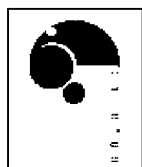


AN AGENDA FOR TAX REFORM

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Any views expressed in this paper are those of the author and should not be attributed to the organization for which he works.

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I. INTRODUCTION

The 1997-8 budget will be the first full-fledged budget of the new government. Major tax reform can enthuse all those who have been complaining of a slow down in reform over the last few years. The middle class has felt particularly let down by the lack of excitement (compared to the 1991, 1992 budgets). The budget can restore this through comprehensive tax reform.

The experience of the last few years shows that tax revenues have responded spectacularly wherever reductions in tax rates have been accompanied by adequate simplification and/or administrative improvements. This is demonstrated by the positive experience of both Personal Income tax and Customs duty reform. On the other hand where tax rate reductions, simplification and administrative reforms have been timid or hesitant, the response has been poor. This is illustrated by excise taxes. Corporate income tax reform falls somewhere in between these two. This argues for a major step forward in the move from the excise/MODVAT system to a central VAT up to the manufacturer/producer level, a continuation of Customs reform so as to eliminate anomalies and end-use exemptions, and the completion of the highly successful Income tax reform.

II. INDIRECT TAXES

A. EXCISE: CENTRAL MANUFACTURER OR PRODUCER VAT

Excise taxes have been the most disappointing feature of the entire tax reform process, with revenues falling far short of expectations. Part of the reason is the slowness in reducing the very high rates on intermediate goods such as polyester, and the complexity created by the dispersion of basic rates. The experience of many countries shows that the complications arising from

VAT off-sets (deductions/credits) can be minimised only by switching over to single general VAT rate and reorienting the administration towards cross-checking.

Given the groundwork done in the past few years and the experience gained, it is time for the "big bang" in excise tax reform: The introduction of comprehensive Central producer VAT [CENVAT].¹ This requires a number of concrete actions, some of which are detailed below:

1. Comprehensive MODVAT Credit (set-off) System

To be called a [central] VAT, MODVAT must become comprehensive and universal: Every producer who pays excise duty on his output (good or service) must be able to claim credit. Excise paid on all inputs used in the production or marketing of the good or service whether they are "consumable", "design and drawings", "telephone" or "insurance" service must be deductible from excise paid on the final output. In a full-fledged manufacturers' VAT, excise paid on office equipment and furnishings must also be eligible for MODVAT credit.

There could be a selected list of inputs, which are **not** eligible for MODVAT credit/set-off. One consideration is the degree to which they can be considered as personal consumption rather than "business costs or inputs". The second factor is whether they are subject to a "special excise tax rate". Items such as cigarettes (tobacco manufactures), jewellery, personal care products [perfumes, toilet & beauty preparations, garments & shoes (excluding uniforms)], are clearly consumption items and would be on the ineligible list.² Dual use items such as cars & motor spirit, and hospitality/entertainment are necessary for business but are also commonly misused, the world over, for

¹ The name is chosen so as to be able to present it as a comprehensive VAT, while at the same time re-assuring the states that their rights are fully protected.

personal purposes. These could be included in the ineligible list if they have a special excise. World over, office Air Conditioners are taken as business costs, but could be included in the list as they will have a "special excise" tax rate (40%).³

Action Points: a) Existing MODVAT credit/set-off notifications to be identified for deletion.⁴ b) Drawing up of a single comprehensive notification applicable to all excise tax payees, and to all inputs with the exception of items listed in a "special inputs list". c) Drawing up of "special inputs list".

2. Invoice System Logic of VAT

The accounts of firms are the basis of invoice based excise and MODVAT credit. All units and warehouses of the firm who have a unified account are counted together. All output which leaves the manufacturing concern, is in principle, subject to excise. All inputs that enter (or re-enter) the manufacturing concern must, in principle, be given MODVAT credit. The goods produced at intermediate stages of production within the firm are of no direct concern. Excise administration needs to focus on undeclared exit/sale of inputs or outputs from the business premises, and false invoices.¹ A general notification on MODVAT credit can make points 1 & 2 clear. Co-ordination with income tax administration and company law (accounting standards for VAT) is needed.

