Chapter V

Summary Conclusions and Suggestions
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Significance of the Study

Taxation of corporate incomes is a prominent form of taxation in countries all over the world, including India. In India, corporation income-tax contributes about 1.6 per cent of the Gross Domestic Product and constitutes about 51 per cent of all direct taxes. Reform of direct taxes has received serious attention of successive Indian Governments in the post-independence period and a number of Study Groups and Committees have been appointed from time to time to recommend policy measures for improving tax collection, compliance and administration.

Most of the Study Groups and Committees set up by the Government have recommended that tax administration in the country must be streamlined. The question of what it exactly means to ‘streamline’ administration has largely been left unanswered, except for a few sporadic suggestions on isolated aspects of tax administration. Further, most of the Tax Reforms Committees have dealt with the administration of direct taxes as a whole and have not devoted particular attention to corporate taxpayers. All ingredients of tax administration have not been studied with a holistic perspective.

Since corporation income-tax now happens to be the single largest contributor of direct tax revenue in the country and since its contribution is expected to grow further in the coming years, there is need to focus specific attention on the administration of corporation income-tax and on the problems faced by taxpaying companies. To fulfill these gaps, this study makes a modest attempt to examine the scheme of corporation income taxation in the country and the problems therein, to assess the tax behaviour of companies with reference to
empirical data obtained from a sample covering a cross section of Indian companies and to evaluate the impact of the recent tax reforms programme of the Government of India on the administration of the corporation income-tax, particularly from the perspective of the companies.

The study focuses attention on some theoretical and practical aspects of the taxation of companies, highlights the nature and magnitude of problems in the administration of the tax and presents appropriate policy suggestions for improving tax administration and for the overall reform of the tax system. This study is different from others on the subject in the sense that it has gone deeper into the ingredients of tax administration and analyzed the problems therein in considerable detail, on the basis of empirical data obtained through actual interaction with the tax-paying corporate entities.

Corporate Taxation: Theory & Practice

The Case for a Corporation Income Tax: Some economists have questioned the very justification for treating companies as separate taxable entities. There is, however, a very strong case for the levy of such a tax for the following reasons: (i) companies are viable economic units engaged in activities distinct from those of their shareholders, (ii) corporations enjoy special privileges like limited liability and are recognized as separate legal entities, which give the government the right to tax their incomes; (iii) corporation income-tax is necessary to protect the equity consideration and revenue potential of the personal income-tax; (iv) the corporation income-tax contributes to progression in the tax system; (v) absence of a corporation income-tax would create a differential between corporate profits and retained earnings and violates equity; (vi) the corporation income-tax already exists and its elimination would confer windfall gains on existing shareholders; (vii) Governments have great revenue requirements which can be met easily by corporation income-tax, (viii) corporation income-tax is a withholding tax on
income from capital, and (ix) corporation income-tax has less harmful effects on the economy than many other taxes. Thus a corporation income-tax is economically justified, administratively feasible, politically convenient and socially desirable. The main objections to the taxation of corporate income are that it leads to inequity, causes double taxation of dividend incomes and that corporations do not have taxable capacity. These objections are easily overcome through suitable policy measures and do not come in the way of taxing corporate incomes.

The incidence and impact of corporation income-tax: Some economists believe that the corporation income-tax is actually shifted on to individuals and is not borne ultimately by the companies themselves. However, there is no definite conclusion about the incidence of the corporation income-tax and it could be on any one or on all of the four groups of persons, namely, the entrepreneurs, the shareholders, the labour or the consumers of companies' products or services. In the long run, the ability of corporations to shift the tax appears to be limited. There is a point of view that the impact of a corporation income-tax is to reduce corporate savings and depress rates of return on corporate investments, but there is no evidence to prove such contentions. In fact, the disincentive effects of a corporation income-tax, if any, could be much lower than those induced by other forms of taxation.

Classification of corporate tax systems: Depending on the base and rate of tax and the level of integration with personal income-taxes, corporate income-tax systems followed in different countries of the world are classified into various categories. Some of the major corporate income-tax systems prevalent in the world include the classical system, the imputation system, the two rate system, the integrated system, the cash flow or the flow of funds system, the avoir fiscal system and the formula apportionment system. The question of what constitutes the correct tax design for a country depends on the overall socio-economic goals of that country. In general the corporate income tax system should be such as to promote
investment, corporate form of enterprise, allocative efficiency and domestic savings, without ignoring equity considerations.

Corporation Tax in India: In India, the classical system of corporate taxation is followed. Companies have been treated as separate taxable entities since 1860. Various direct tax legislations were enacted in the country in 1886, 1918, 1922 and 1961 and a new legislation is proposed to be enacted in 1998, for taxing incomes of different entities, including corporations. The Chelliah Committee set up by the Government of India in 1991 has favoured the continuation of the exiting classical system of corporate income-taxation, with a lowering of tax rate for all domestic companies.

Base of Corporation Tax: Viewed from the perspective of the number of taxpayers, the base of corporation income-tax in India is not very wide because less than fifty percent of all companies incorporated in the country are assessed to income-tax. Viewed from the point of view of what is actually taxed, the tax base suffers from serious erosion created by the deductibility of interest on borrowed capital and by various other tax incentives allowed to companies. The base of corporate income-tax in India is thus narrow and the reform objective of widening the tax base has not been realised because the rate of growth in the number of taxpayers has declined after reforms.

