INDIAN ECONOMY
BUDGET 1998

The details mentioned in this booklet are only for information. Readers should take professional advice from their consultants before taking any decisions.

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To,
Clients and Friends,

Dear Sir/Madam,

We are pleased to present our views on Budget 1998 and the Indian Economy.

1. This was the first budget by a BJP led government. The Honourable Finance Minister has sought to introduce some policies announced in the BJP's election manifesto. For some others, he has continued with the previous government's policies.

   Indian economy is in a serious position. By making nuclear explosions, Government has disturbed the already fragile situation. This is on the top of political uncertainties. And the Finance Minister has not risen to the occasion. He has not proved to be a man worthy of the challenges posed before him.

2. We have presented our analysis of the budget after considering various views and comments. The presentation is divided into two parts:

   (i) Economics and
   (ii) Taxation

3. This booklet contains brief views on the subjects. Detailed notes on South East Asian Crisis are placed on our home page. You are welcome to visit our home page –
   http://rashmin.home.ml.org

4. For the past several years, on the day after budget, about ten of us-chartered accountants meet and study the provisions of the budget. So far, out of this group only we used to publish a note on the budget. This year, it has been decided that all the chartered accountants involved in the exercise will jointly publish the book.

   A group has written the basic notes on taxation. Naresh has edited all the notes on taxation.

   The economic aspects are provided by Rashmin.

   We welcome your feedback on the same.

   Thanking you,

Yours sincerely,
For **Rashmin Sanghvi & Associates**

Rashmin Sanghvi **Naresh Ajwani**
1st August, 1998

I. Executive Summary

Positive

- Tax rates remain unchanged. With the abolition of Gift-tax, India has one of the best tax systems in the world.

- FERA and Anti-money laundering bills are to be introduced in the current session of the parliament.

- Administrative and Procedural set up is to be streamlined for foreign investors, and domestic businessmen.

- Advance rulings provisions are to be extended to specified residents.

- Samadhan Scheme has been introduced to reduce litigation. Saral returns are introduced for assessees with income less than Rs.2,00,000 per year.

- "Resurgent India" bonds have been introduced for NRIs & OCBs.

Negative

- GDP growth rate has decelerated to 5% in 1997-98.

- Fiscal deficit has shot up to Rs.86,000 crores in 1997-98 against the budget estimate of Rs.65,000 crores.

- Government is in a debt trap.

- There are no radical steps in the Budget. There are more of small amendments.

II. The Economy

1. Dr. M. R. Sivaraman

Dr. Sivaraman, Executive Director, IMF gave a talk at Indian Merchants' Chamber on 13th June, 1998.

Like a journalist , or a good listener, let me report his views faithfully and without adding my comments or views:

Indians are not as aggresive as the Americans.

1. **Liberalisation :**

1.1 **Moderation**

India cannot afford to be moderate in its liberalisation. Twenty first century will be owned by the aggressive people. Those who remain moderate, will have modest rate of growth and will lag behind the others.

1.2 **DFI**

Encourage huge foreign investment.

All the public sector units, railways, post and telegraph put together; Government may be controlling wealth worth more than $500 billions.

If you allow foreign investment, are they going to take over these huge assets? Do not be afraid that foreigners will take over the country. Japan has been investing heavily into U.S.A. It has not taken over the U.S. Government.

Shed the fear.

Why don't you be strong enough to take over foreign companies? In fact Indians have invested all over. Every country where I have travelled, there is an Indian investment. These countries do not prevent Indians from investing there. In fact, an Indian group has purchased a large steel mill in the U.S.A. – 5th largest in the world. No one prevented them.

If we do not grow aggressively in the world market we will have the voice of a cockroach. Have you ever heard the voice of a cockroach?

1.3 **USA**

We are not aggressive. We are not prepared to take risks. Indian businessman keeps asking for protection.

Why U.S.A is the richest country?

Americans have always taken risks. And they have aggressively grown.

1.4 **Olympics**

We, Indians are not going "all out". One example is, with 900 million people, we have not received a single Olympic award. Why?

Indian GDP is underestimated even on PPP basis.

2. **Indian GDP**

2.1 Indian GDP is underestimated.

At market rates, the per capita GDP is around $350 per annum. At 'purchasing power parity' (PPP) it should be $1400. Even this is an underestimate.

2.2 Since 1980 till 1998 average compounded growth of Indian GDP has been above 5% per year. This is second highest in the world – next only to China.

3. **Protection**

3.1 As executive director of IMF, I get complete horoscopes of 183 countries of the world. Each country's full financial data is available to us. India is the most protected country in the world. All the countries are reducing barriers. Even the poor African countries that are highly indebted. They have no physical controls on imports. (No licensing.) And they are reducing import duties.

3.2 **China**

China has grown much faster than India. Its growth has come more because of increase in productivity than because of increase in capital.

3.3 Our **exporters** are not prepared to study economics. Today studies in economics are far reaching. But we do not bother about it.

3.4 Only industry can lift the economy. Governments cannot.

Capital goods industry in India has been the driving force for last few years. For 3 years consistently, this industry had more than 20% growth. Customs duty on capital goods has been brought down from 85% to 25%. They have never complained. They have only asked for an adjustment. If duty on finished goods is reduced, similarly, the duty on raw materials and components also should be reduced. A reasonable request.

4. Rupee Devaluation

4.1 Exchange Control

Till 1938, Indian economy was one of the freest economy in the world. There were no exchange controls, no industrial licensing, and no import controls.

When the second world war tremors started, Bank of England advised that India should impose exchange controls.

Governor of the RBI/Imperial Bank stoutly refused. He said, "Indian businessmen have always traded in a free economy. For 5000 years they have traded without exchange controls. I do not want to impose exchange controls on them. "

When the war started, he was summoned to London. Bank of England forced him to agree to exchange controls and a wide range of other regulations.

4.2 Devaluation

Exporters' demand for devaluation is the major cause of India remaining poor.

If Indian growth rate is second highest in the world for almost eighteen years, why is it that we are considered poor?

The exporters have to be blamed.

They keep on asking for rupee devaluation.

In 1980, rupee-dollar parity was Rs.7.80 per dollar. Today one dollar gets more than Rs.40. This means, Indian wealth has been reduced to 20% of what it was just eighteen years back.

The exporters do not know any method of competing in the world markets. They have never increased productivity. They do not believe in employing outside, professional experts for increasing their efficiency. Hunches do not pay in this modern world.

Very eminent industrialists have talked flippantly and told me – "Country X has depreciated its currency, so we must depreciate." Such depreciation of your currency cannot take you any far. It harms the whole country. Your debt keeps increasing.

It is like the poor man who keeps toiling for the whole year. He works hard and repays his debt. And at the end of the year he finds his debt increased!

4.3 **Convertibility**

We are going ahead for capital account convertibility in the right manner. We have to liberalise our financial sector first. Have a free banking system, free interest rate regime and then only we can go for capital account convertibility.

4.4 You have eminent chartered accountants. I am asking you to do an exercise. Consider price increases in India and USA from 1980 to 1998. And then advise what should be the value of rupee.

4.5 Value of a currency is highly sensitive item. Be careful when you talk about rupee value. Do not create oscillations where there is stability. Minutest instability in exchange markets can be very risky.

5. **Labour**

U.K. is the mother of all trade union activities. After suffering, it has learned.

Today, U.S., U.K., & Netherlands have most flexible labour laws. And they have the lowest levels of unemployment. All the countries that have rigid labour laws – are indirectly & yet effectively forcing their industrialists to go for mechanisation and reduction in labour.

With trade unions, the person who gets employment, keeps asking for more and more rights. To the detriment of the unemployed.

Consider a specific example.

There is a particular manufacturer in India. He got firm order for exporting electric guitars. A very high value addition item. He supplied the guitars. Every year he went on increasing the supplies. Suddenly, in the 5^{th} year, the supplies stopped.

The labour went on strike.

So what happened ? The American party did not wait. The order to India was cancelled. It went to Taiwan.

Who suffered ? Who gained ?

6. Other Observations

6.1 Education

Education is the key to growth.

How did the South East Asian countries achieve such excellent growth? For thirty years, these countries have been spending over 30% of these budgets on education. Education is the key to the growth.

6.2 Fiscal Deficit

Fiscal deficit of centre, state and PSUs is 9.5% to 10%.

Our fiscal deficit is very high. We have to consider the Central Government plus the State Governments plus the PSUs. All put together the deficit is between 9.5% to 10%. This is too high.

Our tax to GDP ratio is just 14% to 15%. Why such low rate? We can increase the revenue without raising tax rates at all. Individual industrialists have come and talked to me openly. And they have told me – when I was the Revenue Secretary – how huge evasions they have been making of excise.

If only, everyone paid his dues, the tax to GDP ratio can easily be raised to 20% - without increasing any tax rates. (Imagine the benfits. No deficits, no inflation, no extending the tax net.)

For every rupee of tax that the Government gets, a rupee is lost in evasion. Then Government has to borrow. And ultimately, it enters the debt trap.

It is for our own good that our Government should be financially strong. Only a strong Government can avoid instability of the kind we have witnessed in the South East Asia.

6.3 Largest Democracy

What is so great about having a large population?

And where is the democracy in U.P. and Bihar ? We are proud of what?

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Reporter – Rashmin Sanghvi

2. Mr. Chandrakant Sampat

12th June, 1998

Comments on the Budget by the noted economist and market strategist Mr. Chandrakant Sampat.
(In his own words and without any editing or comments.)

From Mr. Chandrakant Sampat

To Mr. Kanu Doshi & Mr. Rashmin Sanghvi

I had the privilege to be with you on 12.6.98 while the subject matter happened to be the budget. My response was on altogether different lines. May I take this opportunity to reiterate what I had to say.

The budget can only become a meaningful instrument if it can focus itself on these points.

1. In what condition the society is at present.

2. What crucial challenges will mark our future.

3. How must we respond to these challenges.

These premises have been stated by Rita Sissmuth, President of the German Bundestag (parliament) in a publication by the Drucker Foundation titled, 'The Community of the Future.'

GDP is around U.S.D. 350 billions and 50% of our population is below poverty line.

As far as the first point she made, I have to say that our GDP is around USD 350 billion and 50% of our population is below the poverty line.

