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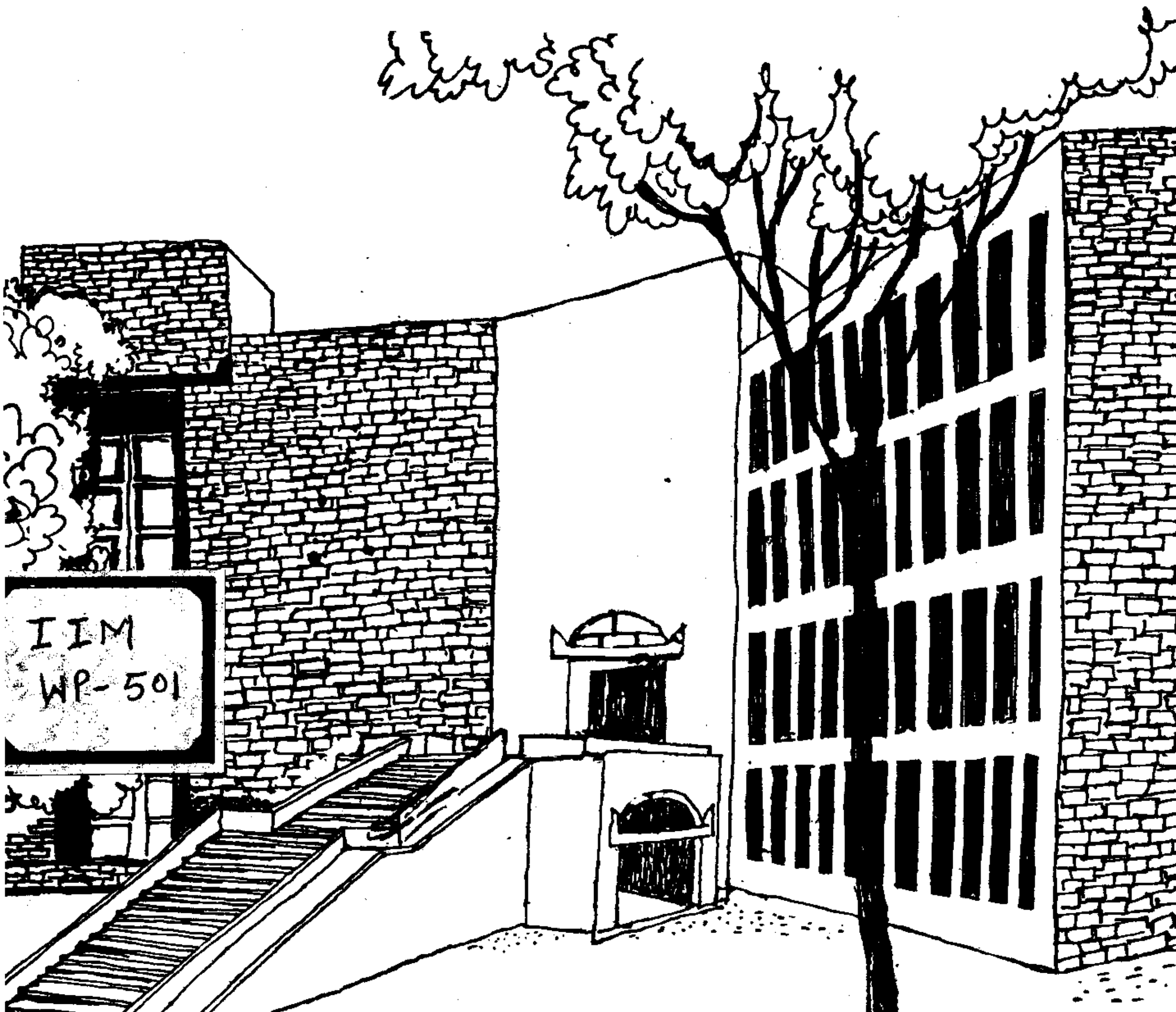

TAX EXPERIENCES OF INDO-AMERICAN JOINT VENTURES

By

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TAX EXPERIENCES OF INDO-AMERICAN JOINT VENTURES*

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I. INTRODUCTION

Nearly 300 Indo-American joint ventures are currently in operation in India. A very large number of them are engaged in manufacturing: they manufacture a wide range of products, including agricultural equipment, chemicals, computers and peripherals, construction and mining equipment, cosmetics and toilet goods, drugs and pharmaceuticals, electrical and industrial equipment and components, electronic parts and components, elevators, industrial control instruments, insulation materials, machine tools and hand tools, material handling machinery, medical instruments and supplies, metals and fabricated metal products, and steel products. Other activities in which Indo-American joint ventures are engaged include: advertising, book publishing, consultancy and engineering services, deep-sea fishing, export business, hotels, and poultry farming. The total book value of American partners' share in the equity capital of Indo-American joint ventures is estimated at approximately US$ 500 million.

