SOME ASPECTS OF TAXATION AND ECONOMIC PLANNING

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The problem of employing the instrument of taxation to achieve goals and objectives by any state is a delicate one. No new levy howsoever mild is ever likely to be welcomed by the tax-payer. It may not be an exaggeration to say that no other event is dreaded more by the tax-payer and, to a considerable extent, by even the Finance Minister, than the occasion of the Budget speech.

For a government the politico-economic repurcussions of a new tax can indeed be crucial for its continuing to remain in office. It is not surprising that several under-develope states entered the "Space Age" without ever daring to introduce an income-tax. Thus the first personal income-tax law in Gautemala's history came into force on July 1, 1963.[1]

With low per capita incomes and consequently poor national savings, the capacity of the government of any underdeveloped state to raise revenue must *ex-hypothesi* be limited. In search of more money the State no doubt taxes more those who are affluent and, as a consequence, it is the industry which has usually to bear the brunt of taxation. No less a person than an Indian Finance Minister pointed out that about half direct taxes come from taxes on corporation.[2] The pursuit of such a policy is always fraught with the danger that such capital resources as may usefully be employed in productive investments may very easily be siphoned off. In taxing the industry the State must strike a balance between the needs of the industry and its own requirements. In India there has been a tendency, from time to time, to ignore this salutary principle. The taxes introduced in 1946-47 provide a striking example of this tendency.

The policy of economic development which has almost become the *raison d'etre* of the contemporary underdeveloped state, can best be achieved by allowing greater degree of participation to the foreign enterprise in

1. See Decree No. 1559 of November 24, 1962. See also 69 *International Commerce*, No. 31, 26, August 5, 1963.

2. The Budget speech for 1956—57. This fact notwithstanding, the Finance Minister felt "in view of the large development expenditure that has taken place in the First Plan period and the even larger expenditure contemplated in the next plan, I think there is adequate justification for putting a small extra-burden on companies." XXIX I.T.R. 40 (1956).

the developmental schemes and projects. To the doubtful Thomases one can only refer to the many resolutions passed and studies undertaken by the United Nations.[3] One factor, apart from political instability and inconvertibility of earnings, which certainly scares the foreign capitalist is the complex and heavy burden of tax. The purpose of this paper is to present some aspects of the tax-incentives which are extended to foreign capitalist is the complex and heavy burden of tax. The purpose of this paper is to present some aspects of the tax-incentives which are extended to foreign investors in India. At the outset, therefore, attention is invited to certain constitutional aspects of taxation, in particular, to the power of the State to use taxation as an instrument for ushering in economic reforms, followed by a reference o a new examples where the tax has been imposed for attaining social goals. Lastly, tax-incentives made available to foreign investors with a view to make investment in India more attractive, have been examined. Here the present writer had to exercise selfrstraint and only a brief reference has been made to some selected aspects of tax-incentives:

I. Constitutional Aspects of Taxing Power

Indian Judiciary's attitude has been an important factor in the use of taxation as a means of achieving social objectives in India. It is no doubt, well-settled that no tax can be levied without the authority of law and that such a law must not violate the fundamenal rights guaranteed under the Indian Constitution.[4] Article 14 of the Constitution which guaranteed to every person equality before the law and the equal protection of laws, therefore, presents a formidable obstacle to the exercise of the taxing power by the State. The reason is that the tax must always carry germs to inequality in as much as it may be applicable only to a certain class or classes of persons, incomes, property, transactions etc. The Supreme Court, therefore, has held that although a taxing statute cannot infringe the provisions of article 14,[5] it has time and again maintained that the power of State to classify persons or objects for purposes of taxation is very wide. It does not of course, follow that the Court will ignore the principles developed for the interpretation of article 14. According to Subba Rao, J., (as he then was).

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3. See for example, General Assembly Resolutions 622-c (VIIO of Decembei 21, 1952, 724-c (VIII) of December 12, 1953; Economic and Social Council Resolutions, 294 (XI) of August 12,1950; 368 (XIII) of August 22, 1951; 512-B (XVI) of April 30, 1954; 762 (XXIX) of April 21, 1960; 780 (XXX) of August 3, 1960; 836 (XXXII) of August 3, 1961.

4. *C. J. Patel & Co.* v. *Union of India,* A.I.R. 1962 S.C. 1006; *K. M. Nair* v. *State of Kerala,* A.I.R. 1961 S.C. 552; *Purshottam* v. *Desai,* A.I.R. 1956 S.C. 20.

