DIRECT TAX REFORMS AND VARIOUS SCHEMES OF INCOME TAX IN INDIA

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Abstract

The policy of taxation suffers from intrinsic denials, which make its application complex. Thus, the palpable explanation of fiscal streamlining dwells on an in-depth understanding of the fiscal system of a state mainly on a sequential analysis of the pointers that throws light on the performance of a tax system. Since 1991, the tax structure has been substantially rationalized. Changes at the central government level include reducing customs and excise duties, lowering CIT rates, extending a form of VAT to some industries, and broadening the tax base to some services. At the state level, the main reform has been the introduction in 2005 of the VAT in 24 states and union territories, after ten years of delay. During the recent years innovative schemes introduce by the respective authorities in India commodity tax, security tax, fringe benefit tax, tonnage tax, banking cash transaction tax and dividend tax are the main important direct tax schemes in India. Direct Tax Code 2009 suggest to improve the efficiency and equity of Indian tax system by eliminating distortions in the tax structure, introducing moderate level of taxation and expanding the tax base. And the aim of the new code is to simplify the enormous complexity in direct tax since the enactment of IT Act 1961. The proposed changes in the tax rate will rob the exchequer of the benefits of the larger tax base and likely to result in the significant revenue loss to the exchequer. The special interest group prevails in keeping the exception and preference unchanged while the tax rate is reduced, there will be huge loss of revenue. The vital question is whether the country can afford this at the time when the need of hour is to return to the path of fiscal consolidation.

Introduction

The reform programme initiated in June 1991, though gradualist in its approach was nevertheless very different from the incremental approach to reforms of the 1980s. As far as objectives are concerned, the current reforms are based on a much clearer recognition of the need to integrate with the global economy through trade, investment and technology flows and for this purpose to create conditions which would give Indian entrepreneurs an environment broadly comparable to that in other developing countries, and to do this within the space of four to five years. As far as instruments are concerned, there is clear recognition that the reforms cannot be limited to piecemeal adjustments in one or other aspect of policy but must bring about system changes affecting several sectors of the economy. The comprehensiveness of the reforms was not perhaps fully evident at the very beginning, when the primary focus was on restoring macro-economic stability, but as the reforms proceeded the scope and coverage of the reform effort was more clearly outlined. The main elements of the reform are fiscal stabilization, industrial policy and foreign investment, trade and exchange rate policy, public sector policy, financial sector reform, agriculture reform, labour sector reform and tax reform.

Tax Reform

The main thrust of tax reform is to combine lower statutory rates with base broadening, to realize more revenues while lowering the marginal tax burden and removing distortions. This in turn should foster growth, leading to an "expansionary" fiscal adjustment. The authority to levy taxes in India is divided between the central government and the state governments. Since 1991, the tax structure has been substantially rationalized. The motivation for these reforms has varied from one country to another and the thrust of reforms has differed from time to time depending on the development strategy and philosophy of the times. The tax system has to adjust to the requirements of a market economy to ensure international competitiveness.

Models of Tax Reforms

Conventional wisdom on tax reforms provides us with at least three different model of tax reform. The optimal tax model is satisfactory in terms of its theoretical soundness, but has been found to be impractical in its applications. The Harberger tax model is not to design a system that will be optimal, but emphasise the system that will minimize tax-induced distortions and at the same time be administratively feasible and politically acceptable. Harberger suggests that tax reformers should pay less attention to the economic methodology and more to best practice experiences. The third is the supply-side tax model. This model emphasises the need to reduce the role of the state. Reduction in the volume of public expenditures has to be achieved by cutting the tax rates, particularly the direct tax rates to minimize disincentives on work, saving and investment. The recent reform approaches combine elements of all three models sketched above. The thrust of this approach is to enhance the revenue productivity of the tax system while minimizing relative price distortions. The best practice approach has attempted to make the tax systems comprehensive, simple and transparent

Methodology of the study

This study was based on the data collected from different sources, like RBI web site, articles from reputed journals and test books. The study is analytical in nature and the important statistical tools used for the study are method of least squares and percentage and the data are in a graphical form for clarification and attraction. The main objectives of the study are as follows.

