ECONOMIC SITUATION AND TAXATION PROPOSALS

The Minister of Finance and Iron and Steel (Shri T. T. Krishnamachari): Mr. Deputy-Speaker, Sir, I am taking the liberty of encroaching on the valuable time of the House to make a statement because I propose to ask for the leave of the House to introduce two Bills.

Ordinarily, a speech is not necessary on the occasion of introducing a Bill. As the titles, however, indicate these two Bills are Finance Bills; and although they are being presented in the form of two separate Bills, they represent a set of connected proposals.

Sir, the economic situation was reviewed in detail in September last in connection with the debate on the Plan. My main conclusion then was that while there were yet no signs of a general inflationary situation, there were vital points in the economy which were under pressure. That broadly is a correct characterisation of the present situation although the strain on the economy may well increase in the coming months because of the gathering tempo of the Plan and of the international situation.

The index of wholesale prices remained more or less steady for about eight weeks since early September but there has been a rise of some ten points in the last two weeks. It is too early to say whether prices are about to resume an upward trend or whether they will keep around the level they have maintained over the last two or three months. The outcome depends partly on the crops and partly on international developments. It is clear, however, that the price situation will have to be watched closely and every effort made to ensure that the pressure of demand on available supplies does not go too far. Money supply in the hands of the public is now Rs. 147 crores more than what it was twelve months ago and the level of bank credit outstanding is higher by Rs. 163 crores as compared to the level about this time last year. During the current slack season, money supply declined much more than in the previous slack season, but the major contractionist factor has been the large import surpluses we have been having of late. The demand for funds has continued unabated and the resources of the banking system are fully strained. Government are anxious to ensure that the legitimate needs of trade and industry do not suffer on account of the present tightness in the money market. It is necessary at the same time, in view of the price trends mentioned above, that credit creation by the banking system is kept within reasonable limits. These are matters of day-to-day monetary management and I need hardly dilate on them at any length at present.

There is, however, an aspect of the economic situation to which special attention is necessary—I mean the foreign exchange situation. Since the end of March 1956, the foreign exchange reserves held by the Reserve Bank have declined from Rs. 746 crores to Rs. 543 crores—a fall of over Rs. 200 crores. Although this decline has taken place as a result of the large imports required for the Plan, and not because of any unplanned imports, it is obvious that this rate of drawal cannot be sustained for any length of time. We are now fairly close to the minimum level of reserves we ought to maintain and I must tell the House, and the public at large, that a most determined effort to conserve and augment our foreign exchange resources is now called for. This consideration must, in my judgment, be given higher priority than the consideration regarding internal prices, although the latter is important. The requirements of foreign exchange for the Second Five Year Plan are proving even larger than were estimated, and it would be necessary not only to economise on

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imports and to increase our exports, but also, in addition, to take active steps to secure the necessary quantum of supplemental resources from abroad.

This brings me to the international situation which has taken a turn for the worse in the last few months. The House is aware of these developments and I need hardly dilate on them. What started as action to keep the Suez Canal open has resulted in closing it completely. On the most optimistic estimates it will take anything between three to six months for the Canal to be opened again. The work of clearing up the Canal has not yet started, and, on the whole, I should think we would be wise in assuming that it will take almost a year before normal traffic on the Canal is resumed. Even before the outbreak of hostilities in that area, a shortage of shipping was developing and this has now been accentuated. The shortage of shipping is, of course, not confined to the areas or routes affected; it has and will become more and more a global shortage. We are taking measures to ensure that the available shipping space is utilised for bringing in our priority imports. A certain lengthening of shipping schedules is, of course unavoidable, and freight rates and insurance charges have already gone up. If, as may be hoped, the closure of the Canal is not too prolonged, we expect to be able to face the temporary difficulties I have mentioned above without any serious dislocation to our Plan. But it would hardly be proper at this stage either to take an optimistic or a pessimistic view of the future in this matter. All I should like to say is that for the next few months we shall have to exercise the fullest vigil not only in regard to our internal situation but also in respect of developments abroad.