The question now being asked is: Why is the share of American equity investment in India's corporate sector so low? Several explanations

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* This is a revised version of a study presented at a meeting, jointly organised by the India-U.S. Business Council and India Chamber of Commerce of America, held in New York on November 29, 1983. The author is most grateful to Amaresh Bagchi for valuable comments.

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have been put forward for this, one of which relates to the tax burden in India. The perception among many U.S. investors is that the tax rates in India are so high as to make potential investment in India unattractive. The purpose of this study is to analyse the system of corporate income taxation currently in operation in India and to evaluate the actual tax experiences of selected Indo-American joint ventures.

II. THE SYSTEM OF CORPORATE INCOME TAXATION IN INDIA

The rate of tax on corporate income currently leviable under the Income Tax Act of 1961 generally is 57.75 per cent (55 per cent plus a surcharge of 2.75 per cent). In some cases, it is even higher. For example, closely-held domestic industrial companies are liable to pay income tax at the rate of 63 per cent (60 per cent plus a surcharge of 3 per cent).

Under the provisions of the Companies (Profits) Surtax Act of 1964 a surtax is also leviable on companies showing a high degree of profitability. The surtax is leviable on chargeable profits of companies in excess of the statutory deduction. Chargeable profits broadly comprise profits as computed for the purposes of income tax reduced by income tax. The statutory deduction is a sum equal to 15 per cent of net worth or Rs. 0.2 million, whichever is higher. On excess profits up to five per cent of net worth, the surtax is 25 per cent; on the balance of excess profits, it is 40 per cent.

To illustrate, let us consider the case of a company which has a net worth of, say, Rs.100 million and pre-tax profits of Rs.50 million. If the company is liable to pay income tax at the rate applicable to the generality of cases, its total tax liability will amount to Rs.30,575,000 (income tax: Rs.28,875,000; surtax: Rs.1,700,000). This works out to as much as 61.15 per cent of its pre-tax profits.

But this is just one side of the picture. The tax system in India is honeycombed with provisions which enable companies to generate substantial tax savings. One of these provisions relates to investment allowance which is available at the rate of 25 per cent of the cost of new ship or new aircraft acquired or new machinery or plant installed. Where machinery or plant is installed for control of pollution or for protection of the environment or for manufacture of an indigenously developed article, the investment allowance is 35 per cent.[1] Thus, if a company instals a new machine that costs, say, Rs.1 million for manufacturing an indigenously developed article, it will be entitled to claim a deduction of Rs.350,000 on account of investment allowance. This, using the rate of corporate income tax applicable to the generality of cases, will enable the company to reduce its tax liability by Rs.202,125.

The Indian tax system also provides tax holidays. A complete tax

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1 Investment allowance is in addition to the normal depreciation allowances and is not taken into account for determining the written down value of the plant and machinery to which it applies. Hence the allowance acts as a bonus or special allowance over and above the normal recoupment of the cost of plant and machinery through depreciation allowances.

holiday for five years is available for newly established industrial undertakings in free trade zones. In other words, no tax whatsoever is payable in respect of income made during the first five years by new industrial undertakings set up in free trade zones. At present there are two free trade zones: Kandla in Gujarat and Santa Cruz in Maharashtra. The Government of India has decided recently to set up free trade zones at Cochin, Madras, Noida (Uttar Pradesh), and Falt (West Bengal) as well.

New industrial undertakings, hotels, etc. established anywhere in India are entitled to claim tax holiday benefit equal to 25 per cent of their income for eight years. New industrial undertakings and hotels established in backward areas enjoy additional tax holiday benefit. In their case the benefit is equal to 20 per cent of profits and is available for ten years.

