IV. REFORM OF DIRECT TAXES

1. Introduction

The budget of 1997-98 introduced a reduction of income tax rates to internationally comparable levels following the decades old practice of a very high rate structure. There has been a significant increase in direct tax revenue in terms of GDP following these changes. Nevertheless, there are many incentives that continue to exist within the prevailing structure. Given the need for direct tax revenues enunciated in Chapter III, resource mobilisation through direct taxes should focus on base expansion, though selected other measures are also recommended, including the rationalisation of rates.

2. Rates of Personal Income Tax

The rates of tax are an important determinant of the compliance behavior of taxpayers and hence revenue collection. These also affect the economic behavior of taxpayers i.e. choice between work and leisure and the choice between consumption and savings. The design of the tax rate schedule – progressivity – also signals the re-distributive policy of government. Hence, the need to redesign a rate schedule which is equitable and efficient.

The principle of equity requires that a person with a higher income should pay a relatively higher proportion of his income as tax. This could be achieved by providing for a high basic exemption limit and/or high marginal rates of tax. However, a high basic exemption limit has the effect of keeping a large number of taxpayers outside the tax net. Therefore, it becomes necessary to provide for high marginal rates of tax with an objective of generating revenue. This, however, causes a relatively higher distortion in the economic behavior of taxpayers and therefore, promotes inefficiency.

The equity of the tax schedule is also distorted if it imposes additional tax burden resulting from "bracket creep" of income due to inflation. This is because, an individual may be dragged into a higher tax bracket just because his nominal income has increased though his real income may have remained the same or even decreased. This phenomenon is also referred to as "fiscal drag". Accordingly, in designing the rate schedule it is, therefore, important to ensure the following:

(i) The basic exemption limit must be at a moderate level - an appropriate balance between the tax liability at the lowest levels, administrative cost of collection and compliance burden of the smallest taxpayers. The ability of the tax administration to render quality service to taxpayers will also significantly affect the choice of the exemption limit;

(ii) The number of tax slabs should be few and their ranges fairly large to minimize distortions arising out of bracket creep;

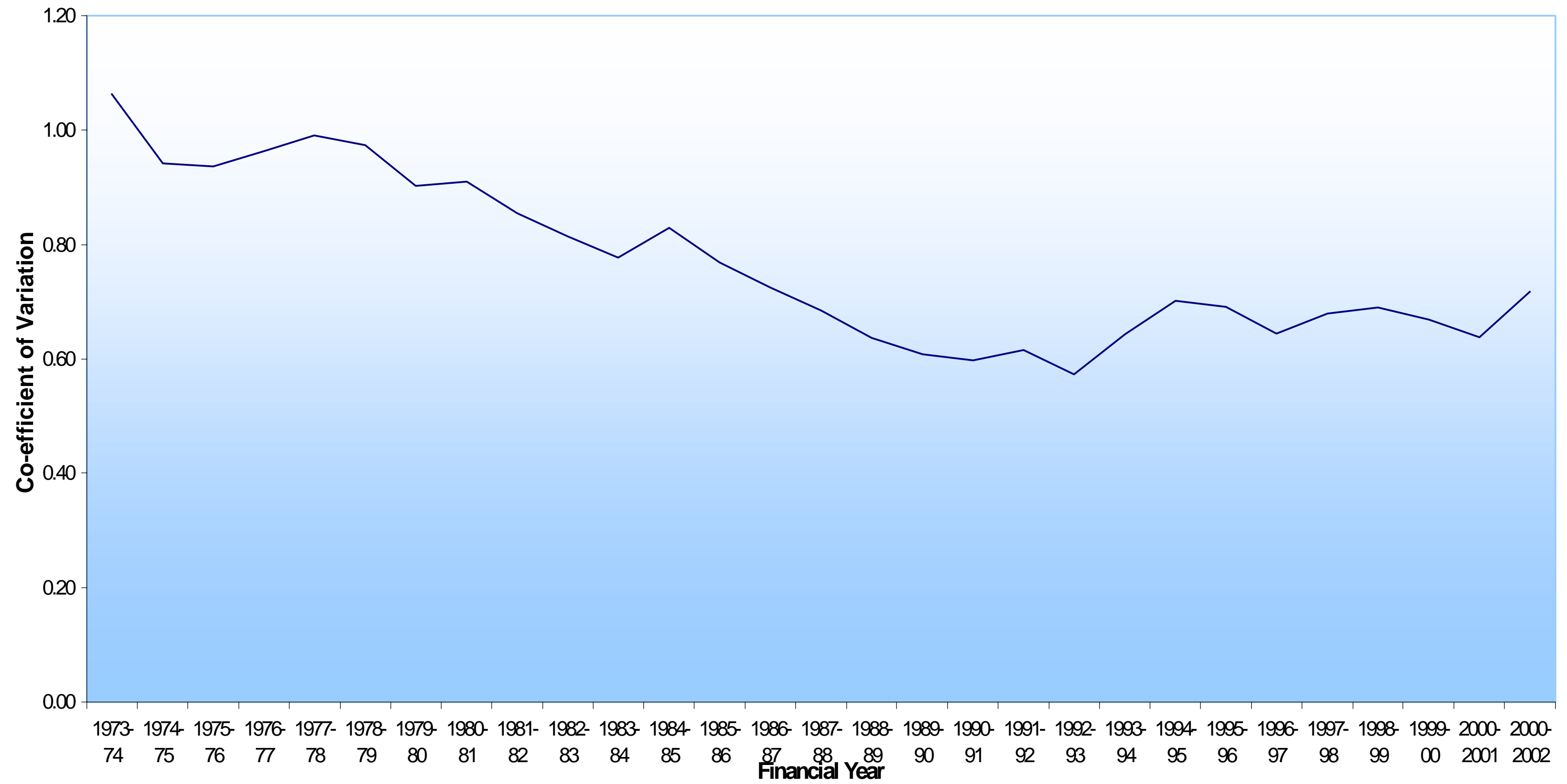
(iii) The maximum marginal rate of tax should be moderate so that the distortions in the economic behavior of the taxpayer and incentive to evade tax payment are minimized.

Personal income tax rates in India were at their peak in 1973-74, with the exemption limit at Rs. 5000, the minimum marginal rates of tax at 10 percent, and the maximum marginal rate of tax rising to 85 percent spread over eleven tax slabs. Additionally there was also a surcharge at the rate of 10 percent in cases where the total income was below Rs. 15000 and at the rate of 15 percent in other cases. Therefore the 'effective' maximum marginal statutory rate was 97.75 percent. The progressivity of the tax system was very high. This is measured by the variation of tax liability for different levels of taxable income. This coefficient of variation was then at a high of 1.06 **(Table IV.1)**. Since then the progressivity of the tax rate schedule has declined substantially to 0.64 **(Chart IV.1**). Further, given the large number of tax slabs, the progressivity of the

TABLE IV.1: PROGRESSIVITY OF THE PERSONAL INCOME TAX SCHEDULE

Fin. Year	Average tax Liability for Assumed Level of taxable Income at 1999-2000 prices												Coefficient of Variation
Income Levels	50000	60000	75000	100000	120000	150000	175000	200000	300000	500000	1000000	2000000	
1973-74	1.68	3.23	4.79	7.52	9.38	12.81	15.01	17.45	28.27	43.66	64.72	79.24	**1.06**
1974-75	2.21	4.04	6.12	8.72	10.75	13.83	16.67	20.08	31.43	44.55	60.77	68.89	**0.94**
1975-76	0.00	1.84	5.22	8.59	10.78	21.55	25.69	27.97	38.12	66.13	71.56	74.28	**0.94**
1976-77	0.00	1.63	4.60	7.58	9.57	12.38	14.73	17.01	25.90	37.00	50.53	58.27	**0.96**
1977-78	0.00	0.00	5.61	6.51	8.88	12.50	15.38	18.35	27.57	39.82	53.65	61.32	**0.99**
1978-79	0.00	0.00	5.99	6.98	9.26	13.03	16.00	19.26	28.17	40.59	54.15	61.58	**0.97**
1979-80	0.00	4.38	7.10	8.32	10.99	15.12	18.43	22.12	31.40	44.07	57.63	64.82	**0.90**
1980-81	0.00	0.00	7.57	7.24	10.52	14.76	18.80	21.95	31.00	42.19	54.05	60.03	**0.91**
1981-82	0.00	0.00	3.07	10.56	14.54	19.73	23.19	25.80	34.55	45.25	55.63	60.81	**0.86**
1982-83	0.00	0.00	5.29	12.22	16.23	21.52	24.73	27.14	36.56	47.36	56.68	61.34	**0.81**
1983-84	0.00	1.36	6.72	13.68	18.24	23.59	26.65	29.49	39.39	50.05	58.78	63.14	**0.78**
1984-85	0.00	2.70	7.01	12.96	17.10	11.34	16.15	28.35	36.78	46.23	54.05	57.96	**0.83**
1985-86	0.00	0.33	5.26	11.08	14.24	17.39	19.79	22.32	28.21	36.35	43.17	46.59	**0.77**
1986-87	0.00	2.04	6.63	12.40	15.33	18.27	21.20	23.55	29.03	37.30	43.65	46.82	**0.72**
1987-88	0.00	4.05	8.58	13.94	16.61	20.98	23.98	26.23	32.21	40.33	46.41	49.46	**0.68**
1988-89	1.71	5.59	10.16	15.12	17.60	22.52	25.31	27.39	33.70	41.22	46.86	49.68	**0.64**
1989-90	3.15	6.79	11.39	16.04	18.37	24.41	27.09	29.11	35.87	43.12	48.56	51.28	**0.61**
1990-91	4.26	7.77	12.22	16.66	19.78	23.82	29.27	31.21	38.78	45.67	50.83	53.42	**0.60**
1991-92	3.07	6.28	11.02	16.15	20.12	26.99	29.54	31.87	39.91	46.35	51.17	53.59	**0.62**
1992-93	4.67	8.51	12.81	18.39	21.99	25.59	31.02	34.14	41.43	47.26	51.63	53.81	**0.57**
1993-94	1.75	4.79	7.83	12.73	15.60	18.48	23.31	26.00	32.27	37.28	41.04	42.92	**0.64**
1994-95	0.00	2.30	5.84	10.28	13.56	16.85	18.73	27.10	31.40	34.84	37.42	38.71	**0.70**
1995-96	0.00	1.88	5.50	10.97	14.14	17.32	19.81	22.33	28.22	32.93	36.47	38.23	**0.69**
1996-97	0.10	3.42	6.78	12.59	15.49	18.44	21.52	23.83	29.22	33.53	36.77	38.38	**0.64**
1997-98	0.68	2.23	4.46	8.34	10.29	12.23	13.35	15.43	20.29	24.17	27.09	28.54	**0.68**
1998-99	0.00	1.30	4.68	8.51	10.43	12.34	14.48	16.42	20.95	24.57	27.28	28.64	**0.69**
1999-00	0.00	1.83	5.87	9.90	11.92	13.93	16.66	18.70	23.47	27.28	30.14	31.57	**0.67**
2000-2001	0.56	2.97	6.77	10.58	12.48	15.69	18.38	20.39	25.09	28.86	31.68	33.09	**0.64**
2001-2002	0.97	2.48	3.98	6.46	8.72	10.97	12.26	14.21	19.47	23.68	26.84	28.42	**0.72**

Chart IV.1



tax system was also distorted due to bracket creep. Clearly, the design of the tax rate schedule was neither economically efficient nor equitable, nor amenable to voluntary compliance.

