

# Suggestions On Report of National Task Force

**(Recently the Institute submitted its considered response to the interim report of the National Task Force headed by Dr. Vijay Kelkar. The same is published for the information of members)**

## I. INTRODUCTION

- 1.1. The National Task Force headed by Dr. Vijay Kelkar, Advisor to the Minister of Finance and Company Affairs, has submitted its report on both Direct and Indirect Taxes. The underlying philosophy of the recommendations is to abolish incentives and at the same time bring down the tax rate. The report makes out a strong case for simultaneous implementation of both the measures. If withdrawal of exemptions and deductions are deferred while the tax rates are reduced, the report cautions that it could lead to disastrous impact on revenue flows.
- 1.2. The Task Force has taken into consideration the reports of various Committees submitted in the past to the Government. International Tax Practice has also been studied on certain proposals. The Task Force has identified the basic deficiencies in the existing tax system in the nature of structural complexity, low transparency, delay in issue of refunds and PAN numbers, high compliance costs, lack of attention to tax payer needs, tax payer harassment, tax leakage etc. Lot of measures are suggested in the report to transform the tax system so as to make it simple and transparent; to reduce transactions costs of revenue collection and compliance costs of tax payers; to achieve the alignment of incentives of tax payers and the tax administration and for widening of the tax base.
- 1.3. The Task Force has placed on record its concern that the efficacy of its recommendations is likely to be seriously vitiated if individual components are selectively accepted or rejected; success of tax reform efforts depend on their implementation in an integrated manner. The report aims at building a trust-based rather than an overtly punitive tax system which requires an alignment of the objectives of the tax authorities with obligations of tax payers.

- 1.4. The Institute of Chartered Accountants of India places on record its appreciation for the commendable job done by the Task Force in formulating innovative and meaningful recommendations. Some of the recommendations, if implemented in the true spirit in which they are made, would go a long way in upgrading the quality of tax payer service thereby facilitating voluntary compliance resulting in substantial increase in the tax paying population in the country.

## II. GENERAL COMMENTS ON THE RECOMMENDATIONS

- 2.1. The Task Force has indicated that the success of the tax reform efforts depends on the implementation of all its recommendations in totality. If this stipulation is made, it is felt that the acceptance of the report may only get delayed and consequently the implementation may get postponed. Instead, it may be desirable for the Task Force to compartmentalize its recommendations wherein the set of suggestions which need to be considered as a package can be advanced together and the suggestions that can be delinked and separately considered for implementation in due course can be given independently. For instance, levy of tax on agricultural income by the Central Government requires the concurrence of the State Governments and it involves time consuming exercise and therefore needs to be delinked from the package of recommendations.
- 2.2. While we appreciate the strong reasons given for abolition of incentives in the nature of deductions and rebates, one indisputable factor that needs to be borne in mind is the fact that there is no social security scheme in our country and therefore some of the existing incentives should not be done away with. Mere increase in the basic exemption limit, we

sincerely apprehend, will not compensate for the abolition of certain incentives. This aspect may be appreciated while considering some of our specific suggestions made hereinafter.

2.3. The Institute is confining in this submission to making suggestions only with reference to the recommendations which are critical in nature or where further strengthening is called for. All other recommendations, both with reference to direct taxes and indirect taxes, which are not specifically commented upon in the following paragraphs are considered as welcome measures to be implemented without any deviation.

### III. SPECIFIC COMMENTS ON THE RECOMMENDATIONS IN THE REPORT ON DIRECT TAXES

#### 3. Recommendations on Tax Reforms and Administration

3.1. The Task Force has rightly emphasized on the need for controlling public expenditure and productive spending of tax payers money. In this regard our suggestions are as follows:

- a) A study needs to be carried out for bringing the non-plan expenditure to the minimum level and the measures based on the results of the study should be implemented as per a time bound plan.
- b) There should be proper mechanism for accounting and certification of capital assets created through plan expenditure.
- c) Government should adopt Double Entry System of accounting for effective monitoring of the flow of funds.
- d) The Government should enforce right sizing of the manpower.

3.2. Widening of the tax base has also been focused by the Task Force. It is suggested that an effective system of monitoring of the following types of transactions or expenses should help in widening the tax base:

- a) Bank deposits beyond a specified limit;
- b) Air travel expenditure above a certain limit;
- c) Transfer of any immovable property beyond a particular value; and
- d) Electricity bill payments beyond a certain limit.