Several other provisions in the Indian tax system enable companies to generate handsome tax savings. These include: additional depreciation at the rate of 50 per cent of the normal depreciation in the year of installation of new machinery or plant; extra shift allowance equal to 50 per cent/100 per cent of the normal depreciation when the plant and machinery works double shift/triple shift;[1] 100 per cent deduction in respect of capital expenditure on scientific research in the year in which

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[1] Thus, with the general rate of depreciation in respect of plant and machinery now being 15 per cent, a company can claim, for income tax purposes, deductions amounting to as much as 72.5 per cent of the cost of a new plant or machinery in the first year. The details are: normal depreciation, 15 per cent; extra shift allowance, 15 per cent; additional depreciation, 7.5 per cent, and investment allowance, 35 per cent.

it is incurred; tax saving through deposits with the Industrial Development Bank of India under the Companies Deposits (surcharge on Income Tax) Scheme of 1983; deduction of 25 per cent in respect of profits and gains from projects outside India: tax concessions based on export turnover; deduction in respect of intercorporate dividends; deduction in respect of dividends received from certain foreign companies; and deduction in respect of royalty, commission, fee, etc. from foreign enterprises.

Because of the various incentives such as these, many companies in India pay little or no tax. For example, Tata Engineering and Locomotive Company (TELCO) has reported profits of the order of Rs.1,502.2 million during the last seven years (1976-77 to 1982-83) but has no income tax or surtax liability. In other words, while the company has reported handsome profits in its books, it has reported no taxable profits in its tax returns for as many as seven years in a row. The company has been able to do this because of the tax benefits it has claimed by way of investment allowance, tax holiday, 100 per cent deduction in respect of capital expenditure incurred on scientific research, export markets development allowance, and so on.

TELCO is not the only company which has benefited from various incentive provisions in the Indian tax law. A recent Industrial Credit and Investment Corporation of India (ICICI) study on the financial performance of the corporate sector in India has revealed that out of the 338 profit-making companies covered by the study, as many as 153 belong to the category of what has now come to be known as "Zero-tax companies".[1]

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[1] The Industrial Credit and Investment Corporation of India Limited, Financial Performance of Companies: ICICI Portfolio 1982-83 - Summary Results (Bombay, 1984), pp. 6-7.

What is more, the zero-tax companies are not concentrated in any one size group. Indeed, one finds them in almost equal proportion in all size groups.

The ICICI study does not list the zero-tax companies discovered by it. But this does not matter. If one takes a careful look at the data available from other sources, one can easily come up with cases of many companies in India which have managed to pay little or no tax on their income.† Table 1 presents data for 20 such companies.

†For a discussion on how the various incentive provisions in the Indian income tax law enable companies to reduce their tax liabilities, see Anand P. Gupta: "Management of the Income Tax Function: Is India a Tax Haven?", Economic and Political Weekly, vol. XVI No.9, February 28, 1981. pp. M15-21.

TABLE 1

TAXATION OF CORPORATE INCOME IN INDIA: 20 EXAMPLES

Company	Period	Profit before tax (Rs. million)	Profit after tax (Rs. million)	Tax Liabilit (Rs. mill
1. Ahmedabad Electricity	1979-80	21.3	21.3	0
	1980-81	58.6	58.6	0
	1981-82	69.7	69.7	0
2. Andhra Cement	1979-80	4.4	4.4	0
	1980-81	6.2	6.2	0
	1981-82	15.5	15.5	0
3. Arvind Mills	1980	18.9	16.9	2.0
	1981	16.1	14.2	1.9
	1982	18.9	18.4	0.5
4. Ashok Leyland	1980	126.5	126.5	0
	1981	150.5	150.5	0
	1982	107.3	107.3	0
5. Bombay Dyeing and Manufacturing	1979-80	53.4	53.4	0
	1980-81	50.2	50.2	0
	1981-82	30.4	30.4	0
6. J.K. Synthetics	1979	97.4	97.4	0
	1980	67.0	67.0	0
	1981	120.0	120.0	0
7. Kunal Engineering	1979-80	5.3	5.3	0
	1980-81	6.5	6.5	0
	1981-82	12.4	12.4	0
8. Lohia Machines	1980-81	6.3	6.3	0
	1981-82	9.3	9.3	0
	1982-83	11.3	11.3	0
9. Mahindra Ugine Steel	1979	31.5	31.5	0
	1980	35.2	35.2	0
	1981	71.0	71.0	0
10. Milkfood	1979	2.5	2.5	0
	1980	3.0	3.0	0
	1981	6.4	6.4	0

