Chapter - III

"It is increasingly recognized that sustained economic growth is possible only with a sound macroeconomic framework and that such a framework tax policy plays a key role."

- Stanley Fisher & William Easterly

HISTORY OF DIRECT TAXATION IN INDIA
CHAPTER-III

HISTORY OF DIRECT TAXATION IN INDIA

3.1 INTRODUCTION

It is generally believed that taxes on income and wealth are phenomena of modern days. However there is enough evidence to show that taxes on income in some form or the other were levied in ancient days in India. There are references in ancient scriptures like Manu Smriti and Arthashastra to a variety of taxes. Taxes prevalent in ancient India as (Sarkar:1978) observed that the admixture of direct taxes with indirect taxes secured elasticity in the tax system, although more emphasis was laid on direct tax. In modern days income tax was introduced for the first time in India in 1860; when India was a colony of Britain. India has a three-tier federal structure (the union government, the state government and the urban/rural local bodies). The power to levy taxes and duties is apportioned between the union government and the state governments in accordance with the provisions of the Indian constitution. Tax system in India comprises of direct taxes as well as indirect taxes. Except for land revenue and agricultural income tax, all other direct taxes are levied and collected by the federal government. At the federal level Central Board of Direct Taxes (CBDT) has been given responsibility of all matters relating to various direct taxes in India and the Board derives its authority from Central Board of Revenue Act 1963. The organizational history of income tax department dates back to the year 1922. Income Tax Act, 1922 gave for the first time a specific nomenclature to various income tax authorities and laid the foundation of a proper system of
administration. In independent India till the year 1961, direct taxes were administered as per provisions of Income Tax Act, 1922.

3.2 DIRECT TAX REFORMS: AN OVER VIEW

Structure of direct taxation in India underwent fundamental changes since independence. The phase of direct tax reforms may classify into two periods.

- Direct Tax Reforms after Independence till 1991
- Direct Tax Reforms since 1991

3.2.1 Direct Tax Reforms After Independence Till 1991

Structure of direct taxation in India underwent fundamental changes since independence. To study and investigate direct taxes in independent India, Income-Tax Investigation Commission headed by Sir Srinivasa Varadachariar was constituted under the Taxation on Income (Investigation Commission) Act, 1947. The Commission gave its report in December 1948 and made a number of recommendations to plug loopholes for preventing tax evasion and tax avoidance and also to simplify various provisions of law and procedures. Based on the Commission’s recommendations, a comprehensive Income-Tax (Amendment) Act was passed.

3.2.1.1 Taxation Enquiry Commission

First initiative to bring improvement in the tax system was made by Taxation Enquiry Commission constituted under Dr. John Mathai in 1953-54. Taxation Enquiry Commission was appointed not only to study the structure of taxes on income but also to carry out an in-depth study of the central taxes and their administration. It was primarily concerned with increasing the tax revenue, to find resources for the planned development of the economy and with improving income distribution through progressive taxation. It
even advocated a reduction in the income tax exemption limit from Rs.4200 to Rs.3000 per annum and it also recommended a maximum marginal tax rate of 85% on income above Rs1.5 Lakh. It was against any change in the basic direct tax structure and accordingly it opposed introduction of wealth tax, capital gains tax and gift tax. Taxation Enquiry Commission was concerned more with improving the existing system rather than changing the tax structure in any substantial way.

3.2.1.2 Kaldor Reforms

The next major study of the Indian tax system was one made by Nicholas Kaldor whose report on Indian tax reform was published in 1956. Kaldor recommended the broadening of the tax base through the introduction of an annual tax on wealth, the taxation of capital gains, a general gift tax and personal expenditure tax. For reducing the scope of tax evasion, Kaldor committee suggested the introduction of the institution of a comprehensive tax return for all direct taxes and the introduction of comprehensive reporting system on all properties transferred and other transactions of a capital nature. The committee was of the opinion that rates should be lowered and that maximum rate of income tax should not be more than 45%. The recommendations of Kaldor for introduction of new taxes were accepted and taxes on expenditure, capital gains, wealth and Gifts were introduced in direct tax system in India. Kaldor’s suggestions for reducing the tax evasion and tax avoidance were referred for considerations to the Direct Taxes Administration Enquiry Committee.

3.2.1.3 Direct Taxes Administration Enquiry Committee

Direct Taxes Administration Enquiry Committee was set up in June 1958 to advise the government on the administration, organization and procedures necessary for implementing the
integrated scheme of direct taxation. Its mandate was also to study the need for eliminating tax evasion and avoiding inconvenience to the assessees'. It was chaired by Sri Mahavir Tyagi, M.P and was popularly known as "Tyagi Committee". The committee was of the view that augmentation of revenue should be the primary purpose of tax policy. In the year 1956, the Law commission was asked to revise the Indian Income Tax Act, 1922. The commission's recommendations became the basis for the enactment of the Income-Tax Act 1961 (the existing Act for direct tax administration) while the earlier Act of 1922 was repealed.

3.2.1.4 Boothalingam Committee

A major attempt for rationalization and simplification of tax structure was made on the basis of the recommendations made by the Boothalingam Committee, which submitted its final report in 1967. Mr. Boothalingam dealt mainly with a few selected aspects of taxation in which improvement was desirable. He suggested measures for rationalisation and simplification of personal income tax, corporation tax and in respect of excise duties. The committee also suggested donee based gift tax. The committee was very critical of the language used for drafting tax laws which can't be easily understood by even the educated people. He urged that the tax laws should be redrafted so as to make them intelligible to reasonably educated persons. Several of the recommendations made by committee were implemented and this certainly brought about some improvement in tax system.

3.2.1.5 Wanchoo Committee

Direct Taxes Enquiry committee set up in 1971 under Wanchoo carried out major study in the area of direct taxes. The committee looked into the aspects of tax evasion and accumulation of black money. The committee was of the view that factors like high
tax rates, controls and licences, ineffective information were major problems in Indian direct tax system. The committee also opposed voluntary disclosure as means of controlling the growth of black money. In place of voluntary disclosure, it favored more stringent measures of enforcement mechanism like searches and seizures.

3.2.1.6 Committee on Taxation of Agricultural Wealth and Income

Committee on Taxation of Agricultural Wealth and Income was constituted under K.N.Raj to explore ways to bring agricultural income and wealth to tax. The committee under K.N.Raj suggested several options in this direction. One of them was to bring agricultural income under income tax net through integrated system of agricultural and non-agricultural income. Due to practical difficulties the committee however ruled out this option. Even today, agricultural income is not under tax net of federal government. Major steps towards tax reforms were taken in 1985-86 when long term fiscal policy was launched. Under this policy, tax rates were lowered and attempts were made to rationalize tax incentive. However, it was only after 1991 that significant reforms measures were initiated.

