CHAPTER - VII

EPITOME

India has a fairly elaborate and complicated structure of Income-Tax. This structure is unstable; without any long term policy and completely based on trial and error method. It contains a number of superfluous provisions, which have no use and exist merely to complicate the tax structure. Some provisions are found irrational, illogical and somewhat inconsistent with the underlying objectives. The government wants to achieve all the economic goals through income tax and it seems that the income-tax has become a controlling steering of Indian economy. The present way of operating the income-tax is clearly unjust and it taxes, far more than proportionately, the income of salaried persons and those who choose to remain honest.

In India, taxation has been used as a powerful instrument of fiscal policy. Taxation alone constitutes more than half portion of the total budget resources. The level of taxation in India, is much less than that in developed countries but it is fairly high in comparison to the countries with similar per capita income. The revenue from major direct taxes of the union government as a proportion of 'non-agricultural gross domestic product' shows a decreasing trend. There is a substantial growth in tax revenue since 1951. At constant prices, the total central revenue has increased 12.43 times since 1950-51 to 1990-91.
The indirect tax revenue increased 18.2 times in the same period but the direct tax revenue increased only 4.92 times. The increase in income-tax revenue is 4.81 times in this forty years period.

The major portion of total tax revenue comes through indirect taxes. In most of the years, more than three-fourth of total tax revenue has come from indirect taxes and the contribution of direct taxes has been less than one-fourth. There is a decreasing trend in the relative contribution of direct taxes in total tax revenue. Like other developing countries, India has also kept major reliance on indirect taxes. In spite of the fact that the direct taxes found relatively lesser reliance of the fiscal system, yet the contribution of income-tax in resource mobilisation has been significant. The percentage contribution of income-tax in central tax revenue has decreased but it has increased in absolute terms. The decrease in the percentage contribution of income-tax in total central tax revenue is due to relatively high increase in indirect tax revenue. The share of personal income-tax and corporation income tax is roughly equal.

The composition of income tax revenue shows that the company assessees constitute only about one percent of total assessees and contribute roughly fifty percent of total income tax revenue. Individuals assessees are about 80 per cent in number, contribute about 40 per cent of total income.
tax revenue. About three-fourth of total income-tax revenue comes from 'business and profession' head and the salaried persons share about 10 per cent of the income tax revenue. Roughly three-fourth assessees are in the income range of below Rs. 50,000 and they contribute only one tenth of the income tax revenue. There is only a handful of assessees who are in the incomes range of above Rs. 1,00,000 and their contribution in income tax revenue is roughly three-fourth.

Indian income-tax structure is not only complicated but also far from rationality. It contains same provisions which have become superfluous, outdated or inconsistent with the underlying objectives of these provisions. One such type of provision is under section 10(13-A) related to the tax exemption of House Rent Allowance received by an employee. For granting this relief, the income tax department insists on production of rent receipts to prove that the rent paid by employee is more than ten per cent of his salary. Most of the employee are not able to produce rent receipts and consequently not getting any deduction under this provision. The tax treatment of House Rent Allowance creates discrimination between the employees posted in metropolitan cities and rural areas. This provision also places these assessees in a disadvantageous position, who are not lucky enough to get an accommodation from their employer. The present way of providing exemption for 'House Rent Allowance' hunts those employees who occupy their own house as they are not entitled to get exemption under this
provision. The fact has been recognised by the High Court also but the government has set aside the judgment by making an amendment in the law. To make this provision meaningful, the amount of HRA received by government and semi government employees should be fully exempted without taking into consideration whether any rent is paid or not and to prevent the misuse of this provision, some ceilings of H.R.A. can be imposed for private sector employees, taking H.R.A. of central government employees as standard.