11.	Modi Rubber	1980-81	68.6	68.6	0
		1981-82	80.5	80.5	0
		1982-83	70.7	70.7	0
12.	Nagarjuna Steels	1978-79	4.8	4.8	0
		1979-80	5.4	5.4	0
		1980-81	10.2	10.2	0
13.	Punjab Anand Batteries	1979-80	4.1	4.1	0
		1980-81	5.0	5.0	0
		1981-82	4.0	4.0	0
14.	Raunaq International	1979-80	1.1	1.1	0
		1980-81	1.1	1.1	0
		1981-82	1.6	1.6	0
15.	Reliance Textile Industries	1981	197.0	197.0	0
		1982	291.6	291.6	0
		1983	385.3	385.3	0
16.	Shree Vallabh Glass	1979-80	11.3	9.7	1.6
		1980-81	36.7	36.7	0
		1981-82	39.5	39.5	0
17.	Siyaram Silk Mills	1979-80	0.9	0.9	0
		1980-81	1.8	1.8	0
		1981-82	2.7	2.7	0
18.	Tata Sons	1980	13.4	12.9	0.5
		1981	14.4	13.9	0.5
		1982	16.3	15.8	0.5
19.	Usha Martin Black	1979	10.7	10.7	0
		1980	16.3	16.3	0
		1981	17.3	17.3	0
20.	Usha Rectifier	1979-80	0.5	0.5	0
		1980-81	2.8	2.8	0
		1981-82	2.8	2.8	0

Source: Compiled by the author.

One may now ask: What about the tax experiences of Indo-American joint ventures? Have they also benefited from various incentive provisions in the Indian tax law? If yes, to what extent? If not, why not?

III. TAX BURDEN ON INDO-AMERICAN JOINT VENTURES

To determine the extent of the tax burden on Indo-American joint venture the experiences of five companies were looked at in detail: Bharat Steel Tubes, Escorts Tractors, Goodyear India, Kelvinator of India, and Modipon. Considering the activities of these companies and the equity holdings of American partners in them, these companies can be regarded as a representative sample of Indo-American joint ventures currently operating in India.

Bharat Steel Tubes

Bharat Steel Tubes was incorporated on November 20, 1959 as a private limited company and was converted into a public limited company on August 29, 1962. It manufactures steel tubes and pipes and recently has established a new plant for manufacturing PVC pipes. It is planning to enter the business of manufacturing industrial laminates and shipping.

The company has promoted several projects, including Apollo Tubes, Apollo Tyres, Bharat Gears, and Universal Steel and Alloys.

The company has a paid-up equity capital of Rs.37 million, divided into 3.7 million shares of Rs. 10 each. Of these, 298,504 shares are held by Abbey Etna Machine Company, Perrysburg, Ohio and its associates. The present share of Abbey Etna and its associates in the company's equity is

8.07 per cent, down from 34.89 per cent in 1964 and 18.37 per cent in 1974. Abbey Etna and its associates are represented on the company's board of directors by Mr. N D Abbey and Mr. Stephen Stranahan.

The pre-tax profits reported by the company in its books amounted to Rs.11.2 million in 1979-80, Rs. 13 million in 1980-81 and Rs.14.1 million in 1981-82. The company did not have any surtax liability in these years. Income tax liability reported by the company is as follows: 1979-80, Rs.4.6 million; 1980-81, Rs.7.5 million; and 1981-82, Rs.2.9 million. The nominal tax rate (including surcharge) applicable to the company was 59.125 per cent in 1979-80 and 1980-81, and 56.375 per cent in 1981-82. But the effective tax rate worked out to 41.07 per cent in 1979-80, 57.69 per cent in 1980-81, and 20.57 per cent in 1981-82. If pre-tax profits are adjusted for brought forward losses and estimated disallowances and depreciation as per the income tax law, the effective tax rate works out to 47.71 per cent for 1979-80, 50.86 per cent for 1980-81, and 29.29 per cent for 1981-82.

The effective rates are lower than the nominal rates because of the tax benefits claimed by the company under various provisions such as those relating to investment allowance, export markets development allowance, dividends from new industrial undertakings, intercorporate dividends, and royalties from concerns in India. The tax savings generated by the company during the three years (1979-80 to 1981-82) total Rs.5 million. The company expects to generate considerable tax savings in the years to come due to recent and projected investments.