3.2.2 Direct Tax Reforms Since 1991

During late 1980s and 1990s tax system witnessed significant changes as many countries cutting across ideologies and varying levels of development initiated reforms. Besides efficiency considerations, these tax reforms had to address the issue of replacing public enterprise profits with taxes as a principal source of revenue and aligning tax policy to change the development strategy. The supply side tax reforms of the Thatcher-Reagan era also was guiding force in initiating tax reforms in developing countries. Tax reform as a component of broader fiscal reforms was
at the heart of the stabilization and adjustment process in many developing courtiers (World Bank: 1991). However as has been stated by (Rao: 2005) unlike most developing countries, which were guided in their tax reforms by multilateral agencies, Indian tax reform attempts have largely borne a domestic brand.

Indian tax system, which evolved to conform to the public sector dominated import substituting industrialization for almost 45 years after independence had to be reformed to facilitate liberalized open economy (Rao: 2005). Indian tax system before the reforms were undertaken was characterized by 1) a high dependence on indirect taxes 2) low average effective tax rates and 3) high marginal effective tax rates and large tax-induced distortions on investment and financing decisions. Therefore reforms undertaken by India aimed at improving fiscal consolidation, lowering the marginal tax burden and reducing tax-induced distortions, besides these reforms also aimed at creating a stable and predictable market environment.

The Post-1991 tax reform is tailored to meet the requirements of new economic policy launched in July 1991. The New economic policy envisaged liberalization of both the domestic sector and the external sector of the economy. It made a major departure from the earlier development strategy which assigned primacy to public sector and strongly advocated the dismantling of excessive regulations and controls which stifled enterprise. In order to facilitate the expansion of private enterprise, a market oriented approach to development came to be accepted. This approach is based on the principles of supply-side economics. The tax policy has to be in conformity with the new economic policy and therefore a supply-side tax policy was envisaged.
3.3 MODELS OF TAX REFORMS

Conventionally, at least three different models of tax reform may be found in existence. One important model studying the philosophy of taxation which focuses on the design of a tax system is optimal taxation. Optimal taxation theory encompasses a range of models that focus on particular aspects of the tax system. However all these different models share three features. First each model specifies a set of feasible taxes for the government such as commodity taxes and the government’s revenue needs. Second, each model specifies how individuals and firms respond to taxes. Third, each model states the government has an objective function for evaluating different configurations of taxes. In the simplest of the models, the government’s objective is seen as minimizing the excess burden generated by the tax system while raising a set amount of revenue. Ahnmad Ehtisham and Nicholas Stern are among the proponents of this model.

The second model propounded by (Harberger:1990), draws much more on practical experience. According to this model, while efficiency is clearly desirable in the design of tax policy, administrative capability is equally important. The principal concern according to this approach is to design a system that will minimize tax-induced distortions and at the same time be administratively feasible and politically acceptable. It has been suggested in the model that tax reformers should pay less attention to the economic methodology and more to the best practice experiences.

Another model in the field of tax policy is the supply-side tax model. The model emphasizes the need to broaden the base with minimal exemptions and preferences and to have low marginal tax rates. There are two versions of supply-side tax policy.
One propounded by theoretical supply side economists and the other given by popular supply-side economists. While the former lays emphasis upon reform of the tax system in all its aspects, the latter lays emphasis upon reform of the taxation in particular, especially by reducing the top marginal tax rates. The best exponent of this view is Arthur Laffer who has suggested that beyond some tax rate, higher tax rates will shrink the tax base so much that revenues will actually decline. Laffer curve supposes that for a given economy there is an optimal income tax level to maximize tax revenues. If the income tax is set below this level, raising taxes will increase tax revenue; and if the income tax level is set above that level then lowering taxes will increase tax revenue.

**Diagram: 3.1**
The Laffer curve

Recent reforms approaches in India combine elements of all three models discussed above (Rao: 2000). These incorporate both theory and past reforms experiences and take into account administrative, political and information constraints in designing and implementing reforms. The recent approach takes into account that a broader base requires lower rates to be levied to generate a given amount of revenues. It also takes into account that
broadening the tax base helps to ensure horizontal equity. Based on the approach to reforms as discussed above, post-1991 tax reforms in India aimed at restructuring the direct tax structure for increasing the share of direct taxes in the total revenue of the centre.

Tax Reforms Committee constituted under Dr. R.J. Chelliah in response to new economic policy initiated in 1991 came out with new tax proposals which basically aimed at supply-side tax policy with a view to broadening the tax base and rationalizing rates of not only income tax but also of other taxes so as to remove all tax related distortions. Apart from raising the share of direct taxes in the total revenue, tax reform measures also aimed at improving tax buoyancy.

After Chelliah Committee, Advisory Group on Tax Policy and Tax Administration constituted by Planning Commission of India in 2001 under Dr. Parthasarathi Shome, also gave their valuable recommendations to the government on tax reforms. Significant recommendations were made by the Task Force constituted under Dr. Vijay Kelkar in 2002 to examine various issues involved with direct tax structure and direct tax administration.

3.4 REFORMS IN PERSONAL INCOME TAX

Tax on Personal Income is considered as fair basis of taxation in developed as well as developing economics. Acceptance of personal income as an important tax base is based on the premise that an individual’s income reflects in true sense one’s ability to contribute to the exchequer. Tax on personal income is also related to nation’s economic performance. Receipts from the individual income tax tend to rise more steeply in economic booms and drops more sharply in recessions as individuals’ income itself is quite sensitive to changes in the level of overall economic activity.
Furthermore, tax on personal income in most of the cases is regulated by a progressive rate structure. Result of progressive rate structure is that a rise in individual income creates additional income taxable at a higher rate. Conversely, a drop in individual income causes some taxpayers to be taxed at a lower rate. Personal income tax takes into account needs of taxpayers, is adaptable to progressive rates and its yield can also be elastic. Due to these reasons, tax on personal income has a great appeal.

Personal Income Tax in India has scheduled features as it makes distinction between different sources of income e.g. Income from agriculture is excluded from taxation and capital gains are taxable at a different rate although the incidence of income tax falls upon all non-agricultural incomes such as Salaries, Income from House property, Investments, Business and Profession or Vocation, Income from other sources etc.

Indian personal income tax system was plagued by a number of deficiencies, which necessitated reforms. It suffered from low yield, extremely limited coverage and low level of compliance. To overcome these deficiencies and to attain objectives like revenue productivity, horizontal and vertical equity and appropriate reforms were considered necessary. Policy of tax reforms evolved around the assumptions that lowering of tax rates, broadening of the tax base and rationalization of the incentives are the ways to overcome the deficiencies in personal income tax. Reforms since 1991 are mainly focused in these directions.

3.4.1 Personal Income Tax Rates

An important and pertinent task before tax administration is to design a personal income tax rate schedule that is equitable and efficient. This is because the rates of tax affect economic behaviour of taxpayers i.e. choice between work and leisure, the choice
between consumption and savings and also the compliance behaviour of taxpayers. A highly progressive tax rate schedule, while meeting the ends of vertical equity causes higher distortion in the economic behaviour of taxpayers and therefore promotes inefficiency. Further, high rates of taxes induce tax evasion.

