CHAPTER-3

ANALYSIS OF THE RECOMMENDATIONS OF VARIOUS TAX REFORMS COMMITTEES
CHAPTER-3
ANALYSIS OF THE
RECOMMENDATIONS OF VARIOUS TAX-REFORMS COMMITTEES

3.1 The Terms of reference of the committee of expert

The Government of India constituted a Committee of expert to examine the structure of direct and indirect taxes through its Resolution dated August 29, 1991. The terms of reference of the Committee were to examine and make recommendations on:

1. Ways of improving the elasticity of tax revenues, both direct and indirect, and increasing the share of direct taxes as a proportion of total tax revenues and of GDP.

2. Making the tax system fairer and broad-based, with necessary rate adjustments, particularly with regard to commodity taxation and personal taxation;

3. Rationalisation of the system of direct taxes with view to removing anomalies, improving equity and sustaining economic incentives;

4. Identifying new areas for taxation;

5. Ways of improving compliance of direct taxes and strengthening enforcement;

6. Simplification and rationalisation of customs tariffs with a view to reducing the multiplicity and dispersion of rates and to eliminate exemptions which have become unnecessary;

7. Reducing the level of tariff rates, keeping in view the need for mobilising resources to facilitate fiscal adjustment and the objective of promoting international competitiveness;

8. Simplification and rationalisation of the structure of excise duties for better tax compliance and administration;

9. The scope of extending the Modvat Scheme;

10. Any other matter related to the above points or incidental thereto.

---

As regards income tax evasion in the country, the Tax Reforms Committee (TRC) opined, "not more than 30-35 percent of legally taxable income is being disclosed, on the average." (p.47 of Interim Report)² In this context it observed, "It would be fair to say that the income tax department which is in charge of all the Central Government direct taxes is in shambles. It cannot complain of lack of manpower, but the majority of personnel is constituted by inspectors and clerks (Interim Report). It is necessary to change the attitude of the people towards Government and its laws. In this connection, the Committee observed, "......... there is a widespread feeling among the electorate that there is considerable waste in government expenditure, that there is exess staff and that there is considerable waste in government expenditure, that there is excess staff and that the tail to teeth ratio is unduly high. And with it all, it is generally felt that the public which pays the taxes gets poor service and members of the public are treated often not as masters who pay but as suppliants". (p. 44 of Interim Report).³ Moreover, salaried persons envy tax evasion opportunities available to self-employed professionals and retail traders, and are tempted to conceal their incomes from non-salary sources.

In its Interim Report, submitted in December 1991, the Committee examination the problems and possibilities of taxing the small business sector. The Committee suggested two new presumptive taxes on small businesses. (1) A fixed tax on businesses whose turnover was less than Rs. 5 lakh and (2) An estimated income scheme for small businesses with turnover above Rs. 5 lakh but less than Rs. 25 lakh. The schemes envisaged profit to be a certain percentage of turnover depending on the type of activity from which it was earned. The Government introduced the first scheme through the Finance Act, 1992 but deferred its decision to introduce the second scheme.

Following the recommendations of the Committee, the scheme of capital gains tax was drastically recast in the following manner by the Finance Act 1992:⁴ (a) The cut-off date for valuation of assets acquired in earlier years was shifted from April 1, 1974 to April 1, 1981, (b) a system of indexation was introduced for the first time under which long-term capital gains are now computed by allowing the cost of acquisition and the cost of improvement of the asset to be adjusted for general

---
inflation, (c) a new section 112 was inserted in the Income Tax Act to provide that long-term capital gains would be subject to a flat rate of income tax. The rate of tax is 20 percent. Presently, concessionary treatment to long-term capital gains is given through inflation indexing, relatively low flat rate of tax, and a set of exemptions.

Similarly, consequent upon the recommendations of the Committee, the various provision of the wealth tax law were drastically restructured by the Finance Act, 1992. The Committee had recommended that in order to encourage the taxpayer to invest in productive assets such as shares, securities, bonds, bank deposits, mutual funds etc. these financial assets should be exempted from wealth tax. Wealth tax should be levied on individuals. Hindu undivided families, and all companies only in respect of non-productive assets such as residential houses, jewellery, bullion, motor cars, yachts, and aircrafts which are not used for commercial purposes. Hence, the definition of the term 'assets' was significantly narrowed from wealth to unproductive assets. Following pressure that a residential house is a universal necessity and should not be subjected to tax, the Finance Act, 1993, exempted the value of one house from the levy of wealth tax.

The Committee identified many items which were outside the excise net but which could be considered for levying excise duty. Some of the identified items included: butter and cheese, skimmed milk powder, spices, fertilizers, feature films, wood pulp, umbrellas, bicycles, toys and sports goods, buttons, and vacuum flasks.

The Committee also recommended imposition of tax on certain selected services, viz. services of stock brokers, advertising, non-life insurance, and telephones. In line with this recommendation, a service tax was levied from July 1, 1994 on services of telephones, non-life insurance, and stock brokers.

Reform of the customs tariff was high on the agenda of the Committee. Its terms of reference enjoined it to examine and make recommendations, inter alia, on "simplification and rationalisation of customs tariffs with a view to reducing the multiplicity and dispersion of rates and to eliminate exemptions which have become unnecessary;(and) reducing the level of tariff rates, keeping in view the need for mobilizing resources to facilitate fiscal adjustment and the objective of promoting international competitiveness."

---

The Committee suggested the following as elements of the programme of import
tariff reform:
(1). reduction of the general level of tariff,
(2). reduction of the spread or dispersion of tariff rates,
(3). simplification of the tariff system,
(4). rationalization of tariff rates, along with the abolition of numerous exceptions
and concessions, and
(5). abolition of the practice of making changes ineffective rates through
notifications.

3.2 Summary of Recommendations: Interim Report (Chairman Raja J.
Châlliah)  
3.2.1 Guiding Principles of Tax Reform
The guiding principles underlying the tax reforms proposed by the Committee
are as follows:-
(1). The tax system and its burden must be acceptable to the citizens i.e., the
potential tax-payers.
(2). Given our past experience and the present totality of circumstances affecting
the tax system and its operation, it is better to have moderate rates with broader
bases.
(3). While the tax structure should be progressive, it should not be such as to include
the generation of unaccounted income and wealth.
(4). The tax system must be rational from the economic point of view. For this
purpose, the structure once established must remain stable unless and until the
economic conditions undergo a radical transformation. Ad hoc changes from
year to year will undermine rationality and reintroduce complications.
(5). The tax system and law should be as simple as possible it should have the
strictly limited objectives of raising revenues for the government in a fair and
efficient manner, achieving redistribution and discouraging some industries and
these of consumption of some products as well as granting a reasonable degree
of protection of domestic industries. A simple system will have only a limited
number of rates and exemptions or deductions and give the least possible
discretionary power to the tax officials for interpreting the law.
(6). Methods of tax administration should be modernized and tax enforcement should be visibly improved.

(7). The tax reforms suggested should be fully, or at least nearly, revenue neutral in their totality; however, the system should become more income elastic.

3.2.2 Income Tax

Ideally, a single rate income tax would be simplest both for compliance and administrative reasons. However, for the present, the following tax rate schedule for different taxable entities is recommended:

1. In the case of individuals, the exemption limit should be fixed at Rs. 28,000. The marginal rates of tax (inclusive of surcharge, if any) should be:
   - 20 percent for total income in the range of Rs. 28,000 to Rs. 50,000
   - 7.5 percent for total income in the range of Rs. 50,000 to Rs. 2,00,000 and
   - 40 percent for total income exceeding Rs. 2,00,000.

2. In the case of Hindu undivided family, the existing distinction between a "specified HUF" and a "non-specified HUF" should continue. The rate schedule for non-specified HUFs should be same as recommended in the case of individuals. For specified HUFs, the exemption limit should continue at Rs. 12,000. The margin all rates of tax (including surcharge, if any) should be 27.5 percent of total income in the range of Rs. 12,000 to Rs. 1,00,000 and 40 percent for total income exceeding Rs. 1,00,000.

3. In the case of local authorities, tax should be levied at a flat rate of 30 percent.

4. In the case of domestic companies, the tax rate (inclusive of surcharge) should, in the course of the next three years (i.e. by assessment year 1995-96), be reduced to the same level as the maximum marginal rate of tax (inclusive of surcharge) in the case of individuals i.e. 40 percent. Further, the existing distinction between companies in which the public are substantially interested and companies in which the public are not substantially interested for the purposes of tax rate should also be abolished within the next three years.

When the new scheme of taxation of partnership firms, AOP and BOI recommended in this report comes into operation, there will be no need for prescribing a separate tax schedule tax schedule for registered firms.
Complete integration of the incomes of both the spouses or, for that matter, all adult members in the family is not feasible or necessary. However, the existing safeguards in the income tax law for aggregation of incomes in the case of splitting of assets should continue, with the modifications that all incomes of a minor, other than wage income, should be aggregated with the total income of:

(1). The parent having the higher income, where total income one parent or of both the parents happens to fall below the exemption limit for individuals.

(2). Any one of the parents at the option of the parents where the income of both the parents exceeds the exemption limit; and

(3). If over time the income of the parent, with whom the income of the minor was aggregated earlier, goes below the exemption limit, the parent having the higher income.

(4). The income of the minor arising from assets transferred to him or her by any one including his grandparents should be aggregated with the income of the parent as recommended above.

The following tax concessions now available under the Income-tax Act should be abolished:

(1). Exemption under Section 10(15) (iiic) in respect of interest on notified Relief Bonds:

(2). Exemption under Section 10(15)(iv)(h) in respect of interest received from any public sector company in respect of notified bonds or debentures;

(3). Exemption under Section 10(15)(iv)(i) in respect of interest received from Government notified scheme out of moneys due on account of retirement;

(4). Deduction under Section 80-L in respect of income from specified sources.

