

## CHAPTER - II

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## **CHAPTER TWO**

### **TAXABLE ENTITIES**

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#### **2.1 INTRODUCTION:**

The tax structure in India takes into account the fact that a unit of taxation is split-up into various taxable entities. For the purpose of taxation, each entity is accountable for taxes on its income during the preceding year. The term 'person' stands defined under the law; it includes an individual, HUF, firms, cooperative societies and companies, so far as the income-tax is concerned.

The tax rates and the basic exemption for each such category varies from one to another. The mood of companies is, however, the same, and it would be a prudent to elaborate this further as under.

#### **2.2 AN INDIVIDUAL:**

An 'individual' means a natural person, i.e. a human being, and includes a minor as also a person of unsound mind.

An individual is liable to pay tax in respect of the following incomes:

- (a) Income earned by the individual himself;
- (b) Share of income from a firm;

- (c) Share of income from an association of persons; and
- (d) Income of other persons included in his income under sections 60 to 65.

The following incomes, however, included in the total income of the individual for the purpose of determining the rate of tax applicable to his taxable income:

- (a) Profit from unregistered firm, assessed as such, and
- (b) Income from an association of persons.

Income-tax Rates for Individuals:

It may be useful, at this stage, to have a look at the personal as also the corporate rates of tax over the past few years.

Table 2.1  
Individual income-tax rates for the  
assessment years: 1990-91 to 1993-94

Taxable incomes	Assessment years			
	1990-91	1991-92	1992-93	1993-94
Upto Rs 18,000	nil	nil	nil	nil
Upto Rs 22,000	20%	nil	nil	nil
Next Rs 3,000	20%	20%	20%	nil
Next Rs 3,000	30%	20%	20%	nil
Next Rs 2,000	30%	20%	20%	20%
Next Rs 20,000	30%	30%	30%	20%
Next Rs 50,000	40%	40%	40%	30%
Over 1,00,000	50%	50%	50%	40%

Source: Phadke, S.S., in: Bombay Stock Exchange  
Official Directory, (undated)

Individual as a Taxable Entity:

It is seen from the foregoing statistics that the exemption limit has been raised twice during the period 1990-91 to 1993-94. From the assessment year 1991-92, it was raised to Rs.22,000 from its previous limit of Rs.18,000. Again for the assessment year 1993-94, it has been raised to Rs.28,000 from the earlier limit of Rs.22,000. The slab of income bearing tax rates of 20% was raised from Rs.25,000 in the assessment year 1990-91 to Rs.30,000 in the next year. From the assessment year 1993-94, it was raised further to Rs.50,000. The tax rate for the income slab of Rs.50,000 to Rs.1,00,000 has been reduced to 30% while the income above Rs.1,00,000 bears tax at the rate of only 40%, as against 50% till now.

The rates of surcharge have been as under:

- AY : 1990-91 : 8% of income-tax, if the taxable income exceeded Rs.50,000;
- AY : 1991-92 : 12% of income-tax, if the taxable income exceeded Rs.75,000;
- AY : 1992-93 : 12% of income-tax, if the taxable income exceeded Rs.75,000;
- AY : 1993-94 : 12% of the income-tax, if the taxable income exceeds Rs.1,00,000.

Note: 'Surcharge' is calculated on the net tax, i.e. tax after deducting the allowable tax rebates.



### 2.3 A HINDU UNDIVIDED FAMILY:

A Hindu Undivided Family (HUF) is assessable as a separate and distinct unit of taxation. According to the Hindu Law, a HUF, or a joint Hindu family, is made up of all persons lineally descended from a common male ancestor and includes their wives and unmarried daughters. Common mess, common worship, common residence, coupled with ties of blood as also introduction into the family by marriage and adoption, make them members of HUF. The relation of an HUF is by status, not by contract. It cannot be created by acts of parties, except where a stranger is introduced into it by marriage or by adoption.

Only Hindus can constitute an HUF. But under the codified Hindu laws such as Hindu Marriages Act, 1955; Hindu Succession Act, 1956; Hindu Minority and Guardianship Act, 1956; and Hindu Adoption and Maintenance Act, 1956, the scope of the term 'Hindu' has been enlarged such that it covers not only a Hindu by birth or religion alone but also Jains and Sikhs, unless there is a custom or usage to the contrary. Legitimate children of a Hindu father by a Christian mother, who are brought up as Hindus, will also be governed by the Hindu Law. But the joint families of Muslims are not HUFs.

#### Rates of Tax:

For the purpose of computation of taxability, HUFs are

classified as:

(a) Non-Specified HUF:

Where no member has an independent total income exceeding the maximum tax-free amount of Rs.22,000;

(b) Specified HUF:

Where one or more members have an independent total income exceeding the maximum tax free amount specified above.

The rates of tax applicable to a non-specified HUF is the same as in the case of an individual. For a specified HUF, the rates of tax are as follows:

Table 2.2  
Rates of tax for a specified HUF

Total income	Marginal rates of income-tax
1. Where the total income does not exceed Rs.12000	NIL
2. Where the total income exceeds Rs.12,000/- but does not exceed Rs.20000	25% of the amount by which the total income exceeds Rs.12,000;
3. Where the total income exceeds Rs.20000 but does not exceed Rs.40000	Rs.2,000 plus 30% of the amount by which the total income exceeds Rs.20,000;
4. Where the total income exceeds Rs.40000 but does not exceed Rs.60000; Rs.40,000;	Rs.8,000 plus 40% of the amount by which the total income exceeds Rs.40,000;
5. Where the total income exceeds Rs.60,000 but does not exceed Rs.1,00,000;	Rs.16,000 plus 50% of the amount by which the total income exceeds Rs.60,000;

contd. on p.16.