5. See *State of Bombay* v. *United Motors* 1953 S.C.R. 1069.

> From the aforesaid statement of the principles it is clear that the fundamental principle of classification is the same whether it relates to tax laws or other laws, but the approach is slightly different and greater latitude is given to a state if the classification is made to adjust the burden on a fair and reasonable degree of equality.[6]

A few examples of the application of this policy will be instructive. Thus the following classifications have been held as not to violate article 14. Progressive graduation of income-tax according to varying salary-slabs; fixation of a minimum limit of income for taxation,[8] different rates of taxation for residents of different parts of a state,[9] distinction between private buildings and buildings owned by the government;[10] geographical classification based on historical reasons;[11] distinction between tea and rubber plantations;[12] distinction between different qualities of the same commodity;[13] different costs of maintenance and construction of roads;[14] poshness of the locality, customers and greater seating capacity of cinemas[15] and quantum of escaped income.[16]

It can easily be seen that although a law imposing a tax to satisfy principles for legislative classification as laid down by the Supreme Court,[17] it has not been an easy matter to prove infringement of article 14 by such laws. Most of the limited number of cases in which article 14 could be invoked successfully related to the somewhat ill-fated Income Tax Investigation Commission of Mr. Liquat Ali Khan.[18] The position is not very different in the actual administration of taxation where even considera-

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6. *G. B. Choudhry* v. *State of Andhra Pradesh*, 9 S.T.C. 107. See also his Lordship's observations in *K. S. Bhat* v. *Agricultural Income-tax Officer, Kasargod*, A.I.R. 1963 S.C. 591, at 594.

7. *Sukhlal* v. *A. C. Jain*, *A.I.R.* 1958 Cal. 669.

8. *State of Bombay* v. *United Motors Ltd.*, *Supra* note 5.

9. *Ramjilal* v. *I.T.O.*, A.I.R. 1951 S.C. 97.

10. *Shyamlal Mandal* v. *Municipal Bd.*, A.I.R. 1951 Assam 126.

11. *Bhaiyalal Shukla* v. *State of Madhya Pradesh*, *A.I.R.* 1962 S.C. 981.

12. *Travancore Rubber and Teak Ltd.*, v. *State of Kerala*, A.I.R. 1964 S.C. 572.

13. *E. J. Tobacco Co.* v. *State of Andhra Pradesh;* (1962) 2 S.C.A. 691.

14. *Sainik Motors* v. *The State of Rajasthan* (1963) 1 S.C.J. 292.

15. *Western India Theatres Ltd.* v. *Municipal Corporation*, A.I.R. 1959 S.C. 586.

16. *M/s. K. S. Rashid* v. *Income-tax Officer*, (1964) 1 I.I.T.J. 73; A.I.R. 1964 S.C. 1190.

17. See M. P. Jain, *Indian Constitution Law*, (1962) 375.

18. Set-up under the Taxation of Income (Investigation Commission) Act, 1947. See *Suraj Mall* v. *Viswanath*, A.I.R. 1955 S.C. 13, *M. C. J. Muthia* v. *The Commissioner of Income Tax*, (1955) 2 S.C.R. 1247.

tions of "administrative convenience" have been regarded a valid basis for classifications.[19]

The granting of tax exemptions or rebates are likewise subject to article 14. Thus in *K. T. Moopil Nair's* case[20] the Supreme Court declared unconstitutional exemptions allowed under the Kerala Land Tax Act as the same were arbitrary inasmuch as the impugned legislation disclosed no policy for guidance in granting the exemption. But a classification based on different types of machinery for purposes of rebate is valid.[21]

While discussing the constitutional power of the State to impose tax, one aspect must be borne in mind. It is the almost complete protection that such laws enjoy from attack under article 31. Article 31(5)(b)(ii) of the Constitution saves the said laws from the challenge under article 31(2). An attempt to bring the taxing Statutes under article 31(1) did not succeed. The Supreme Court held.[22]

> If collection of taxes amounts to deprivation of property within the meaning of Article 31(1) then there was no point in making a separate provision again as has been made in Article 265. It therefore follows that clause (1) of Article 31 must be regarded as concerned with deprivation of property otherwise than by the imposition or collection of tax, for otherwise Article 265 becomes wholly redundant.[22]

In some pronouncements the judiciary went further by holding that the validity of laws imposing taxation could not be examined under article 19. Indeed the judgment of Venkatarama Ayyar J., in *Anantha Krishna v. State of Madras*[23] lent support to the view that Part III of the Constitution could not control article 265. In *Murlidhar Jalan* v. *Income-Tax Officer, Dibrugarh*[24] he constitutionality of section 46(5A) of the Income-Tax Act was challenged on the ground that it conferred power on the Income-Tax Officer to issue notices to the debtors of the assessee directing them not to pay the amount of debt to the assessee, but to pay the same towards the liquidation of the amount of settlement. It was contended that the debt due to the assessee was his property and that the impugned section offended article 19(1)(f) as it affected the right of the assessee to hold and dispose of property. The impugned section therefore could not be regarded as a reasonable restriction under article 19(5). The Assam High Court rejected this contention. The decision shows the confusion that very often arises as a result of trying to find the "police

19. *Pannalal Binraj* v. *Union of India*, A.I.R. 1957 S.C. 397.