Fiscal Incentives and Tax Expenditure: The Indian income-tax law allows a large number of exemptions and deductions to companies, for achieving diverse socio-economic goals. However such fiscal incentives cannot be justified in public interest because such exemptions and deductions have (i) constituted a large tax expenditure and an unjustified and invisible subsidy to companies, (ii) created wide divergence between the statutory and effective tax rates, (iii) created inequity in the tax system, (iv) introduced complexity in tax laws and administration, (v) increased litigation and tax evasion, (vi) created a widespread feeling of unfairness among different classes of
taxpayers, (vii) resulted in the distortion of allocation of economic resources, (viii) 
not helped in achieving the objectives for which they were envisaged, (ix) resulted in 
tax code being used to conduct governmental policies and (x) existence of a number 
of profit-making, zero-tax companies.

Depreciation: Depreciation happens to be the most predominant of all 
deductions availed by Indian companies. The Indian Income-Tax law allows 
depreciation on capital assets on an accelerated basis which leads to misallocation of 
resources and violates uniformity of taxation among industries. A tax regime that 
provides accelerated depreciation distorts economic decision-making of companies, 
 apart from causing considerable loss of tax revenue.

The Rate of Corporation Income-Tax: A uniform rate of tax is now applied to the 
 incomes of all domestic companies in India. The statutory rates of income-tax have 
 been reduced over the last few years, in accordance with the Chelliah Committee 
 recommendations. However, this step was not accompanied by the removal of 
 unnecessary tax shelters. Thus, effective tax rates are much lower than the statutory 
 rates and the divergence between the two rates has increased after reforms.

Double Taxation of Dividends and Integration of personal and Corporate Income Taxes:
Double taxation of dividend incomes arises in the classical system of corporate 
income-taxation because dividends are subject to both corporation income-tax and 
the personal income-tax. Equity and efficiency considerations call for the integration 
of the two taxes and removal of such double taxation. Several methods have been 
tried to achieve such an integration. In India, the problem is sought to be 
ameliorated with effect from assessment year 1998-99, with the introduction of a 
‘corporate dividend tax’ to be paid by companies on the dividends paid by them and 
with the exemption of the dividend incomes from taxation in the hands of 
individual shareholders.
Presumptive Taxation of Companies: The levy of a presumptive tax on companies is suggested as the best method of ensuring that all corporations with taxable profits do pay the tax. The existence of a number of ‘zero-tax’ companies in India justifies the levy of such a tax. This method offers a way by which substantive base broadening can be achieved. The opponents of presumptive taxation argue that it would be far better to insist on tighter enforcement of existing tax laws and better compliance from companies rather than to introduce the presumptive minimum tax. They point to the past failures of presumptive schemes and warn of enormous litigation and tax disputes resulting from the implementation of such schemes. However, tax policymakers have rightly accepted the concept of a minimum tax on companies and have recently introduced a scheme of minimum alternative tax on companies in India.

Tax Avoidance and Evasion: The phenomena of tax avoidance and evasion are some of the most widely acknowledged problems in taxation. Non-compliance with tax laws, whether it is called tax avoidance or tax evasion, indicates the failure of taxpayers to act in accordance with statutory requirements or intentions of the tax law. Rampant tax evasion has rendered tax systems in many countries inefficient and inequitable. In India, large scale tax evasion has been attributed to high tax rates coupled with complex procedure of tax compliance, legal complexity leading to prolonged litigation, administrative lapses, inefficiency, corruption and nexus between influential tax evaders and political elements. There are significant economic, psychic and social effects of tax evasion and the existence of tax evasion could contribute to the further erosion of the tax structures.

Issues in Tax Reforms: The expression ‘tax reforms’ is usually understood to mean an exercise aimed at making a tax system fairer and more acceptable to citizens, making tax laws simpler, removing anomalies, improving compliance with tax laws, strengthening enforcement, improving the income elasticity of tax revenue and making the tax system revenue neutral and equitable.
**Tax Administration and Tax Reforms:** In tax reform, there is a clear relationship between good tax policy and tax administration. Reform of tax structures is generally more effective when accompanied by improvements in tax administration and strengthening tax administration is one of the most important objectives of tax reform. A good tax policy cannot exist without good administration. The key to successful tax reform is to design a tax structure that can be administered adequately with the available resources. It is critically important in proposing changes in tax policy to be sure that such changes do take into account existing administrative capabilities.

**Computerization of Tax Administration:** Computerization of tax administration offers the most effective means of meeting additional budgetary needs for revenue, increasing compliance with tax obligations and more efficient collection which are becoming priorities of developing countries. There are several areas in which tax administration could benefit from computerization. Such areas include processing tax returns, calculating taxes, identifying errors in computation, maintaining taxpayers’ records, preparing notices, group assessments, issuing of refunds, generation of statistical reports, etc. Replacement of paper tax returns with electronic returns is another task achievable with computerization. Computerization also facilitates tax enforcements through identification of tax defaulters and evaders, selecting returns for audit and identification of areas where large amounts of tax are potentially evaded.