I come now to the more immediate problem in hand, namely, taxation. Taxation policy at this stage has to be determined in the light of two main considerations: (a) the requirements of the Plan, and (b) the general economic situation. As regards the former, the position needs only to be briefly stated. The Plan requires mobilisation of financial resources on a scale not attempted hitherto. The Planning Commission has put forward a target of Rs. 850 crores by way of additional taxation over the five-year period. The outlay required for carrying through the development programmes incorporated in the Plan will, it is now estimated, require Rs. 400 to Rs. 500 crores more than the total of Rs. 4,800 crores envisaged in the Plan document. This is partly because some of the financial provisions in the Plan were inadequate; partly, the higher estimate reflects the increased cost on account of higher domestic or external prices. The domestic effort for raising resources will, in consequence, have to be larger.

The general economic situation has also altered somewhat since the Plan was formulated. Prices have registered an almost continuous upward trend—the index is now 430—and the danger of inflationary pressures getting the upper-hand has to be safeguarded by taking steps to mop up a part of the purchasing power now with the public. This is evidenced by the fact that the demand for food, for cloth, for steel and for cement has been rising rapidly. In a sense, the creation of new demands all along the line is of the very essence of developmental planning. An under-developed economy suffers from insufficient demand, insufficient investment opportunities and insufficient production. The vicious circle has to be broken at various points, that is, by a simultaneous expansion of demand and of production. There is danger of inflation when demands grow more rapidly than supplies. One part of the economic policy for the plan period is to increase production, in the short run especially of articles of general consumption like food and

cloth; the other part is an appropriate tax policy aimed at regulating the flow of purchasing power so as to ensure that development proceeds under conditions of economic stability.

In the last session of Parliament, the excise duty on cloth was raised with a view to checking a situation of developing scarcity and consequent windfall profits for the producers or traders. The time has now come for some increase in direct taxation which will on the one hand restrain non-priority spending and on the other afford some corrective to inequalities of income and wealth. This is the two-fold objective behind the proposals now being made.

The Indian tax system has got into a settled groove. It does not bring into the public exchequer even a constant proportion of national income. If a development programme of the dimensions we have in hand is to be carried through successfully the tax system has to be made more elastic. It is hardly possible to do this by stepping up any further the rates of direct taxation, which has now reached a stage when a straightforward increase in the rates would yield poor results. It is necessary now to increase the coverage of taxation by reaching a class of incomes which has hitherto been kept out of the purview of the income taxation—I mean capital gains. Capital gains are an important factor in aggravating economic inequalities, and there is no justification for regarding capital gains as a species of income not liable to taxation. This is a lacuna in the tax system of most countries, a lacuna, one dare say, they will have to rectify in due course. For a developing economy like ours, it is necessary to take early action as the implementation of our programmes is certain to create conditions, if it is not already doing so in which assets of all kinds will appreciate. It is only fair that the exchequer should get a proportion of these incomes when realised in the form of capital gains.

Secondly, the problem of raising resources for investment has to be looked at both from the point of view of the public sector and of the private sector. Just as an increase in public saving is necessary for financing the investment in the public sector, an increase in corporate saving is required for meeting the needs of the private sector. Personal saving is undoubtedly important, but the large-scale investment that is needed for the private sector can hardly be found by individuals. There is a trend in the industrially advanced countries of Western Europe towards greater reliance on corporate savings. The main source of capital for private enterprise in these countries is savings effected by industry itself, supplemented by funds obtained from other institutions in the field of industrial finance. We have increasingly to look to these institutional sources for finding funds for the development of industry. Suggestions have been made on the floor of the House from time to time for dividend limitation, imposition of excess profits tax and the like. These are devices which have been tried in the past but with no great success. In the last budget, a tax on dividends was introduced and a further tightening in the same direction is now called for. This is a better course of action than limitation of dividends by law to a prescribed maximum. It is administratively simpler and it leaves discretion regarding dividend policy to the company or corporation concerned subject to the tax liability it has to meet.

The ploughing back of profits which it is sought to encourage will enable companies to build up larger reserves. It is important that these reserves are used in pursuance of the investment policies laid down in the plan. It would, of course, be wrong to impede in any way the utilisation of these reserves for the legitimate

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purposes of expansion or modernisation for the unit or for the industry concerned. Every facility should, in fact, be given to encourage such use and to direct the balance of reserves for the time being unutilised towards channals in which investment is called for in order to promote the pattern of development envisaged in the plan.