Section 16(ii) of Income-Tax Act 1961, contains a provision on the pretext to exempt the entertainment allowance received by an employee. This provision does not serve any purpose and just complicates the tax structure. It should be deleted without any delay and let the entertainment allowance fully taxable. Another outdated provision is related to the valuation of perquisites in respect of motor car and domestic servants. The value of perquisite for domestic servants (sweeper or watchman) is maximum Rs. 60 for one month. These rates were fixed in 1969 and there has been no revision in these rates since then. Had these amounts been raised on the basis of inflation, it would have been around Rs. 500 per month. The provision governing the valuation of perquisite in respect of car, has also become outdated due to the lack of inflationary adjustments. This provision, as it stands now, does not serve any purpose. So the value of these perquisites should be revised taking into account the rise in prices.
Due to inflation, the tax treatment of interest income has become a typical problem. It has become necessary to recognise the impact of inflation on the interest receipts and distinction must be made between the real income and the inflationary gain, so that the inflationary component of interest income may be exempted from taxation and tax can be levied only on the real income. In a number of countries, including Argentina, Austria, Belgium, Brazil, Canada, Colombia, Chile, Denmark, Germany and United Kingdom, either the interest income is fully exempted from income tax or the inflationary component is excluded from the tax base on the ground that the investments suffer an erosion in their real value due to rise in prices. Since the government has introduced indexing of capital gains with inflation, it has placed the interest earner comparatively in a disadvantageous position. Now the income tax system offers a more favourable tax treatment for capital gain than that for the interest income, as the 75 per cent of inflationary component of capital gain is exempted from income-tax and only 25 per cent of inflationary gain is taxable. On the other hand the inflationary component of interest income is fully taxable. This policy of taxation is unjust and inequitable for earners of interest income. This is a discrimination between different categories of taxpayers and is against the spirits of our taxation policy. To meet the demand of globalisation of the tax structure, either the inflation adjustment scheme should be introduced for
interest income or as an alternative, the interest on deposits in post offices, banks and similar other institutions, should be exempted from income-tax. As the rate of interest on these deposits is low and the tax exemption will compensate for this and at the same time this will simplify the tax system.

In lieu of the expenditure incurred for earning the income, section 16(i) of income-tax Act provides a standard deduction for salaried persons. The quantum of standard deduction has not been raised according to the rise in prices. This point was also ignored by the Chelliah Committee. If the standard deduction had been raised on the basis of consumer price index, it would have been around Rs. 20,000 in 1992-93. The main objective of providing standard deduction is to cover the expenditure incurred as conveyance. There is a steep rise in the prices of petrol, cars, scooters and the fare of public transport, but the standard deduction has not been raised accordingly.

The present way of operating the standard deduction places the salaried persons in a disadvantageous position in comparison to the businessmen and professionals with the same expenditure on conveyance. The rising prices hit the salaried persons more in comparison to the businessmen and professionals. As the standard deduction is given in lieu of expenditure incurred for earning the salary, it is the right of the salaried persons and it should not be dependent on the mercy of the Finance Minister. The method of
providing the standard deduction is arbitrary, discriminatory and inconsistent with the objectives, for which the provision was introduced. The monetary ceiling on standard deduction should be lifted and it should be equivalent to one third of salary.

The method of computing surcharge on personal income tax, violates the basic principle of slab system. Under the income tax law, surcharge @ 12 per cent is leviable if the taxable income of an individual or HUF, exceeds Rs.1,00,000. After earning an income of Rs.1,00,000, an increase of Rs.100 in income will result in an additional tax liability of Rs.2373 and consequently, while the taxable income increases by Rs.100, the after tax income will decrease by Rs.2273. After earning an income of Rs.1,00,000, the additional income upto Rs.4220, will not increase the after tax income. The taxpayers in some such cases may be prompted to evade payment of tax by reducing their income to Rs.1,00,000 by all means. To remove this anomaly, either the surcharge should be abolished or if it is not possible, then it may be merged with the tax rate applicable on income exceeding Rs.1,00,000. It will never result in negative marginal income and the tax structure will become rational.

A similar anomaly exists in section 88 B, that provides- a rebate in tax liability of senior citizens. The objective of the government behind this provision is political rather than social. It is intended to gain cheap popularity. If
the government really wants to give relief to the senior citizens, the pension income should be made tax free. The increasing medical expenditure in old age and decreased earning capacity of a retired person make sense to exempt pension from income taxation.

In our income-tax law, different tax treatments are given to employees of government, semi-government, public sector and private sector. It resulted in a complicated and unfair tax law. A good tax structure should be based on equity principle and there must not be any discrimination between different sections of the assesses. In order to rationalize the income-tax law, it is essential to modify these provisions and equal tax treatment should be given to persons of equal economic status, irrespective of the fact whether the person is a government employee or non-government employee, however, reasonable restrictions may be imposed on private sector employees to counteract the misuse of tax provisions. Several meanings of one concept is also one of the reasons for complications of tax structure. It makes the tax law ambiguous and encourages litigation. To avoid unnecessary litigation and to make the tax law understandable at least for reasonably educated persons and to remove interpretational hazards, one concept must have only one meaning for all purposes.

It has been found that certain provisions have been modified, keeping aside the basic purpose, only to achieve certain political objectives. The political purposes should
not be achieved through income-tax and the government should not play with the tax provisions for political reasons.