Further, all professionals carrying on profession notified for the purpose of Sec.44AA must be compulsorily required to file the return of income same as presently required in the case of Companies irrespective of the income or loss made during any year.

3.3. The Task Force should emphasis on long term fiscal policy to be in place. Once the recommendations of the Task Force are considered and extensive changes are made, there should not be any further tinkering of the law, except to the extent of strengthening the existing provisions, for at least a period of 5 years. The tax payer's familiarity with the law which ultimately improves compliance and the conducive investment climate in the country depend on the stability of Fiscal Laws. Frequent changes demoralizes substantial tax paying population and destabilizes large investment plans. For instance, reversal of the policy on taxation of dividend income and reducing the tax exemption from 100% to 90% u/s.10A and 10B for one year (assessment year 2003-04) causes considerable discomfort in the minds of the tax payers dislodging the faith and infusing a sense of apprehension.

3.4. Frequent changes in law will also make many of the recommendations of the Task Force unworkable or cumbersome. For instance, extensive use of information technology in rendering quality tax payer service can work better in a scenario where the stability of the law is ensured. Floppy diskettes from the Income-tax Department will be rendered outdated depending on the frequency of the amendment of laws.

3.5. Department can render services over the net for educating the tax payers and for those who cannot afford a computer can be made to access the website through Cybercafes or at the "Tax Payers' Clinics" to be constituted in various centers of the Income-tax Department. Television media and press can also be effectively used to create awareness for improved voluntary compliance.

3.6. The efficacy of the suggestion of allotment of PAN to all citizens to serve as a Citizen Identification Number would depend on the efficiency of its implementation. The present experience does not encourage support to be extended to this suggestion. Unless an efficient network is laid in place for accurate and flawless implementation, the suggestion may not work. Not only the allocation of PAN is important but also channelising/collecting and correlating various data in terms of financial transactions with reference to the PAN and the using of such data at the time of processing of return is more crucial and therefore to be ensured.

3.7. Recommendations made for collection of information are good. However, the requirement of filing "Annual Information Return" may be avoided. The Institute recommended to the CBDT about the various information that can be called for in a return and the return

form was also accordingly modified. However, when it came to implementation, the new form was not insisted upon and tax payers have been allowed to file returns using the old forms. It is possible that the annual information returns may end up as numerous TDS returns without further cross verification or necessary action. Besides, low tax paying individuals/firms/companies will have the additional compliance costs of providing information through the "Annual Information Return" which can be avoided. Instead, it may be advisable to ensure mandatory filing of a "Balance Sheet" or "Statement of Affairs" along with the income returned wherein all the assets and liabilities of a person as on 31<sup>st</sup> March is fully reflected. This would help the Department to ascertain and monitor the increase in "Net Worth" of a person on annual basis.

- 3.8. Selection of cases for scrutiny on a centralized basis without any subjectivity is welcome. Selection need not necessarily be based on the return furnished but can also be based on the data collected against the PAN. Notices can be issued based on the data collected and case taken up for scrutiny if prima facie the data collected does not appear to find a place in the return or enclosures.
- 3.9. Outsourcing for processing of returns is a welcome measure. Considering the secrecy and confidentiality involved about the information relating to tax payers more particularly enunciated u/s.138 of the Income-tax Act, it is desirable to outsource to an agency which imbibes a strict code of conduct and ethics and also a thorough knowledge of the tax provisions and accounts. If called upon, the profession of Chartered Accountancy would raise up to the expectation of the Government in discharging its duties in all areas where the Task Force has recommended for outsourcing in an appropriate manner.
- 3.10 The modus operandi suggested for payment of TDS/taxes, recording thereof, refunds on a daily basis through designated Bank are most welcome measures. In view of the feasibility of accounting payments to the credit of the tax payer online, in the event of refund the tax payer should be entitled to interest even for the period from the date of remittance of TDS/advance tax upto the 31<sup>st</sup> March of the previous year which is not presently granted. The tax payer can be issued a pass book indicating the debits and credits on account of taxes or may be issued with annual statements. If there is any delay in sending the information to the designated Bank for refund, there has to be penal interest or such other measure so that the tax payer is not again made

to chase his refund by making unwarranted visits to the Income-tax Department. Again, proper safeguards have to be built into the system to prevent loss due to human error in keying in the data.