I have mentioned earlier the rapid drawing down of our sterling reserves in the last few years. Although this drawing down is a reflection of the genuine increasing needs of the economy for our development programmes and it would be wrong to take an alarmist view of the situation, it is necessary at the same time to make the utmost effort to conserve and develop our foreign exchange resources. One plank in this programme has to be export promotion, but this is a theme on which I do not propose to dwell in the present context. The other plank is restraint in the matter of imports. The proposals that I am now making are intended to facilitate this latter process. A tighter policy on imports will reduce available supplies and tend to push up prices to the maximum that the consumer will pay. In these circumstances, if there is a large difference between the landed price of the article and the price which the consumer is prepared to pay, the profits will go entirely to the trader. The import duties now proposed will serve to mop up a portion of these unmerited profits. I should stress here that the articles in question are of a luxury character and the raising of import duties does not in any way impinge on the consumption of the mass of the people.

I now come to my detailed proposals. I am circulating to hon. Members two memoranda explaining the provisions of the Bills, but I may briefly refer to them here. Dealing first with direct taxation, my first proposal is to impose a tax on capital gains made on or after the 1st April, 1956. As hon. Members are aware, a tax on capital gains forms part of our existing Income-tax Act, but it was, in operation only for a short period, that is, in respect of capital gains which arose during the period 1st April, 1946 to 31st March, 1948. In the present Bill, I have somewhat altered the existing provisions.

The definition of "capital gains" remains unchanged, but some of the existing exemptions are proposed to be withdrawn. These are capital gains arising on transfers of property on compulsory acquisition, capital gains arising on distribution of assets on dissolution of partnerships or on liquidation of companies, capital gains arising on the sale or residential property possessed by the taxpayer for seven years, etc. Such gains will now be subjected to tax.

Under the existing law, capital gains up to Rs. 15,000 are not subject to tax in the case of individuals. This limit is proposed to be reduced to Rs. 5,000, but an additional concession is proposed to be given to persons in the lower income groups in that no capital gains tax would be chargeable if the total income, including the capital gains, does not exceed Rs. 10,000. I am also considering some concession for small people making gains by the sale of small and medium-sized houses. Under the existing law, capital gains are to be taxed on the basis of slab rates. This, however, bears no relation to the other income of the person making the gains. It is now proposed that the rate of tax to be charged on capital gains should be the income-tax rate applicable to the other taxable income of the assessee increased by one-third of the capital gains he makes in the relevant year. In the case of companies, the rates of tax will be the usual income-tax rate.

Another important change is that the assessee has the option to have his gains worked out either on the basis of original cost or on the basis of its value on the 1st January, 1954.

My second proposal is to increase the rates of super-tax payable by companies which declare dividends in excess of six per cent. of paid-up capital. For the current financial year, such super-tax is two annas and three annas in the rupee in respect of dividends declared between six per cent. and ten per cent., and above ten per cent., respectively. I propose that for the financial year 1957-58, the rates of super-tax should be two annas per rupee for dividends between six per cent. and ten per cent. four annas per rupee on dividends between ten per cent. and eighteen per cent. and six annas per rupee on dividends in excess of eighteen per cent.

My third proposal is not a direct taxation measure, but relates to a proper control over the depreciation and other reserves of companies. Such control becomes imperative when the effect of tax on dividends is to increase the resources of the company. At present, large deductions are made in the computation of profits and of gains of a business by way of development rebates and depreciation allowances. These deductions are related to buildings, plant, machinery and other assets used in the business and are permitted on a consideration of the unduly high cost of acquisition of capital goods, of the possible wear and tear which these assets may suffer by their use in the business and of the need to enable the undertaking to build up adequate funds internally for rehabilitation of its assets from time to time. In the interests of the industrial development of the country, it is necessary that these tax-free reserves are utilised for purposes conducive thereto and not frittered away in other ways. Once we accept the policy of discouraging the distribution of profits, it is essential simultaneously to ensure that the retained profits are put to uses which promote industrial development in accordance with the plan. I propose, therefore, that in the case of companies, depreciation allowances and development rebates due will be added back in the computation of the income, unless a certain amount is deposited with the Government or with the Reserve Bank of India, as Government might determine, before the 30th June of the relevant assessment year. The amount to be deposited will be partly a certain percentage of the excess of the available current profits after payment of taxes and of distribution of dividends over one lakh of rupees and partly a certain percentage of the past accumulated profits and reserves which are not represented by fixed assets in the business. The Bill provides that the percentages will be subject to the ceiling of 75 per cent. as regards the current profits and 25 per cent. as regards the past accumulated profits and reserves. It is, however, my present intention to fix the former at 50 per cent. of the current profits only. The deposits will carry interest and will be refundable wholly or in part on request by the company if the Government is satisfied that the amount refunded will be used by the company in the business for purposes approved by Government in furtherance of the objectives of the plan. It is proposed to constitute a Board of Referees to advise Government on this matter. While it is our intention that a large part of these deposits has to be utilised for the development of industries envisaged in the plan, such residue as is left over from year to year will cumulatively add to the resources of the plan.

