CHAPTER VI
RECENT POLICY AS ADOPTED BY THE GOVERNMENT ON DEVELOPMENT REBATE
In the previous chapter, a review of the functioning of Development Rebate as an incentive to industry has been made. From this review an inference may be drawn that Development Rebate has made substantial and effective contributions to the development and diversification of industries. As mentioned earlier, a decision was taken by the Government in 1971 that Development Rebate would cease to operate after May 1974. The withdrawal of the incentive was primarily sought for safeguarding the interests of the exchequer. It may be recalled that this decision was also readily endorsed by Bhootalingam and Wanchoo Committees.

The decision was viewed by many with great concern and attracted widespread criticisms. The perusal of the speeches as delivered by the Chairmen of different companies at different times reveals the fact that the withdrawal of the incentive would act as a positive deterrent to the industrial progress. It has been pointed out by Mr. J.R.D. Tata that the abolition of Development Rebate would hard hit the industries in general and heavy industries in particular. The plant and machinery in heavy industries is generally used for a long period of time and consequently, there is an enormous gap between the historical costs and replacement costs of these assets. The costs of acquiring

plant and machinery have increased four-fold. The discontinuance of Development Rebate, in this case, is sure to dry up the internal resources of the industrial sector and will slow down the replacement or expansion work resulting in considerable reduction in production.

Mr. P. N. Talukdar, Chairman, Hindustan-Pilkington Glass Works Limited, observed that discontinuance of Development Rebate would produce a deterrent effect on the growth of new industries requiring to install plant and machinery involving heavy costs and also on the existing industries requiring replacement or expansion².

While advocating the continuance of Development Rebate Mr. Ramdas Kilchand, Chairman, Polychem Limited, pointed out that the Petrochemical Industry involving heavy capital expenditure was still in its infancy. Consequently, the discontinuance of Development Rebate would mean the withdrawal of the favourable environment essential for the growth and development of the industry³. While criticising the decision of the Government on Development Rebate, Mr. Ramdas Kilchand remarked, "While on one hand the Government proclaims that the tempo of industrial development should be speeded up not only for achieving greater growth rate but also for making up the shortfalls which occurred during the initial years of the fourth plan, the fiscal policies on the other hand are so changed that I am afraid it may considerably slow down the pace of industrial investment and development".

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² Ibid, "Hindustan - Pilking/Glass Work Limited; Speech of the Chairman; Mr. P. N. Talukdar", p. 1725.
Similar views were also expressed by Messrs K. Bajaj, Chairman, Murkand Iron and Steel Works Limited, C.S. Desai, Chairman, Premier Tyres Limited, A. Ramaswami Mudaliar, Chairman, Indian Steamship Company Limited and others.

Realistically, the withdrawal of Development Rebate would create an additional tax burden of the corporate sector. In order to determine the magnitude of such a tax burden, certain factors are to be considered. These factors include, amongst others, the quantum of qualifying assets, the rates of Development Rebate applicable to different classes of such assets and the rates of tax on profits applicable to different categories of enterprises. But the appropriate data on these aspects are not always available. Thus the quantum of increase in the tax burden of the corporate sector in the event of withdrawal of the incentive appears to be difficult to ascertain very accurately. However, on the basis of the Reserve Bank of India's study of finances of Joint Stock Companies, an annual increase in the tax burden of the corporate sector may be estimated at about Rs. 55 Crores, assuming Development Rebate at an average rate of 20 per cent, the rate of corporation tax at 55 per cent and the annual investment in plant and machinery.

of the order of Rs.500 Crores. Moreover, in addition to the withdrawal of Development Rebate, slashing of special deduction which was being allowed to the priority industries on their profits and the discontinuance of the status of priority industries in the case of a number of industries would entail a rise of 16 to 17 per cent over collections from corporate income tax.

Another study of the finances of joint-stock companies undertaken by the Reserve Bank of India reveals the fact that the effective rate of income tax on corporate profits in respect of organised industry was found to be nearly 43 per cent in 1970-71, but the rate would shoot up to 57.75 per cent in the case of abolition of Development Rebate.

