ECONOMIC GROWTH CENTER

YALE UNIVERSITY

Box 1987, Yale Station
New Haven, Connecticut

CENTER DISCUSSION PAPER NO. 405

TAXATION OF DIVIDENDS IN INDIA: A REVIEW

(1974-1977)

J.V.M. Sarma

May 1982

Acknowledgements.

This is the first of the two studies I completed during my visit to the Economic Growth Centre, Yale university. The study is intended to provide an outline of some aspects of Indian tax law and its development since 1947, which had a bearing on dividend behaviour of public limited corporations in India. The study is followed-up by another on 'Income taxation and corporate dividend behaviour in India, 1947-1977', which is a quantitative analysis.

I wish to express my thanks to Prof R J Chelliah, National Institute of Public Finance and Policy, and the Ford Foundation -- who made my visit to Yale possible.

My thanks are due to Prof R Radhakrishna, University of Hyderabad, for helping me in planning the study, and to Prof D U Sastry, Institute of Economic Growth, for useful discussions.

At Yale, my thanks are due to Prof T N Srinivasan for all his comments and help, to Prof Hugh Patrick and to the Economic Growth Centre, for making my stay comfortable and meeting the computer and secretarial expenses.

Contents.

		page
Section 1.	The income tax system in 1947.	2
	The 'grossing-up' practice.	
Section 2.	Tax changes relating to public limited corporations as dividend payers.	9
	Income tax on companies - Penal tax on dividends Abolition of 'grossing-up' - Super tax - Excess divdends tax - Dividends tax - Bonus shares tax - Taxes on excess profits.	
Section 3.	Tax changes relating to dividend receivers.	24
	Tax on inter-corporate dividends - Personal income tax - Capital gains tax.	
Table 1.	Company tax rates relevant for Indian public limited companies, 1947-48 to 1977-78	34
Table 2.	Tax rates/rebates on dividend distributions and bonus shares, 1947-48 to 1968-69.	36
Table 3.	Ownership pattern of corporate sector in India.	38
Table 4.	Personal marginal income tax rates on 'individuals' in respect of their 'unearned' incomes, 1947-48 to 1977-78.	39
Appendix.	Corporation tax incentives relating to Indian public limited companies.	46

TAXATION OF DIVIDENDS IN INDIA: A REVIEW

(1947 - 1977)

It has been a common practice in many countries to control dividend payments of corporations by means of taxation. In India also, over the last three decades, private corporations have been subject to various dividend regulations within the framework of income tax system. But tax laws designed solely for the purpose were relatively few. Many a time tax reforms were made based on other considerations such as simplifying the tax structure, or beinging about more equity into the system and so on, though such changes leading to dividend restraints were, as a rule, welcomed. All these resulted in a not-too-clear-cut dividend control policy, to which the response of the corporate sector also remained a mystery. This study is aimed to briefly examine the Indian income tax system and the tax reforms thereof since 1947, with a view to identify some of the elements that have had a bearing on dividends.

The instrument usually employed for the purpose is tax differential between dividends and retained profits, and in India it is caused by several elements in the income tax system. Therefore, in a broad sense, studying dividend taxation is equivalent to studying the whole income tax system itself. It is not hard to envision the all-pervading nature of dividend taxation if it is realised firstly, that a company can derive its income in several forms namely, profits, interest on securities, capital gains, intercorporate dividends, royalties and so on; secondly, that dividend recepients fall under several tax-payer categories namely, individuals, companies, Hindu undivided families, cooperative societies, registered and unregistered firms; and thirdly, that the gamut of rate-schedules, exemption limits, deductions, as well as modes of tax collections (direct collection or deduction at source, or advance payments) of not one, but several taxes which differ according to income sources as well as the tax-payer types. Therefore, the scope of the study is limited to taxes relating to Indian public limited companies. Also among the dividend recievers only'individuals' need to be considered in view of the fact that shareholdi in India are concentrated in the hands of two types; companies and individuals and a large portion of dividend incomes of companies can be assumed to ultimately reach individuals.

1. The income tax system in 1947.

Prior to Independence, the Indian income tax system under British rule was well-developed and had been moulded after the British system itself. It remained so for the first few years after Independence. The main features of the system inherited from the British in 1947 were as follows: It consisted of income tax and super tax both at the company level as well as at the shareholder's level. The income tax was deemed to have been paid on behalf of shareholders and thus, a credit was allowed to the shareholders for the income tax paid at at company's level. This system which came to be known as 'grossing-up' of dividends will be dealt in detail later. The super tax however, was meant to be borne and absorbed entirely by companies. The tax rates relevant to public limited companies[1] were as follows: The income tax rate was 5 annas in a rupee or 31.25 per cent on companies whose income exceeded Rs 25,000 and those with income less than that limit were entitled to a rebate of 1 anna and therefore were charged at 25 per cent. Further, an income tax rebate of 1 anna was granted for restrained dividend payments. The super tax was levied at 12.5 per cent rate. (see table 2.1) Apart from these two main taxes two other taxes on companies also featured. They were; business profits tax levied at the rate of 16.75 per cent on profits over and above Rs 1 lakh or 6 per cent of capital whichever was greater, (the term 'capital' being defined for this purpose included a portion of reserves), and capital gains tax freshly introduced in India, at the same rate as income tax on gains arising out of sale, exchange or transfer of any capital assets over and above Rs 15,000 held for less than seven years.

The personal income tax system was also fairly developed by 1947. The tax payers were grouped under individuals, Hindu undivided families, companies, unregistered firms and associations of persons and seperate rate schedules were prescribed. Also to facilitate framing of rules regarding the computation of income and to determine the mode of tax collection; either by direct assessment or by deduction at source,-- incomes were classified under five different heads; salaries, interest on securities, income from house property, professional and business earnings and income from other sources. Dividends[2] came under the second category and therefore, whatever taxes applicable were deducted at source, usually at the maximum tax rates. Further, there existed a distinction between 'earned' and 'unearned' incomes the tax rates for the latter being higher.

That the tax burden underlying the system was not neutral between dividends and retained profits should be obvious. Dividends were subject to double taxation as they were liable to company income tax, supertax, business profits tax and capital gains tax at the company level, and were further liable to personal income tax and personal super tax (at the rates applicable to unearned incomes) in the hands of shareholders. The only reliefs from the double taxation were, first through an income tax rebate for restrained dividend payments and second, through 'grossing-up' arrangement.

The 'grossing-up' practice.

