CHAPTER 3
CHAPTER 3
TAX REFORMS IN THE PRE AND POST ECONOMIC REFORMS ERA OF INDIA

3.1 INTRODUCTION

Tax reforms are an integral part of the development process of any country. Even developed countries such as the United Kingdom and the United States, which are often the role models for developing countries such as India, too undertook reforms in the last few years. Take the United Kingdom the conservative liberal democrat coalition government undertook reforms between 2010 and 2015. In the reforms initiated in 2013, two million people were virtually removed from paying income tax altogether when the Chancellor of the Exchequer presented the budget. The draft of reforms brought about a rise in the personal allowances, which meant that no one paid any tax until he or she earned more than Euro 9,440. The threshold for the higher rate of tax above which people pay tax at 40 percent dropped from Euro 34,370 to Euro 32,010, excluding the personal allowance. At the same time the top rate of income tax fell in 2013-14 from 50 percent to 45 percent for those whose taxable income exceeded Euro 1, 50,000. Take a country like United States. A symbol of free trade and an advanced economy, it is a country that needs tax reforms very badly. Realizing this, two legislators are trying to deliver a broad tax reform.\(^{81}\)

The philosophy of tax reform has undergone significant changes over the years in keeping with the changing perception of the role of the state. With the change in the development strategy in favour of market determined resource allocation, the traditional approach of raising revenues to finance a large public sector without much regard to economic effects has been given up. The recent approaches to reform lay emphasis on minimizing distortions in tax policy to keep the economy competitive. Minimizing distortions implies reducing the marginal rates of both direct and indirect taxes. This also calls for reducing differentiation in tax rates to reduce unintended distortions in relative prices (M. Govinda Rao

to achieve this, the approach suggests broadening of the tax bases. Thus, over the years, emphasis has shifted from vertical equity in which both direct and indirect taxes are subject to high marginal rates with minute in rates, to horizontal equity in which, the taxcs are broad-based, simple and transparent, and subject to low and less differentiated rates. Equity in general, is taken to mean improving the living conditions of the poor. This has to be achieved mainly through expenditure policy and human resource development rather than reducing the incomes of the rich as was envisaged in the 1950s and 1960s.

Indian taxation system has always been under criticism because Income Tax Act 1961 has become very old and number of defects in the present tax system. It does not fulfill the basic cannons of taxation like equity, ability to pay, elasticity and of number of defects in the present tax system e.g. complex nature of taxes, multiplicity of taxes, more dependence on indirect taxes, problem of tax evasion, frequent changes in tax rates, narrow base of the taxes, Unscientific, Inelastic, Inflexible, Traditional Nature of Taxation, Inadequate, Predominance of Indirect Taxes, Regressive, Unequal distribution, Rigid, Complicated, adverse effect on saving and Investment. It has been modified many times since 1961. This has made the old act complicated and difficult to interpret, leading to many disputes and court cases. There are many causes of increasing fiscal deficit, such as increase in the non-planned expenditure of the government, increasing tax limits, reducing tax rates and increase in the arrears of taxes. One of the Problem is “Fiscal Crisis has been proven to be the mother of tax reforms”, At macroeconomic level, a fiscal deficit is viewed as a spillover of the problem related to balance of payment and as a consequence creates inflationary pressure on the economy. The other problems that developed during the period are Low Revenue Productivity, Narrow base of direct taxes, exemption to agricultural incomes, tax evasion and avoidance, poor information system, low tax compliance, unnecessary Tax Exemption like PF, PPF, NPS, Difficult to calculate and understand old system, very difficult process of Tax Collection, Government

Tinker with Tax Rates every year, Uncertainty Tax Rate to Corporate, Investors and Individuals, Exempt-Exempt Tax system.

3.2 TAX REFORM COMMITTEES

The Government of India appointed various committees from time to time for making recommendations to improve the existing tax system i.e right from Taxation Enquiry Commission (1954), One Man Committee Nicholas (1956), Direct Tax Administration Enquiry Committee Tyagi Committee (1958), Bhoota Lingam Committee (1967), Wanchoo Committee 1970, K.M. Raj Committee (1972), L.K. Jha Committee (1976), Chokshi Committee 1977, Chelliah Committee (1991), Kelkar Committee (2002).³³

3.2.1 TAXATION ENQUIRY COMMISSION – 1953-54

In 1953, the Government of India appointed a Taxation Enquiry commission under the Chairmanship of Dr. John Mathai examined the incidence of taxation, the suitability of the tax system, effects of taxation on capital formation and the use of taxation as fiscal instrument to control inflation and deflation. It was primarily concerned with increasing the tax revenue to find resources for the planned development of the economy and with the improving income distribution through progressive taxation. The Commission submitted its report in February 1955. It is divided into three volumes. The first deals with tax system as a whole. The second with central taxation and the third with the state and local taxation (S. Chand 2011).³⁴

Tax System

The Commission analyzed only formal incidence and not effective incidence. Formal incidence refers to the money burden of tax while effective incidence signifies the real burden of tax. The commission confined itself to formal

³³Website: indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X

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incidence due to the complexity of effective incidence. It also studied the problem of incidence with reference to rural and urban population. There have been no major shifts in income from the urban to the rural sector of the economy and vice versa. Urban indirect taxation is more progressive than rural taxation. Indirect taxes can be used as a means of progressive taxation in a limited way. There is scope for widening the base of taxation. On the whole, it can be stated that the total burden of taxation has increased in urban sector as compared to the rural sector.

The Commission also suggested that direct taxes should be made more progressive to avoid inequality. It also recommended additional taxation of luxury and semi luxury products. With regard to the suitable tax system for the country, the Commission observed that “on the whole the kind of tax system which would be best adopted to meet the requirements of the Indian economy, having regard to the development programme and the resources for investments available to the public sector with as small a diminution as practicable of investment in private sector, and which, therefore is accompanied by the largest possible restriction on consumption by all classes, restraint on the consumption of higher income groups must of course, be greater than in respect of low income groups”. The Commission felt that the difference in consumption level will affect the will to work of the people. Therefore, it suggested a ceiling on net personal income which should not exceed 30 times of the prevailing average per family income in the country. This should be achieved gradually over a period of time. Additional revenue can be raised by an increase in income tax and excise duties, a moderate land revenue surcharge, an increase in the rates of agricultural income tax, more extensive use of property taxation, taxes on transfer of property by local bodies and widening of coverage and rates of sales taxes.

As the tax revenue in India is only seven to eight per cent of the national income, there is every possibility of additional taxation before the limit of taxable capacity is reached. The Commission also pointed out that there is greater scope for indirect taxes like central excise and state sales taxes. It also suggested the setting up of an All India Taxation Council of securing coordination of tax policies
and administration between the Centre and the States. The Council should have a permanent secretariat in the form of a Tax Research Bureau attached to the Finance Ministry. It also suggested the setting up of a committee for formulating an adequate railway freight rates policy. This Committee should have some officials of Railways, of the ministries concerned and Planning Commission as members.

Central Taxation

With regard to central taxation, the commission recommended that certain receipts like premium on lease, sale- proceeds of patent rights and copy rights, compensation for loss of employment should be taxed. Casual income like winnings from a cross word puzzle should be taxed through a separate tax. No distinction should be made between agricultural and non-agricultural income for purposes of taxation. Debts foregone by a creditor should be treated as income to the debtor. Unclaimed wages should be treated as income after three years. Business losses should be allowed to be carried forward indefinitely and should be allowed to be adjusted against any business. The Commission also recommended the continuation of the existing system of giving rebate at the rate of one anna per rupee on the undistributed profits. Tax holiday for a period of six years should be given to new firms. Regarding the rate structure of income tax, the commission felt that 85 per cent on incomes above 1 half lakhs is the limit. It recommended the reduction in the lowest taxable limit from Rs. 4,200 to Rs. 3,000. Tax exemption limit should be increased from Rs. 1,500 to Rs 2,000 for married persons and reduced to Rs. 1,000 for bachelors. All incomes above Rs. 24,000 should be treated as unearned income. The Commission also suggested that the existing system of abatement should be increased from one sixth to one fifth with a maximum limit of Rs. 16,000 for undivided Hindu joint families and Rs. 8,000 for others. It also recommended that the name super tax on companies should be changed as corporation tax.
In order to solve the problem of tax evasion, it recommenced the following measures:

1. Income tax officers should be given permission to enter into business premises to inspect the accounts and the documents.
2. The maximum limit of penalty should be increased to three times of tax evaded.
3. Every assessee should submit a statement of his assets and liabilities every three years.
4. An Income Tax investigation commission should be set up to investigate cases of tax evasion.