The tax rebate allowed under section 88 for investment in provident fund, NSCs, etc. should continue to be allowed at the entry point rate of tax but only for investment upto a reduced maximum level of Rs. 10,000. Further, the tax concession should be restricted to contributions to provident fund, life insurance policies and repayment of loans taken for purchase or construction of a residential house property.
The tax concession under Section 80-CCA for any investment in the Jeevan Dhara Akshay annuity plans of the life Insurance Corporation of India should be withdrawn. The concession under Section 80-CCB for investment in equity linked saving scheme should be abolished.

The existing ceiling of Rs. 40,000 deposits in the National Savings Scheme under Section 80-CCA should be increased to Rs. 50,000.

The provisions of Sections 35-AC, 35-CCA, 35-CCB and 80-GGA should be amalgamated with Section 80-G. The 100 percent deduction at present allowable under Sections 35-AC, 35-CCA, 35-CCB and 80-GGA should be restricted to 50 percent as in the case of deduction for other donations under Section 80-G. Further, deduction should be allowed only in respect of donations to an approved association/institution and not for expenditure incurred on an in-hours programme.

The tax incentives under Section 80-HHA, 80-I, 80-IA, 80-JJ, 80-QQ and 80-QQA should be abolished with immediate effect, with the result, the taxpayers would not henceforth be eligible for the tax benefits they have been enjoying under the above-mentioned provisions.

The provisions such as Section 80-HHC, 80-HHE, etc., need to be kept under review.

The rules for perquisite valuation of concessional rent accommodation nor rent-free accommodation should be modified so as to remove the present distinction in perquisite valuation between employees of the Government, companies in the private sector and public sector and other autonomous bodies. The perquisite value of both the rent-free accommodation and concessional rent accommodation should be taken to be equal to twenty percent of the salary or the expenditure incurred by the employer in providing housing, whichever is lower. This rule should be made applicable to all employees are in the private sector or in the public sector or in the Government. However, where the expenditure incurred by the employer in providing housing is fully recovered from the employee, the perquisite value should be taken to be nil. Further, the perquisite value should be taken to be nil all cases where the annual income under the head ‘Salary’ (excluding non-monetary benefits or amenities) does not exceed Rs. 36,000.

The provision of clause (13A) of Section 10 of the I.T. Act providing for exemption of house-rent-allowance as per rule 2A should be abolished.
All taxpayers, whether enjoying a rent-free accommodation or concessional rent accommodation or in receipt of house rent allowance or receiving no such benefit on account of being self-employed should be entitled to relief under Section 80GG of the income-tax Act for rent paid. For the purposes of computing relief under Section 80GG, 'rent paid' should mean the rent actually paid as increased by the amount of HRA that would otherwise have been admissible to the taxpayer. The existing provisions of Section 80GG of I.T. Act should be modified to provide for deduction in respect of rent paid in excess of ten percent of salary up to a maximum of twenty percent. The limit of Rs. 1,000 under Section 80GG of the I.T. Act should be removed. Further, since the income from a let-out property is taxable and the income from a self-occupied property is deemed to be nil, the benefit under this provision should not be available in any case where the taxpayer or his spouse or minor child or the Hindu undivided family of which he is the Karta has a self-occupied property anywhere in India.

Where the expenditure incurred by the employer in providing housing to its employee is in excess of twenty percent of the salary of the employee, such excess which remains uncaptured in the tax in the hands of the employer at the flat rate of 30 percent. The tax so paid by the employer, however, should not be allowed as a deduction in the computation of profits of the employer. The expenditure incurred by the employer in providing housing to its employees should be the rent which a similar accommodation would realize in the same locality or actual rent paid if accommodation is hired by the employer or the municipal valuation in respect of the accommodation, whichever is higher.

At least 80 percent of the leave travel allowance, home travel allowance, travel allowance on retirement, passage money and such other payments should be subjected to tax.

The allowances paid to legislators should be fully subjected to tax.

The exception respect of allowances covered under sub-clause (ii) of clause (14) of Section 10 of the Income-tax Act should not be exceed 10 percent of salary.

All loans given to employees should be deemed to have given at the rate of 12 percent and any concession implicit in the interest actually charged should be treated as a fringe benefit and taxed accordingly. However, where other income generating
asset, the perquisite value of the concession interest loan should also be allowed as a
deduction in the computation of income from such house property or any other
income generating asset, the perquisite value of the concession interest loan should
also be allowed as a deduction in the computation of income from such house
property or any other income generating asset.

The value of all other perquisites as contained in Rule 3 of the Income-Tax
Rules should be revised upward to take account of inflation since the values were last
fixed or revised.

For purposes of computation of capital gains arising on the transfer of a capital
asset:

(1). A long-term capital asset be defined to mean a capital asset transferred after one
year from the end of the financial year in which the asset is acquired. To
calculate long-term capital gains, all long-term capital assets should be deemed
to have been acquired on the last day of the financial year in question and
transferred on the first day of the financial year in which the transfer takes place.

(2). The cost of all assets acquired prior to a cut-off date be converted into the value
of the asset on the cut-off in to the value of the asset on the cut-off date. For the
present, the existing cut-off date of 01-04-1974 should continue.

(3). The value of the asset should be indexed for inflation for the subsequent period
of holding in a manner described below.

(4). The cost of acquisition of an asset or the value of the asset, as the case may be,
should be increased by a cost-inflation index (CII), which should be equal to 75
percent of the consumer price index for urban non-manual employees (CPI), for
the entire period of holding or for the period reckoned from the specified cut-off
date, respectively. Similarly, the cost of any improvement undertaken to the
asset should also be inflation indexed using the CII.

(5). In the case of non-corporate taxpayers, long-term capital gains duty indexed will
be subject to tax at the marginal rate applicable rate applicable to the assessee in
the concerned year subject to a maximum of 27.5 percent. If income other than
capital gains is below the general exemption limit the tax on long term capital
gains will be applied of the excess of the sum of other income and long term
capital gains over the exemption level. In the case of corporate assesses the
indexed long term capital gains will be subject to a flat rate of 40 percent. When the rate of tax on corporate profits is reduced to 40 percent, as per our recommendations, the rate of tax on long-term capital gains for the corporate assesses should be fixed at 30 percent.

(6). In the case of firms, the income from capital gains should be apportioned among the partners in the ratio of their share in the partnership. This income should be treated as capital gains in the hands of the partner.

(7). The roll-over provisions should be retained but the special exemptions granted under Section 53 and 54E of the Income-tax Act should be withdrawn. Roll-over relief should, however, be granted uniformly in each roll-over section of the Income-tax Act in the following manner:

(7.1) The gain should be computed after adjusting the cost of acquisition and improvement by the cost inflation index as recommended earlier.

(7.2) The fraction of the capital gain that is allowed, "roll-over" relief should be equal to the proportion formed by the cost of the newly purchased asset (old asset). In the case of a new asset, capital gain should be reckoned as the sale price less the inflation adjusted cost of the old asset. The inflation adjusted cost of the old asset should, however, be calculated for the entire period of holding of the new asset and the old. Where the old asset is acquired prior to the cut-off date, the cost of acquisition and the period of holding of the old asset should be reckoned to be respectively, the value of the old asset on the cut-off date and the period from the cut-off date.

(8). The existing Capital Gains Accounts Scheme should be replaced by a simple scheme along the lines of a money-multiplier scheme promoted by some banks in the country.

(9). The existing method for computing the period for re-investment, with reference to the date of transfer should be replaced by a method whereby the period is computed with reference to the financial year in which the asset is transferred. Accordingly, the period specified for re-investment should be either within the financial year immediately preceding or within two succeeding financial years immediately after the financial year in which the original asset is transferred.
(10). There is no necessity to make any further change in the existing scheme of allowing set-off of capital losses only against capital gains.

(11). Capital loss should be computed after adjustment of the cost of the asset by the cost inflation index. Provisions relating to scaling down to long-term capital losses may, consequently, be deleted.

(12). The existing provisions relating to tax treatment of capital gains from depreciable assets used for business of profession does not merit any change.

The existing provisions seeking to restrict the deductibility of certain expenses in business be reviewed and limits prescribed be revised. The restriction on the deductibility of certain expenses have been rationalized.

The deductions of Rs. 3,600 in respect of each residential unit forming part of a building for a period of five years from the date of completion of such a building at present allowable under second proviso to sub-section (1) of Section 23 of the Income-tax Act should be withdrawn. Further, since the proposed lower rates of personal income tax will benefit also tax payers having income from house property, the deduction for construction of new residential units should be withdrawn from the Assessment Year 1993-94 for all taxpayers even in respect of residential units in a building completed prior to the implementation of this recommendation.

An amount equal to 1/5th of the "annual value" of the property should be allowed as a statutory standard deduction for the aggregate expenses on repair of the house property and collection of rent.

The number of years in which the interest on borrowed capital relating to pre-completion period that is allowed as a deduction in the computation of "income from house property" should be reduced from five to three.

In the case of partnership firms:

(1). The scheme of registration of firms for income tax purpose should be abolished. All firms should be treated alike for income tax.

(2). The existing separate tax on the income of the firms should be abolished. The firm should be required to calculate capital gains than capital gains should be apportioned amongst the partners in the ratio of their share in the profits of the firms, for taxation in their hands at the appropriate income tax rates. In
computing the income of the firm, it should be allowed, as against the present practice, to claim as a deduction any payment of interest, salary, bonus, commission or remuneration to any of its partners.

(3) Where new partners are admitted to the benefits of a partnership at any time during the accounting year after the end of the first three months. The share of the new partners in the profits of the firm should be ignored and profits should be apportioned amongst the old partners in the revised ratio of their shares in the manner. However, this should only be in respect of the financial year in which the new partners have been admitted. This however will not apply when firm is reconstituted on the death of a partners.

