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ARE INVESTORS QUALIFIED?

WILL BUDGET SPUR DISSAVING?

CORPORATE COMMUNICATION

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UNION BUDGET 1990-91

Will the Budget spur dissaving?

The budget for 1990-91 has initiated some fundamental changes in the fiscal policy concepts underlying personal finances of individuals, Hindu undivided families, association of persons and body of individuals. The proposed changes in the tax laws assume special import because the flow of savings in the economic system depends on the propensity to save and inducements offered to channelise the Savings into attractive, preferably gilt-edged high yielding, financial assets.

Over the years, those categories of tax payers who belong to the household sector have played an important role in contributing to the savings of the economy. In fact, the household sector contributes not less than 80 per cent of the gross domestic savings of the national economy.

It is not untrue to say that although the overall savings scenario for the economy has been rather discouraging during the Seventh Five Year Plan, with the share of the public and private sectors sagging behind and experiencing even dissaving, the household sector has been looking forward in the upward direction. Considering that, for the fiscal year to end and to start, the savings scenario is not going to be markedly different and the household sector will be expected to continue its yeoman service to the national savings.

It is in the above context that the conceptual changes in the fiscal policy format have to be analysed. The redeeming features of the change, some simple, some fundamental, include raising of the exemption limit from the present level of Rs.18,000 to Rs.22,000 and pushing the application of the eight per cent surcharge to incomes above Rs.75,000. The conceptual changes include abolition of deduction based incentives under Section 80C and Section 80CC and replacing the same through new, rebate-based incentives under Sections 88 and 88A. The other proposals deserving mention include an enhancement of limits under Section 80CCA and launching of the Equity-linked Savings Scheme (ELSS) through a proposed new Section 80CCB.

Exemption limit

The raising of the exemption limit amounts to increasing the level of income exempt from tax from the present gross income of Rs.30,000 (Rs.18,000 + standard deduction of Rs.12,000) to Rs.34,000 (Rs.22,000 + the standard deduction). The first rupee of income to be taxed will effectively commence from Rs.34,0001. Although the amount increased in the limit is just Rs.4,000 and comes after half a decade the tax payer does get some marginal relief. The last increase in the household level of income subject to tax came in the budget of 1985-86 through a Rs.3,000 increase.

While the fixed income, middle class, salary earners would have been happy to receive another sop in terms of the deductions under Section 16 of the Act, the finance minister has restricted the concession only to raising the threshold level. The 20 per cent tax rate which applies to the lowest income earners subject to income tax is now to start from Rs.22,000 and extend upto Rs.30,000. The next slab from Rs.30,000 to Rs.50,000 is to attract tax at 30 per cent. Interestingly the then finance minister had mentioned while presenting the Finance Bill 1989 that the tax rate to prevail at entry points of the tax net was supposed to be rather sensitive from the assessee's point of view. When an income earner enters the tax net a 25 per cent tax rate, was viewed as harsh. To quote the erstwhile Finance Minister, S.B. Chavan, "It has often been presented that a 25 per cent tax at the entry point discourages many tax payers in coming to the tax net voluntarily."

These changes, in fact concessions, will provide tax relief of varying amounts to different income levels. The relief ranges from Rs.200 at the lowest taxable income level (of Rs.19,000) to Rs.1,300 at the higher income level (of Rs.5 lakh).

While the above raise in exemption limit and restructuring of tax rate at entry point may not be a
very big deal yet, in the context of the overall poverty prevailing in the country, a sop to people earning taxable incomes upto Rs.22,000 cannot be totally discounted. The sop is surely not adequate to absorb the impact of inflation and insulate the salaried class against increases in price level. But it is definitely an attempt to provide atleast a small cheer.

**Rebate based incentive**

Section 80C of the I.T. Act used to prove a tax relief by way of deductions at prescribed graded differential percentage of the amounts saved in specified financial assets like Life Insurance Provident Fund, units of UTI, National Savings Certificate (VIIIth series) and others. These graded percentages had undergone changes from time to time and during certain periods from year to year.

When the Janata Government came to power, in his third budget (1979-80) the Finance Minister, Mr. Charan Singh had said "the present concessions in respect of long-term savings through life insurance premia give a disproportionately large tax benefits to tax payers in higher income brackets." With a view to making Section 80C less regressive the budget for 1979-80 (assessment year 1980-81) had diluted the Section 80C concessions by reducing the graded percentage deduction available to savers at higher income levels from 50 per cent to 35 per cent for the second slab of savings of Rs.5,000, the first slab of Rs.5,000 being allowed as 100 per cent deduction.