Regarding Estate duty, the commission suggested a reduction in the existing limit of one lakh of rupees. It also felt that there is no possibility of increase in income from import duties. Export duties may bring in more revenue as exports get diversified. In the field of excise duty, the commission made a number of recommendations.

1. It recommended enhancement of duty on all varieties of cloth on a moderate scale.
2. Surcharge on cigarettes should be abolished. The loss of revenue should be compensated by an increase in the rate of cigarettes.
3. It also recommended an increase in the rates of taxes in the case of sugar, kerosene, loose and packed tea.
4. It also suggested the imposition of new duties on woolen textiles, electric lamps, paper sewing machine etc.

**State Taxation**

The Commission felt that sales tax should be a State Tax. Inter- state sale may be the concern of the Union. It was against the levy of sales tax on services and newspapers. In order to cover the low income group under taxation, the commission suggested a low rate multipurpose tax system. There should also be a single tax for the middle and higher incomes. Only few commodities should be exempted from the tax. In order to bring about coordination and uniformity the
committee suggested the Heads of the Sales Tax Departments of all States to meet at least once in a year. It also recommended the establishment of Sales Tax Advisory Committees and Sales Tax Tribunals in each state. Motor vehicles and motor spirits, are subject to various taxes by the Central, State, Local and Municipalities. Therefore the commission recommended that the terminal or octroi levied by the municipalities may be retained. Since sales tax on motor vehicles is a tax on passengers and goods, it recommended its abolition where sales tax on vehicles in high. The Commission considered that uniformity in the rates of stamp duties is neither necessary nor desirable. It did not accept the re-introduction of stamp duties on cheques. But it accepted the view that court fee should be on the basis of the administrative expenses. The commission recommended the replacement of slab rate of entertainment tax by tax imposed on percentage basis. It should be graded on a very broad basis. Tax on prize should be taken over by the central Government. Duties on light and fans should be low tax on domestic appliances should be lowered and tax on industrial consumption should be extremely low. The Commission recommended the adoption of Agricultural Income tax by all the states to achieve unity in the tax structure. All agricultural income above Rs. 3,000 should be taxed. Betterment levy should be fixed at a maximum of 50 percent of the increase in the value of land due to irrigation and its recovery should be spread over a long time.

Local Taxation

The Commission recommended the following taxes for the local authority (1) Tax on land and building (2) Taxes on goods entering into the local area: (3) Tax on vehicles (4) Taxes on animals and boats: (5) Taxes on professions, traders, callings and employments (6) Taxes on advertisements (7) Taxes on theatre (8) Taxes on goods and passengers earned by road and inland water ways and (9) Tolls. The Commission also recommended a system of grants in aid. The local bodies should be given a basic general purpose grant. For this purpose local bodies should be given a basic of population, area and resources. The basic grant should be given for three or five years. In addition to this specific grants should also be given to the local bodies. Though the commission recommended the abolition of
octroi duty, it could be achieved only in the long run. Therefore, it made the following suggestions to remove the defects of the tax:

1. Octroi should be levied on the basis of weight and not ad valorem:
2. The Collection of octroi should be supervised frequently:
3. Existing rates on food articles should not be permitted:
4. The Introduction of terminal tax may be permitted in suitable cases.

Other Important recommendations are as follows:

1. The annual value of the property should be the basis for property tax.
2. The levy of land cess should be replaced by surcharge on land revenue.
3. A Tax on profession should be a tax belonging to the local bodies. It should be assessed on the basis of income. The maximum limit should be increased from Rs. 250 to Rs. 500.
4. Tolls should be abolished except on bridges costing above Rs. 5 lakhs. The loss of revenue should be compensated by motor vehicles tax.

3.2.2 ONE MAN COMMITTEE KALDOR REFORMS - 1956

Prof. Nicholas Kaldor submitted his report on “Indian Tax Reform” in March 1956. He gave a number of far – reaching suggestions. He pointed out that the revenue of the centre and states was only seven percent of the national income and the tax revenue did not show any increase in yield with the increase in production. He considered India’s direct taxation as inequitable and inefficient. It is inequitable because the base of taxation i.e., Income is defective as income can be easily manipulated by the taxpayers. It is inefficient because of large scale evasion through concealment or under- statement of profits. To remove these defects, Kaldor recommended an annual tax on wealth. A tax on Capital gains, a general gift tax and a personal expenditure tax. tax is a tax on personal consumption expenditure of the tax payer. This tax payable on expenditure in excess of Rs. 10,000 per annum. Tax rates is calculated on a slab system rising from 25 per cent for expenditure between Rs. 10,000 and Rs. 12,500 to 300 per cent on expenditure in excess of Rs. 50,000 per annum. All investment expenditures will be exempted from taxation. Business expenses, gift, dowries, funeral and birth expenses, medical expenses up to a certain amount will be exempted. Expenditure on
durable consumers up to a certain amount will be exempted. Expenditure on
durable consumer goods can be spread over a period of years. Wealth tax is a tax
on the wealth of a person based on the value of total net assets. Wealth tax
includes all forms of property including agricultural property, real estate,
ownership of stocks and shares, bank balances, jewels and valuables.

Kaldor recommended that all capital gains should be taxed. A flat rate of
seven annas in a rupee will be levied once the income (including all capital gains)
exceeds Rs. 25,000. Kaldor also suggested the substitution of gift tax to estate
duty. It will be a tax on all gifts. Gifts over and above Rs. 10,000 will be taxed at a
rate of 10 percent if the net wealth is between Rs. 1,00,000 and Rs. 1,50,000, 20
percent between Rs. 1,50,000 and Rs. 2,00,000 and so on: and the rate becomes 80
percent if the total estate (including the gift) of the donee exceeds Rs. 20,00,000.

The Net aggregate yield of new taxes according to the Kaldor Report would be as
follows:

<table>
<thead>
<tr>
<th>Sl.no</th>
<th>Taxes</th>
<th>Estimated Yield Per Year</th>
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<tbody>
<tr>
<td>1</td>
<td>Expenditure Tax</td>
<td>Rs. 10 Crores to Rs. 15 Crores</td>
</tr>
<tr>
<td>2</td>
<td>Wealth Tax</td>
<td>Rs. 15 Crores to Rs. 25 Crores</td>
</tr>
<tr>
<td>3</td>
<td>Capital Gains Tax</td>
<td>Rs. 25 Crores to Rs. 40 Crores</td>
</tr>
<tr>
<td>4</td>
<td>Gift Tax</td>
<td>Rs. 30 Crores</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>Rs. 80 Crores to 100 Crores</td>
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Less: a loss due to the elimination of super tax above three annas in the rupee

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</thead>
<tbody>
<tr>
<td>Net Yield</td>
<td>Rs. 62 Crores to Rs. 82 Crores</td>
</tr>
</tbody>
</table>

Kaldor justified his proposals by arguing that they would prevent tax evasion
because “If all these taxes assessed at the same time, by the same authority, and on
the basis of a single comprehensive account submitted by the taxpayer, evasion
and concealment would become more difficult, not only on account of the
difficulty of the individual tax payer to conceal consistently particular receipts on
items of property but owning to the fact that the evidence furnished by others”. 
Kaldor’s recommendations, if implemented would bring equity and fairness in the 
distribution of tax burden. But the capital gains tax, the gift tax and the wealth 
would reduce the incentive to save and curtail capital formation. Kaldor did not 
recognize the problem of tax evasion. Further, the new taxes would create a 
multiplicity of taxes which would be difficult to administer. Such a tax system 
should be condemned. “First of all, there is income tax on what you learn. Then 
these is the expenditure tax levied on what you spend, the wealth tax on what you 
save, the gift tax on what you given in your life-time and finally the estate duty on 
what you are unwise enough not to give away or spend before you die. India has 
too little to save, too little to invest, too little to gift and too little to spend, then all 
this multiplicity of taxes seems like much of a muchness for nothing very much at 
all”.

3.2.3 DIRECT TAXATION ADMINISTRATION ENQUIRY COMMITTEE- 
1958

The direct Taxes Administrative Committee was set up in June 1958 to 
advise Government on the administration organization and procedures necessary 
for implementing the integrated scheme of direct taxation with due regard to the 
need for implementing tax evasion and avoiding inconvenience to the assesses, 
chaired by Mahavir Tyagi, M.P. It submitted its report in November, 1959. It did 
not favour one comprehensive return for all direct taxes and recognized that the 
simplification of statues was not an easy task. It also made far reaching 
suggestions regarding administrative machinery, improving training facilities and 
adopting 'merit and efficiency' as the sole criteria for filling of selection posts in 
any cadre. Most of the recommendations were accepted through legislation or 
through administrative measures.