The 'grossing-up' practice, introduced in India around 1916, was based upon the 'agency' principle of corporate taxation that the income tax paid by companies was assumed to have been paid on behalf of the shareholders. In order to avoid double taxation on dividends, first the incoem tax paid by companies was apportioned between distributed and undistributed profits in the same ratio. The amount of tax attributable to dividends was credited to shareholders. While assessing the shareholders for individual income tax, their respective tax rates were determined not according to actual dividends, but on the basis of dividends 'grossed-up' for the company income tax. The 'grossed-up' dividends per unit of actual dividends was computed as $1/(1-t)$ where t is the effective company income tax rate. Depending upon whether the tax liability on 'grossed-up' dividends at the company income tax rate was higher or lower to that at the individual shareholder's tax rate, the difference was either refunded or charged to the shareholders. In the end, the undistributed profits were thus, charged at the company income tax rate whereas distributed profits were charged at the individuals' tax rates.

The 'grossing-up' system no doubt, provided a relief from the double income taxation of dividends. But it is doubtful if it could completely neutralise the income tax differential as the resultant tax rate on undistributed profits was not quite equal to the tax rate on distributed profits. Further, the practice involved many administrative complications. Historically, when 'grossing-up' was first introduced in Britain, companies were treated as mere agents of their shareholders and company taxation was found to be just a convenient way of bringing the undistributed portions of shareholders' incomes into the tax net by taxing at source.[3] As the individual income tax rate itself was proportional (and there being no other taxes), taxing undistributed profits at a rate equal to the personal income tax rate posed no problem. Companies paid the income tax and recovered it from the shareholders at the time of dividend distribution. But once personal income tax rate was made progressive, the task of equalising the rates as well as adhering to the 'agency' principle became formidable. To quote the Royal Commission; "The real problem is to relate the taxation of the company's profits at the undistributed stage to the general scheme of progressive taxation of personal incomes, bearing in mind that distributions when they take place in dividend form fall under progressive system. A tax on corporate income that is not ultimately adjusted in account with each shareholder according to his share of that income means that income accruing on joint stock is taxed by a standard peculiar to itself and at a rate for each shareholder that may be heavier or may be less heavy than his true marginal rate." [4] Even the 'grossing-up' could not solve the problem completely for, if the test, ".. that the average marginal rate of tax for all members of a large public company must often differ very little from the standard rate " on undistributed profits, is accepted then it is clear that in India the ' standard rate ' on undistributed profits was not the 'average marginal rate' but the highest rate on the income tax ladder.

The tax differential left unfilled in the income tax rates was however, was negligible compared to that caused by the other taxes levied under the direct tax system. Both super tax as well as business profits tax came into existence as war-time taxes, super tax being introduced during World War I and business profits tax owed its origin to World War II (born as excess profits tax). Both these taxes stayed-on to peace times as well, as they became sufficiently 'old' and their yields were considered to be too crucial to do away with.

The continuation of these taxes without attempting to neutralise their differential burden on distributed and undistributed profits was usually justified on the grounds that companies are seperate legal entities capable of owning property, that their liability is independent of their shareholder bodies and therefore, can be taxed independently. The seperate taxation of companies found support in such theories as the 'benefits theory', the 'social cost theory' and so on.[5] Perhaps, an equally important reason to continue with these taxes could be in order not to distrurb whatever degree of tax differential that existed between dividends and retained profits. For, subjecting the tax differential to undue changes, especially during peace times, may result in economic instability by affecting savings, investment as well as income flows patterns. The British experience demonstrated this.

In Britain, until 1947 there existed a profits tax simillar to super tax in India, in addition to the British income tax on companies. In 1947, a relief was given to the undistributed profits which was opposed all around. Again, in 1958, the system was reverted to flat profits tax. Surprisingly, even this move was also met with strong resistance. Infact, the Royal Commission on taxation, which was responsible for the recommendation, was itself divided on this issue.[6] In both the instances the substance of the arguments against the moves was that economic stability would be affected. Viewed in an objective manner, these two instances of British experience provide a clear demonstration of a general aversion to the alteration of tax balance between dividends and retained profits.

The above analysis gives a brief outline of the nature and causes of tax differentiation underlying the income tax system at the time of Independence. With this picture, attention can now be turned towards the developments in the post-Independence period.

While dealing with the tax changes since 1947, for analytical convenience, they are classified into those that relate to taxes on dividend payers, specifically Indian public limited companies, and those that relate to dividend receivers. Further, a distinction is made between individual shareholders, corporate shareholders and others in so far as their tax structures differ. These divisions no doubt, are not always clear (as for example, tax liability of corporations as dividend payers also depend upon tax rates on intercorporate dividends to the extent intercorporate dividends received by them form part of their total income).

2. Tax changes relating to public limited corporations as dividend payers.

Income tax on companies.

As seen in the previous section, the main taxes on public limited companies in 1947 were income tax and super tax. Compared to super tax, income tax on companies was subjected to fewer changes in the post-Independence period. The tax rates on companies with income above Rs. 25,000 remained at 31.25 per cent upto 1950-51, and except for the five years from 1957-58 to 1961-62, the rate normally applicable was 25 per cent. The detailed fluctuations in income tax are shown in table 1. After 1964-65, the incometax and super tax were combined into one tax. These rate changes were important in so far as they affected the actual degree of tax differential between dividends and retained profits.

Apart from the rate changes, income tax was subject to two structural changes during the period, and both these changes are important from the point of view of dividend payments.

Penal tax on dividends.

The first was the introduction of an additional tax on dividends in excess of current net profits, and a rebate for restrained distributions. This tax, introduced in 1948 was designed to restrict dividends payments of public limited companies. The tax was in the form of an additional levy of income tax on those dividends which exceeded current profits as reduced by income tax and super tax at prevailing rates and as reduced by exemptions if any. The base for additional liability was computed as an excess of equity plus preference dividends over and above current profits minus deductions and exemptions, after payment of income tax and super tax, whose combined rate at that time was seven annas in a rupee or 43.75 per cent. The 'excess dividends' computed thus, were taxed at a rate equivalent to the difference between the maximum income tax rate allowed by the law and the rate actually borne by the compamy in question. The idea was to disqualify such a company for tax concessions usually given to Indian public limited companies.[7] The grant of income tax rebate of one anna in a rupee to companies whose dividend payments were below the prescribed limit was continued. Initially, companies with income below Rs. 25,000 were exempted from the additional levy, though the rebate frr restrained dividends was extended to them also. However, from 1949 the small companies were also subjected to the additional tax.