Total income	Marginal rates of income-tax
5. Where the total income exceeds Rs.1,00,000.	Rs.36,000 plus 55% of the amount by which the total income exceeds Rs.1,00,000/-.

Surcharge on Income-tax:

The amount of income-tax computed in accordance with the preceding provisions of this, shall, in the case of every person having a total income exceeding Rs.75,000, be reduced by the amount of rebate of income-tax calculated under section 88 and the income-tax so reduced be increased by a surcharge for purposes of the union, calculated at the rate of 12% of such income-tax.

From the assesment year 1993-94, and in respect of the payment of advance-tax during the financial year 1992-93, the rates of tax will be as follows:

Table 2.3

Rate of tax for the assesment year 1993-94

Total income	Marginal rates of income-tax
1. Where the total income does not exceed Rs.18,000;	NIL
2. Where the total income exceeds Rs.18,000 but does not exceed Rs.1,00,000	30% of the amount by which the total income exceeds Rs.18,000;
3. Where the total income exceeds Rs.1,00,000.	Rs.24,600 plus 40% of the amount by which the total income exceeds Rs.1,00,000.

Surcharge: 12% surcharge only if income exceeds Rs.1,00,000.

Source: Mehta, V.V., 'Income-tax Ready Reckoner'.

## **2.4 ASSESSMENT OF FIRMS AND ASSOCIATIONS OF PERSONS:**

### **2.4.1 New Scheme as to Taxation of Firms:**

The Finance Act of 1992 has introduced a new scheme as regards taxation of income of firms without any discrimination based on registration, with effect from the assessment year 1993-94. Accordingly, a firm assessed as such will be taxed at a flat rate of 44.8% (40% income-tax and 12% surcharge) in respect of its total income. The share of the individual partners in the total income of the firm will be exempt in their hands by virtue of the new section 10(2A). The firm will be allowed deduction as to the payment of interest and remuneration to its partners in accordance with the conditions and ceiling prescribed in section 40(b) and such remuneration or interest paid to individual partners, to the extent it is allowable to the firm, will be chargeable in the hands of the partners under 'Profits and Gains of Business or Profession'.

A firm which is not an FAS will be assessable as an association of persons. Accordingly, in respect of its total income, it will be liable at the rates applicable to an individual or at the maximum marginal rate of 44.8% or even a higher rate, say, 57.5%, if a company happens to be its partner. A non-FAS firm will be included in their respective total incomes and taxed depending on whether the



the total income of the non-FAS firm is:

- (a) chargeable at the maximum marginal rate or a higher rate;
- (b) chargeable at the regular rates; or
- (c) not chargeable.

**2.4.2 Types of Firms:**

Under the Income-tax Act, a Firm may be -

- (a) Registered firm,
- (b) Unregistered firm assessed as such; and
- (c) Unregistered firm assessed as registered firm under section 183(b).

**2.4.3 Assessment of Registered Firm:**

The assessment of a registered firm will be done as follows:

- (a) Determine the residential status of the firm;
- (b) Compute the total income of the firm under each appropriate head;
- (c) Determine the amount of income-tax payable by the firm;
- (d) Deduct the amount of income-tax from the total income;
- (e) In case of any salary, interest, commission, etc., that has been paid to partners, deduct the aggregate of such amounts from the total income;
- (f) Apportion the balance of profit among the partners in their profit-sharing ratio  $[b-(c+e)]$ ;
- (g) In case the balance is a loss, apportion it among the partners again in the profit-sharing ratio;

- (h) Now to compute each partner's share of income of the firm. If any interest, salary commission or any other remuneration is paid to a partner in respect of the previous year, this will be added to the partner's share in profit as worked out (and if any loss has been apportioned to him as per the amount of interest, commission, etc., it will be adjusted against the loss). the remaining sum shall be treated as his share in income of the firm.

2.4.4 Assessment of Unregistered Firm:

The assessment of an unregistered firm is to be done as follows:

- (a) Determine the residential status of the firm;
- (b) Compute the total income of the firm;
- (c) Deduct from the total income the aggregate of salary, commission, fees, etc., payable to each of the partners;
- (d) Apportion the balance (b)-(c) among the partners in their profit-sharing ratio;
- (e) Even where the balance, after deduction as per (c), is a loss, apportion the loss among the partners in their profit-sharing ratio;
- (f) Now add the profit apportioned to each partner (or adjust the loss apportioned to him) to the salary, commission, interest paid to him and the resulting sum shall be his share in the total income of the firm. However, where the net result after such adjustment

is a loss, the partner cannot set-off such loss against his other personal income. Only the firm can carry forward and set-off its loss computed as per (c) against its income, for a maximum of eight subsequent assessment years.

#### 2.4.5 Tax Rates:

An unregistered firm is charged at the same rates as an individual. These rates are relatively high and the highest marginal rate is 50%. On the other hand, for a registered firm, there is a different rate schedule, which not only provides considerably low rates for each slab but the highest rate there is only 15% in the case of a firm engaged in a profession and 18% in the case of a trading firm.