85 Website: indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand Publishing ISBN 81-219-0997-X
Law Commission's report (1958)

The Government asked the Law Commission in 1956 to revise the Indian Income tax Act, 1922. About the said Act, the commission remarked, "there is hardly any Act on the Indian Statute Book which is so complicated, so illogical in the arrangement, and in some respects so obscure as the Income-tax Act, 1922". The revised draft was prepared by a committee of eminent jurists, consisting of P. Satyanarayan Rao, G. N. Joshi and N.A. Palkhiwala. The commission submitted the draft in September, 1958. It re-arranged and regrouped the various sections of the Act and simplified the language mainly by splitting long sections into independent ones and converting the proviso into independent provisions. Apart from changes in form some changes in the substance were also made. The committee draft was the basis for the enactment of the Income tax Act, 1961.

3.2.4. BOOTHALINGAM COMMITTEE – 1967

Boothalingam Committee submitted its report on rationalization and simplification of the tax structure in 1967. The recommendations of the Committee are as follows:

1. The Committee recommended the continuation of the existing system of excise duties on commodities like tea, coffee, sugar, unmanufactured tobacco, mineral oils, rayon, paper, cement etc. it recommended the introduction of a General Excise Duty”. It should be ad valorem in nature. As it will be of universal application, it is necessary that the rate should be relative low.

2. As regards customs duties, the Committee recommended rationalization and simplification of import duties. It recommended only few rates of customs duties instead of large number of rates.

3. With regard to the determination of business profits and corporation tax, the Committee stated that a distinction has been made between income tax on companies and other non-corporate assessee. Progression was applied only to the latter. The Committee felt that the difference between closely held companies and other companies has no justification. Therefore it
recommended that the principle of progression is relevant to personal taxation and not to company taxation.

4. The “Dividend Tax” aimed at the retention of profit by the companies for further development. But the committee recommended the abolition of the tax as nothing good came of the dividend tax.

5. The committee examined the case for the sur-tax on profits or super Profits. Tax and came to the conclusion that it has no validity in the long run. It penalizes the more effective use of capital.

6. In Income Tax acts, total income is the tax base. But the committee wanted to use the term “tax base” for the sake of clarity.

7. With regard to depreciation, the committee stated that depreciation allowance is not adequate due to rapidly rising prices. Therefore, it recommended that depreciation should be allowed in such a way that 20 per cent more than the original cost should be provided for.

8. Though the development rebate was welcomed by industry generally, the Committee recommended its abolition as it led to wasteful use of capital.

9. The Committee felt that as cooperative societies are subject to certain handicaps as compared with companies, the tax rate on cooperative societies should be 10 per cent less than on companies.

10. The committee recommended that the exemption limit on income tax should be raised to Rs. 7,500 for individual and Rs. 10,000 for Hindu Undivided Families.

11. The Committee pointed out that the liability to pay the gift tax is formally laid on done. So all gifts received by a person in an year should be added up and the total should be subject to gift tax.

12. The Committee recommended a uniform rate of 45 per cent profit tax to priority industries.
13. The Committee recommended that fiscal policy should be correlated with economic policies for mobilizing the savings of community.

3.2.4 WANCHOO COMMITTEE - 1971

The Government of India appointed a committee under the chairmanship of K. N. Wanchoo in 1970 to examine and suggest measures to check tax evasion and avoidance. It was asked to:

(a) Recommend concrete and effective measures to (i) un-earth black money and prevent its proliferation through further evasion, (ii) check avoidance of tax through various legal devices, and (iii) reduce tax arrears;

(b) Examine various exemptions allowed by the tax laws with a view to their modification, curtailment or withdrawal and

(c) Indicate the manner in which tax assessment and administration may be improved for giving effect to all its recommendations.

The Committee submitted its Report in December, 1971.\(^{86}\)

The term ‘Black Money’ is generally used to denote un-accounted money or concealed income and or undisclosed wealth, as well as money involved in transactions wholly or partly suppressed. Tax evasion and black money are closely and inextricably inter-linked. While tax evasion leads to the creation of black money, the black money utilized secretively in business for earning more income inevitably leads to tax evasion. The effects of black money on the country’s economy are disastrous. Economic development is seriously handicapped because resources needed for development are not adequately forthcoming as business is carried on in the ‘black’ it leads to a distortion in the use of resources, diverting them to lavish and conspicuous consumption. The Committee estimated income on which tax has been evaded would probably be Rs.700 crores and Rs.1,000 crores for the year 1961-62 to 1968-69 (about 100 per cent) the income on which tax was evaded for 1968-69 can be estimated at a figure of Rs. 1,400 crores. The

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Extend of income tax evaded during 1968-69 would be of the order of Rs. 470 crores, being one-third of Rs. 1,400 crores. The money value of deals involving black money may, therefore, be not less than Rs. 7,000 crores for 1968-69.

The Committee listed the cause of tax evasion as follows;
(a) High rates of taxation under the direct tax laws.
(b) Economy of shortages and consequent controls and licenses.
(c) Donation to political parties.
(d) Corrupt business practices.
(e) Ceilings on, and disallowances of business expenses,
(f) High rates of sales-tax and other levies.
(g) Ineffective enforcement of tax laws.
(h) Deterioration in moral standards.

Certain measures have been taken from time to time in the past for preventing tax evasion e.g., stiffening of penalties for evasion, greater publicity in respect of tax offenses and gearing up the tax administration. Similarly, measures for tackling black money built up out of past evasions have included the demonetization of high denomination notes and voluntary disclosures of suppressed incomes in 1951 and again in 1965.

The committee did not favour a voluntary disclosures scheme as it would shake the confidence of honest tax-payers and would have a deleterious effect on the level of compliance among tax-payers and on the morale of the administration. The Committee made certain recommendations regarding powers relating to searches and seizures and the system of intelligence for unearthing black money.

1. Reduction in tax rates. The Committee thought that the prevalence of high rates of taxation is the first and foremost reason for tax evasion, as they make evasion profitable and attractive. It recommended that the maximum marginal rate, including surcharge, should be brought down from its present level of 97.75 percent to 75 percent and that some reductions in tax rates should also be given at lower levels. The Committee drew up a schedule of
tax rates which it recommended for adoption. It thought that the beneficial results of the measure will more than offset any immediate fall in revenue.

2. Minimization of controls and licenses: Control encourages illegal transactions and hence leads to tax evasion, according to the committee. Though they cannot to given up altogether in a developing economy like ours, they can be reduced and rationalized. There should be a comprehensive review of the existing controls and those which are ineffective, redundant or irksome should be eliminated or modified to meet the needs of the changed situation. Those controls which are retained should be streamlined and made more effective. A committee of experts should go into the existing system of control, licenses and permits and suggest necessary changes.

3. Regulation of donations to political parties: There is already a ban on donations by companies to political parties. This should not be removed. Donations by tax payers other than companies to recognized political parties should be allowed as deduction from gross total income, subject to a limit of 10 per cent and ceiling of Rs. 10,000. Reasonable grants-in-aid should be given by the government to national political parties and suitable criteria should be evolved for recognition of such parties and determination of grants-in-aid to them.

4. Creating confidence among small taxpayers: The practice of being too meticulous in small cases where no worthwhile revenue is involved has done much to damage the image of the department. The Committee welcomed some procedural changes in this regard.

5. Changes in penal provisions: The Committee thought that penalty serves its purpose only so long as it is within reasonable limits. It suggested a number of changes in penal provisions, which are in some cases milder and in other cases harsher than the existing provisions.
6. Vigorous prosecution policy: The department should completely re-orient itself to a more vigorous prosecution policy in order to instil fear and wholesome respect for tax laws in the minds of tax payers.

7. Intelligence and Investigation: The committee suggested a number of steps for improving the machinery and procedures of intelligence and investigation to cope with the increasing refinement and sophistication of the techniques of tax evasion.