20. *Moopil Nair* v. *State of Kerala*, A.I.R. 1961 S.C. 552.

21. *Southern Roadways* v. *The Union*, (1962) 2 S.C.J. 310.

22. *Ramji Lal* v. *Income-Tax Officer*, A.I.R. 1951 S.C. 97; 19 I.T.R. (1951) 17 at 181.

power" and "eminent domain" under the Indian Constitution. tI was held that the taxing power of the State is different from the "police power" and the "eminent domain" and inasmuch as provisions from article 19 clause 2 to clause 6 contained police power the validity of the impugned provision could not be examined thereunder. Thus where

> the State has acted in the exercise of its taxing power, the limitations imposed on the exercise of police powers under article 19 cannot be placed on the exercise of the taxing power of the State.[25]

It is submitted that to hold that taxation is merely concerned with the raising of the revenue and that it may never be used for regulatory purposes is to ignore the realities and deprive the State of an effective instrument for attaining the community objectives. The Supreme Court has put the matter in its right perspective in *Moopil Nair's* case. In that case land tax amounting to Rs. 51,000 per year was imposed on petitioner's forests under the Travancore-Cochin Land Tax Act, 1955 as amended by the Travancore-Cochin Land Tax, (Amendment) Act, 1957, when petitioner's income from forests was only Rs. 3,100 per year. The Supreme Court struck down the tax as confiscatory. It is interesting to note that for the decision in that case it was not necessary to examine the validity of the impugned legislation under article 19(1)(f) inasmuch as the entire legislation, due to the inapplicability of the doctrine of severability, had become void under article 14. That Sinha C.J., did not stop at that point but went on to hold that the validity of a law imposing a tax be examined under article 19, demonstrates the Court's keenness to set at rest all doubts relating to the supremacy of article 19 over article 265.

One other aspect of the Court's decision in *Moopil Nair's* case also merits attention. It may not be without significance that the majority of the Supreme Court remained silent as regards the applicability of article 31(1) to a taxing statute and did not reiterate the Court's observations in *Ramjilal* v. *Income-tax Officer*.[26]. In that case it was held that

> Clause (1) of Art. 31 must be regarded as concerned with deprivation of property otherwise than by the imposition or collection of tax, for otherwise Art. 265 becomes wholly redundant.[27]

From the foregoing survey of the case-law it will appear that it has not been a simple matter to successfully challenge the validity of a taxing

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23. A.I.R. 1952 Mad. 395 at 405.
24. 41 I.T.R. (1961) 80.
25. Per Mehrotra J., *Id.* at 100.
26. A.I.R. 1951 S.C. 97.
27. *Id.* at 100.

statute under article 14, and it is too early to assess the impact of *Moopil Nair's* case on the taxing power of the State. It is however clear that circumstances in that case were indeed exceptional and only rarely is one likely to be faced with the problem where the quantum of tax on property exceeds the income accruing therefrom. Thus as long as the tax is not confiscatory, it will appear that the government can use this instrument for achieving the social objectives.

Two questions may be posed at this stage: Is there any prohibition, express or implied in our Constitution against the use of taxing power for purposes other than the raising of revenue? Has the State ever raised a tax for attaining any social goal?

It is submitted that the Indian Constitution does not prohibit the levying of tax for purposes other than the raising of revenue. The motive of the legislature for imposing the tax is an irrelevant issue which may be clearly regulatory or otherwise as long as the legislature is vested with the power to regulate the subject as well as to impose a tax upon it. The position is different where the exercise of taxing power is manifestly colourable as where the legislature has no power to regulate a subject and the tax is employed as a cloak to regulate that subject; such a tax will be bad.[28]

II. Taxation and Social Goals

As rgards the second question it may be mentioned that on a number of occasions close nexus has existed between the imposition of taxes or exemptions in respect thereof and the attainment of social objectives. Some idea of the social policy underlying taxation of an independent India, was conveyed by Mr. Liaquat Ali Khan in these words:

> India is a land of glaring contrasts and disparities; we have here on the one hand a class of multi-millionaires rolling in wealth and holding the economy of the count y in their grip by exploiting for their own profit the labour of the poorer classes and on the other hand the vast multitudes who eke out, somehow or other, a miserable existence precariously near the starvation line. The conditions created by the last war served to accentuate these disparities: the rich became richer and the poor poorer. This meant the concentration of wealth in fewer and fewer hands and, inevitably, the use of that wealth for the purpose of tightening the stranglehold of Big Money over the economic life of the country os a whole as a acquisition of business, companies, public utilities, and the press. A set of conditions in which the few are able to wield such vast power over the many can hardly be regarded as anything but a negation of the principles of social justice. And although I am not one of those

29. *R.M.D.C.* v. *State of Mysore,* A.I.R. 1962 S.C. 594 at 600.