(4) Where a firm has any income from capital gains, it will be eligible to claim “roll-over” relief wherever permissible. Any capital gain (after allowing for the “roll-over” relief) or loss incured by the firm should be apportioned amongst the partners in the ratio of their share in the profits of the firm. However, the partners should not be allowed any “roll-over” relief in respect of such share in the capital gains. The relief for “bunching” of gains should be allowed to be claimed by the partners in their personal assessments.

(5) All association of persons and bodies of individuals should be taxed in the same manner as firms.

(6) Where the shares of partners in a firm or of members in the AOP or BOI are not specified, they should be presumed to be equal amongst them and no partner or member should be allowed to claim differently at anytime in the future in respect of profits of the year for which such presumption is made.

(7) The firm or AOP or BOI should not be allowed any credit for the tax deducted at source from payments received by it. However, it should be allowed to apportion the same amongst its partners in the ratio of their share in its profits.

(8) The firm should be required to pay advance tax on behalf of partners in respect of the income of the partner form the firm and income from all other sources along the same lines as the facility available under sub-section(2), (2B) and (3) of Section 192, to both the employer and the employee, in respect of deduction of tax at source. The advance-tax paid by the firm on behalf of the partners should be deposited with the Central Government through a single challan. The
firm should after the end of the previous year be required to submit separate annual statements regarding advance-tax paid on behalf of the partners.

(9). Every firm should be required to issue a certificate to every partner indicating the amount of interest, salary, bonus, commission remuneration paid by it, the share of the partner in the profits of the firm, the share of the partners in the tax deducted at source on payments received by the firm and the advance-tax paid by the firm in respect of income of the partners.

(10). Notwithstanding the fact that there would be no tax liability on the part of the firms, AOPs and BOIs, they should be required to file their returns of income irrespective of their level of income. Where the firms file the return of income voluntarily but after the due date, they should be required to pay one-half percent of the computed income of the firm subject to a minimum of Rs. 200, as a late fee for every month of default. If the return is filed in response to a notice issued after the end of the assessment year and the firm has not deposited the deducted tax at source, in the appropriate manner, from payments made to the partners, the firm should be assessed to tax at the maximum marginal rate of tax for individuals and also be required to pay late fee as indicated above. In such a case, distribution of income in the partners' hands would not arise.

(11). In a case where the returned income of the firm is increased as a result of additions or disallowances, the difference between the assessed income and the income declared should be taxed at the maximum marginal rate in the hands of the firm but exempt from any additional tax liability in the hands of the partners. However, in a case where loss is returned and where the additions made result in a reduction in the loss or in the computation of a positive income, the income or loss computed should be apportioned amongst the partners and consequential rectifications should be carried out in their tax assessments.

(12). The problem of "benamidar" partners should be tackled only be sustained investigation under the Benami (Prohibition) Act, (1988) without causing undue distortion in the tax structure. Where it is established that a partner in a firm is the benamidar of any other partner of the firm or is an undisclosed benamidar of an outsider and any one of more of the other partners new or had

---

reasons to believe that it was so, the whole of the income of their firm (including any payment income to the partners) should be taxed at the maximum marginal rate.

In the case of co-operative societies:-

(1). The deduction, presently available to cooperative societies under Section 80-P, in respect of whole of their profits from business, should be restricted only to 20 percent of their profits. However, all other deductions under Section 80-P should be abolished.

(2). The income exemption limit for cooperative societies should be fixed at Rs. 25,000.

(3). The total income of the cooperative society, in excess of the exemption limit, should be subjected to tax at the flat rate of 30 percent.

For inducing traders and manufacturers operating on a small scale but enjoying taxable income to make some contribution to income tax, two simple schemes based on the presumptive approach and recommended. The first variant which we call the scheme of presumptive taxation envisages a very simple system under which one is required only to pay a lump-sum tax in lieu of income tax. This scheme will apply only to traders and manufacturers having a total business turnover of between Rs. 3 lakh and 5 lakh. Under the other scheme the net income of the taxpayer will be estimated as a specified percentage of the gross turnover in business (the percentages depending on the type of business activity). This, we call, the estimated income (EIS). The specifications of the two schemes are outlined below:

3.2.3 Presumptive Tax Scheme

Under this scheme, traders and manufacturers deriving income from business should be allowed an option to pay tax in a lump-sum of Rs. 1,000 without filing any return if their total turnover in business happens to fall between Rs. 3 lakh and Rs. 5 lakh as estimated by themselves.

It is possible that even such small traders/producers have income from other source like brokerage from commission agency, interest, dividend, property, etc. The facility of this scheme should not be denied to them so long as income from these sources remains modest. For brokerage income, this limit may be fixed at Rs.25,000. But tax at the rate of 20 per cent may be realized from such income without going
through the process of aggregating such income with income from other heads. When
the trader/producer has income from other sources, again the scheme would still be
open to the trader or producer if the receipts from such other sources do not exceed
Rs. 10,000. Here 'receipts from other sources' would include interest, dividend,
property, salary, etc. However, in such cases the taxpayer should not be permitted to
claim any refund of tax deducted at source on such receipts.

Taxpayers opting for this scheme should not, however, be allowed any
deduction on account of savings incentives or any other provision of the Income-
tax Act. As mentioned earlier, no return need be filed by persons opting for this scheme.
Nor should they be required to make any advance payment of tax in installments. It
should suffice, if they pay the tax in one lump-sum any time before the 15th March
during the accounting year.

3.2.4 Estimated Income Scheme (EIS):

Persons having business turnover of more than Rs. 5 lakh or brokerage or
commission receipts exceeding Rs. 25,000 or receipts from other sources above Rs.
10,000 should come under the alternative scheme, namely, the Estimated Income
Scheme (EIS). Under this scheme, net income from business will be presumed to be
equal to:

(1). Eight per cent of the turnover from trading or manufacturing operations.

(2). Fifty per cent of the receipts from brokerage or commission;

(3). Ten per cent of receipts from contracts relating to construction of roads, bridges,
buildings, other public works and transporting.

(4). Eighty per cent of receipts from other sources, being in the nature of interest,
dividend, rent, export incentive schemes or any other receipt of similar nature.

'Receipts from other sources' for this purpose will not include any receipt
falling under the head 'salaries' or 'income from house property' or 'profits and gains
from business or profession.' The income estimated in the aforesaid manner will be
aggregated with income from profession and income under the heads like 'salaries'
and 'house property', if any, to determine the gross total income. Taxpayers opting
for the scheme will be eligible for deduction allowed for savings and specified
activities as may be available under the Income-tax Act from time to time. The total
income so computed should be subjected to tax at the appropriate rates. Unlike in the
case of PTS, tax due under the EIS should be paid in advance in three installments and the provisions in the Income-tax Act relating to the payment of advance tax should apply. The EIS, however, be restricted to persons whose turnover and/or receipts do not exceed Rs.25 lakh.

Further, a simple statement should be furnished by taxpayers coming under these schemes to the nearness income tax office. The challan and statement forms should be made available freely in all bank offices or branches, market committees, office of trade associations, etc. For the first three years, the statements of turnover may be accepted without any question, unless there is strong evidence to the contrary. Every attempt should be made to estimate the ratios separately for each separate activity and for different locations as has been done in Israel for the "takshivs". Once these ratios are set up they should be given wide publicity (subject to periodic revisions), so that they can be used for self-assessment by taxpayers having income from business on their own and also by tax officers as a check against gross understatement. In other words, these ratios can be used as benchmarks or guidelines for estimating business income where verifiable accounts are not maintained. Income computed on the basis of the ratios should be accepted without any question. Any variation above or below the norms so set up beyond say 10 per cent should be subjected to scrutiny and approval by the next higher official.

In order that the presumptive income approach suggested above for small enterprises does not come under any legal attach, it would be necessary to make the presumptions rebuttable. In the case of contractors, 10 per cent of contract receipts from all contracts relating to construction of roads, bridges, buildings, other public works and transporting, should be presumed to be the income in such cases and the same should be formalised in law. Efforts should be made to introduce the estimated income system on the basis of physical indices. A beginning may be made by prescribing that each truck with an inter-State permit could be presumed to yield an income of Rs. 4,000 per month. Similarly, each truck with a State permit could be presumed to yield income of Rs. 3,000 per month.

3.2.5 Taxation of Wealth

The tax on wealth should be abolished in respect of all items of wealth other than those which can be regarded as unproductive forms of wealth or other items whose possession and use could legitimately be social interest.
The new scheme of new wealth tax should be as follows:

(1). An annual tax on the aggregate capital value, in excess of the specified exemption level, of the following items of wealth will be levied in the hands of individuals, Hindu undivided families, and all companies.

(2). The items on which wealth tax would be levied are: residential houses, motor cars (other than those used in the business of running them on hire), bullions and jewellery, (other than those used as stock-in-trade), yachts and boats and planes (other than those used for commercial purposes) and urban land.

(3). Residential houses should include all farm houses within 25 kilometers from the local limits of any municipality or cantonment board.

(4). For the purpose, the valuation of the above items for wealth tax purposes would be according to the procedures now being adopted under the Wealth Tax Act. However, the rules regarding valuation of residential property would be required to be re-examined, as there is a general feeling that these rules are a little too liberal. Simultaneously, efforts should be made to suitably adjust the rates of stamp duty on transfers of property and the level of municipal property tax. The objective should be that the total burden of all these taxes on property income should be reasonable.

(5). Any liability specifically incurred for acquiring the assets which are liable to wealth tax and charged against them will be deductible from the computed value of the assets before the tax is applied.

(6). The first Rs. 15 lakh of the net value of the taxable items of wealth will bear nil tax. Any excess of net value over that level will bear tax at one per cent of value.