3. MODVAT Chain & Cross-Checking

As distributor/dealers/wholesalers are not subject to excise rules, Small Scale Industries that generally buy from them cannot get MODVAT credit if

² These would normally not be allowed as a business expense in calculating taxable income (PIT, CIT).

³ An alternative approach would be to use the same definitions and procedure as income tax, and to allow everything which is allowed there as business costs.

⁴ A comprehensive listing and analysis of all notifications directly or indirectly related to set-off/credit is required.

such distributors refuse to register. The system of endorsement of manufacturers invoice, by the intermediary to the buyer, was proved less effective than the subsidiary gate-pass system, because of the earlier informal authentication system. Further improvements in the invoice system to cross-check fraudulent claims (authenticated subsidiary invoice as in NIPFP report), while allowing small producers to get their MODVAT credit, is essential for an efficient CENVAT.

4. Eliminating Product Exemptions

Exempted manufactured goods must be brought into the excise/MODVAT net if we are to have a comprehensive CENVAT. The only way to deal with the large number of producers who will be brought into the system is to switch to a system based on self-assessment coupled with computerisation and systematic (random) sample checking.¹ This will in any case be essential if CENVAT is extended to other services.

5. Computerisation & Cross-Checking

In a comprehensive and universal CENVAT there will be too many tax payees for individual checking of MODVAT credit taking. A computerisation program for entry and automatic crosschecking of such receipts is needed. It could start with distributor/traders not themselves subject to excise, where 1995-96 experiences suggest that evasion and leakage are taking place.¹ Validity of claimed invoices on inputs could then be checked through the computer network. MODVAT credit could also be given to the Small Scale Industries after checking. Invoices issued to and by Small Scale Industries could also be computerised, so that a credible assurance of zero inspector visits could be

⁵ As we are doing in income tax for persons with taxable income below 1.2 lakhs.

⁶ There are indications that distributors of steel have little positive incentive to register, while the costs of opening the business to excise inspectors are considered formidable.

given. They could file their invoices at the computer centre where they would be entered and available for crosschecking.

Action Point: A management consultant should be hired to devise a complete MIS, on the basis of a comprehensive analysis. The experience of Indonesia and Korea could also be useful for this purpose.

6. Single Comprehensive SSI Exemption

The SSI exemption should be standard and available to all industries/services subject to excise tax. It should not be dependent on individual notifications and exceptions. Though our final objective is to remove all other exemptions connected with smallness such as non-use of power and KVIC, the 1994-95 post-budget experiences has taught us to be cautious. The types of exemptions which may need to be retained for a year or two appear to be those in which there are either multiple production stages carried out by different small producers, or there is a chain of wholesale/retail traders on the input side, making it difficult to utilise MODVAT credit.

Action Points: a) Compile and review all notifications relating to small-scale industries (including Khadi & Village, Hand made). b) Draw up a single universal exemption applicable to all industries & products. c) Identify products & items, which need to have a special exemption for a year or two.

7. Zero Rating vs. Exemption: MODVAT Refund

Exports are currently zero rated, and exporters are entitled to a refund of excise or countervailing duty paid on inputs used in export production. In contrast, Schedule I drugs, Life Saving Medical equipment and most basic foods and certain other products are fully exempt from excise tax. The difference from zero rating is that taxes on inputs are not refundable to producers of these items. In the case of drugs and certain other products an effort is then made to identify and exempt specified inputs from excise duty. This a messy way of

moving towards zero rating, as end-use exemptions un-necessarily complicate the entire excise tax system. We should abolish these end-use exemptions. Socially desirable final products could be zero-rated and a refund provided on excise duties paid.

8. Number of Rates & Rate Structure

The key to a comprehensive VAT type system is a **single general ad-valorem rate**. This does not preclude having a few higher rates (3) for finished luxury consumer goods and demerit goods and a few lower rates (2) for basic consumer necessities and social goods. The base rate must be between 15% and 20%. This is chosen for revenue neutrality reasons, but also turns out to be the band in which most countries VAT rate falls. The 50% rate should apply only to de-merit goods like cigarettes.⁷ Carefully selected and identified finished luxury consumer goods should have a rate of 30% (CTV, VCR, Stereos, Perfume, motor cycles, refrigerators?) or 40% (Cars, A/Cs, yachts, personal aircraft). Food, drugs & contraceptives, medical equipment and educational/literary material (e.g. books) should, as far as practicable, have lower rates of 0% or 10%. This is essential for ensuring that the excise/vat is equitable, as the poor have a larger proportion of these in their consumption basket (table 1). Specific rates should be eliminated possibly excepting for some time, goods which are not used in manufacturing excise-paying goods.