The company has distributed part of its after-tax profits as dividends. The rate of dividends declared by the company was 12 per cent for 1979-80, and 15 per cent for 1980-81 and 1981-82. Dividend remittances (net of tax) to the American stockholders were as follows: 1979-80, Rs.304,794; 1980-81, Rs.273,017; and 1981-82, Rs.273,017.

The company has been involved in tax disputes. The tax authorities have frequently questioned the claims of the company and have asked it to pay taxes far in excess of the tax liability estimated by it. The company has contested this before the appropriate authorities. Available evidence suggests that the tax disputes have so far been decided in favour of the company.

Escorts Tractors

Escorts Tractors was incorporated in 1969. The company manufactures tractors, diesel engines and also spare parts. The company has plans to diversify by manufacturing multi-purpose rough terrain fork lift trucks. A site for setting up manufacturing facilities for this new product has been acquired. The company also has decided to establish a scientific research and development centre. The initial focus of the centre's activity will be on conservation of energy, pollution control, development of new products, increased productivity, and cost reduction. Application for recognition of the centre's research programme by the Government of India's Department of Science and Technology has been made.

The company has a paid-up equity capital of Rs.25 million, divided into 250,000 shares of Rs.100 each. Of these, 40 per cent are held by Ford Motor Company, Ford Tractor Operations, Troy, Michigan. There has been no change in the Ford Motor's share in the company's equity capital since its inception. Ford Motor is represented on the company's board of directors by Mr. M H Manning, Mr. P Lagasse and Mr. R J Kravutske.

The pre-tax profits as per the company's books amounted to Rs. (-) 13.2 million in 1980, Rs. 42.6 million in 1981 and Rs.17.9 million in 1982. The company had a surtax liability (of Rs.0.2 million) in only one of these years, viz. 1981. Income tax liability reported by the company amounted to Rs.10.8 million in 1981 and Rs.5.2 million in 1982. (No income tax liability was reported in 1980 as the company reported a loss in that year.) The nominal income tax rate applicable to the company was 56.375 per cent in both 1981 and 1982. But the effective income tax rates for these years, after adjusting for brought forward losses pertaining to 1980, worked out to 36.73 per cent and 29.05 per cent respectively. If account is taken of disallowances for income tax purposes, the effective tax rates would be still lower.

The effective tax rates are lower than the nominal rates because of tax benefits claimed by the company. A large portion of the tax benefits has been claimed under the provision relating to investment allowance. Additions to plant and machinery during 1980-82 amounted to Rs.56.9 million which enabled the company to claim tax benefits amounting to Rs.8 million. The company will generate considerable tax benefits in the years to come mainly due to the implementation of its plan to establish a new industrial undertaking for manufacturing multi-purpose rough terrain fork lift trucks, a scientific research and development centre, and other facilities.

The company has declared dividends at the rate of 20 per cent for 1981 and 1982. Gross dividends due to Ford Motor Company totalled Rs.4 million. With the withholding tax rate applicable to non-domestic companies being 25 per cent,[1] dividend remittances (net of tax) to Ford Motor Company were Rs.3 million.

The company's dealings with the income tax authorities do not appear to have been very smooth. Indeed, available evidence shows that the company has been involved in litigation with the income tax authorities. One case which has been pending for some time relates to computation of deduction under the tax holiday provision of the income tax law.

Goodyear India

Goodyear started business in India in 1922. The company presently manufactures automotive tyres and tubes, repair materials, and rubber

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The withholding tax rate applicable to domestic companies is 22 per cent.

The rate applicable to non-domestic companies is higher owing to the fact that whereas domestic companies are liable to pay income tax on part of their dividend incomes, non-domestic companies are under no such obligation.

dock fenders. The company has decided to include in its range of products extra large earthmover tyre sizes. It is expected that the production of such tyres will commence shortly. The company has also decided to convert its bicycle tyre plant to produce scooter/motorcycle tyres and tubes.

