For 4th Semester Economics (G) Students

GE4T: Public Finance

Tax Reforms in India-A brief note

Prior to the liberalization of Economy, India's tax regime suffered numerous problems. These problems which were in vogue in 1960s and 1970s were as follows:

- There was a *high degree of progressiveness* (rich needed to pay exorbitant taxes). On the other hand, tax collection efficiency was very low (rich were smart enough to evade tax).
- There was large number of exemptions, which eroded the already narrow tax base in the country.
- In terms of corporation tax, there were numerous discriminations between different kinds of the companies that discouraged the investments. Double taxation of dividends was also common in those days.
- In terms of Indirect taxes, the high rates of custom / excise duties were prevalent. There was no VAT; there was no service sector within the purview of tax.

The efforts to reform India's tax system began in mid 1980s when the government announced a *Long Term Fiscal Policy, 1985*. This policy recognized that the fiscal position of the country is going downhill and there was a need to make changes in the taxation system. In that decade, a technical group to review and rationalize the central excise duties was established and this led to introduction of Modified System of Value-Added Tax (MODVAT) in 1986.

Raja Chelliah Committee

The Government appointed a Tax Reforms Committee under Prof Raja Chelliah to lay out agenda for reforming India's tax system. This TRC came up with three reports in 1991, 1992 and 1993 with several measures, which can be summarized in these points:

1. Reforming the personal taxation system by reducing the marginal tax rates. There is also the need to narrow the spread between the lowest rate and the maximum marginal rate (the rate of the highest slab) .To neutralize the fall in tax revenue due to lowering of the rates of taxation, it is necessary to withdraw some of the tax incentives.
2. Avoiding double taxation: At present , there is double taxation of partnership firms. Such firms pay corporation tax, the partners also pay personal income tax.
3. Reduction in the corporate tax rates and reducing corp[orate tax rate differences between domestic and foreign companies.
4. Rationalising capital gain tax: The committee opined that the system of long term capital gains lacked rationality. Some sort of indexation of the effects of price inflation over the period during which taxable gain has occurred is recommended.
5. Rationalisation of wealth tax: distinction between productive and unproductive wealth must be made-tax should not be imposed on productive assets such as shares, bonds, bank deposits
6. Reducing the customs duty:

   a) a reduction in the general level of tariff

   b) a reduction of the dispersion of the tariff rates

c) abolition of numerous end use exemptions and concessions

7. Simplifying the excise duties and its integration with a Value-Added Tax (VAT) system.
8. Bringing the services sector in the tax net within a VAT system.
9. Broadening of the tax base.
10. Building a tax information and computerization.
11. Improving the quality of tax administration.

The tax reforms that began with the Chelliah Committee recommendations are still going on. Later on, government appointed the Vijay Kelkar Committee in 2002 which further provided direction to the tax reforms in the country.

Vijay Kelkar Committee

The latest Impetus to direct tax reforms in India came with the recommendations of the Task Force on Direct & Indirect Taxes under the chairmanship of Vijay Kelkar in 2002. The main recommendations of this task force related to the direct taxes related to

- increasing the income tax exemption limit,
- rationalization of exemptions,
- abolition of long term capital gains tax,
- abolition of wealth tax
- PAN (Permanent Account Number) to be expanded and it should cover all citizens
- reducing the Corporate tax

In India, the tax system was reformed following the recommendations of the tax reform committees. The recommendations relationg to direct tax was implemented. Customs duty were gradually reduced, central excise duties were substituted by MODVAT and later by CENVAT. Service sector was bought under the tax net.But, with respect to the indirect tax, the introduction of The Goods and Services Tax (GST) is so far the biggest tax reform in the country. At present, the GST-Bills have been passed and came into force from July 1, 2017.

References:

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