The second point is "What are the challenges before us" What I am visualizing is the changes that are around on account of explosion of information technology. The instance that I gave was that the computer will become 100 times faster by 2000. Perhaps computer will become 1/10th today's price. That the networking society will dominate if it does not take over. By 2003, it is visualized that the net trade will be worth $360 Billion USD. Banks will not exist in their present form. Perhaps in an networking society, we will have to communicate with them through networking of computers.

Basic question is, what do we do with the 1,80,000 people working in SBI. This is only one of the instances of the challenge of technology. This will mean that we will have to have a vision to provide the alternative jobs or think of a migration from today's jobs to alternative jobs. Protection will only create further unemployment and would weaken us immeasurably in the global economy. How do we respond to this?

India can be the food supplier of the world.

Another instance could be the challenge of making India, "the food factory of the world." Inspite of tremendous natural advantages, 7 billion USD worth of fruits and vegetables are spoilt every year in the country. 8% of the total wheat crop is wasted. And only 20% of the selling price of fruits and vegetable reaches the ultimate producers.

Another challenge is that the government's interest payments are compounding at 17%. In the budget itself, Rs.75,000 cr. is provided as interest. The road map to the future shows that by 2001, the entire revenue income would be equivalent to interest payments.

This would mean that we will have to close down what is bad and open what is good. In other words, it is the challenge of production and innovation, to live in the globalised world. As Peter Drucker puts it, "If we achieve profit at the cost of downgrading or not innovating, they aren't profits. We're destroying capital. On the other hand, if we continue to improve productivity of all key resources and our innovative standing, we are going to be profitable. Not today, but tomorrow."

China is closing down the entire public sector. If it succeeds, it will be very difficult for our country to think of any exports, unless we become productive and innovative. If it doesn't succeed, there is a possibility of the yuan getting devalued – The result is the same.

The entire SE Asia is in crisis and is cleaning up. What happens if we don't –i.e. what happens to our foreign exchange reserves which is 80% made up of NRI deposits and portfolio investments. What type of currency valuations are we looking at? What will be the future rate of inflation and interest rates? All these questions remain unanswered by the budget.

Cut down expenses on defence, give liberal VRS, close down PSUs.

Coming to the last point, the basic question is How do we respond to these challenges? If I had my own dream, I would say that I am destroying all the nuclear weapons and will never again go near them. That I will totally close down all defence expenditure worth Rs.45,000 cr. Use this resource for a very liberal VRS to close down all PSUs which are 40% of the gross fixed assets of the nation. Only 1.1% of the organised labour force is with the public sector. Once this unproductive sector is off the economic map. What we are stifling is entreprenuership, innovation and productivity. I'll use the Rs.45000 cr. to payback Government debt. I will remove all barriers to FDI inflows. In light of the above FDI inflows of Rs. USD 30 billion within no time can be expected to flow into India, boosting infrastructure development and productivity in the economy. In short, with the productivity and innovation revolution, I would dream for 11% GDP growth and by 2015 to bring the country to a greater GDP on PPP basis, on the doorstep to a greater economy than the US. There will be no one poor, and since we become rich, we will move to a pre-independence era wherein India, Pakistan, Bangladesh and Sri Lanka will all become one nation. Is our leadership invested with the wisdom, humility and courage to perceive these new realities?

Regards,

Chandrakant Sampat

Back in the 1960s and early 1970s, there was a general sense of certainty about where we were going and how to get there. Successful corporations, powerful post-war economies and long-established institutions were driving to the future like large luxury sedans on a wide open freeway. They imagined they saw a long, straight road stretching out before them into the distant horizon, one that could be traveled in much the same way as the road they had left behind. The future, it seemed, belonged to them. Nothing could have been farther from the truth. The lesson of the last three decades is that nobody can drive to the future on cruise control.

— Rowan Gibson

3. Indian Economy

Rashmin C. Sanghvi

3.1 Role of Business & Industry

1. Let us consider a macro view of the Indian economy.

   (i) Central Government has a tremendous financial problem.

   (ii) World is advancing technologically and commercially at a tremendous growth rate. Barring a few instances of Government owned organisations like ISRO; we are significantly behind the world in technologies. Especially, the private sector has fared very badly in research and development.

   (iii) Because of the economic sanctions the financial position may deteriorate.

2. Some experts have asked the question –"What has the budget done to tackle this situation; to make India a leading nation in the world/"

   I would like to reframe the question. "What are we, the Indians doing to tackle this situation; to make India a leading nation?"

   It is for we Indians to tackle the problems of Indian economy.

   Government is a small part of Indian life. Central Government budget is even smaller part of the whole picture. Let us stop looking to the Government for everything and then blaming the Government for everything. Let us do our share of the duties.

3. Economics is a social science. The performance or non-performance of an economy depends to a large extent on the performance by the people of that society. Hence, the review of a budget is essentially the review of performance by the whole society and not just by the finance minister. Mr. Chidambaram's dream budget – 1997did not work out as expected. Is it the failure of Mr. Chidambaram or failure of Indians as a whole?

   There is a hypothesis. When you reduce the tax rates, you are enabling the society to perform better. I have full faith in the hypothesis. However, the revised estimates for the year 1997-98 have proved that tax-revenues have gone down and not up. This is no proof that the above hypothesis does not work. The hypothesis is workable. But there were several other reasons, which did not allow it to work.

4. Budget is a presentation of a part of government's policies. The whole of the budget, the whole of the monetary and fiscal policies and the whole govt. together cannot achieve anything by themselves.

The people of India have to work. The farmer has to produce food-grains and other agricultural products. The industrialist has to produce goods. The professional has to provide services. And the politician has to behave.

Fiscal and monetary policies, tax incentives and liberalisations can only work as bearings facilitating a vehicle to move. But they are not the engine of growth. The engines of growth are the agriculturists and the industrialists.

Appreciation of rupee is one important strategy for growth of Indian economy. It can not be achieved without co-operation from business & industry.

5. RBI cannot determine and stabilise foreign exchange rates. I firmly believe that rupee must start appreciating. The more I discuss, and the more I see the performance of the Indian economy; the more I get convinced that appreciation of the rupee is one important strategy for ensuring growth of Indian economy. However, that appreciation can be achieved only by making the Indian economy more competitive. The Indian products should be sold in the International market at a premium. This marketing of Indian products has to be done by the Indian exporter. It is not the government's job. Government can only help as a bearing it cannot be the engine.

6. Rupee value is not an "administered price". It is not that if we want to revalue the rupee, RBI can simply announce a new rate of rupee.

   Leaving aside announcements; even if the Government and RBI made all the efforts, they cannot achieve it.

   Indian industrialists have to work for improving productivity. Exporters have to work at macro level strategies to increase India's market share at even higher rupee values. Importers have to form "import cartels" and manage the prices so that goods can be bought at lower cost even if rupee values increase.

> *When I find the road narrow, and can see no other way of teaching a well-established truth except by pleasing one intelligent man and displeasing ten thousand fools - I prefer to address myself to the one man.*
>
> ***— Maimonides***

3.2 Recession

1. India is suffering from recession since 1994.

There is no sign of recovery.

New problems keep cropping up.

What is the reason and what is the way out?

Government of India has come more than half way to satisfy the needs of the business community. One look at economic laws before 1991 and today is good enough. Of course, there is still more to be done and Government is doing with all its constraints.

Government of India has come more than half way to satisfy the needs of business.

Have the businessmen taken one positive step to equip themselves for the Global challenges? Or are they still asking for more protection and subsidies?

Government has no duty to protect these industrialists and traders. Those who are not competitive and strategists, will loose the battle. And they should.

Government's only duty is to create an environment where entreprenuership grows, and flourishes. Government's duty is to protect the common man of India.

Recession in India has continued for too long. Share markets have never fully recovered after the securities scam. Real estate markets are in recession since 1994. Industry is in the recession since 1994.

2. Let us consider one of the causes of the recession.

2.1 The Central Government of India does not have the funds required for all the projects that the Government would like to implement. This is the norm in the life. Everyone wants to do more than his resources would permit. Basic definition of "economics" is "best application of limited resources to achieve unlimited goals".

2.2 Dr. Man Mohan Singh started a series of budgets where the theme was as under:

Government will get out of new investment in infrastructure projects. Indian investment as well as foreign investment in infrastructure would be liberalised. The shortfall of investment because of non-allocation of funds by government will be compensated by the flow of private as well as foreign funds.

Dr. Singh placed tremendous emphasis on control of fiscal deficit and hence achieved the objective of controlling inflation.

Unfortunately, Dr. Singh's expectations did not materialise. Just because people were allowed to invest, they did not in fact, invest. This resulted in recession. Recession resulted in lower growth rates in all directions including taxes.

2.3 Mr. Chidambaram presented a "dream budget." He reduced tax rates. He expected that there will be better compliance and that the GDP will grow. Both these factors would increase government revenues and the fiscal deficit would remain under control. His expectations have miserably failed. Tax revenues have gone down, expenses have increased and development expenditure has gone down. All these together have caused continuity in recession.

Because of continuous recession, private sector investment plans have also gone haywire.

2.4 Mr. Yeshwant Sinha had tremendous constraints. If revenues had fallen last year, there is no reason why this year they should increase. And yet, he has built in an assumption of significant growth in tax revenues. This is largely wishful thinking. His projections may prove wrong.

3. Other reasons for Recession.

3.1 **Investment Markets**

Last year we had seen a position where all investments had lost values. If somebody had spread his investment over several items and wanted to encash, he was in difficulty.

Share prices had gone down. There were no buyers in the market.

Same position for real estate investment.

There were a few days when even gold was not saleable. Everyone was expecting fall in gold price so the jewellers at Zaveri Bazar were not prepared to buy gold.

Why such a serious state of affair?

In the past, people have bought dreams and lost money.

3.2 In the last ten years, Indians have been **sold dreams.** People have bought dreams and lost money.

However, the expectations once raised, have remained high. Now we want to invest only if there is a 50% return per year. We are not prepared to realise that annual yield of 50% is simply not possible. This is called greed.

3.3 In the investment markets all kinds of people have cheated investors. Cheaters have not been punished. Victims have not been compensated. Hence no one has any confidence in any promoter, any builder. Even if we have savings, we do not want to invest.

4 Political instability is a significant depressant.

5 Many industrialists do not know how to deal with increasing competition. So they do not want to diversify/expand.

6 With liberalisation of imports and reduction in duties, we have seen prices of white goods continuously falling. Even if we need goods, we want to postpone the purchase until further reductions.