The company has a paid-up equity capital of Rs.74,828,460, divided into 7,482,846 shares of Rs.10 each. Of these, 4,484,200 shares are held by Goodyear Tire and Rubber Company, Akron, Ohio. The present holding of Goodyear Tire in the company's stock in absolute terms is higher than its earlier holdings. But if one looks at its present holding in relative terms, one finds that there has been an erosion: The share of Goodyear Tire in the company's equity now works out to 59.93 per cent, against 80 per cent and over earlier. Goodyear Tire is represented on the company's board of directors by Mr. J R Glass, Mr. D F Hill, and Mr. I Thomson.

The pre-tax profits as per the company's books amounted to Rs.54.8 million in 1980, Rs.68.9 million in 1981, and Rs.22.8 million in 1982. The company had surtax liability in two out of these three years - of Rs.1.1 million in 1980 and Rs.1.4 million in 1981. Income tax liability reported by the company amounted to Rs.32.3 million in 1980, Rs.33.4 million in 1981, and Rs.10.5 million in 1982. The nominal income tax rate applicable to the company was 59.125 per cent in 1980, and 56.375 per cent for both 1981 and 1982. The effective income tax rates worked out to 58.94 per cent for 1980, 48.48 per cent for 1981, and

46.05 per cent for 1982. If pre-tax profits are adjusted for depreciation as per income tax law, the effective tax rates work out to 59.54 per cent for 1980, 52.77 per cent for 1981, and 53.40 per cent for 1982. If account is taken of disallowances for income tax purposes, the effective tax rates would be slightly lower.

One does not see much of a difference between the nominal income tax rates applicable to the company and the effective income tax rates worked out after adjusting pre-tax profits for depreciation as per the income tax law. What this means is that the company has not benefited much from the incentive provisions under the Indian income tax law. For example, total additions to plant and machinery during the period 1980-82 amounted to Rs.30.4 million which enabled the company to claim tax benefits on account of investment allowance of just Rs.4.3 million.

The company has declared dividends of 12 per cent for 1980, 16 per cent for 1981, and 13 per cent for 1982. Gross dividends due to Goodyear Tire, the company's American partner, amounted to Rs.18.4 million. With the withholding tax rate being 25 per cent, dividend remittances (net of tax) to Goodyear Tire for 1980-82 were Rs.13.8 million.

The company has been involved in litigation with the Income Tax Department. One of the pending cases relates to the company's tax holiday claim amounting to Rs.4.9 million. Available evidence suggests that the tax disputes have so far been decided in favour of the company.

Kelvinator of India

Kelvinator of India was incorporated on July 19, 1960. The company manufactures refrigerators, deep freezers, fractional horse power compressors, laminations, electro mechanical and electronic cash registers, and control equipment.

Aravalli Svachalit Vahan Limited (ASVL), a joint sector company having a sick scooter unit in the State of Rajasthan, has recently been amalgamated with the company. With this amalgamation, the company has entered into the automotive industry. The company is also setting up an industrial unit for manufacturing mopeds.

The company has a research and development centre which has been recognized by the Government of India's Department of Science and Technology.

The company has a paid-up equity capital of Rs.17.75 million, divided into 1.775 million shares of Rs.10 each. Of these, 12 per cent are held by White Consolidated Industries Inc., Cleveland, Ohio. White Consolidated is represented on the company's board of directors by Mr. J L McGowan.

A look at the available data shows that the holdings of the American partner in the company's equity have grown from 50,000 shares in 1960 (which were allotted for consideration other than cash pursuant to a contract for the supply of machinery) to 70,000 shares in 1971, and to 210,000 shares in 1974. The increase in 1971 - from 50,000 shares to 70,000 shares - took place as a result of the issue of bonus shares by the company in the ratio of two for five, and that in 1974 - from 70,000 shares to 210,000 shares - as a result of the issue by the company of 70,000 shares as bonus shares and another 70,000 shares as right shares. Considering the price at which the company's stock is presently selling in the market, one may say that against a total investment of Rs.1.2 million (including Rs.0.5 million in kind), the American partner today holds equity stock worth at least Rs.15.8 million.

