2. TAX STRUCTURE AND INCENTIVE PROVISIONS

THE income tax as well as special provisions of deduction for charitable contributions in calculating taxable income may affect the volume and distribution of the contributions. The effect of these on the contributions is twofold.[1] First, the tax decreases disposable income which tends to reduce the contributions.[2] Second, special provisions of deduction for charitable contributions reduce the price of contributions and this tends to increase the contributions.[3] In this chapter we give a brief description of the Indian corporate income tax and the provisions of the incentive for charitable contributions.

1. Provisions of the Tax Incentive

The Indian income tax structure contains provisions to stimulate contributions to charitable[4] organisations. Under section 80G of the Income-tax Act 1961, donors are allowed to reduce their taxable incomes by a part or full amount of the contributions, depending on the specified[5] charitable activities of the recipient charitable organisations. In India, unlike in the USA, only contributions of money and not contributions in kind (such as property and paintings) qualify for the tax incentive. If the amount of contributions is less than Rs. 250, then these contributions do not qualify for the tax incentive.[6]

The amount of charitable contributions that qualifies for the tax incentive is subject to a ceiling in the case of some of the recipient charitable organisations and any amount of contributions qualifies for the incentive in the case of other organisations. Therefore, for purpose of a description of the tax incentive provisions, the recipient charitable organisations could be classified into two broad categories depending on the ceiling on the amount of contributions that qualifies for the tax incentive. Let category I consist of those organisations to whom the contributions qualify for the tax incentive subject to a ceiling, and let category II consist of the rest of the organisations.

The charitable organisations covered under category I are the National Defence Fund, the Jawaharlal Nehru Memorial Fund, the Prime Ministers' Drought Relief Fund, the Prime Minister's National Relief Fund, the National Children's Fund and the Indira Gandhi Memorial Trust. Category II includes those approved or notified by the Central Government for the purposes of promoting family planning, maintenance of places of public worship or of historic, archaeological or artistic importance, and for the purpose of stimulating any other charitable activity.

The ceiling on the amount of contributions that qualifies for the tax incentive, in the case of contributions to category I organisations, is calculated as a minimum of 10 per cent of the gross total income, and Rs. 5 lakh.

A deduction of 50 per cent of the amount of contributions is allowed for charitable contributions except for contributions to the Prime Minister's National Relief Fund falling in category I and for contributions to organisations involved in promoting family planning covered under category II. For contributions to the Prime Minister's Relief Fund and to those involved in promoting family planning, a deduction of 100 per cent of the amount of contributions is allowed.

Regarding the historical development of the provisions of the tax incentive, the basic structure of the incentive has remained unchanged since the mid-seventies. The scope of the incentive has however been widened over time. The contributions to the Prime Minister's National Relief Fund, the organisations involved in promoting family planning, the National Children's Fund, and the Indira Gandhi Memorial Trust have been brought within the purview of the tax incentive with effect from the years 1975, 1977, 1983 and 1985 respectively. From April 1, 1989 the contributions to the Rural Development Fund, and to a trust or institution of national importance, undertaking scientific research, etc. will also qualify for the tax incentive.

The provision of deduction of 100 per cent of the amount of contribution was first introduced with effect from April 1, 1977 for contributions to organisations involved in promoting family planning and later, with effect from April 1986, contributions to the Prime Minister's National Relief Fund were also allowed a deduction of 100 per cent. Contributions to the Rural Development Fund and to a trust or institute of national importance will also qualify for 100 per cent deduction with effect from April 1, 1989.

2. Structure of Corporate Income Tax

The rate structure of Indian corporate income tax depends both on the category of the company and on the source of income. For the purpose of corporate income tax, the companies are classified into two broad categories: domestic and other than domestic (foreign). Domestic companies are further classified into two categories, namely, widely held companies (those in which public is substantially interested), and closely held companies (those in which public is not substantially interested). Closely held companies are further split into two categories: industrial and other than industrial (such as leasing and trade companies).

Domestic companies are subjected to different income tax rate schedules depending on the category of the company, whereas foreign companies are taxed according to source of income. Income of foreign companies from Indians on account of royalty and technical services is taxed at a rate lower than that applicable to their income from other sources in India.