> who consider the abolition of private property and the complete equalization of incomes as the only remedy for these ills, I do believe in the Quarantic injunction that wealth should not be allowed to circulate only among the wealthy, and the stern warning given against accumulations of wealth in the hands of individuals. It is against this background that my budget proposals have been formulated, although I am afraid I cannot claim that they represent anything more than the first stage of a policy of social justice and development which it will require years to bring to full fruition.[29]

Further attention may be drawn to the Dividend Tax of 1945-46 which was imposed to discourage the dissipation of a Company's resources in excessive dividends. The idea was that a company should be penalized if it distributed roughly more than one half of its profits left after taxation.

The government's disapproval of the private enterprise carrying on the business of life insurance became evident from its tax policy of as early as 1951. Thus the government accepted the suggestion of the Income-tax Investigation Commission that the rebate of super-tax given to Life Insurance Companies was not justified in respect of that portion of profits of business which went to the pockets of the shareholders.[30] Exemptions have been granted to prevent concentration of business activity in the hands of big business.

To achieve this purpose income-tax on companies with an income of Rs. 25,000 and below was reduced to half the usual rates in 1948.

That the tax-structure was being geared to meet the requirements of a socialist State becomes clear from the budget speeches of Finance Minister after 1956. In this connection the Statement of Objects and Reasons of the Wealth Tax Bill of 1957 is significant:

> The object of this Bill is to impose an annual tax on the net wealth of individuals, Hindu undivided families and companies. The proposed tax is an important constituent of an integrated tax structure which government have been aiming at for some time. With income-tax, estate duty and a tax on capital gains already in existence and with the addition of the wealth-tax and a tax on large personal expenditures..... the direct taxes will form a composite system made up of complementary elements. Apart from the fact that a composite tax system of this type helps to satisfy the criterion of the ability to pay, it is consistent with the avowed goal of the attainment of a socialist pattern of society.

Thus a novel tax came into being which is not to be found even in the leading countries of the world such as the U.S.A., Canada, U.K. and Australia. In order to make the integrated system more integrated a new

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29. 15 I.T.R. 7.

30. See in this connection Section 4, Finance Act 1951, Act No. XXIII of 1951.

tax on gifts made by individuals, companies, firms and associations of persons was imposed.

III. The Tax System

Before examining some of the tax incentives granted to the corporate sector, a brief reference may be made to the rate of taxation in India.

The taxation of companies has been greatly simplified by the Finance Act of 1965.[31] In the earlier years the system — if at all it could be described as one — was indeed incomprehensible. The final effective rate of tax was arrived at by calculating at first, the amount of rebates at specified percentages for various items of incomes, varying with different classes of companies; reducing the amount of rebate so calculated by the amount of tax chargeable on the company with reference to the amount of its bonus issued or distributions of dividends to its equity shareholders during the relevant year; and, thereafter, deducting the balance of the rebate, if any, from the tax of 80 per cent.

The baffling complexity of the tax rate structure could hardly inspire any enthusiasm in the foreign investor for investing capital in productive investments in this country. The recognition of this fact, even though coming so late, is nevertheless to be welcomed as a major step in promoting the object of increased foreign capital participation in our economic development.

An important step taken is the merger of the super-tax with the income-tax. Thus the taxation now takes the following form for the year 1966-67.

A foreign corporation is not automatically regarded as a company for purposes of taxation in India. For being assessed as a company, a foreign corporation has to get a declaration from the Central Board of Revenue, unless it was assessed as a company for the assessment year 1947-48. Where a declaration for being treated as a 'company' has been obtained, it is taxed at the rates prescribed in the Income-tax Act, 1961 as amended by the Finance Act, 1966. Such company becomes a non-resident even where its control and management is even partly situated outside India. Foreign corporations which have not obtained the declaration mentioned above are assessed as "association of persons" and are considered as "resident" if their control and management is wholly or partly situated in India.

An Indian branch of a foreign company is not a separate taxable

31. See in this connection "Explanatory Memorandum to the Finance Bill, 1965," Vol. 5, 1 I.T.J., 115.

entity and it is the foreign company which is treated as the assessee. However, the maintenance of an Indan branch constitutes a "business connection" and tax will become payable on the income which can reasonably be attributed to the operations carried on in India.

There is no difference in the rates of incom-tax applicable to resident and non-resident companies. Taxes are lower in case of companies which make arrangements for declaration and payment of dividends in India.

