PERSONALITY TEST PROGRAMME 2019

(Current Affairs Interview Issues)

TAX REFORMS IN INDIA

Introduction

Taxation is **not just a vehicle for raising state revenue**. It can also be critically **important for economic and political development**. In recent times, India has introduced some far reaching reforms to increase compliance (like Goods and Services Tax (GST), reduction in corporate tax rate and phasing out of exemptions etc.) and to reduce tax evasion (like Place of Effective Management, Black Money Act etc.). In addition, the legacy of contentious, adversarial tax issues from the past is being cleaned up. Tax administration is being improved: now around 95% of filings are electronic, tax refunds are now being issued in a record 7-8 days.

However, the success has only been limited and sporadic in mobilizing larger tax revenue and still, **India remains largely a tax non-compliant society**.

- Only 6.08 cr individuals pay taxes (~4.9%) much below the desired level of 23%.
- In India, only 15.5% of net national income is reported.
- Overall, Tax-to-GDP ratio (at 17.82% in FY 2017-18) still remains below that of emerging economies (~21%) and much below OECD average (~34%).
- According to the Union Budget 2018-19, gross tax revenue as a proportion of GDP declined to 10.9% of GDP in 2018-19 from 11.2% in 2017-18, primarily due to shortfall in Goods and Services Tax (GST).

Reasons behind low Tax-to-GDP ratio in India

- **Low tax base:**
  - **Income Tax:** In India, the **exemption threshold** of income tax has been **consistently raised**, much rapidly than underlying income growth. This implies that **relatively well off people are subsidized** at the cost of services which could be provided to poor with the forgone money.
  - **Corporate Tax:** Before the recently unveiled tax-cuts, India was branded as a **high-tax destination with corporate tax rate over 30%.**
    - ✓ Moreover, a complex system of exemptions, tax cuts, preferential tax rates, deferral of tax liabilities etc. has led to large tax collection expenditure and a significant amount of revenue foregone.
- **Tax Evasion: Tax evasion** and **corruption** undermines the legitimacy of the State. It creates a belief among the citizens that the public resources are being wasted, reducing the willingness to pay.
  - A state that over-emphasizes or prioritizes redistribution over delivery of services ends up having middle class **'exit from the state'** i.e. people start avoid paying taxes, start associating state with inefficiencies, promote using private hospitals or sending children to private schools etc. This will reduce demand of services from state, further eroding its legitimacy to earn taxes.
  - **Multiplicity of exemptions** and **exclusions** further increase the **complexity of the tax structure** and acts as a disincentive for tax compliant society, as in case of GST.
- **Weak Tax Administration:** is considered a key barrier to effective and fair tax collection in the country.
  - Tax administration and tax compliance is weak due to **lack of technical expertise** and **financial resources**, as well as due to **corruption**.
  - Tax administrative capacity at **sub-national** and **local government levels** (e.g. user charges, property tax etc.) is particularly wanting.
- **Structural Issues:** Several structural factors have impinged upon India's tax revenue performance such as:
  - large share of agriculture (historically untaxed sector) & service sector (lightly taxed sector)

- low literacy rate and large rural population
- large informal economy partly due to onerous regulations on businesses, including labor regulations and high corruption
- low financial development, due to which financial transactions are conducted in cash, making it difficult to track tax evasion

Implications of low Tax-to-GDP ratio

- **Limited Fiscal Capacity:** Low Tax-to-GDP ratio reduces the resources available to the government and puts a **constraint on Government spending**. It increases the **fiscal risk from cyclical factors** such as rural deprivation, slow credit generation and weak corporate sentiment.
- **Government Accountability: Democracy** is a **contract** between **the state and its citizens**. This contract has a vital economic dimension: the state's role is to **create the conditions for prosperity** for all by providing essential services and protecting the less well-off via redistribution. In tax-compliant societies, Govt is more accountable to citizens. So, there is a better provision of essential services to people.
- **Citizen Participation in Governance: Taxation** is the **economic glue** that binds citizens to the state in a necessary two-way relationship as part of the social contract. It is the responsibility of citizens to hold state accountable. If a citizen does not pay, he becomes a free rider (using the service without paying), and cannot complain if the state provides a poor quality service. If he exits (not using the service at all), he loses interest in holding the state accountable.