Since then there has been a steady increase in the exemption limit, decrease in the maximum marginal rate of tax and reduction in the number of tax slabs. As a result, the design of the tax rate schedule has been made relatively more efficient. Since the number of tax slabs has been reduced substantially, the distortion in the equity of the schedule arising due to bracket creep has also been considerably minimized. And, there has been a steady decline in the progressivity of the schedule.

The decline in the progressivity over the years is partly due to the sharp reduction in the maximum marginal rate of tax and failure to adjust the tax slabs to inflation. For example, the exemption limit of Rs. 5000 in 1973-74 is equivalent to Rs. 50000 at current prices in 2001-2002. However, the exemption limit was increased to Rs. 50000 in 1998-99 itself i.e. 3 years in advance. Therefore, the increase in the exemption limit has out paced inflation[5]. The tax rates of 10 percent and 20 percent were applicable for incomes up to Rs. 10,000 and Rs. 20,000 respectively, in 1973-74. The inflation adjusted corresponding income levels are Rs.100,000 and Rs. 200,000 in 2001-2002[6]. Contrast this with the existing corresponding income levels of Rs 60,000 and Rs 1,50,000 and these are substantially lower than the inflation-indexed levels thereby resulting in an increase in the real tax liability.

In view of the above, we recommend that the personal income tax rate schedule be revised along the lines indicated in Table IV.2.

Table IV.2. Proposed Personal Income Tax Structure

Income levels	Tax rates
Below 50000	Nil
50001 – 100000	10 percent of the income in excess of Rs.50,000
100001 – 200000	Rs.5000 **plus** 20 percent of the income in excess of Rs. 100000
Above 200000	Rs.25000 **plus** 30[7] percent of the income in excess of Rs 200000

1 However, this is not true for all years since exemption limit has not been adjusted for inflation on a year-to-year basis.

2 This is based on expected rate of inflation for 2000-2001 and 2001-2002, and then rounded off to the nearest '0000.

3 At present, the maximum marginal tax rate inclusive of surcharge is 34.5 percent.

This change will eliminate the current surcharge. In future Government must desist from imposing surcharge since these have the effect of increasing the marginal rates of tax which adversely affect compliance. The revenue gain from such discretionary changes is always illusory. In any case all such levies should only be through adjustment in the basic tax rates to avoid complexities in tax calculations.

The effect of this proposal will also be to broaden the base of the various slabs and significantly reduce the adverse effect arising out of bracket creep due to inflation. Further, the proposed schedule will also enhance progressivity, as indicated in Table IV.1 between 2000-01 and 2001-02. The smaller taxpayers will be encouraged to declare higher incomes without being subjected to a higher marginal rate of tax. The impact on tax liability at different levels of taxable income will be as indicated in Table IV.3**.** Also, though the new schedule will result in revenue loss of **Rs. 6000 crores** at the current level of compliance, this theoretical revenue loss should be more than neutralised in reflection of an expected improvement in compliance due to the change in structure.

TABLE -IV.3

IMPACT OF CHANGES IN TAX SCHEDULE

Taxable Income	Existing Liability			New Liability			Relief
	Basic	Surcharge	Total	Basic	Surcharge	Total	
50000	0		0	0	0	0	**0**
60000	1000		1000	1000	0	1000	**0**
75000	4000	400	4400	2500	0	2500	**1900**
100000	9000	900	9900	5000	0	5000	**4900**
125000	14000	1400	15400	10000	0	10000	**5400**
150000	19000	1900	20900	15000	0	15000	**5900**
200000	34000	5100	39100	25000	0	25000	**14100**
250000	49000	7350	56350	40000	0	40000	**16350**
500000	124000	18600	142600	115000	0	115000	**27600**

The above recommendation is based on the premise that our recommendations in the following sections are also fully adopted. If for some reason the Government is not able to immediately implement the other elements of the recommendation package, the maximum marginal rate should be retained at 35 percent in which case the revenue loss would be restricted to Rs 4500 crores at the existing level of compliance, the loss reflecting the correction in the effect of "bracket creep".

2. Tax Base

a. Widening of the Tax Base

At present, the Income tax Act is riddled with tax concessions, which take the form of full or partial exemptions, deductions, and tax holidays (**see Appendix table I.**). These concessions may have been justified in the era when the marginal tax rates were exorbitantly high. However, over the years the marginal tax rates have been steadily reduced substantially and we have recommended further reduction in both the personal tax rates and the corporate tax rates. It is therefore, important to review the large number of these exemptions/deductions/holidays so as to expand the tax base and also increase the average tax liability.

Tax incentives are generally profit based and therefore their value depends on the size of the profit. The value of the incentive increases with the increase in profit. Arguably, they end up benefiting those who need the least. To this extent these are also inequitous. Accordingly, the bulk of the revenue foregone is likely to have no beneficial impact on the objective, which it seeks to serve and so the ratio of benefits to cost is likely to be low.

Tax incentives being profit based, encourage only those enterprise engaged in low risk activity. In fact, these are of little benefit to major capital-intensive projects, which have long gestation period and are not likely to make profit in the initial years.

Tax incentives by their very nature represent a revenue cost for the government. For the most part, this revenue cost is wasted because the incentives go to investments that

would have been made in any event. It is argued that foreign/ domestic direct investment in countries in transition to a market oriented economy would not occur without the incentive, and so there is no real revenue cost. However, experience has shown that there is investment in short term, high profit projects. Because these projects would occur even if there were no tax incentives, the tax incentive is a pure windfall to them. Incentives have been subject to serious tax avoidance, which has added greatly to their revenue cost.

The revenue impact of tax incentives, in theory, is tied to new activity. Thus the revenue impact is generally low in the initial years but grows over time as more firms become eligible. Where buildup of unused deductions and losses are allowed it also reduces the predictability of the government's revenue stream. Firms, which do not expect to use their deductions in time, seek ways of transferring them to firms with current taxable income, often in the form of transactions that entailed a lower cost of financing for the tax deductions. Thus, the deductions earned in one sector reduced the taxable income of another. Loss trading mechanisms such as leasing are frequently used in this context.

Tax incentives introduce complexity into the tax system, because the rules themselves are complex and because tax authorities react to the tax planning that inevitably results from their introduction by putting into place anti-avoidance measures. This complexity imposes costs on administrators and taxpayers and increases the uncertainty of the tax results. Uncertainty can deter the investment the incentives are intended to attract.

Tax incentives provide an extra challenge to tax administrators, who must first verify that the incentive has been applied correctly. Verification can be difficult if complex calculations are involved which is generally the case. Second, administrators must ensure, that the activity or firm actually qualifies for the incentive. This process can be complicated if concepts and definitions are vague or ambiguous. Third, tax officials must ensure that the amounts eligible for the incentive are correctly reported. The need to carry these assessments essentially to verify that no tax, or a reduced amount, is payable diverts resources from other administrative tasks, which can be ill afforded given the shortages of

trained staff that exist in most developing countries. Hence, tax incentives are particularly burdensome for the tax administration.

A large number of tax incentives are discretionary and often entail some form of preapproval of the authorities. Approval process is generally time consuming and cumbersome. The authorities can obtain the detailed information necessary for evaluation only from companies that have an incentive to portray it in an advantageous manner. In the real world of politics it is difficult to deny the incentives to companies that are promising to create employment. Moreover, discretionary incentives are an invitation to corruption. Finally, an approval process undermines the tax system's transparency, which is probably the most important criterion of companies making the investments. For these reasons the track record of discretionary incentives is not encouraging.

The potential market and the low-cost labor is an attraction for investment in developing countries but other considerations inhibit large-scale investment, such as uncertainty in the policy stance of governments, political instability, and inadequate legal set-up. Further, to prospective investors, the general features of the tax system (tax base, tax rates etc) are more important than tax incentives Taxpayers expect to be able to predict the tax consequences of their actions, which requires clear laws that are stable over time. In many developing countries, the tax laws are not clearly written and are subject to frequent revision, which makes long term planning difficult for business and adds to the perceived risk of undertaking major capital-intensive projects. The administration of the law is as important as the law itself, and it is clear that tax administrations in developing countries often have difficulty in coping with sophisticated investors, whether in providing timely and consistent interpretations of the law or in enforcing the law appropriately. Therefore, what is required is fundamental reform of the economic and institutional situation. Tax incentives attempt to overcome these handicaps thereby pushing fundamental reform to the background.

Introduction of tax incentives creates a clientele for their continuation and spread. The fact that many industrial countries maintain some tax incentives after the tax reforms

of the 1980s is less a statement that they are considered to be effective and more a testament to the political difficulty in removing them once they have been introduced. It is because of this tendency that many "temporary" measures, designed to respond to particular perceived disincentives, remain in force long after the conditions that originally led to their introduction have changed.