Personal Income Tax rates in India were quite high in earlier times. At its peak in 1973-74, with the exemption limit at Rs.5000 the minimum marginal rate of tax was at 10 percent and the maximum marginal rate of tax was as high as 85 percent. The rates spread over eleven tax slabs. In addition, there was also a surcharge of 10 percent where the total income was below Rs.15000 and a rate of 15 percent in other cases. Therefore, the effective maximum marginal statutory rate was 97.75 percent. This shows that the progressivity of the tax system was very high. The large number of tax slabs also distorted the progressivity of the tax system due to bracket creep. Keeping in view the recommendations of the Wanchoo Committee 1971, marginal tax rates were reduced to 75% in 1974-75, 67% in 1976-77, 50% in 1985-86, 40% in 1992-93 and 30% in 1997-98. Tax Reforms Committee constituted under Chelliah in 1991 observed, “As is well known, our general approach is that the best results, in terms of compliance (and therefore, revenue) efficiency and equity are obtained through a system incorporating moderate rates on a broad base”.


a) The basic exemption limit must be at a moderate level.
b) There must be an appropriate balance between the tax liability at the lowest levels, administrative cost of collection and compliance burden of the smallest taxpayers.

c) The ability of the tax administration to render quality services to taxpayers significantly affects the choice of the exemption limit.

d) The number of tax slabs should be few and their ranges fairly large to minimize distortions arising out of bracket creep.

e) The maximum marginal rate of tax should be moderate so that the distortions in the economic behaviour of taxpayers and incentives to evade tax payments are minimized. Along with the lines of the recommendations of Taskforce on Direct Taxes the rates were reduced.

3.4.2 Widening the tax base

Table 3.1 shows the number of effective assessees during the period 1995-96 to 2004-05.

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Individual</th>
<th>H.U.F</th>
<th>Firms</th>
<th>Trusts</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995-96</td>
<td>187574</td>
<td>8798212</td>
<td>406456</td>
<td>1192193</td>
<td>42769</td>
<td>37310</td>
<td>10664514</td>
</tr>
<tr>
<td>1996-97</td>
<td>227228</td>
<td>9761426</td>
<td>412470</td>
<td>1158319</td>
<td>49629</td>
<td>34471</td>
<td>11643543</td>
</tr>
<tr>
<td>1997-98</td>
<td>274319</td>
<td>11194953</td>
<td>437251</td>
<td>1172647</td>
<td>51865</td>
<td>36701</td>
<td>13167736</td>
</tr>
<tr>
<td>1998-99</td>
<td>295327</td>
<td>15135956</td>
<td>469730</td>
<td>1228023</td>
<td>83847</td>
<td>41328</td>
<td>17254211</td>
</tr>
<tr>
<td>1999-00</td>
<td>309627</td>
<td>17653745</td>
<td>507843</td>
<td>1272217</td>
<td>87165</td>
<td>46427</td>
<td>19877024</td>
</tr>
<tr>
<td>2000-01</td>
<td>334261</td>
<td>20662926</td>
<td>55394</td>
<td>1336861</td>
<td>63999</td>
<td>51035</td>
<td>23002276</td>
</tr>
<tr>
<td>2001-02</td>
<td>349185</td>
<td>23734413</td>
<td>607519</td>
<td>1378706</td>
<td>97272</td>
<td>58784</td>
<td>26225879</td>
</tr>
<tr>
<td>2002-03</td>
<td>365124</td>
<td>25935556</td>
<td>644489</td>
<td>1345232</td>
<td>117304</td>
<td>57224</td>
<td>28464929</td>
</tr>
<tr>
<td>2003-04</td>
<td>372483</td>
<td>26624224</td>
<td>654848</td>
<td>1338613</td>
<td>154276</td>
<td>57952</td>
<td>29202396</td>
</tr>
<tr>
<td>2004-05</td>
<td>373165</td>
<td>24792990</td>
<td>620468</td>
<td>1235373</td>
<td>71375</td>
<td>65190</td>
<td>27158561</td>
</tr>
</tbody>
</table>


Looking at a trend of number of assessees’ in the decade of 1990s, it is seen that in the year 1995-96, the number of effective assessees’ was 1,06,64,514. By the year 2003-04, it grew up to
2,92,02,396. Thus, there has been increase in number of assessees' over last seven years. In the year 2004-05, however the number of assessees' again declined to 2,71,58,561.

The growth ineffective assessees since 1995-96 reflect the fact that the reduction in rates has yielded positive results in broadening the tax base. However, the very fact that with a population of about 1.10 billion, India has a tax base of less than 3% of personal income tax assessees' which necessitated the requirement of broadening of the tax base so that it yields more coverage and more revenue. It is also a cause of concern that in the year 2004-05, the number of effective assessees has actually declined in comparison with 2003-04. Bringing hard-to-tax groups under the tax net is one solution to this problem and one way of bringing hard-to-tax groups to tax cover is presumptive taxation. Under presumptive taxation, assessment is made using certain indicators of income rather than the actual income. In absence of direct information proxies are also sometimes used.

3.4.3 Presumptive Taxation

Presumption in direct taxation has received a great deal of attention in developing countries as a part of the search for fiscal correction. Due to massive evasion and non-compliance, pursuit of vertical equity through global progression has become increasingly subordinate to the search for improved equity through expansion of tax base (Shirazi and Shah: 1991). Presumptive norms can be used either to generate estimated income actual, or potential incomes in terms of what is possible with average effort. Both these forms may be used as a base-broadening accretion to the structure of conventional income taxation in place in less developed countries (Rajaraman: 1995). Presumptive taxation also serves the objective of equity by creating an opportunity for collecting tax from those who
are not paying any income tax for reasons of non-availability of proper accounts for determining the income. Where the estimated income is taxed, both the revenue and the taxpayer are aware that it is not the actual income that is taxed but rather some substitute of it (Lapidoth: 1997).

Presumptive methods can be rebuttable or irrebuttable (Thuronyi:1996). Rebuttable methods include administrative approaches to reconstructing the taxpayer’s income and may or may not be specifically described in the statute. If the taxpayer disagrees with the result reached, the taxpayer can appeal by proving that his or her actual income, calculated under the normal tax accounting rules, was less than that calculated under the presumptive method. By contrast, irrebuttable presumptive assessments are specified in the statute or in delegated legislation. Because they are legally binding, they are defined precisely. Irrebuttable presumptions can be of two types: I) minimum tax, where tax liability is no less than that determined under the presumptive rules and II) exclusive, where tax liability is determined under the presumption alone, even if the regular rules might lead to a higher liability. Presumptive methods can also be distinguished according to the degree of discretion to tax officials. Some presumptive methods are quite mechanical, allowing no discretion, for example methods based on a percentage of gross receipts or of a firm’s assets. Other methods, such as the net worth method involve a large degree of discretion. Presumptive methods can be further distinguished according to the types of taxpayers who are targeted. In general terms, three groups of taxpayers have been the source of problems against which presumptive methods have been directed. The most common problem is non-compliance by small businesses and professional. A second problem is non-compliance by individuals (this may be related to the first, but the focus is on
amounts that individuals have taken out of their businesses or received from other sources and used for consumption). A third group of targeted taxpayers is business as a whole including large companies. It has been suggested that for the income tax, the small businesses may be subjected to a Minimum Alternate Tax (MAT) based on both gross assets and turnover, whichever yields higher revenue. The tax rate of MAT should be set to equivalence with the lower marginal income tax rate under the assumption of a reasonable rate of return on capital (Shome: 2004).