**Privatization of Tax Administration:** It is desirable to privatize certain components of tax administration that is better done by private agencies and that could result in considerable cost-saving for tax administration and realization of better results. Selective privatization has the merit of freeing more time for tax administration to devote to weightier matters and concentrate its efforts on greater efficiency in assessment, investigation and tax collection. Some of the areas where privatization is desirable include printing of forms, advertisement campaigns,
creation of computerized data base for non-classified information, collection of income-tax returns from assessees, return certification, advance rulings, etc.

**Tax Deduction at Source:** Tax Deduction at source is a time-tested method which serves not only as a mechanism for ensuring tax payments, but also as an approximation of taxes due by assessees. Tax administration can benefit by improving the implementation of tax deduction at source provisions. This area is an example of successful privatization in tax administration.

**Public Relations:** There is great need for tax administrations to improve their public relations because the public’s perception of a tax administration’s integrity, efficiency and effectiveness directly affects the citizens’ willingness to voluntarily comply with the tax laws.

**Service Conditions of Tax Personnel:** Tax administrations should not be treated as just another appendage of the general civil service of countries, but must be endowed with functional and financial autonomy, so as to infuse professionalism in tax administration and attract the best of talents. The status of revenue institutions in the public sector is one of the major factors affecting their ability to specialize and respond positively and adequately to changes in the economy. Poor package of pay and allowances hardly commensurate with risks and responsibilities of tax personnel, lack of security to field staff and lack of incentive systems and career advancement opportunities adversely affect tax administration. The success of any reform package crucially depends upon administrative capabilities to translate policies into reality and this cannot be expected out of a frustrated and poorly paid tax personnel.

**Tax Reforms in India:** A number of tax enquiry committees have been appointed in India since its independence to recommend measures for reforming the tax system in India. The latest of such committees was the Chelliah Committee which submitted its final report to the Government in August 1992. The Chelliah Committee recommended the lowering of corporate tax rates, broadening of tax
base and phasing out of tax shelters. Following these recommendations, the

International Trends in Tax Reforms: The dominant theme in worldwide tax
reforms has been to lower the corporate income tax rates and to broaden the tax
base. Among developed countries, the UK led the way by reducing corporate tax
rates to 35% in 1984. The United States, Canada, the Netherlands, Japan, Denmark,
France and Germany have also reduced corporate income-tax rates. Many of the
developed countries, including the USA, UK and Canada have eliminated fiscal
incentives and broadened their corporation income-tax bases.

In the USA and Australia, electronic returns filing systems have been
introduced with considerable success. Japanese tax administration has introduced a
self-assessment system for corporate and individual taxpayers to enhance voluntary
tax compliance. Most of the developed countries such as Sweden, the Netherlands
and the USA have attempted to integrate their individual and corporate income taxes
by providing some form of dividend relief.

The developing countries have also been trying to move towards a broad-
based, low-rate regime of corporate income tax and to align the corporate tax rates
to the top bracket personal income-tax rate, facilitating integration of the two. Base
broadening has been sought to be achieved in these countries through weeding out
tax deductions and introducing presumptive schemes of taxation.

Tax Behaviour of Indian Companies

This study has attempted to study the tax behaviour of Indian companies on
the basis of data collected through structured questionnaires from a cross-sectional
sample of companies. The inter-relationship of income-tax paid by companies with
other variables such as turnover, profit, returned income, effective tax rate and
deductions availed has been examined by computing simple correlation coefficients and then the relative importance of these variables in determining income-tax paid has been determined through step-wise multiple regression analysis.

The analysis has been carried out with respect to two three-year time-periods namely, before reforms and after reforms and tax behaviour in the two period has been compared to ascertain changes brought about by the tax reforms programme. Disaggregated analysis has been carried out across different size-groups, sectors of industry, patterns of ownership and regional distribution of sample companies, to ascertain variations and similarities in tax behaviour of companies. Finally, Deduction-Tax Ratios (DTR's) have been computed for all companies taken together as well as for each group of companies on the basis of the classifications explained above, to predict tax behaviour induced by successive cuts in deductions allowed.

**Tax Behaviour of All Companies:** In the post-reforms period, although the average turnover and profit of all sample companies increased in absolute terms, average returned income and effective tax rates declined and deductions availed by companies increased substantially. Regression analysis shows that returned income was the most dominant factor influencing income-tax paid by all companies and a decline in this variable has adversely affected income-tax paid after reforms. Fall in effective tax rates has created wide divergence between the statutory and effective tax rates. Tax behaviour prediction Table computed for these companies yields a Deduction-Tax Ratio of 0.66, indicating that a unit increase in income-tax paid could be achieved by reducing deductions allowed to companies by about 0.66 unit.

**Tax Behaviour across Size-Groups:** In the case of small companies, average returned income has emerged as the most important variable after reforms and there is a significant improvement in the same, both in absolute terms and as a proportion of profit. However, since the highest rise in deductions availed is in this group,
income-tax paid has also recorded the highest decline, both in absolute terms and as a proportion of profit. The Deduction-Tax Ratio of 0.54 for small companies is better than the ratio of 0.66 for all companies and of 0.92 for large companies. In other words, a unit decrease in deductions allowed to small companies would result in greater increase in income-tax paid than in the case of large companies or all companies taken together.