Table 2.4  
Rates of income-tax in the case of  
every registered firm

Total income	Marginal rate of tax
1. Where the total income does not exceed Rs.15,000	NIL
2. Where the total income exceeds Rs.15000 but does not exceed Rs.50000;	6% of the amount by which the total income exceeds Rs.15000;
3. Where the total income exceeds Rs.50000 but does not exceed Rs.1,00,000;	Rs.2100 plus 12% of the amount by which the total income exceeds Rs.50000;
4. Where the total income exceeds Rs.1,00,000.	Rs.8100 plus 18% of the amount by which the total income exceeds Rs.1,00,000.

Source: Same as Table 2.4

Surcharge:

In the case of every person having a total income exceeding Rs.75,000, computation of tax be increased by a surcharge for the purposes of the Union, calculated at the rate of 12%.

In the case of every registered firm whose total income includes income derived from a Profession carried on by it and the income so included is not less than 51%.

Table 2.5  
Marginal rate of tax

Total income	Marginal rate of tax
1. Where the total income does not exceed Rs.15000;	NIL
2. Where the total income exceeds Rs.15000 but does not exceed Rs.50000;	5% of the amount by which the total income exceeds Rs.15000;
3. Where the total income exceeds Rs.50000 but does not exceed Rs.1,00,000;	Rs.1750 plus 10% of the amount by which the total income exceeds Rs.50,000;
4. Where the total income exceeds Rs.1,00,000;	Rs.6,750 plus 15% of the amount by which the total income exceeds Rs.1,00,000.

Source: Same as Table 2.3

Surcharge:

In the case every person having a total income exceeding Rs.75,000 be increased by a surcharge for the purposes of the union calculated at the rate of 12%.

## 2.5 ASSESSMENT OF COOPERATIVE SOCIETIES:

### A Cooperative Society (under Section 2(19)):

A 'cooperative society' means a society registered under the Cooperative Societies' Act, 1912, or under any law in force in any State for the registration of cooperative societies. A regional rural bank is deemed to be a cooperative society.

### Taxable Income - How Computed:

First, the gross total income has to be computed, ignoring the exemption under section 10. Then permissible deductions under sections 80G, 80GGA, 80HH, 80HHA, 80HHB, 80HHD, 80I, 80-IA, 80JJ, 80-O, 80P and 80Q are to be made.

### Deduction under Section 80P:

Deduction under section 80P is only allowed to a cooperative society in respect of its income from any business activity, investment, etc.

### Amount of Deduction under Section 80P(2)(a):

A cooperative society is allowed 100% deduction in respect of its profits and gains attributable to any of the following businesses or activities:

- (a) Business of banking or providing credit facilities to members;
- (b) Cottage industry;
- (c) Marketing of agricultural produce of members;

- (d) Purchase of agricultural implements, seeds, livestock or articles meant for use in agriculture, with a view to supplying these to its members;
- (e) Processing, without the aid of power, of agricultural produce of its members;
- (f) Collective disposal of labour of its members; or
- (g) Fishing or allied activities, in other words, catching, curing, processing, preserving, storing or marketing of fish or purchase of materials and equipment in connection with such activities for supplying the same to its members.

Note: In the case of cooperative societies engaged in (f) and (g) above, it is necessary that voting rights are restricted only to the following of its members:

- i. individuals contributing their labour and engaged in fishing or activities allied to it;
- ii. cooperative credit societies which provide financial assistance to the society; and
- iii. the State Government.

100% Deduction under Section 80P(2)(b):

There is a 100% deduction also in respect of profits and gains of a cooperative society which is a primary society engaged in supplying milk, fruits or vegetables grown by its members to:

- (a) a federal society engaged in similar business;

- (b) the Government or a local authority, or
- (c) a Government company.

100% Deduction under Section 80P(2)(d) and (e):

A cooperative society will be entitled to 100% deduction in respect of its income by way of interest and dividend on its investment as received from another cooperative society.

Likewise, the whole of the income derived by a cooperative society from letting of godowns or warehouses for storage, processing or facilitating the marketing of the commodities will be allowed deduction. However, where the letting is for the purposes other than these, the deduction will not be available (CIT vs. Ahmedabad Maskati Cloth Dealers Cooperative Warehousing Society Limited, 162 ITR 142 GUJ). Shops let out for carrying on wholesale or retail business do not fit into the description of a godown or a warehouse.

Limited Deduction under Section 80P(2)(c):

In respect of its income attributable to any business or activity other than those specified above, a cooperative society is to be allowed a deduction as below:

- (a) If it is a consumer cooperative society : Rs.40,000;
- (b) In the case of any other society : Rs.20,000.

Rates of Tax:

The Finance Act, 1990, as effective from the AY:1991-92, has amended the rates of tax applicable to a cooperative

society. Given below are the rates applicable in the case of the assessment year 1991-92:

Table 2.6  
Tax rates as applicable to cooperative societies

Total income	Tax rate as %-age of total income
Upto Rs.10,000	10
Rs.10,000-20,000	20
Above Rs.20,000	35

Source: Same as Table 2.3.

Surcharge:

At 12% of the amount of tax, if the total income exceeds Rs.75,000.

## 2.6 COMPANY AS A TAXABLE ENTITY:

Corporation tax is levied on the incomes of registered companies and corporations. The rationale behind the corporation tax is that a joint stock company is a separate entity and thus a separate tax, different from personal income-tax, has to be levied on its income. Until 1960-61, corporations were taxed in a partial sense. A corporation was required to pay income-tax on behalf of its shareholders on the dividends distributed among them and each shareholder got a credit to this effect. Since 1960-61, corporations are being treated as independent entities and the shareholders are no longer allowed any credit against their individual tax



liabilities.