The pre-tax profits as per the company's books amounted to Rs.36.5 million in 1979-80, Rs.44.8 million in 1980-81, and Rs.43.3 million in 1981-82. The company had a surtax liability in all the three years - Rs.3.6 million in 1979-80, Rs.4.5 million in 1980-81, and Rs.2.3 million in 1981-82. Income tax liability reported by the company amounted to Rs.20 million in 1979-80, Rs.22.7 million in 1980-81, and Rs.8.7 million in 1981-82. The nominal income tax rate applicable to the company was 59.125 per cent in 1979-80, and 56.375 per cent for both 1980-81 and

1981-82. But the effective income tax rates worked out to 54.79 per cent for 1979-80, 50.67 per cent for 1980-81, and 20.09 per cent for 1981-82. If pre-tax profits are adjusted for disallowances for income tax purposes, the effective income tax rates would be still lower.

The effective rates are lower than the nominal rates because of tax benefits claimed by the company under various provisions including those relating to investment allowance, expenditure on approved scientific research programme, set-off of accumulated losses in certain cases of amalgamation, tax holiday, and intercorporate dividends. The company has plans to claim considerable tax benefits in the years to come on account of its recent and projected investments.

The company has declared dividends at the rate of 15 per cent for 1979-80, 20 per cent for 1980-81, and 22.5 per cent for 1981-82. Gross dividends due to the company's American partner for these years amounted to Rs.1.2 million. With the withholding tax rate being 25 per cent, dividend remittances (net of tax) to the American partner amounted to Rs.0.9 million.

The company has been involved in some litigation with the tax authorities. The issues involved have generally been concerned with the disallowance of certain expenses, reliefs, etc. The company's appeals against these disallowances are pending with the appellate authorities.

Modipon

Modipon was incorporated on August 19, 1965. The company manufactures nylon/yarn and polyester filament yarn. The company is going ahead with /filam the various formalities for amalgamation of Indofil Chemicals Limited. With this merger, the company will get into the business of manufacturing agricultural and industrial chemicals. The company is also planning to set up a new industrial unit for manufacturing nylon tyre cord yarn.

The company has a paid-up equity capital of Rs.70 million, divided into seven million shares of Rs.10 each. Of these, 40 per cent are held by Rohm & Hess, Philadelphia, Pennsylvania. While the percentage share of Rohm & Hess in the company's equity has remained unchanged at 40 per cent, their holding in absolute terms has grown by 250 per cent - from 0.8 million shares in 1965-66 to 1.4 million shares in 1975-76 and to 2.8 million shares in 1980-81. All of this growth has taken place as a result of bonus issues by the company. Rohm & Hess are represented on the company's board of directors by Mr. V L Gregory, Mr. J T Subak, Mr. J J Doyle and Mr. C O Metzger.

The pre-tax profits as per the company's books amounted to Rs.20.2 million in 1979-80, Rs.30.1 million in 1980-81, and Rs.16.1 million in 1981-82. But the company has not reported any surtax or income tax liability for any of these years. This has been due to two factors. Firstly, the company has claimed depreciation, for tax purposes, at rates allowed under the income tax rules, whereas depreciation in the books has been provided at lower rates. This resulted in a difference between pre-tax profits as per the company's books and profits as per the income tax law of Rs.12 million in 1979-80, Rs.16.1 million in 1980-81, and Rs.12.2 million in 1981-82 - or a total of Rs.40.3 million in the three years (1979-80 to 1981-82).

Secondly, the company has claimed deductions under certain provisions such as those relating to investment allowance, capital expenditure on scientific research, and intercorporate dividends to the extent absorbed by pre-incentive profits. The company, it seems, will continue to generate considerable tax savings in the years to come.

The company has declared dividends at the rate of 25 per cent for 1979-80, 17 per cent for 1980-81, and 12 per cent for 1981-82. Gross dividends due to Rohm & Hass for these years amounted to Rs.11.6 million. With the withholding tax rate being 25 per cent, dividend remittances (net of tax) to Rohm & Hass amounted to Rs.8.7 million.

The company has been involved in tax litigation. The tax authorities have questioned the deductions and allowances claimed by the company and have raised some tax demands which the company has contested before the appropriate authorities.

IV. CONCLUSIONS

Five major conclusions emerge from the analysis. Firstly, tax laws in India make no distinction between a hundred per cent Indian company and an Indo-American company. The nominal tax rates applicable to an Indo-American company are the same as those applicable to a company with no American equity. Furthermore, an Indo-American company is entitled to claim all the tax concessions available under the tax laws in India.