Tax incentives are in the nature of subsidies and since most developing countries do not account for these as tax expenditures, they escape closer scrutiny of its effect both by public and parliament. Because of this, these are also perceived as politically easier alternative to expenditure of funds. Hence, tax incentives do not provide for a transparent fiscal management system.

Tax incentives are, therefore, inefficient, inequitous, impose greater taxpayer compliance burden and administrative burden, result in revenue loss and complexity of the tax laws and encourage tax avoidance. These should be discouraged and wherever necessary political environment created to purge the tax statute of such incentives. Given the Government's bold initiative in eliminating the incentives relating to exports of goods and services, the die is now cast for eliminating other incentives.

The various incentives/deductions in the statute listed out in **Appendix table 1** can be broadly classified into the following:

1. Incentives for investment in financial assets
2. Incentives for encouraging external borrowings
3. Exemption/concessional treatment of perquisites
4. Incentives for industrial development
5. Incentives for export of goods and services
6. Incentives for social sector
7. Incentives for non-profit organizations
8. Incentives for regional development
9. Exemption for income of Funds
10. Exemption for remuneration from foreign sources

11. Other incentives.

Our recommendations are summarily indicated in the Appendix table 1. However, in the sections below we have also separately discussed some of these classes of exemptions.

b. Tax base: Reviewing the system of incentives for savings

Conceptually, in contrast to an expenditure tax, the personal income tax includes savings in its base. The decision to save is affected, amongst other factors, by the return on savings (net of tax). Given the pre-tax return on savings, the post-tax return depends on the marginal rate of tax on personal income. Therefore, in effect, the decision to save is also determined by the marginal rate of personal income tax. Hence, income tax is sometimes said to comprise a disincentive against savings. However, this theoretical under-pinning does not necessarily find support in available empirical evidence which indicates that given the pre-tax rate of return, taxation or exemption from taxation have no significant effects on savings.

Nevertheless, in India, like many other countries, tax relief is provided for savings in specified assets. It is provided in the form of tax credit on savings in the form of such assets. Tax credit is government by Section 88, deductions are covered by Section 80L, and exemptions are allowed under Sections 10(11) and 10(15) of the Income Tax Act 1961. In addition, under certain specific schemes, tax relief is also allowed as deduction of savings from taxable income under Chapter VIA and exemption from long term capital gains tax. In general, assets in incentive schemes are totally exempt from wealth tax.

(i) Section 88

Since 1968-69, incentives took the form of exemption to whole or part of the fund out of current income invested in specified financial assets subject to monitoring limits. This provision was contained in section 80C of the Income Tax Act. It covered funds

saved or set-aside for fairly long periods of time in life insurance policies, deferred annuity policies, provident funds superannuation funds and 10 years or 15 years cumulative time deposits with post offices. In other words, the relief was granted at the marginal rate of tax applicable to the taxpayer.

Subsequently, scope of the provision was also enlarged by the inclusion of investments in National Savings Certificates VI and VII issues (with effect from the assessment year 1983-84). Later, from assessment year 1988-89 the scope of the provision was further enlarged to provide that payments, upto a maximum of Rs. 10,000 per year, made towards cost of purchase or construction of a new residential house property, would also qualify for deduction. This deduction was available for payments made towards any installment or part payment of the amount due under any self financing or other scheme of any development authority, housing board, etc., or to a company or co-operative society of which the taxpayer is a member. The deduction was also allowed for repayment of amounts borrowed from the Government, any bank, LIC and certain other categories of institutions engaged in carrying on the business of providing long term finance for construction or purchase of houses in India. The overall limit and the proportion of the qualifying amount entitled to deduction remained unchanged. The amount eligible and permissible for deduction u/s 80C (at the time of its removal from statute) was Rs. 40,000 and Rs.20,200 respectively. A higher eligible limit of Rs.60,000 was provided for authors, playwrights, artists, actors, musicians or sportsmen and the maximum permissible deduction in their case worked out to Rs, 28,200.

From assessment year 1991-92, the existing section 88 replaced the incentive provisions under section 80C. Under the new scheme the taxpayer was allowed a rebate of 20 percent of the investment in the forms specified in section 80C. The rate of the tax rebate was determined at the minimum marginal rate of personal income tax then prevailing.

The scope of section 88 has been expanded continuously since then (Appendix Table IV.2). Further, the amount of tax rebate has also increased from Rs. 10,000 (w.e.f.

assessment year 1991-92) to Rs. 12,000 (w.e.f. assessment year1993-94), to Rs. 14,000 (w.e.f. assessment year 1997-98) to Rs. 16,000 from assessment year 2001-02. The rate at which the tax rebate is calculated continuous to be twenty percent even though the minimum marginal rate of tax has reduced to ten percent.

(ii) Section 80L

Section 80L was introduced by the Finance Act, 1967, originally with a view to encouraging investments in the shares of Indian companies and, perhaps, also to mitigating the double taxation of dividends for the smaller shareholders. The Finance Act, 1970 substantially enlarged the scope of this Section by including Government securities, debentures issued by specified co-operative societies or institutions, investments in units of the UTI, deposits with banking companies or co-operative banks and deposits with financial corporations engaged in providing long-term finance for industrial development. The scope of Section 80L was also increased by the inclusion of interest on National Savings Certificates (VI, VII and VIII issues), and bonds issued by certain public sector undertakings carrying interest generally at the rate of 13 per cent or more. However, from assessment year 1998-99, the exemption for dividend income has been taken out of the purview of section 80L since the whole of the dividend income is now exempt in the hands of the shareholders. **Therefore the very rationale for introducing the provision ceases to exist.**

At present, the amount of deduction permitted under section 80L is Rs.12000 with an additional separate deduction of Rs 3000 for income from Government securities. The maximum deduction available under section 80L is, therefore, Rs. 15000.

(iii) Incentive for Capital Gains

Sections **54, 54B, 54D, 54EA,and 54EB** of the Income tax Act provide for **deduction from income** if capital gains from specified sources are invested in certain forms of investment/assets.

(iv) Other Savings Incentives

Apart from these major incentives for savings, the statute also provides for unlimited exemption of income from investment under the various provisions of section 10. Similarly, deductions from income are also allowed under sections 80CCC, 80D, 80DD, 80DDB, and80E for specified investment.

(v) Evaluation

The wide array of savings oriented tax incentives under the Income-tax Act is depicted in Appendix Table IV.2. The scope of the incentives to savings under the income tax has been gradually enlarged over the years. The limits on permissible investments and eligible deductions have also been raised. The general intent of the scheme is to encourage the disposition of savings in forms readily accessible to the Government/public sector companies. However, it can be said that most of the concessions were introduced on an ad hoc basis from time to time without adequate examination of the total impact of the different schemes put together. Taken as a whole, the scheme does not seem to satisfy or fit in with any definite set of principles.

(v.a) Impact on Efficiency:

1. While investment (or saving) under section 88 is rewarded, disinvestment (dissaving) is not brought under charge. The incentives are available not necessarily for saving but also for mere diversion of funds from one form of investment to another and that too for mere locking up of these funds (i.e., surrendering the purchasing power to the Government) only for a specified period of time. The netting principle is not applicable and dissavings remain untaxed. Therefore, there is a bias in favor of investment in short term instruments. To this extent, it creates serious distortions in the allocation of savings. The tax rebate, for repayment of installments of housing loans made by taxpayers to specified

institutions encourages debt as against "equity" financing. This increases the transaction cost in the economy and is therefore wasteful.

2. In any scheme of incentives for savings, it is desirable that the investments which are being encouraged should have broadly similar rates of return. Any variation in the rates should only be on account of differences in the holding period, risk or some overriding considerations of priority for particular sectors. While the major consideration behind the incentive schemes seems to have been to encourage investment in financial assets so as to direct savings to the public sector, there are arbitrary variations in rates of return even among such assets. The rates of return bear no systematic relation to the length of the holding period of assets**.** In effect, by delinking rates of return from holding periods, the public sector crowds out the private sector through offers of quick and perceptibly safter returns. To the extent that there is wasteful use of resources by the public sector, such incentives exacerbate waste.

3. Deduction of net investment and allowing deduction of income from such investment are broadly equivalent in that each is sufficient to achieve treatment of saving as under a proportional expenditure tax. Yet assets such as National Savings Certificates and provident funds enjoy both deductibility of investment (under section 88) and of interest earnings (under Sections 80L and 10(11) or 10(12) respectively). This leads to inordinately high effective rates of return to these assets (Table IV.4). In turn, these serve as a benchmark for rates of return (discount rate) and therefore lead to high cost of borrowing across all sectors in the economy and to dampening of investment.

TABLE: IV.4
Rates of Return for Selected Assets with and without Tax Concessions

	Holding Period	Relief u/s 10/80L/88	Types of return	Marginal Income tax rate 0.0	10.0	22.0	34.5
National Savings Certificate (VIII)	6	88, 80L	A	11.50	17.47	20.16	24.01
			N	11.50	10.35	8.97	7.53
Public Provident Fund	15	88, 80L	A	11.00	14.07	16.24	19.33
			N	11.00	9.90	8.58	7.21
Unit Linked Insurance Plan	15	88, 80L	A	14.25	17.74	20.46	24.37
			N	14.25	12.83	11.12	9.33
Post Office Time Deposit Account	3	80L	A	11.00	12.22	14.10	16.79
			N	11.00	9.90	8.58	7.21
Post Office Time Deposit Account	5	80L	A	11.50	12.78	14.74	17.56
			N	11.50	10.35	8.97	7.53
Indira Vikas and Kisan Vikas Patra	5.5		A	13.43	13.43	13.43	13.43
			N	13.43	12.09	10.48	8.80
Financial Institutions Bonds	3		A	10.00	10.00	10.00	10.00
			N	10.00	9.00	7.80	6.55
Financial Institutions Bonds	5		A	11.00	11.00	11.00	11.00
			N	11.00	9.90	8.58	7.21

Note: A refers to actual, N refers to no concessions

4. Finally, the special limits of Section 80L deductions applicable to Government securities, create legally induced distortions in the allocation of savings as between these and other assets covered by Section 80L, irrespective of the intrinsic rates of return.