This 'carrot-and-stick' policy was designed with a twin purpose. During the World War II many companies were believed to have made enormous profits. The penal tax was aimed at restraining these companies from passing-on the war-time accumulated profits to their shareholders which would have added to the inflationary tendencies in the economy. Secondly, the industrial sector was experiencing the post-war recession. In addition to the negative discouragement by way of penal tax, positive measures in the form of tax rebate for ploughing beck of profits became necessary to step-up the investment activity in the economy. Of course, the rebate (or additional income tax rate) was not taken into account while 'grossing-up' the dividends.

The penal tax was continued upto 1955-56 when it was replaced by another form of excess dividends tax under super tax.

Abolition of 'Grossing-up' practice.

The second important change with regard to income tax was abolition of 'grossing-up' of dividends in 1959-60. As we have seen above, 'grossing-up' practice was intended to give relief from double taxation of dividends. We have also noted that, with all its complicated computations it could not equalise income tax burden on dividends and retained profits. The very fact that the arrangement was not extended to super tax and other taxes, resulted in only a partial adherence to the 'agency' principle of corporation taxation, and therefore, a reflection on government's dillemma as to which way to swing, between agency theories and seperate entity theories. But there were more serious considerations that led to its abolition. The main consideration was administrative delays in assessments. The difficulty with 'grossing-up' was in linking the rate of 'grossing-up' of net dividends with the actual tax rate applicable to the dividend-paying company. In the words of the Finance Minister; "For one thing the rate of grossing depends on the effective rate at which the company's profits are initially subjected to tax. The effective rate in its turn depends upon the composition of the income of the company. The dividends themselves may be paid out of reserves accumulated over some years which again complicates the determination of the effective rate at which the profits have been taxed. Further, the assessments of shareholders have to wait till the completion of the assessments of the companies. All these led to considerable inconvenience to all concerned...." [8] Accordingly, 'grossing-up', the last remnant of 'agency' theory in India, was done away with. The Classical system has been in force eversince. The impact of the abolition of 'grossing-up' on tax differential was claimed to have been minimised by 'suitably adjusting' the tax rates.

The public reaction to the abolition of grossing-up is worth-noting. It was contended that the government's step would severely affect the middle-income shareholders who held approximately 80 percent of the capital of limited companies. "The result of the abolition of the principle of grossing-up of dividends", in the words of Palkhiwala; "would be that the aggregate yield on investment in shares will be appreciably reduced in many cases. At a time when the Government should strive hard to induce people to invest in industrial concerns the new Budget proposals will have directly the contrary effect." [9] Thus the apprehension that the abolition of 'grossing-up' would significantly alter the tax differential was obvious. It was also pointed out that the tax rate adjustment did not sufficiently compensate the loss.

Super tax.

By far it was super tax law which contained most of the company tax law reforms after 1947. The rate structure was much diversified. Apart from the existing distinction between companies according to (a) size of income, and (b) whether a company is that in which public are substantially interested, or not interested, further distinctions were introduced subsequently, the criteria being based upon (c) the main activity a company is engaged in (such as financial, insurance, 'industrial' or 'priority' as defined in Finance Act 1964), as well as (d) the nationality factor (Indian or foreign). The rate also differed according to the source of income (intercorporate dividends, royalties, technical fees and so on).

As far as the Indian public limited companies are concerned the main distinction was still on the basis of income size. The income limit for a long time had remained at Rs.25,000. It was raised to Rs.50,000 in 1967-68 and further to Rs.1 lakh in 1974-75. Though the supertax rate was lower compared to income tax rate to start with, it rose sharply from 12.5 per cent to 25 per cent by 1960-61 and remained at that level till its merger with income tax in 1965-66.(table 1). From then on, the combined rate was generally 50 per cent with little variation during the later years.

It should be noted that the average rate paid by companies resembled but little, the statutory rates, as a result of a number of tax rebates, incentives, exemptions and deductions granted from time to time. Important among these are briefly described in Appendix

Excess dividends tax.

A crucial development of super tax law in respect of dividend payments was the revival of excess dividends tax in 1956. With the introduction of this tax, the dividend tax policy, for the first time was claimed to have been geared to the needs of planned development effort with a commitment to mixed economic frame. The tax was formulated not only with a view to encourage corporate savings and to make private sector companies selfsufficient in financing their investment needs, but also such a policy was believed to reduce competition for bank credit, thus making it available to public sector undertakings to finance their heavy investments as envisaged in the Five-year Plans.

The statutory limit for dividend payments was redefined in terms of capital employed unlike in terms of total income as in the previous 'penal' income tax on dividends. Also, a certain progression was introduced in the tax rate. The additional super tax was 12.5 per cent and 18.75 per cent as dividends exceeded 6 per cent and 10 per cent of capital. In the very next year, the rates were revised as 10 per cent, 20 per cent, and 30 per cent on dividends exceeding 6 per cent, 10 per cent, and 18 per cent of capital respectively. (table 2). The term 'capital' defined for the purpose, included only paid-up capital. Further, a tax on bonus shares was levied along with the excess dividends tax.

In its nature as well as in its effects the excess dividends tax was different from the earlier 'penal' income tax. The limit for distributions of dividends was defined in terms of 'capital' in the new tax whereas it was in terms of current net profits in the penal tax and consequently the definition of 'excess' was also different.

It may be stated that the excess dividends tax, by linking the dividend payments to 'capital' was somewhat discriminatory as it did not take into account the differences in the capital needs among firms operating in the production of different goods. The tax discriminated against those firms which did not need a large capital base to operate, say, firms producing consumer goods, compared to firms with larger capital base. The later could distribute more profits.

An important aspect was the psychological impact of this tax which was perhaps, more severe than that of the earlier penal tax. If the existing dividend theories are any indication, shareholders are probably more interested in a regular rate of return on their investment in shares irrespective of the size of total amount of dividends paid-out or the proportion it made in current profits. It was precisely the rate of return which was affected by the excess dividends tax as against the 'share of dividends in profits. This can be illustrated as follows: Consider a firm with a paid-up capital of Rs. 1 lakh (wholly consisting of equity shares) showing a profit of Rs.10 thousand in a particular year. In the case of 'penal' tax limiting the size of total dividends to 50 per cent of profits (total tax liability being 50 per cent, say), then the available profits for distribution were Rs. 5 thousand, yielding a return of 5 per cent to shareholders. Next year suppose, the firm is able to show a profit of Rs. 20 thousand. And let the tax liability has risen from 50 per cent to 70 per cent. The available profits for distribution then would be only Rs. 6 thousand out of Rs.20 thousand. But the rate of return to shareholders works out to be 6 per cent. In the view of shareholders this would mean an increase of one per cent on their stocks though the curbs on dividends are actually higher. Thus, the increased restrictions on pay-out ratio of dividends might go unnoticed by shareholders. On the other, if the limit on dividend payments is interms of capital, as in the case of excess dividends tax, and if it is say 5 per cent, then the shareholders would not have benefited by the extra one per cent. In this sense, the excess dividends tax had a greater psychological impact than the earlier 'penal' tax.

