CHAPTER VI

CONCLUSION AND SUGGESTIONS

CONCLUSION AND SUGGESTIONS

The large number and variety of provisions have been thus designed to facilitate and stimulate economic growth in conformity with national priorities and objectives. The tax incentives are the concessions provided for in 'Tax Statutes' with a view to attract the tax payers to pursue those courses of economic activity which are generally designed to result in promotion of economic growht and achievement of social justice and social objectives. Such tax incentives serve to attain various goals such as encouragement of specific types of business activities or occupations, stimulation of savings and investment, inducement to incure expenditure for the promotion and development of agriculture industries, exports, scientific research etc.

The tax system since the beginning of the Third plan in particular is heavily oriented towards the urban and industrial sectors of the economy and has neglected the rural and the agricultural sectors.

An examination of the corporate income tax structure suggests that there is ample justification for simplifying and reationalizing the overall structure in particular the acceleration of exemptions, incentives and allowances.

Tax incentives are intended not so much to promote the personal savings and investment of the tax payer as to symultaniously augment the productive capacity of industries, strengthen the agricultural base of the country, activate its external trade, encourage investment in scientific and technological research and, in many ways to facilitate the growth of the national economy. These incentives are selective tax concessions and we may call them positive tax incentives.

Of the incentives provided on a wide renging and massive scale to the industries the important ones are those designed to facilitate the inflow of capital, technical know-how and skills, foreign sources into sophisticated fields of industry, promote the establishment of new industries and the modernisation, expansion and diversification of existing units, particularly in the core or priority sectors, enable industry to make substantial contrbutions to scientific research to encourage establishment of the business in rural and backward area, development of agricultural fi eld etc. A number of tax incentives have been introduced in recent years with the object of facilitating development of rural areas, through the setting up of new industries in such areas or the disposal of existing ones to these areas, and in other ways including training of personnel in programmes of rural development, enlarging the scope of tax cerdit scheme for shifting of industrial undertaking from urban area etc., these incentives are positive in the sence that there is concession in the payment of tax or there is a tax holiday or rebate and other rebates and other such incentives.

The another group of tax incentives is in the form of the negative incentives of disincentives. Such disincentives may be levies and disallowances designed to mop up excessive profits in the corporate sector and unearned increments in personal wealth and discouraging wasteful expenditure in trade and industry.

Taxing Book Profits - New Concept. The proposed introduction of section 115-J into the Income Tax Act 1962. This provision, whcich seeks to tax book profits, will primarily hurt companies which have a good track record of growth.

A t present, most fast growth companies have fallen in line with the government's objective of expanding their industrial bases and buying new plant and machinery every year. As a result of the high amount of depreciation permitted to be deducted under the Income-tax Rules, 1962, which (even b efore the recent amendments) 30 per cent when an industrial unit worked a triple shift, the direct tax liability of a large number of such companies had been reduced to zero in the year in which heavy investment was made in plant and machinery.

Therefore, companies which have fallen in line with government policy and added substantially to their assets have not been liable to pay income ta x primarilly on account of the high rates of depreciation given by the government itself. At the same time, as permitted under section 205 of the Companies Act 1965, such companies have been providi-ng for depreciation on the straight line method and therby showing a book profit while for tax purposes, the permitted depreciation has converted book profits into losses.

The only effect of the new amendment will be that dynamic fast growth companies will not be induced to invest heavily in plant and machinery, as the minimum tax on book profits will lengthen the period for repayment of loans to financial institutions and will also make it difficult for such companies to raise funds from the public, as their dividend payment will be adversely affected.

In other words, if such companies were to write off depreciation in the account books by adopting the tax method, no disposable surplus would be available for distri-bution to shareholders. On the other hand, if the straight line method of depreciation is adopt ed, tax would have to be paid on 15 per cent of book profits, regardless of the amount of depreciation available under the Income-tax Law.

Basically, the tax incentives have been provided in the form of writing of expenses allowances in respect of capital expenditure of different categories in industry, special deduction in respect of profits of new industries or priority industries or industries set up in backward areas or in respect of certain categories of income, subject to certain limits and conditions, selevtive tax credits intended resources for industrial development and weighted deductions for certain categories of expenditure which are essential but involve heavy costs and bring benifits only in the long term or otherwise need to be supported by additional tax savings or for contributions to organised institutions to be employed on research projects and programmes, rural development programmes and the like. The positive tax incentives make significant contribution in a particular field for example the resources may be diverted to establish new industries in the rural area, the investment may be made to acquire and instal new ships and plants the funds may be employed for research and development, the capital may be employed in the priority sector, the business may be further straighten etc.