The rates of income-tax in the case of companies for the assessment year 1966-67 in respect of income other than capital gains and inter-corporate dividends are as follows:

1. Domestic companies (i.e., Indian companies or foreign companies which have made the prescribed arrangements for the declaration and payment of dividends within India) in which the public are substantially interested (including a wholly owned subsidiary of such a company);

   (1) in a case where the total income does not exceed Rs. 25,000 45 per cent of the total income;

   (2) in a case where the total income exceeds Rs. 25,000 55 per cent of the total income

2. Domestic companies in which the public are not substantially interested:

   (1) In a case where the company is an 'industrial company' (i.e. 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).

      (i) on the first Rs. 10 lakhs of the total income 55 per cent;

      (ii) on the balance of the total income 65 per cent.

   (2) In the case of a company other than an 'industrial company' referred to above 65 per cent of the total income.

3. Foreign companies which have not made the prescribed arrangements for the declaration and payment of dividends within India:

   (1) on income consisting of royalties and technical service fees received from an Indian concern under agreements entered into, respectively, after 31st March, 1961 and 29th February, 1964,

where such agreements have been approved by the Central Government 50 per cent.

(2) on any other income included in the total income 70 per cent.

It will be noted that the above-mentioned rates of income-tax on income other than the royalties and technical service fees referred to in Item 3(1) above are, in each case, higher than the effective rates of income-tax under the Finance Act of 1956, by 5 per cent of the income except that in the case of domestic companies in which the public are substantially interested and whose total income does not exceed Rs. 25,000, the increase is to the extent of 2.5 per cent only. No increase has been made in the rate of income-tax applicable in the case of foreign companies to their income consisting of royalties and technical service fees received from Indian concerns under agreements entered into after specified dates and approved by the Central Government.

Domestic companies, (other than those which are required to make a compulsory distribution of dividends upto the statutory percentage of their distributable income under section 104 of the Income-tax Act) are chargeable to an additional tax with reference to the amount of dividends declared by them during the previous year on their equity share capital. Such tax is calculated with reference only to that part of the equity dividends which exceeds 10 per cent of the paid-up equity capital of the company as on the first day of the previous year. This tax is restricted to an amount calculated with reference only to so much of the excess dividends as does not exceed the amount of the total income of the company. For example, if the total income of the company for the assessment year 1966-67 is Rs. 8 lakhs, and it has declared or distributed dividends to its equity shareholders during the previous year of an amount of (Rs. 15 lakhs minus 10 per cent of Rs. 60 lakhs) but, as the company's total income is only Rs. 8 lakhs the tax will be restricted to the amount calculated only on an amount of Rs. 8 lakhs.

IV. Tax Incentives

A. Tax holiday to new industrial undertakings.
B. Development Rebate.
C. Development Allowances.
D. Tax-free interest on loans.
E. Concessional rates on intercorporate dividends.
F. Tax credit certificates.
G. Depreciation.[32]

32. Sec. 32, Indian Income-tax Act, 1961 as amended by Finance Act, 1966.

H. Expenditure on scientific Research[33]
I. Set off and carry forward of losses[34]
J. Concessions to foreign technicians.[35]
K. Exemptions to employees temporarily in India serving a foreign enterprise[36]
L. Leave Passages.[37]
M. Concessional tax on royalties received by a company.[38]

Due to the limited scope of this paper only the first six incentives have been discussed below while relevant references have been given for the remaining ones.

Tax-holiday to New Industrial Undertakings

New industrial enterprises and hotels are not required to pay income-tax on their income-tax on their income upto six per cent per annum on the capital employed in the enterprise or hotel.[39] This benefit is available from the accounting year in which the undertaking goes into production up to four succeeding years.[40] As regards hotels the exemption will apply to the assessment for the financial year next following the previous year in which the hotel starts functioning and for the four assessments immediately succeeding.[41]

Following conditions must be satisfied before an enterprise can claim the tax-holiday;

(a) The enterprise must be new i.e., it should not have been formed

33. *Id.* Sec. 35.

34. *Id.* Sec. 70—79. See also M. S. Srinivasan, "Carry-Forward Loss of Companies (A Critique of Section 79 of the Income-tax Act, 1961)," Vol. 5, 1 I.T.J. 51 (1965).

35. Sec. 10(6) (vii), Indian Income-tax Act, 1961 as amended by Finance Act, 1966.

36. *Id.* Sec. 10(6) (vi).

37. *Id.* Sec. 10(6) (i).

38. See in this connection II B supra. Under Finance Act (No. 2) Act, 1962, whereas the tax on royalties was at the rate of 50 per cent, other income was taxed at the rate of 50 per cent, other income was taxed at the rate of 63 per cent. The latter percentage was raised in 1964. See V. B. Harbhakti, "Incidence of Tax on Non-Resident Companies. Under the Income-tax Act, 1961) as amended by the Finance Act, 1964)", Vol. 3, 1 I.T.J. 129, at 133 (1964). Now it has been raised to the expropiatory limit of 70 per cent.

