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AN INTRODUCTION TO TAX STRUCTURE

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Abstract

Taxation constitutes a major source of capital formation in the developing countries. Tax structure in most of the developing countries continues to be complex, inelastic, inefficient and inequitable. Hence, there arose need for tax reforms. Tax reforms constitutes an integral part of economic reforms and countries throughout the world have reformed or are attempting to reform their tax system.

Introduction

Economic development has been one of the most popular slogans in almost all the developing countries all over the world. Similarly, achievement of high rate of economic growth rate, reduction of income disparities and poverty and improvement of living standard of people are some development strategies towards which most of the government efforts have been directed in developing countries. It is known that government needs more revenue mobilization for overall economic development and state welfare. Besides this, for meeting day-today expenditure, the government also requires some sources of income which is called revenue.

Objectives

To study the tax structure of developing countries specially in India.

To study the process of tax reform in India.

Taxation constitutes a major source of capital formation in the developing countries. It has at least four major functions to perform. First, taxation acts as an instrument for transferring resources from the people to public authorities. Second, taxation may help in channelising scarce resources of a country by discouraging investment in low priority sectors and providing incentives to investment in high priority sectors. Third, taxation helps in bringing distributional justice by mobilizing more resources for the welfare of the poor through higher rate of taxation of the incomes of the rich and the commodities consumed by them. Last, taxation may act as an instrument in bringing stability in the economy through appropriate measures during boom and depression conditions (Dhingra, 2005).

Tax policy is an important instrument, both in the developed and developing countries. The government can collect revenue from taxable and non taxable sources. Tax is a key source for revenue generation and mobilization. Different persons have defined taxation in different ways. In this respect, it would be better to take the definition given by Prof. Seligman. In his words, “Tax is the compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred.”

The objectives of tax policy are to be clearly defined in view of the prevailing conditions of the country. Tax structure in most of the developing countries continues to be more and more complicated because the policy makers wanted the tax system to achieve objectives of revenue mobilization, allocation of resources, equity considerations, stabilization and balanced regional development etc., simultaneously. This also led to difficulties in enforcement of the taxes. A complicated tax system gives birth to disputes and litigation because of different interpretations of tax law. Hence, there arose need for tax reforms.

In general, tax reforms are designed to reduce distortions and disincentives, inefficiencies and inequalities in allocation of resources and to stabilize the economy (World Bank, 1991).

Tax reforms are a component of fiscal reforms which are at the heart of stabilization and adjustment programmes and are inextricably linked with other aspects of development policy.

Thus tax reforms constitute an integral part of economic reforms and countries throughout the world have reformed or are attempting to reform their tax system (Stiglitz in Thirsk, 1997).

Amongst the profile of desirable tax reforms in the developing countries (Thirsk, 1997), an important one is to avoid imposition of indirect taxes on inter-industry transactions. In India, the need for avoiding such taxes and imposing Value Added Tax (VAT) was emphasized by the Indirect Tax Enquiry Committee, way back in 1978.

At the time of independence, India inherited a tax system which suffered from serious shortcomings. Later on, the shortcomings got reinforced over time.

There was problem of double taxation of commodities and multiplicity of taxes resulting in a cascading tax burden. For example, initially in general sales tax structure before a commodity produced inputs are taxed first and after the commodity is produced with input tax load output was taxed again. Thus, it causes an unfair double taxation and had a strong cascading effect. This resulted in high cost of production in the economy, putting the domestic industry at disadvantage in general. Besides this there was unhealthy competition among the states as the rate of taxes were different for different states. Similarly, direct tax structure also suffered from many shortcomings.

The process of tax reforms in India started with Taxation Enquiry Committee Report (1953-54), which was followed by Direct Taxes Administration Committee Report (1968), Report of the Committee on Rationalization and Simplification of the Tax Structure (1971), Report of the Indirect Taxes Enquiry Committee (1978), Report of the Tax Reforms Committee (1991, 1992 and 1993), Report of the Committee of Experts on Indirect Taxation (1993) and Reports of the Task Force on Direct and Indirect Taxes (2002).

On the basis of the recommendations of various committees, different tax reforms were undertaken in the country. Progressivity of income tax rate structure was reduced, exemptions were rationalized, MODVAT and CENVAT were introduced and custom duties were restructured.