Significantly, Mr. Morarji Desai said in his budget speech in 1968, "I have also come to the conclusion that the familiar instrument of Development Rebate need not be abandoned or replaced."

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6. Economic and Political Weekly; July 10, 1971, Vol.VI, No.28; "Tax Incentives to Industries"; pp.1404-1405. The conclusion has been made on the basis of the Reserve Bank of India's studies of finances of Joint Stock Companies:

7. Budget for 1971-72; Vol.II; Ministry of Finance, Govt. of India, Manager of Publications; 1972; p.117.


9. F.A. Mehta: "Wanchoo Committee Recommendations-I" in The Economic Times, July 25, 1972; Vol.XII, No.143; p.5. The conclusion has been made on the basis of the study of finances of Joint Stock Companies by the Reserve Bank of India; Reserve Bank of India Bulletin, February 1972; Vol.XXVI, Number 2; p.212.
by fancier alternatives. Accordingly, the development rebate will continue to be admissible. Just before Development Rebate was proposed to be withdrawn, Mrs. Indira Gandhi, the then Prime Minister and Finance Minister, while presenting the budget for 1970-71, declared that the structure of corporate taxation should remain undisturbed insofar as any significant change in corporate taxation might act as a deterrent to higher production and investment. But the budget for 1971-72 as presented by Mr. Chavan shortly after this significant announcement appeared to be diametrically opposite to what was intended by Mr. Morarji Desai or Mrs. Gandhi. The taxation proposals including the withdrawal of Development Rebate came as a rude shock to the business circle which at once raised a pertinent question: Has the rate of industrial production "galloped ahead and overheated the economy" leading to the hasty withdrawal of Development Rebate?

The answer lies in the budget speech delivered by Mr. Chavan himself at the time of presenting the Budget for 1974-75. He said, "It is, however, a matter of deep concern to us that in the fourth plan our overall rate of growth has been much lower than the plan


target. It is also a matter of deep regret that the upsurge in industrial production that was evident in 1972 was not sustained in 1973. The available indicators suggest that there was hardly any increase in the rate of growth of industrial production in 1973. 14

This speech is a clear pointer to the fact that industrial development was in doldrums at the time when Mr. Chavan abolished Development Rebate.

The Reserve Bank of India Bulletin for the month of December 1973 reveals certain statistics relating to industrial production. The following table indicates a significant decline in industrial production in some of the major industries.

### Index Numbers of Industrial Production:

(1960 = 100)

<table>
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<tr>
<th></th>
<th>March 1972</th>
<th>March 1973</th>
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<tr>
<td>A. General Index (unadjusted)</td>
<td>208.0</td>
<td>207.1</td>
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<tr>
<td>B. Intermediate goods industries (which include cotton spinning, Jute manufactures, tyres and tubes, synthetic fibres etc.)</td>
<td>171.7</td>
<td>164.1</td>
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<tr>
<td>C. Consumer goods industries</td>
<td>172.6</td>
<td>158.2</td>
</tr>
<tr>
<td>(1) Consumer non-durable goods industries (which include Hydrogenated oil, cotton weaving, pharmaceuticals, soaps, matches, glass and glass products etc.)</td>
<td>151.7</td>
<td>137.5</td>
</tr>
<tr>
<td>(2) Consumer durable goods industries (which include Electrical appliances, Communication equipments etc.)</td>
<td>288.9</td>
<td>273.1</td>
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It may, however, be pointed out that Indian industry is passing through difficulties like unabated price rise, shortages of raw materials, coal, wagons, power or interruptions in power supply, labour troubles, deterioration of plant and machinery etc. These factors are also responsible for low output in this country. Although a taxation policy is not expected to overcome all these difficulties, a realistic taxation policy can go a long way in the fulfilment of the objectives of industrial growth and development. Development Rebate, it was pointed out, "was helpful in narrowing the gap between original and replacement costs, although to a small extent. Its impending abolition will, therefore, further aggravate the seriousness of this problem". In this context, it may be mentioned that rapid industrial growth and productivity that can be witnessed in industrially advanced countries are largely due to exceptionally quick replacement of old assets by new ones.

