

Impact of the Recommendations

9.1 The impact of our recommendations on equity, revenue collections, savings, financial sector and transaction costs have already been indicated in various sections of this report. Nevertheless we consider it appropriate to summarise the multidimensional impact of our recommendations.

On Equity

9.2 The recommendations relating to personal income tax also enhance progressivity to the highest level in the last two decades (**Table 4.3 and Chart 1**). Taxpayers with incomes below Rs. 1 lakh will not have to bear the rigors of complying with a progressive tax. The consumption tax burden borne by such taxpayers would be adequate contribution to the treasury. The taxpayers at the relatively higher level of income will now contribute a relatively higher proportion of the income tax revenues.

9.3 The proposals to eliminate exemptions particularly those relating to savings will enhance the equity of the overall tax system. Individual with same gross income will now be treated equally. Since the corporate profits will now bear the full burden of the corporate tax, the effective burden on individual shareholders will be substantially higher inspite of the elimination of the tax on dividend and on long-terms capital gains. To the extent, the individual shareholders are likely to be higher income groups, the effective burden will be higher. As a result the recommendations should further improve the progressivity than what is reflected in the chart. Other recommendations which will enhance equity relate to the elimination of various sectoral/activity based incentives and the extensive use of information technology to identify tax evaders.

On Revenues

9.4 The Task Force conducted an elaborate exercise to analyse the revenue impact of the recommendations and identify the change in the incidence of the recommendations

on different categories of taxpayers. During the assessment year 2001-02, 2,04,70,771 tax returns were filed by individual taxpayers. Based on the actual distribution of these returns across income groups and the recent trend in the annual growth of tax returns, we have estimated the number of returns which are expected to be filed in assessment year 2003-04 and their distribution across income groups (**Table-9.1**).

9.5 In order to obtain a typical taxpayer profile for each income group, income tax return data of 9.25 lakh individual taxpayers was collected from the city of Mumbai which accounts for 35 per cent of the country's direct tax collections. The data related to four assessment years⁸²: 1998-99, 1999-00, 2000-01 & 2001-02.

9.6 The sample data for the four years was segregated into two categories, i.e. salaried and non-salaried taxpayers⁸³. For each income group and category, a typical taxpayer profile for each of the four assessment years was separately obtained. Thereafter, we further determined the four years average of such profiles for each income group to obtain a typical taxpayer profile for all income groups for the purposes of revenue estimation.

9.7 **Table – 9.2** indicates the tax liability of a typical non-salaried men taxpayer in each income group based on the tax law for assessment year 2003-04 and the total revenue collected from each income group. Similarly, **Table – 9.3** indicates the tax liability for a typical salaried men taxpayer. The total revenues collected from these two categories of taxpayers is Rs.24,629 crores, excluding the tax on dividends in the hands of the shareholders. **Table – 9.4** and **Table – 9.5** indicate the tax liability for a typical non-salaried and salaried men taxpayer consequent to our recommendations. The revenue collections at the existing level of compliance is estimated to be Rs. 17,345 crores, thereby resulting in a tax relief of Rs. 7,284 crores to such individual tax payers.

9.8 The impact of our recommendations on senior citizens is also expected to be beneficial. Under the existing law, a senior citizen with income up-to Rs. 1,30,000/- does not have to pay any income tax. **Table 9.6** indicates the revenue collection from senior

⁸² Assessment year means the year following the financial year.

⁸³ A taxpayer deriving 90 per cent or more of his gross total income from salary has been categorised as a “salaried taxpayer”.

citizens across income groups, under the existing law. Our recommendation to provide a higher exemption limit of Rs. 50,000/- for senior citizens means that senior citizens with income up-to Rs. 1,50,000/- will not have to pay any income tax. **Table 9.7** indicates the estimated revenue collection consequent to our recommendations. Those with income above Rs. 1,50,000/- will benefit significantly from a 10 percentage point reduction in the tax rate. Therefore, senior citizens at all income levels stand to gain by an estimated Rs.190 crores from our recommendations.

9.9 The demographic profile of taxpayers is in favour of relatively younger taxpayers. The income of such taxpayers can reasonably be expected to increase (in large number of cases rather rapidly) over the years. Under the existing law, the maximum marginal rate of personal income tax is leviable at a rather low income level i.e. Rs. 1,50,000/-. Most of the younger taxpayers therefore can be expected to pay at the highest rate rather early in life. The recommendation to levy the highest rate of 30 per cent only on incomes above Rs. 4 lakhs would benefit this generation of younger taxpayer substantially. Infact as their incomes approach Rs. 4 lakhs, this threshold for the highest rate would have increased due to inflation indexing overtime. Therefore, the lifetime income tax rate for most younger taxpayers would be the lower rate of 20 per cent.

9.10 **Table – 9.8** summarizes the tax benefit for senior citizens, salaried and non-salaried (other than senior citizens) taxpayers for each income group, arising from the recommendations made in this report. **It shows that taxpayers of all categories and in every income group benefit substantially from the recommendations.** Similarly, women as a class of tax payers will also benefit from the package of our recommendations. In the case of a married couple, the recommendations are likely to reduce tax liability on the family as a unit. The recommendation to abolish wealth tax will also benefit the female taxpayer. Women as a class of tax payers will benefit from a relief of Rs.404 crores. With reduced tax burden for each income group, disposable income will be higher for every class of taxpayer. This also means that the entire middle class will benefit from our proposals.