Though corporate incomes are being taxed at a flat rate, there are provisions for various kinds of rebates and exemptions. For the purpose of rebates and exemptions, companies have been classified on the basis of their size and nationalities. In order to give incentive to development activity in the industrial sector, a system of development rebate was introduced in the year 1955 in place of the initial depreciation allowance. Between 1974 and 1976, development rebate was withdrawn and the system of initial depreciation was reintroduced. This arrangement, however, was shortlived as in the Budget for 1976-77, a system of investment allowance on the pattern of the development rebate was provided. In the Budget for 1990-91, the investment allowance and the investment deposit account scheme was withdrawn, but the corporate enterprises were compensated by lowering down the rate of corporation tax. However, in the budget for 1990-91, the rates of corporation tax was raised.

For inducing the setting-up of new industrial companies, various incentive provisions have been made in the corporation tax, from time to time. The most important of them is the provision with regard to the tax holiday. In the beginning, new industrial companies were not liable to pay any corporation tax until their profit rate remained less than 6%. Later on, the system of tax holiday became somewhat complex

as more and more qualifying provisions were added to the original provisions. In 1978-79, this incentive was abolished for the industrial units set-up in the non-priority sectors. Certain exemptions have also been permitted in order to promote exports.

The corporation tax yielded a revenue of Rs.40.0 crores in 1950-51, Rs.1310 crores in 1980-81 and is expected to yield Rs.8130 crores in 1992-93 (Budget), reflecting the growing industrialization in the economy.

#### COMPUTATION OF TOTAL INCOME:

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The procedure for computation of the total income in the case of a company is the same as in regard to other assessees, such as classification and computation of income under each head, aggregation, computation of gross total income, etc.

From the gross total income, excluding incomes exempt under sections 10, 10A and 10B, a company is allowed the following deductions:

<u>Section</u>	<u>Nature of Deductions</u>
80G	Deduction in respect of donations to funds and charitable and religious institutions;
80GGA	Deductions in respect of donations for scientific research or rural development;

<u>Section</u>	<u>Nature of Deductions</u>
80HH	Deduction in respect of profits and gains of newly established undertakings or hotels set-up in certain backward areas (deduction not to be allowed in respect of undertakings which began to produce articles after 31st March 1990);
80HHA	Deduction in respect of profits and gains from newly established small-scale industrial undertakings set-up in the rural areas (deductions not to be allowed in respect of undertakings which began to produce articles after 31st March 1990);
80HHB	Deduction in respect of profits and gains from projects outside India;
80HHC	Deduction in respect of export turnover;
80HHD	Deduction in respect of earnings in convertible foreign exchange;
80HHE	Deduction in respect of profits from export of computer-software, etc.
80I	Deduction in respect of profits and gains from industrial undertakings, after a certain date (deduction to be available upto the assessment year 1991-92);
80IA	Deduction in respect of profits from industrial undertaking, ship or business of hotel,

SectionNature of Deduction

	where the business starts functioning after 31st March 1991;
80JJ	Deduction in respect of profits from poultry farming;
80M	Deduction in respect of inter-corporate dividends;
80-O	Deduction in respect of royalties, fees or commission from foreign enterprises;
80-Q	Deduction in respect from business of publication of books.

Table 2.7

Income-tax rates of companies for the period from 1990-91 to 1993-94 assessment years

	1990- 91	1991- 92	1992- 93	1993- 94
1.	2.	3.	4.	5.

- (a) In the case of a domestic company in which public are substantially interested
- |  |     |     |     |     |
|--|-----|-----|-----|-----|
|  | 50% | 40% | 45% | 45% |
|--|-----|-----|-----|-----|
- (b) In the case of a domestic company in which public are substantially interested:
- in the case of a trading or investment company
  - in the case of any other company
- |  |     |     |   |     |     |
|--|-----|-----|---|-----|-----|
|  | 60% | 50% | ) | 50% | 50% |
|  | 55% | 45% |   |     |     |
- (c) In the case of a foreign company:
- in respect of income when consists of royalty received from an Indian concern in pursuance of

	1.	2.	3.	4.	5.
an agreement made by it with the Indian concern after 31.3.1976 but before 1.4.1976, or fees for rendering technical services in pursuance of an agreement made by it after 29.2.1964 but before 1.4.1976 and where such agreement has in either case been approved by the central government		50%	50%	50%	50%
ii. in respect of any other income		65%	65%	65%	65%

Source: Same as Table 2.1

Surcharge:

This is charged at the rate of 8% where the total income of the company exceeds Rs.50,000, for the assessment year 1990-91. For the other years, namely, the assessment years 1991-92, 1992-93 and 1993-94, surcharge is levied at 15% where the income exceeds Rs.75,000. This surcharge is leviable only on the domestic companies for all these years. No surcharge is leviable in the case of foreign companies. It will be seen from the above Table that while the tax rates were reduced for the assessment year 1991-92, these have again been hiked in the immediate next year

and continue at that high rate even now. Similarly, the surcharge levied to meet the situation arising out of the Gulf War continues at that high level even after the war has ended. It is, however, gratifying to note that the Finance Minister in his Budget Speech for 1992-93 has given 'advance notice' of his intention to begin lowering the corporate tax rates as early as possible. The Chelliah Committee Report recently submitted to the Government contains such various aspects of the corporate tax structure. The brief particulars of these recommendations have been reproduced later. It is to be hoped that the Finance Minister will accept the recommendations of the Chelliah Committee in this respect and will bring down the rate to 40%. As regards surcharge also, the Finance Minister stated that he was compelled to retain it for one more year because of severe resource constraints and it is to be hoped that it will be abolished the next year.