7. How/when the situation will improve?

The situation can improve when-

(i) The investor sheds his greed and would forget about 'dream' rates of returns.

(ii) Government and judiciary must act swiftly to punish the guilty and compensate the victims of investment market. This will go a long way in restoring investor confidence.

Government and judiciary must act swiftly to punish the guilty.

When the churning and restructuring of the economy is over, there will be a regeneration of demand and all markets will improve.

What lies beyond the end of the road? In his book Powershift, Alvin Toffler describes it as terra incognita - the unchartered landscape of tomorrow. Up ahead we see a world of chaos and uncertainty. A world of accelerating change. A world where economics will be based not on land, money or raw materials but on intellectual capital. Where competition will be fierce and where markets will be merciless. Where small companies will outsmart giant corporations on a global scale. Where customers will have infinite access to products, services and information. Where networks will be more important than nations. And where you'll either be doing business in real time, or you'll be dead.

— Rowan Gibson

3.3 Further Liberalisation

1. **Global competition**

Within around three years, India may be opened up to Global competition.

Having done these activities, Government has to only act for preservation of law & order. Catch the fraudulent people, the white collar criminals and punish them. People cannot expect more from Government.

Those who have oft repeated the saying that – "Government has no business to be in Business" – have no business asking Government to protect them.

Level playing field is necessary in terms of exchange rate of rupee.

2. **Level playing field**

Protection is different from Level playing field.

International exchange value of rupee is 25% of its domestic purchasing power parity. This immediately puts all Indian entrepreneurs at a 75% disadvantage. But we have said enough on this in many of our writings.

It may be enough to give one example.

Europe is going for European Monetary Unit or EMU. There will be only one common currency for all the nations joining it. Why U.K. is not joining it?

U.K. has considered a notional value of pound vis-à-vis other currencies of Europe. That notional value is higher than the current market value of pound. If U.K. joins EMU at this level, it means that all its assets will be undervalued to an extent. That means, U.K. will be poorer. And that will be permanent. No going back. U.K. would like to wait till it can raise the market value of pound to its desired levels. And then only join the EMU.

Indian businessmen and especially exporters simply do not realise that every devaluation is pauperising India – and incapacitating the Indian businessmen.

For achieving a level playing field, rupee must be brought nearer to its purchasing power parity. This cannot be done by Government or RBI alone. Entire country has to work for it by increasing productivity and stopping all talks of devaluation of rupee.

3. **Protection**

It is the common man who should be protected and not the industrialists.

We must protect the Indian economy and make it grow.

But protecting whom?

The existing industrialist?

Or the common man of India?

Well, answer is clear. It is the Indian common man who has to be looked after. His long term interest has to be protected.

Existing industrialists, like the labour unions have become over protected, unproductive vested group lobbies. Both have kept on asking for more to the detriment of the common man.

Existing industrialist has only learned the skills of growing in a regulatory environment. But the interest of the common man lies in good healthy competition.

Industries must be exposed to competition. They must serve the common man by giving better products at lower costs with better service. This will be enforced only by healthy competition. Not the American laissez-faire which can permit Coca Cola eating away Parles. But our own Indian brand of healthy competition. Cocacola & Pepsi are only creating a duopoly by eating away all the competition. They and other MNCs having similar designs must be restrained.

Theme : Indian common man needs protection not the industrialists.

Protect the common man from the exploitative practices of Indian entrenched vested interest groups – Industries, including their associations and organised labour including their unions.

Every time the Indian businessman makes losses, he runs for cover.

Asks for protection, subsidies, devaluation and generally blames Government for everything.

All these businesses will die their natural death.

New and aggressive competitive businessmen will own India in the next century.

4. Trades

There were several trades where traders earned huge gross profit margins.

Items in restricted supplies, imported items offered huge profits. Anyone who had capacity to hold stocks was bound to make profits.

These margins supported entire trades like brokers in licences, money lenders charging 2% to 4% per month interest etc.

These margins also supported lazy traders. Certain markets do not even start work before noontime. And they have no innovation. Father did the business and made millions. Son is doing the business and expects that the grand son will also do the same business.

And now, the trade margins have disappeared. On stocks, more often, people make losses. Import duties and restrictions go down and market prices do go down. IF one trader is selling at 15% gross margin, there is another ready to sell at 10% or lower margin.

Competition is good for customers.

What is good for customers is good for the country.

Those traders, who do not learn to work on thin margins and low costs of operations, will go insolvent. All those who have lent them – bankers, moneylenders and suppliers – will also suffer. There is nothing new. The warning that India is opening up to competition was given in the year 1991. In the last seven years, those who have learned to work in competitive environment will survive next three years of crisis. Rest may not be seen in the markets in the next century.

5. **Consumers**

Consumer is the king in Western world. In India, one-third people do not have purchasing power itself. It is they who need protection.

In the Western world, economists say, the consumer is the king. We do not say that.

Consumer in the market is one who has the purchasing power. If he has the money, he may buy food or cigarettes or items of luxuty. The western world may not distinguish.

India has more than one third people who have no purchasing power. If they are not taken care of; natural forces will harm and keep harming India. And natural forces are more powerful than market forces.

Government's duty is to protect the common man. Not any vested interest group or lobby. Government's duty is to provide all help to the poor and the exploited. They deserve subsidies. Not the industrialists and the rich farmers.

Hence in this paper we have used the term the "common man" and not the "consumer".

Conclusion

We can not set any targets as to the GDP or per capita income etc. That is not the purpose of this paper.

Government should create environment where entrepreneurship grows.

We are only saying that the Government should create an environment where entrepreneurship grows and flourishes. Government has come more than half way.

It is now for the businessmen to stop asking for further reliefs and protection. They have to start working for taking up the global challenges.

For the investor, the message is – many of the old blue chip companies will find it difficult to change-even though the environment has changed. So start searching for new companies and entrepreneurs as investment targets.

Experience is a hard teacher because she gives the test first, the lesson afterward.

— Vernon Law

III. DIRECT TAXES

Naresh Ajwani

A. Infrastructure, Computer software-reliefs

1.1. Infrastructure [Section 80-IA]

This is one of the several tax provisions – where the Government wants the tax payers to plan and reduce their taxes. Fulfill the conditions – go to backward area, export, invest in P.P.F. – and save your taxes.

1.2 Income-tax Act provides for relief from tax on profits arising out of the business of operating infrastructure facilities. This relief depends on the type of infrastructure carried on by the assessee, the year of commencement of business, etc. The budget proposes to widen the scope of the areas where relief is available. In September 1997, the income tax act was amended to provide for additional reliefs for infrastructure facilities. Changes made in September 1997 and the Budget are explained below.

1.3 Services of radio paging, domestic satellite services, trunk services and EDI services will now be granted relief. Any person who had commenced these activities after 1st April 1995 will be given a tax holiday for first five years of operation. Persons who commence operations upto 31.3.2000 will also be given a tax holiday for first five years of operation. For the next five years (i.e. 6th year to 10th year), relief will be granted @ 30% of the profits in case of companies. For other assessees, the relief is 25% of the profits.

Reliefs have been extended to radio paging, domestic satellite services, trunk services and EDI.

1.4 Relief under this section is given to persons in the business of commercial "production" of mineral oil in the North Eastern Region. Now relief will also be given to persons engaged in "refining" of mineral oil. Persons who commence activities of "refining" mineral oil, on or after 1st October 98 will get a tax holiday. The tax holiday will be for the entire profit for initial seven years.

Further tax holiday for production and refining of mineral oil is extended to persons who commence this activity in any part of India. This relief is at present available to activities only in the North Eastern States.

For persons engaged in Power generation and distribution, the tax holiday will be available where the business commences at any time upto 31st March 2003. This limit is currently upto 31st March, 2000.

In our view, Power generation is also an infrastructure industry. There is no time limit for commencement of operation of infrastructure facility.

Similarly there should be no limit for commencing Power generation business by a particular date. The government have announced the date before which the activity should commence. Then it extends the same. This leaves some uncertainty. It should remove the time limit for commencement activity.

Inland waterways, inland ports, highways and housing projects are included as "infrastructure" industries.

1.5 Relief is also proposed to be given to infrastructure facilities namely "inland waterways", "inland ports", "highways" and "housing projects". Tax holiday is proposed to be given for any ten consecutive years out of the twelve years, commencing from the year in which the person starts operating the facility.

For "highways" the holiday is available for any ten consecutive years out of the twenty years, commencing from the year in which the person starts operating the "highway" facility. For highways, the government can allow the persons to develop houses or do other activity as integral part of the highway. Profits derived out of such activities also will be tax free. There is a condition that profits out such activity should be transferred to a special reserve. The amount in the special reserve should be utilised for the highway.

1.6 Industrial Undertakings in specified industrially backward districts have been given reliefs. In September 1997, these districts have been classified into category A and category B. Reliefs are different for each of the categories as under:

Relief	**Category A**	**Category B**
Full tax holiday	Initial 5 years	Initial 3 years
Total number of years for relief Is available	10 years	8 years

This is good case of bureaucratic delay which has caused avoidable uncertainty. Though this section was introduced from assessment year 1995-96, the industrial districts were not specified till September, 1997. Only in September, 1997, the districts were notified. Till that time no one was sure whether his industrial undertaking will get relief or not. Now the districts have been classified into A and B categories. The relief is available to those who commence manufacturing on or before 31st March, 2000.

1.7 For hotels, relief is available for earnings in foreign exchange U/s. 80HHD. Relief is also available U/s. 80-IA.

Legally, it is possible to claim relief under both sections, which at times results into more relief than the eligible profits.

The budgets proposes to plug this loophole.

1.8 Relief is available to companies carrying on scientific & industrial research & development work. Full profits are exempt from tax. It is available to those companies which are approved by the Ministry of Science & Technology before 1st April, 1998. This relief is extended to those companies which are approved before 1st April, 1999.

1.9 Relief has been given for housing projects. Entire profits will be exempt from tax. This is subject to certain conditions :

- The project should be approved by the local authority;

- The plot of land has an area of at least one acre;

- The residential unit has a built up area not exceeding one thousand square feet;

- The development & construction of the project commences on or after 1st October 1998, and is completed before 31st March, 2001.

2. **Investment in Venture Capital Undertakings [section 10(23F)]**

Venture capital investments have been granted additional relief.