8. Taxation of Agricultural Income: The Committee pointed out that black money can be camouflaged and tax evasion is facilitated because of the fact that agricultural income is not taxable and income from non-agricultural sources as well as black money can be shown as having been earned from agriculture. The non-taxation of agricultural income also results in inequity between the taxation of agricultural and non-agricultural incomes. Although agriculture accounts for nearly half of India's national income, yet the tax contribution of the non-agricultural sector is over six times that of the agricultural sector. The benefits of the 'green revolution' have increased the already existing inequalities in income and wealth in the rural sector. The Committee was therefore of the view that uniform and progressive taxation of agricultural income is urgently necessary for ensuring that agricultural income ceases to offer any scope for tax evasion, and also on grounds of equity and distributive justice.

9. Co-ordination between sales- tax and income tax authorities: wherever possible, excise duties should be substituted for sales tax to reduce evasion. There should be close coordination between income tax and sales tax authorities.

10. Compulsory maintenance / audit of accounts: The Committee recommended that accounts must be compulsorily maintained by persons having income above certain levels. Similarly, compulsory audit of accounts was recommended for incomes above certain levels.
11. Reintroduction of expenditure tax: The Committee did not recommend the reintroduction of the expenditure tax because of its administrative difficulties. However, it recommended the introduction of an expenditure statement as part of the income tax return and thought that this would be as effective as the expenditure tax in checking evasions. It recommended that unexplained expenditure should be made taxable.

12. Permanent account number: Every assessee should be given a permanent account number to facilitate indexing and linking of information to concerned assessees and proper maintenance of records. The principles for the construction of such numbers have been suggested by the committee.

13. Power of Survey; The Committee suggested measures giving powers to income – tax authorities regarding visit to business premises and surveying cash, accounts and stocks.

14. Measures for evasion in specific fields: The Committee suggested measures for checking evasion in certain specific fields like the film industry, property transaction, foreign exchange transactions etc.

15. Arousing social conscience: The Committee was of the view that tax evasion cannot be checked by legal measures alone. Such measures must be backed by strong public opinion. The Government can help in building up such opinion by denial of various privileges to tax evaders e.g. eligibility for elective offices, directorships of companies, eligibility for national awards etc.

3.2.5 RAJ COMMITTEE- 1972

The Government of India appointed the Committee on Taxation of Agricultural wealth and Income under the Chairmanship Dr. K N. Raj in February 1972 to examine the question of taxation of agricultural income and wealth from
all aspects. It submitted its report in 1972\textsuperscript{87}. The major recommendations of the Committee were:

1. A Progressive Agricultural Holding tax should be imposed on agriculture who have no other assessable income.

2. In the case of assessees having non-agricultural taxable income, income from agriculture should be included in the total income for the purpose of calculating income tax.

3. Income from livestock, fisheries, poultry, dairy farming etc should be subject to tax.

4. An integrated taxation of agricultural property through wealth tax should be introduced.

5. Capital gains tax on transfer of agricultural lands should be imposed. Raj committee recommended integration of agricultural and non- agricultural incomes only if the assessee had taxable income exceeding the minimum exemption limit for income tax. The tax rate suggested by the Committee is given below

<table>
<thead>
<tr>
<th>It on the first Rs. 5,000</th>
<th>Nil</th>
</tr>
</thead>
<tbody>
<tr>
<td>It on the next Rs. 5,000</td>
<td>10%</td>
</tr>
<tr>
<td>It on the next Rs. 5,000</td>
<td>17%</td>
</tr>
<tr>
<td>It on the next Rs. 5,000</td>
<td>23%</td>
</tr>
<tr>
<td>It on the next Rs. 5,000</td>
<td>30%</td>
</tr>
<tr>
<td>It on the next Rs. 5,000</td>
<td>40%</td>
</tr>
<tr>
<td>It on the next Rs. 10,000</td>
<td>50%</td>
</tr>
</tbody>
</table>

\textsuperscript{87} Website: indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chaud, publishing ISBN 81-219-0997-X
Raj committee recommended that the Agricultural Holding tax should be supplemented with a tax on agricultural property and a tax on capital gains. It proposed to do away with all exemptions. Wealth tax should be levied on family basis. It also recommended that the definition of the capital asset should be widened to permit taxation of capital gains from transfer of all agricultural land irrespective of their location. Gains from transactions in assets held for not more than a year should be treated as ordinary income and taxed accordingly. It also suggested that income from livestock breeding and poultry and dairy farming, should be subjected to income tax.\textsuperscript{88}

3.2.6 JHA COMMITTEE REPORT – 1977

The Government of India appointed the Indirect Taxation Enquiry committee under the Chairmanship of L.K. Jha in 1976. It submitted its final report in 1977. The main recommendations are:

1. In order to achieve progressive in tax structure and to fulfil economic priorities tax structure should be rationalized.

2. Duties on raw materials should be rationalized so as to cascading so as to lower the cost of production in the economy as a whole.

3. Steps should be taken to solve the problem of cascading. Value added tax should be introduced. It is a tax on all goods and services and it falls on the value added at each stage.

Import duties fall mainly on raw materials, intermediate products and machinery. This will increase the cost-price structure making our industry less competitive in the international market. The committee recommended a reduction in taxation on inputs and machinery. This will help in achieving our economic objectives.

In the field of sales tax, the Committee recommended that the state governments should move to a single point sales tax at the final stage. The sales of

\textsuperscript{88}Website: indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X
inputs to manufacturer should be free from taxation. The interstate sales tax now subject to a ceiling of 4 percent should be brought down to one per cent. The Committee also recommended the abolition of octroi.

3.2.7. CHOKSHI COMMITTEE REPORT – 1978

The Direct Tax Laws Committee was appointed under the chairmanship of C.C. Chokshi. It submitted its report in 1978. The Committee observed that the problem of simplification and rationalization of tax should be done in the light of the background of the economic activity in which the tax laws operate. It also observed that it is impossible to simplify tax laws. It emphasized the need for continuous fiscal research. It did not accept a switch over from income to consumption as tax base. Regarding income tax, the committee recommended that the tax rates should be specified in a schedule instead of being laid down from year to year in a separate act of Parliament. The maximum marginal rate of tax should be 60 per cent for income above Rs. 2 Lakh. The surcharge on income tax should be abolished. With regard to Agricultural Income Tax, the committee insisted on the continuation of the scheme of integration of agricultural income with non-agricultural income. Agricultural income tax should imposed under a central act. If the center is not in favour of imposing agricultural Income tax then Central government may advise the state governments to introduce it at an early date. The legislation should be uniform in all states, on all categories of income including plantations cash crops or food crops. Further for easy administration, the law should provide for a flat determination of income taking into account the category of the land and the nature of agricultural activity carried out. The state law should provide for taking the non-agricultural income of a tax payer into account for determining the rate of tax applicable to his agricultural income.89

It considered the idea of having uniform definition for the term salary for different purposes as unnecessary. The standard deduction should be fixed at 20 percent at all levels of salary. The standard deduction should be applicable to pensioners at a rate of 10 per cent subject to ceiling of Rs. 1,000 per year. In case of arrears, it may be spread equally over five years including the year of payment.

89 Website: indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X
In the case of gratuity, compensation etc., they may be spread over the last five years including the year of retirement. Capital gains should also be taxed if the sales of immovable property is evidenced in writing. Capital gains accruing from self-generated assets should also be taxed. Regarding Sur-tax, the committee insisted that the levy of Sur-tax should not merged with the income tax on companies. The statutory deductions under Sur-tax act should be increased from 15 per cent to 20 per cent of the capital. In calculating the net wealth for purposes of wealth tax, debts used or buying property should be disqualified from deduction. Provision should be made for avoiding double assessment. A specific provision should be made in the wealth tax act to exempt the net wealth of all such institutions which are exempted from income tax.

The Committee recommended the continuation of gift Tax Act in its present form. The definition of company as contained in the Income – tax act should apply for the purpose of the Gift tax act too. The committee suggested the following rates of gift tax.

<table>
<thead>
<tr>
<th>Range</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 20 Lakhs to Rs. 25 Lakhs</td>
<td>65%</td>
</tr>
<tr>
<td>Rs. 25 Lakhs to Rs. 30 Lakhs</td>
<td>70%</td>
</tr>
<tr>
<td>Rs. 30 lakhs and above</td>
<td>75%</td>
</tr>
</tbody>
</table>

In the case of estate duty, the maximum rate should be fixed at 80 percent. For the value of Rs. 20 lakhs to Rs. 25 Lakhs, the rate should be reduced from 85 per cent to 60 per cent. For the value of Rs. 25 lakhs to Rs. 30 lakhs, the rate of duty should be brought down from 85 percent to 70 percent. For properties exceeding Rs. 30 lakhs, the rate should be fixed at 80 percent.