39. Sec. 84 (1), Indian Income-tax Act, 1961 as amended by Finance Act, 1966.

40. *Id.* Sec. 84(7).

41. *Id.* Sec. 84(8).

by the splitting up, or the reconstruction of a business already in existence; or by the transfer to a new business of a building, machinery or plant previously used for any purpose. The latter restriction, however, is not absolute. The use of such building, machinery and plant up to 20 per cent of the value of these assets is permitted and the value of the building, machinery or plant so transferred is not taken into account in computing the capital employed in the industrial undertaking or hotel for purposes of the exemption.

(b) The enterprise has already produced or begins production up to April 1, 1971 or such further period as may be specified by the Central Government in respect of a particular enterprise.

(c) It must employ ten or more workers in a manufacturing process carried on with the aid of power and twenty or more workers in a manufacturing process carried on without the aid of power.

The hotel in respect of which the exemption is claimed must be owned and run by a company registered in India with a paid up capital of at least Rs. 500,000 and is run in premises owned by the company. Further, the hotel must have been functioning since April 1961 or after this date. The exemption will be available only in respect of hotels approved for this purpose by the Central Government and it appears that the number and types of guest rooms and other amenities may also be prescribed. It is, however, not clear whether the Central or the State Government have the power to do so.

B. *Development Rebate*

In addition to the depreciation allowances the Income-tax Act also provides for development rebate in the following manner:

(a) New Machinery: The rebate is allowed only on such machinery or plant which has been installed after 31.3.1954.

(i) 25 per cent of the cost of the new machinery and plant where it was installed between 1.4.1954 and 1.4.1961.

(ii) 35 per cent if installed between 1.4.1963 to 31.3.1965, both days inclusive, for purposes of business of mining coal.

(iii) 20 per cent if installed between 1.4.1961 and 31.3.1965 for purposes of any other business.

(iv) When the machinery or plant is installed after 31.3.1965 for the purpose of business of construction, manufacture or production of any one or more of the articles or things specified in the fifth schedule.

(a) 35 per cent of the actual cost of machinery or plant to the assessee, when it is installed before 1.4.1970.

(b) 25 per cent of such cost where it is installed after 31.3.1970. Where the machinery or plant is installed after 31.3.1965 in other businesses.

(a) 25 per cent of the actual cost where it is installed before 1.4.1970.

(b) 15 per cent of the cost where it is installed after 31.3.1970. Detailed provisions have also been made in respect of acquisition of ships and machinery or plant which was used outside India.[42]

The development rebate can be claimed from the profit arising in the year of installation or acquisition. It is available only where the prescribed particulars have been furnished.[43] For claiming the development rebate an amount equal to seventy-five per cent of the development rebate to be actually allowed is debited to the profit and loss account of the relevant year and credited to a reserve account to be utilized by the tax-payer during the period of eight succeeding years for purposes of the business of the undertakingss. The amount is not to be used for distributing dividends or profits or for outward remittance of profits or creating assets outside India[44] If the assets on which the development rebate is allowed are sold or transferred, except in connection with amalgamation or succession referred to below, within succeeding 8 years to any person other than government, governmental corporation or company or local authority the tax on the development rebate can be recovered.[44] The plant or machinery should be used wholly for the tax-payer's business.[46]

Where a company is amalgamated in the manner discussed below, or a partnership firm converted into a limited liability company[47] and the machinery and plant on which development rebate is transferred to the

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42. *Id.* Sec. 33 (I-A)b.

43. *Id.* Sec. 34 (1).

44. Except in case of a company being a licensee under the Electricity (Supply) Act, 1948 or when the machinery or plant was installed before January 1, 1958.

45. Ss. 34(3)(b) and 155, Indian Income-tax Act, 1961 as amended by Finance Act, 1966.

46. *Id.* Sec. 33 (I-A)(b)(iv).

47. The conditions are: (a) All the property and liability of the firm immediately before the succession should become the property and liability of the company and (b) all the shareholders o fthe company were the partners of the firm immediately before the succession.

successor, the development rebate already allowed will not withdrawn and the unabsorbed development rebate will be available to successor[48]

"Amalgamation" is defined to mean the merger of two or more companies to form one company in such a manner that;

(i) all the property and liabilities of the amalgamating companies immediately before the amalgamation becomes the property and liabilities of the amalgamated companies; and

(ii) Shareholders holding atleast 90 per cent of the share capital of the amalgamatory companies become shareholders of the amalgamated company. A merger of a 100 per cent Indian subsidiary in its holding company is also regarded as "amalgamation".

An important aspect of the development rebate is the provision allowing the carry forward of the development rebate in certain circumstances. Thus if full effect cannot be given to the development rebate th amount of development rebate can be carried forward to eight succeeding years for being set off against the other income of the assessee. While setting up the carried forward rebate against available profits, the rebate for the earlier year will get precedence over that for later years.[49]

C. *Development Allowances*

The Finance Act of 1965 makes provision for a development allowance in respect of tea bushes in any land in India owned by a tax payer who carries on business of growing and manufacturing tea.