At the same time there are provisions designed to check to use to scarce resources in non-priority uses, by denying these incentives to such industries.

But to be trully effective these incentive must be well conceived, sufficiently attractive, reasonably inducing easily workable and not liable to wide spread abuse. While some of the incentives fulfil these requirements, there are few which do not. It means tax incentives have also their own limitations and not so desirable side effects.

There are three types of limitations which the statutory provisions in this regard suffer from. These limitations are-

1) Tax incentives which are well intentioned but ill conceived in that they provide relief in an area where the exemption provided can not yield adequate profits,

2) Multipal incentives which concurrently operate in the same field and render the intended benifit in effective.

3) Incentive which offer a time can become counter productive and lead to prodigality in the use of scarce resources.

The first limitation is that a tax incentive is meaningful only if, to the extent that there would be a tax liability. In other words there has to be profits sufficient to attract tax before the incentives step in to relieve that tax wholly or partially and allow the amount to remain with the enterprises. The tax incentive does not by itself create profits, it can only help to conserve, within the enterprise, the profits generated by the factors of production. The profits so remained with the business can be used for its's future expansion and diversification or the profits may be used for even distribution to the owners. The tax incentive in the form of the development rebate and investment allowance retains the profits in the business for expansion and diversification. However the benefit of the development rebate or investment allowance can be taken only if the business has made sufficient profits during the stipulated period. In absence of profits, the benefit of the development rebate and investment allowance can be taken, thus if the enterprise does not produce due to the operational factors such as, high process of inputs low prices realised for the products, high overheads, labour unrest leading to interruption or slowing down of production, Governments policies, managerial inefficiency etc., then the tax incentives become indffective. This brings out the vital fact that a tax incentive can operate effectively only where the other conditions are favourable for profitable operation, not otherwise.

An example of a tax incentive well intentioned but ill conceived and ineffective was provided by section 80H

introduced by the Income-tax Act in 1967 with the laudable object of inducing industrial units to employ displaced persons from East Pakistan and repatriates from countries as Burma, Ceylon etc. The tax concession consisted in the exemption from tax of 50 per cent of the profits of such enterprises upto a maximum exemption of Rs. One Lakh per year for a period of ten years. Advocates of this concession did not realise that, with a labour force, made up predominantly of such persons who were either peasants and landless agricultural labourers or petty traders and the like, possessing hardly any industrual skills, no industrial unit would be able to function profitably. Events showed that this was indeed the case. The provision was accordingly deleted in 1975.

The next limitation is multiple incentives which concurrently operate in the same field and render the intended benefit ineffective. This can be illustrated by considering the impact of depreciation and development rebate/investment allowance on the tax holiday deduction under section 80J in case of a new incustrial undertaking. The tax holiday operates with reference to the profits that remains after the deduction allowances and development rebate/investment allowance which are, in themselves, quite substantial. Many industrial units found that, after availing of the depreciation allowance and development rebate/

c9

investment allowance there was precious little profit left, in the initial years of the enterprise, to reap the tax holiday benefit, thus in theory the tax holiday benefit, available upto 6 per cent (7.5%) per annum on the capital employed for a total profit of 5 years qualifying for freedom from tax, many units could not earn that much pr-ofits even over the period of 8 years since the commencement of production. The introduction of section 80HH, followed by section 80HHA, with the objectives of inducing industri-alization of backward area is bound to reduce the effectiveness of the tax holiday benefit still further.

Thus there seems to be an anomaly in some provisions provided under section 80HH/80HHA and 80J. This is discussed here-

a) Under section 80HH/80HHA, 20 per cent of the profits of the new unit set up in a backward area or rural area will be exempt from tax.

b) Under section 80J there is a tax holiday for new business unit at the rate of 6 per cent (7.5%) of the capital employed for 5 initial years. We give below four hypothetical cases -