1) To know the main direct tax innovative schemes introduced by the nation during the recent years.
2) To asses the trend of direct tax in India for the last ten years and to estimates the tax revenue.
3) To study the relationship between the total tax with the components of direct taxes for the last ten years.

Direct Tax Reforms

At the central level, the changes in the income tax structure until the mid- 1970s were largely ad hoc, dictated by the exigencies of bringing about a socialistic pattern of society. In 1973–74, the personal income tax had eleven tax brackets with rates monotonically rising from 10 percent to 85 percent. When a surcharge of 15 percent was taken into account, the highest marginal rate for persons with income above Rs. 0.2 million was 97.5 percent. The classical system of taxation involved taxing the profits in the hands of the company and dividends in the hands of the shareholders. A distinction was made between widely held companies and different types of closely held companies, and the tax rate varied from the base rate of 45–65 percent in the case of some widely held companies. Although nominal rates were high, the effective rates were substantial lower due to generous depreciation and investment allowances. The large-scale tax evasion to confiscatory tax rates and recommended reducing marginal rates to 70 percent. This change was implemented in 1974–75, when the tax was brought down to 77 percent including a 10 percent surcharge. In 1976–77, the marginal rate was further reduced to 66 percent, and the wealth tax rate was 37. For incomes from capital alone, with a wealth tax of 5 percent, the above tax structure meant that there was a ceiling on income at Rs. 250,000. In 1979–80, the income tax surcharge was increased, and the wealth tax rate returned to a maximum of 5 percent. A major simplification and rationalization initiative came in 1985–86, when the number of tax brackets was reduced from eight to four, the highest marginal tax rate was brought down to 50 percent, and wealth tax rates came down to 2.5 percent. As per the recommendations of the TRC the personal tax brackets were only three, of 20, 30, and 40 percent, starting in 1992–93. Financial assets were excluded from the wealth tax, and the maximum marginal rate was reduced to 1 percent. Further reductions came in 1997–98, when the three rates were brought down further to 10, 20, and 30 percent. In subsequent years, the need for revenue has led to a general surcharge and additional surcharge of 2 percent dedicated to primary education, the latter applicable on all taxes. A surcharge of 5 percent of the income tax payable was imposed in 2002–03 in the wake of the Kargil war and was discontinued the following year. It was replaced, however, with a separate 10 percent surcharge imposed on all taxpayers with taxable incomes above Rs. 850,000; the level was raised to Rs. 1 million in the 2005–06 budget. Further, all taxes are topped up by a 2 percent education cess. The 2004–05 budget did not raise the exemption limit but provided that those with incomes under Rs. 100,000 need not pay the tax. During the assessment year 2006-07 maximum limit the case of individual regarding tax liability was 100000 that were 150000 for the assessment year 2009-10. Rebate u/s 80B, 80C is not applicable from the assessment year 2006-07 on wards, sec 88D was applicable for the assessment year 2006-07 and sec 88E applied for the assessment year 2005-06 to 2008-09. Savings in a variety of instruments funds up to Rs. 100,000 were made deductible from taxable income. The Income Tax Act has a provision to assess the value of identifiable perquisites provided by companies to their employees and to include the same in the taxable income of the individual. The budget for 2005–06 goes a step further and classifies a range of other expenses by the company, which provide indirect perquisites to the entire group of employees but are not directly assignable to any single employee. A specified proportion of each of these benefits is to be taxed at a rate of 30 percent through a fringe benefits tax, to be paid by the employer.

