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The New "Funding" Scheme

Essential Features

Section 32AB (Investment deposit account) has been inserted in the Act with effect from April 1, 1987. It will apply in relation to the assessment year 1987-88 and subsequent assessment years.

The main features of this new incentive provision are given in Appendix IV. Essentially, it entitles an assessee carrying on a business or profession to reduce his taxable income by the sum utilised by him for purchase of new plant and machinery and/or deposited with the Industrial Development Bank of India for such utilisation. The maximum deduction available is 20 per cent of the profits of the eligible business or profession. It is hoped that by this scheme along with the proposed enhanced depreciation rates, the retained earnings and internal resources generation of the companies will improve. The new scheme is expected to be neutral as between small and large companies; insulate the timing of investment decisions from tax considerations and curb conspicuous extravagance in the corporate sector. It is also expected to help neutralise the bias in favour of borrowing and needless capacity creation.[1]

Points of General Importance

Investment allowance was initially meant for 'priority industries'. Its eligibility criterion became diluted over the years. Investment deposit account starts on a different note. It is qualitatively different from the investment allowance. Many businesses which have all the time been outside the purview of

investment allowance, may avail of the new incentive, e.g., processing industries and cold storage plants. While leasing or hiring of machinery or plant is specifically included in its ambit, entitlement of hotels to it will not be questioned on the ground that a hotel is not an industrial undertaking engaged in any manufacture or production. Even professionals will benefit from it.

A critique of section 32AB is outside the scope of this study. However, to the extent the phraseology of section 32AB is drawn from section 32A, working of the new incentive may present similar problems. The more important of them are dealt with in Chapter 6. The recommendations made therein which are of interest from the viewpoint of section 32AB are listed in the section on "Problems of Implementation" in the Summary of Observations and Recommendations given in Chapter 8. The following paragraphs bring out a few points of general importance pertinent to section 32AB in the light of experience with the development rebate and investment allowance.

The use of the expression "eligible business or profession" implies that for getting tax benefit under section 32AB, the deposit in the Development Bank or the purchase of any new ship, plant, etc., should be out of income from the eligible business or profession and this is clearly spelt out in the executive instructions.[2] However, this expression is used in sub-section (1) of section 32AB only to prescribe the monetary limit to which the deduction is to be restricted, viz., 20 per cent of the profit of the eligible business or profession. It is, therefore, possible to argue that provided an assessee has an eligible business or profession, the actual deposits etc., upto the prescribed limit may be out of any income chargeable to tax under the head "profits and gains of business or profession", be it from an eligible business or profession or otherwise. Executive instructions cannot travel beyond the statutory provision. This also raises a question whether an assessee may avail of section 32AB if the "profits and gains of business or profession" included in his total income for a particular assessment year work out to a loss figure although the eligible business or profession by itself shows a profit for the year. Further, clause 9 of the Investment Deposit Account Scheme, 1986 (IDAS '86) makes no mention of eligible business or profession and may also be read to mean

that the requirements of section 32AB may be satisfied if the amounts are utilised for the purposes of any business or profession carried on by an assessee irrespective of whether or not it is an eligible business or profession. That presumably is not the intention. Therefore, to avoid all controversy in cases of assessees carrying on both eligible and ineligible businesses, it may be desirable to amend sub-section (1) of section 32AB or at least clause 9 of the IDAS '86 to bring out clearly that the deposits have to be out of the profits of an "eligible business or profession" and the utilisations, whether initially or after withdrawals from the deposit account, have also to be for the specified purpose.

In 1980, while recommending discontinuance of investment allowance, the Expert Committe on Tax Measures to Promote Employment said, "A tax concession linked to the value of plant and machinery has a *prima facie* bias in favour of capital-intensive technology. Given the rising costs, direct and indirect, of employing labour, the preference for mechanisation is already strong. Even if fiscal measures may not succeed fully in neutralising the preference for capital-intensive teehnology, it would be inadvisable to strengthen these biases further."[3] The bias for capital-intensive technology remains under section 32AB.