5. The granting of exemption from income tax for income from capital (as under section 80L or section 10) is equivalent to the expenditure tax principle but a progressive expenditure tax cannot be introduced through that route. However, if exemption for capital income is given without limit under a progressive income tax, it would amount to having a progressive income tax only on work income. Hence, the introduction of public sector bond and other instruments, income from which is exempt from income tax without any limit, as is the case under section 10 of the Income tax Act, leads to unjustified distortion.

(v.b) Impact on Equity

1. One consequence of the present scheme is that where the concessions take the form of deduction from income as in the case of section 10, section 80L and the provisions relating to roll-over of capital gains tax, they favor upper bracket taxpayers disproportionately. The post incentive rates of return vary substantially across taxpayers with different marginal tax rates. In general, the post incentive rate of return increases with the marginal tax rate of the saver. These provisions are therefore, regressive.
2. The provisions discriminate between taxpayers and non-taxpayers in as much as the rates of return are significantly lower for non-taxpayers.
3. To the extent exemption is allowed for roll over of capital gains, the scheme is biased in favor of taxpayers with income from capital gains. Therefore, the scheme distorts horizontal equity. Further, since the large taxpayers generally have a larger proportion of their incomes from capital gains, the roll over provisions are biased in favor of the rich thereby distorting the vertical equity of the tax structure.
4. Inequity also arises from asymmetric information about the various tax concessions for savings. To the extent information is available with a taxpayer, he is able to avail of the tax concession. This problem is particularly aggravated in the absence of any meaningful taxpayer education and assistance program by the tax administration. Appendix Table IV.1 is indicative of the complexity and, therefore, the likelihood of uneven information regarding many incentives.
5. The tax rebate for repayment of installments of housing loans made by taxpayers to specified institutions tends to favour the richer taxpayers since the incentive can, in addition, be subjected to the criticism that it discriminates against both those who build houses out of taxed savings and others who are forced to borrow from private sources on account of circumstances beyond their control (their areas are not served by housing finance institutions or they cannot put up the necessary security or collateral and are not Government servants). Further, the manner in

which the concessions for savings are offered tends to favour the richer tax payers.

Recommendations

1. Given the distortionary effects on both efficiency and equity of the tax system, and the restructuring of the tax rate schedule proposed, abolition of tax incentives under Sections 80CCC, 88, 80L,and 10(15) of the Income tax Act is recommended.

2. The tax concessions under sections 80D, 80DD, 80DDB and 80E of the Income Tax Act should be given in the form of tax credit rather than in the form of deductions for savings/investment. The rate of tax credit should be restricted to 10 percent, being the minimum marginal rate of personal income tax. This should be further subjected to a ceiling equal to ten percent of the maximum investment permissible under the respective provisions.

3. Since the computation of capital gains provides for inflation adjustment of cost of the asset and relief from higher marginal rate of tax due to bunching of gains (it is taxed at 20 percent), the roll over provisions under sections 54, 54B, 54D, 54EA,and 54EB of the Income Tax Act should be done away with.

The proposals have the effect of reducing distortions, improving equity and enabling better compliance. Further, they also expand the tax base and result in an increase in tax revenue to the extent of Rs.7700 crores according to estimates.

(c) Incentives for External borrowings:

Section 10 of the Income tax Act provides a large number of exemptions in respect of interest paid on foreign borrowings, whether from non-resident Indians or other foreign entities. These exemptions have been listed in **Appendix table: 1.**

The purpose of these deductions is ostensibly to mobilize external debt at a concessional rate. However, it is doubtful whether the tax concession in effect fulfills this objective. The interest received by the lender is liable to tax in the country of his residence[4]. To the extent the interest payment is taxed in the host country, the tax so paid is allowed to be credited against the tax liability in the country of residence. Therefore, any exemption from tax liability in the host country does not benefit the lender in any way. Hence, it is unlikely that the lender would cut interest rate on such lending. In fact, the result is that the host country loses tax revenue without the benefit of lower interest burden.

Further, these exemptions may have been justified when the tax rates in India were relatively higher than those in the lender's country of residence. As a result, the lender could not have availed credit for the full amount of taxes paid in India. However, with tax rates having been reduced substantially, such possibility ceases to exist.

In view of the above, we recommend that all such provisions as listed in **Appendix table I should** be deleted.

(d) Exemption for Income of Funds

At present, section 10 of the Income tax Act provides for exemption of income of various Funds. This exemption is provided on the premise that the Funds are mere conduits through which income flows ultimately to the beneficiaries. Accordingly, tax liability, if any, is fully borne by the beneficiaries. However, another alternate model for taxation of income of the Funds is to tax the income in the hands of the fund but exempt the same from further taxation in the hands of thousands of beneficiaries. This is administratively more simple but considerably inequitous in as much as all beneficiaries bear the same tax liability irrespective of their individual marginal rates of tax.

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[4] This is so only in cases where there is no tax treaty or the tax treaty does not provide for tax sparing. The indian tax treaty with USA, germany, and Italy do not provide for tax sparing. The Indian trearies with UK, France, Singapore and Australia provide for tax sparing in respect of this incentive. However, since the bulk of the external commercial borrowing is from USA, our analysis holds good.

In India, the income of the funds is exempted both in the hands of the Fund as well as in the hands of the beneficiary. The only economic rationale for such double exemptions could be the appropriative high rates of tax then prevailing. With marginal rates of tax having been reduced substantially over the years, this rational ceases to exist.

In view of the above and keeping in view the ease of administration we recommend that the income of the funds (other than mutual funds) should be taxed in the hands of the funds while the beneficiaries should continue to enjoy the exemption. However, since most beneficiaries of the funds covered in section 10 of the Income tax Act would be relatively smaller taxpayers, the rate of tax applicable to such funds may be at 10 percent, being the minimum marginal rate of personal income tax rate.

(e) <u>Exemption for Foreign Income and Remuneration</u>:

Sections 10 (8), 10 (8A), 10 (8B), and 10 (9), of the Income tax Act provide for exemption of foreign income and remuneration received by a consultant either from a foreign government or an international organization subject to certain conditions. We do not find any rationale for these exemptions. In fact in U.S.A. the income of employees of both the World Bank and the International Monetary Fund is also subjected to personal income tax, which is borne by the two organizations. Remunerations, being income should be subjected to tax irrespective of the source from which it is derived. We therefore, recommend the deletion of these provisions

(f) <u>Incentives for foreign exchange earnings/export of goods and services:</u>

Sections 10A, 10B, 80HHB, 80HHBA, 80HHC, 80HHD, 80HHE, 80HHF, 80-O, 80R, 80RR and 80RRA of the Income tax Act provide for incentive for foreign exchange earnings/ export of goods and services. These incentives are provided to neutralize the adverse impact of poor infrastructure, regime an administered and distortionary input tax regime on input cost and a controlled foreign exchange regime on international

competitiveness. However, with reform of the input tax regime and decontrol of the foreign exchange regime, the handicap is considerably reduced. It will further reduce as economic reforms continue. In view of this, the Government has, through the Union Budget, 2000, already announced the phased withdrawal of these incentives (except sections 10A and 10B) over a period of five years. We welcome this initiative.

Sections 10A of the Income tax Act provide for exemption of income from export of goods and computer software by units located in Free trade zones, technology parks, and special economic zones. These special areas enjoy a substantially higher quality of infrastructure facilities and a relatively less distortionary input tax regime. Therefore, the impediments to international competitiveness and therefore to exports are considerably less than those suffered by units operating from outside these zones. Since the Government has already taken a decision to phase out the export related concessions to units outside of these special zones, we see no valid reason for the continuation of the special income tax regime for units in the special economic zones.

Similarly, section 10B allows a deduction of profits and gains derived by a 'hundred percent export oriented undertaking' from the export of goods and computer software. For this purpose, a 'hundred percent export oriented undertaking' has been defined to mean an undertaking which has been approved as a hundred percent export-oriented undertaking by the Board appointed in this behalf by the Central Government in exercise of the powers conferred by section 14 of the Industries (Development and Regulation) Act, 1951, and the rule made under that Act. It is obvious that the tax concession under section 10B is a premium on export licensing; in other words, the Government has introduced the export-licensing regime through the back door. This is inconsistent with the overall policy of trade liberalization. It is also biased against undertakings which export almost whole of their output but have not been approved by the Board.

In view of the above, we recommend the phased withdrawal of both section 10A and 10B of the Income tax Act along the lines of section 80HHC. In other words the

concession would be available at the successively reduced rates for the next five years after which it would cease to exist.

(g) Incentive for regional / industrial development:

In India, industrial enterprises established in backward areas receive income tax incentives. These are of different magnitudes and for different durations. The main features of existing system of backward area tax incentives offered in India are discussed below. First, income tax incentives for backward areas are being granted only to industrial enterprises and not the enterprises of other sectors e.g. service sector. It is unclear why the policy makers see industries alone as a source of development and not any of the service sectors. The eligibility of only industrial enterprises for backward area incentives is economically inefficient as it distorts investment in the services sector. Second, the backward area incentives are granted to industrial enterprises at different rates, depending upon the form of organization of the enterprise – co-operative societies, for example, receive more generous incentives, than the corporate enterprises, while unincorporated enterprises receive the least favorable incentives amongst them all. The incentive is therefore, not neutral to the form of organization. Third, small differences seem to have been created under the Income Tax act between income tax incentives offered to enterprises established in backward districts of Category A or those of Category B (The former are considered a bit less backward than the latter, based on the "derived" averages of selected sets of quantitative criteria). Finally, the scope and definition of backward areas has been widened greatly over time. In F.Y 1990-91, eight States of North Eastern region (Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) were covered and the availability of tax incentives in these States was restricted only to industrial enterprises existing in the Integrated Infrastructure Development Centers and Industrial Growth Centers. Moreover, other backward States and Territories (Jammu and Kashmir, Himachal Pradesh, Goa, Andaman and Nicober Islands, Dadar and Nagar Haveli, Daman and Diu, Lakshadweep, and Pondicherry) as well as districts in other, less backward, States of India (such as Andhra Pradesh, Bihar, Gujarat, Kerala, Madhya Pradesh, Maharashtra, Orissa,

Rajasthan, Uttar Pradesh, and West Bengal) have been added to the list of beneficiaries. This ever-expanding definition and scope of backward areas in recent years has complicated tax administration and generally eroded the income tax revenues. Further, the criterion used to select /identify backward areas is also inefficient.