The basic corporate tax rate was reduced to 50 percent, and rates applicable to different categories of closely held companies were unified at 55 percent. Following the recommendations of the TRC, the distinction between closely held and widely held companies was done away with

and the tax rates were unified at 40 percent in 1993–94. In 1997–98, the corporate rate was further reduced, to 35 percent, and the 10 percent tax on dividends was shifted from individuals to companies. Since then the measures adopted have lacked direction. The most important reform in recent years is in tax administration. Expansion of the scope of tax deduction at source is one of the significant measures taken to reach the "hard to tax" groups. The government is also issuing permanent account numbers and strengthening the tax information system. Strengthening the information system, along with processing and matching the information from various sources on a selective basis is an important initiative that is likely to improve tax compliance.

Income Tax Schemes

The dividends tax rate was increased to 20 percent in 2000–01, then reduced again to 10 percent in 2001–02 and levied on shareholders rather than the company. The policy was reversed once again in 2003–04, with the dividend tax imposed on the company. The major corporate tax preferences are investment and depreciation allowances. Tax incentives were also provided for businesses locating in underdeveloped areas. As a result, some companies planned their activities to take full advantage of the generous concessions and fully avoid the tax. This form of tax avoidance by "zero-tax" companies was minimized by the introduction of a MAT in 1996–97. In subsequent years, a provision was incorporated allowing those companies paying a MAT to take a partial credit against income tax liabilities in following years. To improve tax compliance and create an audit trail, a securities transactions tax was introduced in April 2004 and tax of 0.1 percent on all cash withdrawals above Rs. 25,000 from current accounts of commercial banks was introduced in April 2005 and banking cash transaction tax omitted after 31St march 2009.

Tonnage tax schemes applied from the assessment year 2005-06 as per the section 115 V to 115 VZC. It is a scheme of taxation where by the notional income arising from the operation of a ship is determined based on the tonnage of ship. The notional income is taxed at the normal corporate rate applicable for the year. A company may opt for the schemes and one such option is excised there is lock in period of 10 years. This scheme is applicable when a company owning at least one qualifying ship. A qualifying ship is one with a minimum tonnage of 15 tons and having valid certificate. Certain types of ships like fishing vessels, pleasure crafts, harbour and river ferries are excluded as per section.

Net tonnage	**Tonnage income**
Up to 1000	46 for each tons
1000-10000	460 + 35 for each 100 tons
10000-25000	3610 + 28 for each 100 tons
More than 25000	7810 + 19 for each 100 tons

Daily income shall be multiplied by the number of days in ship operated Securities Transition Tax has been introduced with the effect from October 1St 2004 and it is applicable when purchase or sale of equity share in a company or a derivatives or a unit of equity oriented fund entered in to recognized stock exchanges and sale of unit of an equity oriented fund to the mutual fund. The value of the taxable securities transaction computed differently under different situation. In the case of derivatives being option in securities it shall be the aggregates of the strike price and option premium of such option in securities. In the case of any other taxable securities transaction relating to derivatives futures, it shall be the price at which such securities

are purchased or sold and stock exchanges collecting securities transaction tax. Securities transaction tax is not applicable in the case of preference shares, government securities, bonds, debentures, units of mutual fund other than equity oriented mutual fund and in such a case tax treatment of long term and short term capital gain shall be as per the normal provision of law.