Fiscal Capacity

- **Fiscal capacity** refers to the **ability of government to generate revenue**.
- The fiscal capacity of governments depends on a variety of factors including **industrial capacity**, **natural resource wealth** and **personal incomes**.
- Identifying fiscal capacity helps governments to determine the tax rate necessary to finance such expenditure.
- Country's existing fiscal capacity is limited, primarily due to low tax base & poor quality spending.

Direct Tax Reforms

Background

- Various committees, to consolidate the direct taxes, were constituted by the government like **Raja Chelliah Committee** (early 1990s), **Vijay Kelkar Committee** (2002), and recently **Easwar Panel**.
- Recently, with the constitution of **Arbind Modi Committee** on Income Tax Reforms and **Akhilesh Ranjan Panel** on formulating a new Direct Tax Code (DTC), Government seems to be moving firmly in the direction of Direct Tax reform.

Direct Tax

- It is the tax where the incidence and impact of taxation fall on the same entity.
- It is termed as a **progressive tax** because the proportion of tax liability rises as an individual or entity's income increases.
- It is of various types such as: income tax, corporate tax, dividend distribution tax, securities transaction tax, fringe benefit tax and wealth tax.
- **Income Tax Act 1961 (ITA)** has provision for income tax, corporate tax, property tax etc.

- **Direct Taxes Code (DTC)** aims to revise, consolidate and simplify the structure of direct tax laws (like Income-tax Act, 1961; Wealth Tax Act, 1957) in India into a single legislation.

Need for Direct Tax Code (DTC)

The Income Tax Act 1961 should be redrafted to account for the **structural changes** in the Indian economy, **new models of doing business** (e.g. international businesses, digital businesses etc.) and **evolving methods of income calculation** based on the objectives of economic policy.

- **Rationalization and simplification of Income Tax Structure:**
  - The rate structure – slabs of 10%, 20% & 30% in personal income tax - has broadly remained the same in the last 20 years. Further, there is a need for **rationalization of exemptions** and a rethink of incentives on savings (such as small savings schemes like PPF)
  - Over the past two decades, countless amendments, deletions & additions in the Income Tax Act, 1961 has made it incomprehensible to an average tax payer.
  - The problem has been further compounded by judgements (often conflicting) on ambiguities rendered by the courts at different levels.

- **Simplify corporate tax rate structure and phase out exemptions**
  - The **differential** in effective corporate tax rate **across sectors** is very high. E.g. in 2014-15, effective tax rates for cement manufacturers, consultancy service firms and banking service firms were 9 %, 16 % and 35 % respectively.
  - Moreover, the exemptions to corporate tax are not equitable vertically. E.g. in 2014-15, small companies having a profit of up to ₹1 cr paid an average tax rate of 29.37% while companies having a profit of greater than ₹500 cr paid an average tax rate of only 22.88%.
  - According to Ministry of Finance, in 2014-15, there were a total of 32 exemptions on corporate tax that had a projected impact on revenues of around ₹1 lakh crore.
- **Wide tax base** will help deal with the problem of potential revenue loss due to lower tax rates and simplified tax structure.
- **Reducing tax litigation:** Tendency of tax officials to **initiate an action** without the necessary justification or assessment is reflected from **low success rate of appeals** (~30%).
  - Protracted tax litigation in India has not only put a burden on Indian judiciary but has also cost the government exchequer.
  - **Reduction in tax terrorism** is needed through clarity in taxation framework in the country and by reducing the discretionary powers of the tax department.
  - New Act needs to provide for **alternate methods of dispute settlement** such as negotiation, mediation etc.
- **Provide level playing field between large businesses and start ups & young companies:** A complicated tax structure in effect helps large business groups who can manipulate the system with the help of their in-house tax experts (tax avoidance strategies).
- **Taxation based on Ease of Doing Business:** Traditionally, for the sake of administrative convenience, the tax laws have **segregated tax-payers only on the basis of ability to pay**. It has seldom tried to differentiate between high-risk & low-risk income; legal & illegal income; recurring & non-recurring income etc. Considering such nuances in tax policy would make the **structure more equitable**. E.g. treating income from earned for Government securities (one of the most secure sources of investment) at par with high risk business income or share holder income is an anomaly that needs to be addressed.
- **Ensure balance between direct and indirect taxes:** Contribution of direct taxes has declined from 60% in 2010-11 to 52% in 2017-18. **Increasing share of indirect taxes** in revenue is alarming as **indirect taxes are regressive** which hurt poor people more.
- **Clarity in cross border transactions:** Till now, source rule of taxation for non-residents was linked to **physical presence** (permanent establishment) which has led to protracted litigation, base erosion and profit shifting.
- **Better sync with global economy:** Since India is much more integrated with the world globally in terms of business linkages and capital account convertibility, the differential treatment of foreign and domestic companies in the country should be gradually phased out.
- **Need of Technology infusion** in the tax administration to improve efficiency of tax collection as well as to aid the taxpayer.