The fundamental cause of backwardness often lies in the persistence of one or more of the following basic factors which are essential to the growth of economic activity:

Availability of raw materials.

Adequate roads and other transport facilities.

Skilled labour supply.

Adequate consumer markets.

Availability of credit and other banking facilities.

Adequate supply of power, water, telecommunication and other public utilities.

It is these factors, which determine the profitability necessary to motivate investors. Non-availability of the above-mentioned factors can lead to such serious cost disadvantages to investors and entrepreneurs of such localities and regions which no amount of profit linked tax incentives can compensate. It is only when cost disadvantages are relatively marginal, and taxation itself is seen as imposing an additional cost disadvantage, that income tax reliefs or incentives could be-- could be but not necessarily always are-- a useful tool for assisting the industrialization of backward areas. However, experience all over the world clearly shows that tax incentives fail to promote industrialization if the inherent cost disadvantages for an investor resulting from the above mentioned lacunae are large and substantial. In such situations, the removal of the basic obstacles to private investment, through public infrastructure development, rather than income tax incentives tend to help and need to receive the top most priority.

If income tax incentives offered to industrial enterprises in backward areas had been effective, there would be (a) a significant growth in industrial investment; (b) a large growth in the number of factories in such areas; (c) a perceptible growth in

employment. Gandhi et al examine the effectiveness of the backward area incentives, by reviewing the 'Before and After' data on selected key industrial development indicators.

Unfortunately the non-availability of relevant industrial data for the backward areas/districts of the country, benefiting from income tax incentives, does not permit a detailed analysis of this issue. However, as most of the backward districts, combining Category 'A' and Category 'B', belong to four States (Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh), one can study the growth in these , along with the available data of 11 other backward States for which income tax incentives have been made available since the early 1990's, to assess the effectiveness of the available income tax incentives in promoting industrialization.

Table IV.5 contains the data on the numbers of industrial investment proposals made in different backward areas and the growth of investment and employment promised in relation to them and compares these with the investment actually realized.

Table IV.5: Industrial Investment Proposals: August 1991- December 1998 (Industrial Entrepreneur Memorandum (IEM) and Letters of Intent(LOI))

	Number	**Prposed Investment (Rs.Crore)**	**Percentage Of Total**	**Employment (% of Total)**	**Implemented Investment (IEM Only) Rs. Crore**
Assam	89	5343	2.79	0.78	24
Andaman and Nicobar	9	332	0.05	0.04	0
Arunachal Pradesh	6	39	0.01	0.07	0
Goa	329	4629	0.84	0.95	148
Himachal Pradesh	379	8125	1.63	2.14	128
Jammu and Kashmir	70	503	0.13	0.72	458
Manipur	0	0	0.00	0.00	0
Meghalaya	14	254	0.04	0.02	1
Mizoram	0	0	0.00	0.00	0
Nagaland	6	159	0.02	0.03	0
Tripura	4	1040	0.16	0.02	0
Pondicherry	367	5370	1.84	0.96	200
Sikkim	10	30	0.00	0.04	0
All India	**38385**	**757316**	**100**	**100**	**123945**

Source: Ministry of Industry, Annual Report 1998-99.

The contrast is extremely disappointing, to say the least. In 7 States, in fact, the implementation rate was nil altogether.

This table IV.5 also shows that the emergence of new investment proposals in *the North-East* States is practically nil during the nineties, despite complete tax holiday for ten consecutive years under 10 C, except in Assam. In Assam, several letters of intent have been signed in respect of licensed sector (petrochemical units). The situation is far more worse with respect to the implementation of these proposals.[5]

Table IV.6 gives the data on the nominal investment per factory and shows how it grew at a higher rate during the second period (1990/91-1997/1998) only in four out of ten backward states (Assam, Goa, Himachal Pradesh and Jammu and Kashmir) when compared with the first period (1984/85-1990/1991). The evidence is mixed for backward districts in non-backward states of Bihar, Madhya Pradesh, Rajasthan and uttar Pradesh too, where only two states show improvement.

Table IV.6 : Growth in Nominal Investment per Factory (per cent per annum)

	1990-91 over 1984-85	**1997-98 over 1990-91**
All India	16.33	12.56
Backward States		
Assam	16.40	19.54
Goa	-4.86	25.04
Himachal	-3.26	16.61
Jammu & Kashmir	1.75	3.36
Manipur	73.38	-49.74
Meghalaya	293.12	-15.83
Tripura	55.23	-2.95
Pondichery	33.51	14.14
Andaman	122.74	-2.50
Dadra &Nagar Haveli.	N.A	27.19
Non-backward States with Backward Districts: Select List		
Bihar	16.36	7.50
Madhya Pradesh	6.05	11.62
Rajasthan	7.16	5.28
Uttar Pradesh	13.98	32.02

Source: Annual Survey of Industries: Summary Result For Factory Sector (various issues).

[5] It may be noted that signing of IEM or LOI is not mandatory to set up a new factory. As a result, the findings in table 1 and table 6 seem to be contradictory in nature. Usually a major investment proposal is approved after the signing of an IEM or a LOI. No such formality is required for tiny plants.

While this picture may seem encouraging to some, it must be borne in mind that these data relate to nominal investments and not real investments. In fact, the rate of nominal investment per factory in the second regime in many cases may well be much smaller, or even negative, if the data were adjusted for inflation.

Similarly analysis of industrial investment in the backward States/areas) indicates that except in Assam and Pondichery, the rate of industrial investment declined during the nineties (the average of 1992-93 and 1997-98) in all backward states and in Bihar, Madhya Pradesh and Rajasthan (**Table IV.7**). The decline in the rate of investment is much more severe when compared with 1984-85 and 1990-91 and when compared to the rate of investment for the country as a whole.

Table IV.7: Rate of Investment (Gross Capital Formation / Output) (Per cent)

	1984-85	1990-91	1992-93	1997-98	Average 84 & 90	Average 92 & 97
All India	11.87	12.88	16.49	13.11	12.37	14.80
Backward States						
Assam	8.83	8.85	9.31	17.42	8.84	13.37
Goa	19.43	5.50	16.24	9.18	12.47	12.71
Himachal	37.45	14.17	23.39	23.03	25.81	23.21
Jammu & Kashmir	17.50	6.45	5.38	6.15	11.97	5.76
Manipur	12.33	96.85	14.08	-15.37	54.59	-0.64
Meghalaya	-1.86	111.43	32.22	-4.46	54.79	13.88
Tripura	4.43	32.73	7.82	5.77	18.58	6.79
Pondichery	12.72	15.11	18.90	9.74	13.92	14.32
Andaman	0.79	49.71	15.25	21.99	25.25	18.62
Dadra & Nagar	NA	6.46	4.91	15.23	NA	10.07
Non backward States with Backward Districts: Select List						
Bihar	13.40	13.09	15.12	9.19	13.25	12.15
Madhya Pradesh	25.89	14.82	22.79	12.64	20.35	17.72
Rajasthan	24.14	14.77	15.52	10.39	19.45	12.96
Uttar Pradesh	12.30	11.69	16.35	34.44	11.99	25.39

Source: Annual Survey of Industries: Summary ResultFor Factory Sector (various issues).

However, the number of industrial factories seem to have grown faster in the backward states in the second period as compared to the first period; however, no such evidence seem to exist for the backward districts in non-backward states **(Table IV.8).**

Table IV.8: Growth in Factories (per cent per annum)

	1990-91 over 1984-85	1997-98 over 1990-91
All India	2.20	2.94
Backward States		
Assam	-1.76	2.61
Goa	-0.68	6.32
Himachal	4.88	10.54
Jammu & Kashmir	-10.01	8.32
Manipur	3.87	3.55
Meghalaya	0.00	4.22
Tripura	-0.55	0.06
Pondichery	6.37	7.09
Andaman	4.12	6.03
Dadra &Nagar Haveli.	NA	15.70
Non backward States with Backward Districts: Select List		
Bihar	-3.76	-0.47
Madhya Pradesh	1.12	0.93
Rajasthan	3.77	5.85
Uttar Pradesh	4.72	0.22

Source: Annual Survey of Industries: Summary Result For Factory Sector (various issues).

Similarly, the growth in the level of industrial employment was higher in six out of ten backward states during the second period as against the first period. On the other hand, the rate of growth of employment seems to have registered a decline in the backward districts **(Table IV.9).**

Table IV.9: Growth in Employment (per cent per annum)

	1990-91 over 1984-85	1997-98 over 1990-91
All India	0.62	2.78
Backward States		
Assam	-0.67	4.96
Goa	0.42	6.74
Himachal	8.96	3.50
Jammu & Kashmir	-18.05	17.51
Manipur	5.02	22.37
Meghalaya	0.43	2.10
Tripura	-0.43	-4.12
Pondichery	12.21	7.78
Andaman	-0.08	3.14
Dadra &Nagar Haveli.	NA	17.51
Non backward States with Backward Districts: Select List		
Bihar	0.51	-3.84
Madhya Pradesh	1.02	1.50
Rajasthan	1.55	2.67
Uttar Pradesh	0.88	-0.39

Source: Annual Survey of Industries: Summary Result For Factory Sector (various issues).

In the light of the above empirical analysis, Gandhi et al conclude that "the evidence of growth of backward areas promoted by income tax incentives is at best mixed and it would not be unfair to conclude that, if the primary objective of these incentives was to boost private industrial investment in backward districts/states, the results have not been very encouraging…..The growth of industry in a particular region depends more on the level of physical infrastructure available in the area, access to banks and other institutions providing finance, the size of the consumer market, the level of urbanization, the law and order situation and the quality of skilled and unskilled manpower available in the area. Once these have been made available, then and only then income tax incentives can be expected to play any role, and even then perhaps a marginal role, if at all."