The demand of raising the income-tax exemption limit has been a burning topic. The level of exemption limit is directly concerned with the cost of subsistence. In India, the empirical evidences reveal that the exemption limit has not been raised according to the increase in the cost of subsistence. Had the exemption limit been fixed after indexing the exemption limit of Rs.15,000 for the income earning year 1981-82 with consumer price index, it would have been more than Rs.40,000 for the income earning year 1993-94. The recommendations of Chelliah Committee on the exemption limit are not fair and have been arrived at after manipulation of the facts. Taking the exemption limit of 1976-77 as base was illogical and the computation of exemption limit by indexing was also wrong.

There is a strong case for raising the exemption limit to Rs. 50,000. The Finance Minister's plea that raising the exemption limit to Rs. 50,000 may result in substantial loss of revenue, does not hold much water, as the government is receiving 90 per cent of total income tax revenue from the taxpayers having income above Rs. 50,000 and the assessees under the income range of below Rs. 50,000, contribute only 10 per cent of income-tax revenue. Therefore, the state will continue to receive atleast 90 per cent of present income-tax revenue, even if the exemption limit is raised to
Rs. 50,000 and the loss of 10 per cent can be easily compensated by taking more stringent steps to check evasion in case of higher income groups. It is wrongly believed that raising the exemption limit will reduce the coverage of income-tax by making substantial reduction in the number of taxpayers. Statistics show that there is no correlation between the changes in exemption limit and the total number of taxpayers.

It has been found that the cost of collection of income-tax is about Rs. 300 per assessee and a large number of taxpayers are paying tax of less than Rs. 300, not sufficient even to meet the cost of collection. It also supports the logic to raise the exemption limit.

India has a history of exceptionally high rate of Income Tax at least as far as the maximum marginal tax rate is concerned. We have come from an extremely high rate environment to a moderate tax rate structure. The rates of tax have been quite unstable. The changes made in the rates in the past were not based on any solid reason. Although the maximum marginal tax rate has been reduced substantially but there is no change in the level of income at which the maximum marginal tax rates (MMTR) is applicable. There is a strong case for raising the MMTR level of income. At present prices, the MMTR level of income was 15 lakhs in 1970-71. It was about 3 lakhs in 1987-88. The MMTR level of income has not been changed since 1987-88, in spite of the fact that there is a steep rise in prices. So the MMTR
On surface of it, it appears that there is substantial reduction in income-tax rates at all levels. But the study based on constant prices does not recognise this fact. It reveals that the tax rates are reduced only for high income groups and there is a considerable increase in tax rates for lower income groups. The tax rates, upto the income level of Rs. 75,000, have increased. On the middle income group (one lakh to 1.5 lakh), there is no significant effect of the change in rate structure. For the very high income group (Rs. 3 lakhs and above), the rates have been reduced substantially. It may be concluded that the relief in the tax burden to high income groups, is given on the cost of lower income groups. The empirical results reveal that the progressivity of tax rates has been decreased substantially. The effects of 'tax preferences' on the tax rates reveal that undoubtedly, the effective tax rates have been reduced by the 'tax preferences', still the rates of tax are high in India.

The top individual income tax rate which was highest in the world around 1973, has been reduced substantially and the recent trend is towards the globalisation of the rate structure. Recently, the government has further reduced the tax rates. But this reduction is made by withdrawal of a number of deductions and consequently, the assessees in the income range upto Rs. 1,00,000, may not benefit much, but
the creamy layer will certainly be benefited. The study concludes that the task of restructuring the tax rates is still incomplete and the government should retake the task of restructuring the rate schedule. The exemption limit should be raised to Rs. 50,000. Tax should be levied @ 20 per cent on the income range between Rs. 50,000 and Rs. 1,00,000. A 30 per cent rate should be prescribed for the income range of Rs. 1,00,000 to Rs. 2,00,000 and 40 per cent on the income above Rs. 2,00,000. Surcharge should be abolished. The rate structure may be reviewed after every five years and no change should be made in between.

The inflation causes significant increases in the tax burdens of individuals. The increase in tax burden is several times more than the increase in monetary income. It causes a person to pay a different amount of tax than the would pay on the same real income in a non-inflationary period. Inflation causes significant increases in the effective rate of the individual income tax. The inflation alters the structure of income tax rates, the real width of tax brackets and real value of all exemptions, deductions and allowances fixed in nominal terms. The effect of inflation on the tax liabilities of individuals is not uniform on different income brackets. The low income group is effected more and comparatively lesser effects are there on high income group. The salaried persons are effected more by the inflation because of fixed 'standard deduction' for them in lieu of allowing expenditure in computing the
taxable income and the inflation reduces the real value of 'standard deduction' which is fixed in monetary terms.