The following provisions have been summarized with a view to point out some of the specific features of the fiscal operations in regard to the corporate taxation. The statutory corporate taxation stands on a different footing because the revenue realized from the corporate taxation is not shareable between the centre and the States, as it exclusively goes to the centre. The Table below is the statutory corporation tax rates at-a-glance for the Indian public limited companies.

Table 2.8

Statutory corporate income-tax rates and effective  
tax rates for Indian Public Limited Companies

Accounting year	Corporate income- tax	Surcharge	Statutory rate	Effective rate (all companies	Effective rate(profit making cos.)
1971-72	55.0	2.5	56.37	45.4	41.3
1972-73	55.0	5.0	57.75	46.2	42.6
1973-74	55.0	5.0	57.75	46.3	43.4
1974-75	55.0	5.0	57.75	48.9	46.5
1975-76	55.0	5.0	57.75	58.5 (59.0)	48.8 (49.0)
1976-77	55.0	5.0	57.75	60.5	49.4
1977-78	55.0	5.0	57.75	57.5	48.0
1978-79	55.0	5.0	57.75	57.1	44.9
1979-80	55.0	7.5	59.13	46.7	43.8
1980-81	55.0	7.5	59.13	43.8 (42.7)	40.2 (39.4)
1981-82	55.0	2.5	56.37	42.6	37.3
1982-83	55.0	2.5	56.37	36.9 (39.4)	30.1 (31.5)
1983-84	55.0	5.0	57.75	49.4	35.5
1984-85	55.0	5.0	57.75	48.1	35.3
1985-86	50.0	5.0	52.50	40.8	32.2
1986-87	50.0	-	50.0	na.	na.
1987-88	50.0	5.0	52.50	na.	na.
1988-89	50.0	5.0	52.50	na.	na.

na : not available.

Note: Figures in brackets pertain to the previous years series. Effective rates of corporate income-tax in column '5' relate to all selected medium and large public limited companies numbering 1650 for 1971-72 to 1974-75, 1720 companies for 1975-76 to 1978-79, 1651 companies for 1980-81 to 1982-83 and 1838 companies (including 100 small companies for 1982-83 to 1984-85 and 1867 companies in 1985-86. Of these, the number of profit-making companies varied from year to year.

Sources: Central Government Budgets and Reserve Bank of India's Company Finance Data.

The rate structure of the corporate income-tax vis-a-vis personal income-tax presents certain salient features. The following observations made by Sharma, K.C. further highlight the issue.

In order to make a proper assessment of the nature and burden of corporate income-tax in India, it is desirable to take into account the income-tax structure in the non-corporate sector also. The burden of income-tax may be varied in four ways, viz. by changing minimum exemption limit, the basic rate structure, the maximum marginal rate and tax rebates or concessions. The basic rates of corporate income-tax in respect of domestic companies in which public are substantially interested remained fixed at 45% and 55% upto 1982-83 with variations in the amounts of total income in respect of these two slabs. For instance, a basic rate of 45% was applicable if the total income of a widely-held domestic company was upto Rs.25,000 in 1966-67; upto Rs.50,000 from 1967-68 to 1972-73 and upto Rs.1,00,000 from 1973-74 to 1982-83. Corporate income-tax at the rate of 55% was made applicable uniformly to all the levels of the corporate income. However, in the case of closely-held domestic companies, i.e. in which public are not substantially interested, income-tax was levied at a higher rate of 55% on income upto Rs.10.0 lakhs till 1972-73 and upto Rs.2.0 lakhs thereafter and 60% on the balance in respect of the industrial companies and 65% on other companies upto 1984-85.

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The rate was reduced to 60% for investment of trading companies and 55% on other companies from 1985-86 onwards, following alteration in the classification of companies. The foreign companies, which paid income-tax at the rate of 50% on income from royalties, fees, etc., and 70% on the balance of their total income upto 1984-85, were required to pay a lower rate of 65% on the balance of total income from 1985-86 onwards. Thus, corporate income-tax was lowered by 5% points in respect of all the three types of companies whether domestic or foreign with effect from 1985-86 onwards.

The maximum marginal rate of income-tax inclusive of surcharge in respect of widely-held domestic companies has moved in a narrow band from 55% to 59.13% between 1965-66 and 1984-85, whereas the maximum marginal rate of personal income-tax (inclusive of surcharge) has varied between the high of 97.75% in 1971-72 (93.5% in 1970-71 and 82.5% in 1969-70) and a low of 61.9% in 1984-85. The number of income-tax slabs with different basic rates also came down from 11 in 1969-70 to 8 in 1984-85 and further to 4 in 1985-86. It was for the first time in 1984-85 that the maximum marginal rate of corporate income at 55% while the surcharge remained still higher at 12.5% in respect of personal income. The 1985-86 budget considerably simplified the personal income-tax and brought its maximum marginal rate lower at 50% along with that of the corporate income-tax and abolished the surcharge on personal income. Thus, a

note of compatibility between the corporate income-tax and the personal income-tax was struck first in 1984-85 and then from 1985-86 onwards, as against the highly taxed personal income and fairly stable corporate income tax structure in the preceding two decades. Therefore, the general impressio that India was a highly taxed nation was true in regard to personal income but not in regard to the corporate income, although the same feeling prevailed for the latter as well and as a result, both adversely affected the growth of new investment activity, particularly till the beginning of the 'eighties.

The Table below indicates the revenue raised from the corporate taxes and its ratio to taxes on income other than the corporate taxes.