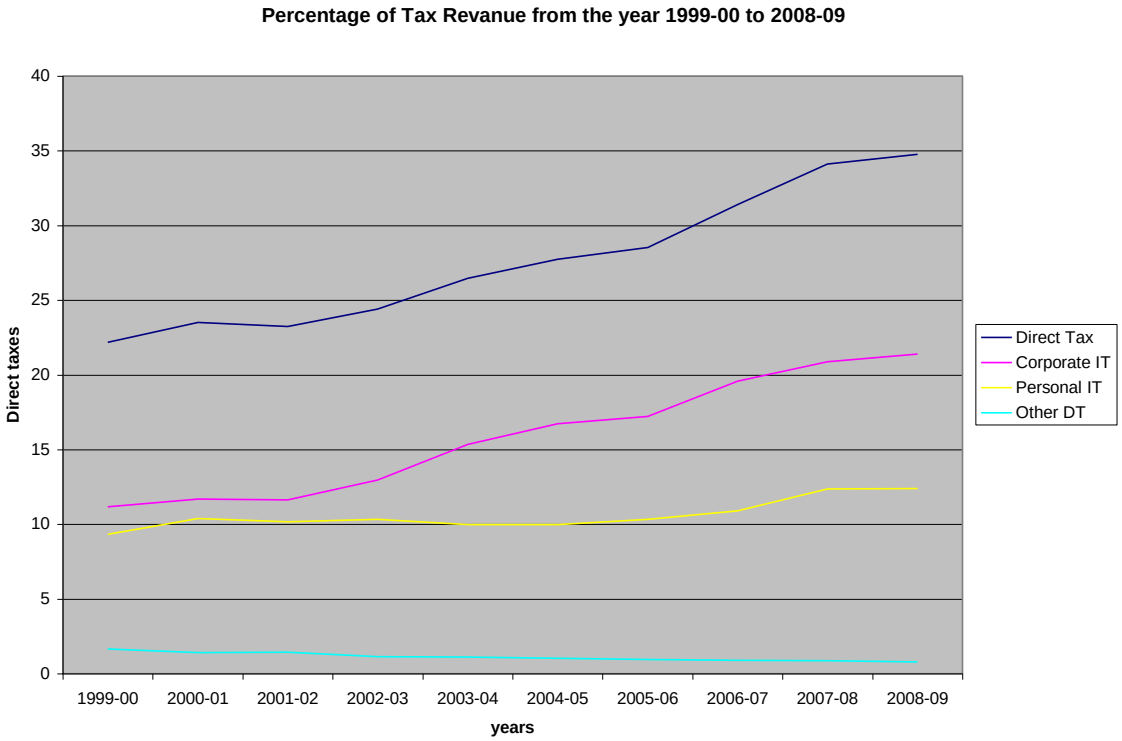
Fringe benefit tax has been inserted tax man laws ordinance issued on 31St October 2005 and applicable form or after first day of April 2006. Fringe Benefits Tax, tax is calculated on the basis of value of fringe benefits and those benefits are provided by the employer to their employee during the previous year. Tax would be payable on amount of expense reflected in the books of account relating to the Indian operation. Surcharge is applicable when the benefits exceed 10 lakhs and FBT liability will be deducible for calculation of book profits. The employer shall submit the return of fringe benefits to the assessing officer on or before the due dates and the due dates is different on the basis of employers. If the employer is company or employer having income from business / profession other than company and books of accounts are required to audited their due date is September 30th and other situation July 31st of the Assessment Year. After 31st March 2008 all corporate assesses has to make electronic payment of tax through internet banking facility offered by authorized bank and they can used credit or debit cards. Advance fringe benefits tax will be payable by the company in four installments and for non corporate assesses in three installments. As per section 115 WJ the employer liable to pay interest for non payment and short payment of advance tax, the rate of interest is 1% per month.

Banking transaction tax applicable to the whole of India except the state of Jammu and Kashmir from June 1st 2005 to March 31st 2009.It is applicable when the withdrawal of cash by what ever mode on any single day from an account other than saving bank account maintained by any scheduled bank.Excemption limit is different from person to person ie, if any individual or HUF limit is 50000 and in the case of any other person that limit is extended up to 100000 and if the transition is beyond the exception limit tax is calculated on entire amount. The cash withdrawal from different branches of on a single day withdrawal will not be aggregated for the banking cash transaction tax. At the same time if the cash is withdrawn by using a credit card such withdrawal will not be subject to banking cash transaction tax. Every assesses who fail to credit the banking cash transaction tax to the account of the central government with in the specified period shall pay simple interest at the rate of 1% of such tax for every month . The rate of banking transaction tax was 0.1% of the value of taxable banking cash transaction and no surcharge and education cess.