Measures taken by the Government

- **Increasing Tax Compliance**
  - CBDT launched **'E- Sahyog'** portal to facilitate online filing of the returns
  - **Project Saksham** was launched by CBIC to help in implementation of Goods and Services Tax (GST) and in extension of Indian Customs Single Window Interface for Facilitating Trade (SWIFT)
  - **Extending the scope of Tax Collected at Source (TCS):** For e.g. 1% TCS is charged on luxury items (cars > 10 lakh/ cash payment > 2 lakh) collected by seller.
  - Push towards digitalization and formalization will increase expansion of tax net.
- **Anti Tax Avoidance Measures**
  - **Advanced Pricing Agreements (APAs):** APA is an agreement between a tax payer and tax authority determining the **transfer pricing methodology** for pricing the tax payer's international transactions for future years.
  - **GAAR (General Anti-Avoidance Rules),** effective from April 1st, 2017, is a set of rules which helps the revenue authorities to decide: (i) whether a particular transaction has commercial substance or not (ii) tax liability associated with a genuine transaction.

- ✓ It enables Government to tackle instances of tax avoidance due to practices like **transfer pricing**, **round tripping** (parking money in low tax jurisdictions and rerouting it as FDI or FII) etc. E.g. Vodafone Case
- ✓ GAAR provisions are applicable on firms who **claim a tax benefits of over ₹ 3 crore.**

- **Place of Effective Management (POEM)** guidelines were introduced for the determination of residency of foreign company, applicable from FY 2017-18. If PoEM of a firm is in India, then its worldwide income would be taxed here.
  - ✓ It intends to curb the formation of shell companies, which are located abroad but controlled from India, mainly for the purpose of avoiding taxes.
  - ✓ PoEM is decided by the indicators like place from where management & commercial decisions are taken (not where the decisions are implemented), location of source of income, % assets held in India, % employees "situated or residing" in India and are on the local payroll expense etc.

- **Efforts to curb black money/tax evasion**
  - India has signed up for a multi-lateral regime for sharing of financial information known as **Automatic Exchange of Information (AEOI)** with European Union and Switzerland.
  - India has also entered into information sharing agreement with USA under **Foreign Account Tax Compliance Act (FATCA) of USA**.
  - Recently, India made **modifications in Double Taxation Avoidance Agreement (DTAA)** with Mauritius & Cyprus so that all transactions attracting **capital gains tax** for investments made out of such tax havens will be taxed at full rate prevailing in India.
  - **Operation Clean Money and Project Insight** was launched to use data analytics to improve tax compliance and effectively utilize information in tax administration.
- **Corporate Rate Cut:** To boost industrial activity and increase compliance, tax rate for all corporates is reduced from 30% earlier to 22%. Effective tax rate for all **domestic companies** would now be **25.17%** – nearly 10% less than the existing 34.94%, providing they don't avail any exemptions. New manufacturing companies will have to pay an **even lower corporate tax rate of 15%.**
- **Administrative Reforms:** Based on the recommendations of **Tax Administration Reforms Commission under Parthasarthi Shome**, a Tax Policy Research Unit headed by Revenue Secretary has been created for better research capability on fiscal topics and a Tax Policy Council chaired by Union Finance Minister to help the government make better policy decision on tax policies.
  - The panel also **recommended integration of CBDT & CBIC** for holistic tax compliance regime