Further regression was introduced in the same year by reducing the percentage deduction from 40 per cent of the last slab of Rs.20,000 to 20 per cent. However, this regression in the provisions of Section 80C did not find favour with the Congress Government which in their very first budget (1980-81), following the return of Indira Gandhi to power, reintroduced the earlier graded percentages of 100 per cent for the first Rs.5,000, 50 per cent for the next Rs.5,000 and 40 per cent for the last Rs.20,000.

Thereafter, the situation changed to the advantage of the higher income groups.

In 1982-83, Pranab Mukherjee further liberalised Section 80C provisions by altering the amount of deductions but keeping the decreasing graded percentages unchanged. Thus, the first slab was Rs.6,000 (100 per cent deduction), the next slab again Rs.6,000 (50 per cent deduction) and the last slab was Rs.28,000 (40 per cent deduction).

The maximum amount eligible for the graded percentage deduction used to be Rs.40,000 and the maximum amount of deductions computed according to the graded scale used to be Rs.20,200. Since 1982-83, the same graded three tier deductions based on decreasing percentages of amounts saved remains. In fact even for the fiscal year ending March 31, 1990 the same pattern and percentages of deductions apply.

**Section 88 introduced**

The proposed fiscal provision rationalises and simplifies the operationally complicated Section 80C. A new concept of tax rebate under Section 88 provides for an uniform single percentage rate of rebate, which is to be computed by using a standard factor of 20 per cent and is functionally related to the amount of savings. The maximum tax rebate permitted is Rs.10,000 which, using the standard factor of 20 per cent, calls for a savings of Rs.50,000.

The rationalisation and simplification has the effect of making Section 88 easy to understand, simple to operate and absolutely bereft of inequities and anomalies between tax payers at different tax brackets inter-se. It is interesting to observe that tax shelter or relief is no longer a function of the marginal tax rate and the amount of savings.

Table One presents the implications of Section 80C and Section 88 in juxta-position, for different savings level and marginal tax rates. Under the present arrangement for any given level of savings Rs.6,000, Rs.12,000 or Rs.40,000 the concept of tax deduction resulted in anomalies and inequities. At lower tax rates, for the same amount of savings, the tax rebate or relief was substantially less, as compared to that at higher levels.

Thus, a savings of Rs.12,000, say, resulted in a deduction of the same amount alright, that is, Rs.9,000 but yielded a tax rebate of Rs.1,800 at a 20 per cent tax rate as against Rs.4,500 at a marginal tax rate of 50 per cent. Section 80C had a built-in mechanism to allow the tax rebate to relate itself to the marginal tax rate for any given level of savings. The entire structure was, therefore, regressive. Hence, the proposed new Section 88 provides to rectify this anomaly.
Impact of section 88

The impact of the proposed Section 88 is presented in Table One. The points to note are that (a) savings of Rs.6,000, Rs.12,000 and Rs.40,000, for instance, will generate a tax rebate at the standard factor of 20 per cent, of Rs.1,200, Rs.2,400 and Rs.8,000 respectively regardless of the income levels or marginal tax rates, and (b) savings of Rs.50,000 (a savings level which was not covered by Section 80C) will provide a tax rebate of Rs.10,000 at the said standard factor.

There is yet another way of looking at the data presented in the Table. A savings of Rs.6,000 meant an effective deduction of like amount under Section 80C. Again, a savings of Rs.12,000 resulted in an uniform effective deduction of Rs.9,000 at the different tax rates. However, if the effective deduction concept, which has been replaced by the tax rebate concept, is transplanted to the new Section 88, a comparative picture can be obtained.

Thus, if the savings level is Rs.12,000, the tax rebate under the proposed Section is 20 per cent of Rs.12,000, that is, Rs.2,400. Now assuming a 30 per cent tax rate, the tax rebate can be expressed as the product of the tax rate and the deduction. Using this formula the effective deduction, for a tax rebate of Rs.2,400 and marginal tax rate of 30 per cent, can be expressed as (0.3 x Rs.2,400).

The deduction (d) works out to be Rs.8,000 implying that if Section 88 gives a tax rebate of Rs.2,400 it is equivalent to a deduction of Rs.8,000 for assessees with marginal tax rate of 30 per cent.