3.2.8. RAJA CHELLIAH COMMITTEE – 1992

Since Independence, a number of committees were constituted by the Government of India for suggesting reforms in the Indian Tax System. The Government of India constituted a committee in August 1991 a high level committee under the Chairmanship of Dr. Raja Chelliah in order to examine and recommend. The committee made several important recommendation covering
both direct and indirect taxes including tax administration. The recommendations are follows:

Measures and Recommendations:

1. Finding ways and means for increasing the Elasticity of the tax revenues in both direct and indirect taxes.

2. Restructuring the Tax System as broad based and fairer particularly with regard to personal taxation.

3. Rationalization of the Existing Direct Tax system for removing anomalies, improving equity and sustaining economic incentives.

4. Identifying new areas of taxation to increase Productivity.

5. Raising of Income tax Exemption limits.

6. Reduction in the number of income tax rate slabs.

7. Lowering the Tax Rates.

8. Clubbing of Income of minor child with that of the parent


10. Introduction of the presumptive tax on small retail traders with annual turnover not exceeding Rs. 5 lakhs

11. Imposition of Wealth Tax @ 1% of the value of nonproductive assets in excess of Rs. 15lacs.

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90 Website: indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X

91 Website: indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X
12. Limiting the perquisite value of rent free or concessional rent residential accommodation provided by employer to employees whose annual salary exceeds Rs. 36000 to equivalent of 20% of the salary or the actual expenditure incurred by employer, whichever is less.

13. Inflation adjustments for capital gains for tax purpose.

14. Inclusive of 15% of leave travel allowances, sitting allowances received by MPs and MLAs etc.

15. Implementation of estimated income schemes with respect to those assesses whose total annual business turnover is more than Rs. 5 lakhs but less than Rs. 20 or Rs. 25 lakhs.

16. Corporation profit tax including taxation of foreign entities, the issue relating to business taxation, interest tax, agricultural income taxation, gift tax and tax on charitable organizations.

17. Further reforms of the system of Domestic Indirect taxes particularly at the central level.

18. Improvement in tax administration procedures, removal of harsh and complicated provisions and appellate procedures.

19. Major problems relating to tax administration like Administration cost reduction, processing cost should be reduced and settlement of complicated cases should be speedup.

20. Revenue audit.


22. Targets for tax collection should be fixed on some realistic basis.
23. The assessing officers should be made accountable for their actions so as to remove harassment caused to the assesses.

24. The Committee recommended the lowering of the corporate tax for all domestic companies from 51.75 per cent to 45 per cent in 1993-94 and to 40 per cent in 1994-95.

25. The multiplicity of rates of excise duty should be reduced to two or three rates at 10, 15 or 20 per cent.

26. A high rate of 30, 40 or 50 per cent could be levied on non-essential commodities or commodities injurious to health.

27. The tax base should be enlarged by including services within the tax net.

28. The present excise tax system should be gradually transformed into VAT at the manufacturing level.

29. The law and procedure relating to valuation should be simplified and specific duties should be replaced by ad valorem duties in respect of most goods.

30. The Committee recommended the abolition of interest tax as it acts as a wedge between the reward to the savers and return on investments.

31. The Committee recommended 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 be raised to Rs. 30,000 from the present level of Rs. 20,000

The main aim of the recommendations of Chelliah Committee thus proved to be rationalization, restructuring the tax system, simplification of tax structure and tax administration to make them equal with international standards. Secondly it aimed at widening the tax base. Thirdly large number of exemptions was to be
removed. Fourthly lowering the tax rates was aimed at. In recent years, various budgets have implemented most of these recommendations in modified form\textsuperscript{92}.

**Steps Taken by the Central Government for Implementation.**

The Government of India accepted most of the recommendations made by Dr. Raja. J. Chelliah committee. Some of their recommendations so far taken up by the government for implementation have been duly enacted through the finance act. They are given below;

**Recommendations Implemented by the Government**

1. Reduction in the Rates of Personal Taxations.
2. Taxation of Capital gains through Inflation adjustment.
3. Clubbing of Income of Minor children in the hands of their parents.
4. Introduction of presumptive taxation scheme for small businessman.
5. Restructuring and Rationalization of the Procedure relating to assessment of firms.
6. Restricting Taxation of Wealth to unproductive assets.
7. Raising the monetary limit of contributions to charitable organizations.
8. Revision of Tax Exemption limit.
10. Raising gift Tax Exemption limit to Rs. 30000(now abolished).
11. Amendment of section 132 regarding searches etc.

The other recommendations of the committee which have been already accepted by the government are also in the process of implementation in a phased manner.

**3.2.9. KELKAR TASK FORCE COMMITTEE REPORT – 2002**

A task force under the Chairmanship of Vijay Kelkar was set up to study simplification and rationalization of direct and indirect taxes. The report was submitted on 25\textsuperscript{th} November 2002. Its recommendations were as follows.

\textsuperscript{92}India budget.nic.in Tax reforms in India P.T. Chaudharishreeniwas publications Jaipur 2003. ISBN: 81-88730-02-5
A DIRECT TAXES

Personal Income Tax:

1. Personal Income Tax: Exemption limits 50,000 to 1,00,000 for widows and senior citizens Rs. 1.50 Lakhs. Therefore standard deduction can be removed.

2. Two tier system of tax rates - 20 percent up to an income of Rs. 4 Lakhs and 30 percent for incomes above Rs. 4Lakhs. There should be no surcharge on personal income tax.

3. All tax incentives under sections 80, 88 and for interest incomes under section 10 should be removed.

4. Elimination of Standard Deduction.

5. Incentives-wise borrowing for housing loans was suggested. Reforms in agricultural income tax were suggested to avoid tax evasion.


7. Charge Interest Rate On Tax Defaulters If a company or individual doesn’t pay his taxes on time.

8. Direct Taxes Code Bill, 2010 is implemented in its present form then there will be considerable tax losses to the Income Tax department.

9. Data Mining : the Income Tax Department has been electronically obtaining a large volume of information from third-parties through the Tax Information Network (TIN) to check Black Money.

Corporate Tax Reforms

1. Reduction in Corporate Tax rate 30% for domestic companies and 35% for foreign companies. The existing rate of depreciation for plant and machinery should be reduced to 15%.

2. Elimination of Minimum Alternate tax.
3. Wealth tax should be abolished. Merge of Tax on Expenditure in hotels with Service tax.

4. Removal of Exemption under section 33AB, 33B, 35, 35AC, 35CCA etc.

5. Income of Mutual funds short term and capital gain interest to be taxed at flat rate.

**Tax Administration**

1. Extension of PAN to cover all Economic agents/Citizens.

2. Tax Payer services should be expanded both quantitatively and qualitatively. The easy access to tax payers through internet and E-mail. Tele-filing and Tele-Refunds should be introduced.

3. Abolition of Block Assessment of Search and Seizure cases

4. Speed up the Processing of all returns and Issues of Refunds within four months.

5. Introduction of Transference and Objectivity in the process of selection of cases.

6. Outsourcing the Preparation and Dispatch of refunds.

7. Empowering CBDT with appropriate administrative and financial powers.

**B INDIRECT TAXES**

**Central Excise Duties**

1. All excise duties should be replaced by CENVAT.

2. Excise duties should be varied
   a) No excise duty on life saving drugs and equipment, security items, food items and agricultural products.

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93: indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X
b) 6% duty on processed food products and matches.
c) 14% standard rate for all items not mentioned against the rates.
d) 20% on Motor vehicles, air conditioners and aerated water.
e) Tobacco products to have separate rates.
f) Uniform excise duty of 16% on all fibers and yarns – all exemptions should be removed from textile sector – exemption only for certified handloom products.
g) Only small sector units with a turnover up to Rs. 50Lakhs to be exempted.

3. Uniformity in all state legislations, Procedures and documentation relating to VAT\(^{94}\).

4. All Exemptions to be removed on the Textile sector except for fabrics woven handlooms, handloom fabric certified as Khadi, etc.

5. Service tax is to be extended to all fields. Only a few services are to be included in the negative list.

6. E- Governance in Central Board of Excise and Customs (CBEC)\(^{95}\).

7. 6% Excise duty on Merit goods only is collected by Union Government, on the goods manufactured or produced in India.

**Customs Tariff**

1. Customs duties structure should be simplified. There should be only three categories: Basic Customs Duty, Additional customs duty and Anti-Dumping duties.