Suggested Reforms

- **Tax treatment of cross border transactions: Arbind Modi Panel on Income Tax Reforms** recommended that an income shall be deemed to be derived from a source in India, if the payment has been made from India, for any goods/services consumed or towards interest, dividend, bonus, or any other return on capital.
- **Reintroduction of wealth tax:** Moderate rates of personal income tax are not sufficiently progressive to contain growing inequality. Thus, wealth tax can be reintroduced.
  - However, in order to keep the **compliance cost low** and prevent **protracted litigation** as experienced under the Wealth Tax Act, 1957, the valuation of the assets should be done transparently.
  - Threshold limit should be such (for e.g. ₹10 cr) to keep the **middle class out of the purview** of this tax.
  - It will help **fill the void created by the inadequacy of property tax** at the local level.
- **E-assessment:** New Income Tax Act should provide a complete legal framework for the introduction of e-assessment based which will be **paperless** and **faceless**. It will enhance **efficiency**, **effectiveness** and **accountability** and eliminate all opportunities for rent seeking behaviour.
  - In faceless assessment, tax-payer doesn't have to appear before the assessing officer neither will he know who is assessing his/her return. **Information will be sought** from the assessee via **email** and there will be **no physical movement** of the document.
  - Budget 2019-20 has initiated **'faceless assessment'** on the pilot basis.
- **Dispute resolution mechanism:** A **Directorate for Public Rulings** has been created mandated to issue **pre-assessment clarifications** to prevent litigation and provide certainty. Similarly, **in-house dispute resolution panel** must be empowered to settle disputed issues.
- **Performance assessment of tax officials** based on success rate of their cases.
- **Penalties for technical offences** should be replaced by **graded fees** to be automatically levied.
- **Voluntary compliance** through Tax Deducted at Source, Tax Collected at Source etc. Such mechanisms need to be strengthened

- Arresting tax evasion when non-agricultural income is declared as agricultural income
- **Reducing stamp duty on property registrations** would increase the declared property value by the buyers and reduce incentive to pay a part of the payment in black.

Recently, Akhilesh Ranjan Committee on formulation of new Direct Tax Code (DTC) is expected to have recommended (report not public): (i) Widening of tax slabs: 10% tax slab is expected to be widened to incomes upto 10 lakh. This would benefit over 27% (1.47 cr) of the country's individual taxpayers who had incomes between ₹5 lakh and 10 lakh; (ii) Scrapping of the surcharges/cesses (iii) Review of the existing long term capital gains (LTCG) tax, the securities transaction tax (STT) and dividend distribution tax (DTT).

> **Securities transaction tax (STT)** is a tax levied at the time of purchase and sale of securities listed on stock exchanges in India. This tax came into effect from 1 October 2004. The rate of STT differs based on the type of security traded.
>
> **Dividend Distribution Tax (DDT)** is on the dividends paid by a domestic company at 15%. The effective rate is 20.35%, including a surcharge and education cess.

Goods & Services Tax (GST)

Hailed as the biggest tax reform, GST has completed 2 years of operation. It was launched on 1st July, 2017 in a special session of Parliament.

About Goods and Services Tax (GST) and its present structure

- GST is a **destination-based indirect tax** and is **levied at the final consumption point**.
- Under GST, **17 indirect taxes** like excise duty, VAT, service tax, luxury tax etc are subsumed.
  - **Taxes not subsumed under GST**: Basic Custom Duty, Anti-Dumping Duty, Central Excise on Petroleum Products, VAT on alcohol for human consumption, Stamp Duty, Property Tax (levied by local bodies), Professional Tax etc.
- GST is currently levied on every product [except **petroleum products, alcohol, real estate & electricity**] in four slabs of **5, 12, 18 and 28%.**
  - Most of the daily use articles have zero GST as per the latest revision of the tax rates last year. Almost **50% of the items** in the **Consumer Price Index** are exempt.
  - Special rates on precious metals (0.25%), gold (3%) and job work in diamond industry (1.5%).
  - In addition, a cess is levied on automobiles, luxury, and demerit and sin goods.
- From Government's perspective, it is **easier to collect** and **reduces tax evasion**, for customer it is **easier to understand** & will **reduce tax burden** and for industry, it ensures that there is **no cascading effect of the tax** and there is **harmonization of tax laws, procedures and rates of tax**
- Businesses upto an annual turnover of **₹40 lakh** are GST exempt.