Presumptive norms establish the link between tax liability and observable entity specific indicators. The type of indicator selected determines the form of presumption chosen (Raja Raman: 1995). There can be a number of methods of presumptive taxation. Particular presumptive methods which are in practice are as follows:

1) **Reconstruction Income**: This method is applied if the taxpayer has failed to file a return or has substantially understated his or her income and transactions giving rise to income cannot be traced. In such cases, the tax administrators are usually authorized to assess income on their best judgment. This could involve use of a method such as net worth, bank deposits or expenditure method.

2) **Percentage of Gross Receipts**: In this method, legislation provides a minimum tax type of presumption whereby the taxable income of a business can be no less than a specified percentage of assets of business.

3) **Asset Based Taxation**: Several countries including Argentina, Colombia, Mexico and Venezuela have adopted minimum taxes on a fixed percentage of assets of business.
4) **Industry-Specific Methods:** Many countries use industry specific methods for framing presumptive taxation. Ghana applies a minimum tax based on an individual’s profession or trade. Countries like France use contractual method (Forfait). Contractual method differs from other presumptions in that its application is based on advance agreement between the taxpayer and the tax authority to base the tax liability on estimated income instead of actual incomes. Similar approach is prevalent in countries like Belgium. Some countries tax particular types of income or income from specific industries on the basis of turnover, with presumptive deductions based on ratios developed for the industry or type of income in question. France allows deduction fixed as a specified percentage of gross receipts e.g., in case of income from the rental of immovable urban property. Standard assessment guides (tachshivim as used in Israel, subsequently replaced by tadrihim) and similar methods are used in several other countries. Tachshiv is based on various ascertainable factors, which are developed for particular industries. For example, a restaurant may be taxed on the basis of location, number of seats and average price of items on the menu. The objective is to determine net profit. The tachshiv does involve an element of agreement between taxpayers and the tax authorities, but the agreement is on the tachshiv in general (being negotiated with industry representatives), not on its application to particular taxpayers.

5) **Based upon Outward Signs of Lifestyle:** A presumptive minimum tax based on outward signs of lifestyle has been in operation in a number of countries. In France while assessing, not only ownership but also effective enjoyment of
assets such as vacation homes & Yachts is taken into account. Under Article 168 of General Tax Code of France, the items that are taken into account for determining tax are rental value of the principal residence, rental value of secondary residences, number of domestic employees, automobiles, motorcycles, pleasure boats, airplanes, horses, hunting rights and golf club membership. For each item, a fixed amount per unit is taken into account or the amount spent or value of the item is multiplied by a specified figure. The total is then compared with taxable income computed under normal methods. If the presumptive calculation exceeds the normal calculation by more than one-third in both the current year and the preceding year, then the taxpayer is taxed on the amount resulting from the presumptive calculation. Countries like Lesotho and Mali also use presumptive methods based on outward signs of life style.

6) Taxation of Agriculture: In many countries (France is one country where agriculture is covered under presumptive taxation) income from agriculture is taxed on a presumptive basis. The usual approach is to base the tax on the area of land and its quality since land is easily observable, non-substitutable, non-concealable and stable indicator of income from agriculture. A system based on land measured in physical units stratified by soil quality and irrigation, using updated product prices and region specific yields, as in French Forfait, is likely to be both simpler and more transport (Rajaraman: 1995).

Presumptive taxation is in vogue in a number of countries. France, Israel, Bolivia, Chile, Costa Rica, Ecuador, Guatemala, Mexico, Paraguay, Uruguay, Ghana, Sierra Lone, Lesotho, Nigeria,
Mali, Cameroon, Niger, Morocco, Gabon are some countries which has applied presumptive schemes for small business and professionals.

Tax Reforms Committee in 1991 looked into the feasibility of presumptive taxation in India and on the recommendations of the Tax Reforms Committee, Budget 1992-93 made provisions for presumptive taxation for Individuals and Hindu Undivided Family engaged in retail trading having an annual turnover of Rs 5,00,000 or more. They were given the option to pay a lump sum of Rs.1400 per Annum without going through the trouble of filing a return. However, the collection on this account was not very encouraging and the scheme was abolished in the year 1997-98.

Earlier presumptive taxation scheme has now been replaced by an estimated income scheme according to which, in the case of retailers having turnover of Rs.8 to 40lakh (1 lakh=Rs.100000), 5 % of the turnover is taken as income. In the Budget for 1994-95, Estimated Income scheme was introduced in case of contractors. As per the provisions of Income Tax Act, 1961 contractors having turnover up to Rs.40 lakh can estimate their income at the rate of 8% of the gross receipts. In this scheme, maintenance and audit of books of account is not required. Similarly as per provisions of Sec. 44AE of Income Tax Act, 1961 truck owners (up to 10 trucks) could estimate their income taking income of Rs.2000 per month per truck incase of heavy transport motor vehicles and Rs.800 per month per vehicle in case of light commercial and medium vehicles. With effect from 1.4.2005, tonnage tax (Chapter XII-G of the Income Tax Act, 1961. A company with a least one qualifying ship may join. Qualifying ship is one with a minimum of 15 tonnes and a valid certificate) has been introduced for the shipping companies.
Notional income in such cases is determined based on the tonnage of the ship.

3.4.4 Annual Information Return

As a measure of widening of tax base, with effect from 1.4.2005 concept of Annual Information Return (AIR) has been introduced. As per the provisions of section 285BA of the Income-Tax Act, 1961, AIR of ‘high value financial transactions’ is required to be furnished by ‘specified persons’ in respect of ‘specified transactions’ registered or recorded by them during a financial year. Information will be used for identifying non-filers and to ask them to file return of income. The ‘specified persons’ required to file Annual Information Return and the ‘specified transactions’ for which AIR is applicable are listed in Rule 114E of the Income-Tax Rules, 1962.