(7). The existing provisions in the Wealth Tax Act will apply to taxable items of wealth transferred to members of one’s family without adequate consideration. However, in line with our recommendation in respect of income of minor children, we recommend that the net value of the taxable items of wealth in the hands of any minor child should be aggregated with the net value of such assets in the hands of the parent whose taxable assets have a higher value if one or both of them are not liable to pay wealth tax and with the net value of the taxable assets of either parent if both of them are liable to pay the wealth tax.
(8). Although only items of wealth mentioned in (b) above will be subjected to wealth tax, all income tax payers whose gross total income exceeds Rs. 1 lakh should be required to file a net wealth statement. For this purpose, all assets should be valued at cost. The statement should from an integral part of the return of income. The statement should not give details of individual items of wealth, but only values of specified categories of wealth, e.g., equity shares and debentures. Net wealth tax should also be levied on the specified assets owned by all public and private sector companies. The wealth tax paid should not be allowed to be claimed as expense for income tax purposes.

3.3 Recommendations in the Interim Report:-

We would first like to reiterate some of our earlier recommendations in the Interim Report which have not been so far implemented.

3.3.1 Direct Taxes

For broadening the base and improving the fairness of the income tax system:

(1). the perquisite value of rent-free or concessional rent residential accommodation provided should be taken to be equal to 20 percent of the salary or the actual expenditure by the employer, if lower, for those employees whose annual income under the head ‘Salary’ exceeds Rs. 36,000 the taxable perquisite value could be the above perquisite value as reduced by the sum of rent paid and house rent allowance foregone:

(2). 15 percent of leave travel allowance, sitting allowances received by members of Parliament and State Legislatures and the fringe benefits implicit in the concessional interest rate charged on loans granted to employees for the acquisition of durable goods and houses should be included in taxable income;

(3). the allowances exempted from tax under sub-clause(ii) of clause (14) of Section 10 of the Income-tax Act should be limited to 10 percent of the salary.

In order to induce greater voluntary compliance and to subject the majority of taxpayers to the same marginal rate, the middle rate of 27.5 percent should be applied to income in the range of Rs. 50,000 to 2 lakh. However, since the Government has fixed the rate 30 per cent last year, it may be retained at the level for the time being.
To remove many of the problems in tax assessment and the scope for harassment of small assesses in respect of the assessment of income from business of smaller assesses whose total turnover is less than Rs. 20 or 25 lakh, the estimated income scheme which is an important component of our recommendations relating to hard-to-tax groups should be implemented.

### 3.3.2 Further Reform of Direct Taxes

#### 3.3.2 (01) Taxation of Corporate Profits: Domestic Companies

It is difficult to devise a system of corporate profit tax that would be satisfactory from all the relevant points of view. In India, we follow the classical system which treats corporations as a distinct taxable entity, and thus leads to the double taxation of dividends. Briefly speaking, the following are the deficiencies of the classical system:

1. It discourages distribution of corporate profits and thus affects free flow of funds into new companies;
2. It tends to encourage mergers to the disadvantage of new enterprise;
3. It puts premium on debt as opposed to the disadvantage of new enterprises;
4. The dividend/retained earnings differential tends to distort the choice between corporate and non-corporate forms of doing business.

Hence, the need for integration of corporate tax with personal taxes.

Full integration system wherein the corporation tax is fully transformed into income tax on the respective share holders is, however, fraught with insurmountable practical difficulties. Partial integration systems have been adopted in various countries with a view to reducing the dividends/retained earnings differential. In India the earlier system of partial integration (in vogue think 1960-61) led to considerable administrative and compliance problems. We think that the simplest and fairest method of giving relief from the double taxation of dividends would be to exempt a proportion of the distributed profits from the corporation tax. For the present, we do not recommend even this for three reasons viz.

1. The total burden of tax on dividend income in any case would be considerably reduced if the corporate and personal income tax rates as recommended by us are adopted:
(2). the whole issue could be re-examined after the findings of the Rudding committee appointed by the EEC are available.

(3). given the revenue constraint, it is preferable to bring down the corporate profit tax rates to reduce dividend/retained earnings differential.

The Committee would, therefore, recommend the retention of the existing "classical system" of taxation for the present with the lowering of the corporate tax for all domestic companies to 45 per cent in 1993-94 from the present level of 51.75 per cent by the abolition of surcharge and to 40 per cent in 1994-95. This rate of 40 per cent would not be unreasonable for foreign investors given the spread of the present tax rates in different countries.

At the same time, the committee would reiterate its recommendations made in the Interim Report for withdrawal of the concessions under Sections 35 CCA, 35 CCB, 35AC for making donations to associations and institutions carrying out rural development or any scheme or project for promoting social and economic welfare. This would simplify and improve the equity of the tax system, give less room for tax avoidance and reduce disputes.

3.3.2 (02) Depreciation Allowance: As in many other countries, depreciation under the Indian Income Tax Act is allowed as a percentage of the historic capital cost of the assets. The replacement cost method of allowing depreciation has not found favour in many countries including India for the reasons that it is not easy to measure or estimate asset-wise replacement costs because of divergent price trends and the cost of replacement is known only at the time of replacement while the depreciation allowance has to be availed of, during the period of use of the asset. Thus, only board adjustment could be provide for taking care of the rise in the price of the assets. Following the recommendations of the Economic Administration Reforms Commission (EARC), the system of granting depreciation was simplified and the general rate of depreciation of plant and machinery was fixed at 33.33 per cent in 1988-89, merging he various types of depreciation available and to provide sufficient funds to replace capital assets in the context of rising capital goods prices. EARC’s recommendations were against the background of a rate of tax of 55 per cent on corporate profits and the top marginal rate of 66 per cent on personal income. The general rate of depreciation was reduced to 25 per cent in the 1991-92 budget when the corporate tax rate was fixed at 45 per cent.
We have assessed the funds that will flow to a business if depreciation on plant and machinery (along with interest net of tax) is granted at alternative rates 33.33 per cent, 25 per cent, 22.5 per cent and 20 per cent. It was seen that with the adoption of the depreciation rate at 25 per cent, the business enterprise would be able to recoup the total cost of the asset within a period of about 5-1/2 years. This is considered quite reasonable by the Committee when it is seen along with its recommendation for lowering the corporate tax rate to 40 per cent. In view of this, the committee would like to recommend the retention of the general rate of depreciation plant and machinery at 25 per cent.

3.3.2 (03) Deduction under Section 43B: Section 43 B makes a departure from the well accepted principle of allowing deduction for business expenses on an accrual basis. We are of the view that the use of tax law for collateral purposes, quite apart from complicating the law, is unfair and unjust as it militates against the principle of taxation of 'real' income. However, considering the need for prompt collection of revenue, we recommend that Section 43B should be restricted to taxes, duties, etc. Other items of expenditure like contributions to provident fund or gratuity fund or any other fund for the welfare of the employees, sums referred to in clause (ii) of subsection (1) of section 36 and interest on any loan or borrowing from any public financial institution should be taken out of the purview of Section 43B.

3.3.2 (04) Reconstruction and other Arrangements of Companies: Under the present provisions of the Income-tax and the 'Gift Tax Act capital gains or gift, if any, is exempt from tax in Scheme of Amalgamation of companies. However, such exemptions are not allowed in the case of Compromise, Arrangement and 'Reconstruction of companies. The provisions of company law in these cases are similar to the provisions in the case of Amalgamation. The Committee is of the view that there is no likelihood of the abuse of the scheme of Compromise, etc. to defraud revenue, shareholders or the company in view of the procedures of the Companies Act, which empower the High Court to take into account the views and objections of the Central Government, shareholders and the creditors of the company before any scheme is approved. We, therefore, recommend that no capital gains tax or gift tax may be levied in the case of Compromise, Arrangement and Reconstruction, necessary clarification may be issued that the provisions of Section 2(22) (a) of the Income-tax Act would not apply in such cases.
3.3.2 (05) Taxation of Non-residents including Indian Branches of Foreign Companies: Taxation has a significant impact on international investment and financing decisions. Simplicity, transparency and perceived fairness are essential to attract the much needed foreign investment. The Committees, therefore, of the view that the expenditure like contributions to provident fund or gratuity fund or any other fund for the welfare of the employees, sums referred to in clause (ii) of sub-section (1) of Section 36 and interest on any long or borrowing from any public financial institution should be taken out of the purview of section 43B.

The Committee would also recommend the amendment to provision under sub-section (2) of Section 195 for enabling the recipient of income also to make an application to the assessing officer for determining the appropriate proportion of income on which tax is deductible.

The Committee notes that although the intention to introduce the system of advance ruling has been announced in the 1992-93 Budget Speech of the Finance Minister, no further follow-up measures have been taken to implement the intention. The Committee would recommend expeditious actions in this regard.

The Committee considers that the difference between the tax rate on domestic companies (at present 51.75 per cent including surcharge) and the tax rate on foreign companies (at present 65 per cent) is quite large even at the withholding tax rate of 25 per cent on dividends paid to 40 per cent there will be scope for reduction in the tax rate on foreign companies. The effective average withholding tax rate would not often exceed 15 per cent given the network of tax treaties with almost all developed countries. However, taking the withholding tax rate of 25 per cent the differential between the rates on domestic and foreign companies should be around 7.5 percentage points assuming that half of the after tax profit is distributed as dividend. In any case, this differential should not exceed 10 percentile points.

The Committee would consider that, as a further measure for attracting foreign investment and foreign technical know-how, double taxation of the foreign company in respect of both the fees obtained for the technical services and the salaries paid to its personnel staffed in India beyond a certain number of days needs to be avoided.

---

The law should be amended for exempting the salaries paid to such personnel from Indian tax irrespective of the length of their period of stay.

Under Section 10(15)(iv) of the Income-tax Act, interest payable by the Government, financial institutions and industrial undertaking on borrowings abroad is exempt from tax. In the absence of any provision for tax sparing by the home country, the beneficiary of the tax concession is not the investor but the home country. In effect, there is transfer of resources from the host country treasury to the home country treasury. We therefore, recommend the discontinuance of the provisions in Section 10(15)(iv).