As mentioned earlier in the Chapter-V of this study, Development Rebate was replaced by Initial Depreciation with effect from 1st April 1975. A sum equivalent to 20 per cent of the actual cost was to be allowed on ship, plant, machinery, aircraft etc. Obviously, the system of Initial Depreciation was not viewed as an adequate investment incentive to industry insofar as it was not capable of financing the enhanced cost of replacement.

17. Ibid. p.8.
While Development Rebate was available to all industries, Initial Depreciation allowance was limited to only 24 selected industries. Moreover, the tax laws provided different rates at which Development Rebate was to be allowed to different industries. It may be recalled that the shipping industry enjoyed Development Rebate even at the rate of 40 per cent. Initial Depreciation allowance, therefore, cannot be looked upon as an adequate substitute for Development Rebate. Although the withdrawal of Development Rebate was sought for safe-guarding the interests of the exchequer, it may be argued that the exchequer will be able to earn more revenue by allowing a concession like Development Rebate than by withdrawing it. A real industrial incentive will cause increasing production by stimulating investment and there will be a significant rise in taxable profits. In that case, the loss resulting from such a concession will be more than compensated. While recommending Development Rebate as a measure to help promote industrial investment in India, the Taxation Enquiry Commission 1953-54, pointed out that the industrial expansion when stimulated by Development Rebate would cause, in due course, "a larger flow of taxable profits and greater receipts in consequence of the allowance".

Mr. Chavan, however, provided an incentive to investment in backward areas while introducing Initial Depreciation. An Indust-

trial undertaking set up in a specified backward area was to be allowed a deduction of a sum equivalent to 20 per cent of its taxable profits. But this measure would have been meaningful, had there been proper availability of infrastructure facilities in the backward areas. Almost all previous efforts of the Government to persuade the entrepreneurs to undertake industrial investment in the backward areas practically went in vain "mainly because of the absence of reasonable infrastructure facilities and the shortage of power and other essential materials". What is more surprising is that the Marwaris could not be allured to set up industries in Rajasthan, their homeland.

Soon it was recognised by the Government that if the discontinuance of an incentive like Development Rebate was perpetuated, it would act as a serious blow to a developing economy where the corporate sector would always be in need of adequate resources to fight inflationary pressures and meet technological advances. Mr. C. Subramaniam who succeeded Mr. Chavan as the Finance Minister remarked: "I have already drawn attention to the sharp increase in capital costs that has taken place. This has not only prevented faster expansion of capacity, but also has imposed considerable strain on existing undertakings which are obliged to replace worn-out and obsolete equipment. Unless the corporate sector is enabled to provide adequately for renewals and renovations, employment...

and industrial growth will be jeopardised. Fiscal policy should therefore be oriented to provide necessary stimulus for the growth and modernisation of the corporate sector. No greater authority is, therefore, needed to bring home the point that the withdrawal of Development Rebate was ill-timed and ill-conceived.

The Finance Act, 1976, replaced Initial Depreciation by Investment Allowance. Inclusion of Investment Allowance in tax laws can actually be regarded as the re-introduction of Development Rebate in another name insofar as it is based broadly on the lines of Development Rebate. Investment Allowance is given at 25 per cent of the costs of ships, aircrafts besides machineries and plants on fulfilment of certain conditions more or less similar to those laid down when Development Rebate was introduced. Originally, the concession was to be given to selected industries, but Mr. H. M. Patel, while presenting the first ever Janata Government's full fledged Budget, extended the scope of the concession to all industries except only those producing low priority items such as cigarettes, cosmetics, alcohol and beverages. Moreover, the rate of Investment Allowance was raised from 25 per cent to 35 per cent in respect of plant and machinery installed for the purpose of manufacturing any article by using know-how developed in Government laboratories, public sector companies and universities.

26. Ibid., p. 10.
The above study, therefore, reveals the fact that the abolition of Development Rebate was a retrograde step. Consequently, the fiscal policy has to be reoriented to ameliorate the difficulties the industrial sector was put to after the discontinuance of Development Rebate.