Many years ago NIPFP had estimated that a 9.3% uniform rate of Central manufacturers VAT, coupled with special excises, would be revenue neutral [i.e. all exemptions except SSI (30 lakh) and primary agricultural commodities abolished. This implies that a 15%(20%) general rate would allow about 38%(53%) by value of the goods to be fully exempt. My cross-check of this estimate, based on Annual survey of industries, indicated a revenue neutral rate

⁷ If car import is allowed such a rate could also be applied to cars of engine capacity above 1.6 litre(say) for a transition period.

of about 10% if rates on Beverages (Ch 22), tobacco products (Ch 24), Air Conditioners & Refrigerators, Cars & Busses were not lowered. Thus a general rate of 15% with special excise on the above products and selected exemptions could be revenue neutral. This needs to be checked with latest available data.

Instead of a single basic rate, a dual rate system (15%, 20%) with all taxable goods and services divided into two mutually exclusive categories could form an **intermediate reform stage**. The "Inputs" category, consisting of all goods that are inputs into the production of goods & services subject to excise/CENVAT, would have a uniform rate of 15%. The "pure consumer" category, consisting of all other goods & services in the CENVAT net, would have a general rate of 20%, and five other rates (0,10,30,40,50). It is also possible to let "pure consumer goods" with a current rate less than 15%, to be raised only to 15% for the time being (transition period).

9. Processed Primary Products

As the central excise is applied only on manufactured products, the imposition of a rate of 15% to 20% on goods produced from agricultural, allied and primary minerals (including coal), would result in a very high tax on value added at the processing/first manufacturing stage, it would be appropriate, in a 5 rate system, to have a lower rate (10% say) on such goods.

As it is administratively impossible to zero rate primary agricultural produce, inputs such as fertilisers, pesticides and agricultural equipment are currently exempted or taxed at a low rate. Producers of these agricultural inputs, however, have unused credits. This has lead to provision of end-use exemptions on raw materials/inputs used by them. This again results in complication of the system. These secondary exemptions should be eliminated. Fully exempted products such as fertilisers could be zero rated, if administratively feasible.

⁸ A 20% rate would allow over 53% to be fully exempt.

10. Additional Excise Duty (AED)

An attempt should be made to revert AED back to the states. This is necessary for an efficient excise-MODVAT system on textiles up to the fabric stage. If we are unable to do so, then given the AED of 10%, the excise tax on fabrics can not be set higher than 10%. Normal MODVAT credit must simultaneously be made available for the excise tax portion.

11. Expansion to Other Services & Exemption Elimination

Points 1 to 4 on MODVAT credit chain must be addressed when expanding the list of services in the excise net. The priority for extension of MODVAT to other services should be on business services such as advertising/marketing, financial services, leasing, construction and repair. Consultancy services which are vitally linked to the efficiency and productivity of companies must be **excluded**.

12. Duty Drawback

Duty drawback rates will have to be re-calculated.

B. BASIC CUSTOMS DUTY: REFORM ISSUES

Despite reductions in customs duty rates, the average collection rate has remained virtually unchanged in the last few years. This suggests that the reduction in evasion that was anticipated at the beginning of the reforms has indeed started taking place. Structural reforms must therefore be carried forward to the point that it will require only one further budget to complete them. This means tackling all chapters of the HSN, and addressing the following issues:

1. Peak Rate on Consumer Goods

In the 1995-6 budget the overall peak rate was reduced from 65% to 50% (with the exception of liquor). As we reduce the peak rate below 50%, with most consumer goods still on the restricted list of imports, we will have to start differentiating between consumer goods. A general reduction in the peak rate below 50% may cause temporary problems in the case of a few consumer goods such as luxury cars (above 1.6 litre). We should therefore define, in terms of 6 or 8 digit HSN, a list of (5 to 10) consumer goods on which the import duty would be left at 50%. One possible criterion is potentially large demand/value of imports (if and when it is put on OGL) coupled with public perception as a super luxury item (e.g. Rolls Royce). This category would also include low alcohol content beverages such as wine and beer. The duties on hard liquor need to be reduced to between 60-80%.