9.11 However, the calculations do not reflect the impact of taxation of dividend in the hands of the individual shareholders introduced by the Finance Act, 2002. Adjusting for

an estimated Rs. 1,500 crore in tax collection from dividends⁸⁴, the total revenue collection from individual taxpayers is estimated at Rs. 32340 crores representing about 75 per cent of the total income tax collection. The balance amount is collected from partnership firms, HUFs, etc., but does not include collection from companies.

9.12 Our recommendation to reduce the tax rate for partnership firms from the existing levels of 36.75 per cent to 30 per cent will result in a loss in the revenues 18.37 per cent. The current revenues from partnership firms is estimated to be Rs. 10,000 crore, thereby resulting in a revenue loss of Rs. 1,837 crore.

9.13 The package of recommendations relating to corporate tax will result in a estimated revenue gain of Rs. 10,762 crore (**Table-9.9**). This estimate is based on the financial results of 1,334 profit making companies for the financial year 2001-02. This sample of 1,334 companies comprised of 59 banking companies reporting a corporate tax payment of Rs. 5,844 crores and 1,275 companies reporting a corporate tax payment of Rs. 13,420 crores. The effective corporate tax rate for assessment year 2002-03 for the sample non-banking companies and banking companies was 21.75 per cent and 35.01 respectively as against the statutory rate of 35.7 per cent. In the assessment year 2003-04, these effective rates are estimated to increase by 3 per cent on account of the increase in the surcharge. Adjusting for the measures recommended for the corporate tax reform, the revenue collection from the sample non-banking companies is estimated to increase by 34 per cent while in the case of banking companies it is expected to reduce by 35.5 per cent. In the aggregate the corporate tax revenues are estimated to increase by 22.42 per cent.

9.14 **Table-9.10** summarises the revenue impact of the recommendations. Overall, the recommendations are revenue neutral at the existing level of compliance. To the extent the new simplified and liberalized tax regime will induce compliance, the revenue gains are likely to be substantially higher and it will enhance buoyancy by widening the personal and corporate income tax bases.

⁸⁴ The collection from the 10 per cent dividend distribution tax was Rs. 1,480 crores in 2001-02. A significant proportion of the dividends is received by the government and a large number of other non-taxable entities such as charitable trusts. Therefore, the average tax on dividends in the hands of the shareholders is not likely to exceed 10 per cent.

On Savings

9.15 As indicated in the earlier chapters, the existing tax incentives for investment in savings instruments are inefficient. The recommendations to eliminate them will improve efficiency of the economic system in as much as it will result in reduction in interest rates. Further, the proposed doubling of ceiling on contributions to the pension plan under Section 80CCC to Rs.20,000/- will achieve the social objective of promoting genuine long term savings for increasing old age economic security.

On Financial Sector

9.16 Our recommendations for aligning the corporate tax base with real income means that banks will henceforth enjoy full tax credit for complying with the RBI prudential standards for NPA provisioning. This would encourage banks to "clean" their balance sheets, achieve improved capital adequacy ratio and help the country to move towards a sound and robust banking system. Since banks do not avail of any capital allowances, the benefits will lower tax rates will increase retained profits of the financial sector which will facilitate an increased supply of commercial credit. Banking companies will gain by as much as Rs.2,840 crores in tax reliefs from our recommendations.

On Transaction Costs

9.17 In the earlier chapters we had referred to a NIPFP study commissioned by the Planning Commission which had estimated the compliance cost of personal income tax to be as high as 48 per cent. Such high cost raise serious doubts about income tax as an efficient source of revenue. Therefore, the Task Force was singularly concerned with designing a new simplified system which will foster compliance, impart transparency and discourage rent seeking and crony capitalism. We must reiterate at the cost of being repetitive that our recommendations for eliminating the exemptions, the extensive use of information technology and privatization of non-core activities of the tax administration will result in sharp reduction in transaction cost. A 10 per cent reduction in the transaction cost for personal income tax would help taxpayers to save an estimated Rs. 4,000 crores. Since the burden of compliance cost is essentially regressive, such reduction in transaction cost is, by corollary, progressive.

Conclusion

9.18 The Task Force is convinced that if its recommendations are fully adopted, our tax system will become more transparent and it will align the obligations of taxpayers with the objectives of the tax administration - this is crucial in engendering a trust-based system in place of the present one based on punitive enforcement (often bordering on harassment), This is crucial to both attracting and retaining young taxpayers with their demand for customer-oriented procedures, as well as to bring the "missing middle" - mainly service professionals who are currently outside the tax-net into compliance. The best tax systems in the world deal with taxpayers in a professional customer-relationship environment, which requires the system to be responsive and non-discriminatory. This reduces transaction costs for both taxpayers and the tax administration. We have sought to replace the present "exemption raj" with a tax system that is outcome oriented rather than input aligned, viz., higher productivity of income taxpayers and increased profitability of businesses is encouraged. This is the case with most dynamic countries among the emerging markets.