(i) Where tea bushes have been planted on any land for the first time or on any land which had been previously abandoned, 50 per cent of the actual cost of planning, and
(ii) Where tea bushes have been planted in replacement of tea bushes that have died or have becom prmanently useless on any land already planted, 30 per cent of the actual cost of planning. The development allowance may also be used as deduction in the prescribed manner.[50]

D. *Tax-free Interest on Loans*

Local enterprises have very often to raise loans abroad for the carrying on of their business activity. In this connection the policy to tax interest accruing on borrowed moneys brought into India from foreign

48. *Id.* Sec. 33 clauses 3 and 4.
49. *Id.* Sec. 33 (2).
50. *Id.* Sec. 33 (A).

sources may prove a major hurdle in the flow of private foreign capital. Interest on loans raised by the following has, therefore, been exempted from taxes:

(a) By government or a local authority on moneys borrowed by it from sources outside India;

(b) By an industrial undertaking in India on moneys borrowed by it under a loan agreement entered into with any such financial institutions in a foreign country as may be approved by the Central Government.

(c) By an industrial undertaking in India on any monies borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of raw materials or capital plant and machinery to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf, having regard to the terms of the loan or debt and its repayment.[51]

E. *Intercorporate Dividends*

Concessional rates of tax apply in respect of dividends received by companies. Thus where the dividends are received by a company from an Indian company or a company which has made the prescribed arrangements for declaration and payments of dividends in India, such dividends are taxed at the rate of 25 per cent. But in case of a company which has not made the prescribed arrangements for the declaration and payment of dividends in India has received dividends from a company in which the public are not substantially interested and which is engaged in generation and distribution of electricity or of construction, manufacture or production of any articles prescribed in the fifth schedule, the dividends are taxed at the rate of 15 per cent. A company is to be categorized as one mainly engaged in the type of activities mentioned above if the income attributable to any of such activities included in its total income for the previous year is not less than 51 per cent of the total income.[52]

Concessional rates of tax also apply to dividends received by an Indian company from a foreign company. If such an income is received by way of dividends on shares in the foreign company allotted to it for the supply of technical "know-how" or technical services to the foreign

51. *Id.* Sec. 10(15)(iv).

52. *Id.* Sec. 85-A.

company in pursuance of an agreement approved by the Central Government in this behalf before October 1, of the relevant assessment year, will be taxed at the rate of only 25 per cent.[53]

F. *Tax Credit Certificates*

Tax credit certificate is one of the more recent measures for providing tax-relief. These certificates are issued in th following cases:

(a) In order to promote subscriptions to equity capital in public companies engaged in important industries, tax credit certificates are issued for an amount calculated at 5 per cent of the amount paid up to Rs. 15,000; at 3 per cent of the next Rs. 10,000 and at 2 per cent of the next Rs. 10,000.[54]

(b) Tax credit certificates are also issued for the promotion of exports. Thus these certificates are issued to persons who export goods out of India after 28.2.1965, and receive payment in the prescribed manner. The tax certificate is granted for an amount calculated at a rate not exceeding 15 per cent on the amount of such sale proceeds.[55]

(c) With a view to avoiding concentration of industries in urban areas tax credit certificates are issued to public companies owning an industrial undertakng niad which shifts from an urban area in respect of tax payable by that company or capital gains accruing from transfer of assets in the course of shifting from the urban area.[56]

(d) Certificates are also issued as an incentive for increasing production. Thus provision has been made for granting tax credit certificate to a company engaged in the manufacture and production of articles mentioned in the First Schedule to the Industries (Development and Regulation) Act, 1951. Such a company becomes entitled to get a tax credit certificates only when the income-tax is in excess of the income-tax for the assessment year 1965-66, which is regarded as the base year. The amount of tax credit is calculated at 20 per cent of the excess of income-tax the company would be liable to pay in the relevant assessment year as compared to the income-tax in the base year. The maximum amount to which the

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53. *Id.* Sec. 85-B.

54. Sec. 280-Z. "Tax credit certificates and other reliefs", vol. 5, 1 I.T.J. 3 (1965); S. Swaminathan, "Paved with good intentions (A study of Tax Credit Certificates)," *Id.* at 69.

55. Sec. 280-ZC, Income-tax Act, 1961, as amended by Finance Act, 1966.

56. *Id.* Sec. 280-ZA.

benefits of the section would be available is 10 per cent of the aggregate tax of the company for the relevant year.[57]

(e) With a view to providing a stimulus for an increase in production of goods, provision has been made for the grant of tax credit certificates to any person who *manufactures and produces goods,* during any one or more of the years in the 5 year period from the financial years 1965-66 to 1969-70, in excess of his production during the base year (1964-65 in the case of an existing undertaking which produces goods during that year, and the next one of the succeeding years during the aforesaid 5 year period, in any other case).