In the case of medium-sized companies, profit has emerged as the most important variable after reforms. However profit, measured as a percentage of turnover, has declined marginally. The fall in returned income and income-tax paid and the increase in deductions availed are moderate in this group. In the case of large companies, effective tax rate has emerged as the most important factor determining income-tax paid in the post-reforms period, but the highest fall in the effective tax rate is seen in this group only. Average pre-tax profit as a proportion of turnover is the lowest in this group and returned income has suffered the most serious erosion in this group. The Deduction Tax Ratio of 0.92 computed for this group of companies is greater than those for all companies and small companies and thus greater cuts in deductions allowed to large companies appear to be called for. Generally, there has been a tendency for effective tax rates to decrease from year to years (except in assessment year 1992-93) and average effective tax rates have been lower in the post-reforms period.

The declining trends in effective tax rates mean that the companies have been receiving much more in the form of deductions than what they are paying to the State as income-tax. This phenomenon has become particularly alarming after initiation of the tax reforms program. It is a cause for serious concern particularly because the average annual growth rate of income-tax paid is most significantly correlated, in case of all the three groups of companies, with the rate of growth of effective tax rate and the negative growth (decline) in the effective tax rate is bound to diminish revenue collections. Thus, although, in absolute terms, there appears to
be a rise in the income-tax paid by companies after reforms, the same is wiped out by the far greater measure of deductions and tax concessions extended to the companies.

**Tax Behaviour across Sectors of Industry:** Before reforms, tax behaviour of the manufacturing, services, miscellaneous and construction sectors were similar in the sense that income-tax paid was governed primarily by returned incomes. The same similarity is observed between the textiles and electronics sectors, where income-tax paid was affected most by profits. While deductions was the most important variable in case of the chemicals sector, effective tax rate was the most important variable for the engineering sector.

After reforms, the manufacturing, services and miscellaneous sectors exhibited similar tax behaviour in the sense that returned incomes primarily controlled income-tax paid in all the three sectors. Returned income fell steeply in all the three sectors. Average annual growth rate of income-tax paid by manufacturing sector companies was highly correlated with that of effective tax rate, but the rate fell by 4 percentage points after reforms. Average annual growth rate of income-tax paid by companies in the services and the miscellaneous sectors was highly correlated with deductions, but average deductions availed by companies in these sectors increased at high rates.

The net result of these developments has been reflected in the fall in income-tax paid in the manufacturing and services sectors and stagnation in the income-tax paid by companies in the miscellaneous sector (in terms of proportion of pre-tax profit). Among these three sectors, the miscellaneous sector has the highest Deduction-Tax Ratio of about 1.5 and the services sector has the highest Deduction-Tax Ratio of about 0.18.

In the post-reforms period, tax behaviour of companies in the chemicals, textiles and electronics sectors shows similarity in the sense that, income-tax paid by
companies is governed primarily by the average pre-tax profits. Profits as percentage of turnover have increased in all the three sectors and so has the income-tax paid (in absolute terms). Average annual growth rate of income-tax paid shows high correlation with the growth rate of effective tax rate in the chemicals sector and with the growth rate of returned income in the electronics sector.

However, effective tax rate declined in all the three sectors. Returned incomes have declined very appreciably in both the chemicals and the electronics sector. As a result, income-tax paid, measured as a proportion of the pre-tax profits, declined in the textiles and the electronics sectors. Although there seems to be a very high increase of about 70 per cent in income-tax paid in the chemicals sector, the increase turns out to be a meagre 1 percentage point in real terms (as a proportion of the pre-tax profit). Among the Deduction-Tax Ratios for these three sectors, the lowest ratio of about 0.38 is seen in the textiles sector and the highest ratio of 1.5 is seen in the chemicals sector.

In the engineering sector, effective tax rate has emerged as the most important variable governing income-tax paid by companies, in the post-reforms period. However, the decline in the effective tax rate is substantial. Here also, while there appears to be an increase of about 19 per cent in income-tax paid by companies in absolute terms, income-tax paid has actually declined in real terms (as a proportion of pre-tax profit) by about 1.6 percentage points. In the construction and other industries sector, returned income has fallen and income-tax paid has declined. In absolute terms, income-tax paid has decreased in the construction and other industries sector. Among all the eight sectors, the lowest Deduction-Tax Ratio of 0.38 is seen in the textiles sector and the highest ratio of 1.5 is seen in the chemicals sector.

A common feature in all sectors is the steep decline in effective tax rates, which has occurred as a result of the very high increases in deductions availed. The decline in effective tax rates is more pronounced in the post-reforms period and the
lowest effective tax rate in the latest year covered by the study is seen in the textiles and electronics and electricals sectors. The highest fall is observed in the Services sector.

**Tax Behaviour across Ownership-Groups:** Before reforms, tax behaviour of private and public sector companies differed in terms of the variable most influencing income-tax paid. While income-tax paid was primarily determined by deductions availed by private sector companies, returned income formed the most important variable for public sector companies. After reforms, however, this distinction in their tax behaviour has vanished and income-tax paid by both private and public sector companies has been influenced primarily by the returned income.

Average returned incomes have declined significantly in both the sectors: in the private sector, although there is an increase of about 35 per cent in the returned income in absolute terms, there is a real decrease of about 4.3 percentage points, when average returned income is measured as a proportion of average pre-tax profits of companies; in the public sector, there is a palpable decrease in average returned income, both in absolute and in real terms (decline of about 100 per cent in absolute terms and of about 28 percentage points in real terms).