Commodities transaction tax has been levied on taxable commodities transactions entered in to recognized association The rate of tax in the case of taxable commodities transaction, sale of an option in goods or an option in commodity derivatives rate is .017% and the rate is applicable on option premium payable by seller. If sale of an option in goods or option in commodity derivatives other than option is excised the rate is .125% and the rate is applicable on the basis of settlement price payable by the purchaser and sale of any other commodities derivatives rate is .017% and the rate is applicable on the basis of selling price and payable by the seller. For non and short payment or late payment a simple interest rate of 1% per month or part of month shall be charged. If the assesse submit false statement they shall be punishable with imprisonment for a terms which may extended for three years and with a fine.

Percentage of Total Tax Revenue from the year 1999-00 to 2008-09

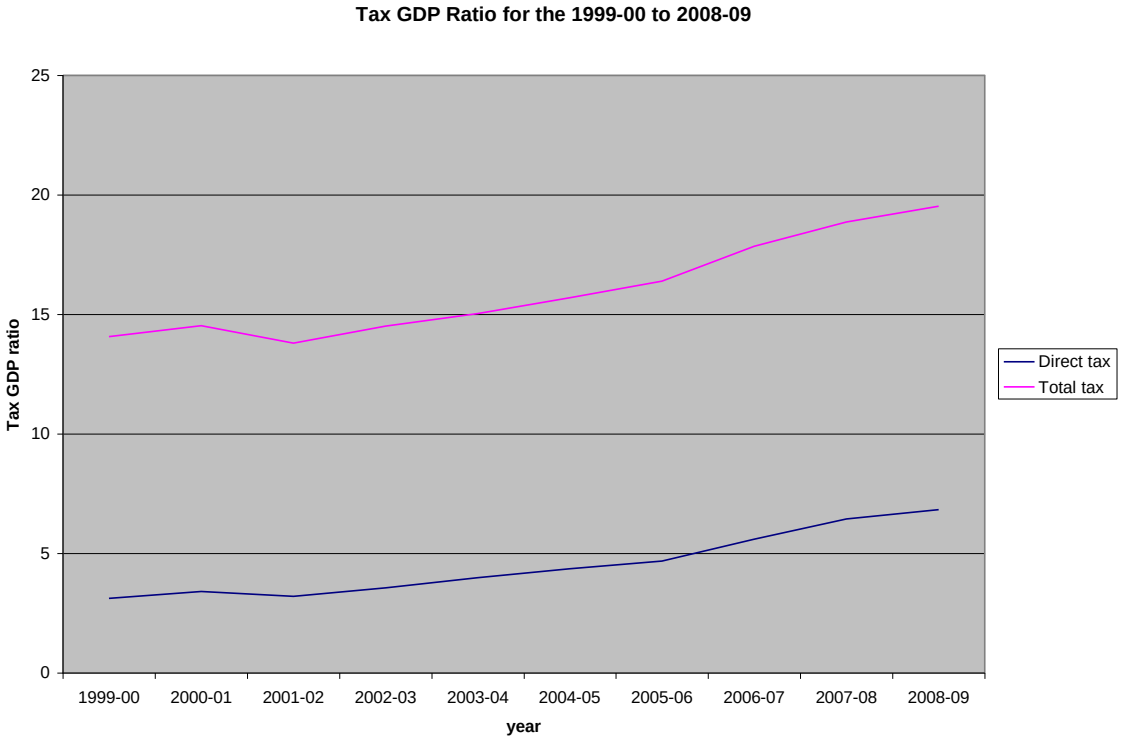
Year	Direct Tax	Corporate IT	Personal IT	Other DT
1999-00	22.17	11.18	9.34	1.65
2000-01	23.50	11.69	10.40	1.41
2001-02	23.24	11.64	10.18	1.43
2002-03	24.42	12.95	10.33	1.14
2003-04	26.46	15.35	9.99	1.11
2004-05	27.73	16.72	9.97	1.04
2005-06	28.52	17.23	10.34	.95
2006-07	31.41	19.59	10.91	.90
2007-08	34.12	20.88	12.37	.86
2008-09	34.77	21.39	12.39	.80