Relief has been given for dividends and long-term capital gains in case of investment by venture capital funds & companies, in venture capital undertakings. Such dividend & gain is totally tax-free. There are some conditions attached for claiming the relief. One of the conditions is that, the shares in venture capital undertakings will not be transferred for three years. (Investment should be in unlisted venture capital undertakings. If the shares of the venture capital undertaking are listed subsequently on the stock exchange and then the shares are sold, then the condition of lock-in-period of three years does not apply). This condition is now removed. Thus now, if the shares are sold before the end of three years, relief will be available for dividends & long-term capital gains.

It was further provided that the venture capital undertaking should be engaged in the industries, which will be notified by the Central Government. Now the industries have been mentioned in the section itself. The industries include infrastructure industries, computer software, etc.

3. **Infrastructural capital funds and companies [Section 10(23G)]**

Infrastructure capital funds and Infrastructure capital companies were given relief last year. Any interest, dividend or capital gains earned by such funds/companies from investment in enterprise carrying on infrastructure business was tax free.

The finance bill had provided that relief will be granted to funds/companies only on interest from Long Term Finance given to enterprises carrying on infrastructure business. Investors in shares would not have been eligible for any relief.

The Finance Minister has been pragmatic enough to understand this difficulty. At the time of passing the bill, it has been provided that relief will be continued to be provided on Capital Gains from investments in shares also.

Further, now the infrastructure companies and infrastructure funds will have to be approved by the CBDT as per guidelines.

However, there is a condition imposed that the relief will be granted in case of investment made on or after 1.6.98. This condition can cause avoidable problem. The relief was first brought in by Finance (No.2) Act, 1996, with effect from Assessment Year 1997-98. At that time there was no condition regarding the date of investment. The old provision is now replaced by the new provision which has this condition that investment should be made on or after 1.6.98. Hence, investments made prior to that date, are not eligible for any relief. This should be rectified at the earliest.

4. **Relief to supporting software contractors [Section 80 HHE]**

Currently relief is given to software exporters. The profits on export of software are free of taxes. However, software producers also sub-contract their work to others.

In case of export of goods, there are provisions where by a supporting manufacturer, who manufactures goods for exports, but exports it through another exporter, also gets relief. The spirit behind the relief is now brought in for software also.

Similar provisions are brought in for supporting software contractors. If the contractor produces any software which is exported through the main software exporter, relief will be given to the supporting contractor. This is subject to the condition that the main software exporter forgoes the relief to be given to the contractor.

5. Conversion into companies [Section 47(xiii), 47(xiv)]

Conversion of proprietorships and partnerships into companies is tax-free.

Businesses may be started as proprietory concerns or partnership concerns. As & when the business expands, the need may arise to have a corporate entity. If the business is transferred to a corporate entity, there is an exposure to tax liability. The cost of conversion into a company can become quite high. Hence, to avoid taxes, businessmen have converted their partnership concerns into companies under Part IX of the Companies Act.

Under Part IX of the Companies Act, a proprietory or a partnership, is "registered" as a company. It is considered as one entity, only registered under a different act. If there is only one entity, there cannot be a "transfer" from one entity to another. As there is no transfer, there is no capital gains tax.

"Conversion under Part IX" as it is normally called, is not free from doubts. The income tax department has accepted the same without any problems. But one is never certain when the problems may start.

Thus, primarily a commercial route, conversion under Part IX was used for tax planning.

The government have realised that economic realities demand that tax breaks should be given for growth. In fact, this is not a tax break but more of a confirmation, that if you are growing, there will be no taxes due to technical reasons. Two clauses have been introduced in section 47 – nos (xiii) & (xiv).

5.1 Conversion of a firm into company [Section 47 (xiii)]

If any capital asset is transferred from a firm to a company on succession, there will be no tax on capital gains. Certain conditions are prescribed :

5.1.1 All assets and liabilities of the firm relating to the business, become assets & liabilities of the company.

5.1.2 All partners of the firm become shareholders of the company in the same proportion in which their capital account stood in the firm. It may be noted that it is not the profit sharing ratio, but the ratio in which their capital stood immediately before conversion. The partners will get shares in the capital ratio and not the profit sharing ratio. Thus, on conversion, the ratio of profit sharing can change, so to say.

5.1.3 The partners do not receive any consideration except allotment of shares in the company.

5.1.4 The aggregate shareholding of the partners in the company is not less than 50% of the total voting power. The holding to the extent of 50% continues for five years from the date of succession. Thus after conversion, the company may make a public issue. But the original partners' holding should not go below 50%.

5.2 For conversion of proprietory concern into a company, there are similar conditions, except that condition as in 4.1.2 does not apply.

5.3 The new provisions have thrown up a few issues :

5.3.1 The provisions refer to the "business" which is transferred in a succession. A firm or a proprietorship can have many "businesses". Thus, it is possible to transfer every business to a separate company. This appears to be legally possible. Thus, the section provides relief, not only for conversion of firm into companies, but also for restructuring like spinning off a business into separate entity. At the time of passing the budget, the Finance Minister has announced that the whole issue of mergers and acquisitions is being referred to a committee to examine various issues in entirety.

5.3.2 In case of a partnership firm, there may be a debit balance of a partner. On conversion into a company, shares in proportion to the balance in the capital will have to be issued. But for a negative balance, one cannot issue shares in any "proportion". However, atleast one share will have to be issued, so that "all partners" become shareholders.

The negative balance plus value of the shares issued, will have to be treated as loan receivable from that partner.

5.3.3 If the firm has investments in say shares, it is doubtful whether relief will be given on transfer to the company. The relief is to be given for transfer of assets of a business. If the shares do not form part of the business, then there may be capital gains on transfer.

Conversion of proprietorship into partnership is still not exempt from tax.

5.3.4 Government has missed one step in the business expansion. Normally, the cycle of expansion is such that a proprietor takes in a few partners. When the partnership grows further, they go for a limited liability company. The first stage of a sole proprietor expanding into a partnership is not granted any exemption. In fact, Section 45(3) makes a deeming provision that such an expansion would be liable to capital gains tax. This anomaly is because of flagrant misuse by many assessees. Proprietors were selling away their assets through the medium of a firm without paying any capital gains tax. Hence S. 45(3) was brought in. Now it remains as a hurdle even for genuine people expanding their business.

6. **External commercial borrowings - Tax exemption on interest [Section 10(15)(iv)(c)]**

Businessmen in "Computer Software" industry can pay tax-free interest for ECBs.

Residents can borrow loans in foreign currency (External Commercial Borrowings). Interest on such loans is exempt from tax. The exemption is subject to approval from Central Government. About two years ago, Central Government delegated the authority to Reserve Bank of India, to approve foreign currency loans upto U.S. $ 3 million. Interest on these loans are not entitled to the relief, as the same are not approved by the Central Government.

There is a view that RBI approves loans under authority delegated to the RBI. Hence if RBI gives an approval, the same should be sufficient for claiming relief. We are of the view, that as the section requires an approval from the Central Government to claim a relief, a specific approval should be taken.

Further, the exemption is available, to an "industrial undertaking". Industrial undertakings are specifically defined to mean those undertakings which are engaged in manufacture of any goods, generation and distribution of electricity, providing telecommunication services, etc. However some kinds of industries are not covered under the existing law e.g. Software & hotel industry.

Budget proposed to withdraw the relief on all External Borrowings barring a few.

The withdrawal of exemption would have increased the cost of interest for the Indian borrower. The foreign lender would have insisted on the Indian borrower bearing the Indian tax. On representations, the finance minister has agreed to retain this relief.

At the time of passing the Finance Bill, the Finance Minister has included computer software within the meaning of "industrial undertaking". Thus now, interest on foreign currency loan taken by software company, will be exempt from tax.

B. Non- residents

7. **Foreigners - Withdrawal of some reliefs**

7. 1 Foreign nationals who come to India for shooting films, are given

exemption for tax on remuneration. This exemption is proposed to be removed. (The exemption was specifically granted for shooting of the film - Gandhi) - [Section 10 (5A)].

7.2 Foreign nationals are deputed to India by multinationals for short term assignments. Their children however, normally continue their education in the home country. Indian companies provide passage money so that the children can visit their parents in their vacation. This passage money paid by the Indian company, is exempt from tax, although, it is a perquisite. This exemption is also sought to be removed - [Section 10(6)(aa)].

The abolition of NOR status could have created several problelms.

8. Resident but Not Ordinarily Resident (NOR) - the concept [Section 6(6)]

8.1 The concept of Not Ordinarily Residents is a unique concept available only in Indian Income-tax Act. It benefits foreign employees deputed to India, NRIs who have returned to India and others.

The budget had proposed to delete this provision. Many people have criticised the proposal of abolishing the concept of "Not Ordinarily Resident". However, it may be noted that such a concept does not exist in most countries. In fact several countries consider their subjects as "residents" long after they have left their countries. Such people remain taxable in their home countries on their world incomes.

A U.S. citizen or a U.S. 'Green Card' holder remains liable to U.S. income-tax on his world wide income even though he may be permanently settled outside U.S.A. There have been cases of American citizens relinquishing American citizenship to avoid American taxes. However, the American Government is one step ahead. Such a person may be "deemed" dead & liable to pay estate duty on his relinquishment of the citizenship.

Indian Government's fiction has never gone to the extent of deeming a person to be "dead" – even when the Estate Duty Act was in force.

Anyway, since strong representations were made to drop the amendment, it has been dropped. In other words, the NOR concept continues.

8.2 However, it has been noticed at times that some particular officer is keen on an amendment. He keeps trying to push his proposal. With some finance ministers it gets shot down. Some times, due to strong protests, the proposal is shot down. However, the officer, or his successor keeps trying for the amendment. In changing scenario, the proposal may get through. The change in partnership taxation is one such example.

Hence, even though the NOR status is maintained, NRIs who have returned to India may plan their foreign affairs. Also, in future, any person planning to come to India with a view to becoming resident in India may plan his affairs before returning to India.

8.3 Normally a person is considered as a "resident" or a "non-resident" -depending on his physical stay in India.(S.6). If a person is a resident, his worldwide income is taxable in India. Non-residents are taxable only on income, which arises in India. (S.5).

8.4 Non-residents who wish to stay in India, initially come for exploratory visits and may stay in India for two to three years. Similarly, there are expatriates who may be deputed to India for 2-3 years. Such persons go back to their home country after deputation. Normally they will become residents under the Income-tax Act for the period of their deputation in India. Consequently worldwide income would become liable to tax.

