off and carry forward and set off different types of losses; and deductions granted to promote certain specified objectives of having balanced economic growth in India, like Sections 80-HH, 80-HHA, 80-J, 80-I, 80-M, 80-N, 80-MM, 80-HHB and 89A, have been fully analysed as to their utility, scope for rationalisation and better means for simplification. Incentives under sections 80-HH and 80-HHA are meant for industrialisation in rural and backward areas of the country; 80-J and 80-I for general industrialisation; sections 80-M, 80-N and 80-MM are in connection with inter-corporate dividend, royalties and commissions; and sections 80-HHB and 89-A are meant for earning foreign exchange have been analysed and some tentative suggestions have been made to make them more effective (3.5).

Our recommendations in this connection, after a careful study may be briefly stated as follows:-

1) The complicated process of classification of companies for the purpose of taxation as 'widely-held' and 'closely-held' 'industrial' and 'non-industrial' should be dispensed with (3.4).

2) To keep tax structure as simple as possible a straight deduction from the computed tax may be made for industrial

companies recognising national priority (3.4).

3) In place of lower rates of tax on companies having income upto a certain limit income-tax may be charged at an uniform rate irrespective of the level of income and it would be better to help small business houses by taking such measures as liberalisation in the granting of license, method of financing, product marketing and various infra-structural facilities (3.4).

4) The provisions of additional income-tax may be withdrawn from the purview of the non-industrial companies also as they provide feeder services to the industrial sector and their contribution to the economic growth and employment is not of lesser importance (3.4).

5) To check the contemplating 'avoidance' of tax liability the provision of 'deemed dividend', specially under section 2 (22) of the Income-tax Act regarding payment of advance or loan to a person having 'substantial interest' with the company should be applicable to all types of companies irrespective of their nature and activities (3.4).

6) Uniform rate of income-tax, say at 50 per cent or less may be charged to all domestic companies irrespective of their nature of activities and levels of income (3.4).

7) In case of foreign companies, comparatively

higher rate of income-tax was suggested to be levied as it is difficult, if not impossible, to realise personal income-taxes from most of the shareholders who are diffused throughout international regions (3.4).

8) Regarding depreciation allowance it is suggested that other than 'normal depreciation', all other types of depreciation allowances like, initial depreciation, additional depreciation, extra shift allowances, terminal depreciation might be discontinued. As 'free method' might result in deliberate tax deferral in many cases with the consequential undesirable fluctuations in government revenue, it may be suggested to give some limit in the rates of depreciation within which the companies may be allowed to operate (3.5).

9) Sometimes it is said that investment allowances usually does not help a newly floated company and also does not help to create more employment, it is high time to think by the Government whether the scheme of investment allowance which induces capital intensive production system and quick turnover of capital goods in a developing country like India is really wanted or not. In India, employment and output levels are more endowed with labour resources rather than capital. If it is to be continued at all, it should be linked up with conditions of creating more employment also. So far as the objective of

'replacing the asset' concerned behind depreciation allowance, this investment allowance together with depreciation allowance might enable a company to have an allowable deduction of at least 125 per cent of cost of new plant and machinery with a view to compensate skyrocketing capital costs in recent years. In that perspective it is suggested that this scheme of investment allowance should be extended to all other capital assets and should not be allowed to remain confined into plant and machinery only (3.5).

10) All types of capital expenditure, which are incidental to or connected with the business of a company, should be allowed as chargeable expenses, whether in the form of depreciation or in the form of amortisation. 'Ceiling' as regards 'qualifying amount' @ 2½% for amortisation is suggested to be withdrawn (3.5).

11) As divergent difinitions of 'capital employed in a business' for different provisions of income-tax lead to complications, unwanted exertion on the part of companies, tax authorities and tax planners which also invite legal conflict, a single definition for different purposes may be accepted. For the purpose, 'Capital employed' may be defined to mean the aggregate of paid-up share capital; reserve as appropriation of profits having the same meaning as in Part III of Schedule VI of the Companies Act; and debentures and long-term borrowings, repayable after a

certain period, say 5 or 10 years, on the last day of the previous year (3.5).

12) Regarding set-off and carry forward of losses, it is suggested that loss under one head of income should be allowed to be set-off against any head of income in the current year as well as in future years in case of carry forward of such losses. 'Restrictions on period' of carry forward of losses under any head of income forming part and parcel of total taxable income should be withdrawn (3.5).

13) When there is a provision for set-off and carry forward of losses in a business undertaking, we do not find any reason for further allowing such benefits to certain other expenses and allowances, like depreciation, investment allowance etc., which are deductable and automatically adjusted for the purpose of computation of profits/losses. So, it is recommended to dispense with this present practice (3.5).

14) Benefits under sections 80-HH and 80-HHA are given as incentives for industrialisation in rural and backward areas in India. But it is seen that the quantum of incentives is uniform for all marked 'backward' regions irrespective of the degree of backwardness. It may be suggested to link up the quantum of incentives for industrialisation, which are meant for removing regional imba-

lances, with the degree of backwardness. More the backwardness higher should be the rate of incentives. Adequate infrastructure facilities along with the concessional treatment in various fiscal measures including this tax benefit might help in rural industrialisation (3.5).

15) The system of percentage deduction on profits and gains, under sections 80-J (redundant) and 80-I, as tax incentives for general industrialisation in India, is also suggested for abolition. In place of that there should be new provisions giving adequate incentives, which should be directly related with the level of production and capacity utilisation (3.5).

16) Present favourable treatment in taxation of Inter-corporate dividend should be dispensed with. All kinds of return on investment, including inter-corporate dividend should be uniformly treated (3.5).

17) Provisions regarding technological development under sections 80-MM and 80-N are welcome (3.5).

18) Section 80-HHB, meant for augmenting foreign-exchange earnings, should be related with the quantum of foreign-exchange earnings rather than to profit earnings, later being dependent on many haxazonous factors on which the company may not have sufficient control (3.5) and

19) Companies may be urged upon by suitable legislation, to plough back a certain portion of their disposable income in a way, as desired by the Government or they may be asked to deposit a certain portion of their disposable income on a fixed term and the amount may be directly deducted to compute tax liability in the year of such deposit. On expiry of the term, the fund, when withdrawn together with interest, should be subject to tax. That will help to divert a portion of fund in the corporate sector to the desired channel by the Government to keep parity with the economic goal (3.4).