2. Dual Peak Rate

Leaving aside the defined (as above) list of consumer goods, there are two possible approaches to the peak rate. One approach is to lower the general peak rate to 35%. The other is to have a dual peak approach, with one peak of 40% applicable to final, finished consumer goods, and a second peak of 30% applicable to all other goods (raw materials: chapters 1 to 27, components, parts, capital goods, instruments etc.). A few selected items in this category could, however, have rates above 30%. I would recommend the dual peak approach.

3. Intra-Group Inconsistency: Agriculture & allied

India has a comparative advantage in agriculture and allied products such as dairy, poultry & meat. As a result the rates have been reduced to 10% in many chapters. Quite illogically the tariff rate is 195% for “other food prep”[2106.90], 130% for dried grapes [8.06] & still 50% in several other chapters [1,8, 12, 13, 16, 17, 19, 20, 21, 23], and 35 or 40% in others [9.0940,

15, 18]. These, along with rates on primary goods falling in other chapters must be lowered to the 10 to 20% range. These cover beverages [22.01-02, 22.08-09], non-manufactured tobacco [24.01], Leather [42.01, 43.01, 43.04-06], Wood [44.04-07], Cork [45.01-03], Straw et al [46.01], Pulp [47.01-06], Wool [51(-51.11)], and Agro Fibres [52.01-07, 53.01-08]. Consumer goods based on these raw materials and falling in the same chapter [42, 43, 44, 45, 46, 47, 50-53] should have a rate not exceeding 30%. Most exemptions⁹ could consequently be eliminated. If de-licensing of agro imports happens in the next year the tariff rate on some of the agricultural & allied items also need to be raised to about 20%.

4. Capital Goods: Inconsistency & End use exemptions

Tariffs on machinery, equipment & instruments (chapter 84, 85, 90, 98) have been considerably reformed, with a majority of items having a basic duty of 25%(or less). These reforms need, however, to be carried to their logical completion. Peak rates (50%) are, still applicable to most Railway equipment (86.01-06, 86.09) despite being a Public utility. Both efficiency and equity require a reduction of the rate to 25%. In chapters 84, 85, 87, 89 & 90, peak rates (50%) are also still applicable to some (non-consumer) machinery & equipment¹⁰ and to components & parts¹¹, giving rise to end-use exemptions.

The duty on all capital goods, parts and components in chapters 84 to 90 should be brought down to 25%. Only finished consumer durable goods falling

⁹ 17 in 1995-6 in chapters 1 to 24

¹⁰ 84.1440/80, 84.1581-83; 84.1891, 84.2219, 84.4720, 84.4811-19, 84.5020, 84.5110, 84.5221-29, 84.69, 84.70, 84.72; 85.0810-80, 85.0110, 85.12, 85.1721-80(40%), 85.25, 85.26, 85.29, 85.3110/80, 85.3910-49, 85.4340-89, 85.22; 87.01, 87.04, 87.05, 87.09, 87.1620-80; 90.0580, 90.0610-30, 90.1380;

¹¹ 84.1430/90, 84.1590, 84.1891-99, 84.2290, 84.4851-59, 84.5090, 84.5190, 84.5230-90, 84.73, 84.85; 85.0690, 85.0790, 85.0990, 85.1090, 85.11, 85.1290, 85.1390, 85.1790, 85.2290, 85.3120/90, 85.32, 85.33, 85.34, 85.3610-69, 85.37, 85.38, 85.3990, 85.40, 85.41, 85.42, 85.4430, 85.4451-70, 85.4890; 87.08, 87.14, 87.1690; 89.0120-90, 89.02, 89.04, 89.05, 89.06, 89.07; 90.0110-20, 90.0190, 90.0390, 90.0590, 90.0691-92, 90.0791-92, 90.0890, 90.0990, 90.1090, 90.13, 90.2229, 90.2230, 90.2290.

in these chapters should have a higher rate of 40% (with personal automobiles at 50%). Even parts & components of consumer goods should not generally exceed 30% (only a few selected at 40% e.g. household A/C compressors, car chassis & body).¹ With the duty on parts & components falling in chapter 84 to 90 reduced to 25%, end-use exemptions (about 80 in 1995-96) for electronic, computer, automobile, machine tool and other capital goods can be eliminated.¹³