<table>
<thead>
<tr>
<th>S.No</th>
<th>Class of person required to file AIR</th>
<th>Nature and value of Transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Banking company to which Banking Regulation Act, 1949 applies</td>
<td>Cash deposits aggregating to ten lakh rupees or more in a year in any savings account</td>
</tr>
<tr>
<td>2</td>
<td>Banks to which Banking Regulation Act, 1949 applies, Any other company or institution issuing credit card.</td>
<td>Payments made in respect of a credit card aggregating to two lakh rupees or more in the year.</td>
</tr>
<tr>
<td>3</td>
<td>Trustee or authorized manager of Mutual Fund</td>
<td>Receipt from any person of an amount of two lakh rupees or more for acquiring units of that Fund.</td>
</tr>
<tr>
<td>4</td>
<td>Company or institution issuing bonds or debentures.</td>
<td>Receipt from any person of an amount of five lakh rupees or more for acquiring bonds or debentures issued by the company or institution.</td>
</tr>
<tr>
<td>5</td>
<td>Company issuing shares through a public or rights issue.</td>
<td>Receipt from any person of an amount of one lakh rupees or more for acquiring shares issued by the company.</td>
</tr>
<tr>
<td>S.No</td>
<td>Class of person required to file AIR</td>
<td>Nature and value of Transaction</td>
</tr>
<tr>
<td>------</td>
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<td>--------------------------------</td>
</tr>
<tr>
<td>6</td>
<td>Registrar or Sub-Registrar</td>
<td>Purchase or sale by any person of immovable property valued at thirty lakh rupees or more.</td>
</tr>
<tr>
<td>7</td>
<td>Authorized officer of the Reserve Bank of India</td>
<td>Receipt from any person of an amount or amounts aggregating to five lakh rupees or more in a year for bonds issued by the Reserve Bank of India.</td>
</tr>
</tbody>
</table>


### 3.4.5 Permanent Account Number (PAN)

In India, every taxpayer is required to have a PAN which is a unique number given to him or her which he or she is supposed to quote in returns of income. Further every tax deductor is also supposed to quote PAN in his or her return prescribed under the laws relating to Tax Deduction at Source (TDS). With a view to broaden the tax base, PAN has been made compulsory for a number of transactions (S.139 A of the Income Tax Act, 1961). With effect from 1.10.2006, Securities and Exchange Board of India have made PAN mandatory for all the entities/persons trading in cash market. Provision for suo-motu allotment of PAN has also been introduced as a measure for widening of tax base. The amendment takes effect from 1st June, 2006.

### 3.4.6 Tax Deduction at Source (TDS)

Another important device for widening the tax base is Tax Deduction at Source (TDS). TDS is an important measure for bringing those incomes to tax, which goes unreported for tax purposes. Tax Reforms initiated after 1991 introduced a number of provisions for deducting tax at source. The Income Tax Act, 1961 at present provides for deduction of tax at source (Amount up to which tax is required to be deducted at source varies for different kind of
transactions) for a number of incomes. The list of TDS as per the provisions of Income Tax Act, 1961 includes:

a) Payment of salary (Sec. 192).

b) Interest on securities (Sec.193)

c) Payment of dividends except referred to under Section 115-O (Sec.194).

d) Interest other than interest on securities (Sec.194A).

e) Winning from lottery or crossword puzzles (Sec.194B).

f) Winning from horse races (Sec.194BB).

g) Payment to contractors and subcontractors in pursuance of any work of contract including supply of labour contract (Sec.194C).

h) Insurance commission covering all payments for procuring Insurance business (Sec.194D).

i) Payment to non-resident sportsman (including athlete) or sports association or institution (Sec.194E).

j) Payment in respect of deposits under NSS, 1987 (Sec. 194EE).

k) Payment on account of repurchase of Units by Mutual Fund or UTI (sec.194F).

l) Commission to stockists, distributors, buyers and sellers of lottery tickets including remuneration or prize on such tickets (Sec.194G).

m) Commission or brokerage (Sec.194-H).

n) Payment of rent (Sec.194-I).

o) Fees for professional & technical services (Sec.194J).
p) Income in respect of units of Mutual Fund specified under Section 10(23D) or UTI (Sec 194K).

q) Any compensation/consideration or enhanced consideration/compensation paid up to 31.05.2000 on account of compulsory acquisition under any law of any capital asset (Sec.194L).

r) Any compensation/consideration or enhanced consideration/compensation on account of compulsory acquisition under any law of any immovable property (other than agricultural land) (Sec.194 LA).

s) Any interest or any other sum chargeable to tax (other than salary and dividends referred to u/s 115-O) payable to a non-resident or a foreign company (Sec.195).

t) Income in respect of units of UTI or of Mutual Fund specified under section 10 (23D) payable to a unit holder being a non-resident or a foreign company before 1.4.2003 (Sec.196A).

u) Any income from units purchased in foreign currency including long-term capital gain arising in respect of units referred to in Sec.115AB of Income Tax Act, 1961 payable to an offshore fund (Sec.196B).

v) Income (by way of interest or dividends or long-term capital gains) arising from foreign currency bonds or global depository receipts of Indian Company to a non-resident u/s 115AC but excluding dividends referred to u/s 115-O (Sec.196C).

w) Income (other than capital gains) in respect of securities referred to u/s 115AD, payable to a foreign institutional investor but excluding dividends referred to u/s 115-O (Sec.196D).
Although provisions relating to TDS have been introduced to cover a number of transactions, it is necessary that they are to be followed vigorously.

3.4.7 Rationalizing the Incentives for savings

Tax incentives become a source of litigation. Tax incentives also have the potential of increasing the discretionary power of tax administrators. The results of exemption Raj comprising of complex allowances and exemptions are two-fold. While on one hand filing the income tax return becomes complex, on the other hand tax administrators themselves face acute difficulties in carrying out assessments due to both time and resource constraints.

One important objective of tax reform has been rationalization of incentives for savings built in tax system of India. This would not only result in higher tax yield but also in widening of tax base.

Various committees and expert groups have extensively studied issues of tax exemptions and deductions in respect of saving instruments. The issues have been discussed in detail in the reports of the Tax Reforms Committee headed by Raja J.Chelliah, Advisory Group on Tax Policy and Tax Administration for the Tenth Plan (May, 2001), headed by Dr.Parthasarati Shome and Expert Committee to Review the System of Administered Interest Rates and Other Related Issues, September, 2001 in past. Task Force on Direct Taxes (2002) and FRBM (2004) have also considered these issues in their report.