Applying the above logic, the effective deduction Section 88 gives to assessees with different amounts of savings and tax rates, will be as shown in Table One. A socialistic glimpse of the new Section can be obtained as the effective deduction figures are traced through. There is a declining effective deduction of Rs.12,000, Rs.8,000, Rs.6,000 and Rs.4,800 for a savings level of Rs.12,000 assuming tax rates of 20, 30, 40 and 50 per cent respectively.

Socialistic approach

Assessees with higher income level have to work harder to earn the same tax rebate vis-a-vis the provisions of Section 80C and also in relation to their counterparts in the lower tax brackets.

Under Section 80C, the regression and inequity had stemmed from the uniform deduction of Rs.9,000 for a savings of Rs.12,000, at all tax rates, with the marginal tax rates causing the cascading effect on the amount of the tax rebate. Thus, with the same amount of savings the richer benefitted more than the rich. The position is now reversed.

Once again Prof. Dandavate's socialism can be experienced by examining the Rs.40,000 savings level, at different tax rates. A Rs.40,000 savings provides at a 40 per cent tax rate, an effective tax deduction of Rs.20,000 and a lower deduction of Rs.16,000 at the 50 per cent tax rate. Thus the rich and the rich will get the same tax relief of Rs.8,000. But the rich will enjoy an effective deduction of Rs.20,000 as against the richer who can get an effective deduction of Rs.16,000 only.

Earlier under the same tax rates of 40 per cent and 50 per cent and savings of Rs.40,000, the rich and richer enjoyed the same amount of deduction with the tax rebate operating in favour of the rich and more so for the richer through the marginal tax rates.

The tax rebate as percentage of the savings also communicates the same message of non-discrimination between savers on account of their capacity to save, and no difference in treatment to savers based on differences in the marginal utilities of money, unlike Section 80C which operated in a diametrically opposite manner.

Section 80CC vs section 88A

Section 80CC is replaced by Section 88A which presents the same duel presented in Table One. Section 80CC makes available a deduction of an amount equal to 50 per cent of the amounts invested in shares forming part of an eligible issue of equity capital or units issued under any scheme of mutual fund of the UTI if the amount mobilised is invested only in the eligible issue of capital. The amount eligible for deduction is Rs.20,000 and provides a deduction of not more than Rs.10,000.

The provision of Section 80CC also suffered from the same anomalies and inequities as did Section 80C. Assessees in higher tax brackets enjoyed a higher tax rebate than those in the relatively lower tax brackets. Thus, at 30 per cent tax rate, the effective investment for an investor, who had taken full advantage of Section 80CC, would be Rs.20,000 minus Rs.3,000, or Rs.17,000. But for the same amount of investment, the investor in higher tax brack-
### TABLE ONE
A COMPARATIVE VIEW OF THE EXISTING AND PROPOSED TAX CONCESSIONS
SECTION 80 C VERSUS SECTION 88

<table>
<thead>
<tr>
<th>TAX RATE %</th>
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<tr>
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<td>TAX REBATE AS % OF SAVINGS</td>
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N.A. = NOT APPLICABLE

APRIL 16, 1990
ends enjoyed a greater relief and lower effective investment.

For instance, at 40 per cent tax rate, the effective investment would have amounted Rs.20,000 minus Rs.4,000 or Rs.16,000, at 50 per cent, the effective investment was Rs.20,000 minus Rs.5,000 or just Rs.15,000. If the performance of the investment is to be captured in terms of the popular concept of return on investment (ROI), the rich enjoyed a higher ROI than the less privileged at the cost of the treasury.

This is proposed to be clamped by introducing an uniform standard factor, on the lines of the factor mentioned in Section 88, which will provide for tax rebate on the basis of the amount saved and, simultaneously, ensure that the tax rebate is immune to the marginal tax rates. However, the proposed new Section 88A provides for an enhanced amount that is eligible for the rebate.

The new ceiling relating to the amounts of savings is Rs.25,000 (instead of the existing ceiling of Rs.20,000) and the standard factor to measure the rebate is 20 per cent. The maximum rebate, therefore, works out to be Rs.5,000. The impact of the intended new provisions of Section 88A is presented in Table Two, which reveals that:

(a) The existing Section 80CC used to result in anomalous and inequitous situation of cascading ROI for rich, richer and richest in that order, because although the amount of deduction was uniform at all income levels and tax rates, the tax rebate increased with the tax rates.