To overcome the problem of inflationary effects on the tax system, we need an 'automatic inflation adjustment scheme. In a number of countries including Canada, Uruguay, Israel, Denmark, Chile, Colombia, Argentina, Peru, Sweden, U.K. France, Luxembourg and several other countries, there are inflation adjustment schemes which protect the tax system from inflationary effects.

India has experienced a very high rate of inflation. The increase in prices has come on the top with a 16 per cent rise during the 12 months ending October, 1991. This means statistically, that there has been an increase of over 25 per cent in wholesale price index in two years. It makes it urgent to introduce the inflation adjustment scheme in income-tax structure. Due to the lack of inflation adjustment, a number of provisions which are fixed in monetary terms, have become outdated and the revision in monetary values of these provisions will be an ad hoc solution only. Unless an inflation proof tax system is adopted, the problem will arise again and again. The automatic adjustment of inflation can play a great role in stabilizing the tax structure. The good experience of other countries also justifies the plea to adopt an inflation proof tax system and it will also meet the demand of globalisation of the tax structure.

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The performance of income tax department in discharging of its duties is not satisfactory. It is poor not only in quantitative terms, but also the quality of work is very degraded. A huge number of assessments is pending with income-tax department and waiting for disposal. The system of 'withholding the tax at source', has been widely used for collection of taxes. About one-third of total income tax collections, is being deducted at the source of income. The 'advance payment of tax' and self assessment system are also very effective. But the post-assessment tax collection system has not been used effectively. In the pre-assessment tax collection system, (T.D.S & Advance tax), the role of income-tax department is not much important and the efficiency of the tax administration may be assessed by the post assessment collections. There is a sharp increase in the arrears of taxes. Contrary to general presumption, the substantial increase in the arrears of income-tax is not due to non-compliance with the provisions relating to T D S and advance tax, as some people think. It has been found that the provisions of TDS and advance tax have been adhered to a large extent and the fault lies in the mode of collection by self assessment and regular assessment i.e. in the income tax administration.

The performance of income-tax department in disposal of appeals in also not satisfactory as the pendency of appeals is increasing year by year. While the tax administration has shown poor performance in disposal of assessments and
collection of tax, on the front of refund of excess payments, the position appears to be good. It is due the self interest of assessees and good offers of bribes for income tax officials. The anti-evasion provisions in income tax law, have not been used efficiently by the tax administration. The search and surveys have become just a mode of bribe collection by the tax officers. The corruption in the income tax department has made the anti-evasion provisions ineffective.

On the point of 'cost of collection', the income tax department is over assessing its economy. The cost of collection is not the cost incurred by the income-tax department only. In fact, all the departments are helping the tax administration in collections of taxes in form of TDS. The banking institutions are also providing free services to income tax department by accepting tax payments of on behalf of tax administration. As a major portion of tax collections comes from TDS and advance tax, the credit of this cannot be given to income tax department and therefore, the claim of income-tax department of showing economy in tax collection is merely an eyewash. The wrong recruitment policies for tax officers, corruption, prevailing in the department, lack of co-operation from taxpayers and general public, are the few major causes for the poor performance of tax administration.

There must be a complete change in recruitment system and steps should be taken to check corruption prevailing in tax
administration.

At the end, the researcher firmly believes that the implementation of the suggestions made in this study can add a new chapter in the history of income taxation in India.
MAJOR RECOMMENDATIONS AT A GLANCE

i) The exemption limit should be raised to Rs. 50,000.

ii) Monetary ceiling from 'standard deduction' should be deleted and let it continue as one third of salary.

iii) H R A should be fully exempted from taxation without taking into consideration whether any rent is paid or not.

iv) Section 16(ii) for entertainment allowance should be deleted and let it be taxable.

v) The provisions for valuation of perquisites in respect of car and domestic servants should be modified.

vi) Interest income from the deposits in post offices, banks and similar institutions should be exempted from income-tax.

vii) Surcharge should be abolished and if it is not possible than merge it with the maximum marginal tax rate.

viii) Pension should not be taxed.

ix) Government should not play with the tax provisions for political reasons.

x) Level of income for maximum marginal tax rate should be raised to Rs. 2 Lakhs.

xi) Introduce 'automatic adjustments for inflation' in income-tax structure.

xii) Change the recruitment procedure of IRS officers and inspectors of income-tax.