CHAPTER-IV

INTRODUCTION OF DEVELOPMENT REBATE IN INDIA
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In the previous chapter of this study, the propriety or otherwise of historical cost depreciation during rising prices has been considered and it has been found that historical cost system does not appear to be the accurate answer to the problem of financing enhanced costs of replacement of fixed assets. There was a growing demand for replacement cost depreciation which was considered by many as an appropriate method of financing replacements during inflation. But the system of replacement cost depreciation was also found to suffer from many defects and consequently, the system could not be adopted in different countries.

Moreover, the propriety or otherwise of many other suggestions including those of Exposure Draft 8 and SSAP 7 has been considered in the previous chapter of this study and it has been seen that application of the principles of any such suggestion would create confusion to many users of accounts. It has also been seen that even the Sandilands Committee, while recommending 'Current Cost Accounting' - the latest development along the line of inflation accounting, has recommended further study inasmuch as the Committee itself has not been able to give a complete shape to the system.

From the above it follows that it was not something unnatural to apprehend that no firm would adopt any method of its own initiative that would ensure writing off depreciation
at a higher rate without any tax incentive. Accordingly, the corporate sectors in different countries were found to claim tax incentives during the fifties to carry out plans for internal financing of replacements of old worn-out assets. Industrial incentives like investment allowance, accelerated depreciation, grants etc were granted to the corporate sectors by different governments for creating a favourable climate for investment activities. These incentives are still found to continue their operations in different countries to facilitate industrial growth and development.

In India, Development Rebate was considered to be a more appropriate method for financing enhanced costs of replacement of plant and machinery. A discussion has, however, been made in the first Chapter of this study about the circumstances leading to the introduction of Development Rebate in India in 1955.

Development Rebate

Development Rebate was introduced in India on the basis of the recommendations made by the Taxation Enquiry Commission, 1953-54. As rising prices enhanced the costs of replacement of fixed assets, there was a long standing demand in India for increase in the depreciation allowances. The Taxation Enquiry Commission, 1953-54, examined the subject and recognised the problem of replacement which varied "from industry to industry and from unit to unit". The Commission wanted the

1. The Budget for 1955-56: Speech of Finance Minister; Ministry of Finance; Government of India; Manager of Publications, Delhi, 1956; pp. 141-142.
tax-laws to provide greater incentives to industry in order to stimulate productive investment relating to expansion and replacement activities of existing industries and setting up of new enterprises. According to the Commission the "intensification of competition in the world market makes it all the more necessary that the capacity of Indian industry to finance development should be reinforced in a general way". Consequently, one of the suggestions that were advanced by the Taxation Enquiry Commission, 1953-54, was to grant Development Rebate to selected industries of national importance. The rebate was to be allowed at 25 per cent of the cost of new plant and machinery installed and wholly used for business purposes only. The Government, however, while granting Development Rebate went beyond the recommendations made by the Taxation Enquiry Commission. The Finance Act, 1955, provided a new section, 10(2)(vib), and Development Rebate was initially allowed, in lieu of existing initial depreciation allowance, to all industries without any distinction on new plant and machinery installed after 31st March, 1954, for business purposes only.

Development Rebate was allowed over and above the cost price of the plant and machinery and it did not form a part of depreciation allowances provided by the income-tax law to enable a businessman to recoup the cost of plant and machinery. Introduction of Development Rebate in addition to depreciation allowances was actually aimed at accelerated amortization of

3. Ibid., p.98, para 2.
the cost of new plant and machinery. The rebate was, therefore, as good as a tax-free gift made available to an industrialist by the Government.

In 1958, the then Finance Minister announced in his budget speech his decisions to increase the rate of Development Rebate from 25 per cent to 40 per cent in respect of ships acquired after 31st December, 1957. The Finance Act, 1958 introduced certain conditions for the grant of the concession in order to prevent its abuse. Firstly, a reserve account was to be created in respect of plant and machinery and ships and an amount equal to 75 per cent of Development Rebate actually allowed on plant and machinery and ships installed or acquired after 31st December, 1957, was to be debited to profit and loss account of the relevant previous year and credited to such reserve account. A licensee under the Electricity (Supply) Act, 1948 was not, however, required to create such a reserve account.

Secondly, the amount so reserved could be utilised for a period of ten years next following only for business purposes. In other words, the amount could be utilised for acquiring assets or for investment for the purposes of the undertaking. The amount was not to be utilised for distributing dividends or profits. Moreover, no remittances could be made or assets could be created outside India out of the reserved amount.