## SEARCH AND SEIZURE

- 4.1. The recommendations are appreciable and well thought out. However, Chapter XIV-B was introduced with effect from 01.07.95 and the special procedure prescribed therein for assessing undisclosed income for the block period is in the process of evolving with so many issues getting settled through amendments and also through Court pronouncements. Sec.158BFA takes care of any delay or default in complying with the provisions of Chapter XIV-B along with Sec.276CCC. The advantage in this Chapter is that the entire block period is reopened by a single notice; responded by a single return and concluded by a single assessment order. Multiplicity of proceedings is avoided. Uniform rate also prevents disputes on the year of assessment. The primary suggestion, in the light of these factors and also to ensure stability, is to retain Chapter XIV-B and fine tune the same by removing the irritants. In case the suggestion is not considered favourably, then the advantages of Chapter XIV-B can be suitably incorporated in the procedure laid down for assessment and re-assessment u/s.147 to 153 so that all the assesseees are subjected to a uniform procedure.
- 4.2. The Institution of Ombudsman in the top 10 tax paying Cities and all State Capitals on the lines similar to Banking sector can be expanded upon by ensuring that tax payers' forums have an effective role in the process. It should be an high power body which can resolve tax payer grievances by maintaining confidentiality, wherever possible, about the source of complaint or information.
- 4.3. Same as abolition of rewards for officials carrying out search operations, any performance evaluation for officers should not be rewarded in financial terms. Even assuming the levels of penalty or rewards are specified, it should be imposed or awarded only on the relevant proceedings attaining finality and not before.
- 4.4. There is a dire need for improving the infrastructure of income-tax offices. The tax payers and their representatives should be given better facilities within the Department so as to provide a conducive atmosphere making the tax payers feel comfortable and proud to visit the offices of the Department.

## 5. REFORMS IN PERSONAL TAXATION

- 5.1. As regards the various proposals in the context of personal tax reforms, the following suggestions are advanced:
- a) While increase of basic exemption limit is welcome, the entry tax rate can be retained at 10%. Accordingly slabs can be modified with maximum marginal rate at 30%. This will ensure that at the lower level (small income earners) do not end up paying more.
  - b) Standard deduction for salaried class should be continued since there is an element of expenditure that needs to be allowed instead of taxing the gross earnings. However, a single slab of standard deduction, say, 25% or Rs.25,000/-, whichever is less, may be appropriate.
  - c) Housing is an important basic requirement. Therefore, interest on loan for housing can be allowed deduction. However, the quantum of deduction can be restricted to Rs.50,000/- per annum so that small and medium income group earners do not get affected.
- 5.2. As regards omission of deductions and tax rebates, the suggestions are as under:
- a) The deductions which are gradually getting phased out can be phased out as per the existing plan.
  - b) The omission of deductions can be prospective in their operation without upsetting the eligibility of existing clients. For instance, Sec.10A and 10B operate with the sunset clause upto assessment year 2010-11. Those who are already operating on the premise of these benefits may not be deprived before the sunset clause. Those who commence the units in future can be disqualified even for the unexpired period.
  - c) Rebate u/s.88 can go for all outgoings except the following:
    - c) Life insurance premium;
      - i) Housing loan repayment;
      - ii) Long term savings – lock-in period of 7 or 10 years; and
      - iii) Recognised welfare fund contributions over which the assessee employee has no control.
    - d) Rebate u/s.88B for senior citizens should be retained in view of lack of social security measures in the country. Rebate u/s.88C can be omitted.
- 5.3. Exemption of long term capital gains on equity is not advisable as it may lead to abuse of the exemption in more than one way. Besides, litigation will be rampant on deciding whether the gain derived is from shares

held as “investment” or from shares held as “stock-in-trade”. If one particular source of income is accorded tax exemption, the tendency will be to modify the colour of income and route it through the source of income which is exempt. The Task Force has rightly recommended abolition of tax on dividend so as to avoid double taxation. Such measure is sufficient to boost the stock market operations and exemption on long term capital gains on equity may be a measure beyond comprehension to achieve that objective. More than the benefits such a measure can bring, the complications and disadvantages will be abundant to dislodge the well founded intention as misdirected.