5. Anomalies: Metals-Capital Goods

The existing anomalies in the mineral-metals-capital goods chain should be eliminated in this budget. The peak rate for Iron & steel (Ch 72) and non-ferrous metals (in Chapters 74 to 81) and articles of Steel (Ch 73), i.e. excluding finished consumer goods, should be reduced to 25%, the rate for capital goods.¹⁴ Most metal inputs for capital goods should, however, have a 20% rate. The duty rate for Ores, slag and ash (Ch 26) should also be unified at 10%. These reductions are essential if Small Scale Industries producing metal parts are to meet the competition from China. Consequently, about 20 exemptions (as of 1995-6) could be deleted.

6. End-use Exemptions: Chemicals, Mineral products

Many of the remaining end-use exemptions pertain to chemicals (Ch 28 to 40) and non-metallic mineral products (Ch 68 to 71), which in turn makes it necessary to have high tariff rates to preserve revenues.¹⁵ Identifying the 4-digit HSN GROUP from which a majority of these inputs come, and setting a peak rate of 30%, while simultaneously abolishing the exemptions, can break the

¹² List of Consumer Durable Goods Falling in chapters 84 to 87 & 90 (HSN) 84.15, 84.18, 84.2211, 84.2310, 84.5210; 85.06, 85.09, 85.10, 85.13, 85.1610, 85.1631, 85.1633, 85.1640, 85.1650, 85.1660, 85.1671, 85.1672, 85.1710, 85.18(pt), 85.20, 85.21, 85.23, 85.24, 85.28; 87.03, 87.11, 87.12, 87.14; 90.05, 90.06; 91.02, 91.04, 91.15.

¹³ For instance, the reduction of duty on electrical & electronic components falling in chapter 85 (85.2610, 85.2691, 85.32) to 25% will allow elimination of end-use exemptions related to chapter 85.

¹⁴ 25% on parts and components will reduce to the capital goods rate. 83.11 must be reduced to 30%.

nexus. The 1996-97 budget reduced some of these inputs to 30%, others to 40%, while leaving some unchanged at 50%. A reduction in the latter two to 30% will allow elimination of end use exemptions for pesticides, electronics etc. (users).¹⁶ The peak rate on (non-consumer) non-metallic minerals (Ch 25) should correspondingly be set at 20%.

7. End-use Exemptions: Drugs & Pharmaceutical

A large number of end-use exemptions relate to Drugs, Bulk drugs and intermediates. As most drugs and proto-drugs fall in chapter 30 and HSN 29.37 to 29.41 of chapter 29, the tariff rate on these can be reduced to 20%-30%, and all end-use exemptions for drugs eliminated. Within the Pharmaceutical chapter there would be four rates: 10% for Drugs for cancer etc. [30.0490], 15% for Wholesale medicines [30.0310-39], 20% for Anti-sera & alkaloids [30.02, 30.0340-90], and 30% for Bandages & other medical supplies in chapter 30.

8. Textile Chain

The Textile chain (Chapters 50 to 63) can be rationalised by lowering the peak rate on all basic & intermediate goods (up to yarn stage for synthetic) to 30%.

III. DIRECT TAXES

A complete review of the Direct tax laws, rules and internal Procedures is needed, so as to simplify the tax, eliminate legal disputes, and make it possible for honest citizens to file a return without help of a CA/lawyer.

¹⁵ There were 40 exemptions in chapters 25 to 40 in 1995-96.

¹⁶ The 30% peak will apply to chs 28 to 31, 32.01-07, 32.11-15, 33.01-2, 35, 37.0110, 37.0210, 37.07, 38, 39.01-16, 39.19, 39.20, 39.23, 40.01-10, 40.1693.

A. PERSONAL INCOME TAX

Marginal Income tax rates have been gradually reduced since 1991, in the belief that lower rates will provide an incentive for better compliance. The dramatic increase in the *buoyancy* of personal income tax collections over the last few years has confirmed this conclusion. It is therefore time to go in for even more radical changes.

An important aspect of tax evasion is that most potential taxpayers are not even registered in the income tax system. One factor that inhibits entry is that the average tax rates rise dramatically at the entry point. Another reason is that a potential taxpayer expects that he will be subjected to ever-higher marginal tax rates as his income rises over the years.¹ Though the former reason may be more important in terms of number of tax payers, the latter may be much more important in terms of proportion of potential revenue collection.