Thirdly, the assets concerned were not to be sold out or transferred by the assessee before the expiry of ten years from the end of the year in which they were acquired or installed. No such restriction was, however, imposed on the assessee in respect of sale or transfer of the asset to Government.

Lastly, any infringement of the conditions laid down by the Finance Act 1958, would lead to the withdrawal of Development Rebate once allowed on any asset even from the very first stage of its operation.

The Finance Act, 1958, however, provided, a liberal policy in respect of the unabsorbed portion of Development Rebate. In the case of inadequacy of profits in one year, Development Rebate could be carried forward for eight subsequent years.

The Taxation Laws (Amendment) Act, 1960, laid down a specific provision according to which Development Rebate was not to be allowed on office appliances and road transport vehicles.

The restrictions as laid down by the Finance Act, 1958, in respect of sale or transfer of an asset were severely criticised on the ground that the policy was "divorced from consideration of justice and fairplay". It was pointed out that an asset might be considered useful after the expiry of ten years from the end of the year in which it was acquired, while another

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might prove useless even after five years from the date of its acquisition. Moreover, a businessman would not be able to undertake reorganisation of his concern insofar as conversion of a firm into a public or a private limited company would lead to discontinuance of Development Rebate.

The Finance Act, 1961, however, made certain amendments in respect of Development Rebate and restrictions in respect of sale or transfer of assets were considerably relaxed. The rate of Development Rebate was reduced from 25 per cent to 20 per cent in the case of plant and machinery installed on or after 1st April, 1961. The rate of the Rebate, however, remained at 40 per cent in the case of ships.

The Finance Act, 1961, further provided that Development Rebate once granted to an asset was not to be withdrawn in the event of sale or transfer resulting from amalgamation of companies or conversion of a partnership firm into a private company. The successor, however, was to abide by the relevant conditions.

The ten-years period before the expiry of which the sale or transfer of an asset, after its acquisition, was restricted for the purposes of Development Rebate, was reduced to a period of eight years.


The Finance Act, 1963 (No. 43 of 1963) provided that a higher rate of Development Rebate at 35 per cent was to be allowed on new coal mining machinery or plant installed after 31st March, 1963 and before 1st April, 1966.\(^{12}\)

The Finance Act, 1964, widened the scope of operation of Development Rebate and made certain amendments in this respect.\(^{13}\) The allowance was extended to second-hand ships or second-hand plant and machinery acquired from non-residents or newly imported from a foreign country after 31st March, 1964, "at such rate or rates and subject to conditions as may be prescribed in the income-tax rules".\(^{14}\)

The Finance Act, 1964 also provided that the Central Government was capable of disallowing Development Rebate by issue of notification specifying a period of not less than three years.\(^{15}\)

The Finance Act, 1965 (Act No. 10 of 1965) brought about a change in the rates of Development Rebate in respect of new plant and machinery installed after 31st March, 1965.\(^{16}\) Development Rebate was to be allowed on such plant and machinery at graduated rates.

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15. Ibid.; p. 437.
16. Budget for 1965-66; Finance Act, 1965; Ministry of Finance; Govt. of India; Manager of Publications, Delhi, 1966; pp. 542-543.
In the case of new ships acquired and new coal mining machinery installed after 31st March, 1965, the rates of Development Rebate, however, remained at 40 per cent and 35 per cent respectively. A higher rate of Development Rebate at 25 per cent was to be allowed on plant and machinery installed for the purpose of business of ship building or production of articles of priority industries specified in the fifth schedule. The lower rate of Development Rebate at 15 per cent was to be allowed on plant and machinery installed in all other industries. The lower rate of Development Rebate was, however, not to be applicable to those industries which were previously entitled to the allowance at 20 per cent. Moreover, Development Rebate was not to be allowed on plant and machinery installed in an office or a residential accommodation after 31st March, 1965.

The Fifth Schedule specifying the priority industries was inserted by the Finance Act, 1965 (Act No. 10 of 1965)\(^\text{17}\). The Fifth Schedule, when it was inserted by the Finance Act, 1965, specified 25 items. Subsequently, the items were increased to 33\(^\text{18}\) (Appendix-I).

The Finance (No.2) Act, 1965 modified the rates of Development Rebate\(^\text{19}\) and provided that a higher rate of the Rebate at 35 per cent was to be allowed on plant and machinery installed in priority industries before 1st April 1970 and a

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17. Ibid., pp.573-574.


