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Introduction

General

CAPITAL allowances in the form of accelerated depreciation or development rebate have been in operation in India with a brief interruption for almost forty years now. Along with tax holiday for new industrial undertakings, capital allowances were considered necessary to further industrialisation and capital formation especially in crucial areas. It was the Taxation Enquiry Commission (Matthai Commission, 1953-54) which suggested an incentive by way of deduction in computation of taxable income of a sum equal to 25 per cent of the cost (in addition to full recovery of cost through depreciation provisions) on all specific acts of investment in fixed assets in the form of plant and machinery, whether intended for replacement or for expansion by new or existing concerns. The Commission recommended introduction of this incentive, which was termed as "development rebate", on a selective basis to be confined to the group of industries broadly described as producers' goods and capital goods industries.[1]

However, development rebate appeared on the statute in 1955 as a universal machinery installation allowance. It was given at the rate of 25 per cent of the cost in respect of all new machinery or plant installed after March 31, 1954 for business purposes, irrespective of the line of manufacture or production. Subsequently, road transport vehicles and office appliances etc., were debarred from the allowance and to prevent its abuse, creation of a statutory reserve came to be insisted upon. When the standard rate of development rebate was reduced to 20 per cent from April 1961 and later to 15 per cent from April 1970, increased support was given to a segment of the industrial sector, e.g., industries listed in the Fifth Schedule to the Income Tax Act became entitled to development rebate at 35 per cent and 25 per cent in April 1965 and 1970 respectively. New plant and machinery installed after March 1967 for the business-related scientific research and in approved hotels also got the higher rates. Ships had been given 40 per cent development rebate from as early as January, 1958. Thus, the principle of selectivity recommended by the Matthai Commission for grant of development rebate was not followed, except to the extent it may be said to have been applied by grant of the rebate at a higher rate to certain industries.

With widespread idle capacity in the late sixties, it began to be felt that the emphasis should shift towards prudent and economic use of capital.[2] On the view that the practice of offering a development rebate in respect of new investment in plant and machinery had had full play, a notification directing its discontinuance after May 1974 was issued in May, 1971.[3] Later, while for cases involving delayed deliveries the availability period was extended to May 1975, the critical shortage of petroleum products and the need to switch over to alternative sources of energy led to allowance of the rebate for coal-fired equipment if installed before June 1977.[3]

There was a steep escalation in capital costs which could not be foreseen when the decision to withdraw development rebate was taken. Referring to it, the Union Finance Minister in his Budget Speech for 1976-77 said that this had not only prevented faster expansion of capacity, but had also imposed considerable strain on existing undertakings which were obliged to replace worn-out and obsolete equipment and unless the corporate sector was enabled to provide adequately for renewals and renovation, employment and industrial growth would be jeopardised. He, therefore, announced a scheme of investment allowance, at the rate of 25 per cent of the cost of a new ship or aircraft acquired and new machinery or plant installed after March 31, 1976 in priority industries listed in the Ninth Schedule to the Act, and hoped that it would facilitate investment in priority industries and reduce their dependence on publicfi nancial institutions.[4] Like the erstwhile development rebate allowed under section 33 of the Act, with which it had points in common as also differences in material respects, the investment allowance admissible under section 32A was over and above full recoupment of the cost through depreciation allowance.

Section 32A saw a number of amendments till the Long Term Fiscal Policy (LTFP) announced in December 1985 proposed its withdrawal. While acknowledging that the investment allowance (and its earlier version, the development rebate) had played a role in the industrialisation of the Indian economy, LTFP said that it tended to favour the larger and more well established concerns with good access to the market for borrowed funds and ability to set it off against profits of old established units without waiting for profits from fresh investment. In order to retain the merits of the investment allowance while removing some of its drawbacks, LTFP outlined a new 'funding' provision. These proposals have since been given a statutory mantle. While a new section 32AB (Investment Deposit Account) has been inserted in the Act from April 1, 1987, it has been notified that the investment allowance under section 32A shall not be allowed in respect of any ship or aircraft acquired or any machinery or plant installed after March 31, 1987.

Salient Features of the Investment Allowance Scheme

The salient features of the investment allowance scheme as evolved over the years were as follows:

(*i*) The incentive was available in respect of the specified assets acquired/installed any time during the eleven-year period between April 1, 1976 and March 31, 1987. Any corporate or non-corporate taxpayer could obtain a deduction of 25 per cent of the actual cost of a specified asset in computation of its taxable business income for the previous year of acquisition/installation of the asset or of the immediately succeeding previous year if that happened to be the year in which the asset was first put to use. This was in addition to full write-off of the cost of the asset allowed under the depreciation provisions of the Act.