Units	A	B	C	D
80J benefit	50,000	50,000	50,000	50,000
Profits		20,000	50,000	1,00,000
Benefit under section 80HH/80HHA	-	4,000	10,000	20,000
Profit available for				
80J benefit	-	16,000	40,000	80,000
80J benefit enjoyed Now.	-	16,000	40,000	50,000
Taxable profit	-	-	-	30,000
Deficiency under section 80J(3) is	50,000	30,000		-
Total benefit under sec. 80HH/80HHA & 80J	50,00	30,000	50,000	70,000
Tax benefit lost for want of profit.	-	40,000	10,000	-

It is clear that in the case of 'A', 'B' and 'C' units, the overall benefit under section 80HH/80HHA and 80J is equal to 80J benefit and in case of 'D' benefit to the extent of Rs. 70,000/- is available. It may be logical to say that because (D) has obtained more profits it is exposed to heavier tax burden and hence the benefit is more. Applying the same logic perhaps it would be difficult to reconcile the position with reference to A, B, and C which have no parity in the profit pattern but stand on the same platform as regards the total tax benefit.

The most serious side effect of tax incentive is that it leads to prodigality in the use of scarce resources. This effect should be studied from the point of view of the economy and the country as whole. As an incentive once introduced in the law is not, generally subject to **frequent** review not only as to its's effectiveness but also to the need for its continuance. The point may be illustrated with reference to the development rebate, which was first granted in 1955 and further made attractive in the following decade. As the allowance was based on the cost of new machinery and plant istalled for the purpose of production, it encouraged business houses to go in for more and more machinery and technology based on it, without any thought being given to the other aspects. For example whether such technology beyond a point, did not become counter-productive and even in appropriate for a country like India with it's vast reserve human labour remaining unemployed. It was only when Mr. Bhoothalingam pointed out this aspect of the development rebate in his Report on Simplification and Rationalisation of the Tax structure, that the Government woke up to the problem and notified the withdrawal of the concession from the middle of 1974. Later following the example of the other countries, the investment allowance was introduced with effect from 1.4.1976, this is only the development rebate in a new grab with some added limitation and refinements. The denial of the investment allowance to industries producing the so called non priority products, except in the " small scale sector" no doubt mitigates the evil to some extent.

The Government is anxious that more attention be paid to the development of backward areas because this is the only way regional imbalances can be corrected.

It is suggested that the block should be the unit for giving backward areas, incentives. Instead of the non-industry district, it is proposed to have non-industry blocks.

Though Govt. emphasis for develop backward areas has been there for many years, no significant results have been achieved.

The distance criterion of 100 Km. from urban centers for identifying backward area and for entitlement to central incentives for backward area is unrealistic. As a result of such a criterion backward areas close to urban centres may be deprived of incentives needed for industrili-sation. It is suggested that the distance criteria of fixing backward area should be changed.

It is also suggested that the setting up of growth centres is very essential for backward areas development. The necessary in frastructural facilities are to be established in such growth centres, so that industries would be attracted to invest in these area. At present, despite the existence of incentives industries are reluctant to enter into backward areas because of the absence of infrastructral facilities.

Proliferation of incentives for various purposes in the tax law leads to an increase in tax letigation. When once the legislation has been brought on the statute Book, every one starts bisecting, dissecting, analysing and interpreting every sentence and every word of the law with a view to discovering hidden meanings loop holes; so that they can derive the maximum advantage out of the provision regardless of whether such advantage was originally intended or not. The administration reacts against such attempts by swinging to the other extreme and trying to deny even what is legitimately due to the tax-payer and if necessary, back it up with further legislation. With a view to providing further incentives for savings, it is suggested that to amend section 80 CC to increase the deduction to 100% and the maximum amount which will qualify for such deduction is being enhanced to Rs. 30,000/-. As a social security measure, it is also suggested to extend the scope of section 80 CC to the deferred annuity plans of the Life Insurance Corporation as prescribed by the Central Government. However, the overall limit of investment for bothe deductions has been fixed at Rs. 30,000/- Provisions in regard to the incentives which are related to the industrial growth should ~~to~~ be simplified. Ceiling limit of some incentives should be removed.

There is no uniformity in giving these tax concessions. Some of the incentives are given to only the carporate sector, while the non corporate sector is denied the benefit of the same. Again some of the provision granting the incentives are couched in such language and are interpre ted in such a manner by the revenue. That in some case which is supposed to have been given by way of incentive by one hand is taken away by other hand. There also conflicting views about the interpre tation of some of the provisions relating to tax incentives and several technical problems have arisen as a result of this conflict of views.