Table 2.9  
Ratio of receipts from corporation tax to taxes of income  
other than the corporation tax

Year/ Plan	Corporation tax	Taxes on income other than cor- poration tax	Ratio of Col.2 to col.3
1.	2.	3.	4.
1969-70	353	449	0.79
1970-71	371	473	0.78
1971-72	472	537	0.88
1972-73	472	537	0.88
1973-74	583	745	0.78
IV 5-Year Plan (Total)	2337	2834	0.82
1974-75	710	874	0.81

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1.	2.	3.	4.
1975-76	862	1214	0.71
1976-77	984	1194	0.82
1977-78	1221	1002	1.22
1978-79	1252	1177	1.06
V 5-Year Plan (Total)	5029	5461	0.92
1979-80 Annual Plan	1392	1340	1.04
1980-81	1311	1506	1.87
1981-82	1970	1476	1.33
1982-83	2185	1570	1.39
1983-84	2493	1699	1.47
1984-85	2556	1928	1.33
VI 5-Year Plan (Total)	10515	8179	1.29
1985-86	2865	2509	1.14
1986-87	3160	2878	1.10
1987-88	3433	3187	1.08
VII 5-Year Plan First 3 years Total	9458	8564	1.10

Note: Figures in Col.3 represent total receipts which are shared by the Central Government and the State Governments, on the basis determined by the Finance Commissions from time to time.

Sources: Compiled from the Union Budgets for the respective years

Sharma, K.C.'s further observations as regards the burden of corporate income-tax are also very significant.

It would be seen that the corporate income-tax which yielded lower revenue till 1976-77 as compared to non-corporate income-tax, accelerated in 1977-78 and with the exception of

1980-81, kept up its ascending over non-corporate income-tax. The annual average ratio of revenue from corporate income-tax to non-corporate income-tax improved from 0.82 during the Fourth Five Year Plan to 1.29 in the Sixth Plan and fell to 1.10 during the first three years of the Seventh Plan, which, besides reflecting a better growth of the corporate profits, also reveals the fact that rationalized and reasonable corporate and personal income-tax structure is mutually more productive than the one which is highly progressive and complicated; for instance, after the initial measures of rationalization in 1985-86, the revenue from these sources picked up. Collection rose by 10.3% in 1986-87 over 1985-86 and by 15.5% in 1987-88 over 1986-87. The personal income-tax collections increased by 14.7% and 16.4%, respectively. It is, nonetheless, noteworthy that with low levels of income, inadequate spread of proper accounting practices and widespread tax evasion in India, realizations from the share of personal income-tax collections is, therefore, likely to remain high. It does not, however, mean simply that there is no tax evasion in the corporate sector. But certain factors such as liberalization of imports, sufficient availability of raw materials, good industrial relations, technological upgradation and enrichment of the skills of industrial labour are bound to bring, in their wake, notable improvement in corporate profits and an upward thrust in the corporate tax realizations.

Evaluating the burden of corporate income-tax from yet another angle, its proportion in the total tax revenue of the Government of India may be examined. Although the revenue receipts from corporate income-tax (or corporation tax) had gone up from Rs.353 crores in 1969-70 to Rs.3,433 crores in 1987-88, its proportion in the total tax revenue (net of States' share) had declined from 16.0% to 12.9% in the corresponding year. The share of corporate income-tax in the total revenue (net) had declined from the annual average of 15.7% during the Fourth Plan to 13.1% during the first three years of the Seventh Plan. In fact, if gross tax revenue of the Central Government, i.e. without excluding the States' share is to be taken into account, the contribution of the corporate income-tax to the exchequer would further dwindle considerably. The share of receipts from corporate income-tax in the gross tax revenue stood at 12.5% in 1969-70 and after fluctuations, fell to 9.6% in 1987-88. In absolute terms, however, the collection of corporate income-tax maintained its up-trend.

An attempt has also been made by researchers to measure the burden of corporate income-tax with a view to the fact that the actual burden of corporate tax in India is much lower than that in other countries.

The overall tax:GNP ratio may also be said to indicate the tax burden, which is often considered significant for

the purposes of policy and that a high tax:GNP ratio and the related concept of tax burden are particularly relevant when considering the questions of taxable capacity and tax efforts.

The ratio of corporate income-tax to gross national product at factor-cost at current prices was a little over 0.9% in 1970-71, 1.2% in 1975-76, 1.0% in 1980-81 and 1.5% in 1985-86. Comparing the corporate income-tax:GNP ratio in India with that in other countries, it would be noteworthy that even two decades ago, the ratio was 4.3% in Japan, 4.5% in Canada, 2.9% in the UK and 5.1% in the USA.

Now the maximum rate of corporate taxation in India has been around 50%. In contrast, it is 42.5% in the UK, 48% in the USA, 50% in Canada and 35% in Japan. However, 1990-91 budget reduced the rate of corporation tax to 40%.

#### **CORPORATE INCOME-TAX IN UK and USA:**

The rates of corporate income-tax vary widely among different countries as also between domestic and foreign companies. The rates discussed here pertain to the domestic companies. The corporate income-tax, called the 'corporation tax' in the UK was fixed at 40% in April 1964 and raised subsequently in two stages to 42.5% from April 1967 and 40% from April 1970 to March 1973. It was raised to 52 per - cent for a decade from April 1973 to March 1983 and

and fixed lower at 50% in 1983-84 and was proposed to be reduced in stages, by 5 percentage points each year, in order to bring it to 35% in 1986-87, in keeping with the trend in the USA, to have lower statutory corporate income-tax rates. It was accordingly fixed at 45 per cent in 1984-85, 40 per cent in 1985-86 and 35 per cent in 1986-87 and has since remained stable at that level. These were the maximum marginal rates of corporate income-tax and lower rates were applied to smaller companies. At present, small companies in the UK pay income-tax at the rate of 25 per cent. A comparative picture of the rates of corporate income-tax applicable to small and other companies during the past nearly two decades is presented in Table 2.10 below.