2. Varied customs duties recommended

   a) Zero percent on important items like lifesaving drugs

   b) 5% duty on basic raw materials like Coal

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\(^{94}\)indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X

\(^{95}\)indiabudget.nic.in and Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X
c) 10% duty on Raw Materials, inputs and intermediate goods, finished goods other than consumer durables.

d) Duty on Crude oil and petroleum products to be gradually reduced.

e) Higher duty of up to 150% on specific agricultural products and demerit goods.

f) All exemptions are to be removed except for life saving drugs, goods of security and goods for charitable purposes and relief.

**Service Tax**

1. Increase the coverage of service tax: Non profit Organizations like Department of Post, renting houses, Funeral services, Railways etc.

Implement Goods and Services Tax (GST) will automatically increase the industrial output, exports and (thus) the tax revenues.

**Tax Administration**

1. The limit is to be set for processing import and export documents.

2. Customs clearance should be based on trust for both importers and exporters.

3. Time limit for processing an import or export documents.

4. A System of Self-Assessment by the importer to be introduced for bill of entry.

5. Central Excise should be progressively levied upon value addition upto processing stage.

6. CENVAT credit rules to be amended to abolish the difference between capital goods and inputs.

7. Guidelines on determination of cost of production to be issued at the earliest.
8. MRP based levy to be expanded.

9. All Customs and Central Excise Commissionerates to fully automate their processes.

**Decrease the Outgoing Money**

**Reduce Subsidies**

- Kelkar says increase the prices of diesel, petrol, kerosene, LPG and Urea etc. (Actually he says Government should reduce the subsidies on each of them, in phased manner = price will increase automatically!)

- Kelkar also clarifies that he doesn’t want complete elimination of subsidies. He says we shouldn’t eliminate subsidies. Food subsidy is defensible. For undernourished children or lactating mothers food subsidy is not only defensible, it is ethically right and morally correct

- Subsidy must be continued for kerosene as long as it is affordable (for the government). But the subsidies should be reduced as and where possible. For example, LPG subsidies do not go to our people who fall in the low income bracket, therefore LPG subsidies should be removed.

- With a drastic cut in subsidies, a bigger part of the resultant savings should be channelized towards programmes that lead to creating new job opportunities.

**Change focus of Government schemes**

Kelkar suggests that all Government schemes/Programmes for the poor should be centered on employment generation. (Rather than populist schemes aimed at free electricity, TV Fridge etc.)

Source: Public Finance (Fiscal Policy) S. Chand publishing ISBN 81-219-0997-X

The Main aim of the Recommendations of Kelkar Task Force thus proved to be simplification of tax structure and tax administration to make them equal with international standards. Secondly it aimed at widening the tax base. Thirdly large
number of exemptions was to be removed. Fourthly widening of service tax was aimed at. In recent years, various budgets have implemented most of these recommendations in modified form.

**Steps Taken by the Central Government for Implementation of Tax Reform Measures**;

The Government of India accepted most of the recommendations made by Vijay Kelkar committee. Some of their recommendations so far taken up by the government for implementation have been duly enacted through the finance Act. The following is given below:

<table>
<thead>
<tr>
<th></th>
<th>Implemented by the Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Personal Income Tax</td>
</tr>
<tr>
<td>2</td>
<td>Data Mining the Income Tax Department has been electronically obtaining a large volume of information from third-parties through the Tax Information Network (TIN) to check Black Money.</td>
</tr>
<tr>
<td>3</td>
<td>Created Tax Profiles to all Tax Payers.</td>
</tr>
<tr>
<td>4</td>
<td>Corporate Tax rate 30% for domestic companies and 35% for foreign companies.</td>
</tr>
<tr>
<td>5</td>
<td>PAN/UID Card Mandatory extended to all citizens and economic agents.</td>
</tr>
<tr>
<td>6</td>
<td>CENVAT</td>
</tr>
<tr>
<td>7</td>
<td>Uniformity in all state legislations relating to VAT</td>
</tr>
<tr>
<td>8</td>
<td>Reduce multiplicity of rates, rationalization of the rate structure, and adoption VAT procedure in union excise duty and sales tax.</td>
</tr>
<tr>
<td>9</td>
<td>Modernizing Tax Administration</td>
</tr>
<tr>
<td>10</td>
<td>Fringe Benefit Tax (FBT) introduced</td>
</tr>
<tr>
<td>11</td>
<td>Introduction of VAT</td>
</tr>
<tr>
<td>12</td>
<td>The existing rate of depreciation for plant and machinery reduced to 15%.</td>
</tr>
</tbody>
</table>

*Source: indiabudget.nic.in*
DIRECT TAX CODE IN INDIA

3.3.1 INTRODUCTION

The Direct Tax Code (DTC) has recently been proposed by the Government of India, to bring about a change in the whole taxation system of the country. The new tax code aims to make the system more efficient and easy for taxpayers, with simplified rules and regulations. It is a step towards replacing the four decade old Income Tax Act of India. The new code will completely overhaul the existing tax proposals for not only individual tax payers, but also corporate houses and foreign residents. It has been drawn with inspiration from the prevailing tax legislation in US, Canada and UK. It is a topic of interest and a matter of concern for every taxpayer in India. India wants to modernize its direct tax laws, mainly its income tax act which is now nearly 50 years old. The government wants a modern tax code in step with the needs of an economy which is now the third largest in Asia. The new tax code is expected to widen the tax base, end unnecessary exemptions, moderate tax rates and add to the government's coffers.

The new Direct Tax Code would impact both individuals as well as corporate with changes in Taxation Slabs, Public Provident Funds, Insurance Policies, Home Loans, Mutual Funds and Shares. Although, initiative was taken by Mr. P. Chidambaram in his first stint as Finance Minister, to bring out new legislations to replace the existing direct tax legislations, there was hardly any progress. The Union Finance Minister Mr. Pranab Mukherjee during his speech in the Parliament on the 6th of July 2009 had promised to bring about structural changes in direct taxes by releasing ‘New Direct Taxes Code’. Keeping with his promise, the Finance Minister has released the draft Code along with discussion
paper on 12\textsuperscript{th} August 2009\textsuperscript{97} inviting the public to share their views and suggestions. The final version of the code will then be presented before the Parliament in the winter session 2009, for enactment.

The Direct Taxes Code Bill, 2010 was referred to the Standing Committee on Finance on 09 September, 2010 for detailed examination and Report thereon. At the outset, detailed background note was obtained from the Ministry of Finance (Department of Revenue), based on which preliminary questionnaire was sent to them. A communication was sent to different stakeholders like Chambers of Commerce, professional bodies, associations/councils, Non-Governmental Organizations, charitable societies and companies/firms etc. for furnishing their views/suggestions on the Bill. Subsequently, a Press Communiqué inviting suggestions of the public including experts on the Bill was also issued on 2 November, 2010\textsuperscript{98}. In response to the communication and Press Communiqué, a large number of memoranda numbering about 260, comprising of thousands of suggestions were received. The memoranda pertain to different categories such as Chambers of Trade and Commerce, Professional Institutions, NGOs and Charitable Societies/Trusts, Companies/Firms, Associations/Councils, Senior Citizen Groups and individuals/experts.

The suggestions received were compiled, tabulated and forwarded to the Ministry for their comments inter-alia seeking comments on various aspects like tax rates/slabs, Incentives/exemptions, new provisions introduced and rationale thereof issues relating to international taxation, Non-Profit Organizations, provisions relating to anti-avoidance etc. A comprehensive questionnaire

\textsuperscript{97} Direct tax code report 2009
\textsuperscript{98} Direct tax code report 2010
comprising both general issues and clause related points was also sent to the Ministry for their comments. During the course of examination of the Bill, the Committee held a number of sittings which included briefing/oral evidence of representatives of the Ministry of Finance and the oral hearings of the representatives of different stakeholders like CII, ICAI, NASSCOM, Export Promotion Council for EOUAs and SEZs. Earnst and Young Private Limited, KPMG, Coalition of International taxation in India and Cellular Operators Association of India. The Committee also heard the views of several stakeholders like Bombay Chambers of Commerce, Bombay Chartered Accountants Society, General Insurance Council and Life Insurance Council, Indian Merchant’s Chamber, Madras Chambers of Commerce and Industry, Income Tax Appellate Tribunal Bar Association, Mumbai, Saifee Hospital Trust, National Sea Farers Association, Container Shipping Lines Associations, All India Federation of Tax Practitioners etc. during the study visit of the Committee conducted from 31st January, 2011 to 3rd February, 2011 in Mumbai and Chennai. Certain issues relating to tax administration were also discussed with the Income Tax Department during the study visit to Srinagar during 15-16 June, 2011. Subsequently, the Committee concluded their examination of the Bill after taking clause-by-clause oral evidence of the Ministry. Thus examination of the Bill was very detailed and exhaustive spanning a little more than a year. It was proposed to make it effective from April 1, 2012. However the Union Finance Minister informed the Parliament in his budget speech for 2012-13 that the Government received the Report of the Parliamentary Standing Committee on March 9, 2012\textsuperscript{99}.