To avoid hardship to such persons, an intermediate status is provided in the Income-tax Act - known as "Resident but Not Ordinarily Resident" (NOR). Persons who are NOR, are not liable to tax on foreign incomes. They are liable to tax only on Indian incomes. Thus such persons need not worry about their foreign incomes which will be tax free in India. The NOR status can continue for nine years if a person has been a non-resident for two consecutive years.

8.5 What can happen if this concept is abolished? Some of the issues are discussed below.

8.6 Expatriates

Expatriates and foreign technicians could have come into difficulties.

The expatriates would be liable to tax on worldwide income. They would have to disclose their foreign incomes from each and every source. Some incomes (e.g. interest on Provident Fund contribution with foreign trusts), would become taxable in India as the foreign trusts are not the "Approved Provident Funds" as per Indian Income-tax Act. This is only one example. There could be several other issues, which could create problems.

8.7 Foreign technicians/consultants

At times, foreign technicians come to India for installation of plant and machinery. Consultants also come to India to render services. If their stay exceeds 181 days in a financial year, they will be residents of

India. In the absence of NOR concept, for that particular year, their worldwide incomes would be liable to tax in India.

8.8 Disclosure of foreign assets

Under FERA, Reserve Bank has permitted returning Indians and foreigners, to retain assets abroad without disclosing the same. However, these persons would have to disclose foreign assets to the income-tax department for income-tax and wealth tax purposes.

8.9 RFC account - Section 10(15)(iv)(fa)

NRIs who return to India, have been allowed to retain funds in foreign currency accounts with a bank in India. These accounts are called – "Resident Foreign Currency Accounts". Interest on such accounts is exempt from tax in case of NOR. This relief would not be available in the absence of NOR concept.

8.10 Wealth tax

The value of assets located outside India and belonging to the NOR, are excluded from wealth tax. Such assets would be liable to wealth tax. Thus if an NOR owns any assets outside India, which are considered as taxable assets (e.g. immovable property), the same would be liable to wealth tax.

8.11 Double Tax Avoidance Agreements

Even DTAs do not solve all problems of double taxation.

Double Tax Avoidance Agreements (DTAs) may help in reducing difficulties. But these do not eliminate the same. In many countries, there is no "number of days stay" criteria for determining the residential status. Or this criteria exists alongwith other subjective tests.

If a person comes to India from say Australia, he will be resident in India if his stay in India exceeds 181 days. However as per Australian laws, he will be considered as a resident of Australia also. In Australia, unless a person is out of Australia for two years, he is considered as resident. Even this is only a practice. Legally, if he retains his ties and connections with Australia, he will be a resident of Australia, even if he stays outside Australia for a longer duration. This becomes subjective. Hence for atleast two years, such persons will have to take recourse to "tie-breaking" tests. These tests are subjective and can create controversies. Thus DTAs, may reduce problems but cannot eliminate the same.

C. Depreciation [Section 32]

9. Intangible Assets

Intangible assets will be eligible for depreciation.

9.1 Depreciation is allowed on tangible assets like buildings, plant and machinery and furniture. Intangible assets like brands, know-how, etc. were not considered as assets eligible for depreciation. Only know-how was at times considered as Plant and machinery.

The importance of Intellectual property has been recognised during the past few years. The Government has now thought it fit to recognise such property as **assets** and to allow depreciation on the same.

9.2 Intellectual property is to be considered as "Intangible Assets". These include know-how, patents, copyrights, trademarks, licenses, franchises or any business or commercial rights [Section 2(11)]. Depreciation will be available on such intangible assets. This provision will apply from financial year commencing from 1.4.98. Assets purchased on or after 1st April, 1998 and owned by the assessee will be eligible for the depreciation.

9.3 For know-how, deduction u/s. 35AB was available @ 1/6th of the amount paid for know-how. With the introduction of depreciation on such assets, Section 35AB is proposed to be deleted.

9.4 Under section 37, expenses incurred for business, which are not on capital account, can be claimed as a deduction. It is a settled principle, that expenses on know-how which are of revenue nature, are deductible as expenses. Section 35AB (1/6th installment) applies only to those expenses, which are of capital nature. This principle remains undisturbed. If any expenses are incurred on know-how which are revenue in nature the same are deductible in the year of incurring the expenses. Only expenses for acquiring know-how, which are of capital nature, need to be capitalised.

9.5 The definition of intangible assets includes any business or commercial property. Even Goodwill will be considered as commercial property and depreciation will be available. On similar grounds, payments for "non-compete" payments should be considered as intangible assets. It must however be clarified that any intangible asset which is developed over a period of time will not be eligible for depreciation. e.g. brands, goodwill cannot be valued and depreciation claimed on the same. These assets should be purchased or developed in a manner where costs can be specifically identified with the assets – for being eligible to depreciation.

There could be however some assets which will be difficult to classify as intangible assets. e.g. tenancy rights. Whether such assets will be eligible or not may be doubtful. In our view, tenancy rights also are commercial rights.

As per newspaper reports, Maharashtra Government is considering that the payment of premium (pugree) for tenancy rights may be legalised. Assessee can officially make & receive payments for tenancy rights. Can we say that the tenancy rights are "intangible assets"; or "that they pertain to immovable properties & are in the nature of tangible asset"?

State Government would like to treat the same as an immovable property & levy stamp duty on the same.

This is an issue, which will require more consideration.

10. **Assets of Power plants**

Depreciation is available on block of assets for the purpose of claiming deduction under income tax. The concept of Block of Assets does not recognise individual assets. Depreciation is available on the total of all the assets within a category. Further, under the concept of block of assets, any new purchase of an asset is added to the block. Any sale of an asset within a block is reduced from the block. Only if all assets of the block are sold, any capital gain or loss is recognised. There is no concept of gain or loss on any individual asset.

In September 1997, income tax act was amended to provide for depreciation on individual assets owned by power plants. The power plants were given a choice to claim depreciation for individual assets or for the block of assets. Once the choice is exercised, it cannot be changed. As a consequence recognition of gain or loss on individual assets is brought back for such assets.

D. Business Deduction

Payments for protection will not be considered as business expense.

11. **Extortion money [Section 37]**

A regressive amendment is addition of an explanation to section 37. It provides that any expenditure for any purpose which is an offence under any law, shall not be allowed as business expenses.

Recently, there was a tribunal decision in the case of M/s. Pranav Construction Co. Vs Assistant Commissioner of Income Tax 61 ITJ

145, wherein it was held that, any expenses paid on account of protection money, is allowable as expenses.

Many of us are aware the extent to which the underworld has gone to. The amounts which a businessman has to pay as protection money has increased. The government cannot provide adequate safety. Hence people are forced to buy protection. Legitimate expenditure should definitely be allowable as expenses. In any case, for the payer, the money paid is not illegal or offence. It is for the receiver that money may be illegal provided that he is collecting it under a threat. Buying protection can never be illegal. Hence legally, money paid for protection should still be allowed as expenses. Instead of calling the payment a "hafta" to a "mafia don"; call it service charge paid to security guards.

However, money paid as "bribes" to buy favour is not allowable as expenditure. This is already the legal position. This amendment only clarifies this position.

12. **Modvat**

Change in accounting system for Modvat should reduce litigation.

Modvat is one issue where there has been a difference of understanding between the Income Tax department and the assessees since its introduction.

Basically the modvat scheme provides for set off of excise duty paid on raw material (MODVAT), against set off of excise duty on sales. The Institute of Chartered Accountants has provided two methods of accounting. In the first method, one can account for the purchases at a cost that is net of Modvat. Correspondingly, closing stock is also valued at a cost which is net of Modvat.

The second method provides that the purchase of raw material, and closing stock are accounted for at gross costs. Under both the methods, there is no difference in the profits.

In the tribunal decision of S.H. Kelkar v/s Deputy Commissioner of Income-tax (44 ITD 170), it was held that purchase and closing stock should be accounted for at gross cost. However, even if the assessee has accounted for the same at net cost, the Income-tax department cannot increase the profit by only increasing the value of closing stock. The correct procedure is to recast the profit and loss account by debiting purchase and closing stock at gross cost.

The budget has in a way given effect to the decision by bringing in a new section. It bypasses the Institute of Chartered Accountants' Guidelines and provides that the purchases, sales, stocks will be accounted for at gross costs.

It will reduce litigation as the department will now not file appeals. The appeals in any case have almost always been in favour of the assessee.

An important issue is that in some cases, the Modvat on purchases is more than the excise duty on sales. If the assessee had followed the principle of accounting for every item on "net" basis, following situation would emerge. Raw materials are accounted on net or lower basis. Hence, the surplus of modvat over excise has not been debited to profit & loss account – though it has been paid by the assessee. In such a situation, the Modvat credit is accounted for as income and tax is paid on the same. The Modvat credit goes on accumulating with the government but cannot be fully utilised. It cannot even be refunded. This is something which hurts the businessman. When this assessee will move over to accounting on "gross" basis, a question will arise as to the treatment of the surplus of modvat.

Correct treatment would be, to make all necessary adjustments – arising out of the change in the accounting system – in the opening stock. A clarification by CBDT on these lines will help in reducing litigation.

13. Expenses pertaining to a project [Section 35D]

13.1 On setting up of a project, some expenses are incurred which do not pertain to plant & machinery or other assets. The expenses can be on feasibility studies, legal costs for agreements, stamp duty for issue of shares, etc. These expenses are essentially of capital nature. Hence these are not allowable as deductible expenses.

Income tax Act specifically allows such expenses to be claimed in ten installments i.e. over 10 years. (10% every year.)

The budget proposes that such expenses incurred after 31st March 1998, will be allowed over five years. With the speed at which many technologies are getting outdated, this is a fair provision.

13.2 Further the total expenses which can be spread over is restricted to 2.5 percent of the cost of the project or the capital employed.

This limit is now increased to 5%.

E. Relief for individuals

14. Tax rates

The budget continues with the low tax rates which Mr. Chidambaram had brought in last year. There were reports before the budget that the rates may be revised upwards. However this has not been done. In fact there is a small relief. This is among the few positive features of the budget.

The tax free limit has been increased from Rs.40,000 to Rs.50,000. This will give a relief of Rs.1,000 for those who have incomes exceeding Rs.50,000.

The tax rates for other assessees remain the same.