As per the above table indicates the percentage of total tax revenue which showed the total direct tax percentages are showing increasing trends except the year 2001- 02. The contributions are showed in a better picture that indicates the efficiency of direct tax reforms and the psychology of the tax payers. The percentages of contributions were increased in the case of corporate income tax for the year 2003-04 ie, in the year 2002-03 percentage of contribution was 12.95% that was jumped 15.35% for the year 2003-04.The percentage of personal income tax were reduced for the year 2003-04 and 2004-05 and the percentage was less than 10%. While observing other direct tax the percentage contribution is reducing from year to year.

Tax GDP Ratio from the year 1999-00 to 2008-09

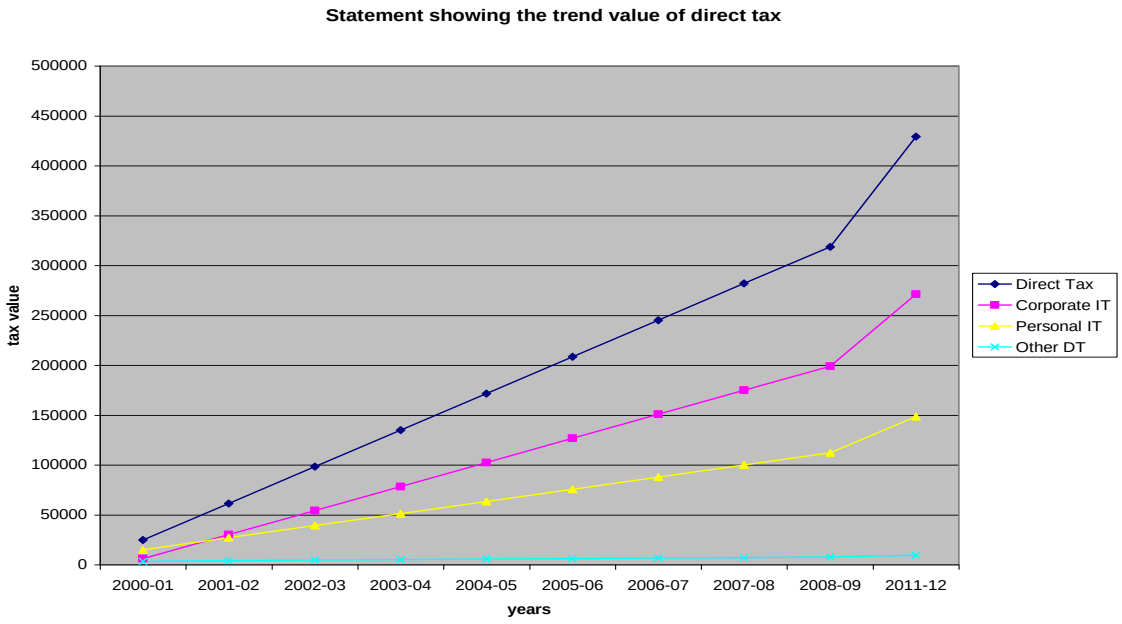
Year	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09
Direct tax	3.12	3.41	3.21	3.56	3.98	4.35	4.67	5.6	6.44	6.83
Total tax	14.07	14.52	13.8	14.51	15.03	15.70	16.39	17.84	18.87	19.52



After1990, coinciding with the reforms marked by significant reduction in the tax rates and simplification of the tax structure, direct taxes increased sharply to over 4.35 percent of GDP in 2004–05 and that was reached to 6.83 percent in 2008–09.Tax GDP rates showing increased trends from the last 10 years and the rate was increased more during the year 2008 -09 and the percent is 6.83.Little decreasing trends showed during the year 2001-02 while comparing the previous year.