Another similarity in the post-reforms tax behaviour of companies in both the sectors is that the average annual growth rate of income-tax paid shows high correlation with that of effective tax rate. However, there is a very high decline in the average effective tax rates in the post-reforms period in both the sectors: while average effective tax rate fell by about 28 percentage points in the private sector, it recorded an appalling 59 percentage points decrease in the public sector. Effective tax rates have declined in all assessment years, except in 1991-92 and 1992-93. Between the two sectors, the lowest effective tax rate is seen in the public sector.

**Tax Behaviour across Regions:** In the pre-reforms period, similar tax behaviour was exhibited by companies in the northern western and eastern regions, with
returned income being the most important determinant of income-tax paid. Income-
tax paid by companies in the southern region was determined primarily by profit. After reforms, tax behaviour of companies in the southern region also became similar to that of the northern region companies, in the sense that returned income became the most important variable determining income-tax paid, replacing profit. In the northern region, however, average returned income declined after reforms by about 41 per cent in absolute terms and by about 17 percentage points, when measured as a proportion of average pre-tax profit.

As a result, average income-tax paid by companies in this region fell by about 16 per cent in absolute terms and by about 7 percentage points in real terms (when measured as a proportion of average pre-tax profit). In the southern region, average returned income increased after reforms. However, although average income-tax paid by companies in this region shows an increase of about 24 per cent in absolute terms, it has declined in real terms by about 2 percentage points, despite the rise in returned income.

In the post-reforms period, tax behaviour of companies in the western and eastern regions differed in the sense that income-tax paid by companies in the western region was governed by profit, whereas deductions decided income-tax paid by companies in the eastern region. In both the regions, average returned incomes and average income-tax paid fell substantially. Deduction-Tax Ratio is the lowest in the northern region and the highest in the western region.

Average annual growth rates of income-tax paid were highly correlated with the growth rates of effective tax rates, but the average effective tax rates have decreased in all the regions. The highest decrease in these rates is seen in the northern region, followed by the eastern region, the western region and the southern region, in the order stated. Average effective tax rates declined in all the regions in four of the six assessment years covered in the study. The lowest effective tax rates
are obtained in the northern region, followed by the western, southern and eastern regions, in that order.

**Tax Exemptions and Deductions:** During the period of study, tax expenditure in the form of tax exemptions and deductions far exceeded tax revenue and this trend is more distressing in the post-reforms period. Deductions availed ranged from 210 per cent to 1976 per cent of income-tax paid by companies.

**Depreciation:** Depreciation constitutes the most prominent of all deductions availed and its relative share among all deductions was about 77 to 97 per cent in different sectors of industry. After reforms, these deductions increased and the maximum increase in depreciation availed is in the textiles sector, followed by the construction, real estate, automobiles and food processing sectors. The lowest increase is in the engineering sector. Total deductions availed by all companies in the form of depreciation increased by about 88 per cent after reforms. This shows that companies seem to have availed depreciation more as a tax-saving device. Therefore, granting of accelerated depreciation to companies appears to be neither necessary nor justified.

**Evaluation of the Tax Reforms Programme**

Most aspects of tax administration involving direct or indirect interaction between the taxpayers and the tax administration have been dealt with in detail in this study. Areas wherein companies as well as tax administration faced problems were listed in the questionnaires and companies were asked to categorize the problems into four categories, namely Very Serious, Serious, Tolerable and No Problem, depending upon the severity of the problem. A comparison between the responses received for the two periods namely “Before Reforms” and “After Reforms” has been made, to measure the degree of improvement, if any, in each problem-area. On the basis of such categorization, problems have been prioritised or ranked in the order
of their severity for the small, medium-sized and large companies separately as well as for all companies taken together, on the basis of a linear problem-ranking scale, developed specifically for the purpose.

For the sample as a whole, processing of income-tax returns and preliminary adjustments of income-tax returns has emerged as the foremost problem-area. The other problem-areas, in their order of ranking, include: amenities/facilities available at income-tax offices, cost of complying with income-tax laws/rules, interest/penalty/prosecution proceedings, complexity of income-tax laws/rules, distance to be traveled to meet income-tax authorities, frequency of visiting income-tax offices, availability of Circulars and Instructions issued by the Central Board of Direct Taxes, receipt of refund orders, adjournment/fixation of hearings, jurisdiction of income-tax authorities, time given to furnish information, availability of prescribed forms, giving effect by assessing officers to appellate orders, recording of statements by income-tax authorities, selection of cases for scrutiny assessments, production of books of account, representation of companies' cases, accessibility of income-tax authorities, remittance of tax through bank challans, compulsory audit of books of account, survey/search and seizure proceedings, maintenance of books of account and preparation and filing of income-tax returns.