\textsuperscript{99} Direct tax code report 2012
Enactment of DTC would take place after the report is examined. In the Budget speech for 2013-14, the Finance Minister observed, “The Direct Tax Code (DTC) work is in progress. The DTC is not intended to be an amended version of the Income Tax Act, 1961 but a new code based on the best International Practices that will be compatible with the needs of a fast developing economy.

The Direct Tax Code will simplify the direct taxes structure further benefitting a large number of the population. The Finance Minister has indicated in 2016-17 budget that the direct tax code was being scrapped. But the standing committee on Finance of Parliament has told the Finance Minister that DTC provisions need to be brought forth as the next major step towards reforming the tax reforms. As envisaged by the government, it seeks to replace the Indian Income Tax Act of 1961 by amending all laws relating to direct taxes, namely income tax, dividend distribution tax, fringe benefit tax and wealth tax with a view to establishing an economically efficient, effective and equitable direct tax system that can facilitate voluntary compliance and help increase the tax- GDP ratio\textsuperscript{100}.

3.3.2 Structure of the Income Tax Act and the proposed Direct Taxes Code Bill, 2010

A. Income Tax Act, 1961

The Income Tax Act 1961 lays down the frame work or the basis of charge and the computation of total income of a person. It also stipulates the manner in which it is to be brought to tax, defining in detail the exemptions, deductions, rebates and reliefs. The Act defines Income Tax Authorities, their jurisdiction and powers. It also lays down the manner of enforcement of the Act by such authorities through

\begin{footnote}
\end{footnote}
an integrated process of assessments, collection and recovery, appeals and revisions, penalties and prosecutions. The Act has been amended annually through the Finance Act. Income Tax Act, 1961 comprises of

(i) 23 Chapters  
(ii) 656 Sections  
(iii) 14 Schedules

B. Proposed Direct Taxes Code Bill, 2010

The Direct Taxes Code Bill, 2010 consolidates and integrates all direct tax laws and replaces both the Income-tax Act, 1961 and the Wealth-tax Act, 1957 by a single legislation. The provisions applicable to a taxpayer are in the main clauses while complex computations and exceptions have been placed in Schedules. The proposed DTC Bill, 2010 comprises of

(i) 22 Chapters  
(ii) 319 Clauses  
(iii) 22 Schedules

3.3.3. OBJECTIVES OF DIRECT TAX CODE

Direct tax code seeks to consolidate and amend the law relating to all direct taxes, namely income tax, dividend distribution tax and wealth tax so as to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax – GDP ratio. All the direct taxes have been brought under a single code and compliance procedures unified, which will eventually pave the way for a single unified tax payers reporting system. The need for Direct Tax Code (DTC) arose from concerns about the complex structure of half a century old Income Tax Act,
1961\textsuperscript{101}, which has been amended a large number of times, making it incomprehensible to the average tax payer. As the marginal tax rates have been steadily lowered and the rate structure rationalized to reflect best international practices, any further rationalization of the tax rates may not be feasible without corresponding increase in the tax base to enhance revenue productivity of the tax system and improve broadening the base has been articulated in the DTC. The first element of the strategy is to minimize exemptions that have eroded the tax base. The removal of these exemptions would, Increase Tax – GDP ratio, Enhance GDP growth, Improve Equity (both horizontal and vertical), Reduce Compliance costs, Lower administrative burdens, address the problem of ambiguity in the law which facilitate tax avoidance, checking of Erosion of the tax base through tax evasion and Discourage Corruption.

3.3.4 Highlights of Direct Tax code

1. Personal tax: Parliamentary Standing Committee on Finance (SCF) had proposed for tax exemption limit to be raised to Rs.3 lakhs. However, this suggestion was not accepted on the account of huge loss of tax revenues to the government and was kept unchanged as per DTC bill in 2010 (which is Rs.2 lakhs for both male as well as female Indian residents & Rs.2.5 for senior citizens who are eligible under IT Act of 1961). Additionally, the 2013 draft had proposed the fourth slab i.e. Higher tax rate of 35% for 'super-rich' with taxable income in excess of Rs.10 crores\textsuperscript{102}.

2. Income from House Property: The committee had recommended for a differentiation between commercial and non-commercial leasing of property. The rental income from commercial leasing of property is proposed to be taxable as business income and eligible for allowance of expenses and

\textsuperscript{101} Direct tax code report 2010

\textsuperscript{102} http://www.pankajbatra.com/india/new-direct-tax-code-dtc-highlights/
depreciation. Also, a tax deduction of 20% of the annual rent for repairs and maintenance of house property had been proposed.

3. Wealth Tax. The wealth tax is levied on assets except the ones that are held in stocks. Also, the following assets do not come under purview of wealth tax-

a) Assets used for charitable activities
b) Agricultural land
c) One house up to 500 square meters
d) Foreign assets of non-resident Indians

The bill proposes that the limit of maximum net wealth not subjected to taxation is to be increased from the existing Rs.30 lakhs to Rs.50 crores. Also, the rate of wealth tax is to be charged at 0.25% of the net value after exemption limit.

4. Corporate Tax: The concept of minimum alternative tax (MAT) was proposed in direct tax code and it is levied if the tax liability under the standard requirements is lower than 18.5% of book profits. However, life insurance companies are not covered under this regulation.

5. Taxation of international entities. If a certain foreign entity has 20% or more of total assets in India, then the income arising from the same is subject to taxation.

6. Change in NRI laws: Present law states that an NRI is liable to pay tax on his global income if the stay in India is more than 182 days within a financial year. DTC proposes that this duration should be changed to just 60 days. An NRI is eligible to be taxed for his global income only if he had stayed in India for nine out of 10 precedent years or 730 days in preceding seven years. The said direct tax was introduced by the Ministry of Finance to make taxation simpler as well as bring transparency along with eliminating the loopholes currently prevailing in economy.

7. Removal of most of the tax saving schemes: DTC removes most of the categories of exempted income. Unit Linked Insurance Plans (ULIPs), Equity Mutual Funds (ELSS), Term deposits, NSC (National Savings certificates),
Long term infrastructures bonds, house loan principal repayment, stamp duty and registration fees on purchase of house property will loose tax benefits.

8. New tax saving schemes: Tax saving based investment limit remains 100,000 but another 50,000 has been added just for pure life insurance (Sum insured is at least 20 times the premium paid), health insurance, med claims policies and tuition fees of children. But the one lakh investment can now only be done in provident fund, superannuation fund, gratuity fund and new pension scheme (NPS).

9. Tax slabs: The income tax rates and slabs have been modified. The proposed rates and slabs are as follows:

<table>
<thead>
<tr>
<th>Annual Income</th>
<th>Tax Slab</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up-to INR 200,000 (for senior citizens 250,000)</td>
<td>Nil</td>
</tr>
<tr>
<td>Between INR 200,000 to 500,000</td>
<td>10%</td>
</tr>
<tr>
<td>Between INR 500,000 to 1,000,000</td>
<td>20%</td>
</tr>
<tr>
<td>Above INR 1,000,000</td>
<td>30%</td>
</tr>
</tbody>
</table>

Men and women are treated same now

10. Home loan interest: Exemption will remain same as 1.5 lakhs per year for interest on housing loan for self-occupied property.

11. Short and long term gains: Only half of Short-term capital gains will be taxed. e.g. if you gains 50,000, add 25,000 to your taxable income. Long term capital gains (From equities and equity mutual funds, on which STT has been paid) are still exempted from income tax.

12. EEE and EET: As per changes on 15th June, 2010, Tax exemption at all three stages (EEE) —savings, accretions and withdrawals—to be allowed for provident funds (GPF, EPF and PPF), NPS (new pension scheme administered by PFRDA), Retirement benefits (gratuity, leave encashment, etc), pure life insurance products & annuity schemes. Earlier DTC wanted to tax withdrawals.
13. Education Cess: Surcharge and education cess are abolished.