Table 2.10  
Rates of corporation tax in UK

Years	Rates of corporation tax on	
	Small companies	Other companies
1970-71 to 1972-73	40	40
1973-74 to 1978-79	42	52
1979-80 to 1981-82	40	52
1982-83	38	52
1983-84	30	50
1984-85	30	45
1985-86	30	40
1986-87	29	35
1987-88	27	35
1988-89	25	35

Source: Compiled from the Budgets of  
the Government of UK

It is seen from the above Table that there has been a considerable reduction in the rates of the corporation tax in the UK from 1983-84 onwards. Presenting the most simplified tax structure, the British Chancellor of the Exchequer, in his budget-speech for 1988-89, quoted in 'Financial Times', said that, "the reason for the world-wide trend towards lower top rates of income-tax is clear. Excessive rates of income-tax destroy enterprise, encourage avoidance and drive talent to more hospitable shores overseas. As a result, far from raising additional revenue over time, they raise less'. Accordingly, the British Government has now introduced only two rates of personal income-tax, basic rate of 25 per cent and a top rate of 40 per cent, as against six rates for different income slabs ranging upto 60 per cent in 1987-88, apart from lower rates of corporate income-tax.

The corporate income-tax rate structure in the USA is simple and facilitates easy compliance. The federal corporate income-tax had five different rates in 1983, unlike India where only one rate is applicable for the entire income. These rates were 15 percent on the first \$25,000 of income, 18 per-cent of income between \$25,000 and 75,000, 40 per cent of income between \$75,000 and 1,00,000 and 46 per cent of income above that amount. These may be called the 'marginal tax rates'. The average tax rates would be lower, due to the graduated system of income-tax brackets. For instance,



average tax rate works out 25.75 per cent if the total income was \$1,00,000 and 20.4 per cent if the total income was \$70,000. In keeping with the present administration's policy of lower tax rates, the maximum rate of federal corporate income-tax in the USA was gradually reduced from 46 per cent in 1983 to 34 per cent presently. The maximum marginal rates of corporate income-tax in the USA are given in Table 2.11.

Table 2.11  
Rates of corporate income-tax in the USA

Year	Maximum statutory corporate income tax rate*	Effective federal corporate tax rate**	Total effective rate
1.	2.	3.	4.
1960	52.0	40.1	55.8
1961	52.0	38.9	54.4
1962	52.0	34.9	50.2
1963	52.0	34.7	49.4
1964	50.0	32.4	46.6
1965	48.0	31.8	45.4
1966	48.0	32.2	46.2
1967	48.0	30.2	45.5
1968	52.8	34.0	50.7
1969	52.8	34.3	54.6
1970	49.2	30.8	55.2
1971	48.0	29.4	52.8
1972	48.0	28.7	50.5
1973	48.0	31.5	54.9
1974	48.0	37.1	68.6
1975	48.0	28.3	56.1
1976	48.0	30.2	53.4
1977	48.0	29.4	52.5
1978	48.0	31.4	54.9
1979	46.0	31.7	54.5

contd. on next page.

Upto end-June 1987

(for 1979)

(for 1979)

1987 (from July  
onwards) 34.0@@

- \* The maximum statutory federal corporate income-tax rate was 52 percent since 1955.
- \*\* The effective federal corporate income-tax rate is substantially lower than the maximum statutory rate due to the graduated system of tax rates for different levels of income.
- @ Total effective tax rate includes, besides the federal corporate income-tax, the incidence of state and local corporate income-tax, state and local property tax and capital gains tax.
- @@ Exceeding \$1,00,000, tax determined is increased by 5% of such excess or \$11,750, whichever is less.

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Sources: 1. US Government Printing Office, Washington, 'Economic Recovery Tax Act', 1981.  
2. Feldstein, Martin (1983) : "Capital Taxation", Cambridge, Mass.: Harvard University Press.

Besides corporate income-tax, there are other taxes, such as capital gains tax, in the UK, which modify the corporate tax structure and enhance its burden. In the USA, these include accumulated earnings tax, personal holdings company tax, minimum tax, corporate gains tax and the taxes levied by the State and local authorities on income and property. The accumulated earnings tax is a special tax on those corporations which accumulate earnings beyond what is called the 'reasonable needs' of their business for meeting future contingencies. This was specified at \$2,50,000 per year. This tax was levied to compel corporations to utilize their higher earnings for the payment of dividends, unless

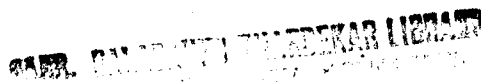
they have reasonable requirements for such accumulations. The personal holdings company tax is also charged. A personal holding company's principal function is the collection of interest, dividends and other passive income at the rate of 50 per cent. It is to ensure corporation's distribution of dividends to the shareholders. A minimum tax is levied if the items of tax preference exceeds \$10,000. Corporate capital gains are taxed at a flat rate of 28 per cent. It is significant that there are similarities in deductions allowed to corporations and individuals although their respective tax rate structures vary and the highest marginal tax rate for individuals was 70 per cent upto 1982 and 50 per cent in 1983. Interest is treated as cost and individuals as well as corporate taxpayers are entitled to deduct it from their taxable income like any other expenditure. But while individuals have a limited interest expense deduction facility, there is no limit for corporations. The impact of this provision is to reduce the corporate tax liability. But all the various corporate taxes, taken together, considerably raise the effective tax rates in the USA, as compared with the effective tax rates on the companies in India.