The Committee noted that there is hardship to non-resident taxpayers in respect of tax liability on account of the interaction given to Rule 15 of the Income-tax Rules, 1962 for conversion exchange payments made for royalty, fees, etc., into rupees for purposes of assessing tax. The Committee would, therefore, suggest the where the income has already been remitted, the conversion rate should be the rate at which the foreign currency was actually purchased. Where the non-resident is paid directly in foreign exchange abroad with no remittance from India, the conversion rate should be that applicable on the day the non-resident receives payment. The Committee would recommend the adoption of this amendment with retrospective effect to cover the income for the accounting year 1991-92 on account of the magnitude of the rupee devaluation which took place during that year.

3.3.2 (06) Treatment of Losses: The Committee is of the view that the inequities in the existing scheme of set off and carry forward of losses need to be corrected. We therefore, recommend as follows:

(1). the newly introduced Section 71A in the Income-Tax Act extending scheduler treatment to loss from house property should be revoked;

(2). the losses carried forward for set off in the subsequent years separately under each head of, income, like, ‘income from house property’ or ‘profits and gains from business or profession’ (other than losses from speculation business or from the activity of owning and maintaining race houses) and ‘other sources’ should all be allowed inter se set off;

---

the condition that the business to which the loss relates should be carried on in
the subsequent year in order that the business loss carried forward from the
earlier year is allowed to be set off should removed.

Further, in the larger interest of the economy, the provisions of Section 79 of
the Income-Tax Act should either be deleted or should be restored to its from as it
existed prior to its amendment by the Finance Act, 1988.9

3.3.2 (07) Treatment of Charities and Charitable Organisations: For rationalizing
the provisions of the Income-Tax Act in regard to charities and charitable
organizations, the Committee recommends the following:

(1). Application under Section 12-A and Sub-section (5) of Section 80G should be
processed together and with utmost expedition, that is, within a period of three
months from the date of receipt of the applications;

(2). Approvals granted and renewals of approvals should be valid for 5 years;

(3). Where the income from any business accruing to a trust/institution is not
more than Rs.5 lakh, the trust/institution may continue to be given the
exemption irrespective of whether the business is incidental to the attainment of
the objectives of the trust/institution or not;

(4). The restrictive provisions contained in Section 13 of the Income-Tax Act for the
withdrawal of exemptions available under Section 11 or 12 need to be reviewed,
for avoiding hardship in genuine cases. The monetary limit of Rs.25,000
prescribed in respect of substantial contributions may be raised to Rs. 50,000;

(5). The last date for filing returns in the case of charitable organizations claiming
exemptions under Section 11 and 12 of the Income-Tax Act may be fixed at 31st
December instead of 31st August as at present;

(6). The income limit for Audit laid down in clause (b) of Section 12A may be
enhanced from Rs.25,000 to Rs.50,000;

(7). There is need to make the law uniform for all charitable organizations.

3.3.2 (08) Interest Tax: The Committee recommends the abolition of the interest tax
as it acts as a wedge between the reward to the savers and return on investments.

3.3.2 (09) Gift Tax: The Committee recommends the continuance of the levy of gift tax, since it discourages transfer of assets for reducing the total tax liability of a family. The exemption limit may, however, be raised to Rs. 30,000 from the present level of Rs. 20,000.

3.3.2 (10) Taxation of Agricultural Income: The Committee is of the view that while agriculturists whose income consists of only agricultural income or agricultural income, say below Rs. 25,000 per annum and non-agricultural income below the income-tax exemption limit may not be brought within the income tax net. The agriculturists income in excess of, say Rs. 25,000 accruing to the non-agriculturists should be brought under the tax net to promote equity and reduce scope for tax evasion. We recommend that in the case of individuals of any other entities having income from non-agricultural sources above the exemption level and also income from agricultural source above Rs. 25,000, agricultural income in excess of Rs. 25,000 accruing to the concerned entity should be aggregated with non-agricultural income and the tax should be levied on the total of such aggregated income. Agricultural income for this purpose will not include income from plantations subject to taxation by the States. The Central Government should obtain the cooperation and consent of the State Governments for enacting a provision which would enable it (the Central Government) to bring under the purview of the Central income tax, agricultural income in excess of Rs. 25,000 of those non-agricultural assesses whose non-agricultural income are above the exemption level. The entire tax yield attributable to the agricultural component of income could be distributed among the States on the basis of origin.

3.4 The Recommendation of Direct Tax Reform Committee, 2002 (Chairman Vijay Kelkar)

At the time of presenting the first batch of supplementary demands for grants to Parliament in July 2002, the Finance Minister had proposed up of two task forces to recommend measures for simplification and rationalization of direct and indirect taxes. Accordingly, two task forces were set up in September 2002 under the chairmanship of Vijay Kelkar, Adviser to Minister of Finance and Company Affairs.

The Task Force on Direct Taxes presented its consultation paper to the Government on November 2, 2002. The discussion paper on indirect taxes was
presented on November 25, 2002. These consultation papers were made public to facilitate an informed discussion on tax policy.

After taking into account the response on the discussion papers, the Task Forces submitted their final reports to the Government in December 2002. These Task Forces have made important recommendations on toning up tax administration to put in place a system that is simple, effective and at par with international standards.

3.4.1 The main recommendations on direct taxes

The main recommendations on direct taxes relate to raising of exemption limit of personal income tax, rationalization of exemptions, abolition of confessional
treatment to long-term capital gains, and abolition of wealth tax.

3.4.2 The Task Force on Direct Taxes was assigned the following Terms of Reference:

(1) Rationalisation and simplification of the direct taxes with a view to minimizing exemptions, removing anomalies and improving equity;

(2) Improvement in taxpayer services so as to reduce compliance cost, impart transparency and facilitate voluntary compliance,

(3) Redesigning procedures for strengthening enforcement so as to improve compliance of direct tax laws; and

(4) Any other matter related to the above points.

3.4.3 Summary and Recommendations

3.4.3 (01) Reform of Tax Administration: Traditionally, the role of the tax administration has been to enforce the tax laws and provide at least minimal taxpayer service. Most employees unable to reconcile to their new role continue to resist this shift in the role perception from an enforcement officer to a facilitator.

(1) The income tax department must expand, qualitatively and quantitatively, the present scope of taxpayer service. These should cover the range of taxpayer services indicated in Table. 3.1 and, inter alia, include the introduction of a telephonic system (by voice massage) to remind taxpayer of important dates and the provision of pre-formatted programmed floppy diskettes through retail outlets.

---

(2). The expenditure on taxpayer service must be increased from the present level of about one percent of the total expenditure on tax administration to at least five percent. In this regard, an important start should be made by the establishment of taxpayers clinic in different parts of the country to enable taxpayer to walk in for assistance. A better treatment of existing taxpayers has an important role in encouraging those outside the tax net to become taxpaying citizens.

(3). The department should provide easy access to taxpayer through Internet and e-mail and extend facilities as tele-filing and tele-refunds. It should design special programmes for retired people, low-income taxpayers and other such groups with special needs who cannot afford expensive services of tax consultants.

Given the ongoing and new initiatives by the Ministry of Home Affairs for issuing a Citizen Identification Number and by the Ministry of Labour for issuing a Social Security Number, PAN can be used to effectively integrate, on the lines enforcement, on the lines of the US Social Security Number system, multiple tasks of tax and commercial enhance national security, both at the Central and State level. The Task Force, therefore, recommends that:

**Table 3.1: Taxpayer Information Programs in Selected Countries**

<table>
<thead>
<tr>
<th></th>
<th>Argentina</th>
<th>Canada</th>
<th>Chile</th>
<th>Colombia</th>
<th>Jamaica</th>
<th>Mexico</th>
<th>Trinidad</th>
<th>USA</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Publications</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Tax guides (instructions)</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>2. Pamphlets and bulletins</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>3. Technical publications</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>4. Audio cassettes for visually impaired</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Newspaper tax supplements</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Reminders in press</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td><strong>B. Media</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Radio or television commercials</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>2. Special television programs</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Video cassettes</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Press conferences</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>C. Telephone contact</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Telephone assistance</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>2. Tele-refund</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>3. Tele-info</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td><strong>D. Personal contacts</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Walk in service</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td><strong>E. Correspondence</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Individually drafted letters</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Standardized letters</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
</tr>
</tbody>
</table>

78
The PAN should be extended to cover all citizens and therefore serve as a Citizen identification number. This will obviate the need for the Home and Labour Ministries to issue new numbers.

(2) Given the manifold increase in the coverage of PAN, the responsibility for issuing should be transferred to an independent agency outside the income tax department. However, the income tax department should have online access to the database for tax enforcement like any other agency.

(3) The requirement of quoting PAN may be expanded to cover most financial transactions.

In view of the extant method of collection of information and constraints in digitizing the volume of information received by the tax administration, the Task Force recommends:

(1) Income Tax Act should be amended to provide for submission of annual information return by third parties in respect of various transactions as may be prescribed. For this purpose, a proper format of the return also needs to be prescribed. Consequently, the CIB to collect information will be eliminated.

(2) Such annual return of information (including returns relating to tax deducted at source) should be mandatory required to be submitted on electronic format.

(3) Many of the Department involved in transactions specified in Rule 114B do not have any mechanism for obtaining the PAN of the concerned person. It is, therefore, necessary that the pro forma used by them for their departmental purposes, e.g., the application form for transfer of motor license should have the necessary column requiring the applicant to disclose his permanent account number (PAN).
1. The PAN should be extended to cover all citizens and therefore serve as a Citizen identification number. This will obviate the need for the Home and Labour Ministries to issue new numbers.

2. Given the manifold increase in the coverage of PAN, the responsibility for issuing should be transferred to an independent agency outside the income tax department. However, the income tax department should have online access to the database for tax enforcement like any other agency.