15. Standard Deduction [Section 16(i)]

Standard deduction is available from salary at the rate of one-third of the salary or Rs.20,000, whichever is lower. This limit is proposed to be changed as under:

Salary	Standard Deduction	Relief in tax
Upto Rs.1,00,000	One-third of salary or Rs.25,000 whichever is lower.	Rs.500 to Rs.1,000
Rs.1,00,000 to Rs.5,00,000	One-third of salary or Rs.20,000 whichever is lower.	NIL
Above Rs.5,00,000	NIL	Loss of Rs.1,500

16 Medical reimbursements [Section 17(i)(v)]

Medical expenses reimbursed by the employer, are exempt from tax to the extent of Rs.10,000. This limit is proposed to be increased to Rs.15,000/- Depending on the slab in which a person is, the relief can be between Rs.500 to Rs.1,500.

17 House Property Income

Additional reliefs have been given for income from house property.

17.1 A deduction for repairs is allowed @ 20% of the rental value. This deduction is proposed to be increased to 25% of the rental value.[Section 24(1)(i)].

17.2 In case of a self-occupied property, interest on housing loan can be reduced from the income to the extent of Rs.15,000. This limit is proposed to be raised to Rs.30,000. The tax impact can be Rs.1,500 to Rs.4,500. This is not a very big relief. If one considers the prices in metropolitan cities, the loan required for the house can be quite large. Interest on the same normally exceeds Rs.30,000. Even with the increased limit, person will not be able to claim full interest. At an interest rate of 15% p.a., interest on a loan of Rs.2,00,000 amounts to Rs.30,000. Thus there will be no relief on loan amount in excess of Rs.2,00,000.

It may however be noted, that if the property is given on rent, full interest can be reduced from the income. However, people who buy houses for themselves, for them full relief is not given. [Section 24(2)].

17.3 If there is a loss from house property, the same can be set-off against other income. However, even after setting off the loss, if there is any balance, it is lost. Now the budget proposes, that such loss can be carried forward and adjusted against house property income of subsequent years. The loss can be carried forward for eight assessment years. [Section 71B].

17.4 The employer has to deduct tax at source from salary. While the employer can take into account, various reliefs, he cannot take into account loss from house property. (The loss from house property primarily arises because of interest on housing loan). Hence TDS is more than the tax payable. Therefore many salary earners have to file the return of income to claim refunds.

Now the budget proposes that loss from house property can be reduced from salary and tax should be deducted at source only from the balance income.

The employees will still have to file the return, but atleast there will be no problem of claiming refunds.

The scope of filing the return of income based on economic critetria is increased.

18. Filing of return based on economic criteria [Section 139(1)]

18.1 Last year, the Government had sought to bring in many new persons in the tax net. It had introduced a scheme, whereby, a person is liable to file an income tax return, if he satisfies any two of the following four economic criteria:

- ownership of a house,

- ownership of a telephone,

- ownership of a car and

- foreign travel abroad.

18.2 The budget proposes to widen the scope by introducing two more criteria

- holding of a credit card (other than an "add on" card)

- membership of a club where entrance fee is rupees twenty-five thousand, or more.

Further, instead of the necessity of satisfying any two criteria, now satisfaction of ANY ONE of the above six criteria will be sufficient. The government hopes to bring in many persons under the tax net.

A small relief has been given. If the foreign trip is made by a person to any neighbouring country, or to any place of pilgrimage, then such person will not be covered. The places of pilgrimage will be notified later.

18.3 **Shifting Policies**

The policy for filing of returns has charged several times.

Governments come and Governments go. With them, the policies keep changing. Earlier, the policy was to reduce administrative work.

18.3.1 Basic exemption limits under income-tax were raised from very small amounts to the present limits. One reason given was that in case of small returns, tax revenue was very little whereas the administration cost was high.

18.3.2 NRIs were invited to invest in India. When they stated that they were hesitant of investing in India for the fear of income-tax department; specific provision was brought in the Act to provide that the NRIs need not file returns. Section 115G of Chapter XIIA makes a specific provision. Where an NRI has only income covered under chapter XIIA and appropriate tax has been deducted at source; the NRI need not file his return.

18.3.3 There were some people who considered it "safe" to "place on records" their details of income & assets. Once they filed the returns, they continued to file the returns even if, in a particular year the income fell below taxable limits.

Sub-section 10 was specifically introduced to section 139 providing that if a return with non-taxable income were filed, it would be treated as "non-est". It would be ignored. In fact department was refusing to accept such returns.

Now there is a change in the policy. They want to maximise the number of people filing the returns. It is immaterial if the person has no taxable income.

All salary earners are now required to file returns. And all people are encouraged to file – either a regular return or at least the simplified form 2C.

18.4 **NRIs**.

18.4.1 Some people had raised a view that NRIs must file their returns if they had fulfilled any two out of the four conditions. Some departmental officers were insisting that such NRIs must file their returns. In the middle-east, some newspapers had published views that NRIs had to file their returns.

All these views are incorrect – as can be seen from the following analysis.

18.4.2 Proviso to S.139(1) creates several sets of conditions.

i. The person should be such that he is otherwise not filing income-tax returns u/s.139;

AND

ii. He is residing in a specified area;

AND

iii. Any time during the previous year, he fulfilled any two out of the four conditions pertaining to property, vehicle, telephone & foreign travel.

All the three sets – A,B & C had to be fulfilled for a person to be liable to file the return. Within the set "C", any two out of the four conditions had to be fulfilled. If any one of the three sets are not fulfilled, there is no liability to file the simplified form-2C.

Thus, for example, Mr. Patel is a farmer staying in a village. He is not resident of a specified city. But he has a motor car, a telephone and has travelled abroad during the previous year. Still, he is not liable to file return as condition 'B' is not fulfilled.

Similarly, NRIs, by definition are not residing in India. They are residing abroad. Hence, they do not have to file return under the proviso to S.139(1). Even if the NRI has one or more houses in the specified area and fulfills some other conditions also – he is not liable to file form 2C as he is residing abroad.

18.4.3 This view has been confirmed by a CBDT letter reproduced below :

CBDT has clarified that NRIs do not have to file the return based only on the economic criteria.

Ministry of Finance
(Department of Revenue)
Central Board of Direct Taxes
Foreign Tax Division

New Delhi, the 16th July, 1997

To
Shri Ram Buxani
Chairman, Overseas Indians Economic Forum,
PO Box 6
Dubai (UAE)

Sir,

I am directed to refer to your letter dated 26.6.97 addressed to Shri Ravi Kant, Chairman, CBDT, New Delhi regarding the articles published in Dubai based Newspapers on the applicability of the newly inserted proviso to Section 139(1) of the Income-tax Act, 1961 in the cases of NRIs and to say that the legal position has not been correctly reported.

The newly inserted proviso to Section 139(1) of the Income-tax Act is applicable in the cases of all persons residing in one of the specified cities who have not furnished return of income and in whose cases 2 of the 4 criteria relating to possession of immovable property, telephone, motor vehicle etc., are fulfilled. Technically speaking, therefore, if a person is not residing in one of the specified cities, he is not under an obligation to file the return of income even if 2 of the 4 criteria are fulfilled in his case.

However, if any of your member is in possession of immovable property, telephone, motor vehicle etc. in a specified area and wants to obviate the inconvenience arising from a possible issue of notice, he may voluntarily file the simplified return form in accordance with the provisions of Section 139(1) indicating therein the income taxable in India. The Chairman in his interview with the representatives of Khaleez Times had also clarified, in response to the specific query, that the NRIs who fulfil 2 of the 4 criteria in a specified city and who are desirous of avoiding any possibility of receiving a notice from the Department may voluntarily file the simplified return form in accordance with proviso to Section 139(1).

You may like to apprise your members of the above position of law and the practical suggestion given by the Chairman in the course of interview to the representatives of Khaleez Times so that there is no unnecessary scare amongst them.

In case you have any further clarification to seek, you may write to the Board without any hesitation.

Yours faithfully,

(RAJAT BANSAL)
Under Secretary (FTD)

Those persons who are filing regular income-tax returns have no responsibility to file form 2C.

If an NRI – or any other person has taxable income and is not exempted u/s.115G (see para 1.2 above); he has to file income-tax return.

If a person fulfills the condition of proviso to S.139(1) and has regular taxable income, it is better to file a regular return in form 2 or form 3 rather than in form 2C.

19. **Use of Permanent Account Number [Section 139A]**

Wherever any major transaction has to be undertaken e.g. purchase of immovable property, etc. it is necessary to quote permanent account number - (PAN). The income-tax department has however not been able to allot PAN to many persons inspite of applications being made more than two years ago. The budget provides that instead of PAN, the General Index Register Number (GIR No.) can be mentioned. GIR No. is the number allotted by the Assessing Officer on assessments.

In an interview with Mr. Yashwant Sinha reported in The Financial

Express dated 16th July, 1998, he has said that the GIR numbers are given to all tax payers. However that is not correct. Many times, the GIR No. is not given on the assessment orders. In such cases, persons will just have to mention "Not Allotted."

At the time of passing the budget, it has been provided that foreign tourists and agriculturists will be exempt from quoting PAN numbers. Such persons may file a declaration and also submit proof of their identity.

For transactions on the stock exchange, it was provided that the PAN will have to be quoted for transaction above Rs. 50,000/-. This limit is proposed to be increase to Rs. 10 lakhs.

F. Other important provisions

20. **Wealth Tax**

Provisions of wealth tax have been liberalised.

20.1 From 1st April, 1993, Wealth-tax is not payable on most of the assets. Last year, Wealth-tax Act was amended to include certain kinds of properties as taxable assets. Even commercial offices are taxable. Only those properties which the owner occupies for a business carried on by him are not taxable.

Even houses which are given on rent are also liable to wealth-tax. The budget now proposes to exempt commercial establishments from wealth-tax. Also if any house is given on rent for atleast 300 days in a year, it will also not be liable to wealth tax. This is a welcome provision.

20.2 Land is a taxable asset. However land held as stock-in-trade (by builders and developers) is exempt from tax. The land is exempt for five years from the date of purchase. This period is to be increased to ten years. With the depressed market conditions this should help the builders.

20.3 Any home given to an employee by the employer is exempt from wealth-tax, if the gross salary of the employee is not more than Rs. 2 lakhs.

This limit is proposed to be raised to Rs. 5 lakhs. This should also release a lot of staff quarters from wealth-tax.

20.4 One house is exempt from wealth-tax. The budget has provided that now a house or a plot of land will be exempt. The plot of land should not exceed 500 square meters.