Task Force has discussed that there are two alternative ways of devising an income tax which neutralizes bias of tax on income against savings and effectively uses consumption as a tax base; (a) Exempt Exempt Taxed (EET) method and (b) Taxed Exempt Exempt (TEE) method. Under EET method, the contributions to a saving
plan/scheme are deductible from the gross income, the income of the plan/scheme is exempt from tax and the withdrawal along with benefits in the form of interest and dividend etc is subjected to tax. Under the method of TEE, contribution to a saving plan/scheme is out of post tax income, the income is exempt from tax and the withdrawal along with the benefits in the form of interest and dividend etc is exempt from tax. In most countries income tax structure has been designed in order to neutralize the bias against savings by following one of the two methods. Most of the OECD countries follow the EET method. Indian tax system at present is full of exemptions and deductions. Basically the system of incentives in Indian tax system is covered by Exempt, Exempt and Exempt method. Under the existing income tax provisions in India, financial savings of households are generally exempted from taxation at all the three stages of savings viz., contribution, accumulation and withdrawals. As has been observed by Task Force on Direct Taxes (2002) “This liberalized treatment has impacted economic efficiency, equity and revenue efforts”. The tax treatment of various financial instruments under the tax statute is summarized in Table 3.3

Table: 3.3
Tax Treatment of Financial Savings

<table>
<thead>
<tr>
<th>S.No</th>
<th>Nature of Instrument</th>
<th>Treatment of Contribution</th>
<th>Treatment of Accumulation</th>
<th>Treatment of Withdrawal</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Gratuity</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>2</td>
<td>Pension/Deferred Annuity Plans</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>3</td>
<td>Life Insurance Policy</td>
<td>Exempt</td>
<td>Taxable</td>
<td>Exempt</td>
<td>ETE</td>
</tr>
<tr>
<td>4</td>
<td>Provident Fund</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>5</td>
<td>Superannuation Fund</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>6</td>
<td>Notified Securities, Bonds, Annuity Certificates, Saving Certificates and other certificates</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>7</td>
<td>9% Relief Bonds</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>8</td>
<td>Public Sector Bonds/Debentures</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>S.No</td>
<td>Nature of Instrument</td>
<td>Treatment of Contribution</td>
<td>Treatment of Accumulation</td>
<td>Treatment of Withdrawal</td>
<td>Method</td>
</tr>
<tr>
<td>------</td>
<td>--------------------------------------------------------------------------------------</td>
<td>---------------------------</td>
<td>--------------------------</td>
<td>------------------------</td>
<td>--------</td>
</tr>
<tr>
<td>9</td>
<td>Deposit scheme for retiring employees</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>10</td>
<td>Certain pension Funds of LIC (Sec.80CCC)</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Taxable</td>
<td>EET</td>
</tr>
<tr>
<td>11</td>
<td>Medical Insurance (Sec.80D)</td>
<td>Exempt</td>
<td>Taxable</td>
<td>Exempt</td>
<td>ETE</td>
</tr>
<tr>
<td>12</td>
<td>Any security of Central or State Govt.</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>13</td>
<td>National Saving Certificates (VI, VII, VIII issue)</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>14</td>
<td>Debentures of any institution, Authority, Public Sector Company or Co-operative Society notified by the Govt.</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>15</td>
<td>National Deposit Scheme</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>16</td>
<td>Any other deposit scheme framed by the Central Govt. and notified</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>17</td>
<td>Post Office (Monthly Income Account)</td>
<td>Taxable</td>
<td>Exempt^</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>18</td>
<td>Units of Mutual Fund</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>19</td>
<td>Units of UTI</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>20</td>
<td>Deposits in Bank or Banking Co-operative societies</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>21</td>
<td>Deposits in any other Bank</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>22</td>
<td>Deposits with Industrial Financial Corporation</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>23</td>
<td>Deposits With Local Development Authorities</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>24</td>
<td>Deposits by a member of Co-operative societies</td>
<td>Taxable</td>
<td>Exempt</td>
<td>Exempt</td>
<td>TEE</td>
</tr>
<tr>
<td>25</td>
<td>Deposits with Housing Finance Companies</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>26</td>
<td>Deposit scheme of NHB</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>27</td>
<td>ULIP</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>28</td>
<td>10 yrs or 15 yrs Account Post Office Saving Bank (Cumulative time deposit) Rules, 1959</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
<td>EEE</td>
</tr>
<tr>
<td>29</td>
<td>Purchase of House Property</td>
<td>Exempt</td>
<td>-</td>
<td>Exempt</td>
<td>E-E</td>
</tr>
</tbody>
</table>

Keeping in account the inefficient nature of EEE method, the Task Force on Fiscal Responsibility and Management Act (FRBM) recommended adoption of EET method. On the lines of recommendations of Task Force and recommendations of earlier committees, government has taken steps to rationalize the incentives provided in the Income Tax Act, 1961. Following measures have been taken in recent years in this direction:

i) Standard deduction has been withdrawn. All prevailing sectoral caps/rebate under Sections 88,88B and 88C have been removed.

ii) Investment in financial instruments hitherto eligible for rebate under Section 88 has been made eligible for deduction from income under Section 80C with a overall cap of Rs 1,00,000/-

iii) Deduction provided in respect of interest on certain securities under Section 80L of the Income Tax Act, 1961 has been withdrawn.

iv) In the Budget 2006-07, exemption available under Section 10(23G) to certain kind of income from investment in infrastructure has been removed.

v) Income from investment of contributions under Section 10(23A) has been made taxable.

vi) Exemption available under Section 54ED* has been withdrawn.

* The existing provisions of section 54ED provided that the capital gains arising from transfer of long term capital asset, being listed securities or units of a mutual fund or of the Unit Trust of India shall be exempt from tax, to the extent such gains are invested in equity shares forming part of an eligible issue of capital, made by a public company and offered for subscription to the public.
Tax exemption under Section 80P granted to co-operative banks in respect of their profits and gains from the business of banking or providing credit facilities to its members has been eliminated.

Scope of the tax exemption under Section 54EC granted for roll over of long term capital gains in specified bonds has been restricted.

In the Budget 2005-06, it was announced that a committee has been set up to examine the various issues relating to adoption of EET regime. On the lines of the recommendations of various committees and report of two Task Forces, in the month of May 2006, the Central Board of Direct Taxes has come out with a discussion paper asking comments from the taxpayers regarding removal or continuance of various exemptions and deductions provided in Income Tax Act, 1961. Altogether 162 deductions and exemptions have been outlined and comments have been invited from taxpayers for removal or continuance of these exemptions and deductions.

3.4.8 Tackling evasion and avoidance

One of the major problems associated with personal income tax has always been the high rate of evasion and avoidance. There are a number of deductions and exemptions, which reduce the taxable income; there is also a tendency of reporting less income than actually earned. Evasion and avoidance are two aspects, which are required to be effectively tackled from the standpoints of both yield and equity. Since widespread tax evasion blunts the allocative signals of the tax system and impedes resource mobilization (Acharya: 1988). Several voluntary disclosure schemes have been introduced from time to time, latest being Voluntary Disclosure Scheme (VDIS) in 1997-98. However, such schemes act
as disincentive to the honest taxpayers. Direct Tax Enquiry Committee (1971) was very critical of voluntary disclosure scheme.

The Committee noted that resorting to such a measure during normal times and that too frequently would only shake confidence of the honest taxpayers in the capacity of the government to deal with the lawbreakers. In fact, enforcement machinery should be made more stringent to provide huge disincentive to the dishonest taxpayers, once rate regime is liberalized. Arousing social conscience, denial of privileges, vigorous prosecution, intelligence and investigation, taxation of agricultural income are some measures suggested to curb evasion (Ray: 1981).