The **reform package** would include the following changes:

1. Rate Reduction [Single or Multiple-Rate System]

The approach to be adopted towards rate reduction depends on whether the final objective is a multiple rate system or a single rate one. Both alternatives are given below, though the former appears more feasible at the current time:

- a) *Multiple Rate System*: Keep the exemption, standard deduction and brackets basically unchanged but the 15%, 30%, 40% rate structure would be replaced by a 10%, 20%, 30% one.¹ A low entry rate is feasible in a modern computerised system based on self-assessment and random checking. Our competitors have rates in this range. A 40%

¹⁷ Not to mention the lifetime of harassment by tax inspectors.

¹⁸ Marginal adjustments could be made so that tax free income for a salaried person is 36,000.

bracket could be introduced at an income of 12 lakh so as to minimise criticism from the left.¹⁹

b) *Single Rate System*: A total exemption of Rs 48,000/- (60,000) coupled with a **single marginal rate of 20% (25%)** for all income above 48,000/-(60,000).¹ Though the average rate will still have a step jump at the entry point new taxpayers will be assured of a uniform, reasonable tax rate for the future.

2. Amnesty

An **amnesty scheme**, in which Tax evaders can declare previously earned income and pay a flat tax rate of 30 to 40%. We can expect a very different response than earlier schemes, because in future, declared income will only be taxed at 30-40% (or 25% in flat tax system). No questions will be asked about the source of income. The amnesty could also have a lower tax rate for declarations within 6 months and higher for 6-12 months. Expenditure surveys could be launched after 6 months.

3. Taxation of Perquisites

Bring non-taxed perquisites into the tax net by making them ineligible as business cost if they are not included in the taxable income of the individual who receives them.¹ Business & Corporations would be given a choice of which method to follow: Deduct costs of perquisites and show cost of giving perquisites as worker salary (under TDS), or do neither. With corporate rates higher than personal rates there will be a strong incentive to ensure that

¹⁹ This would bring our highest bracket more in line with Indonesia.

²⁰ These two numbers could be changed if the exemptions/deductions etc. are changed(a la Cheliah committee).

²¹ The ubiquitous problem of distinguishing business expenses from personal consumption would have to be addressed(conveyance-car, petrol; entertainment; travel) as only the "personal" part should be taxed.

perquisites are declared in the hands of the employees. This will not affect government servants, as govt. has a zero tax rate.

4. TDS of 20% on all Dividends and Interest

TDS of 20% could be applied to payment of dividends [& interest] by companies. This is only acceptable to low income individuals if the law/rule clearly gives automatic 20% credit to all tax payers who show such receipt from companies (including banks). Companies would not have to give individual tax deduction certificates. They would deposit 20% of the value of the gross dividend declared, and prove (if required) that the total net dividend paid is 80% of the gross dividend declared.

The new administrative system should also apply to bank interest.

The tax on interest paid on loans however is distorting and should be eliminated.

5. Compulsory Simplified Registration

Every person engaged in business or profession, and every individual who owns or rents (or occupies illegally what would be rented) any fixed asset including housing, shop or land, will have to fill in and send/mail a newly designed special income tax form. This **simplified form** would have only the following items and should not be more than one page: Name, home and business/professional addresses, telephone number(s), water, electricity and gas connection numbers (where applicable), total income (approximate), a question on income & its sources will list ranges of income, & various sources which the filer can tick off, signature, date and place. The filer must be assured that "approximate" income will not be used for "nit-picking" and harassment of the filer.

On receipt of the forms each filer would be assigned a unique code (Soundex!) for future filing and use. The information on these self-assessment

forms would be computerised and used for analysis and **would not be directly accessible to ground level income tax personnel**. This would be made known to filers so that the fear of harassment for illegal gratification would be minimised. The information could be used for random selection and issue of investigation notice, with a follow-up investigation of the inspector assigned to do the initial checking.

6. Exemptions

Eliminate as many exemptions as possible with a view to raise the new 30% bracket in the multiple rate system to Rs 2 lakhs (or to reduce the single rate system to a 20% rate). Such a system would be a lot fairer than the existing situation in which too many self-employed people are paying little or no tax.