(*ii*) The specified assets were:

A. a new ship or new aircraft acquired after March 31, 1976 by the taxpayer engaged in the business of operation of ships or aircraft;

B. any new machinery or plant installed after March 31, 1976 for the purposes of business of:

(*a*) generation or distribution of electricity or any other form of power; or

(*b*) a small-scale industrial undertaking for the manufacture or production of any article or thing;

(*c*) an industrial undertaking other than small scale:

—upto March 31, 1978: for construction, manufacture, or production of any one or more of articles or things listed in the Ninth Schedule of the Act (Appendix I) (listed priority industries).

—after March 31, 1978: for construction, manufacture or production, mainly of any article or thing not listed in the Eleventh Schedule of the Act (Appendix II) (other than the listed low priority industries).

C. any new machinery or plant installed after March 31, 1983 for the purposes of business of repairs to ocean-going vessels or other powered craft, if the business thereof carried on by an Indian company was approved for the purpose by the Central Government.

(*iii*) Investment allowance at the higher rate of 35 per cent was allowed in respect of:

A. new machinery or plant developed through indigenous technology and installed after June 30, 1977 subject to the prescribed conditions being fulfilled;

B. any new machinery or plant notified in this behalf installed after May 31, 1983 to assist control of pollution or protection of environment in industrial undertakings referred to in items (*ii*) *B*. *a*, *b* and *c* above.

(*iv*) A ship or aircraft used by any other person before its acquisition by the assessee provided it was not owned at the time by any person resident in India was treated as a "new ship" or "new aircraft". Similarly, machinery or plant which before its installation by the assessee was used outside India by any other person was also treated as "new machinery or plant" if it had not been earlier used in India, was imported in India from a foreign country and no depreciation in respect thereof had been allowed or was allowable under the Indian income tax provisions in computing the total income of any person for any period prior to the date of the installation of machinery or plant by the assessee.

(*v*) Following assets were specifically barred from investment allowance:

A. any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;

B. any office appliances and road transport vehicles;

C. any ship, machinery or plant in respect of which the deduction by way of development rebate was allowable under section 33 of the Act.

D. any machinery or plant, the whole of the actual cost of which was allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "profits and gains of business or profession" of any one previous year.

(*vi*) Investment allowance was admissible only if the prescribed particulars were furnished by the taxpayer and an amount equal to 75 per cent of the investment allowance (50 per cent for a ship) to be actually allowed was debited to the profit and loss account of the relevant previous year and credited to the Investment Allowance Reserve Account.

(*vii*) If due to inadequate profits, the investment allowance for a year could not be fully allowed, the balance could be carried forward for set off in the following eight assessment years.

(*viii*) Since the assessment year 1984-85, the aggregate of deduction under section 32A and deductions under other provisions listed in section 80VVA could not exceed 70 per cent of a corporate assessee's pre-incentive total income for a particular assessment year. To the extent full deduction due under section 32A could not be allowed in any assessment year by virtue of only this restriction, the unadjusted deduction was allowed to be carried forward for set off without any time limit.

(*ix*) The investment allowance allowed was liable to be withdrawn, if

A. the ship, aircraft, machinery or plant was sold or transferred, before the expiry of eight years from the end of the year of acquisition/installation to any one other than the Government, a local authority, a statutory corporation or a Government company. Subject to prescribed conditions, the allowance in respect of transfers in connection with amalgamation of the availing company with another company or succession of the availing partnership firm by a company was retained if the amalgamating/successor company continued to fulfill the prescribed conditions.

B. the investment allowance reserve was not utilised for acquiring new assets other than the assets barred under items (*v*) *A*, *B* and *D* above before the expiry of the following ten years.

(*x*) If the Central Government considered it necessary or expedient, it was empowered to omit any article or thing from the Eleventh Schedule list or to direct that investment allowance would not be allowed in respect of any asset acquired/installed after a specified date.

(*xi*) The new "funding scheme" (section 32AB) is operative from April 1, 1987, i.e., for and from the assessment year 1987-88. A transitional provision permits an assessee to avail of investment allowance or the funding scheme for a particular assessment year at his option. If he chooses the latter, he does not lose the benefit of set-off of the unabsorbed investment allowance, if any, for an earlier assessment year to which he might be entitled.