(b) The proposed Section 88A rectifies the anomalies by ensuring a constant ROI for all asses-

sees without discrimination because the tax rebate remains constant for all income levels and tax rebates although the effective deduction goes on decreasing as the income levels and tax rates increase.

(c) The effective deduction in Table Two is worked out on the same lines as Table One. For tax rates of 30, 40 and 50 per cent, the effective deductions under the new Section are Rs.16,666, Rs.12,500, and Rs.10,000 respectively using Rs.25,000 as the investment. A comparison between the two sections, shows that Section 88A provides greater deductions than Section 80CC, for assessee with tax rates of 30 and 40 per cent. However, at 50 per cent tax rate, the two sections provide the same deductions on an investment of Rs.25,000.

Other conditions

The other condition of Section 80CC of minimum holding for three years continues, under Section 88A. The tax concession under the former was to expire on and from April 1, 1990. The tenure of the rebate based facility under Section 88A is available for one more year. In other words, the scheme of Section 80CC now incorporated in the proposed new Section 88A will lapse after March 31, 1991.

Simultaneous to the facility given to the savers under Section 88A, there is a condition imposed on the concerned Mutual Fund or the UTI. A new Section 271 BB of Act proposes to levy a penalty of 20 per cent of the amount mobilised from savers but not subscribed in the eligible issue of capital. The funds so mobilised under the schemes of mutual funds/UTI must be invested in eligible issues of capital within six months from the close of subscription to the schemes.

Again, pending investment in the eligible issue of capital, the mutual funds/UTI would be allowed to invest in such Government Securities as are approved by the Board. Yet another condition is that the benefits will not be available to any scheme, floated by mutual funds/UTI, subscription to which closes after September 30, 1990.

The new Section reinforces the recent guidelines for mega issues where the end use of funds raised by an enterprise in the private sector is monitored both with respect to the final destination of funds and also in the interim period when funds can be parked only in the pre-determined financial assets. And the movement of funds is to be under observation through financial institutions.

The mutual funds/UTI have also come in for similar rigorous check through fiscal legislation which prescribes a levy by way of penalty in the event of default with respect to movement of funds mobilised towards the prescribed destination.

Sections 80CCA & 80CCB

Another incentive for savers, that is Section 80CCA, which provides for a deduction oriented tax advantage, has been modified to make savings more attractive. This Section was introduced in 1987 (from assessment year 1988-89) and provided for a deduction of Rs.20,000 which was enhanced to Rs.30,000 from assessment year 1990-91. The present budget for 1990-91 extends the present ceiling further by 33.33 per cent to Rs.40,000.

The other features of the section,
namely, consideration of savings to income when withdrawn remain intact. The amount deposited under the NSS earns interest at 11 per cent per annum, but any withdrawal of interest will find itself added back to income of the year in which the withdrawal takes place.

However, interest on the deposits under the National Savings Scheme will not be chargeable to tax, except due to withdrawal, as mentioned above. The section remains on the statute books to facilitate tax planning exercises for individuals, hindu undivided families, associations of persons or bodies of individuals as defined in the section itself. However, the section continues to remain an attractive financial asset primarily for those whose incomes chargeable to tax are excepted to be depressed in the coming years.

Thus, assesses on the verge of retirement are likely to find it attractive to postpone tax liability today and enjoy a tax holiday or substantially depressed tax liability later, for want of adequate taxable income following retirement. For any growing and developing set of assesses, the Section provides only a postponement of tax liability avoiding payment of today’s fiscal obligation and extinguishing it at a later date.

The choice of the timing of meeting the fiscal obligation is that of the assessee. And, when the choice is made, the assessee’s income in all probability would have increased. The marginal tax rate applicable to the increased income would apparently be higher.

Whether or not the earlier taxable income which has escaped tax on account of Section 80CCA will attract relatively more taxes at a later date at the time of withdrawal, depends on the set of circumstances of each case. Yet the facility is being used by the salaried class to take advantage of the postponement of tax liability.