While revenue loss on account of the backward area allowance is not readily available, guesstimate of such loss is about Rupees 356 crores on account of this incentive in the selected backward states covered in the Study. In reality, however, the amount of revenue lost could be somewhat higher as the estimate does not include the

revenue foregone from industries in the backward districts of the non-backward States. Furthermore, to the extent these incentives may have been abused by some tax-exempt taxpayers, and much tax administration effort may have been spent on administrating these incentives, the monitoring and investigating of income tax abuses by large tax paying income earners may have been ignored. The effective revenue forgone may, thus, have been somewhat higher.

The tax incentives have also been subjected to abuse. Instances of abuse have been indicated in depth in the Report of the Comptroller and Auditor-General of India-Direct taxes (1998).

It is important to note that inspite of tax incentives the development process in the backward areas has failed to take off. The Government having provided these incentives is lulled into complacency. The need to create urgent infrastructural facilities in these areas is pushed into the background, so typical of any such tax incentives.

The experience in the case of other similar provisions like section 80IA is no different since the design of the incentive is similar and the revenue loss far greater in view of its wide coverage. It would not be feasible for the Government to undertake any meaningful reform of the direct tax structure if such incentives continue to exist on the statute.

Experience in many countries of the world shows that income tax incentives are a poor instrument of encouraging economic activity[6] and that income tax incentives to remove the backwardness of a backward State/Districts/Areas are no exception. This is amply out by the empirical analysis in Gandhi, et al. This is primarily because the bottlenecks to development in such areas tend to be so basic that no amount of tax incentives can compensate for those structural handicaps. Only a well-thought out strategy of public investment-- developed on a case-by-case basis and geared towards removing specific obstacles inhibiting economic development of individual areas -- can

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[6] Sources: Anwar Shah (1995), *Fiscal Incentives for Investment and Innovation*. Oxford University Press; New York.

provide the solution. The economic case for the grant of tax incentives remains extremely weak while the case for a good public investment strategy strong.

In view of the above we recommend that the tax incentives through the provisions of Sections 80-IA and 80-IB should be deleted. Since the benefit of reduced tax rates will flow with immediate effect, the benefit of these provisions for the remaining unutilized period should be terminated even in the case of existing eligible taxpayers. In other words, if a taxpayer has availed of the tax concession for only six years, he should not be allowed of the benefit in the remaining four years.

(h) Widening of the base in respect of taxpayers deriving income from salaries

Under the Income tax Act, a taxpayer is allowed a deduction of a certain percentage of his salary income subject to a maximum amount as standard deduction in the computation of his salary income chargeable to income tax. This standard deduction is allowed in respect of expenditure incidental to the employment of the taxpayer. The evolution of this standard deduction is indicated in table IV.10 below**.**

Table IV.10

Assessment Year	Standard Deduction
Upto 1974-75	Any amount not exceeding Rs. 500, expended by the taxpayer on the purchase of books and other publications necessary for the purpose of his duties
1975-76 to 1980-81	In respect of the expenditure incidental to the employment of the taxpayer
1981-82	A standard deduction on a presumptive basis which is the least of, Rs 3500 or an amount calculated in the following manner: 20 percent of the salary if the salary does not exceed Rs.10000, Rs 2000 plus 10 percent of the amount by which the salary exceeds Rs.10000 if the salary exceeds Rs.10000
1982-83	A sum equal to twenty percent of the salary or Rs. 5000, whichever is less.
1983-84	A sum equal to twenty five percent of the salary or Rs. 5000,whichever is less.

1984-85	A sum equal to twenty five percent of the salary or Rs. 6000,whichever is less.
1987-88 to 1988-89	A sum equal to twenty five percent of the salary or Rs. 10000, whichever is less.
1989-90 to 1992-93	A sum equal to thirty-three and one-third percent of the salary or Rs. 12000, whichever is less.
1993-94	A sum equal to thirty-three and one-third percent of the salary or Rs. 12000, whichever is less. If the taxpayer is a woman, and her income from salary is Rs 75,000 or less, a deduction of a sum equal to thirty three and one-third percent of the salary or Rs.15,000, whichever is less.
1994-95 to 1996-97	A sum equal to thirty-three and one-third percent of the salary or Rs. 15000, whichever is less. If the taxpayer is a woman, and her income from salary is Rs 75,000 or less, a deduction of a sum equal to thirty three and one-third percent of the salary or Rs.18,000, whichever is less.
1997-98	For taxpayers whose income from salaries does not exceed Rs.60,000, a deduction of a sum equal to thirty three and one-third percent of the salary or Rs.18,000, whichever is less. For taxpayers whose income from salaries exceeds Rs.60,000 a deduction of a sum equal to thirty three and one-third percent of the salary or Rs.15,000, whichever is less. If the taxpayer is a woman, and her income from salary is Rs 75,000 or less, a deduction of a sum equal to thirty three and one-third percent of the salary or Rs.18,000, whichever is less.
1998-99	A deduction of a sum equal to thirty three and one-third percent of the salary or Rs.20000, whichever is less.
1999-2000 to 2001-2002	For taxpayers whose income from salaries does not exceed Rs.100,000, a deduction of a sum equal to thirty three and one-third percent of the salary or Rs.25,000, whichever is less. For taxpayers whose income from salaries exceeds Rs.100, 000 but does not exceed Rs.500, 000, a deduction of a sum equal to thirty three and one-third percent of the salary or Rs.25, 000, whichever is less. No deduction is allowed in cases where the salary exceeds Rs.500, 000.

As would be seen, the levels of standard deduction have increased substantially over the years both the percentage and the overall ceiling. It is difficult to accept that a salary taxpayer incurs as high as thirty three and one third percent of his salary income as expenditure incidental to his employment i.e. on books and other publications necessary to perform his duties. Experience and anecdotal information tells us that the expenditure on such items is generally less than five percent.

It is also well known that most employers provide extensive library facilities and reimbursement to senior employees for expenditure on books and periodicals. In fact in the Government, the expenditure by senior officers on newspapers is reimbursed. In the case of the corporate sector, the expenditure on newspapers and periodicals is an allowable business deduction without being treated as a perquisite in the hands of the employee.

In addition, in the case of most salaried taxpayers, the valuation of perquisites continues to be vexatious. Therefore, the taxable base for employees is substantially lower than the real base.

Further the provision of a standard deduction to salaried taxpayers over and above the basic exemption limit is iniquitous in as much as non-salaried taxpayers with similar level of income is subjected to a higher level of tax. It also encourages people to seek employment rather than be self-employed.

The present graded rates of standard deduction introduce complexity in the tax statute and therefore, impose additional burden on both the taxpayer and the tax administration.

In view of the above, we recommend that the standard deduction for salaried employees should be at a uniform rate of 10 percent of the salary subject to a maximum of Rs 5000. The ceiling of Rs. 5000, in effect, is the inflation-adjusted value of Rs.500 in assessment year 1974-75.This will reduce the inequity between the employed and the self-

employed and will also be revenue enhancing. The additional liability on this account will be more than met by the reduction in rates of personal income tax proposed by us.

While we recognize the need to rationalize the provisions relating to taxation of perquisites, we propose to make our recommendations on this aspect in our final report.

(i) Income from self-occupied house property

Upto assessment year 1986-87, the determination of the annual value of the owner occupied dwelling house involves three successive operations. Firstly, the annual value is determined in the manner as if the property were let out to tenants. The full municipal taxes payable are to be deducted in such computation. Secondly, the amount of annual value so determined was reduced by one-half of such value or Rs.3600, whichever is less. This deduction was commonly referred to as the allowance for new construction. Thirdly, if such balance exceeded 10 percent of the total income minus income from self-occupied property (but without deductions allowable under Chapter VI-A), the excess was to be disregarded. In other words, a notional annual value was imputed to the benefit flowing from self-occupation of the house property. Accordingly, full allowance by way of deduction was made for ground rent, repairs and maintenance, interest on borrowed capital and similar other items of expenditure.

However, from assessment year 1987-88, the notional annual value imputed to the benefit flowing from self-occupation of the house property is deemed to be nil. Accordingly, it was also provided that no deduction for the various items of expenditure would be allowed except a small amount of Rs. 5000 towards interest on borrowed capital. While non-deductibility of the various items of expenditure is consistent with the matching principle that expenditure relating to a particular item/source of income should be allowed only if the income is liable to tax in the economic/accounting sense, the allowability of interest expenditure upto Rs 5000 is a deviation from this principle. This is, therefore, in the nature of a tax subsidy. Such a tax subsidy is both iniquitous and inefficient. It is biased against self-financing and encourages borrowing. Further, since the deduction is income

based, it confers a substantially larger tax subsidy to a richer taxpayer. Similarly it also encourages a taxpayer to keep the property vacant rather than offer it in the property market for rent.

These problems have been further compounded by the increase in the ceiling from Rs 5000 to Rs. 100,000 in assessment year 2001-2002. The increase far exceeds the inflation during this period. In fact the existing level only benefit taxpayer in the higher tax brackets. A taxpayer in the lower tax bracket cannot afford to incur such a large interest liability and yet keep the house property under self-occupation. In fact given this tax subsidy, the effective interest rate on large loans for construction/purchase of houses is substantially lower for larger taxpayers relative to smaller taxpayers[7].

In view of the above, we recommend that the provisions relating to allowability of interest on capital borrowed for construction/purchase of a property, which is under self-occupation, should be deleted to rationalize the tax base.

4. Harmonization of Personal and Corporate Income Taxes

In most countries with income taxation, corporate entities are subject to tax on their profits and, in addition, dividends are taxed in the hands of shareholders (subject to exemption upto a point). The base of the corporate income tax, however, is commonly the accounting profits derived with reference to historical costs. Certain modifications are also often made by law to accounting profits to provide incentives for activities considered important for social and economic policies or to provide relief from inflation as well as to curb misuse of the corporate form to reduce personal tax liability.