The change in the eligibility criterion after March 31, 1978 from the manufacture of the Ninth Schedule (Appendix I) priority goods to manufacture mainly of other than the Eleventh Schedule (Appendix II) low priority articles considerably enlarged the area of eligibility. Extensive pruning of the Eleventh Schedule list in 1982 widened it still further. Raising of the aggregate value of machinery or plant installed for an industrial undertaking to be deemed small-scale and thus entitled to investment allowance irrespective of the line of manufacture or production also extended its scope.

Other Countries

An investment incentive comes within the genre of fiscal concessions attaching to new investment which are designed to increase the prospective net-of-tax return from the investment relative to its cost at the time of the investment decision. A wide range of investment incentives is available to serve different purposes, from the more traditional aims of policy [growth, regional, sectoral and conjunctural (economic management)] to the more recent innovations of profit sharing, worker participation and environmental control.[5] So far as encouraging investment in machinery or plant is concerned, Appendix III gives a gist of the provisions relating to investment allowance (tax allowance additional to 100 per cent depreciation) and its sister incentive—investment tax credit (relief against tax instead of income) etc. of various countries, viz., Australia, Canada, Federal Republic of Germany, Japan, Kenya, Republic of Korea, Malaysia, New Zealand, United Kingdom and the United States of America (as of 1985). In the nature of things, the choice of a tax incentive by a country and its exact shape depends upon the state of its economy, its tax system and its perception as to how the object in view may best be realised. Lately, there is a noticeable shift from high nominal rates of tax with generous allowances and reliefs to fewer tax incentives with comparatively low tax levels.

NOTES AND REFERENCES

1. "We suggest the following criteria as the basis on which industries should be selected for the grant of the proposed development rebate : (1) Importance of the industries concerned from the point of view of national development, and (2) extent to which they are unlikely to be developed either by way of expansion of existing concerns or establishment of new concerns—if left to the voluntary effort of private enterprise and without any special stimulus by ways of tax relief. In practice this should mean confining the concession we have recommended to the group of industries that are broadly described as producers' goods and capital goods industries. . . ." *Report of the Taxation Enquiry Commission* (1953-54), Vol. II, page 99.
2. *Final Report on Rationalisation and Simplification of the Tax Structure, 1967*, p. 23, para 5.17.
3. Government of India, Ministry of Finance, Department of Economic Affairs: *Speeches of Union Finance Ministers, 1947-48 to 1984-85 presenting Central Government Budgets*, Budget Speech 1971-72 (Final) May 28, 1971, p. 341, para 42. (Notification No. S.O. 2167 dated May 28, 1971) : No development rebate in respect of a ship acquired or machinery or plant installed after May 31, 1974. Later, in order not to deny relief on account of inability to secure timely deliveries, Finance Act, 1974 extended the operation of development rebate by one year upto May 1975 (for ships : upto December, 1976) if contracts for purchase were made before December 1, 1973, while coal-fired equipment or any machinery or plant for converting oil-fired equipment into coal-fired equipment was allowed development rebate, if installed before June, 1977.
4. *Ibid*—Budget Speech 1976-77 (March 15, 1976), p. 418, para 1.9.
5. Milnes & Huiskamp (1977), have catalogued Investment Incentives as follows:

A. **Incentives which operate through the tax system**

(*i*) Accelerated Depreciation: *a*. Depreciation at choice: *b*. Free depreciation; *c*. Initial allowances; *d*. Advanced depreciation; *e*. Depreciation on the basis of replacement cost; and *f*. Declining-balance depreciation.

(*ii*) Valuation Discount: This incentive consists of allowances, including favourable methods of inventory valuation, in the end-year valuation of business assets for the computation of fiscal profit.

(*iii*) Tax Free Reserves—conditional on an act of new investment.

(*iv*) Investment Deductions: *a*. Investment allowances, *b*. Investment tax credits.

(*v*) Investment Payments: An incentive granted independently of whether any income tax or corporation tax liability exists. It may be regarded as a subsidy even though the legal authority for the investment payment is provided by a tax statute; an intermediate form between a cash grant and a tax-related allowance.

(*vi*) Concessional tax rates; changes in tax rates; tax exemptions.

(*vii*) Carry-back and carry-forward of losses.

B. Direct Subsidies

(*viii*) Investment Grants.

(*ix*) Cheap Loans; Interest Subsidies.

(*x*) Concessional Prices and other Price Subsidies.

(*xi*) Discouragements to investment; selective investment tax—generally intended to relieve congestion in crowded areas.