3. The requirement of quoting PAN may be expanded to cover most financial transactions.

In view of the extant method of collection of information and constraints in digitizing the volume of information received by the tax administration, the Task Force recommends:

1. Income Tax Act should be amended to provide for submission of annual information return by third parties in respect of various transactions as may be prescribed. For this purpose, a proper format of the return also needs to be prescribed. Consequently, the CIB to collect information will be eliminated.

2. Such annual return of information (including returns relating to tax deducted at source) should be mandatory required to be submitted on electronic format.

3. Many of the Department involved in transactions specified in Rule 114B do not have any mechanism for obtaining the PAN of the concerned person. It is, therefore, necessary that the pro forma used by them for their departmental purposes, e.g., the application form for transfer of motor license, should have the necessary column requiring the applicant to disclose his permanent Account Number (PAN).
(4). The Department should set up a structure for Electronic data Interchange (EDI) with some of the major departments and organizations involved in the transaction specified in Rule 114B, such as, Bank, Stock Exchanges Telephone Companies, Regional Transport Authority etc.

In view of the diminution in the deterrence effect of search and seizure operations:

(1). Special procedure for assessment of search cases in chapter XIV B (Block Assessment) which provides for tax at the rate of 60 per cent, be omitted. As and when concealment is detected and established, it should suffer full penal consequences of interest, penalty and prosecution.

(2). Power of Settlement Commission to grant immunity from interest, penalty and prosecution.

(3). The scheme of rewarding officer engaged in search and seizure action taken by the department in his case.

(4). The stocks found during the course of search and seizure operation under the Income Tax Act may only be inventorised inventoried but not seized. This can be done by issuing administrative instruction.

The Central Board of Direct Taxes must issue immediate instructions to the effect that no raiding party should obtain any surrender whatsoever. Where, a taxpayer desires to voluntarily make a disclosure, he should be advised to make so after the search. As a result, the taxpayer will not be able to allege coercion and successfully distract investigations. All cases where surrender is obtained during the course of the search in violation of the instructions of the CBDT, the leader of the raiding party should be subjected to vigilance enquiry. All statements recorded during the search should be video recorded. This will, indeed, add to the confidence of the taxpayer in the impartiality of the system.

The task Force took note of the recent amendments conferring power to seize books of accounts during a survey operation. Accordingly, it recommends:

(1). A survey should be authorized after recording the reasons in writing and the power of authorization should not be vested in any officer below the rank of a joint Commissioner of Income Tax.
(2) The books of accounts impounded by the survey team should not be retained beyond a period of seven days since it has the potential of disrupting the business of a taxpayer. Where it is felt that the books need to be retained beyond the period of seven days, the department may obtain photocopies duly attested by the taxpayer for further investigation.

In line with our view that the tax department should concentrate on its core functions, the department should be allowed to outsource data entry work and clear the backlog of returns (which number 2.8 crore as on September 30, 2002) by end February 2003. Similarly, all returns must be processed within four months of receipt. For this purpose, it would be necessary for the department to either hire additional personnel on a temporary basis during the peak period for filing returns, or outsource data entry work, as is done routinely by national tax administrations all over the world. Further, we must emphasize that outsourcing of such data entry efforts of the departmental staff and officers and not as a substitute. The cost of hiring additional or outsourcing data entry work would be far less in comparison to the benefit from reduced interest burden on refunds and taxpayer satisfaction.

The existing discretion based system of selection of returns should be immediately abolished. The department should progressively develop an audit selection system for risk analysis and assessment, which forms a scientific (and, therefore, objective) basis for identifying cases of potential tax evasion for in depth scrutiny.

In the interim, we recommend the Identification of cases though a random non-discretionary centralized method deploying the PAN database. The current practice of issuing guidelines for selection of cases for scrutiny, which eventually finds its way to the public, must be given up.

Once a case is selected for scrutiny, it should be fully investigated, covering investments, accretion to assets, expenses incurred, savings, transactions entered and profits made, turnover etc. the scrutiny assessment will then serve its purpose of deterrence against tax evasion and contribute to revenue realization.

Section 275 of the Income Tax Act should be suitably amended to provide that the penalty order should be passed within one year from the end of the financial year in which the first appellate order is received. Consequently, the delay in passing the order-levying penalty for concealment would be considerably reduced to about two years.
3.4.3 (02) To speed up the process of modernization: The Government should establish a national Tax Information Network (TIN) on a build, operate and transfer basis. This will comprise of a world class (common carrier) network system and have access to state-of-the-art IT infrastructure. A requisite in built feature of the system is that it should be scalable to offer ease of access across tax administration and taxpayer. The network that is envisaged will facilitate transactions, akin to securities markets, and establish secure and seamless logistics of tax collection through integration of primary information, record keeping, dissemination and retrieval. It should be a repository of information, with a database of all tax payments and refunds. Data mining software associated with such relational databases will allow a quick and systematic identification of non-compliance and abuses, thereby helping to improve compliance. The existing facilities of the National Securities Depository Ltd. (NSDL) can be relatively quickly deployed to make a systemic improvement in processes and reduce transaction cost.

(1) TIN will receive, on behalf of the tax administration, all TDS returns and other information returns for digitization. The information would be received either online, or through magnetic media or in printed format. The digitized information will be downloaded by the National Computer Centre/Regional Computer Centers of the income tax department for further processing.

(2) TIN will also receive online information about collection of taxes from the banks. The information could be downloaded by the income tax department as and when required.

(3) The taxpayer will have the facility of accessing the TIN system through a secure and confidential Permanent Account Number (PAN) based identification to ascertain tax payments credited to his/her account and the status of returns and refunds.

The TIN will therefore serve as a gateway to the National Computer Center of the Income Tax Department. It will help overcome the paucity of technical manpower and inadequate technical infrastructure.

Firms and individuals whose total sales, gross receipts or turnover from the business or profession carried on by it is less than the monetary limits specified under clause (a) or clause (b) of section 44AB should continue to be exempted from the liability of deducting tax at source. However, once the TIN, which has been recommended by this task Force, is fully operationalised, the requirement to issue
TDS certificates to the payee can be dispensed and the scheme can be extended to the smaller taxpayers.

Where a payee receiving salary fails to furnish his PAN, tax should be deducted at a flat rate of 30 percent. In all other cases of such failure, tax should be deducted at twice the normal rate or 30 percent, whichever is lower. Further:

1. Tax should be required to be deducted at source irrespective of the amount of payment.

2. A payee should be allowed to claim exemption from TDS if she/he furnishes a self-declaration to the payer that the tax on her/his Permanent Account Number (PAN) on such.

3. The present system of obtaining a certificate from the assessing officer for deduction at lower rate should be abolished so as to minimize the interface between the taxpayer and tax authorities.

In view of the recommendation for the establishment of TIN, a revised procedure for collection of taxes and their accounting may be designed along the following lines:

1. A taxpayer will be required to fill up only one copy of the challan while making payment of taxes in the bank. The present requirement of filling up four copies of challan for payment of any tax will be given up.

2. The banks will be networked to the TIN and receive payments online. The banks will be required to issue a computerized receipt to the taxpayer instantaneously. The date of presentation of a cheque will be treated as the date of payment. If a cheque bounces, the bank will reverse the receipt online and the department would then be expected to prosecute the delinquent taxpayer.

3. With instant accounting of tax collection, the requirement of enclosing a copy of the challan as evidence of tax payment, along with the annual return of income could be done away.

4. Since the TIN will digitize all TDS returns, the requirement to file TDS certificates along with the return of income will also be dispensed with.

5. At present, taxes are collected through approximately 10,500 bank branches. Since the proposed procedure requires banks to receive online payment, those banks that do not have adequate infrastructure for establishing online connectivity will be debarred from collecting taxes. Accordingly, the
Government, in consultation with the Reserve Bank of India, should also consider paying higher charges for services rendered by banks.

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 (Figure 3.1).

(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 (TDS) & Tax Collection at Source (TCS) and Annual Information Return (AIR) 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/colleected on its behalf which is obtained by matching the TDS/TCS returns submitted by the deductors/collectors with the tax deposit (challan) information from 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.

**Figure 3.1: Diagrammatic presentation of TIN**

![Diagram of TIN System](image-url)

*Source: URL: [http://www.tin-nsdl.com/AboutTIN.asp](http://www.tin-nsdl.com/AboutTIN.asp)*
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 Rules 114E of the Income-tax Rules, 1962. Briefly, these are as per Table – 3.2.

Table 3.2: Class of persons and nature of transactions covered under AIR

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


The process outline above will facilitate real-time accounting of TDS, Advance Tax and Self-Assessment Tax, and help the tax administration to swiftly identify non-compliance. Furthermore, the new procedure of tax accounting will facilitate electronic filling of tax returns.

The existing cumbersome and manually-operated procedures for issue of refunds must be replaced by a more efficient IT-based system. Under the new system department will prepare a separate file of all refunds daily which will be downloaded by a payment intermediary, i.e. a designated bank. The designated bank will be authorized and interest warrants by companies. The designated bank will be required to transmit the information relating to the issue of refunds to the TIN, which will also allow a taxpayer to verify the status of his/her refund claim.
The present requirement of obtaining a tax clearance certificate before leaving the country must be abolished. However in order to protect the interest of revenue, we can continue to allow the income tax authorities to notify the immigration/custom authorities to prevent any particular person from leaving the country if such person is considered to be a proclaimed offender. As a result only a handful of notified persons will be subjected to the process of tax clearance as against the present practice of requiring all and sundry to comply with the requirement of obtaining tax clearance before leaving the country.

The system of issuing Income Tax Clearance Certificates to contractors and others should be eliminated forthwith. However, to help in enhancing effective tax enforcement, all government agencies should be required to obtain the PAN of entities participating in tenders, being designated as vendors to the government, etc., and periodically submit (pre. Specified) relevant information to the tax administration.