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[7] Since the repayment capacity of smaller taxpayers is relatively less than that of the large taxpayers, the small taxpayers can have accessibility to relatively small amounts of loan.

Under a system of general income taxation, whether companies should be taxed independently as separate entitles has been the subject matter of prolonged debate among tax economists. One view is that since corporations are not persons, strictly speaking, there is no case in equity for taxing the profits of companies as such. The tax should be levied only on the owners, that is, the equity holders, by attributing the profits of the companies to the shareholders. Such a system, however, can operate smoothly only if all profits are distributed every year among the shareholders. Where part of the profits is retained, the gain to the shareholders accruing from appreciation in the value of equities escapes taxation unless there is an effective tax on realized capital gains or unless the undistributed profits are attributed notionally to the shareholders. This is not simple in the case of large corporations in which the shares undergo sale or transfer all the time.

Since capital gains are usually treated preferentially, even where the income tax is levied on capital gains, exclusion of retained profits of companies from taxation provides an easy way of avoiding taxation by accumulating profits under the corporate cover. Taxation on the basis of attribution also encounters problems in the determination of capital gains when the shares are transferred, as the cost basis has to be adjusted annually to take account of the notional distribution of accumulated profits underlying the capital gain. Besides, taxation on notional basis gives rise to liquidity problems and hence does not seem equitable or feasible. It is therefore generally accepted that some tax has to be levied on the profits of companies so long as individuals and unincorporated enterprises are subjected to tax on their profits.

Taxation of companies as separate entities is considered reasonable also on the ground that incorporation confers substantial benefits such as limited liability of shareholders, right to sue and be sued and so on. What is more, corporate taxation is an administratively simple device for taxing an important type of income from capital.

The system of taxation of companies independently of shareholders, however, causes misgivings as it tends to be iniquitous in that no discrimination is made between shareholders with varying incomes. Theoretically, the corporate income should be attributed to the shareholder and subjected to tax at the corresponding personal income

tax rate with credit for share of the corporate tax liability. This means that under no circumstances, the corporate tax liability should exceed the maximum marginal rate of personal income tax. Taxation of profits in the hands of the company and again in the hands of the shareholders without any relief for the tax paid by the company – "double taxation" – has been assailed also on efficiency grounds since, given the imperfections of the capital market and lack of perfect foresight on the part of equity holders, it creates a bias in favor of retention and thereby inhibits the flow of corporate surpluses into the capital market and thus, their efficient use. It also imparts a bias against equity capital by subjecting distributed profits to tax twice, apart from involving a discrimination against the corporate form of business organization. Hence attempts have been made to relieve the burden of double taxation through various devices, such as giving some credit to shareholders for the tax paid by companies or by taxing the distributed profits at a lower rate.

In India, corporations are taxed on their profits and dividends are taxed a second time in the hands of the corporation as distribution tax. However, no credit is given to the shareholders either for the corporate tax or distribution tax liability. The rate of distribution tax was increased from 10 percent with a add on surcharge of 10 percent to 20 percent plus a surcharge of 10 percent in the 2000-01 budget. This step exacerbated double taxation and has worsened the efficiency and equity characteristics of income taxation. Since the distribution tax is not attributed to the shareholders, the present scheme of taxation of dividends is particularly burdensome for foreign investors. They have to bear the addition burden of taxation of the dividend in their country of residence without being able to avail any credit paid by the corporation.

However, in view of the above, we recommend that the corporate tax rate should, under no circumstances, exceed the maximum marginal tax liability under the personal income tax (inclusive of surcharge). Accordingly, the existing corporate tax rate of 38.5 percent should be lowered to 30 percent in line with the recommendation made under the

personal income tax. This will also make the rate internationally more comparable.[8] If however, it is decided to retain the maximum marginal rate of tax at 35 percent, the corporate tax should also be reduced to 35 percent.

We also recommend the abolition of the distribution tax on dividends in view of our recommendation on MAT on companies in the following sections and the empirical analysis of the effective rate of corporate tax liability.

At present, the tax rate on foreign companies is 48 percent. Traditionally, this rate has been kept at 10-percentage point higher than the tax rate for domestic companies. This differential is maintained to recoup the potential loss on account of the non-declaration of dividends in India by foreign companies. Since we3 have proposed the abolition of dividend distribution tax, there will be no further justification for maintaining the differential. Accordingly, we also recommend that the tax rate for foreign companies be reduced to the level recommended for domestic companies i.e. to the level of 30 percent.

5. Presumptive Tax: A Minimum-Alternate-Tax (MAT) on Companies

a. Justification for Presumption

Presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on taxpayer accounts. The term "presumptive" is used to indicate that there is a legal presumption that the taxpayers' income is no less than the amount resulting from application of the indirect method. This presumption may or may not be rebuttable. The concept covers a wide variety of alternative means for determining the tax base, ranging from methods of reconstructing income based on

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8 The corporate rate of tax is 30 percent in China, South Africa, Thailand, Indonesia, 28 percent in South Korea and Malaysia and 35 percent in Argentina, Russian Federation and Sri Lanka. Developed countries also have a corporate tax rate in the range of 30 percent to 35 percent.

administrative practice, which can be rebutted by the taxpayer, to true minimum taxes with tax bases specified in legislation.

Generally, presumptive techniques are employed for a variety of reasons. **One** is simplification, particularly in relation to the comp0liance burden on taxpayers with very low turnover (and the corresponding administrative burden of auditing such taxpayers). A **second** is to combat tax avoidance or evasion (which works only if the indicators on which the presumption is based are more difficult to hide than those forming the basis for accounting records). **Third**, by providing objective indicators for tax assessment, presumptive methods may lead to a more equitable distribution of tax burden, when normal account based methods are unreliable because of problems of taxpayer compliance or administrative corruption. **Fourth**, rebuttable presumptions can encourage taxpayers to keep proper accounts, because they subject taxpayers to a possibly higher tax burden in the absence of such accounts. **Fifth**, presumptions of the exclusive type can be considered desirable because of their incentive effects – a taxpayer who earns more income will not have to pay more tax. **Finally**, presumptions that serve as minimum taxes may be justified by a combination of reasons (revenue needs, fairness concern, and political or technical difficulty in addressing certain problems directly as opposed to doing so through a minimum tax).

Presumptive methods can be rebuttable or irrebuttable. **Rebuttable methods** are those under which the income presumptions can be rebutted, if taxpayers can prove that their actual income was lower than the presumed income. Rebuttable methods include administrative approaches to reconstructing the taxpayers income, and may or may not be specifically described in the statute. If the taxpayer disagrees with the result reached, the taxpayer can appeal by proving that his or her actual income, calculated under the normal tax accounting rules, was less than that calculated under the presumptive method. Irrebuttable methods are those under which the presumptions are irrebuttable, which means that the taxpayer is not allowed to claim (and prove) that his actual income was lower than the presumptive income. Therefore, the irrebuttable presumptive assessments

should be specified in the statute or in delegated legislation. Because they are legally binding, they must be defined precisely.

Irrebuttable presumptions can be divided into two types: **minimum tax and an exclusive tax.** A minimum tax is a floor revenue contribution from the largest potential taxpayers, generally corporate, who are best placed to exploit loopholes. This floor revenue is determined on a 'desired' base for taxation, which is not itself measured but is inferred from simple indicators which are more easily measured than the base itself. In other words, the tax liability is no less than that determined under the presumptive rules. The minimum alternate tax (MAT) on companies in India is, therefore, only one of the many forms of presumptive tax.

Under the exclusive tax, the tax liability is determined under presumption alone, even if the regular rules might lead to a higher liability. An example is a tax on agricultural income based on the value of land, with no reference to actual crop experience for the year.

Exclusive presumptions are administratively simpler than presumptions of the minimum tax type, because minimum tax presumptions require two tax bases to be calculated and compared. While exclusive presumptions have the advantage of simplicity and minimal disincentive effects, they suffer from a lack of equity. Taxpayers with substantially differing amounts of actual income must pay the same amount of tax if their presumptive tax base is the same. A large number of countries have introduced minimum tax on companies in some form or the other.

b. Rationale for MAT

Corporate tax legislation all over the world, no matter how streamlined at the outset, acquires an adhesive accretion of special concessions and provisions over time because the corporate sector constitutes a focused interest group with financial backing. A secondary interest group develops, in the form of tax planners skilled in the art of tax

minimization within the framework of what is legally permissible. Profit-making zero tax companies are a worldwide phenomenon. An indirect attack from the flank through presumptive taxation may succeed where a direct attempt to expunge special concessions may fail, and serves also to plug evasion, which is possible and does occur even at the upper end of the business spectrum. An example is transfer pricing by multinationals to take advantage of cross country differences in corporate tax rates; it is far easier to put a floor on such practices through presumption than to attempt a direct attach through construction of arm's length prices.

One of the main reasons for erosion of the tax base is the provision relating to accelerated rate of depreciation for general category of machineries on their written down value. The rate is determined on the basis of estimated replacement cost which in turn is related to the economic life of the asset and the inflationary increase in the cost of the asset over its life cycle. For administrative ease, most assets are lumped together as a block and depreciation allowed at the general rate. In effect the depreciation is neither related to the true economic life of the asset nor to the asset specific inflation in the cost of the asset. As a result the depreciation allowance becomes too generous – often substantially greater than the allowance under commercial accounting, resulting in a total erosion of the tax base – giving rise to the phenomenon of zero tax companies. Such companies result in imposing a relatively higher marginal rate of corporate tax on other companies to raise a given amount of tax revenues. The higher is the marginal rate of tax, the greater is the distortion in the economic behaviour. Therefore, a minimum alternate tax at the average tax liability across taxpayers (which is generally lower than the marginal rate of tax) enables to keep the marginal tax rate low and therefore minimize distortions. Further, the existence of zero tax companies is inequitous in as much as a company with relatively higher real income bears a lower tax burden.