Naturally, the excess dividends tax drew considerable criticism particularly from the Bombay Forum of Free Enterprise.[11] To quote Palkhiwala again; "... the insensate rule of thumb providing that on so much per centage of dividends in relation to the paid-up capital, the company should pay so much more super tax cannot possibly bring about an equitable distribution of the tax burden. Scores of factors might make it inequitable that a company declaring a larger dividend in a given year should be subjected to higher tax than another company declaring a smaller dividends."[12] An example of this discrimination was already pointed above. Other arguments against the tax were as follows:

Firstly, the tax penalised those companies which followed a restrained policy in the past years. In the words of Shroff; "In the initial period a number of industries, particulay those of a complicated character, are unable to declare any dividend at all for shareholders for a number of years. Take for instance, the Tata Chemicals.. After 17 years of bitter experience and hard struggle that company was able to pay its shareholders dividend for the first time."[13] The argument was that the tax penalised such companies.

Secondly, the 'capital' base considered for the purpose was also criticised as a reflection of 'lack of real understanding' on the part of the Government as to "how industries are started and capital formation takes place. To think that to start and run ventures only paid-up capital is required betrays a complete misunderstanding of our industrial structure. There are companies which are in existence for 20, 30,or 70 years and they could never have developed their capacity for production or capacity for earning profits if the total capital used by them was paid-up capital. Therefore the basis itself is wrong."[14] Shroff considered that the right basis should be total capital employed. The same view was also expeessed by Parikh, Palkhiwala and others.[15]

<u>Dividends tax.</u>

In view of the heavy criticism, the excess dividends tax was discontinued from i960-61. But the desire "to discourage the dissipation of these resources in higher dividends" [16] was again felt strongly during 1964-65 resulting in the revival of dividend taxation. 'The resources' mentioned in the quote referred to the tax savings as a result of a 10 per rebate allowed to 'priority' industries in respect of income tax and super tax as well as in respect of sur tax. To avoid complications nevertheless, companies belonging to the non-'priority' sector were also brought under this tax. The tax rate was 7.5 per cent on the whole of equity dividends declared. However, new companies were allowed an exemption upto 10 per cent of equity capital for five years after the maiden declaration of dividends, probably in view of the criticism on the previous excess dividends tax that it penalised companies which could not distribute dividends in the past years. But to qualify for this exemption a company was required not to have declared any dividends during the first five consecutive years of operation. In 1966-67 the tax was extended to all companies.

The question of continuing with the dividends tax was later examined at length by the Bhoothalingam Committee.[17] The Committee, 'on balance of considreations' recommended the abolition of thetax, as "it seems clear that no identifiable good comes out of dividend tax."[18] The arguments put forth by the Committee for the abolition of the tax were mainly on three grounds: Firstly, the Committee doubted whether the objective of dividend tax had been realised or was 'even capable of realisation', and that the response to the tax might even be lower as a result of the abolition of bonus shares tax in the previous year. Secondly, the Committee questioned the rationale for continuing with the tax, reiterating the arguments against dividend restrictions in general, that they might not always result in increased investments and that removal of such restrictions may not always end-up in conspicuous consumption by shareholders. The chance of corporate savings not showing-up as new investment is greater in India where "there were some restrictions on the use of retained profits, (and) companies were positively discouraged from investing in other companies or even diversifying their own activities."[19] Further, the Committee pointed that dividend tax also restricted the freedom of shareholders to reinvest their dividend incomes more efficiently. Thirdly, the Committee questioned the design of tax on the ground that linking dividends to capital being irrational and pressing all companies uniformly to retain profits without regard to their relative needs being unjust.

Inview of the recommendations the dividends tax was finally given-up in 1968, once and for all. This however, does not mean that the tax burden was neutralised. The differentiation under the 'Classical' income tax structure has been still in favour of profit retentions.

Bonus shares tax.

A tax on bonus shares was also featured in the Indian income tax system during 1956-57 to 1966-67 as a supplement to the excess dividends tax. Also for one year,1964-65 they were taxed as capital gains. It is well known that a company while distributing profits, can offer to its shareholders either cash dividends or bonus shares. The prevalent views were against such a tax as bonus shares do not alter the financial position of either the company or its shareholders. In the absence of the other dividend taxes, the primary objective of bonus shares can be considered to be only to convert some of the excess holdings of reserves into capital.

However, the levy of bonus shares tax was largely necessitated by the particular form of excess dividends tax chosen. By linking 'excess dividends' to paid-up capital a loop-hole had been created. A company could, by issuing bonus shares, expand its 'capital' base and thereby could distribute a larger portion of profits in the subsequent years without attracting excess dividends tax. To fill this loop-hole bonus shares tax became necessary. The tax could have been avoided either by defining the limit for excess dividends as a share in profits or by mere extending of the definition of 'capital' base to include reserves which are potential sources for bonus share issues, which would have also satisfied some of the critics. The tax rate on bonus shares was initially 30 per cent on their face value, but was reduced later to 12.5 per cent. The tax was abolished in 1966-67.

Taxes on excess profits.

The tax on excess profits is yet another war-time discovery of revenue source by government. In 1947, this tax was in the form of business profits tax. The rate was 16.75 per cent on profits exceeding Rs.1 lakh or 6 per cent of the sum of paid-up capital and reserves (net worth). In 1948 the rate was reduced to 10 per cent and the abatement limit raised from Rs.1 lakh to Rs.2 lakh or 6 per cent of net worth whichever was higher. The tax was abolished in 1950 only to be reborn in 1963 as Super profits tax, which was levied on profits left after the payment of income tax and super tax. The rates were 50 per cent and 60 per cent as profits exceeded 6 per cent and 10 per cent of net worth respectively. The linking of net profits to capital as in the excess dividends tax resulted in some inequity between companies with large capital base as against those with smaller base. Finally, the Super profits tax was also replaced by Sur tax with the only difference that the capital base now includes debt capital as well.

3. Tax changes relating to dividend receivers.

So much for the taxes applicable to dividend payers. We shall now turn to taxes on dividend recepients which are equally relevant in affecting dividend payments. Among different categories of income tax payers, shareholders in India mainly fall into two categories: (a) companies and (b) individuals. If the information on dividend incomes contained in the All India Income-tax Statistics[20] is any indication then over 90 per cent of dividend income is accrued to these two categories. The share of dividend income accruing to other categories namely, Hindu undivided families, registered firms, associations of firms and others has barely been 10 per cent. (table 3). Therefore, it is sufficient to consider companies and individuals as dividend receivers. As far as companies are concerned, only taxes on inter corporate dividends need to be mentioned.