According to Feldstein, taking into account only four direct taxes, namely, the federal corporate tax, state and local corporate tax, state and local property tax and local property tax and capital gains tax paid by the corporations in the USA, the effective tax rates averaged 59.6 per cent

in the 'fifties (since 1953), 49.9 per cent in the 'sixties and 55.3 per cent in the 'seventies, which were higher than the effective tax rates in India, averaging 42.5 per cent, 47.7 per cent and 50.7 per cent in the corresponding periods.

#### MAIN INFERENCES:

In short, it may be stated that the general impression that the Indian corporate sector is overtaxed seems to be unfounded and the evidence is in fact to the contrary. The statutory corporate income-tax rates (including surcharge) averaged 52 per cent in the 'sixties, 57.5 per cent in the 'seventies and again 57.5 per cent in the first quinquennium of the 'eighties. It is noteworthy that the statutory rate has since been brought down to 52.5 per cent in 1985-86 and 50 per cent in 1986-87, but was again raised to 52.5 per cent in 1987-88 due to the need to mobilize additional resources for meeting the unprecedented drought situation. The rate is to remain the same in 1988-89. The government has assured that surcharge on corporate income is a temporary measure and will be withdrawn in 1989-90, which will again bring down the statutory tax rate to 50 per cent unless some other changes are introduced in the 1989-90 budget. As it has been seen, the effective tax rates work out to be much lower than the statutory rates as the companies can avail of a number of tax reliefs.



The rationalization of the tax structure in general and reduction in the corporate as well as personal income-tax in particular during the last few years is a sufficient proof of the recognition that a progressive tax structure may be theoretically laudable from the viewpoint of reducing disparities of income and wealth, but in actual practice, it may turn out to be counter-productive and discourage investment and productivity and lead to large-scale tax evasion and creation of a black money economy. The reform in the direct tax structure initiated in the 1985-86 Budget by reducing the rates of income-tax on corporate and personal income, to what was considered reasonable, was designed to promote better tax compliance and higher revenue realization. The Long-term Fiscal Policy of the Government of India posed two alternatives: (i) a further reduction in tax rates by 5 percentage points in the next year and withdrawal of surcharge and surtax in the third year, alongwith withdrawal of investment allowance in a phased manner; or (ii) retention of the investment allowance with no further cut in rates. The stability in taxation was, therefore, considered an important feature of rationalization of the tax structure. It was felt that "too frequent changes in tax structure are a source of uncertainty, which discourages tax compliance, creates difficulties for effective tax administration and takes its toll of economic growth". Steps were also taken to discourage tax evasion by removing weaknesses in the law

by incorporating certain provisions in the direct tax laws and enactment of the Direct Tax Laws (Amendment) Act, 1987. It was also noted that the tax reforms had started yielding dividends and the tax revenues had shown considerable buoyancy.

The paradox of the Indian corporate tax structure is that while the corporate income-tax was retained stable at 55 per cent over a long period to mobilize more revenues from the corporate sector, the very purpose of fixing a higher rate rendered counter-productive by a series of fiscal incentives and tax concessions operating side by side which enabled many efficient and profitable companies to reduce substantially their tax liability to a nominal amount or even zero. Instead, it would have been far more purposeful and practicable if a lower rate of corporate income-tax had been levied at 40-45 per cent, which would not only have created a favourable psychological impact on the investor but would also have simultaneously enabled the government to rationalize and reduce the number and quantum of incentives to a select few items like new investment, exports, backward area development, etc. In other words, it would have been better if the process of rationalization and reduction of corporate and personal income-tax rates commenced in 1985-86 had been carried further and extended to cover the system of fiscal incentives. Such a step would also have been compatible with the proposal of the Government of India that fiscal

incentives and tax concessions should not absorb more than 70 per cent of the profits and that the companies should pay tax on at least 30 per cent of their profits.

The numerous fiscal incentives have already brought the overall effective tax rates on the corporate sector in India to levels which are comparable or lower than those even in some advanced countries. Consequently, while the statutory tax rates in India appear to be on the high side, particularly upto 1984-85, the corporate sector in India is not overtaxed. There is, however, an urgent need for rationalization of corporate tax structure in India although statutory rate in India is not widely different from that proposed for the member countries of the European community which have been following divergent policies of corporate income-tax. It is notable that proposals for harmonizing corporation tax systems within the European Community have been pending, although these were agreed in principle long ago. As reported in the 'Financial Times', 'a proposal of member States to bring their corporation tax rates into a band of 45-55 per cent has remained under the consideration of the community for the last 13 years because of lack of support'. If the varying rates of surcharge levied during certain years are not taken into account, the corporate income-tax in India has moved within this band from 1957-58 onwards and was even less than 45 per cent upto 1956-57.

Finally, the responsiveness of revenues from corporate as well as personal income-tax to the partially rationalized system of direct taxes during the last three years has demonstrated that the nature of income-tax **should be only** moderately progressive and that its burden should not be so high as to virtually induce tax evasion. As noted earlier, it is, therefore, considered desirable to have lower statutory corporate income-tax rates combined with a few necessary fiscal reliefs so that effective tax rates, which are actually lower, should demonstratively also appear to be so.

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