On the issue of dispute resolution, the Task Force recommends the following:

(1).the Income tax Act should be amended to provide that all orders/intimation imposing any additional burden should be made appealable.

(2).The institution of Ombudsman should be established in the top ten-taxpaying cities and all state capitals along the lines of that in the banking sector. This institution will provide an independent system to assure that tax problems, which have not been resolved through normal channels, are promptly and fairly handled. It will also identify issues that increase burden or create problem for taxpayers, and bring those issues that increase burden or create problem for taxpayers, and bring those issues to the attention of the Central Board of Direct Taxes (CBDT). The Ombudsman will also enquire into, should a complaint be filed, the practices and performance of all classes of tax professionals. Where necessary, it will also make appropriate legislative proposals. This institution will be independent of the local tax office. Its goal will be to protect individual taxpayer rights and to reduce taxpayer burden. A consolidated annual report of the Ombudsman system will be tabled in Parliament.

Central Board of Direct Taxes (CBDT), which is responsible for administering the direct tax laws, should be given the requisite autonomy in the following manner so that it is made more accountable:
(1) The control of the Central Government over the tax administration be exercised through a Memorandum of Understanding (MOU) between the Central Board of Direct Taxes and the Central Government (we understand that there is already a Cabinet decision to this effect). The Central Board of Revenue Act provides that the two boards (CBDT and CBEC) must function subject to the control of the Central Government, but the mechanism and the extent of control still remains unspecified.

(2) The MOU should, inter alia, specify the financial commitment of the Central Government for tax administration. It should 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. The CBDT should have exclusive power for designing the enforcement strategy, subject to the condition that it is nondiscriminatory and transparent. 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.

As a confidence building measure, the Central Board of Direct Taxes should release annual information (giving Chief Commissioner-wise break-up) of number of complaints received from the public or acts of omission or commission identified through internal mechanism or by external agencies and the result of official enquiry into such complaints. The information must be provided separately for officers and staff. Such information may relate to tax payer profiles, returns received, head wise break-up of income, number of appeals filed and disposed of, penalty orders, rectification applications, reopening of assessment, refund orders, refunds issued, selected for scrutiny assessment and their results, break up of collection, etc.

With a view to further enhancing accountability of (and transparency in) tax administration, it is important that the CBDT publishes an annual report of its own, along the lines of the UPSC/CVC, that is tabled in parliament and put on its web site. The annual report must separate provide for performance achievements of each Chief Commissioner/Commissioner. In addition, the quarterly progress of achievement must be displayed on the web site, so that taxpayers have an opportunity to respond. While defining a stricter accountability structure, however, care must be taken to eschew an excessive and regimented accountability system which over-
burdens AOs with onerous and fragmented oversight that ultimately only serves to reduce its overall effectiveness.

Lack of financial autonomy was identified as an important constraint in the functioning of the CBDT. Therefore, The Task Force is of the view that the position should be immediately rectified through adequate delegation of financial powers to bring in synergy and effectiveness in management functions.

3.4.3 (03) Personal Income Tax Reform: At the beginning of the 21st century, some truths about taxation have become self evident. Even so, they bear repetition.

(1). First, the design of tax policy is of paramount importance for tax administration.
(2). Second, if the objective is to have a transparent, efficient and feasible tax administration, then the structure of all taxes should comprise common elements. These are low rates, few nominal rates, a broad base, few exemptions, few incentives, few surcharges, few temporary measures, and in there instances where are exceptions, there should be clear guidelines.

The task force is unanimously in favour of these overarching fiscal principals. The numerous recommendations derive from these objectives.

The task force endorses the following principal identified in the Report of the Advisory Group on Tax Policy and Tax Administration for the Tenth Plan, for designing the rate schedule.

(1). The basic exemption limit must be at a moderate level an appropriate balance between the tax liability at the lowest levels, administrative cost of collection and compliance burden of the smallest taxpayers. The ability of the tax administration to deliver quality services to taxpayer will also significantly affect the choice of the exemption limit.

(2). The number of tax slabs should be few and their ranges fairly large to minimize distortions arising out of bracket creep. The maximum marginal rate of tax should be moderate, so that the distortions in the economic behaviour taxpayers and incentive to evade tax payment are minimized.

In view of the principles endorsed above:-

(1).the imposition of a single individual income tax rate in rejected in preference for a reformed system of personal income tax with more than one rate. The task force
believes that the alternative lies in multiple rate schedule, but with very little spread between such rates.

(2). and in view of the distortionary impact of multiple slabs, the task force opts for a two rate personal income tax schedule.

(3). and if the full effect of lower tax rates has to be realized, it is not only necessary to have an optimal enforcement strategy but also ensure that the tax cut apply total class taxpayers, taxpayers at the top end. This is possible by broad basing the tax slabs.

According the task force recommends the following Table 3.3 personal income tax rate schedule.

Table 3.3: Proposed Personal Income Tax Structure

<table>
<thead>
<tr>
<th>Income level</th>
<th>Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below Rs. 1,00,00</td>
<td>Nil</td>
</tr>
<tr>
<td>Rs. 1,00,00 – 4,00,00</td>
<td>20 percent of the Income in excess of Rs. 1,00,000</td>
</tr>
<tr>
<td>Above Rs. 4,00,00</td>
<td>Rs. 60,000 Plus 30 percent of the Income in excess of Rs. 4,00,000</td>
</tr>
</tbody>
</table>


Further, the revenue gain from levy of surcharge is generally illusory since such a levy has the effect of increasing the marginal rate of tax, which adversely effect compliance. Therefore, the present surcharge of 5 percent on taxpayers with income above Rs. 60,000 must be eliminated.

If compliance is to be fostered and nurtured and economic incentive sustained, it is necessary to move toward a comprehensive tax regime by reviewing the various exemptions, deductions and rebates.

Tax payers who are residents but not ordinarily resident must be subject to tax on their global/world-wide income at par with residents. To do so, this unusual category of resident but not ordinarily resident taxpayers must be deleted. This will not only enhance the income tax base, but also remove an antiquated anomaly and simplify the few.

The standard deduction under Section 16 (1) of the Income Tax Act should be eliminated. However, the exemption of conveyance allowance subject to ceiling of Rs. 9,600 should be continued. This should serve as a reasonable deduction for
employment related expenses. The additional liability of a taxpayer on this account will be more than met by the reduction in rates of personal income tax proposed by the Task Force.

These recommendations will help mobilize additional resources for the States without the attendant problem of administering the agricultural income tax. Further, given our recommendations on increasing the exemption limit to Rs. 1,00,000 per individual, most agricultural farmers would continue to remain out of the tax net. The proposed rental arrangement with the States could be packaged with the rental arrangement for taxation of services.

The tax incentives for saving under Section 88, Section 80L, Section 10(15)(i), Section 10(15)(iib), Section 10(15)(iic), Section 10(15)(iid), Section 10(15)(iv)(h), Section 10(15)(iv)(i), of the Income Tax Act must all be eliminated. These benefits must be withdrawn with immediate effect and not through a sunset clause.

Further, with a view to overcoming the problem thrown up by individual myopia, we also recommend the continuation of the deduction under section 80CCC for contribution to the pension fund of LIC or any other insurance company. The ceiling on the deduction should, however, be increased from the existing levels of Rs. 10,000 to 20,000. This income-based deduction u/s 80CCC be converted to a tax rebate at the minimum marginal rate of 20 per cent. Consequently, the ceiling on tax rebate for contribution to the pension fund should be Rs. 4,000. The new ceiling has been proposed keeping in view the needs of the smaller taxpayers with income below Rs. 2 lakhs. The scope of section 80CCC may also be extended to a larger number of pension/annuity schemes within the overall ceiling of Rs. 20,000. Since saving in these pension funds will be taxable at the withdrawal stage, the tax benefit for such saving will be consistent with the EET method of tax treatment.

In view of the International practice and the fact that education is one of the basic amenities of life, generating positive externalities, it is necessary to provide continued support to education under the tax law. However, on grounds of equity, we also recommend that the income based deduction under Section 80E should be converted to a tax rebate at the minimum marginal rate of personal income tax. The maximum amount of tax rebate should be restricted to Rs. 4,000.

Since health is also one of the basic amenities in life, support under the tax law will continue to be provided under section 80D of the Income Tax Act for contribution to the mediclaim insurance schemes, subject to a ceiling of Rs. 15,000.
However, the tax support would take the form of a tax rebate at the minimum marginal rate of 20 percent subject to a ceiling to Rs. 3,000/- in tax relief. Similarly, the income based deduction for medical expenses under section 80DDDB is proposed to be restricted to senior citizens subject to a reduced 213 ceiling of Rs. 20,000. The deduction would take the form of a tax rebate at 20 per cent subject to a maximum of Rs. 4,000.

With a view to providing a human face to the tax reform, we recommend that the basic exemption limit for senior citizen should be Rs. 50,000 more then the exemption limit for the general class of individual taxpayers. In other words, the exemption limit for senior citizens should be Rs. 1,50,000 as against Rs. 1,00,000 for the general category of individual taxpayers. The exemption limit for senior citizens should be revised as and when the exemption limit for the general category of individual taxpayers is revised. We also recommend that this benefit of higher exemption limit should also be extended to widows.

Given the personal circumstances of handicapped, the Task Force recommends the continuation of the personal deductions under sections 80DD and Section 80U. However, on grounds of equity between handicapped taxpayers, we also recommend that the income based deduction under these provisions should be converted to a tax rebate at the minimum marginal rate of personal income tax.

Further, in view of our recommendations for increase in the exemption limit to Rs. 1,00,000 and deduction of medical expenses for senior citizens and widows, we recommend that the personal deductions in the form of tax rebate for senior citizens (Section 88B) and (Section 88C) should be deleted.