The basic tax rate structure of the corporate income tax in India has remained stable for a fairly long time. During the assessment years 1974-75 to 1983-84, the tax rate schedules applicable to different categories of companies have remained unchanged, though the surcharge on income tax has varied from 0 to 7.5 per cent. The rate of surcharge on income tax was 5 per cent during 1974-75 to 1978-79, 5 to 7.5 per cent during 1980-81, 2.5 per cent in 1982-83 and nil for the assessment years 1979-80, 1981-82 and 1983-84. The tax rate schedules of different categories of companies applicable to the assessment years 1974-75 to 1983-84 are given in Table 2.1.

It would be noted from the table that the basic marginal tax rate could vary from 45 to 80[7] per cent for widely held companies, from 55 to 80 per cent for closely held companies and from 50 to 70 per cent for foreign companies. This reveals

TABLE 2.1

Rate Schedules of Income Tax[1] by Category of Companies

Types of companies/income			Income tax rate schedule
Domestic companies	Widely held companies		45% if income $\leqslant$ Rs. 1,00,000 55% if income $>$ Rs. 1,00,000[2]
	Closely held companies	Industrial companies	55% if income $\leqslant$ Rs. 2,00,000 60% if income $>$ Rs. 2,00,000[3]
		Other than industrial companies	65%
Foreign companies	Payments received from Indians on account of royalty and technical services		50%
	Balance		70%

Notes: 1. The tax rate schedules given here are applicable to the income relating to the assessment years 1974-75 to 1983-84. In addition, a surcharge on the income tax thus computed is payable at the rate of 5 per cent for the assessment years 1974-75 to 1978-79, at 5 to 7.5 per cent for 1980-81 and at the rate of 2.5 per cent for 1982-83.

2. Such that additional tax does not exceed 80 per cent on the income in excess of Rs. 1,00,000.
3. Such that additional tax does not exceed 80 per cent on the income in excess of Rs. 2,00,000.

differential taxation of companies according to category and the possibility of substantial variation in the marginal rates (45 to 80 per cent) of taxation of different companies during 1974-75 to 1983-84.

In recent years, variation in the tax rates of a company with respect to its income has been eliminated and variation in the tax rates applicable to different categories of companies has also been reduced. In 1984-85, the rate schedules of widely held and closely held industrial companies were replaced by flat rates of tax irrespective of the income level. This did away with the step system of corporate income taxation by income levels. Consequently the possibility of variation in the marginal tax rates of different companies within each of these two categories of companies is completely eliminated. The tax rates for widely held and closely held industrial companies were fixed respectively at 55 and 60 per cent. The tax rates for all the categories of companies except for income of foreign companies from Indians in the form of royalties and technical services have been reduced by 5 percentage points since 1986-87.

The above description of the corporate tax structure reveals that subsequent to 1983-84, the range of basic tax rates of corporate income taxation has been reduced from 45-80 per cent to 50-65 per cent. This suggests that a cross-section of companies in a year upto 1983-84 would have greater variation in the marginal tax rates of different companies than that in a cross-section of companies in a year subsequent to 1983-84. Because of this, the former set of data may be more appropriate than the latter for studying the effects of tax incentive provisions for charitable contributions, on the volume of charitable contributions and on the tax yield.

Notes and References

1. Effects of income tax and special provisions of deduction for the contributions are widely discussed in the literature. See, for example, Taussig (1967) and Feldstein (1975*a*).
2. This is known as 'income effect', discussed elsewhere in the study.
3. Also known as 'price effect', discussed elsewhere in the study.
4. A charitable organisation is defined as one involved in the

advancement of any object of general public utility not involving the carrying on of any activity for profit such as organisations set up for the purpose of relief of the poor, medical relief and education.

5. For example, while 50 per cent of the contributions to the Prime Minister's National Retief Fund or to the Prime Minister's Drought Relief Fund are deductible, the contributions to the organisations involved in promoting family planning are fully deductible in computing the taxable income of the donor. The details of these tax incentive provisions are given in Annexure I.
6. Section 80G of the Income-tax Act 1961 that contains provisions of the tax incentive is reproduced in Annexure 1.
7. A widely held company was taxed under the step system. The tax rate was 45 per cent if income was less than or equal to Rs. 1,C0,000 and 55 per cent otherwise. However, the rate of 55 per cent was applied subject to the condition that the effective marginal tax rate on income exceeding Rs. 1,00,000 did not exceed 80 per cent. In effect this rate structure was equivalent to the following rate schedule:

Income		*Basic Marginal Tax Rate*
Upto Rs.	10,00,000	45
Next Rs.	40,000	80
Exceeding Rs.	1,40,000	55