- 5.4. The abolition of the status “resident but not ordinarily resident” may be sound from economic reasons. However, from fiscal legislation point of view the implications need to be studied in depth. As the suggestion of the Task Force to constitute a separate working group to study non-resident taxation has been acted upon by the Government, the same working group may be assigned the responsibility of studying the implications on this aspect also before a final view is taken.

## 6. CORPORATE TAXATION

- 6.1. Capital expenditure on scientific research must be encouraged and allowed deduction as the expenditure has uncertain future benefits. In-house research can help Indian industry to adequately equip itself to face global competition and need fiscal incentive for sustainability of scientific research activity. The inadequacy of the technological development within the country supports the continuance of Sec.35 for capital expenditure.
- 6.2. Abolition of Sec.36(1)(iii) will still enable the assessee to avail the deduction u/s.37(1) in respect of interest on capital borrowed. However, interest on loans utilised for acquiring capital assets which are capitalized on the basis of Accounting Standard 16 of our Institute will not be eligible u/s.37(1) as the same denies benefit for a capital expenditure. If, on the broader principle of removing the gap between tax profit and book profit this recommendation is made, it is not objected to. After all, the assessee will ultimately get the interest amortized as part of depreciation over a period of years. On the same lines, the removal of Sec.145A can also be considered.
- 6.3. Removal of MAT and abolition of dividend tax are all welcome measures. Similar is the recommendation to allow welfare fund contributions covered by

Sec.43B if the payment is made within the due date for filing the return of income.

- 6.4. With a view to align the book profit and the taxable income to as close an extent as possible, depreciation rates need to be synchronized along with corporate depreciation rates. Harmonization of depreciation for non-corporates and corporates under the Income-tax Act viz-a-viz the depreciation rates under the Company Law assumes significance so as to align book profit with taxable income to a greater extent. If it is left to the assessee to avail any amount of depreciation they choose to claim, which may not be uniform on a year to year basis, distortion of results will occur. A review of the existing scheme of block of assets under the Income-tax Act needs to be considered so that both the Company Law and the Income-tax Law advocate a single treatment and the conceptual framework of depreciation is same under both the enactments.
- 6.5. Infrastructure development needs to be encouraged and therefore the recommendation to eliminate deduction u/s.80IA needs to be reviewed. Infrastructural facilities such as roads, ports, other basic amenities etc. need to be encouraged along with education and housing. These sectors may be accordingly consolidated and given the required fillip in appropriate manner.

## 7. AGRICULTURAL INCOME-TAX

- 7.1. The recommendation is welcome as there is no reason for exempting huge agricultural income earners from the levy of income-tax. The State Governments should be convinced that ultimately there will be no loss of revenue for them and there will be better enforcement of levy and collection by a central mechanism.
- 7.2. Many corporates are also operating in the field of agriculture apart from the fact that horticulture, apiculture, nurseries etc. in urban areas are striving well. While the suggestion is appreciated, small farmers should not be made to suffer by implementation of this recommendation. To begin with, the recommendation can be implemented with an enhanced exemption limit of at least Rs.3 lakhs so that the system can be in place to handle only large income earners in the agricultural field.

## 8. TAXATION OF CHARITABLE TRUSTS

The grading by an outside agency may result in subjectivity and litigation in the absence of exhaustive and proper guidelines being formulated. An inde-

pendent panel can be constituted drawing persons from the relevant fields and Institutions of Nation repute so that the guidelines can be formulated.

## IV. Comments on the recommendations in the report on Indirect Taxes

### 9. MACRO PERSPECTIVE AND APPROACH TO REFORMS

#### Remove plethora of exemptions:

Removal of exemptions should be done in a phased manner. Exemptions should be continued in deserving cases like charity/other social causes/R & D/promotion of industrial development etc. Each exemption is to be examined on its merits. If they do not meet with the overall objective of the excise legislation, they should be removed.

### 10. REVENUE AUGMENTATION, TAX LEVIES AND RATES

#### 10.1. Widen the tax base -

- i) Unorganised sector represents the largest untaxed area in all types of taxes. Hence the same should be focussed with proper administration back up.
- ii) In cases where levy is introduced for the first time, reasonable transition period should be provided and detailed guidelines should be issued.
- iii) There is no denying the fact that there has been a gradual fall in the excise and customs collections as a part of the GDP. This may be due to stagnation of manufacturing activities or evasion.