19. Acts of Parliament 1965; Finance (No.2) Act, 1965; Ministry of Law; Govt.of India Manager of Publications, Delhi, 1966; p.142.
lower rate of 25 per cent was to be allowed on such plant and machinery after 31st March, 1970. In the case of non-priority industries the Rebate was to be allowed at 20 per cent on plant and machinery installed before 1st April, 1970 and a lower rate of 15 per cent was to be allowed on such plant and machinery installed after 31st March, 1970.

The Finance Act, 1966, modified the required reserve percentage in respect of ships acquired after 28th February, 1966. The reserve percentage was reduced from 75 per cent to 50 per cent. The quantum of Development Rebate Reserve was reduced in the case of shipping industry insofar as the profitability of such industry was found to be considerably lower than that of other industries.

The Finance Act, 1967, made available to an assessee a higher rate of Development Rebate at 35 per cent in respect of plant and machinery installed after 31st March, 1967 to carry out research for the purpose of his business and a lower rate at 25 per cent on such plant and machinery installed after 31st March, 1970.

Development Rebate was allowed at a priority rate, i.e. at 35 per cent on plant and machinery installed before 1st April, 1970, by hotels being Indian companies and duly approved by the Central Government for the time being and at 25 per cent

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on such plant and machinery installed after 31st March, 1970. In 1968, Morarji Desai, the then Finance Minister, while emphasizing the need for Development Rebate, declared that the allowance would continue to operate. He also rejected any idea of even replacing Development Rebate by any “fancier alternative.” But S. Bhoothalingam, in his Final Report on Rationalisation and Simplification of the Tax structure, was found to hold a different opinion which ran contrary to that of Morarji Desai. He recommended the withdrawal of Development Rebate insofar as the existence of the allowance, according to him, might lead to imprudent and wasteful uses of capital. The Government of India, however did not accept Bhoothalingam’s suggestion and Development Rebate was allowed to continue.

In 1971, Y.B. Chavan, while introducing the budget for 1971-72, announced that Development Rebate “has had a full pay” and there was no need for continuance of the rebate after 31st May, 1974. Accordingly, he served the required notice relating to withdrawal of Development Rebate. The Direct Taxes Enquiry Committee, 1971 (Wanchoo Committee), in its Final Report, also endorsed the decision of the Government of India in respect of withdrawal of the allowance.

23. Income Tax Manual - Part-I (Nineteenth Edition) : (as amended upto 1970); Issued by Directorate of Inspection (Research, Statistics and Publication); Manager of Publications, Delhi, 1970; Act No.20 of 1967; p.74.
26. Budget for 1971-72; Vol.II - Speech of Finance Minister; Ministry of Finance; Govt. of India; Manager of Publications, Delhi, 1972; pp.116, 117.
27. Direct Taxes Enquiry Committee-Final Report : Ministry of Finance, Govt. of India, 1971; Manager of Publications, Delhi, 1972; p.113.
The Finance Act, 1974 abolished Development Rebate and the Act provided that it was not to be allowed after 31st May, 1974. But the Rebate was allowed to continue in a few cases for a limited period from 1st June, 1974 to 31st May, 1977. The short period concession was allowed on ships, plant and machinery in respect of which there existed unexecuted contracts entered into by the assessee before 1st December, 1973 for purchase of such ships, plant and machinery. The concession was also made available for coal-fired equipments and plant and machinery for converting oil-fired equipments into coal-fired equipments.

Direct Taxes (Amendment) Act, 1974, replaced Development Rebate with effect from 1st April, 1975, by providing Initial Depreciation of a sum equivalent to 20 per cent of the actual cost of ship, plant, machinery, aircraft etc. Insofar as Development Rebate was still to continue for a very short period in a few cases, both Development Rebate and Initial Depreciation were not to be applicable to the same ship, plant or machinery, aircraft etc.

The decision of the Government to abolish Development Rebate was viewed by many with great concern particularly when advanced countries still prefer to continue the systems more or less identical to Development rebate to further industrial development.

expansion. A perusal of the speeches of the company - Chairmen on various occasions on the question of withdrawal of Development Rebate shows that, according to their opinion, there ought to be no case for India to abolish the system of Development Rebate (Chapter-VI).

(The Finance Act, 1976, has however, introduced Investment Allowance seeking to replace Initial Depreciation Allowance. A description of Investment Allowance has been given in the Sixth Chapter of this study).

In this context, it would, therefore, be pertinent to enquire how far Development Rebate has so long replenished the internal resources of the corporate sector at a time when there has been an erosion of real capital - the greatest curse of inflation. An attempt has, therefore, been made in the following chapter of this study to examine how far Development Rebate was capable of aiding the maintenance of adequacy of internal finance of industry and stimulating investment activities.