THE ECONOMIC WEEKLY

Vol XVII No 51 Dec 18, 1965

THE ECONOMIC WEEKLY
Co-operative Insurance Building,
Sir P M Road, Bombay. 1.
Grams: ECONWEEK
Telephone: 253406
Annual Subscription: Rs 36
Foreign: 70s or $ 10

Are Tax Credits Relevant?

THE gazette notification of December 12 merely elaborates on the tax credit scheme for investment in equities announced on December 24 last year and given effect to in the Finance Act, 1965. The salient features of the original scheme remain. There are some further attempts at closing a few possible loopholes, and a couple of concessions regarding purchases from underwriters or from another party. The details also specify the manner and processing of applications for tax credits.

The tax credit still applies to initial issues of equity capital by industries that fall under the first schedule of the Industries (Development and Regulation) Act, which amount to not less than Rs 20 lakhs and which have been made on or after December 24, 1964. The issue has to be declared eligible by the Controller of Capital Issues. The investor in such issues—who may be an individual or an Hindu undivided family—is entitled to a five per cent tax credit on the first Rs 15,000 invested, a three per cent tax credit on the next Rs 10,000 invested, and a two per cent tax credit on the next Rs 10,000 invested. On an aggregate investment of Rs 35.000 he would thus get an annual tax credit of Rs 1,250. Being entitled to this for the year of subscription and for the three following years, he would thus get a total rebate of Rs 5,000 on an investment of Rs 35,000. If the investor purchases the equities from an underwriter, he will get the credit for the period remaining out of the four years from the time of purchase by the underwriter. Also, if an investor purchases the equities from another investor, the credit will be apportioned between them according to their respective share of the four-year period.

The grant of tax credit on purchase from an underwriter (the earlier scheme had provided only for credit on inheritance of the eligible equities on the death of the original investor), or from another investor, are added incentives, welcome in themselves, provided of course that the transferability does not in the present state of the stock markets lead to frequent switches. For, the purpose of the incentive is to help the stock market hold, and easier transfers by definition go against this aim. The ceilings and sums involved in the tax credit indicate that it is aimed at encouraging the relatively small investor who would fall within the Rs 35,000 investment limit. A total lax rebate of Rs 5,000 on this is certainly more sizable than the gain from tax credit schemes formulated earlier for exports and later for production increases. But is it large enough? It is difficult to answer this merely by relating it to the yield pattern or the gestation period of the company. In any case, a system so related would be rather cumberous to operate.

What does seem doubtful about the present tax rebate scheme is its adequacy as a measure in the face of the persistently falling equity values on the stock market. The small investor has suffered the most from this collapse. Would a 14 per cent gain over a four-year period compensate for the capital losses and the loss of confidence that he has suffered even on the "safer" shares by now? For the small investor such capital losses are especially weighted because investment in equities is his hedge against inflation. It is interesting too that since last December, when the outline of the scheme was first announced, the response to new issues has by no means improved and today it is still negligible. It is the loss of hope with the persistent fall in the share market since the cad of 1962, except for very brief periods of improvement, not the size of the present gain, nor the apparently complicated procedure (which is not as complicated as some comments have made out), that may eventually decide the fate of the present scheme.

The sustained decline on the share market has often been attributed to the toughness of the fiscal and monetary measures. So simply put, the picture is misleading. For, it is likely that it is not so much the present toughness as the former leniency towards the stock exchange boom of the early 'sixties, alternated now by sudden and extreme stringency that account for today's unrelieved decline. Share values were rising steeply at that time, and measures such as a rise in Bank Rate, bigger margins on the stock exchange, credit restriction and selective credit control for stock exchange purposes, were steps that did not come on time. Today they have come with full force with severe credit restrictions, the successive rises in Bank Rate, and the tax on bonus issues which hits at the investor's capital gains calculations. Sentiment is low, but the normal methods of introducing buoyancy in the market to counter that are still not available. These could be, it has been suggested for instance, larger advances against shares left as security with banks, or easing of the tax on bonus issues.

The question is, do the authorities want to inject such life into the stock market, though this evidently is the motivation behind the tax credit on new equities? The general burden of taxation cannot be blamed for the present state of affairs. Those le-sources are needed for planned development. And what is more significant, the profits and the dividends paid by companies have still been showing a rising trend. The occasional case of lower dividends is the exception rather than the rule, as for instance the fall in the payment by sugar companies following the land ceiling order by the Maharashtra Government.

