

CHAPTER - V

CONCLUSIONS AND SUGGESTIONS

CHAPTER FIVE

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INTRODUCTION:

In the preceding Chapters, a discussion has already been made about the significance of corporate taxation and its role in revenue mobilization, the rate structure and the various statutory provisions that are directly concerned with the corporate sector.

The Government of India had appointed various Committees to look into the direct tax structure in the country and the reports submitted by these committees are very significant so far as the corporate taxation is concerned. This Chapter firstly deals with the broad recommendations of these committees.

(I) Bhoothalingam Committee Report:

In 1967, the Government of India invited Shri. Bhoothalingam, formerly a secretary in the Ministry of Finance, to examine the question of rationalization and simplification of the tax structure. He submitted an interim report in May, 1967, and many of the recommendations were immediately implemented. The final report was submitted on 26th December 1967. The final report was much wider and comprehensive than the interim report, and apart from

the suggestions for simplification of the tax structure. It contained a number of fairly basic proposals for tax reform. The important proposals in the field of income and corporate taxation are as follows:-

- (1) The distinction between closely-held and other companies for the purpose of rates of corporate taxation should be abolished;
- (2) The principle of progression should not be applied to corporations and all domestic companies should be taxed at a uniform rate;
- (3) Dividend-tax and surtax should be abolished;
- (4) Certain expenses such as preliminary and pre-operative expenses or market surveys, abortive expenses on prospecting, expenses on shifting of factories, payment for goodwill, etc., should be treated as capital expenditure and should be allowed to be written off over a period of time by introduction of a new amortisation allowance;
- (5) In the case of depreciation allowances, the present structure of rates should continue, but the categories of equipment for this purpose should be made fewer by broader groupings. The written down value method is the most convenient and should continue. A new provision for extra depreciation to compensate for price increases of capital goods should be made;
- (6) The purpose of development rebate has been, in a sense,

largely fulfilled and it should be abolished, for it tends to encourage more liberal and less careful use of the capital resources;

- (7) Relief in direct taxation is not a suitable means of encouraging exports and should not be resorted to until other and better methods are exhausted. Export incentive rebate should not, therefore, continue;
- (8) A tax of one per cent on all capital loans - equity, preference, debentures, long-term and short-term loans - and borrowings should be levied;
- (9) Inter-corporate dividends, except dividends from subsidiary companies effectively controlled by the company receiving the dividends, should be subjected to tax at the standard rate and not at the lower rate as at present;
- (10) With the above changes, the personal or family allowances as well as parent's allowances should no longer continue. However, if it is desired to continue family allowance at all, an appropriate deduction before arriving at the tax base in the case of taxpayers with incomes less than Rs.25,000 should be made;
- (11) The tax on earned and unearned incomes should be merged and a uniform tax year from the 1st July should be adopted;

Some recommendations relating to assessment procedure, collection, refund, recovery, appeals, penalties, etc., were also made.

(II) Wanchoo Committee Report:

A five-member committee, known as the 'Direct Taxes Enquiry Committee', was appointed in March 1970, with Mr. Justice K.N. Wanchoo, former Chief Justice of the Supreme Court, as its Chairman, to go into the details of the problems of direct taxes with special reference to the problems of tax evasion and blackmoney. It made an interim report towards the end of 1970. The final report of the Committee was presented to the Parliament on 20th March, 1972.

The committee had estimated that the income on which tax was evaded for 1968-69 can be put at a figure of Rs.1,400 crores. It pointed out that the extent of income-tax evaded during the year would be Rs.470 crores - one-third of Rs.1,400 crores. The money value of the deals involving blackmoney may, therefore, be not less than Rs.7,000 crores for 1968-69. The committee noted that blackmoney is being widely used for conducting concealed business transactions, smuggling gold and luxury articles, purchasing quotas and licences at premia, financing secret commissions, giving donations to political parties and acquiring assets in benami deals, etc. It also pointed out several causes for tax evasion, resulting in the creation of blackmoney. Some of them are: high rate of taxation under the direct tax laws, economy of shortage and consequent controls and licences, donations

to political parties, ceilings on and disallowance of business expenses, corrupt business practices, high rates of sales-tax and other levies, ineffective enforcement of tax laws and deterioration in moral standards. Some of the important recommendations of the committee with regard to the corporate taxation may be mentioned as follows:

- (1) Surtax on companies should be abolished;
- (2) Exemption to priority industries should be withdrawn;
- (3) Allowance of Development Rebate should also be discontinued as already decided by the Government;
- (4) A uniform tax rate of 55 per cent should apply to all domestic companies without any distinction, based on the nature of control or activity, or size of total income;
- (5) A reconstruction and stabilization reserve fund may be established to which all companies may contribute upto a maximum of 10 per cent of their gross total income, which sum, under certain conditions, will be eligible for deduction from taxation;
- (6) A tax on the capital of companies at a general flat rate of 1 per cent may be introduced;
- (7) Additionally, there are specific tax incentives given in respect of industries employing more labour, or of industries which increase productivity in the case of specific goods, or of industries going to backward areas;

- (8) Distributed profits upto 8 per cent of the paid-up capital should be taxed at an effective rate of 30 per cent.

Some of the recommendations of the committee have already been implemented by the Government. For example, the government was prompt to implement the recommendation number (7) relating to income-tax and recommendation numbers (2) and (3) relating to the corporate taxation.