The amount of the tax credit certificate will not exceed 50 per cent of the difference between the Central Excise Duty paid in respect of the goods in the financial year and such duty paid during the base year. The goods covered by this category of certificates and the amount of rebates will be such as may be prescribed by the Central Government.[58]

The amount for which a tax credit certificate is granted to any person under the above provisions, will be adjusted against any existing liability of such person under the Income-tax Act of 1922 or of 1961, or any such liability arising within a period of 12 months from the date on which the certificate is produced before the Income-tax Officer and the amount, if any, remaining after such adjustments will be refunded to the person on the expiry of that period. In the last two cases, (i.e. (d) and (e), however, the refund will be allowed only to the extent of the amount (not exceeding the amount of the certificate) which the assessee has utilized for repayment of its borrowing from any notified financial institution or for the redemption of debentures.

Following are Incentixes as regards Surtax.

Every company is required to pay a surtax in respect of so much of its "chargeable profits" of the previous years, as the case may be, as exceed the statutory deduction at the prescribed rates.[59] The surtax is levied on the execess of the "chargeable profits" over the "statutory deduction."

For computing "chargeable profits" various types of income, profits and gains are excluded from computing the total income for the previous year. Among others, the following types of income are so excluded.

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57. *Id.* Sec. 280-ZB.
58. *Id.* Sec. 280-ZD.
59. Sec. 26. Companies (Profits) Surtax Act, 1964.

(a) The amounts of profits and gains derived from an Industrial undertaking or hotel, covered under the tax-holiday scheme.

(b) Sums donated for charitable purposes.

(c) Income by way of dividends from an Indian company which has made the prescribed arrangements for the declaration and payment of dividends within India

(d) Income by way of royalties received from government or a local authority or any Indian concern

(e) In the case of a non-resident company which has not made the prescribed arrangements for the declaration and payment of dividends within India, its income by way of any interest or fees for rendering technical services received from government or a local authority or any Indian concern

Other important exclusions in case of Indian companies are those rebates allowed on income accruing from transactions earning foreign exchange under the Annual Finance Acts.[60] Further, where a company has also paid taxes in a foreign country in respect of income charged to Indian Income-tax, the amount of Indian tax is aggregated with the foreign tax and the determining "chargeable profits."

The rate of surtax is 35 per cent on the amount by which the "chargeable profits" exceed the amount of statutory deduction. In case of Indian company or a company which has made the prescribed arrangements for the declaration and payment of dividends in India and in which the public are substantially interested and a hundred per cent subsidiary of such a company where its paid up share capital (paid for in cash) on the last day of the previous year is not less than 25 per cent of the amount of capital computed under the Companies (profits) Surtax Act, 1964, *the sum total of the income-tax and surtax shall not exceed 70 per cent of the total income of the company.* The amount of excess is to be deducted from the amount of surtax and only the balance will be payable by the company as surtax. It, therefore, follows that where a company has not made arrangements for declaration and payment of dividends within India the above ceiling of 70 per cent will not be applicable.

By the Finance Act, 1960, no wealth-tax is to be levied on companies.

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60. See in this connection, A. C. Sampath Iyengar, "The Companies (Profits) (Surtax Act, 1964" in *Three New Taxes,* (2nd ed., 1966), 27.

CONCLUSIONS

In Indian development planning taxation has played an increasingly important role. The demands for heavy capital investments have led the government to a prolonged period of deficit financing. One consequence of such a policy has been that while ranking among states with lowest per capita income, India has the additional distinction of being one of the highest taxed nation in so far as direct taxes are concerned.

In no other country does the rate of aggregate tax on resident companies exceeds 54 per cent of th total income but in India last year the tax reached close to74 per cent for resident companies and is expected to touch the high level of 80 per cent this year. Over the years in the name of an integrated system of tax, number of new taxes have come into being. One such was the Expenditure-tax, now abolished, which was unknown to any other country. It is therefore obvious to any observer that taxation in India has not been used exclusively for raising revenue. Attainment of social objectives through taxation has been made more attractive and easier as a consequence of the lenient view the Indian Judiciary has taken of the taxing power of the State by protecting, by and large, the taxing-statutes from attacks under articles 14, 19 and 31.

Realising that the high rate of taxation will be a deterrent to the flow of foreign capital and know how essential for economic development, various tax incentives have been provided. The flow of private foreign capital does not however depend on internal tax concessions only inasmuch as a number of tangible and intangible factors are involved in the investment climate of a country.

In any case there is little doubt that we would not have succeeded in obtaining the present foreign capital participation in the form of equity capital or joint ventures but for the scheme of tax-incentives.