Secondly, the nominal rates of corporate taxation in India are on the high side, but, because of the numerous concessions available under the Indian tax laws, the effective rates are generally ,much lower. Indeed, the effective rates in a large number of cases have been so low that the Government of India recently had to amend the Income Tax Act to ensure that companies in India pay a minimum tax, on at least 30 per cent of their profits.[1] Of course, if one goes through the details of the

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[1] The amendment is not intended to disallow or reduce the benefits of tax concessions available under the Income Tax Act. What the amendment will do is to delay in certain cases the tax benefits available under certain specified provisions of the Act. For details, see Government of India: <u>Memorandum Explaining the Provisions in the Finance Bill, 1983</u> (New Delhi, 1983), pp. 18–20.

amendment and takes a look at certain other provisions in the income tax law as it operates in India, one can figure out situations (e.g. huge depreciation claims, set-off of accumulated losses in certain cases of amalgamation)in which companies in India would still be able to have a very low, even zero, tax liability.

Thirdly, the effective burden of corporate income taxation in India differs from company to company and for a company from time to time. The tax experiences of the Indo-American companies selected for this study illustrate this: While Goodyear India ended up paying 57.36 per cent of its total pre-tax profits as taxes, Modipon did not have any tax liability; Kelvinator of India had a total tax burden (including surtax) of as much as 60.71 per cent in 1980-81 but of only 25.40 per cent one year later. One can come up with many such examples. But the point to note is that, although the Indian tax system is honeycombed with tax concessions, a company may not be able to benefit much from them in a year or for several years in a row. One reason why a company may not benefit much from tax concessions is that its management, for one reason or another, may decide not to undertake any major investment activity, or may not be in a position to do so.

Another reason may be that the company is engaged in manufacturing low priority articles. As things stand at present, no tax benefits under provisions relating to investment allowance and tax holiday are available to medium and large companies engaged in the manufacture of any or more of the articles specified in the Eleventh Schedule to the Indian Income Tax Act. The articles presently specified in this schedule are: beer, wine and other alcoholic spirits; tobacco and tobacco preparations such as cigars and cheroots, cigarettes, chewing tobacco and snuff, biris, smoking mixtures for pipes and cigarettes; cosmetic and toilet preparations; tooth paste, dental cream, tooth powder and soap; aerated waters in the manufacture of which blended flavouring concentrates in any form are used; confectionery and chocolates; gramophones, including record players, and gramophone records; cinematograph films and projectors, photographic apparatus and goods; office machines and apparatus such as typewriters, calculating machines, cash registering machines, cheque writing machines, intercom machines and teleprinters; steel furniture, whether made partly or wholly of steel, safes, strongboxes, cash and deed boxes and strong room doors; latex foam sponge and polyurethane foam; crown corks, or other fittings of cork, rubber, polyethylene or any other material; and pilfer-proof caps for packaging or other fittings of cork, rubber, polyethylene or any other material.

Fourthly, the low tax burden on Indo-American joint ventures does not result in high after-tax returns in the hands of American partners. Take, for example, the case relating to tax burden on Modipon and after-tax return in the hands of Rohm & Hass. Modipon did not have any income tax or surtax liability in respect of profits earned during, say, 1981-82 because of various deductions and allowances available under the Indian tax laws. It declared dividends worth Rs.8.4 million, in which the share of Rohm & Hass was Rs.3.36 million. With the withholding tax rate being 25 per cent, dividends received by Rohm & Hass amounted to Rs.2.52 million. As per the current US tax law, Rohm & Hass will be required to pay a tax of 21 per cent (46 - 25 per cent) on this income to the United States Government.[1] This is so because under the current US tax law, US companies are not spared taxes they may not have to pay in India because of various deductions and allowances available under the Indian tax law. What this in effect means is that it is the United States Government, not the US investor, who benefits from various tax concessions which the Indo-American joint ventures are allowed under the Indian tax law.

Finally, tax litigation is a part of corporate life in India. The nominal tax rates in India are on the high side, which means that the stakes involved are also high. With this being the case, corporate management in India is continually looking for ways to reduce tax liabilities. This, among other things, gives rise to tax litigation. The growing complexity of the tax system is also a major factor responsible for the high rate of tax litigation in India.

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[1] In case Modipon had a tax liability such that it would raise the grossed-up value of dividends received by Rohm & Hass from Rs.3.36 million to Rs.4.67 million, Rohm & Hass will not be required to pay any tax on dividends received by them from Modipon to the United States Government.