My last proposal relates to Section 23A companies. At the present moment, a Section 23A non-investment company, which has failed to make the minimum of 60 per cent. distribution of dividends to its shareholders, is required to pay an additional super-tax on the whole of its undistributed profits at the rate of four annas in the rupee, while an Investment company in a similar situation pays eight annas in the rupee. In view of the proposed increase in the rates of super-tax on dividends, it is felt that the rate of four annas for a non-invest-

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ment company will be low and it is, therefore, proposed to raise the rate of additional super-tax for such cases from four annas to six annas. However, it is necessary to give some encouragement to industrial companies to retain their profits for expansion and development. I propose, therefore, to reduce the minimum distribution for a Section 23A industrial company from 60 per cent. to 50 per cent. The procedure for exempting companies from the operation of the provision in industrial concerns which fall within the scope of Section 23A in deserving cases will be continued.

Coming now to Customs Duties, suitable increases in the import duties are proposed on certain selected articles. These fall broadly into three groups.

There are, firstly, a number of articles ordinarily used by the more well-to-do section of the population. Notable among these are wines and spirits where the duties are being raised approximately from 25 to 50 per cent. so as to produce about Rs. 70 lakhs annually. Another Rs. 50 lakhs are expected from the increased duties on motor cycles and sccoters and clocks and watches.

The second group of articles comprises items like coal-tar dyes and certain types of macinery where, on the one hand, the existing duties are low, and on the other indigenous manufacture has made fair progress. The increases proposed are to be effected partly by changes in the Bill and partly by withdrawal of concessions at present given by executive Notification. While these will have a negligible effect on costs of consumer goods, they are expected to produce an annual yield of about Rs. 180 lakhs.

Lastly I propose an increase in the import duty on artificial silk yarn. With the shortage in supplies of cotton cloth, the art silk industry has been doing quite well of late. There has been a substantial increase in production of art silk fabrics, and since these fabrics compete to some extent with fine and superfine cotton farbrics, they are in a position to bear higher taxation than they do at present. However, having regard to the somewhat fluctuating conditions which have prevailed in the art silk industry in the past, I consider it desirable, that, while the tariff rate should be pitched at a certain maximum level, Government should fix the effective rates from time to time, according to current needs, by executive Notification. The import tariff rate I have proposed is Rs. 3 per lb., but the immediate effective rates will vary from Rs. 1-4-0 to Rs. 2/- per lb. according to deniers. I expect an annual yield of Rs. 160 lakhs from these duties.

I am suggesting a corresponding change in the excise side by proposing the imposition of a Central Excise duty on indigenous art silk yarn. With the protection afforded by a high duty on imported art silk yarn, the restrictions on imports, and increasing demand, the indigenous producers of art silk yarn have been making substantial profits. The excise duty I have proposed is again a ceiling rate of Rs. 1-8-0 per lb. which is being brought down by executive Notfication to 4 annas per lb., and 8 annas per lb. according to deniers. These effective rates generally maintain the measure of protection enjoyed by the indigenous products against the imported product. The annual yield I expect from these rates is Rs. 70 lakhs.

A low excise duty of 2 annas per lb. is being provided, by Notification, for staple fibre and staple fibre yarn.

I have also proposed an excise duty of Rs. 3,000 each on the more expensive types of motor cars made in India. This duty will not fall on trucks or on small cars and is expected to yield about Rs. 80 lakhs in a year. To the extent it discourages the production of big cars, we will have diverted valuable foreign exchange to objects of greater utility.

It is somewhat difficult to make an estimate of the actual yield of Customs duties. On the basis of current imports,

the yield should be about Rs. 9 crores per year. As, however, there is likely to be a substantial reduction in the quantum of imports, the actual extra revenue may well be about Rs. 6 crores in a full year.

Thus, the cumulative financial effect of my Income-tax, Customs and Excise proposals would be about Rs. 16 crores per year, or Rs. 64 crores during the plan period.