Due to the federal set-up of the country, a full fledged and comprehensive VAT upto retail stage could not be introduced in the country as the states did not agree to surrender their tax powers. Therefore, CENVAT was introduced in lieu of union excise duties at the central government level only and the states continued with sales tax.

The Government of India Act of 1935 assigned the power to levy sales tax and taxes on purchases of goods to the states. Different state governments levied sales tax on a wide range of commodities at different rates, and sales tax was the largest source of tax revenue in most of the states. However, sales tax rates, procedures and rules for its collection varied in different states. Most of the states collected sales tax at first-point while a few states collected it at last-point. Some states imposed tax on resellers or on turnover. The rate structure of sales tax varied widely in different states and even in the states in each zone of the country. This led to sales tax competition among the states and also created many other problems (Purohit, 2001).

As central government cannot interfere in the tax powers on the states, therefore central government only encouraged the states to reform sales tax and introduce VAT.

The first preliminary discussion on State-level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of State Finance Ministers. Thereafter, in a significant meeting of all Chief Ministers, convened on November 16, 1999 by Shri Yashwant Sinha, the then Union Finance Ministers, three important decisions were taken, First, before the introduction of State-level VAT, the unhealthy sales tax rate "war" among the States would have to end and sales tax rates would need to be harmonized by implementing uniform floor rates of sales tax for different categories of commodities with effect from January 1, 2000. Second, in the interest of harmonization of incidence of sales tax, the sales-tax-related industrial incentive schemes would also have to be discontinued with effect from January 1, 2000. Third, on the basis of achievement of the first two objectives, steps would be taken by the State for introduction of

State-Level VAT after adequate preparation. For implementing these decisions, an Empowered Committee of State Finance Ministers was set-up.

Thereafter, the Empowered Committee met regularly, attended by the State Finance Ministers, and also by the Finance Secretaries and the Commissioner of Commercial Taxes of the State Governments as well as Senior Officials of the Revenue Department of the Ministry of Finance, Government of India. Through repeated discussions and collective efforts in the Empowered Committee, it was possible within a period of about a year and a half to achieve nearly 98 per cent success in the first two objectives on harmonization of Sales tax structure through implementation of uniform floor rates of sales tax and discontinuation of sales-tax-related incentive schemes. As a part of regular monitoring, whenever any deviation is reported from the uniform floor rates of sales tax, or from decision on incentives, the Empowered Committee takes up the matter with the concerned State and also the Government of India for necessary rectification.

After reaching this stage, steps were initiated for systematic preparation for the introduction of State-Level VAT. In order again to avoid any unhealthy competition among the States which may lead to distortions in manufacturing and trade, attempts have been made from the very beginning to harmonise the VAT design in the States, keeping also in view the distinctive features of each State and the need for federal flexibility. This has been done by the States collectively agreeing, through repeated discussions in the Empowered Committee, to certain common points of convergence regarding VAT, and allowing at the same time certain flexibility for the local characteristics of the States.

Alongwith these measures at ensuring convergence on the basic issues on VAT, steps have also been taken for necessary training, computerization and interaction with trade and industry, particularly at the State levels. This interaction with trade and industry is being specially emphasized.

It may be noted that while such preparation was going on, the Chief Ministers of all the States in an important meeting on State-level VAT convened by the Prime Minister on October

18, 2002, where Shri Jaswant Singh, the then Union Finance Minister was also present, clearly stated their intention of introduction VAT from April 1, 2003. About 29 States and Union Territories had expeditiously, sent their Bills to the Ministry of Finance, Government of India for prior vetting. The Union Ministry of Finance had considered these bills of States and Union Territories, and sent their comments/suggestions to the States and Union Territories in line with the decisions of the Empowered Committee of the State Finance Ministers for incorporating the same in VAT Bills to be placed in the State legislatures and subsequent transmission to the Government of India for Presidential Assent. At this Stage, there were certain developments which delayed the introduction of VAT. Despite these development, most of the States remained positively interested in implementation of VAT. Madhya Pradesh VAT Bill had already been accorded Presidential Assent in November 2002. One State, namely, Haryana, has already introduced VAT on its own with good results on revenue growth. It is important to note that in the meeting of Empowered Committee on June 18, 2004 when Shri P. Chidambaram, the Union Finance Minister, was invited all the Sates, once again categorically renewed their commitment to the introduction of VAT from April 1, 2005. Now nearly all the States have finalized their VAT Bills.

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