Government has taken initiatives recently towards tightening of enforcement machinery which has yielded results. To penalize cases of falsification of books of account or documents, provisions have been made in Income Tax Act, 1961 (Section 277A) that, if any person willfully and with intent to enable any other person to evade any tax or interest or penalty, makes or causes to be made any entry or statement which is false and which the first person either knows to be false or does not believe to be true, in any books of account or other document relevant to or useful in any proceedings against the first person or the second person, the person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to three years with fine.

Several other measures have also been taken in recent years to control tax avoidance and evasion. A new Section 115BBC has been inserted seeking to tax any income comprising anonymous donations received by any university or any hospital or other institutions referred to under Sub-Clausels of section 10(23C) or any trust or institution referred to under Section 11. Commissioner of
Income Tax has been empowered under the provisions of Section 12AA of Income Tax Act, 1961 to cancel the registration of a trust if it is found that the activities of the trust are not genuine or they are not being carried in accordance with the objects of the trust. In Finance Act, 2004 it has been provided that deduction shall not be allowed in respect of interest, commission or brokerage, fees for professional, technical services, payment to contractor/sub-contractor on which tax has not been deducted at source, or if deducted then not deposited within the prescribed time (Section 40a of Income Tax Act). Further, business loss cannot be set-off against salary income (Section 71 of the Income Tax Act, 1961).

With effect from assessment year 2006-07, taxpayers are required to attach a cash flow statement along with the return of income. Cash flow statement shall be a summary of income, receipts such as gifts, loans, investments and expenditure of the taxpayer during the year. The cash flow statement is essentially meant to check whether the taxpayer has made investments and met all expenses from his earning and receipts during the year. The cash flow statement shall be matched with Annual Information Return filed by third parties and then find out whether taxpayer has undisclosed income.

3.4.9 Recent Reforms in Capital Gains Taxation

Capital gain is income derived from the sale of an investment. Capital gains are the increase in the market (or implicit) value of an asset, or set of assets, between two dates. Taxes on capital gains form part of income tax in India. Capital gains tax was first introduced in India in the year 1947-48. It was abolished and re-introduced in the year 1957-58 on the recommendations of Kaldor Committee.
Tax Reforms Committee, 1991 looked into various aspects of taxation of capital gains. As per recommendations of Tax Reforms Committee, measures like indexation for inflation were introduced. Taxing nominal gains raises the effective tax rate on real capital gains and can lead to imposition of a tax in cases of real economic losses. A large percentage of reported capital gains reflect the effects of inflation with the capital gains of lower and middle-income taxpayers commonly representing nominal gains but real economic losses. Thus, indexation of the cost or basis of an asset was rightly proposed to correct for inflation. Task Force on Direct Taxes (2002) considered various aspects of capital gains taxation. It was recommended by the Task Force that concessional treatment of long-term capital gains through a reduced scheduler rate of tax must be abolished. In effect, it means that the long-term capital gains should be aggregated with other incomes and should be subjected to tax at normal rates. This recommendation was made keeping in view of the overall recommendation of liberalized personal income tax rate schedule which reduces the adverse impact in the form of increased tax burden arising from bracket creep. Task Force also recommended that exemption for roll over of long-term capital gains should also be abolished except in case of investment in a house or investment in bonds of National Highway Authority of India until completion of Golden Quadrilateral project and North-South and East-West corridors.

The Task Force also recommended elimination of long-term capital gains on equity and reduction in tax rate to 10% on short-term capital gains arising out of transfer of equity. The recommendations of the Task Force are in alignment with the fact the capital is highly mobile now a days across international markets during the last two decades. This has forced the policy makers to re-orient their tax polices with respect to capital gains tax. In view
of recommendations of Task Force, Budget 2004-05 abolished long term capital gains on equity and reduced the levy of short term capital gains to 10% from normal rates. The Budget also introduced a new tax called Security Transaction Tax (STT).

Several countries have considered STT either as a substitute for capital gains tax or as an independent tax. The general trend has been to impose either capital gains tax or STT. There are also instances of both types of taxes prevailing simultaneously such as in France and Denmark. STT is imposed in one form or other in several countries like Argentina, Australia, Belgium, Brazil, China, France, Greece, Italy, Indonesia, Malaysia, Pakistan, Singapore, UK and Zimbabwe. However, capital gains and STT are not comparable. While capital gains tax is based on certain canons of taxation, STT is essentially a turnover tax. Economics trace academic debate as regards STT to Keynes. The intuitive rationale behind this proposal was to discourage speculative transactions. The idea further developed by (Tobin: 1984) and (Stiglitz:1989). Although even in countries with highly developed security markets STTs do not raise significant amounts of revenue, they have many advantageous characteristics. As experts like (King: 2004) viewed that STTs are usually simple and inexpensive to collect and are becoming even more so as the technology employed in financial markets improves. Because STTs are simple, compliance costs for taxpayer and their agents are also likely to be low. In addition, STT has a strong potential to raise revenue, can be used as an instrument to reduce stock market volatility, can improve market efficiency and allocate social wealth.

The stated objective of introduction of this tax in India is to raise additional resources and also to plug the leakage of tax revenue. After the Budget 2006-07 the rates of STT are as under:
i) At the rate of 0.125% on the value of transactions of delivery based purchase of an equity share in a company or a unit of an equity oriented fund, entered in a recognized stock exchange to be paid by the buyer.

ii) At the rate of 0.125% on the value of transactions of delivery based sale of an equity share in a company or a unit of an equity oriented fund entered in a recognized stock exchange, to be paid by the seller.

iii) At the rate of 0.025% on the value of transactions of non-delivery based sale of an equity share in a company or a unit of equity oriented fund entered in a recognized stock exchange to be paid by the seller.

iv) At the rate of 0.017%, on the value of transactions of derivatives being option or future entered in a recognized stock exchange.

v) At the rate of 0.25% on the value of transactions of sale of units of an equity-oriented fund to the mutual fund.

The bond market is fully exempt form the Security Transaction Tax.

At present there are number of Provisions which grant exemption or deduction from capital gains taxation if the sale proceeds are invested in certain specified assets. As has been recommended by the Task force (2002), except for investment in residential house or investment in bonds meant for construction of highway projects, all other roll over exemptions need to be phased out or abolished and all capital gains be brought to tax fully at normal rates.
3.4.10 Reforms in Direct Tax Administration

Success of any attempt to reform the tax system depends upon the efficiency of the system of tax administration and therefore any attempt at tax reforms should also aim at improving the tax administration. Tax revenue yield is influenced by both tax policy and tax administration. Tax administration is tax policy, as is widely recognized; role of the tax administration must be clearly identified. The Task Force on Direct Taxes (2002) has stated that the fundamental role of tax administration is a) To render quality taxpayer services to encourage voluntary compliance and b) To detect and penalize non-compliance. In the overall ambit of these fundamental roles, the Task Force considered following separable component activities as functions of the tax administration:

I. Taxpayers education and services

II. Collection, collation, dissemination, storage and retrieval of information

III. Verification (appraisal/assessment of information)

IV. Collection of taxes

V. Taxpayers grievances redressal system

VI. Accountability

During the last two decades with change in the role of state, there has been a shift in traditional role of the tax administration as well. Earlier the tax administration perceived its role mere as an enforcement agency. However, with increase in number of taxpayers mere enforcement mechanism cannot help in evolving effective tax administration. There has to be a greater reliance now on self-assessment and trust on taxpayers and tax administration is required to facilitate compliance through the provision of quality taxpayer service.
3.4.10.1 Taxpayers' Education and Services

At present the Income Tax Administration in India is providing a range of services to facilitate compliance viz; publishing pamphlets, brochures, booklets, providing web-based information and tax return forms to taxpayers. As part of reaching out to taxpayers, tax administration has also come out with the schemes of Saral (simple) and Sam Park (contact). During the year 2006-07, as a part of taxpayer service, facility to file returns of income with post offices was also provided. With a view to widening the tax base and providing facilities to taxpayers, new scheme to facilitate submission of returns through Tax Return Preparers has been introduced with effect from 01.06.2006. Thus, the tax administration in recent days has taken major steps towards providing education and services to the tax payers.