Successes of GST

GST marks a fundamental **resetting of the Indian economy**. It redefines the way business is done (with increased formalisation), expands the market for goods and services (replacing many small and fractured markets with a single common one) and totally overhauls the Indirect Tax regime (one nation one tax regime)

- **Tax Compliance:**
  - GST has been **successful in increasing compliance** among small traders through **Composition Scheme**.
  - Self-policing mechanism of GST helps to check tax evasion and expand the tax net
    - ✓ Seamless flow of input tax credit (ITC) is possible only when all the suppliers of a business pay GST. So each business will make sure that its suppliers have paid the GST, so that they can take input tax credit.
    - ✓ It has significantly **reduced cascading of taxes** (tax on tax, mark-up on taxes and tax on mark-ups) through better ITC and inclusion of taxes like central sales tax, octroi, purchase taxes & luxury taxes etc.
- **Revenue Base:** GST has helped the Government to **expand the revenue base** by about 85% in the past two years from 65 lakhs to 1.2 crore.
- **Revenue Collections and Buoyancy:** Relative buoyancy of GST revenue compared to pre-GST period is a result of 2 factors. (1) design of GST that integrated the entire value chain from raw material to retail; (2) tax incidence on services increasing from 14% pre-GST to 18% post-GST.
- **Rationalization of taxes:** Currently, **around 97.5% articles are covered by 18% or lower GST slab**, a significant reduction from tax rates under VAT regime where standard VAT rate was 14.5% along-with excise duty at 12.5%

- **Re-engineering of supply chain:** GST has presented an opportunity to reduce physical supply chain costs (costs attributable to transportation, warehousing etc.)
  - A **unified tax and seamless availability of credit** has reduced the **cost of procurement of raw material.**
  - **Consolidation of storage points** and a **reduction in the number of inefficient nodes** (e.g. opening branch offices merely to avoid inter-state sales tax) in supply chains has helped such companies to reduce their distribution costs.
- **Introduction of E-Way Bills** marks a shift from departmental policing model to self-declaration model for movement of goods
  - Enable hassle free inter-state movement of goods by **eliminating the requirement of separate transit pass** for each state.
- **Use of technology** for all front-end services (registration, payments etc.) and backend IT modules (processing of returns, audits, assessments, appeals)
  - **Reduces interface** between tax collector and taxpayer, thereby reducing corruption, generates **quality quantifiable data** to enable better policy making, improves **GDP estimation**, **encourages compliance gain** due to **linkage** & **exchange of information** between income-tax & GST departments
- **Role of GST Council:** GST council has emerged as a successful example of cooperative federalism and its functioning has been free from political predilections.

Key terms associated with GST

GST council

- It is a **constitutional body** under article 279(A) for making recommendations to the Union and State Government on issues related to GST.
- It is **chaired by the Union Finance Minister** and also includes Union State Minister of Finance and Ministers in-charge of Finance of all the States.

GSTN

- Goods and Services Tax Network (GSTN) is a not for profit company governed under section 8 of the companies Act.
- The Company has been set up primarily to provide IT infrastructure and services for implementation of the Goods and Services Tax (GST).
- Recently, GSTN was restructured to allow 100% government ownership equally distributed between the Centre (50%) and the States (50%).

Reverse Charge Mechanism

- The GST has to be typically paid by the supplier of goods and services. But in some cases, the liability to pay the tax falls on the buyer. This is called reverse charge.
- This is only applicable in certain instances e.g. when a business buys goods or services from a supplier who is not registered to pay GST or in cases of import.

GST Composition Scheme

- Taxpayers registered under this scheme with turnover upto ₹1.5 cr can pay a small tax (1%, 5% or 6%)
- It reduces administrative burden of taxpayers but makes it difficult for them to sell to larger firms as they are not eligible for input tax credits.

E-way Bill (Electronic-way bill)

It is a document introduced under the GST regime that needs to be generated before transporting or shipping goods exceeding ₹50,000 in for sales beyond 10 km in GST regime within state or inter-state.

Challenges remaining in GST Regime

While gains are real, full potential of the reforms is still to be unleashed. GST revenues have been falling short of the target. Budget Estimate for 2018-19 for the Central government was ₹7.43 lakh —the actual collection was 22% lower at ₹5.81 lakh cr. Hence, there is a need for further simplification and rationalization.