The policy measures for the reform of personal income tax therefore comprises of the following elements:

(1). Increase in the generalized exemption limit from Rs. 50,000 to Rs. 1,00,000 for all individual and HUF taxpayers. The exemption limit for senior citizens and widows would, however, be at an enhanced level of Rs. 1,50,000.

(2). The existing three slabs in the personal Income tax rate schedule will be replaced by two slabs. Incomes between Rs. 1,00,000 and Rs. 4,00,000 will be subjected to tax at the marginal rate of 20 per cent.

(3). Dividends received from Indian Companies will be fully exempt.
(4). Long term capital gains on listed equity will be fully exempt.

(5). The standard deduction for salaried taxpayers will be reduced to NIL. However, exemption for conveyance allowance subject to a ceiling of Rs. 9,600 will continue.

(6). The income based deduction under Section 80D subject to a ceiling of Rs. 15,000 in respect of payment of medical insurance premium will be converted to a tax rebate at the rate of 20 per cent subject to a maximum of Rs.3,000.

(7). The benefit of deduction under Section 80DDB will be withdrawn in so far as it relates to the general category of taxpayers. However, consistent with international practice and in view of the special circumstances of senior citizens, dedicational for medical expenses may continue to be allowed in the form of a tax rebate at the rate of 20 per cent of the medical expenses subject to a maximum rebate of Rs.4,000.

(8). The income based deduction under Section 80E for repayment of educational expenses will continue to be allowed. However, on grounds of equity, the same should be allowed as a tax rebate at the rate of 20 per cent subject to maximum of Rs. 4,000.

(9). The tax rebate schemes under Sections 88 for savings will be eliminated.

(10). The tax rebate schemes under Section 88B for senior citizens will be eliminated in view of the enhanced exemption limit for them.

(11). The rebate under Section 88C for women taxpayers below the age of 65 years, will be eliminated.

(12). The income based deduction for handicapped under Section 80DD and 80U will however continue.

(13). The income based deduction under Section 80L for interest income and dividends will be eliminated.

(14). The exemption under Section 10 in respect of interest income from bonds, securities, debentures etc. will be eliminated.

(15). The deduction for mortgage interest in respect of loans for acquiring a owner occupied dwelling will be reduced to Rs.50,000.

3.4.3 (04) Corporate Tax Reforms: The general rate of depreciation for plant and machinery should be reduced to 15 per cent from the existing level of 25 per cent. The rates of depreciation for other blocks of assets must be reviewed along the same lines
as in the case of plant and machinery. Consequently, the depreciation amount charged for tax purposes will be similar to those charged under the Companies Act.

The tax benefit u/s 33 AC of the Income Tax Act should be abolished.

The task Force recommends the abolition of section 35 of the Income Tax Act. As a result, the revenue expenditure on scientific research will qualify for deduction u/s 37 of the Income Tax Act and Capital expenditure on scientific research will be eligible for depreciation under section 32 of the Income Tax Act.

With a view to aligning the provision relating to the allow ability of deduction u/s 36 (1)(iii) with those of the Accounting Standard 16 issued by the Institute of Chartered Accountants of India, it is recommended that a suitable clarificatory amendment to Section 36(l)(iii) should be made to provide for the disallowance of the borrowing costs that are directly attributable to the acquisition, construction or production of a capital asset, as a revenue expenditure.

Accordingly, it is recommended that the provision of section 36(l)(viiia) of the Income Tax Act should be amended to provide that the provision for bad and double-u debts will be restricted to the amount of provision defected and loss account as audited subject to the maximum amount of provisioning permitted under the prudential guidelines issued by the Reserve Bank of India.

Since, the objective of the provisions of section 43B is to ensure that a taxpayer does not avail of any statutory liability without actually making a payment for the same, we are of the view that these objectives would be served of the deduction for the statutory liability relating to labour are allowed in the year of payment.

The distinction between unabsorbed depreciation and unabsorbed business loss should be eliminated. In other words unabsorbed depreciation would be merged with business loss and lose its separate identity. Further, business loss would be allowed to be carried forward indefinitely.

The task Force recommends the elimination of the provisions of section 801A and 801B with immediate effect (and not by a sunset clause).

3.4.3 (05) Taxation of Capital Gains: The Concessional treatment of long-term capital gains through a reduced scheduler rate of tax must be abolished. In other
words, the long-term capital gains would be aggregated with other incomes and subjected to taxation at the normal rates. Further, since we have recommended the abolition of various saving incentives, we do not consider necessary to allow any exemption for roll over of long-term capital gains.

Given the public nature of the project, it is necessary to maintain the flow of funds. Therefore, we recommend that long-term capital gains should continue to be exempt if invested in a house or in the bonds of National Highway Authority of India until completion of the Golden Quadrilateral and the North-South & East-West corridors.

We have also recommended that while short-term capital gains on equity should continue to be taxed, the long-term capital gains on equity should be eliminated. However, recognizing the possibility of abuse by transferring real assets through the corporate vehicle, we also recommend that the exemption on long-term capital gain on equity should be restricted to listed securities as defined in section 112 of Income Tax Act. Treatment of Other Entities.

3.4.3 (06) Treatment of other Entities: Where there is a conflict between simplicity of equity, the Task Force has a preference for simplicity. Complexity is, inherently, regressive and nontransparent. Therefore, what may appear to be equitable could, in effect, be inequitable? In the light of the problems associated with the existing system of taxation of investment fund and the package for corporate tax reform, we recommended the following:

(1). The income of the mutual fund derived from short-term capital gains and interest should be taxed at a flat rate in the hands of the mutual fund.

(2). Since most investors in units are generally smaller taxpayers, we recommend that the rate of tax should be the minimum marginal rate of personal income tax i.e. 20 per cent.

(3). With the view to overcoming double taxation, the dividends received by the unit holders should be fully exempted since the distributable surplus would have suffered the full burden of the tax.

(4). The short-term capital gain arising to the investor from sale of units of investment funds should be taxed at his level at the personal marginal rate of tax.
(5). The long-term capital gain arising to the investor from sale of units of mutual fund should be exempt from income tax.

(6). The tax treatment of mutual funds and their investors should also be extended to venture capital funds, private equity funds and hedge funds. However, the tax rate for these funds should be 30 percent since their investors are likely to be those in the highest tax slab.

(7). All funds must necessarily obtain the PAN of the investor and the databases about every payment made by the fund manager back to the investor, tagged with PAN, should be furnished to the tax authorities as an information return. At present, the profits of a partnership firm are subjected to tax at the same rate of tax applicable to a domestic company. In view of our recommendations, for corporate tax reform, we recommend that the rate of tax for partnership firms should be reduced to the same level as corporate rate of tax.

The tax benefit for donations to charitable trusts must take the form of tax rebate at the minimum marginal rate of tax of 20 percent. Further we also recommend that there should be no quantitative ceiling either in absolute terms or as a fraction of the gross income as is presently provided under Section 80G. Therefore, the Task Force recommends that the exemptions under Section 10(21), 10(23B) and 10(23C) (iiiab) to (via), 10(29A) should be merged with Section 11 to 13A of the Income Tax Act. We also recommend that:

(1). The present practice of exempting a class of charitable trust and through notifications should be abolished. However, the requirement to file a return of Income by such trust and institutions as proof of fulfilling the various conditions stipulated u/s 10(23C), should continue.

(2). Returns to be identified for scrutiny/audit only through a computerized risk assessment system.

(3). Where a return is identified for scrutiny and the assessing officer is of the opinion that the activities of the trust are not charitable in nature, such a case will be referred to a rating to a agency from amongst the panel drawn up by the C &AG. An "A+" rating for the trust will mean that it is indeed a charitable trust. An "A+" rating for the trust will mean that it will enjoy exemption during the current year and will be subjected to review again in the following year. A
B. rating for the trust will be disqualifying it from any tax exemption. The new procedure should be introduced from 01-04-2004 and the interregnum should be utilized to work out the details and also allowing the trust to adapt to the new procedures.

(4) Since a large number of provisions in the Income Tax Act are regulatory in nature, we also recommend the creation of a National Charities Board to assist the government in regulating and promoting charities on the lines of the National Charities Commission U.K. Since, a number of States in India already have the charity commissioners the proposed Board may have to be advisory.

The income Tax Department should reimburse to trusts, the fees payable to the rating agency.

We recommend the elimination of Section 80P of the Income Tax Act. However, the existing exemption limit of Rs. 10,000/-prescribed as part of the rate schedule, should be increased to Rs. 1,00,000/- and the revised income tax rate schedule for cooperatives should be the same as recommended for personal income tax.

The manpower strength of FTD should be immediately augmented so as to assign one team each for America, Europe, South East Asia and Australia, and Rest of the World.

We understand that, as recommended by us in our Consultation Paper, the CBDT has already set up a working group headed by the Director General of Income Tax (International Taxation) and comprising of representatives also from trade and industry to examine the various issues relating to taxation of non-resident individual and foreign companies. We also understand that the working group is expected to submit its report by the end of December. We suggest that the recommendations should be processed during the forthcoming budget exercise.

3.4.3 (07) Treatment of Other Taxes: The Task Force recommends the abolition of wealth tax.

The present tax on expenditure in hotels is in the nature of a consumption tax. It was introduced as a separate tax in the absence of a tax on services. Since tax on service has since been introduced, it is only appropriate that this levy is merged with service tax. We recommended accordingly:
Individual Taxpayers of all categories and in every income group benefit substantially from the package of recommendations. Overall, the recommendations are revenue neutral at the existing level of compliance. To the extent the new simplified and liberalized tax regime will induce compliance, the revenue gains are likely to be substantially higher and it will enhance buoyancy by widening the personal and corporate income tax bases. The recommendations for eliminating the exemptions, the extensive use of technology and privatization of non-core activities of the tax administration will result in a sharp reduction in transaction cost. A 10 per cent reduction in transaction cost for personal income tax would help taxpayers to save an estimated Rs. 4,000 crores. Such reduction in transaction cost is progressive.