3.4.10.2 Use of Information Technology

The use of information technology and modernization in tax administration is result of recommendations of working group constituted by the government in 1993, to suggest a comprehensive computerized plan. The working group suggested layered approach to computerization and implementation of the plan in phases. As a result, National Computer Center (NCC) was set up at Delhi. At present besides NCC, 36 Regional Computer Centers are also operational. As a part of plan of use of information technology in tax administration, National Securities Depository Limited (NSDL) on behalf of income tax department has established Tax Information Network (TIN) which serves as a repository of nationwide tax related information. It has made online application and allotment of PAN (Facilities set up in over 500 cities. At present one can apply for PAN online, track status of his application and also apply for Tatkal (immediate) allotment of PAN) and TAN (Tax Accounting Number)
possible. The TIN system has also led to e-TDS, e-TCS (electronic Tax Deduction at Source and electronic Tax Collection at Source) and also e-tax filing. Further, Income tax department has launched the Electronic Furnishing of Return of Income Scheme in 2004. Under this scheme, eligible assessees’ can file their returns of income electronically through persons authorized to act as e-return intermediaries.

TIN has three key sub-systems. The TIN system revolves around these three key elements, which explain the functioning of the entire system. The three key elements in brief are as under:

i) **Electronic Return Acceptance and Consolidation System (ERACS)** which consists of an infrastructure for interface with the taxpayers and a web-based utility for upload of electronic returns of tax deduction at source, tax collection at source and annual information return to the central system of TIN.

ii) **Online Tax Accounting System (OLTAS)** for daily upload to the central system, the details of tax deposited in various tax collecting branches across the country.

iii) **Central PAN Ledger Generation System (CPLGS)** which is the central system that consolidates for each PAN, details of tax deducted/collected on its behalf which is obtained by matching the TDS/TCS returns submitted by the deductors/collectors with the tax deposit (challan) information form the banks, details of the tax deposited directly by the taxpayer with the bank and details of major expenditure by the PAN holder from the AIR filed by specified entities (Diagram 3.2).
Issue refunds continued to be a major source of public grievance. This is partly due to its inability to promptly process the returns, whose numbers have increased substantially in the last three years and partly due to the cumbersome process for issuing of refunds. The tax department first provided that salaried employees for specified amount of revenue (Rs.25,000) can get their refunds credited in their bank account. The scheme has further been extended to all categories of taxpayers for any amount in cities of Ahmedabad, Bangalore, Bhubaneswar, Chennai, Hyderabad, Kanpur, Kolkata, Mumbai, Nagpur, New Delhi, Patna and Thiruvananthapuram. This has been made possible due to Income Tax Department’s Electronic Clearance Scheme. Once income tax
return is processed, the refund will be credited directly to bank account.

The Income Tax Department is now moving towards Business Process Re-engineering nationwide to connect 745 income tax offices in 510 cities to create national databases. A single database is being created which would consolidate 36 regional databases. This would ensure jurisdiction free filing of returns. A National Data Centre with Business continuity and Disaster Recovery Sites have been planned along with All India Network linking all Income Tax Offices.

The Task Force on Direct Taxes (2002) recommended Risk Based Assessment based upon identification of cases through a random non-discretionary centralized method deploying the PAN base in place of existing discretion based system of selection of returns for audit (scrutiny). The Income Tax Department has implemented this recommendation in part. The cases for scrutiny are selected aided by computers.

3.4.10.3 Autonomy in Tax Administration

In the overall context of tax reforms, one very important issue that has been addressed by a large number of countries is the organizational structure of tax department. Task Force on Direct Taxes (2002) noted that one of the important general organizational issues for tax administration in India relates to the placement of the tax administration in relation to the Ministry of Finance. The Task Force noted that while traditionally the tax administrations have been placed within the Ministry of Finance, tax administrations are increasingly attracted to the Canadian model where the tax administration is placed outside the Ministry of Finance with full autonomy. To make the Central Board of Direct Taxes (which is responsible for administering the direct tax laws in India) more
effective, requisite autonomy should be given. Although Ministry of Finance may have overall control, the Board should have autonomy in financial and administrative matters and the chairman of the Board should report directly to the Finance Minister on all policy matters - administrative as well as financial.

However, once autonomy is granted it is necessary that the tax administration is made accountable. On the question of accountability of the tax administration, the Task Force on Direct Taxes has recommended the following:

i) The control of the central government over the administration to be exercised through a Memorandum of Understanding (MoU) between the Central Board of Direct Taxes and the central government.

ii) The MoU should, inter-alia, specify the financial commitment of the central government for tax administration.

iii) The MoU to provide for full financial autonomy and control over deployment of human resources to the CBDT. The central government should only specify the general guidelines for financial expenditure and deployment of human resources.

iv) The MoU should be for a period of five years specifying observable performance indicators for CBDT and the financial resources that would be made available to CBDT on a year-to-year basis.

v) The CBDT should have exclusive power for designing the enforcement strategy, subject to the condition that is non-discriminatory and transparent.
3.4.10.4 Tax Payers’ Redressal Mechanism

Recognizing the need for a measure of resolving tax payer’s grievances, institution of Ombudsman has been created by the government which will help redress tax payer grievances. To begin with, the institution of Income Tax Ombudsman operated in four metropolitan cities-Mumbai, Kolkata, Delhi and Chennai. It has been specified that grounds on the basis of which complaint can be made include delay in issue of refunds beyond time limits, delay in disposal of rectification of application, delay in giving effect to the appellate orders and delay in allotment of Permanent Account Number.

Conclusion

No doubt recently initiatives have been taken in right direction to bring changes in tax administration. However, much more is desired. Reform in tax administration is essential in the context of overall tax reforms. A discussion paper of Department of Economic Affairs, Ministry of Finance (1994) aptly sums up the imperative for reforms in tax administration by stating “we must recognize that reform of tax policies will be in fructuous without simultaneous and systematic reform and modernization of the entire system of tax administration”.
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