- **List of exclusions:** Petroleum products (crude oil & natural gas), diesel, petrol, aviation turbine fuel, potable alcohol and real estate, which contribute 35-40% of indirect tax revenue, are still out of GST's ambit.
- **Complex GST Structure with multiple tax slabs:** World Bank study said that the Indian GST rate was 2nd highest among 115 countries with a national value-added tax.
  - **4 different rates, several exemptions & cesses, separate rate for gold** etc undermine eventual goal of simplifying tax compliance & leads to foregoing of efficiency gains.
  - **Administering multiple rates** is challenging, such as high cost of auditing the classification of products into tax slabs across every stage and long standing litigation in case of disputes.

Recent Changes in GST Regime

- **E-Invoicing:** GST Council has approved the standards for e-invoicing to increase interoperability across the entire GST eco-system. i.e. an e-invoice generated by one software should be capable of being read by any other software. In the new GST forms, real time invoice uploading has been introduced.
- **Document Identification Number (CBIC-DIN):** Central Board of Indirect Taxes and Customs started using DIN for any communication related to search, seizure, investigation related matters.
- **Setting up of Goods and Services Tax Appellate Tribunal:** It is a quasi-judicial body that will mediate in indirect tax disputes between states and centre.

- **High tax rates on automobiles** and **building & construction material** at a time when **demand conditions are compressed** has caused further slowdown in these sectors.
- **Digital infrastructure and data privacy:** Implementation of GST required **registration at humungous scale** for input based tax crediting and **creating a common database of registered traders to be managed centrally**. This has emerged as a major challenge to GST's IT landscape, along with technical glitches. Until now, states maintained the database individually.
- **Matching concept for claiming input tax credit not implemented:**
  - Matching concept requires a buyer to reconcile his tax payments with the tax collected, deposited and reported by the supplier on the government portal to claim input credit.
  - Any incorrect or unmatched transactions filed by supplier leads to denial of credit to the buyer
- **Refund problem for exports:** Exporters are facing **acute crunch of working capital** due to issues such as delays in refund of Integrated Goods and Services Tax (IGST) on export.
- **GST Dues:** Recently, several states had written to the Finance Minister regarding **delays in payment of GST due by the centre.**
- **Tax Frauds:** In absence of viable means of invoice matching, fake invoice industry has emerged. So far, 9,385 cases of tax fraud by this means have been detected involving an amount of ₹45,682 cr.
- **Agriculture: Farmers are required to pay GST** on agro-chemicals, fertilizers, safety kits (eyewear, masks and gloves), drip irrigation systems etc. but don't receive input tax credit.

Suggested Reforms in GST Regime

- **GST taxable base must include petroleum products**, especially aviation turbine fuel and natural gas, real estate and electricity. Inclusion of real estate will clean up the land market and will lead to revenue gains on direct tax side as well as more transactions will be reported.
- Although indirect taxes tend to be regressive in nature, a **low standard or modal rate with a small list of exemptions** is the ideal GST structure that Government should try to achieve.
  - **Loss of revenue** would be **compensated** by **higher demand** and **better compliance**.
- **Revenue performance of Composition Scheme** needs to be improved by ensuring better compliance among small traders.
- Introduction of **new GST single format annual return form** and **matching of invoices** is expected to substantially improve compliance.
- A **single authority for sanctioning and processing GST refunds** has been proposed to simplify the procedure for exporters. Under the proposed reform, a single tax office will assess, check and sanction refunds of both centre and state GST portions.
- GST Council must be assisted by a **strong technical secretariat** comprising administrators, economists, accountants and lawyers etc.
  - At present, the GST Council relies on the analysis done by the **"fitment committee"**, which consists of the nominated officials of the Tax Research Unit in Central Board of Indirect Taxes and Customs (CBIC), and officials of the commercial taxes department from some states.
- **Greater coordination between Central Board for Direct Taxes (CBDT) and Central Board for Indirect Taxes & Customs (CBIC)** could yield better results. IT Department has already incorporated GST registration and turnover information in their return formats.

Although it is at its early days still, the GST started on a positive note and the benefits for all stakeholders are evident. It is now time for the Government to stabilise the system, remove uncertainty, facilitate compliance by easing processes and expand the tax base to make the GST a real success

Summary

Taxation is critically important for economic and social development of the country. It provides the Government the resources to provide goods and services to the people.

Though India has introduced far-reaching reforms in the domains of both direct and indirect taxes, it remains largely a tax non-compliant society as evident from the low tax-to-GDP ratio. Underperformance in tax revenue generation is not only due to paucity in tax policy reforms, but also due to slow pace of reforms in tax administration, ease of doing business and governance in general.