(III) Chelliah Committee Final Report:

The Chelliah Committee Report, recently submitted to the Government, such as various aspects of corporate tax structure and brief particulars of these recommendations have been reproduced as under:

It is difficult to devise a system of corporate profit tax that would be satisfactory from all the relevant points of view. In India, we follow the classical system which treats corporations as a distinct taxable entity, which leads to double taxation of dividends. Briefly speaking, the following are the deficiencies of the classical system:

- (a) It discourages distribution of corporate profits and thus affects free flow of funds into new companies;
- (b) It tends to encourage mergers to the disadvantage of new enterprises;
- (c) It puts a premium on debt as opposed to equity financing;

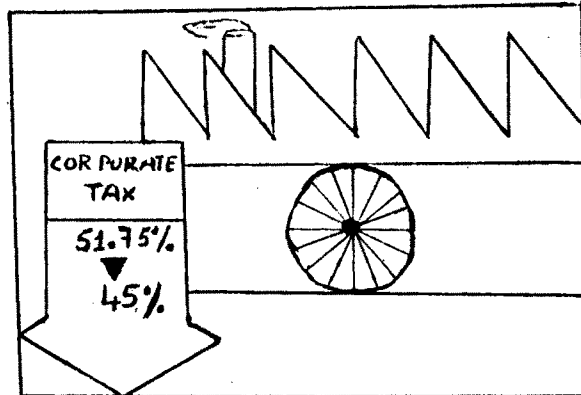
and

- (d) The dividends/retained earnings differential tends to distort the choice between corporate and non-corporate forms of doing business.

Full integration system, wherein the corporation tax is fully transferred into income-tax on the respective shareholders is, however, fraught with insurmountable practical difficulties. Partial integration systems have been adopted in various countries with a view to reducing the dividends/retained earnings differential. In India, the earlier system till 1960-61 led to considerable administrative and compliance problems. We think that giving relief from the double taxation of dividends would be to exempt a proportion of the distributed profits from the corporation tax. For the present, we do not recommend even this for three reasons, viz.:

- (i) the total burden of tax on dividend income in any case would be considerably reduced if the corporate and personal income tax rates as recommended by us are adopted;
- (ii) the whole issue could be re-examined after the findings of the Rudding Committee appointed by the EEC are available;
- (iii) given the revenue constraint, it is preferable to bring down the corporate profit tax rates to reduce

dividend/retained earnings differential.



The committee would, therefore, recommend the retention of the existing "classical system" of taxation for the present with the lowering of the corporate tax for all domestic companies to 45 per cent in 1993-94 from the present level of 51-75 per cent by the abolition of surcharge and to 40 per cent in 1994-95.

This rate of 40 per cent would not be unreasonable for foreign investors,

CONCLUSIONS:

An examination of the overall corporate tax structure and the changes that have been attempted over the period lead to the inescapable conclusion that the structure is a maze of complexities and confusion. This is the result of the frequent changes that have been practised with respect to the revenue code, in the name of disallowances, partial

or total, concessions and incentives and the differentiation of companies on the basis of the class, status and size. No doubt, discretionary tax changes are essential for meeting revenue emergencies. But too frequent changes are unhealthy and at times, prove uneconomical. They lead to greater uncertainty in tax administration and creation of tax loopholes. Further, they demand considerable amount of time and skill from the quarters of both taxpayers and tax administrative authorities. As a result of these complexities, the tax, in fact, may lose the much desired built-in flexibility characteristic. Thus, there seems to be little argument with respect to the proposition that corporate tax structure, there exists a need for streamlining the present-day corporate tax structure. This reform should basically aim at a reduction in the complexities of the revenue code.

The complexities of the present system prove expensive both to the taxpayers and to the tax authorities. There exists an immediate need for simplifying the corporate tax system. The division of companies into different categories with numerous sub-clauses appears unnecessary. Instead, as has been suggested by the recent enquiry committees, a uniform rate for all domestic companies, irrespective of the nature of their operations and whether they are widely or closely held, may help easy administration and minimization of tax leakages. Similarly, the present tax differentiation

of priority and non-priority industries needs re-examination to see the extent to which it conforms with the specified overall economic objectives.

The interests of corporate sector as well as of the national economy indicate that discrimination which works against efficiency is not desirable. It encourages tendencies to dissipate resources and to reduce the profitability of the company in order to escape the clutches of the personalization. The national objective surely is not to make the industrial units less efficient and less competitive, especially those which are engaged in the export markets. These considerations make a strong case for the removal of the surtax.

Also something needs to be done with respect to the double taxation of dividend income. The replacement of corporate taxation with a value-added tax may not be justified on other economic considerations. Perhaps, the better alternative is to go in for an integration of all income taxes.

SUGGESTIONS:

The tax structure in India, in general, is over-complicated and an average assessee cannot comprehend the statutory provisions. This is a general view of the overall tax structure, so far as company taxation is concerned. This confusion



is more profound, as there are a number of divisions and sub-divisions of the companies as separate taxable entities and the tax rates for each of them are different. Moreover, the rate structure is not uniform. Besides, there are different norms for deduction of expenses under various heads of expenditure. There is immense discretion to the assessing officers. All these anomalies, discriminations, discretions and inconsistencies should be minimized. Also, the fixation of the rates is not determined on scientific grounds but random rates are fixed.

Fundamentally, Indian industries have not reached the level of paying the tax over their incomes. The Indian corporate tax would discourage the industrialists to industrialize the country. The economic development of India is purely dependent upon the industries.

In the United Kingdom, there are 29 million income-tax payers, but the number of references filed in the High Court is only around 30 in a year. In India, there are only 7 million taxpayers but the number of references filed in the High Courts is over 6,000; in addition to more than 1000 writ petitions in a year. These figures reflect the tremendous public dissatisfaction with the failure of the law and the fiscal administration.