Reform measures suggested by companies have also been ranked in the order of the priority assigned to them. Such rankings have been computed for all companies taken together and also separately for each category of classification. For the sample as a whole, the reform measures suggested are in the following order of priority: reducing tax rates and abolishing surcharge, computerising tax administration, simplifying procedures/forms prescribed, improving the training of income-tax personnel, improving amenities at income-tax offices, improving public relations of tax administration, decreasing the scope of tax deductions at source, reducing discretionary powers of officers, increasing the number and scope of exemptions and deductions allowed, reducing contacts between taxpayers and tax
officials, improving service conditions of tax personnel, reorganizing the jurisdiction of income-tax authorities, opening up of more income-tax offices, reducing manpower deployed in income-tax offices, simplifying income-tax law, privatizing income-tax administration and introducing presumptive taxation schemes for companies.

Commenting on the overall impact of the tax reforms programme, most of the sample companies have indicated that the programme was in the right direction because it had resulted in increased revenue collections, made tax compliance easier and brought down tax evasion in the country. Some companies felt that the reforms programme was not in the right direction since it had made changes in laws/rules too frequent, increased the complexity of tax laws/rules and the cost of compliance and unduly influenced companies' decisions. Companies have identified improvement in tax administration as the most desirable effect of the reforms programme, followed by such other effects as improvement in tax compliance, widening of the tax base and increase in revenue collections. A majority of sample companies felt that the degree of improvement in the tax administration machinery in the country was negligible and that they experienced no change after reforms in the level of efficiency, effectiveness and responsiveness of the tax administration.

Policy Suggestions

(a) Structural Measures:

The tax base: The goals of widening the tax base and removing the bias introduced by the classical system of corporate income taxation in favour of debt finance can be achieved by eliminating deductibility of interest on borrowed capital from the Income-Tax law. There is a strong case for abolishing many of the tax exemptions and deductions such as those allowed on (i) expenditure on fundamental research, (ii) eligible projects and schemes, (iii) rural development programmes, (iv)
payments for conservation of natural resources, (v) donations to charitable institutions, etc.

In line with the international trends, depreciation rates should be equated for taxation purposes with the accounting treatment, rather than giving higher rates or even 100 percent write-offs in the year of purchase. The most important reform to be made should be to permit a deduction only for the actual wear and tear of plant and equipment, rather than using an excessively generous method to calculate depreciation allowances¹.

Presumptive Taxation: The Minimum Alternative Tax Scheme currently in operation must be given a fair chance in implementation, without dumping the same as a failure. Criticisms against the scheme appear to be based more on past failures, but as long as zero-tax companies exist in India, there can be no rationale for not defining a minimum level of taxes to be paid by such companies, when they have actually earned profits. It is difficult to accept the companies' argument that non-payment of tax by profit-making companies is a growth-oriented phenomenon.

The Tax Rate: The large gap between the statutory and effective tax rates calls for an increase in tax rates. In fixing the statutory rates, due notice should always be taken of the effective tax rates prevailing at a given point of time. There is a strong case for reducing or even eliminating many of the exemptions and deductions that have outlived their utility so that the effective tax rates for companies are brought up to at least near-statutory levels.

(b) Administrative Measures

Computerization of tax administration: Computerization of tax administration should receive the utmost priority in the reforms programme. Computers could be used to pre-read forms, process tax returns and payments, check the accuracy and consistency of data reported, calculate taxes, identify computation errors, maintain taxpayers' records and general accounting controls and records, prepare refund orders, assess and penalty notices, identify tax defaulters, develop mathematical formulas and statistical programs to select returns for scrutiny, audit and investigation, identify tax evaders through cross-checking with external sources or other computer files, etc. Automated data processing through computers can also produce statistical reports to assist tax managers and policy makers in management, formulation of tax policy and economic analysis and research. Efforts should be made to bring very strong computer personnel into the tax administration, besides contracting out some computer work. Setting up of a good management information system and exchange of information among tax collecting agencies is an essential prerequisite of a modern tax administration².

Improvements in Returns of Income: The problems associated with the preparation and filing of income-tax returns could be overcome by making the returns more understandable and by dispensing with items in the form calling for irrelevant information. Introduction of an electronic income-tax returns filing system could be introduced for the corporate assesses, on the lines of the United States of America and Australia.

Introduction of Cost Audit: The scope of audit prescribed under the Income-Tax should also include cost audit for companies and scientific norms should be evolved for fixing the minimum limit of turnover/gross receipts prescribed for subjecting

companies to audit. The limit itself should be reviewed periodically and indexed against inflation.

**Scrutiny Assessment of Companies:** Scrutiny assessment could be made compulsory for all companies and the process of preliminary adjustments could be dispensed with. However, if such adjustments are to be made, then the format used for making preliminary adjustments should in itself contain the adjustment explanatory sheet which should invariably be signed by the assessing officer. In case selective scrutiny is continued, the criteria laid down for selection of cases should be broad-based and widely published to ensure transparency. Additions to returned incomes or launching of interest/penalty/prosecution should not be the only fall-out of scrutiny assessments; scrutiny assessments should become an educative experience for both taxpayers and tax administration.