14. Income arising from House Property: Deductions for Rent and Maintenance would be reduced from 30% to 20% of the Gross Rent. Also all interest paid on house loan for a rented house is deductible from rent. Before DTC, if you own more than one property, there was provision for taxing notional rent even if the second house was not put to rent. But, under the Direct Tax Code 2010, such a concept has been abolished.

15. LTA (Leave travel allowance): Tax exemption on LTA is abolished.

16. Education loan: Tax exemption on Education loan to continue.

17. Corporate tax: Corporate tax reduced from 34% to 30% including education cess and surcharge.

18. Taxation of Capital gains from property sale: For sale within one year, gain is to be added to taxable salary. For long term gain (after one year of purchase), instead of flat rate of 20% of gain after indexation benefit, new concept has been introduced. Now gain after indexation will be added to taxable income and taxed at per the tax slab. Base date for cost of acquisition has been changed to 1st April, 2000 instead of earlier 1st April, 1981.

19. Medical reimbursement: Max limit for medical reimbursements has been increased to 50,000 per year from current 15,000 limits.

20. Tax on dividends: Equity mutual fund will attract 5% dividend distribution tax (DDT). DDT has been removed from debt and non-equity based mutual funds but now dividends on non-equity funds will be taxable in investor’s hand as per his slab rates. There will also be a TDS of 10% (20% in case of NRI and companies) if dividend is more than 10,000 Rs for non-equity funds.

21. News for NRIs: As per the current laws, a NRI is liable to pay tax on global income if he is in India for a period more than 182 days in a financial year. But in new bill, this duration has been changed to just 60 days. An NRI will be deemed as resident only if he has also resided in India for 365 days or more in
the preceding four financial years, together with 60 days in any of these fiscal years. Even if an NRI becomes a resident in any financial year, his global income does not immediately become liable to tax in India. Global income would become taxable only if the person also stayed in India for nine out of 10 preceding years, or 730 days in the preceding seven years. This is very unfair to Seafarers. To avoid any income tax, an Indian sailor employed with a foreign ship will have to stay maximum for 60 days in India.

3.3.5. FEATURES OF DIRECT TAX CODE

The new Direct Tax Code (DTC) has many features of a simplified tax system, particularly, the consolidation of the related provisions, the prescriptive methodology for computation, and simpler language are worth mentioning. The tax reforms have been engaging attention of both the tax payer as well as tax administration over the last many decades. We have had the tax reform studies chaired by Dr. Raja Chelliah, Dr. Partha Sarthi Shome and Dr. Vijay Kelkar. Each of these studies has looked at the tax system from the point of efficiency in the Indian context over the years.

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103 Source: Direct tax code report 2009
Features Of Direct Tax Code

Simple Language
Single code for all Transaction
No Government Intervention Every Year in Rates
Brings Many People in to Tax Network
Improves Tax collection process
Increases Revenue of the Government
Economic Development through GDP
Reduces Tax Evasion
Includes Agricultural Income
Promote Transparency
Tax Payer Friendly
Reduces the Tax Burden
Helps in fiscal Balance
Simplifying the Tax Structure
Gives Clear Cut Information
Reduces Transaction cost

Simple language: With the expansion of the economy, the number of taxpayers can be expected to increase significantly. The bulk of these taxpayers will be small paying moderate amounts of tax. Therefore, it is necessary to keep the cost of compliance low by facilitating voluntary compliance by them. This is sought to be achieved, inter alia, by using simple language in drafting so as to convey, with clarity, the intent, scope and amplitude of the provision of law. Each sub-section is a short sentence intended to convey only one point. All directions and mandates, to the extent possible, have been conveyed in active voice. Similarly, the provisions and explanations have been eliminated since they are incomprehensible to non-experts. The various conditions embedded in a provision have also been nested. More importantly, keeping in view the fact that a tax law is essentially a commercial law, extensive use of formulae and tables has been made.
Simple Calculation & Transparent: Tax system and law should be as simple and clear as possible. A layman can also understand the calculation and it is simple system will have only a limited number of rates and exemptions or deductions and would give the least possible discretion to the tax officials and tax payers for interpreting the law, resulting in reduced litigation. Offers prior consultation with tax-authorities. Consistent enforcement by tax authorities. Offers clear and accessible route for dispute resolution.

Single Code for direct taxes: All the direct taxes have been brought under a single Code and compliance procedures unified. This will eventually pave the way for a single unified taxpayer reporting system.

Reducing the scope for litigation: Wherever possible, an attempt has been made to avoid ambiguity in the provisions that invariably give rise to rival interpretations. The objective is that the tax administrator and the tax payer are ad idem on the provisions of the law and the assessment results in a finality to the tax liability of the tax payer. To further this objective, power has also been delegated to the Central Government/Board to avoid protracted litigation on procedural issues.

Flexibility: The structure of the statute has been developed in a manner which is capable of accommodating the changes in the structure of a growing economy without resorting to frequent amendments. Therefore, to the extent possible, the essential and general principles have been reflected in the statute and the matters of detail are contained in the rules/Schedules.

To ensure that the law can be reflected in a Form: For most taxpayers, particularly the small and marginal category, the tax law is what is reflected in the Form. Therefore, the structure of the tax law has been designed so that it is capable of being logically reproduced in a Form.

Consolidation of provisions: In order to enable a better understanding of tax legislation, provisions relating to definitions, incentives, procedure and rates of taxes have been consolidated. Further, the various provisions have also been rearranged to make it consistent with the general scheme of the Act.
Elimination of regulatory functions: Traditionally, the taxing statute has also been used as a regulatory tool. However, with regulatory authorities being established in various sectors of the economy, the regulatory function of the taxing statute has been withdrawn. This has significantly contributed to the simplification exercise.

Providing stability: At present, the rates of taxes are stipulated in the Finance Act of the relevant year. Therefore, there is a certain degree of uncertainty and instability in the prevailing rates of taxes. Under the Code, all rates of taxes are proposed to be prescribed in the First to the Fourth Schedule to the Code itself thereby obviating the need for an annual Finance Bill. The changes in the rates, if any, will be done through appropriate amendments to the Schedule brought before Parliament in the form of an Amendment Bill.

Equitable: An equitable treatment of tax is critical to the acceptability and therefore success of any tax structure. The dimensions being:

a. Horizontal: Tax payers with equal amount of income or property should pay the same amount of tax. Similarly situated taxpayers should be taxed similarly. Taxation to have a sector-neutral flavor (including fiscal impartiality between those who produce for the domestic market and those who cater to the external markets.)

b. Vertical: Tax burden should be based on tax-payers ability to pay. Vertical equity is the justification for progressive tax structures in income and wealth transfer taxes. Person with higher income should pay relatively higher proportion of his income as tax.

Rationalization: Rational both at the micro and macro level. Ad-hoc changes from year to year undermine rationality and introduce complications. Structure once established should remain stable unless and until the economic conditions undergo a radical transformation. An adverse court decision should not also be considered a justification for an immediate change in the tax law.

Moderate tax rates & Widening of tax bases: Should have moderate rates and broad base. Should bring more assesses/income in the tax-net by having
moderate tax rates, least possible exemptions and encouraging voluntary compliance.

Competitive: Conformity with the recent initiatives in the other parts of the world, including the procedures adopted by best international tax administrations.

Efficient Administration

a. Harness technology for secure and seamless logistics of tax collection through integration of primary information, record keeping, retrieval and enforcement.

b. Simple and efficient processes resulting in reduced transaction cost

c. Minimum administrative burden on both the tax-payer and the government

d. Accountability of tax authorities and quality tax-payer services to enhance deterrence against tax evasion and facilitate voluntary compliance

Economic impact on infrastructure, employment, cost of capital and inputs: The DTC should be referred to a group of experts comprising of economists, tax administrators & practitioners and industry/ business representatives for their opinion on its impact on economy, employment, investment in infrastructure etc.

On Family Trust: On perusing the DTC, it is observed that there is no provision corresponding to provision contained in the Provision of Section 164 of the 1961 Act. This will create a lot of hardships to the genuine trusts and therefore aforesaid provision may please be incorporated in the proposed DTC also. Further as proposed in DTC, the private discretionary trust shall also be liable for Wealth Tax. In case of Private discretionary trust where the share of beneficiaries is determinate, then the beneficiaries should be liable to wealth tax on his share of wealth providing the threshold available in case of an individual\textsuperscript{104}.

\textsuperscript{104} Source: Direct tax code report 2010