Generally, wealth tax amendments are beneficial.

Gift tax is abolished totally.

21 **Gifts**

21.1 Currently gift tax is chargeable on gifts made by the donors. The tax is payable by the donors at the rate of 30% of the value of the property.

About five years ago, there was a proposal to make gift tax donee based - but it was shelved.

The budget had proposed to abolish gift tax for all gifts made on or after 1st October, 1998. Instead, the receiver of gifts was to be liable to income-tax on receipt of gifts. Now, at the time of passing the bill, the Finance Minister has proposed to abolish gift tax and not to impose income tax on deemed gifts.

21.2 Abolition of Gift-tax.

This is one step which calls for a lot of lateral thinking/paradigm shift.

21.3 The Finance Act has now exempted all kinds of gifts from taxation. First reaction is – "unbelievable!" How can you have a transaction of gift without any tax?

Then we realise that truly, an unimportant law has been abolished. We are free to arrange our finances in any manner that we want.

21.4 The next thought that occurs in our mind is that people will misuse the exemption. They will gift their savings and reduce their taxes. One may wonder – is the Government conscious of what it is doing? Why is it allowing openly, the people to avoid their taxes?

This is where lateral thinking comes in.

21.5 Which tax is being avoided? How much of the tax is being avoided? Will it really be worthwhile for the tax payer to avoid the tax?

21.6 **Income-tax**

One benefit that can be achieved by gifting is – transfer of income being earned on the property. If Mr. Patel gifts away Rs.10 lakhs worth of his bank deposits & investments to his adult children; he gets certain benefits. Each donee gets a separate basic exemption (Rs.50,000); lower tax rates; separate limit for chapter VIA deduction. So Mr. Patel can, effectively reduce his taxes.

21.7 It may be noted however, that the benefit of this simple tax planning is also meagre.

Upto a taxable income of Rs.1,50,000; the tax payable is only Rs.19,000. Over & above Rs.1,50,000 – the tax rate is 30%. This is uniform for all assessees. Hence, there is no benefit in gifting away more wealth than necessary.

If Mr. Patel gives a gift of Rs.10 lakhs and his average interest etc. income is 15% per year; the donee will have a taxable income of Rs.1,50,000.

How many people will give a gift of Rs.10 lakhs to save a tax of Rs.19,000 per year? If some people are prepared to give such gifts, let them do so.

Saner people will look at business requirements, control over funds and several other aspects before making substantial gifts.

21.8 This approach behind abolition of gift tax is a solid evidence of strong positive thinking at the highest levels in the Government.

Abolishing gift tax does not mean there will be a free-for-all.

Most people will breathe free & fresh environment.

Some will misuse it.

So be it.

21.9 **Cash Credits**

It has been held in the Samir Diamonds case that – the following must be established by the assessee to the satisfaction of the assessing officer : (i) the donor's identity; (ii) his financial capability to give gift; and (iii) the actual transaction of the gift. If all these three are not established, the assessing officer may be entitled to consider the gift as income under section 68.

Under the new provisions, if a donee with no taxable income receives gift of any amount, and cannot establish any or all of the above requisites; he has to be prepared to pay income-tax on the gift.

21.10 **Foreign Gifts**

Gifts received from abroad keep attracting the provisions of :

(i) Foreign Exchange Regulation Act, and

(ii) Foreign Contributions Regulation Act.

One must consider the provisions of these laws before accepting any foreign gifts.

We are not yet aware of the provisions of the "Money Laundering Prevention Act" that may come into effect. If & when the law becomes effective, its provisions should also be considered. Also see the Chapter on "Resurgent India Bonds", part VI.

Samadhan scheme proposes to reduce litigation.

22 **Samadhan Scheme**

22.1 The budget has introduced a scheme whereby it proposes to reduce litigation pending at various courts. The assessees can pay tax at the current rates and close the pending matter.

22.2 The scheme mentions that if any person has filed an appeal with the tribunal, or any court, he can opt to take recourse to this scheme. The assessee will have to file a declaration with the Income tax department giving details of the amount of tax arrears, and disputed income in appeal. Within sixty days of filing the declaration the department will determine the amount payable.

22.3 The amount of tax arrear payable is as under:

	Person	**Disputed items**	**Rate**
22.3.1	Company or Firm	Income-tax, interest And penalty	35% of disputed income
		Only interest and penalty related to disputed income	50% of interest & penalty
22.3.2	Other than companies and firms	Income-tax, interest and penalty	30% of disputed income
		Only interest and penalty related to disputed income	50% of interest & penalty
22.3.3	Company or firm (in case of raid)	Income-tax, interest and penalty	45% of disputed income
22.3.4	Other than companies and firms	Income-tax, interest and penalty	40% of disputed income

22.3.5	All assessees	Wealth-tax, interest and penalty	1% of disputed wealth.
		Only interest and penalty related to disputed wealth	50% of interest & penalty
22.3.6	All assessees	Gift tax, interest and penalty	30% of disputed gift.
		Only interest and penalty	50% of interest & penalty

There are similar provisions for interest tax and expenditure tax.

22.4 Any person who pays the tax under this scheme will be granted an immunity from interest, penalty and prosecution under direct tax laws. Further the appeal filed will be withdrawn.

22.5 The immunity does not apply in the following situations:

- if prosecution has been instituted;

- if there is no appeal with any Appellate authority;

- if any order has been passed by the Settlement Commission;

- if any prosecution has been launched under Indian Penal Code, Narcotics and drugs act, COFEPOSA, Prevention of Corruption Act, etc.

22.6 The budget had proposed that the relief will be available only to those persons who have tax arrears. If the assessee has paid the disputed tax (even if it is under protest), due to which the outstanding arrears are reduced, then the relief is not available for taxes already paid. The object of the scheme is to reduce litigation and not to collect revenues. By denying relief to those who have already paid their taxes, it is injustice to them. Recognising this, the Finance Minister has provided that the scheme will be applicable even if there are no arrears.

Those who have paid taxes will not be eligible for relief.

22.7 **Benefits of the Scheme**

22.7.1 **Prosecution**

The way, the Income-tax Act Chapter XXII is drafted, once a prosecution is launched, all dices are loaded in favour of the department. A

"Samadhan" under the scheme gets an immunity from possible prosecution. This itself can be a great relief in several cases.

22.7.2 **Tax Amount**

In the past, tax rates were high. Now, a dispute can be resolved by paying current low rates of tax. This can be a significant saving.

22.7.3 **Penalty**

Samadhan is not a VDS scheme.

Sometimes, the assessment order may be passed, penalty proceedings may be instituted but not finalised. In such cases the penalty may not have been determined. The penalty proceedings may be finalised only after the appellate proceedings are finalised. Hence no penalty is determined and no arrears on account of penalty.

On completion of the procedure under "Samadhan Scheme", the appellate proceedings come to an end. However, it cannot be said that either the department has won or the appellant has won. This is simply a compromise.

Yet the officer can not impose any penalty on the declarant because of immunity granted U/s. 94. Hence the assessee does not have to pay anything on account of penalty.

22.7.4 **Litigation costs** can be brought down.

22.7.5 The **uncertainly** of litigation and the relevant risks can be quantified and brought down to a certain amount.

Those to whom this scheme is applicable ; and where the issues do involve uncertainty ; this is a good opportunity to get rid of hassles and buy peace.

22.8 **Clarification** "Samadhan" scheme is not a "Voluntary disclosure scheme". There is no question of laundering money. The scheme is for plain and simple compromise of a pending litigation.

Advance ruling is extended to Residents.

23 **Advance Ruling**

The Government had introduced a scheme of Advance Rulings in 1995. Non-residents who want to know the taxability of a transaction, can file an application with the Authority for Advance Ruling (AAR). The ruling given by the AAR is binding on the assessee and the Income-tax department. This helps the non-residents to know the taxability of a transaction before it takes place.

This facility is proposed to be extended to specified residents also. The details of specified persons will be notified later.

There is however a difference in the applicability of the provisions to non-residents and residents. For non-residents, advance rulings can be given for a "transaction" which has been undertaken or is proposed to be undertaken. For residents, it is proposed that the advance ruling can be given for any "assessment" which is pending before any income-tax authority or tribunal. Residents will be able to take advantage of the advance rulings in case of pending appeals in Tribunals.

24 **Capital gain on sale of immovable property - Section 48**

Section 48 of the Income-tax Act provides for computation of capital gains. It is basically sales less cost of purchase. For immovable properties, the budget had proposed that if the value as assessed by the State Government is more than the sales consideration, then that value shall be considered as the sales consideration. The provision could have caused undue hardship and complications.

It is quite possible that the value for the purpose of stamp duty is different from the sale consideration. (Stamp duty authorities normally have charts for market rates of properties in different areas of the city. It is updated periodically.) The selling price may vary from building to building, from floor to floor, etc. Recognising the difficulties and apprehensions, this amendment is dropped.

IV. TAX PLANNING

The concept of "tax planning" has undergone structural change.

With a sea change in Indian Direct Tax system, the concept of "tax planning" has undergone considerable change. Earlier, one would like to take a chance on a favourable interpretation of law, would like to "fight it out till the end"; would consider interest – saved by delaying the payment – itself as enough incentive to do the tax planning.

All that has changed.

1. **Viable Tax Planning**

A viable tax planning is one where –

(i) There is reasonable certainty about the fairness of interpretation; so that too much litigation is avoided.

(ii) The facts are not changed or twisted. Businessman will do the business in the normal and natural manner that he would otherwise do. He will then examine the laws and find out the benefits available. There must be a "substance" in the nature of transaction from a commercial viewpoint. Mere "form" will not do.

(iii) Such a planning should normally be approved by the department. In case, the department does not accept it; then before filing the appeal, cost-benefit analysis may be made.

(iv) Benefit can be – tax saved by a favourable interpretation as compared to the department's interpretation. Compare this with the costs of –

2. Tax planner's fees, Legal fees in fighting out the appeals; value for the businessman's time & energy lost in litigation etc.

If the benefits for next three years are projected to be in the range of two to twenty times the projected costs; then the planning may be implemented. Otherwise the planning may be discarded and tax may be paid – up.

Some Indian resident – green card holders & U.S. citizens have to do planning to avoid U.S. estate duty.

3. **Cost – Benefit Analysis**

A Macro View of The Indian Tax System

Today, Indian direct tax rate system is one of the best in the world.