7. Administrative Measures

A comprehensive approach to bringing potential taxpayers into the tax net is needed. A computerised database using declared and authenticated expenditure data such as on electricity (bills), automobile purchase, property ownership and rental (or occupation), telephone (bills) etc. needs to be built. This could be supplemented by data on foreign air travel, and domestic tourism (travel & hotel). The tax staff would also have to be re-oriented from existing taxpayers to expanding the number of taxpayers. Perhaps a management consultant could be engaged to build a comprehensive MIS and HRD plan for this purpose.

8. Anti-Evasion Measures

If there is still a fear of revenues loss because of the dramatic reduction in tax rates, a few more steps could be considered for flushing out the black economy. Among these are:

- a) Compulsory Payment by Debit/Credit card or by Certified/ Bankers Cheque for purchase of **all** air tickets purchased in the metros (or top 30-50 towns). This will require introduction of the concept of "certified" cheque, which ensures that the money is sequestered in the issuers account and the cheque is honoured. The banks will also have to ensure that the "certification" procedure is simple and quick.
- b) Make it compulsory for every individual engaged in business or profession to pay a minimum tax of Rs. 1400/- per annum. The person would have the right to file a return for claiming refund of excess payment. Inspectors must be penalised if the collection fails to match the numbers from the compulsory registration, and the business establishments registered with urban authorities.

9. Conclusion

These measures must be part of the package that includes rate reductions outlined above and can be counter-productive if used in isolation.

B. CORPORATE TAX

1. Corporate Tax Surcharge

The surcharge on corporate income tax must be removed this year if the gains from rate reductions seen in personal income taxes are to be extended to the corporate tax. Increase in compliance should be sufficient to compensate for this reduction.

2. Exemptions, Rate Reduction & MAT

If the measures related to Perquisites mentioned in the section on Personal Income tax, can be implemented, or any exemptions & deductions

removed²², further reductions in the corporate tax rate can be considered. The basic rate could be reduced to the extent of revenue enhancement from any reduction in exemptions. As exemptions and deductions are the main reason we have zero tax companies, this will also eliminate the “equity” argument for MAT. In any case MAT should be allowed as a tax credit against tax liability arising in future.

3. Interest Tax

The interest tax is a tax on capital and production and creates distortions. It is completely inconsistent with thrust of economic reforms and should be eliminated immediately.

C. INFRASTRUCTURE

Provision of basic infrastructure services is one of the few economic activities for which some exemptions may be desirable given the horrendous shortfalls, the lack of resources with the government, and the urgency for improvement. Private infrastructure development will, in turn depend on the development of a long-term bond market. The following exemptions are in my view most consistent with simplification and tax reform:

a) In sec 10 a new sub-section should provide an exemption from all income (interest, long-term capital gains) for bonds having a term of 15 years or more. In the case of Special Purpose vehicle, Companies or Funds, which provides basic Infrastructure services, the minimum term could be set lower at 10 years.

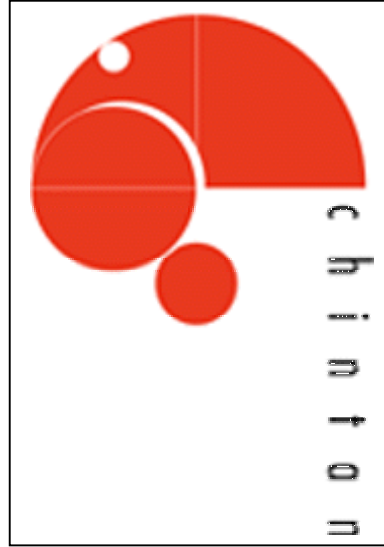
b) In section 80IA the 30% tax exemption for the second block of 5 years should be doubled to 60%. The definition of infrastructure should include, (i)

²² the reason why we have zero tax companies in the first place.

Irrigation Dams and Canal network, (ii) Rural Power supply, (iii) Public/non-exclusive Gas/oil pipelines.

c) Section 88 should be modified to include Private Pension funds, Annuity funds and Insurance companies approved by an appropriate Regulatory Authority as eligible institutions.

d) Convert the backward area incentives, from the current subsidy to manufacturers, into a backward area infrastructure development incentive.



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