Reasons behind low tax-to-GDP ratio

- **Low tax base:** High exemption threshold in case of personal income taxes and convoluted system of exemptions, tax cuts, preferential tax rates, deferral of tax liabilities etc. in case of corporate taxes
- **Tax evasion: Tax evasion** and **corruption** undermines the legitimacy of the State. It creates a belief among the citizens that the public resources are being wasted, reducing the willingness to pay.
- **Weak tax administration,** particularly at sub-national level, as a consequence of lack of technical expertise and financial resources, poorly drafted laws and corruption.
- **Structural issues** like untaxed agricultural sector, low financial literacy, large share of informal economy and large number of cash based transactions.

Implications of Tax-to-GDP ratio

- **Limited Fiscal Capacity:** Reduces the resources available to the government and puts a constraint on Government spending
- **Reduces Government Accountability:** In tax-compliant societies, Govt is more accountable to citizens. So, there is a better provision of essential services to people
- **Citizen Participation in Governance:** A citizen's stake in ensuring accountability would be greater if he pays taxes.

Need for Direct Tax Reforms

- Rationalize and simplify of personal income tax rate structure and reduce exemptions
- Simplification of corporate tax rate structure & phase out exemptions/preferential tax treatments etc.
- Widen tax base and reduce tax terrorism and promote ease of doing business
- Allow better technology infusion in tax administration
- Balance between direct and indirect taxes
- Reduce tax disputes and associated litigation
- Provide better clarity in rules of taxation for cross border transactions and foreign businesses operating in the country

Measures taken by the Government

- Increasing tax compliance by facilitating digital filing of returns **(E- Sahyog by CBDT)** and (**Project Saksham** by CBIC), promoting tax collection at source etc.
- Anti avoidance measures such as **Advanced Pricing Agreements (APAs), GAAR (General Anti-Avoidance Rules)** and **Place of Effective Management (POEM) guidelines**
- International collaboration to curb tax evasion (e.g. **Automatic Exchange of Information (AEOI)** with European Union and Switzerland)
- Corporate tax rate cut
- Administrative reforms such as creation of Tax Policy Research Unit and Tax Policy Council

Suggested Direct Tax Reforms

- Widening of tax slabs and scrapping of the surcharges/cesses
- Reintroduction of wealth tax
- E-assessment for Personal Income Tax
- Dispute resolution mechanism based on arbitration, reconciliation and negotiations
- Performance assessment of tax officials based on success rate of their cases.
- Pushing for voluntary compliance
- Arresting tax evasion when non-agricultural income is declared as agricultural income

- Reducing stamp duty on property registrations

Akhilesh Ranjan Committee on formulation of new Direct Tax Code (DTC) has submitted its report to the Government has suggested significant reforms, but the report hasn't been made public.

Goods & Services Tax (GST): Indirect Tax Framework

GST marks a fundamental resetting of the Indian economy. From Government's perspective, GST is **easier to collect** and **reduces tax evasion**, for customer it is **easier to understand** & will **reduce tax burden** and for industry, it ensures that there is **no cascading effect of the tax** and there is **harmonization of tax laws, procedures and rates of tax**. It redefines the way business is done (with increased formalisation), expands the market for goods and services (replacing many small and fractured markets with a single common one) and totally overhauls the Indirect Tax regime (one nation one tax regime). Use of technology in the GST regime has further simplified tax administration to a great extent.

Challenges remaining in GST framework

- GST revenues falling short of the target
- Large list of exclusions including petroleum products, aviation turbine fuel, potable alcohol and real estate etc.
- Complex GST Structure with multiple tax slabs
- Concerns related to digital infrastructure and data privacy
- Matching concept for claiming input tax credit not implemented
- Refund problem in case of exports
- Pending dues for large number of states
- Tax frauds

Suggested reforms in GST framework

- Include petroleum products, especially aviation turbine fuel and natural gas, real estate and electricity
- Low standard or modal rate with a small list of exemptions
- New GST single format annual return form and matching of invoices
- Single authority for sanctioning and processing GST refunds
- Strong technical secretariat
- Greater coordination between Central Board for Direct Taxes (CBDT) & Central Board for Indirect Taxes & Customs (CBIC).