Still, savings need to be siphoned into investment in the various concerns. When the Finance Minister hinted that he could do without the stock markets, he obviously had institutions such as the LIC, the Development Bank and the Unit Trust in mind. These certainly could provide sizable alternative sources of finance. Being able to set off insurance premia as expenditure for income tax purposes, the exemption of the Unit Trust from double taxation unlike other investment trusts, and similar measures, would make investments through these institutions attractive. But the stock market does on the other hand provide a more direct method of choice for the investor, affords him greater manoeuvrability and promises, in optimistic conditions, comparatively better returns. The period of buoyancy of the early 'sixties, it must not be forgotten, was the period during which much fruitful new industrial investment took place.

Since the economy, despite being planned and controlled, leans heavily on modern private business for cipital formation, there are two further points to reckon with. First, the relevance of controlling prices on the soaring commodity markets, since higher commodity prices, by pressing on costs and profit margins of final manufactures whose market prices are often Government-controlled, depress the investment market and the investment motive. And secondly, the need perhaps, in the circumstances, not to rob private industry of a direct, potentially buoyant source of investment.

Bokaro, How Much Longer?

THE danger of further delays in Bokaro is not entirely over. Acceptance of the Russian project report has to be communicated within two months but a number of decision bottlenecks appear obvious. The cost of the project is significantly higher than was anticipated earlier though it was known that the capital Cost may be high till the final projected capacity is reached. Costs, unfortunately, do not stay constant with the passage of time; in any event, the Russians, no less than others, are susceptible to bargaining. The cost issue does tend to get clouded by the noisy fears of Andhra that Visakhapatnam might go by default as a result of over-spending on Bokaro. The talk in some quarters of inviting global tenders, however, is utterly irresponsible: the Russians do not participate on that basis and, placed as we are, time is infinitely more valuable than a few crores of rupees. What is required is more steel and more of particular varieties in the quickest possible time; the number of steel plants it should come from is an entirely subsidiary matter. Negotiations for Bokaro have to be based on the intrinsic merits of Russian designs and quotations; they cannot proceed on the hypothesis that resources have also to be kept aside for Visakhapatnam.

A greater cause of worry is that the Russian credit is for Rs 100 crores only while the foreign exchange component is significantly higher. Some of the balance might come from the additional credits and trade arrangements which Russia has promised to consider but full cover is not in sight. Free foreign exchange would be required for some imports specifically for the plant and for payment of royalty on the LD process, and indirectly for the fulfilment of targets of procurement from domestic sources which are expected to provide about 35 per cent of the total value of plant and machinery. This sorting out should be facilitated to some extent by the de-freezing of aid from Consortium sources.

The reported moves to introduce aluminising in place of galvanising and to provide for the use of acids other than sulphuric acid are in the right direction. Unless import substitution is built in wherever possible into the plant, there would be avoidable drain of foreign exchange in the course of operations. These changes, too, might tend to delay the execution of the project for no indication of them had been given earlier to the Russians.

With the project report and designs in hand, it should be possible now to proceed with the tapping of domestic sources of equipment. The exploration carried out so far has been perfunctory. Sending out questionnaires is no substitute for sustained location of capacity, indication of delivery schedules and mobilisation of technical assistance within the country to maximise import substitution. Instead, much time and energy are being spent on the issue of Dastur vs Others for the consultancy contract

That a few more consultancy firms have come up since Dastur did the spade work on Bokaro is an entirely welcome development but their existence and competence are not sfrictly relevant. Moral commitments (which are being mentioned as if fulfilling them is an act of charity) apart, Dastur has been indentified with Bokaro and is wholly Indian-owned and staffed. Inviting tenders for the award of consultancy would, for one thing, cause intolerable delay; for another, it does not eliminate the question of choice which in this matter is not a question of the fees alone. The Russians would be handling the consultancy for their part of the work and Bokaro Steel itself would be looking after some of the domestic portion. The residue is not so large as to justu fy the employment of more than one consulting agency. And this agency has to be a unitary organisation, not a consortium, if the intricate task of procuring equipment and parts from something like 500 different enterprises within the country has to be carried out expeditiously. A consortium of uneasy claimants, at least one of whom has been actively lobbying against Dastur at political levels, will not work; it could tarnish the reputation of Indian consultancy, apart from endangering the schedule of the project itself.