Tax on inter-corporate dividends.

Untill 1953-54, inter-corporate dividends did not receive any special treatment under the income tax law. They were subjected company taxes at both the levels of dividend paying company as well as at dividend receiving company. Thus when a company receiving dividends distributed profits to its shareholders, these inter-corporate dividends were further subject to taxes. The one factor that prevented Government from exempting inter-corporate dividends from company taxes was a suspicion that companies might take advantage and it may lead to concentration of economic power. Even the Taxation Enquiry Commission[21] was against exempting such dividends. Finally this malady of 'multiple' taxation of dividends came to the notice of Government in 1953-54 when a mild rebate was granted to new undertakings engaged in certain industries in respect of dividends received by them. The first major step in favour of inter-corporate dividends was in 1957, when dividends from a subsidiary company were taxed at a lower rate of 10 per cent than others. The tax rates on inter-corporate dividends since then were varying almost every year. During the seven year period from 1957 to 1969 the tax rate on income derived from subsidiary companies remained at 10 per cent. But in 1962 the tax rate was lowered to 5 per cent. In the case of income derived from Indian companies other than their own subsidiaries the tax rates differed between (a) domestic widely held companies with total income not exceeding Rs.25000, (b) other domestic companies and (c) non-domestic companies. Finally, thanks to the industrial recession in 1964-65, inter corporate dividends are exempted from company super tax since then. However, levy of income tax continued. With the integration of income and super taxes in 1965-66 a provision was made not to tax intercorporate dividends at rates higher than 25 per cent.

Personal income tax.

A large portion of dividends ultimately accrue to non-corporate shareholders either directly or indirectly (paid by a company out of its inter-corporate dividend income). Further levy of taxes in their hands therefore, result in 'double' (or 'multiple') taxation of dividends especially in the absence of such provisions as 'grossing-up' or exempting inter corporate dividends. By far, it is this kind of double taxation that constitutes a large part of the over-all tax differential between dividends and retained profits in the income tax system. Therefore, it is essential to study the relevant aspects of individual income taxation.

In India dividends constitute a part of personal incomes and were untill 1965-66, liable to two taxes; income tax and super tax the later being levied on incomes above Rs. 25 thousand. The income tax was deducted at source at a standard rate in force, (generally has been 20 per cent) while super tax was not deducted at source except for non-residents. The difference between the actual tax liability and liability 'at source' was made good at the time of assessment of the shareholdr. It should be noted that this adjustment had nothing to do with 'grossing-up'. It should further be noted that the 'grossing-up' practice was confined only to personal income tax and not to personal super tax. With the abolition of 'grossing-up', the levying of two taxes on the same income became redundant and the later integration of income tax and super tax in 1959-60 was a mere formality.

An important aspect of personal taxation relevant to this study was seperate treatment of 'earned' and 'unearned' incomes untill as late as 1969-70. This differentiation was introduced a few years before Independence, largely in conformity with the existing practice in other countries such as United States. Various justifications were advanced later for such a differentiation on the grounds of equity, higher taxable capacity of unearned incomes and so on. Basically however, the objective was to tax those who earn their incomes, that is, sweat and toil for it in contrast to those who derive their incomes from property and investments, that is, without making any direct effort. Dividends, needless to say, form the incomes in the later category.

Initially the distinction was limited only to income tax. Within three years it was extended to super tax as well, and by 1947 the distinction was in respect of both the taxes. While the income tax distinction was continued, there was a break in respect of super tax between 1950-51 to 1954-55. Finally the distinction was altogether abolished from 1969-70.

The method of differentiation between 'earned' and 'unearned' incomes ranged from a simple grant of tax deduetion to a very complicated procedure recommended by the Taxation Enquiry Commission. In 1947 it was a straight deduction of 20 per cent of earned income upto a maximum of Rs. 4 thousand in respect of income tax while in respect of super tax the distinction was in the form of seperate rate schedules, the rates on earned incomes being lower by 6.75 per cent upto Rs. 25 thousand and 3.5 per cent above that limit. The complex procedure suggested by the Taxation Enquiry Commission was in force for one year 1955-56. Apart from the income tax deduction of 20 per cent or Rs. 4 thousand whichever was lower, a deduction of 20 per cent was also granted for super tax for incomes above Rs. 25 thousand. But the maximum limit declined gradually by 20 per cent as income moved up the income ladder disappearing altogether on total inoomes above Rs. 40 thousand. The procedure was simplified from 1957-58 and the differentiation was made only by means of seperate surcharges for the purpose. The surcharge on unearned incomes was higher by 15 per cent upto Rs. 1 lakh of total income and 10 per cent above that limit. Between 1957-58 and 1968-69, these surcharges were pruned, altered, or made progressive, maintaining the average difference at 10 per cent. Finally the distinction was abolished from 1969-70.

Another feature of income tax important from dividends point of view was a grant of special deduction in respect of dividend incomes. In 1967-68, with a view to encourage investments in shares, dividend incomes from Indian companies were exempted upto Rs.500. This deduction was later raised in 1970-71 to Rs. 3 thousand. In 1977-78 a further deduction of Rs.250 was allowed for dividends from new compamies when the tax on such dividends were deducted at source.

Other numerous changes in the personal income tax structure with respect to rates, income brackets, exemptions, tax free deductions and so on can be observed from table 4, and do not need special attention.

Capital gains tax.

A tax on capital gains accruing to shareholders out of thier stock market transactions, is also an important factor affecting the choice between dividends and retained profits. Retained profits provide a 'shelter' from the individual taxes. The preference for such 'shelter' obviously depend on the severity of capital gains taxation.

A s we have already noted that capital gains tax was first introduced in India in 1947-48 and gains arising out of sale, exchange or transfer of any capital assets over and above Rs.15 thousand held for less than seven years were taxed at the same rates as income tax. But it was removed in 1949-50 owing to its adverse 'psychological effect' on investment. But the tax was soon reintroduced in 1955-56 as part of a package of tax reforms recommended by the Kaldor Committee.[22] Thereafter it stayed on. During the later years the tax has undergone numerous changes in respect of the base, the rates and the exemptions. The changes are so varied and contradictory one suspects whether the tax has not been a reflection of the whims of the successive Finance ministers in power. The following are few examples.