**Refund Orders:** The format of refund orders should be redesigned and refund orders should be made payable at specific bank branches. The period of validity of refund orders should be extended to at least six months and revalidation of refund orders should be done by assessing officers across the table. The status of refunds issued in particular income-tax circles must be displayed on office notice boards or published in newspapers, indicating the return acknowledgment number upto which refunds have been issued until a particular point of time. Companies could be allowed to set off pending refunds against their current year's tax demand, without prejudice to the administration's right to determine the correct tax payable in respect of such pending assessments. This step would help save on interest payments made by tax administration on delayed refunds, while facilitating prompt tax payment by companies. There should be a periodic review of monetary limits set by tax administration where approval of senior officers have to be obtained for issuing refunds and where such approvals are called for, delays should be eliminated.
Remittance of Tax: A radical simplification is called for in the format of Challans used for tax remittance. There must be a drastic reduction in the size and number of copies of the Challans required to be filled in by taxpayers. Replacement of the Challan system with demand drafts to be submitted by corporate asseesses could be considered. Opening up of mobile tax collection centres can also be considered.

Circulars and Instructions: Circulars and instructions issued by the Central Board of Direct Taxes should be gazetted and made public and the issue of such Circulars and instructions must be preceded by public debates with professional bodies, chambers of commerce and industry and all others concerned.

Giving Effect to Appellate Orders: “Mass Clearance Drives” or campaigns could be launched by tax administration periodically to ensure proper and adequate attention to pending cases of giving effect to appellate orders and the consequent reduction or enhancement of tax demands.

Supply of Prescribed Forms: Availability of prescribed forms in income-tax offices has to be improved and tax administration could seriously consider privatizing this area.

Recording of Statements: Recording of statements by income-tax authorities should be informed by brevity and freedom from ambiguity.

Jurisdiction of Authorities: Review of rules for vesting or changing jurisdiction of income-tax authorities over cases must be undertaken with a sense of urgency and frequent transfer of jurisdiction on the basis of administrative convenience or reorganization of tax ranges should be avoided. The rationale behind assigning jurisdiction over cases to tax authorities on the basis of pecuniary limits and the method of determining such pecuniary limits should be reexamined and doing away with such a practice or switching over to a system of assigning jurisdiction on the
basis of income-tax paid (rather than total income declared) should be considered. Periodic cross-transfer of territorial jurisdiction among officers independent of changing of incumbents could enhance administrative efficiency.

Group Assessments: The Chelliah Committee's recommendation to entrust assessment tasks to a group of officers rather than to individual officers must be implemented. Alternatively, orders passed by single officers could be subjected to review by an expert panel of senior officers before they are finally passed. It must be made compulsory for companies to file their returns at places where their principal places of operation, rather than from the place of location of their registered offices or from any other place.

Amenities/Facilities: The amenities/facilities available at income-tax offices do not seem to have improved much after reforms. A system of obtaining feedback from companies on the facilities/amenities required to be created or made available at income-tax offices must be established. The current tax reforms programme has not made any specific objective or budgetary allocation to improve amenities/facilities at income-tax offices and this aspect deserves better attention.

Training of Tax Personnel: High priority should be assigned to the training of tax personnel. The objective of imparting training should not only be to update tax administrators' knowledge and skills, but also to bring about positive attitudinal changes towards reforms and towards the need for a better understanding of taxpayers' points of view. Training should include customer service training and cross functional training for employees so they have an understanding of the system of the entire tax administration. There is a need for a highly skilled and trained workforce which has multi-functional talents 3.

Public Relations: Appointment of well-trained and full-time public relations professionals for promoting awareness about various tax schemes and changes in tax
laws and for creating an atmosphere of trust among taxpayers is another important area calling for immediate improvement. Tax administration must ensure that visiting the income-tax office or meeting an income-tax authority should no longer be viewed by taxpayers as an event to be avoided, but should become a pleasant experience. Visiting tax payers or their representatives must be treated by tax administration with due dignity and honor.

It is very important that the tax administration creates an atmosphere of trust among taxpayers and promotes awareness about the various tax schemes and changes in law and administration introduced from time to time through a professional public relations effort. Occasional hiring of the services of private advertising and media experts for the purpose are among the foremost things the tax administration must do. The latter course of action has of late been tried by the tax administration on a few occasions and the effort has been worthwhile. In fact, there is a lot of misconception and misapprehension in the minds of companies about the tax department which should be removed and the image of the department should be improved through major public relations exercises. It is essential that tax administration is seen as friendly and cooperative towards honest taxpayers and firm and unsparing towards tax defaulters and evaders.

Suggestions received from sample companies in this regard include the launching of “Meet The Tax Payers/Tax Consultants” programmes at periodic intervals, initiation of awards to prompt taxpayers and companies making prompt compliance with the TDS provisions, wider publication and education of taxpayers on important tax provisions and latest changes therein and induction of professionals as public relations officers or imparting of specialized training to personnel of tax administration specially selected for public relations work.

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Tax Deduction at Source: Simplification of provisions relating to tax deduction at source (TDS) and introduction of TDS in stock market operations call for urgent attention of tax administration. Since the TDS requirements increase the cost of compliance and involve voluminous work for companies, companies should be provided with incentives for undertaking this task. Initiating awards for prompt and exemplary compliance with the TDS requirements should also be considered.

Service Conditions of Tax Personnel: Widespread dissatisfaction among the rank and file of tax administration about the lack of proper remuneration and career advancement opportunities augurs ill for the development of a professional tax administration. Tax administrations should not be treated as part of the general civil service and their service conditions need to be greatly improved so as to infuse in them a sense of professionalism and to attract the best of talents. The Central Board of Direct Taxes should be granted complete functional and financial autonomy with an administrative unit capable of formulating its own administrative policies and objectives and responsible for its own recruitment, training and salary structure and establishing a code of conduct for its own personnel. Introduction of suitable incentive and reward schemes including non-monetory recognition for outstanding work performance by tax personnel on the lines of the President’s Medal or Commendation awarded in the Defence and Police Services must be considered.