Trend values of Direct tax

Year	Direct Tax	Corporate IT	Personal IT	Other DT
2000-01	24595	6185	14883	3524
2001-02	61369	30272	27037	4057
2002-03	98143	54395	39191	4590
2003-04	134917	78446	51345	5123
2004-05	171690	102533	63499	5656
2005-06	208464	126620	75653	6189
2006-07	245238	150707	87807	6722
2007-08	282012	174794	99961	7255
2008-09	318786	198881	112115	7788
2011-12	429108	271142	148577	9387



Direct Tax Code 2009

The aim of the new code is to simplify the enormous complexity in direct tax since the enactment of IT Act 1961. To improve the efficiency and equity of our tax system by eliminating distortions in the tax structure, introducing moderate level of taxation and expanding the tax base. The proposal to expand the tax base by rationalizing incentives, deduction house loan repaid will no longer would be deductible and deduction on interest paid will be available only when the house earn rental income and will be limited to the extend of rent received and partial allowance for education and medical allowance should help to expand the tax base and simplify the tax system. The difference between short term and long term capital gain, abolition of securities transaction tax and tax on the income from the gain after indexation at regular rates. The new tax code proposes to change the regime to a tax based on the value of the assets in the case of the MAT and proposed sunk cost rather than advance tax. The rate is 2% of the value of

the assets and the rate for firms in banking sector is .25%. A reduction in the corporate tax rate from 30% to 25%. In computing taxable profit of an enterprise assets of the enterprise are segregated in to business and investment assets. The exemption limit has been kept unchanged; it is propose to levy the tax at 10% up to 10 lakh, 20% between 10 lakh to 25 lakh and the above that 30%. In the case of wealth tax exception limits as higher as Rs 50 crores and levies the tax at .25% on the wealth above that. The proposed changes in the tax rate will rob the exchequer of the benefits of the larger tax base and likely to result in the significant revenue loss to the exchequer. The special interest group prevails in keeping the exception and preference unchanged while the tax rate is reduced, there will be huge loss of revenue.

Conclusion

Taxation provides as an instrument for saving and investment in the community. By taxing expenditure and exempting that part of income which is saved or invested which is stimulates the capital formation in the country. The policy of taxation suffers from intrinsic denials, which make its application complex. Thus, the palpable explanation of fiscal streamlining dwells on an in-depth understanding of the fiscal system of a state mainly on a sequential analysis of the pointers that throws light on the performance of a tax system. Since 1991, the tax structure has been substantially rationalized. Changes at the central government level include reducing customs and excise duties, lowering CIT rates, extending a form of VAT to some industries, and broadening the tax base to some services. At the state level, the main reform has been the introduction in 2005 of the VAT in 24 states and union territories, after ten years of delay. The impact of reforms is mainly positive impact by way of generating more revenue to the government and ultimately economic development of country. During the recent years innovative schemes introduce by the respective authorities in India commodity tax, security tax, fringe benefit tax, tonnage tax, banking cash transaction tax and dividend tax are the main important direct tax schemes in India. Results of those new and innovative tax schemes contribute significant portion of in the form of tax revenue to the government. Direct Tax Code 2009 suggest to improve the efficiency and equity of Indian tax system by eliminating distortions in the tax structure, introducing moderate level of taxation and expanding the tax base. And the aim of the new code is to simplify the enormous complexity in direct tax since the enactment of IT Act 1961. The proposed changes in the tax rate will rob the exchequer of the benefits of the larger tax base and likely to result in the significant revenue loss to the exchequer. The vital question is whether the country can afford this at the time when the need of hour is to return to the path of fiscal consolidation.

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