#### 10.2 Expand coverage of service tax -

- i) Selection of new service to be brought under the tax net should be done on the basis of an objective evaluation as to its revenue potential and aspects of administration as well.
- ii) The Institute has already submitted its considered views to the Expert Group on Service Tax in which it has taken the view that there should be no selective taxation of services. All services should be covered with a minimum threshold limit to leave out smaller services.

#### 10.3 Integrate Central Excise (Goods) and Service Tax Legislation.

Same should be done over a well defined PERIOD PLAN and points of view of the Experts/Trade and Industry should be obtained prior to enactment of the statute.

**10.4 Implement VAT**

Deficiencies of VAT System which is in force in different parts of the world, should be studied and analysed, more particularly in the Indian context, and should be duly considered. New legislation should be made litigation free to the extent feasible.

**10.5 Rates of Customs Duty-**

- i Adverse indications, if any, on the domestic industry should be examined in detail.
- ii There are no agreed definitions for “raw materials”, “intermediate” and “final goods”. What may be raw material for one industry may be finished goods for another industry. Another classification in this context is primary goods and secondary goods. Further, due consideration should be given to the fact whether the component in the finished goods is manufactured in our country or not.

**10.6 Transparent budgetary support**

It is common knowledge that only a miniscule percentage of the budgetary support reaches the targeted beneficiary. There is a huge revenue leakage in between. Further, there should be absolute public interest behind all such concessions.

**10.7 Excise rates**

Higher rates may be prescribed for :

- (i) Items of luxurious nature.
- (ii) Items whose consumption is injurious to health.

**10.8 Separate rate structure for petroleum sector**

There is no necessity for having a separate rate for a particular sector when the objective of the Government is to have a uniform rate.

**10.9 Withdraw deemed credit for textile sector**

Decision should be taken after detailed examination of implications.

**10.10 Exemption limit for SSI units**

The SSI units have a definite role to play in the Indian economy considering the geographical spread and lopsided development of different parts of the country. It is a fact that there is a growing understanding between small-scale enterprises and even multi national corporations, which are utilising the services of SSI units for manufacturing their products through franchising arrangements. Given the situation, it is necessary to encourage SSI units. An increased limit of Rs.2 crores may be fixed. All precautions must however be taken to prevent misuse of SSI exemptions. For those SSI units who want to pay excise duty and avail Modvat Credit a presumptive system of taxation may be adopted.

**10.11 Effective date of notification**

A notification should come into force on a specified date or after 15 days from the date of its issue. This will avoid many practical difficulties now being faced.

**11. CENTRAL EXCISE PROCEDURAL SIMPLIFICATION****11.1 Applicability of MRP to repacking into retail containers**

- i Applicability should be strictly restricted to consumer goods and should not be extended to industrial goods.
- ii Deemed manufacture concept, as proposed, could lead to chaos and should be avoided.
- iii Fixation of abatement percentage should be based upon a detailed study and evaluation whereby implications on the SSI sector are avoided.

**11.2. Determination of cost of production**

This is a crucial issue involving accounting and costing principles. The Institute can offer its expertise in any exercise of this sort.

**12. IMPROVING INDIRECT-TAX ADMINISTRATION****12.1. Issue of notifications/clarifications**

System of issue of centralised departmental clarifications should be initiated and current practice of issue of Trade Notices should be discontinued.

**12.2. Bonds/Bank Guarantees**

A bank guarantee contributes to cost. A system of ABC classification of assessee should be adopted based upon the regularity and promptness with which such assessee clear their excise demands. “A” category assessee should be exempt from furnishing bank guarantee.

**CONCLUSION**

The Institute welcomes the abolition of wealth-tax. But at the same time it will be appropriate to require every individual to prepare a statement of affairs indicating assets and liabilities as on 31<sup>st</sup> March of each year to be enclosed with the income-tax return as already suggested herein above.

The Institute has formulated many other recommendations on specific provisions of law relating to Direct and Indirect taxes which are submitted separately as pre-budget memorandum to the Central Board of Direct Taxes. Those suggestions are not included in this representation as they are not directly linked to the recommendations in the report of the Task Force. ■