In 1961-62, a distinction between 'long term' and 'short term' capital gains was made to treat favourably the gains on capital assets held for a reasonably long time. The 'short term' orginally was defined as one year. Within two-years it was stretched to two years. In 1973-74 the 'short term' was further stretched to five years. As though it reached a maximum limit it was shrinked to three years in 1977-78. In 1964-65 a further distinction was made between capital gains arising out of transaction in buildings and land, and those arising out of other transactions, presumably including company shares.

The rates were generally same as the income tax rates but the effective rates on capital gains have been lower as the gains were allowed a number of deductions. For example, in 1955-56 an amount of Rs. 5 thousand of income from capital asset transactions were allowed to be deducted. In 1960-61 only 10 per cent of capital gains in the case of an Indian company and 33 per cent in the case of individuals were taxed. In 1964-65, while the rate on short term capital gains other than land and buildings was the average rate of income tax and super tax as applicable to total short term capital gains, the rate in respect of long term capital gains was 50 per cent of such rate. In the following years, these deductions and computations had undergone further changes. For example, in 1972 the deduction allowed in total income in the case of non-company assessees was reduced from 66 per cent to 50 per cent in respect of capital gains arising out of transaction in assets other than land and buildings and deduction in respect of the long term capital gains was raised from 30 to 35 per cent. In 1976-77, the rate on long term capital gains of widely held companies having total income not exceeding Rs. 1 lakh was reduced to 40 per cent, the rates for the individuals remaining same. Also as we noted earlier, bonus shares were also included as long term capital gains for one year 1964-65. These are only a sample of the changes with respect to the capital gains tax.

Conclusion.

The above brief survey of selected aspects of income tax system shows that taxation of dividends has been a quite a complicated affair in India and that a number of taxes impinge on dividends in a variety of ways at different levels. The main system can broadly be summarised as follows:

Untill 1959-60 it was characterised by attempts at partially integrating the taxes at the two levels; companies and their shareholders by means of 'grossing-up' practice. Therefore it can be described as 'imputation system'. From 1960-61, with the seperation of taxes at the two levels, the system was switched over to pure 'Classical' type. Super-imposed on this broad system were the occassional dividend taxes which accentuated the relative tax burden on dividends. Three forms of 'excess' dividend taxes were experimented with; the 'penal' tax, the excess dividends tax and the dividends tax.

It is clear that the income tax system has always been in favour of profit retentions, although it is difficult to assess the severity of the 'double' taxation on dividends as well its impact on distributions without taking into account the rate-structures prevailing at each point of time (which we shall be attempting in the following chapters). However, it seems that the imposition of excess dividends tax in 1956, quickly followed by the abolition of 'grossing-up' was regarded as a rather severe step. On the other, the penal tax/rebate system along with the 'grossing-up' could have been the least severe.

Table 1 Company tax rates relevant for Indian public limited companies. 1947-48 to 1977-78.

(per cent)

year	income tax[1]		super tax	
	Income below the limit[2]	income above the limit	income below the limit	income above the limit
1	2	3	4	5
1947-48	25	31.25	6.25	12.5
1948-49	15.63	31.25	6.25	12.5
1949-50	15.63	31.25	6.25	12.5
1950-51	20	26.25	9.38	15.63
1951-52	20	26.25	10.94	17.19
1952-53	20	26.25	10.94	17.19
1953-54	20	26.25	10.94	17.19
1954-55	20	26.25	10.94	17.19
1955-56	20	26.25	10.94	17.19
1956-57	20	26.25	10.94	17.19
1957-58	20	31.5	15	20
1958-59	20	31.5	15	20
1959-60	20	31.5	15	20
1960-61	20	20	20	25
1961-62	20	20	20	25
1962-63	20	25	20	25
1963-64	20	25	20	25
1964-65	25	25	17.5	25
1965-66[3]	42.5	50		
1966-67	42.5	50		
1967-68	45	50		
1968-69	45	50		
1969-70	45	50		
1970-71	45	50		
1971-72	45	50		
1972-73	46.13	56.38		
1973-74	47.25	57.75		
1974-75	47.25	57.75		
1975-76	47.25	57.75		
1976-77	47.25	57.75		
1977-78	47.25	57.75		

COntd...

Notes: 1) The rates are inclusive of surcharges. The surcharges on income tax was 5 per cent between 1950-51 and 1959-60. In 1972-73 the surcharge on the combined rate was 2.5 per cent and was raised to 5 per cent in the following year which continues.

2) The limit was Rs. 25,000 till 1966-67, Rs.50,000 between 1967-68 and 1972-73 and has been Rs. 1,00,000 from 1973-74.

3) From this year onwards the rate was the combined rate of income tax and super tax.

Sources:

1) Government of India. Annual Budgets. Ministry of Finance. New Delhi.

Other sources referred for clarity are;

2) Ambirajan, S. (1964) The taxation of corporate income in India. Asia Publishing House. Bombay.

3) Pophale, G.L. (1965) A quarter century of direct taxation in India, 1939-1964. IMC, Economic Research and Training Foundation, Bombay.

4) Suman, H.N.P.S. (1974) Direct taxation and economic growth In India. Sterling Publishers Pvt.Ltd. New Delhi.

5) Rao, V.G. (1980) The corporation income tax in India 1950-1965. Concept Publishing Company. New Delhi.

Table 2 Tax rates/rebates on dividend distributions and bonus shares. 1947-48 to 1968-69.

(per cent)

period		tax base	additional tax rate	tax rebate on total income
1		2	3	4
1947-48		dividends below current profits net of income tax and super tax and exemptions if any	nil	6.25
1948-49 to 1949-50	a)	dividends below current profits net of income tax and super tax and if any	nil	6.25
	b)	dividends above current profits net of income tax and super tax and exemptions if any	difference between 31.25 and the rate borne by the company	nil
1956-57	a)	dividends falling between 6 per cent and 10 per cent of paid-up capital	12.5	
	b)	dividends above 10 per cent of paid-up capital	18.75	
	c)	face value of bonus shares issued	12.5	
1957-58 and 1958-59	a)	dividends falling between 6 per cent and 10 per cent of paid-up capital	10	
	b)	dividends falling between 10 per cent and 18 per cent	20	
	c)	dividends exceeding 18 per cent of paid-up capital	30	
	d)	face value of bonus shares	30	

(contd.)

Table 2 contd.