Opening up of more Income-Tax Offices: Opening up of more income-tax offices in the country should be considered to overcome companies’ problems associated with the distance to be traveled to meet income-tax offices and the frequency of visiting income-tax offices. This suggestion must be examined with all seriousness.

Simplification of Tax Laws/Rules: Simplification of tax laws and rules should receive high priority from tax administration and the objective of evolving a common direct taxes code should be pursued, even after the new working draft of the proposed Income-Tax Bill, 1997, is enacted into legislation by the Parliament.
Privatization: Selective privatization of certain functions of tax departments could bring in desired results in the form of improvement in efficiency and effectiveness. Some of the areas where privatization could be readily implemented include printing of forms, advertising and publicity, creation of computerized database for non-classified information, collection of income-tax returns from assesses, and generation of statistical reports. Adoption of successful management practices prevalent in the private sector with regard to administration, training and other functions of the tax department would also prove helpful.

Advance Rulings: A system of advance rulings wherein a panel comprising representatives from tax administration would give advance decisions on issues concerning the income-tax implications of major corporate decisions and involvement of private professionals in this practice is highly desirable. This gives taxpayers a vehicle to achieve the predictability so important for investment decisions. It is advantageous for tax administration because more transactions can be monitored at less cost.

Representation of Companies’ Cases: As regards representation of companies’ cases before income-tax authorities, transparency must be promoted in all proceedings and, as a measure to reduce areas of litigation, draft assessment and other orders must be supplied well in advance for companies to react to proposals contained therein. To encourage taxpayers to exercise adequate care, the tax preparer, rather than the taxpayer, should be held liable for the amount of understated tax and penalties and prosecution proceedings may be launched against the former, in case of such defaults.

Role of Tax Practitioners and Consultants: Tax practitioners should be recognized in their efforts and given due place in tax administration through introduction of schemes of rewards or incentives for achieving revenue objectives of tax

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administration. A professional course in tax practice on the lines of those in law and management should be launched by Universities or bodies like the National Academy of Direct Taxes, as an effective way of preparing a body of tax consultants well-versed in all aspects of the practice of income-tax law as applicable to companies.

Maintenance of Books of Account: Clear guidelines must be issued about the number of years for which books of account relating to a particular accounting year are expected to be preserved by assessees and the exact types of books so expected to be preserved. The definition of books of account must be enlarged to include documents maintained on computers, floppy diskettes, compact disks (CD ROM’s), etc.

Availability of prescribed forms: For timely and easier compliance of the rules and procedures, it is essential that the prescribed forms become available to companies as and when they are needed. Streamlining the forms and procedures for filing constitutes a significant part of any tax administration’s duties associated with facilitating compliance, enhancing revenue and reducing taxpayers’ irritation with the tax system. Privatisation of printing of forms would go a long way in mitigating this problem.

Survey Operations: The Income-Tax Act specifies only the time of commencement of the operations and not the duration nor the time of conclusion of the same. More clear-cut guidelines are required to be issued in this regard.

Tackling tax evasion: Fewer tax incentives, the development of broader tax bases and lower tax rates and administrative improvements in the area of information, auditing, and collection would help make tax evasion both less feasible and less desirable. Much of the attention in this area has been devoted to why some taxpayers do not comply rather than why others do so. The emphasis should be the

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other way round. The norm is usually to comply rather than not to comply. For a tax system to be effective the majority of taxpayers must comply with it. It follows that there may be greater gains in assisting compliant taxpayers meet their fiscal obligations than in spending more resources in pursuing the minority of non-compliers.

Many taxpayers might be willing to comply in full but are unable to do so because they are not aware of, or do not understand, their full obligations. Even if such taxpayers understood their obligations, they may not know how to meet them or may be unable to do so for other reasons. Additional expenditure devoted to assisting such taxpayers, for example by informing or educating them, might yield greater additional revenues than if it were spent on additional enforcement activities.

Other Suggestions: Other policy suggestions that merit attention of tax administration include speeding up of appellate proceedings, particularly at the level of Commissioners (Appeal), creation of nationwide industry/business data-bases, synchronizing the accounting requirements and depreciation schedules of income-tax and company laws, standardization of interpretation of tax statutes, improvement in record-keeping methods in income-tax offices, establishment of the National Court for Direct Taxes and induction of tax and management professionals at higher levels of tax administration.

The study has achieved its objectives of examining the theoretical issues and problems in the existing scheme of corporate taxation in the country, analysing the tax behaviour of companies in the pre- and the post-reforms periods and evaluating the impact of the recent tax reforms programme on tax behaviour of companies and on tax administration, with reference to empirical data. Both the hypotheses formulated for the study have been tested and confirmed. Policy suggestions have

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been made after taking into account the existing problems in the taxation of corporate income taxation in India and after considering the points of view of taxpaying companies and administrative feasibility. The suggestions are practical and could be readily implemented. Execution of these suggestions in the right spirit would go a long way in improving tax compliance, raising tax collections and making tax administration more efficient and effective.