I propose also to increase substantially the stamp duties on the Bills of Exchange. As the House is aware, there are certain slab rates prescribed in the Stamp Act which go up to 15 annas per Rs. 1,000 in the case of bills payable not more than a year after they are drawn. By a Notification issued in 1940, these slab rates were substituted by a flat rate of two annas per Rs. 1,000. It is now proposed to increase the statutory rate to Rs. 10 per Rs. 1,000 for such bills with proportionate reduction for bills of shorter duration. These are intended to be ceiling rates and it is my present intention to operate on the basis of half these rates. This increase of duty is, it will be appreciated; a fiscal measure with a monetary intent. The additional revenue resulting from the increase will accrue to State Governments. There is thus no effect on Central revenues.

Proposals regarding Customs and Excise Duties will take effect immediately. Those relating to direct taxation are in respect of current profits and gains but can be assessed only in the next financial year. Changes in Stamp duties will come into force when the law is passed.

This brings me to the end of my proposals for the day. These measures have to be judged not only from the point of view of their immediate yield but also in the light of the requirements by way of financial resources for the period of the plan. The budgets of the Central and State Governments this year show a deficit of over Rs. 400 crores for financing a plan outlay of about Rs. 800 crores. The extent of deficit financing has from now on to be operated within limits if it could not be progressively reduced, if prices are to be prevented from going up further and creating fresh difficulties through increased pressures for higher wages and increased costs all round. The full yield of some of the measures mentioned above will accrue only gradually; but this only means that the earlier the task is begun the better it is from the point of view of the overall stepping up of investment which we propose not only during the Second Plan period but for several plan periods to come.

5 P.M.

In conclusion, I should like once again to emphasize the need to step up as much as we can the rate of savings in the economy in order to match it with the investments we are undertaking. This is no easy task. I should also stress that while an under-developed economy has to depend in some measure on resources from abroad, the amount of such assistance itself depends upon the efforts we make domestically to keep down inflationary pressures and to mobilise the savings of the community for the Plan. We have put all our hopes on the Plan and we must do our best by it. It is suggested in some quarters that we ought to revise our Plan in view of the increase in outlays required to which I have made a reference earlier, and particularly in view of the unfavourable turn in the international situation. I think suggestions of this kind are defeatist in themselves and are quite unjustified. We are only in the first year of the Plan, and although the tasks we have taken upon ourselves are large and difficult, I see no reason to be pessimistic of our capacity to implement the Plan. Nor is there anything in the international situation which, at this stage, suggests a revision of the Plan. I am convinced that they do wrong who express scepticism at a time

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when the country ought to be thinking of nothing else but going ahead with the greatest determination. The Plan is a challenge, and it is a challenge which must be met with all the resources and ingenuity at our command.

FINANCE (NO. 2) BILL*

The Minister of Finance and Iron and Steel (Shri T. T. Krishnamachari): I beg to move for leave to introduce a Bill to increase or modify the rates of duty on certain goods imported into India and to impose duties of excise on certain goods produced or manufactured in India and to increase the stamp duty on bills of exchange.

Mr. Deputy-Speaker: The question is:

> "That leave be granted to introduce a Bill to increase or modify the rates of duty on certain goods imported into India and to impose duties of excise on certain goods produced or manufactured in India and to increase the stamp duty on bills of exchange."

The motion was adopted.

Shri T. T. Krishnamachari: I introduce† the Bill.

FINANCE (NO. 3) BILL**

The Minister of Finance and Iron and Steel (Shri T. T. Krishnamachari): I beg to move for leave to introduce a Bill further to amend the Indian Income-tax Act, 1922, for the purpose of imposing a tax on capital gains and for certain other purposes and to prescribe the rate of super-tax on companies for the financial year 1957-58.

Mr. Deputy-Speaker: The question is:

> "That leave be granted to introduce a Bill further to amend the Indian Income-tax Act, 1922, for the purpose of imposing a tax on capital gains and for certain other purposes and to prescribe the rate of super-tax on companies for the financial year 1957-58."

The motion was adopted.

Shri T. T. Krishnamachari: I introduce†† the Bill.

5.02 P.M.

The Lok Sabha then adjourned till Eleven of the Clock on Monday, the 3rd December, 1956.

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†Introduced with the recommendation of the President.

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