1	2	3	4
1960-61	face value of bonus shares	30	nil
1961-62 to 1963- 4	face value of bonus shares	12.5	nil
1964-65	a) on the whole of dividends[2]	7.5	nil
	b) face value of bonus shares	12.5	
1965-66	a) dividends in excess of 10 per cent of paid-up capital	7.5	nil
	b) face value of bonus shares	12.5	
1966-67 to 1968-69	dividends in excess of 10 per cent of paid-up capital	7.5	

Notes: 1) Companies with income below Rs.25,000 were exempted.
2) New companies were granted an exemption on dividends upto 10 per cent of paid-up capital.

Sources: same as Table 1

Table .3 Ownership pattern of corporate sector in India.

(per cent to total)

year	individuals	companies	Hindu und'vided families	registered firms	others
1	2	3	4	5	6
1955-56	54.4	35.3	7.2	1.4	1.7
1960-61	55.4	34.9	5.7	1.9	2.1
1965-66	44.2	47.3	4.3	1.8	2.4
1970-71	42.3	49.8	4.7	1.1	2.1
1975-76	40.0	51.7	5.2	0.7	2.4

Source: All India Income tax Statistics. Government of India. Central Board of Direct Taxes. New Delhi.

Table 4. Personal marginal income tax rates on 'individuals' in respect of their 'unearned' incomes. 1947-48 to 1977-78.

(per cent)

total income level (Rs 000)	1947-48	1948-49	1949-50	1950-51	1951-52 to 1954-55	1955-56
5	6.25	6.25	4.68	4.68	4.92	4.92
7.5						11.49
10	12.50	12.50	10.93	10.93	11.49	14.76
12.5						
15	21.87	21.87	21.87	18.75	19.69	21.33
17.5						
20						26.25
25	31.25	31.25	31.25	25.00	26.25	32.81
30	50.00					
35	53.12					
40		50.00	50.00	43.75	45.94	45.94
45	56.25					
50						59.06
55	62.50	59.40	59.40	50.00	52.50	
60						65.62
65	68.75					
70		68.75	68.75	62.50	65.63	
75	75.00					
80						72.19
85		75.00	75.00	68.75	72.19	
90	81.25					
100		81.25	81.25	71.87	78.75	82.03
105	87.50					
120	93.75					
150	96.87	87.50	87.50	75.00	82.03	85.31
200						
250		90.62	90.62			
300						
350		93.75	93.75			
500 & above	96.87	96.87	93.75	78.12	82.03	88.59

contd.

Table 4. (contd.)

(per cent)

total inco--me level (Rs 000)	1956-57	1957-58 to 1961-62	1962-63	1963-64	1964-65	1965-66
5	4.92	3.00	3.00	4.81	6.00	5.00
7.5	11.49	6.00	7.00	10.69	10.00	
10	14.76	14.76	10.80	12.00	13.00	10.00
12.5		13.20	14.40	17.82	21.20	
15	21.33	16.80	18.00	21.28		15.00
17.5			24.00	27.39		
20	26.25	21.60	27.60	31.94	22.50	24.00
25	32.81	36.00	39.60	38.56	39.37	36.00
30		48.00	51.60	54.38	46.00	48.00
35						
40	45.94	54.00	56.40	59.02		
45						
50	59.06	66.00	68.40	68.40	63.25	60.00
55						
60	65.62	72.00	78.00	78.00		
65						
70	72.19	78.00	84.00	84.00	80.50	75.00
75					86.25	
80	75.47					
85						
90	78.75					
100	82.03	84.00	87.00	87.00	88.12	81.25
105						
120	85.31					
150	88.59					
200						
250						
300						
350						
500 & above	91.87	84.00	87.00	87.00	88.12	81.25

contd..

Table 4 (contd.)

(per cent)

total income level (Rs 000)	1966-67 & 1967-68	1968-69	1969-70	1970-71	1971-72	1972-73 to 1974-75
5	5.02	5.02	5.02	5.02	nil	nil
7.5						
10	11.00	11.00	11.00	11.00	11.00	11.00
12.5						
15	16.50	16.50	16.50	18.70	18.70	18.70
17.5						
20	26.40	22.00	22.00	25.30	25.30	26.45
25	39.60	33.00	33.00	33.00	33.00	34.50
30	52.80	44.00	44.00	44.00	44.00	46.00
35						
40					55.00	57.50
45						
50	66.00	66.00	55.00	55.00		
55						
60					66.00	69.00
65						
70	82.50	82.50	66.00	66.00		
75						
80					77.00	80.50
85						
90						
100	89.37	89.37	71.50	71.50	82.50	86.25
105						
120						
150						
200					88.00	92.0
250			77.00	77.00		
300						
350						
500 & above	89.37	89.37	82.5	82.5	93.5	97.75

contd.

Table 4 (contd.)

(per cent)

total income level (Rs 000)	1975-76	1976-77	1977-78
5	nil	nil	nil
7.5			
10	13.20		
12.5			
15	16.50	18.70	17.25
20	22.00	22.00	20.70
25	33.00	33.00	28.75
30	44.00	44.00	34.50
35			
40			
45			
50	55.00	55.00	46.00
55			
60			
65			
70	66.00	66.00	57.5
75			
80			
85			
90			
100			63.25
105			
120			
150			
200			
250			
300			
350			
500 & above	77.00	77.00	69.00

contd..

Table 4. (contd.)

Notes:

1) Generally, between 1947-48 and 1965-66 super tax started at Rs. 25,000.

2) The rate on Rs.5 lakh & above was raised in 1961-62 to 80.5 per cent by increasing the surcharge.

3) The marginal tax rates are shown against the maximum limit of the bracket on which it is applicable. For example, in 1947-48, the marginal rate 21.87 per cent was applicable to the bracket Rs.10,000 to Rs.15,000. The rates are inclusive of surcharges.

4) Before 1961-62 the surcharges on unearned incomes were 15 per cent higher then on earned incomes upto Rs.1 lakh and 10 per cent on incomes below Rs.1 lakh. In 1964-65 the difference was made progressive as 2.5, 5, 7.5 per cent as total income exceeded Rs. 1.1 lakh, 1.25 lakh and Rs.1.75 lakh respectively.

Sources:

1) Government of India. Annual Finance Acts. New Delhi.

2) Pophale, G.L.(1965). A Quarter century of Direct taxation in India, 1939-1964. IMC, Economic Research and Training Foundation. Bombay.

3) Chawla, O.P. (1972). Personal taxation in India 1947-1970. Somaiya Publishing Pvt. Ltd. New Delhi.

4) Suman, H.N.P.S. (1974). Direct taxation and Economic growth in India. Sterling Publishers Pvt. Ltd. New Delhi.

Notes and References.

1. Public limited companies in India generally come under the tax category of 'widely held companies', in which public are substantially interested and whose shares are offered in recognised Stock Exchanges.