Section 80CCB - ELSS

A new Section 80CCB finds a place in the Act to introduce the Equity Linked Savings Scheme (ELSS) again on a netting principle. The redeeming features of the ELSS are that (a) investment units will be eligible for deduction up to a maximum of Rs.10,000 from the total income, (b) the annual returns from the investment will attract the incentive of Section 80L of the Act, and (c) on sale of the units (repurchased by the concerned fund) the sale proceeds will be charged to income to the extent of the cost of the units and the excess (if any) will be liable to tax as capital gains.

If the sale proceeds in the hands of the recipient, following the termination of repurchase by the concerned fund, exceeds the cost, the difference will attract the provisions of Section 45(1) of the Act which is to be suitably amended. The said difference, to reiterate, is a capital gain and will, therefore, be taxed accordingly. With a view to facilitating tax collection at source, Section 194 F will be inserted in the Act to provide for tax deduction at source at the rate of 20 per cent of the amounts to be returned consequent to repurchase/termination of plan.

The ELSS is supposed to eventually replace the present deduction under Section 80CC which has already been abolished and replaced by the new Section 88A. The proposed equity scheme is intended to promote the equity cult and encourage investors to participate in the risk capital of the corporate sector. And the Exchequer will subsidise the outlay of the investor by giving a tax rebate which this time is a product of the marginal tax rate and the amount of the investment, subject to the ceiling referred to above.

Thus, higher the marginal tax rate greater will the tax rebate. A maximum deduction of Rs.10,000 means that at 40, 50 and 60 per cent tax rates, the tax rebate will be Rs.4,000, Rs.5,000 and Rs.6,000 respectively. The equity outlay of the investor gets subsidised more and more as the tax rate increases. The investment can be made in units of any plan framed in accordance with the ELSS of the mutual funds specified under Clause 23 (D) of Section 10 of the Unit Trust of India Act.

Fiscal objective

The government has over the last few years initiated the process of liberalisation and is slowly learning to allow the market mechanism to be the arbiter of economic activity. Amongst the several measures include inducements to save and identification of financial assets which can attract the savings.

There were attractive gilt-edged investment avenues like the Vth and VIth NSC series which enjoyed the twin concessions under Sections 80C and 80L of the Act. Again, the savings channelled themselves into fixed interest bonds and debentures which were attractive. The government in-
tended last year to ensure that the flow of savings be diverted from safe gilt-edged portfolio into risk-assets viz equity shares.

The Eighth series of National Savings Certificates launched last year perhaps deliberately delinked NSC interest from Section 80L incentive to prevent gilt-edged portfolio from yielding high de facto returns which were comparable with returns on equity. With a view to helping household savers to dare to get involved in the equity capital of enterprises, the ELSS was conceived. As Mr. Chavan in his budget speech of 1989-90 had then put it, "In order to stimulate the flow of personal savings into equity, the government intends to introduce an ELSS". The then conceived scheme is now launched with the twin advantage of dual concessions under Section 80C as well as Section 80 L of the I.T. Act.

What it means

A close scrutiny of the implications of the proposals regarded personal finances cannot but make one appreciate the sincere attempts of Prof. Dandavate to induct socialist ingredients in the country’s fiscal format – concepts, policy and legislation. As mentioned, the intended rectification of the anomalies and inequities in Sections 80C and 80CC through the newly inserted sections 88 and 88A in the Act, is commendable.

Yet the savings scenario of the country clearly indicates that the position is far from encouraging. Section 88A may take the effective progressions built into fiscal legislation to a new extreme where equal incentives exist for all those who cannot save enjoy the incentives “in vacuo”, that is to say, only in statute books and those who can save are burdened with the task of saving more without the Exchequer providing adequate subsidy by way of tax rebate.

The immediate question which posits itself is - if those in the higher income tax brackets do not save who else will? And, if adequate responses are not forthcoming, where will the wherewithal to fund development activity come from? Fortunately, Sections 80C, 80CC, 80CCA, and 80CCB are all deduction based incentives. Now Sections 80C and 80CC are replaced by Sections 88 and 88A respectively, both the new sections being rebate based incentives. However, the latter is to be replaced eventually.

That leaves the assesses with three Sections, namely, 88, 80CCA, and 80CCB that is to say a Socialist Section 88 and two Sections (80CCA and 80CCB) with built-in scope for progression. May be that is the fiscal format with which the National Front Government intends to walk gingerly between low income and high income groups, between the stick and the carrot and between socialism and liberalisation. Needless to add that the didactic approach of the pedagogue Exchequer towards inducting socialism in fiscal laws will be under severe test!

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