There is no **Estate duty**. An entire reason for complicated tax planning has disappeared from India. (Para). Americans go to great extent to do their planning to avoid the estate duty which can go beyond 50%.

The **Wealth-tax** is insignificant. On most of the business assets and even some personal assets, the wealth-tax is not leviable. Even on taxable assets, a basic exemption of Rs. 15 lakhs is available. There after 1% tax is payable.

The Indian tax system is simpler than the systems of several countries.

Income-tax is – at the maximum marginal rate, 30% for individuals and 35% for firms & companies. This is one of the lowest rates amongst most industrial countries. In fact, better than some tax havens also. (Switzerland has estate duty and Mauritius income-tax rate is 35% for the locals.)

With the passing of the Finance Bill, 1998 now there is no **Gift Tax** in India.

There is another reason to appreciate the Indian tax system.

In U.S.A., Switzerland, Germany etc. – income-tax is levied at multiple levels. The federal Government levies income-tax. The State Governments levy income-tax. And the municipalities also levy income-tax. And in most places the Church or the Maulavi also levy their own taxes.

Those who have studied U.S. Internal Revenue Code say that it is extremely complex and stern.

Compare this with India. Our laws are far better.

The tax administration can of course be improved. It will. With the lower tax rates, there should be far lower desire for tax evasion. When the tax payers and the tax advisors become honest, the administration will have no alternative but to improve.

Some people will still need to do tax planning. However, when the tax system itself is excellent, the benefits arising due to planning are bound to be lower.

4. Compare these reduced benefits with the high costs of planning.

5. **Retrospective Amendments**

If the assessee adopts an unreasonable & far fetched interpretation of law, there is a fairly good chance that the Government will amend the law with retrospective effect. Then all the time & money spent on planning & litigation would be a dead loss.

6. **Recovery of tax**

Earlier, the tax payer was happy in delaying tax payment. The taxes delayed improved his cash flow and reduced interest cost. When ultimately (may be after 20 years) the tax was payable; he had saved enough on account of interest. And the value of money payable after 20 years had gone down due to inflation. Earn in the year 1970 and pay tax in 1990 – anyone would love it.

However, this situation has changed. Now the tax department normally recovers the tax immediately after assessment. Sometimes a stay for recovery may be granted for appeal upto the first stage. For subsequent appeals, if the department has won the case, stay for recovery is rare.

There is little charm left in fighting once you have already paid the taxes.

7. Additional Tax

The costs of tax planning are quite high.

If the interpretation is a "wild" or unreasonable interpretation, the assessing officer may, in some circumstances impose additional tax u/s. 143(1A).

8. **Cost of Litigation**

Court fees have been increased by the Government. Professional fees have always been high.

9. A tax payer will look at his cost-benefit analysis & decide –

(i) Whether to do planning or not; and
(ii) Having resorted to planning if assessment order is adverse, - whether to go ahead with litigation or pay – up the tax.

10. Government has assured that :

Benefits of tax planning are considerably reduced by lowering the tax rates; and by enforcing tax payment while appeals are going on.

Costs of tax planning are very high because – (I) the advisors' fees are high; and (ii) ultimately, if tax is payable, it will attract substantial interest.

Chances of winning the planning game are reduced by amending the law.

Hence, tax planning is now a game only for certain categories of people.

International taxation is a new area which has opened up.

11. And yet, a whole new era of tax practice & administration has opened up before our eyes. It is well said that when one door is closed, larger gates are opened up – which make life even more interesting.

Practice & administration of International Taxation is the new area opened up in India..

Government has been consistently opening up the gates for global business. After the nuclear test, the present Government has also decided to give liberal permissions for foreign investments into India. More & more Indians are exposed to international business/services. They need advisors who can plan their affairs.

Most of the times, international tax planning does not even amount to paying lower taxes to Indian Government. Largely we may be taking benefits of the law that is intended; and saving taxes payable to a foreign Government. Hence, there is much less scope for any dispute with the department.

V. SERVICE TAX

Service tax has been extended to many other sectors.

Some views

1. Government gets revenue without much botheration. If you have sold a service like telephone / insurance etc. pay 5% tax. No calculations. No allowance of expenses. No set off. Simply, pay the tax to the Government.

   This means, it is an indirect tax like excise. Not a direct tax like income-tax.

   Such indirect tax is levied in several European and American countries on services like doctors' or chartered accountants' services. There is nothing exceptional about it.

   Only, in India, professionals consider themselves as something superior than others. And their superiority does not mean more sacrifice for the nation. It only means less of taxes for them.

   Government has no reason to believe in it.

2. When service tax is imposed as an indirect tax, in fairness, modvat set off should be granted.

   Chartered accountants also pay service tax on several services purchased – telephone, electricity, professional services etc.

   Probably, by levying 5% tax, instead of higher rates prevailing on industrial goods; and by denying set off; government have sought simplicity in operation.

3. Service tax revenue is as under-

1997 – 98	Rs.1,500 crores.
1998 – 99	Rs.2,100 crores. (projected.)

4. By abolishing service tax on transport operators:

   (i) Mr. Chidambaram and Mr. Yeshwant Sinha – both have established that if you are more vocal, and if you have the power of holding the economy to ransom by going on strike; you can escape taxation.

(ii) Any tax on an essential service like transport is a direct contribution to inflation. To the extent tax on transport is abolished, inflation is contained.

In future, we will have to add 5% on our bills.

VI RESURGENT INDIA BOND (RIBS)

RIBs will offer better rates than those prevailing in international markets.

Finance Minister had announced a scheme of Resurgent India Bonds. State Bank of India has now announced the scheme as under :

Foreign Currency denominated Bonds issued by State Bank of India to NRIs, OCBs and Banks acting in fiduciary capacity on behalf of NRIs/ OCBs.

1. **Salient Features:**

1.1 Tenure : 5 years

1.2 Currencies : US Dollar, Pound Sterling and Deutsche Mark.

1.3 Interest Rates: US Dollar – 7.75% p.a., Pound Sterling – 8.00%, Deutsche mark – 6.25%

1.4 Minimum Subscription: US Dollars 2000; Pound Sterling 1000; DM 3000. Additional investments, in multiples of 1000.

1.5 Payment of interest: Half yearly, or at the option of the investor, cumulative.

1.6 Repatriability: Principal and interest will be paid in foreign currency to non-resident holders.

1.7 Joint holdings: Permitted with non-residents/residents, in the form of 'Former or Survivor'.

1.8 Tax benefits: Interest exempt from income tax.
Bond exempt from wealth tax and gift tax. (In any case, all bonds are free from wealth-tax & there is no gift-tax.)
Income-tax benefit will be available to transferee and donee holders also.

1.9 Transferability: by endorsement and delivery.

1.10 Premature payment: No penalty, however, only in non-repatriable rupees, after a minimum period of 6 months.

1.11 Loans: available to holders and third parties against collateral of the Bonds.

1.12 Utilisation of funds raised: mainly for the development of the infrastructure sector.

1.13 Date of launch: Wednesday, 5th August, 1998.

1.14 Scheduled closing date: Tuesday, 4th September, 1998.

1.15 Earliest closing date: 10 working days.

RIBs are not under immunity scheme.

2. **Comments :**

2.1 This is not an immunity scheme. The RIBs are not like the India Development Bonds issued by the State Bank of India under the Immunity Scheme of 1991. There is no immunity granted under any law either for the subscriber of the bonds or for the receiver of gift of bonds. Hence RIBs cannot be used for money laundering.

2.2 If the history is any guide, several brokers will come up like mushrooms and several gullible people will "buy" the RIBs.

In the following paragraphs, we explain the dangers involved; give the arguments that the brokers usually give and explain why the arguments are false.

3. **Modus operandi for Money Laundering**

When Mr. Patel with black money wants to launder that amount into white, he would pay cash to a broker or an NRI. The broker will deduct his commission & transfer the money to an NRI by "havala". The NRI would purchase/subscribe the RIBs. Later on, he would gift the RIBs to Mr. Patel.

There are several permutations & combinations. Above is a simple method illustrated.

4. **Broker's Argument**

The broker argues in favour of the entire business on the following lines.

4.1 Under FERA, there is no restriction on receipt of gifts of RIBs.

4.2 There is no Gift-tax now.

Both the transactions – of subscription of RIBs by an NRI; and gift of RIBs to Indian residents - are perfectly legal & above board.

4.3 There is no evidence of the cash paid by Mr. Patel. And he may not be involved in havala. So why should he worry?

5. The fallacy

5.1 The moment, foreign exchange & NRIs are involved, FERA is involved. Simple black money in India is violation of Income-tax Act & Wealth-tax Act. In the above scheme, a violation of FERA is also involved.

5.2 "Havala" is one of the more serious violations of FERA.

5.3 "Enforcement Directorate" (ED) probably knows all the important havala racketeers. It knows where to apply its intelligence network.

Costs of "buying" RIBs by residents can be very high.

5.4 Paying cash with an intention of obtaining RIBs is violation of FERA. One who does these transactions cannot claim to be ignorant of the law. In any case "ignorance of law" in such cases may not be adequate excuse.

5.5 When a matter goes before the ED, they do not ask for evidence. They have other methods of making the party confess. And a businessman normally cannot withstand the pressures involved. He will sign the confession with full details.

There will be the usual costs; the penal & prosecution proceedings will continue for ever.

5.6 Income-tax officer can treat the RIBs as unexplained investments under sections 68 to 69B, treat the amount as undisclosed income and start tax recovery, penal & prosecution proceedings. See paragraph 13 under "Gifts" chapter.

All consequences put together are high.

Tax @ 30% is a lower cost than the cost of taking such risks.

We would strongly discourage anyone from using RIBs for laundering their money.

6. RIBs are not meant for Indian residents having black money (or even white money) in India.

They are also not meant for Indian residents having black money abroad.

RIBs are only meant for non-residents.

7. A genuine non-resident may certainly find RIBs a good investment. If, later, he wants to make a genuine gift to any of his relatives, it is perfectly legal.

NOTES

NOTES

Useful Indian Web Addresses

* Bombay Stock Exchange (BSE)
  http://www.bseindia.com/

* Budget 1998 (Finance Ministry)
  http://www.nic.in/indiabudget/budget98-99/

* Central Statistical Organisation
  http://www.nic.in/stat/

* Discover India (Ministry of External Affairs)
  http://www.meadev.gov.in/

* Department of Company Affairs
  http://www.nic.in/dca/

* Economic Survey '97
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