It would seem that under the existing scheme of section 32AB, once an assessee obtains a tax deduction with reference to the profits arising from the use of an asset in an eligible business, there is no obligation on his part to similarly employ the asset in subsequent years for a prescribed length of time. For instance, with the possession of an asset reverting to lessor on determination of a five-year eligible lease he is free to utilise it in an ineligible business, leasing or otherwise. To avoid misuse of the scheme, it may be apropriate to amend sub-section (7) of section 32AB to provide that besides sale or transfer, utilisation of an asset acquired in accordance with the scheme for an ineligible business at any time before the expiry of eight years, will entail the adverse tax consequences spelt out therein.

Generally, a deduction by way of an income tax incentive is limited to a specified percentage of the total income (or gross total income) computed for the purposes of the Act. Section 32AB makes an innovation. The maximum deduction

permissible thereunder both for corporate and non-corporate assessees is 20 per cent of the profits and gains of the eligible business or profession. It is stipulated that the 'profits' of the eligible business or profession shall be as per audited profit and loss account prepared in accordance with the requirements of the Companies Act, 1956 increased by the aggregate of depreciation, and a few other specified items debited therein and decreased by the current year depreciation as provided under section 32(1) of the Act. And, where in respect of the eligible business or profession no separate accounts are maintained or are available, its profits shall be such amount which bears to the total profits of the business or profession of the assessee after allowing depreciation under section 32(1), the same proportion as the total sales, turnover or gross receipts of the eligible business or profession bear to the total sales, turnover or gross receipts of the business or profession carried on by the assessee.

Preparation of accounts as required by the Companies Act and their audit by a qualified accountant by every assessee seeking tax relief under section 32 AB goes beyond the requirements of section 44AA and 44AB of the Act. This will add to the compliance cost of many assessees including the professionals and non-corporate business assessees. Evidently, this is considered a small sacrifice by them to ensure uniformity in determining the 'profits' qualifying for deduction as also to reduce uncertainty about interpretation of this term.[4] However, the general impression is that notwithstanding the detailed requirements of the Companies Act, the quantum of profits reflected in the accounts kept for the purpose of that Act has hitherto lent itself more easily to 'adjustments' within the accounting policies followed by the company than its total income (or gross total income) computed by an assessing authority under the Act. Evidently, that position has now to change. This casts an added responsibility on the taxpayers and the accountancy profession in the matter of correct and complete preparation of accounts and returns of income. The innovation may be best viewed as a measure supporting the new approach of general acceptance of returns on trust without any prior official scrutiny.

The provision for determination of profits of the eligible

business or profession in proportion to its sales, turnover or gross receipts if separate accounts for it are not maintained or are not available, weakens the compulsion for maintenance and production of separate accounts. It gives an undue advantage to a taxpaper with other established business or profession *vis-a-vis* another taxpayer having only one new eligible business or profession as a new business may initially suffer losses and take time to catch up with the profit rate of an established business or profession. Accordingly, the actual working of this provision needs to be closely watched.

The Central Government is empowered to omit any article or thing from the Eleventh Schedule list thus extending the area of eligibility for the new incentive [S. 32AB(8)] and also to restrict it after making such inquiry as it thinks fit, by specifying the class of assessees to be excluded from its operation [S. 32AB(9)]. *Prima facie*, it may be appropriate to withhold the benefits of the new incentive from those classes of assessees who are engaged in highly profitable lines, thus not meriting any special tax incentive or who are burdened with indisputably high idle capacity.

Section 32AB is a bold measure aimed at encouraging corporate savings. But, many legal and administrative aspects need attention to ensure its smooth working. Its actual operation should be closely monitored and evaluated in order that the tax expenditure entailed by it serves the national scheme of priorities.

REFERENCES

1. CBDT Circular No. 461 (F. No. 131/29/86-TPL) dated 9.7.1986: (1986) 161 *ITR* 17 (St) para 17.3.
2. *ibid.*, para 17.6 item (*h*).
3. Government of India, Ministry of Finance, Department of Revenue: *Report of the Expert Committee on Tax Measures to Promote Employment* (January, 1980), p. 125, para 8.4.
4. CBDT Circular No. 461 (F. No. 131/29/86-TPL) dated 9.7.1986: (1986) 161 *ITR* 17 (St) para 17.4 (*a*).