2. The term 'dividends' as defined under the Income Tax Acts 1922 as well as 1961, is not exhaustive but inclusive definition. Generally, for widely held companies the definition includes distributions from accumulated profits, whether capitalised or not, which reduces the assets of the company, or in the form of debentures issue, distributions on liquidation or in the form of loan or advance to the extent such distributions are attributable to accumulated profits. The definition for certain companies of closely held category, the definition is more inclusive.

3. The Royal Commission traces the origin of 'grossing-up' to the Addington Act, 1803 in Britain. See

   Royal Commission on Profits and Income (1955). Final Report. HMSO. London. p.15

4. Ibid. p.16.

5. For a review of these theories see

   Ambirajan, S. (1964). The taxation of corporate income in India. Asia Publisheng House. Bombay. pp.7-19.

6. See, Royal Commission on Profits and Income (1955). op. cit. pp. 155-160 and pp.384-390.

7. The distinction between Indian and foreign companies was started from this year.

8. Budget speech. Central Budget (1959-60). new Delhi.

9. see, Palkhiwala, N.A. (1968). "A drastic budget'. in Pai, M.R. (ed.) Taxation in India: A commentary. Popular Prakashan. Bombay. pp.170-177.

11. Pai, M.R. (ed) (1968). Op.cit.

12. Palkhiwala, N.A. (1968). op.cit. pp.6-7.

13. Shroff, A.D. (1968). 'New taxatio proposals'. in Pai, M.R. (ed.) (1968). op.cit. p.153.

14. Shroff, A.D. (1968). Ibid. p.152.

15. Parikh, H.T. (1958). The future of joint stock enterprises in India. Jaico Publishing House, New Delhi. p45.

16. Budget speech. Central Budget. (1964-65). Government of India, New Delhi.

17. Committee on Rationalisation and Simplification of the Tax Structure. (1967). Final Report. Government of India. New Delhi.

18. Committee on Rationalisation and Simplification of the Tax Structure-(1967). Ibid. p.19

19. Committee on Rationalisation and Simplification of the Tax Structure (1967). Ibid. p.20.

20. All India Income Tax Statistics. Central Board of Direct Taxes. Government of India. New Delhi.

21. Taxation Enquiry Commission (1955). Final report. Government of India. New Delhi.

Appendix

Corporation Tax Incentives Relating to Indian Public Limited Companies.

A number of tax incentives were granted to Indian public limited companies from time to time under the income tax system. As a result the effective rate on companies was generally much lower than the statutory rate. Important among these incentives are as follows: Additional depreciation, tax holiday, development rebate, investment allowance, priority industries treatment, and export incentives.

Additional depreciation allowanc:

An additional depreciation allowance was given from time to time as an incentive for capital formation. For example, depreciation allowance at double the usual rates was granted for all the new plant and machinery installed during the five years from 1.4.1948 to induce the expansionary activities during the recessionary conditions prevailing at that time and to infuse confidence in the share market. The depreciation allwances were also allwed to carry forward indefinitely.

Tax holiday to new undertakings.

New undertakings engaged in industrial activities were exempted from income tax and corporation tax for five years in respect of their profits upto 6 per cent of the total capital (including the debentures and long term borrowings). In 1971-72 debentures and long term borrowings were excluded from the definition of capital for the purpose. The dividends in the hands of shareholders declared by such companies were also exempted from personal income tax.

Development rebate.

Development rebate was first granted in 1955-56, following the recommendation of the Taxation Enquiry Commission. It was at the rate of 25 per cent of the cost of machinery and plant. It replaced the earlier initial depreciation allowance. The rebate was 40 per cent in the case of ships and 35 per cent in the case of machinery and plant expenditure of 'priority' industries. The following conditions were required to be satisfied for claiming the development rebate: 1) The asset should be new and it should not be transferred for at least 10 years. 2) A reserve equivalent to 75 per cent of the amount claimed should be created not to be used for dividend distribution for atleast 8 years. (Electricity supply companies were required to create only 50 per cent of the amount claimed). Unabsorbed development rebate could be carried forward for 8 years. In 1964, second hand machinery and plant were also included for the grant of development rebate. The rate was reduced to 15 per cent for industries other than the 'priority' industries. In 1967-68 the rate was raised to 35 per cent on machinery and plant bought for scientific purposes and installed after 31.3.1974. In 1971-72 it was lapsed on machinery and plant installed after 30.5.1974. The development rebate was substituted by an initial depreciation and later replaced by investment allowance.

Investment allowance.

Investment allowance was introduced in 1976-77 to give relief with respect to increased capital costs. The allowance has been at the rate of 25 per cent of the cost of new machinery and plant installed after 31.3.1976 in industries hitherto qualified for initial depreciation. The allowance as in the case of development rebate is conditional on the creation of a reserve. Further, the allowance is to be withdrawn if the reserve is not utilised for the purpose of acquiring new plant and machinery within a period of 10 years and no part of it is available for dividend distributions. The scheme is intended to encourage investment and reduce the dependence of the corporate sector on financial institutions.

Priority industry allowance.

The 'priority' industry allowance was introduced in 1964-65. Under this scheme a tax rebate of 10 per cent was granted for industries engaged in the production of essential commodities as specified in the Fifth Schedule of Income Tax Act 1961. These industries were:

1) Iron and steel, ferro alloys and special steels,
2) Aluminium, copper, lead and zinc,
3) Coal, lignite, iron ore and bauxite,
4) Major items of specialised equipment used in specific industries as specified in First Schedule to the Industries (Development and Regulation) Act 1951,
5) Boilers and steam generating plants, steam engines,
6) Equipment for the generation, transmission and distribution of electricity including transformers,
7) Machine tools, precision tools, dies,
8) Tractors and earth moving machinery,
9) Steel castings and forgings,
10) Cement and refractories,
11) Fertilisers,
12) Paper and paper pulp,
13) Tea, coffee and rubber
14) Components of above.

In 1966-67, the list was extended to include manufacture of tea, newsprint and printing machinery and hotels run by Indian companies. The list was shortened in 1971-72 and confined only to industries engaged in production and manufacture of aluminium, motor trucks and buses, refractories, soda ash and petro-chemical industries.

Export incentives.

Export earnings were exemptedd from income tax upto 10 per cent from 1962, Also 1965 tax credit certificates were issued to persons exporting goods and merchandise out of India. In 1968 an export market development allowance was granted to domestic companies in the form of a deduction of 133 per cent of their expenses on items such as advertisement outside India and travel abroad providing that the expenses were not of capital expenditure nature.