Excessive depreciation allowance also results in overcapitalization. It encourages mergers and amalgamations often not justified on economic grounds. To the extent depreciation allowance provides tax shield, it distorts private investment behaviour. The distortion is further exacerbated if the allowance is generous. Allowing depreciation on

replacement cost is tantamount to adjusting for inflation in the cost of the assets. Since none of the other heads of income and expenditure is adjusted for inflation, it is biased against investment in sectors where the amount of fixed assets is relatively low (e.g. the services sector). Therefore, a measure designed for administrative ease and compliance generates inefficiency and inequity in the system. Hence, the need to restrict the adverse consequences without sacrificing simplicity. The minimum alternate tax (MAT) fulfills this need.

A tax on profits is subject to wide fluctuations depending upon the fortune of companies. As a result the flow of revenues to the exchequer is disrupted and the government has to resort to ad-hoc discretionary measures. Such changes in the tax laws build up expectations that have a dampening effect on investment decisions. A minimum alternate tax provides the necessary stability.

A variety of economic bases and methods of calculation is used to provide presumption of income. For example, certain presumptions are based exclusively on the taxpayers' net wealth or on the value of the assets used in his business. Others are based on the gross receipts of the enterprise. Still others are based on visible signs of wealth. Standard assessment methods use several key factors and indices of profitability, which vary by activity, to determine the taxpayer's income.

A presumptive tax that is used in lieu of the corporate tax on net profits is a tax on gross receipts. Such a tax avoids the difficulties of measuring such sophisticated concepts as depreciation in calculating net profit. This tax has been found to be effective in terms of revenue yield and ease of administration. Francophone African countries have been pioneers in the establishment of minimum corporate income taxes. This tax can be credited against the regular corporate tax, but no refunds are allowed if the minimum tax exceeds the corporate tax. The minimum tax based on gross receipts is equivalent to a simple presumption of income. For example, if the corporate tax rate in a country that applies this system is equal to 40 percent of net profits and the minimum tax is equal to 1 per cent of gross receipts, authorities are acting as if all corporations earn a

minimum net taxable income equal to 2.5 percent of their gross receipts. As an example outside Africa, in 1983 Colombia established a general presumption of net income based on gross receipts, applicable to all taxpayers, individual and corporate, except those whose main sources of income are wages and salaries. The law presumes that net income amounts to at least 2 percent of gross receipts.

The presumptions based on gross receipts are not a panacea for tax administrations attempting to improve taxpayer compliance. In most developing countries concealment of gross receipts is a favoured method of tax evasion. Presumptions of income based on gross receipts thus mainly affect taxpayers who cannot easily conceal gross receipts (e.g. large corporations). As a result of such presumptions, corporations with genuine losses are treated in the same manner as corporations that artificially reduce their profits by such methods as manipulating transfer prices. All corporations with the same turnover pay the same tax. For smaller enterprises that have previously concealed a portion of their gross receipts and continue to do so, the introduction of a presumption of net income based on turnover is of little consequence and has no material effect on their tax liability.

The income tax legislation of several countries includes presumptions of income based on visible signs of wealth. These presumptions apply only to individuals. In some countries, such as Brazil and Peru, the tax department is empowered, in somewhat general terms, to presume income higher than those reported by taxpayers on the basis of visible signs of wealth. It is left to the administration to decide which signs of wealth to use and what level of income to attach to them. In other countries, including France, Italy and several francophone African countries, presumption based on visible signs of wealth are carefully specified in the Income Tax Act. The signs of wealth that must be considered are described and each is assigned an income equivalent. Such signs of wealth usually include the taxpayer's main and secondary residences, number of domestic servants, automobiles, yachts, private planes and race horses.

In practice, presumptions based on visible signs of wealth have proved difficult to apply. When they are established in general terms, tax administrators are hard pressed to decide which signs of wealth to use as a basis for the presumption and how to establish the income equivalent of each. In those countries in which both the signs of wealth and their income equivalent have been specified in the statute, the inflexibility of the provisions may lead to considerable unfairness. Recognizing these problems, tax departments tend to apply these presumptions cautiously and only when additional assessments cannot be supported by other means. One of the areas in which such presumptions have proved useful is in supporting assessments on illegal incomes, such as those derived from racketeering and drug trafficking.

Several countries, including Argentina, Colombia, Mexico, and Venezuala, have adopted minimum taxes based on a fixed percentage of the assets of a business. The economic rationale for the assets tax is that investors can expect ex-ante to earn a specified average rate of return on their assets.[9] A minimum asset-based levy on corporations or individuals with offset against actual income tax involves presumption by definition, since it as a minimum, carries an efficiency incentive. Until the prescribed benchmark rate of return is attained, the incremental tax on income actuals is zero. Firms or individuals introduces a partial hiatus between tax liability and income actuals. A presumptive levy, even earning rates of return on assets below the minimum presumed pay an implicit tax on income actuals at a rate higher than the prevailing corporate income tax rate, which increases the greater the performance shortfall. In Bolivia, such a tax replaced for a time the corporate income tax; that is, it was an exclusive presumption. The tax base varies from gross assets (Argentina) to net assets – assets minus debts (Colombia) – with the Mexican tax taking a middle position whereby certain debts are deductible. Of course, such taxation could be considered unfair because the ex-post return will differ from what was expected. Moreover, the minimum asset tax can discourage risky investments under circumstances where it denies the taxpayer the benefits of carrying over the losses resulting from the investment. Similarly the asset tax may not be desirable in countries, which have a large number of sick public sector

[9] This discussion on international experience is based on…………………(19…..).

companies. In such cases, the institutional and structural rigidities in the economy inhibit free exit. Given the fact that most adversely affected by this would be the sick public sector companies such a tax would pose serious problems of cash flow and aggravate the problem of recovery. The unpaid tax liability could inhibit privatization.

Whatever be the choice of the measure for MAT there are clearly two requirements for the revenue success, in terms of total corporate collections, of a MAT. First, the threshold minimum presumptive income should be such that, when expressed as a rate of return on corporate assets, it must be proximate to the average pre-levy rate of corporate return. In other words, the threshold minimum rate of return on assets must be near enough to, preferably at, the average pre-levy rate of corporate return, to serve as an adequate efficiency incentive. Secondly, the design or administration of the tax has to carry an incentive for accurate reporting of actual income by providing for a carry forward provision. This preserves the incentive for accurate reporting, although perhaps less effectively for companies which expect to perform consistently at or above the presumptive threshold.

c. Nature and Proposed Changes in the Indian MAT

The direct tax system in India is characterized by a whole set of tax incentives. These incentives have the effect of greatly reducing the tax base. The existing tax incentives generate misallocations of resources both within and between branches of industry. Ideally one would like to start with a clean slate, and introduce a tax system that was, insofar as possible, neutral as among the affected activities. The existing incentives stand in the way of achieving greater neutrality, and are particularly troublesome because of the great variety of provisions. Given the fact of the distortions represented by existing incentives, the idea of a minimum tax has great appeal and therefore the same was first introduced as section 115J in the scheme of corporate taxation by the Finance Act, 1987. Although not presumptive in design the intent of computing minimum taxable income at 30 percent of book profits was to combat base erosion through avoidance. The "book-profit" was defined as commercial profits subject

to specified adjustments. Reflecting an income tax rate of 50 percent, the minimum tax liability was fixed at 15 per cent of the book profit. However, the provision was deleted after a brief life by the Finance Act, 1990 ostensibly for the reason that a large number of incentives including the investment allowance had been withdrawn from the statute.

With the withdrawal of the MAT in 1990, the phenomenon of zero tax companies continued and in 1996, it was once again considered necessary to re-introduce the MAT as section 115J through the Finance Act, 1996. The base was larger than the one in the erstwhile provision in as much as profits on foreign exchange earnings were not exempted. However, under intense pressure from business interest groups, the exemption was introduced in the subsequent year along with the provision for carry forward and set off of excess of MAT liability over "actual" liability against any excess of 'actual' liability over the MAT liability in the subsequent five years. Since then the law has been amended bythe Finance Act, 2000 to introduce section 115JB, which provides for a minimum tax of 7.5 percent of the book profit (defined as the commercial profits). A major shortcoming of the MAT provisions is the fact that it continues to be based on the reported income unmindful of the widely prevalent practice of under reporting. Therefore, these provisions are based on a weak foundation and fail to serve the very objective, which it intended to achieve.

While there has been a drastic cut in corporate tax rates since 1987, incentive provisions continue to exist on the statute. Hence, the effective rate of corporate tax is considerably lower than the statutory rate of 38.5 percent. Empirical analysis of the financial results of 1293 profit making companies out of a sample of 1816 companies effective corporate tax rate for the year ending 31st march 2000 is summarized in **Table IV.11.** The effective tax liability of the profit making companies under the corporate tax regime prevailing in assessment year 2000-2001 is only 25.95 percent of the profits before tax and 0.91 percent of the net worth. Contrast this with the statutory corporate tax rate of 38.5 percent and the erosion of the tax base due to incentives becomes too obvious. However, with the change in the scheme of MAT and the increase in the dividend distribution tax through the Union Budget, 2000, the effective rates have

increased to 28.15 percent and 0.99 percent of profits before tax and net worth, respectively. For assessment year 2001-2002 (financial year 2000-2001). Inspite of this increase, it continues to remain far below the statutory corporate tax rate of 38.5 percent. The new provisions of MAT do not fully resolve the problem of the gap between the statutory tax rate and the effective tax liability. Hence the need for further improvement in MAT.

Experience has shown that book profit, despite the definition in the statute, is easily manipulated insofar as it is amenable to accounting changes/practices and subject to the existing tax incentives. The base of the minimum tax should be chosen so as to provide a plausible estimate of the taxable capacity of the company, reflected comprehensively in the ability to earn (designed to successfully average its ability to pay). The base to which the minimum tax would apply must therefore be something other than income. For example, total assets, fixed assets, total sales and net worth are possible alternatives. Of these, net worth is conceptually the closest to that of income. Thus, there arises the likelihood that a minimum tax based on sales would sharply discriminate against services and one based on total assets would work sharply against the financial sector (for example, banks) and heavy industry (for example, steel and

Table IV.11

Effective Tax Liability under Alternative Corporate tax Regimes*

Assessment Year	Tax Regime			Corporate tax Liability		Total tax Liability (incl. Dividend tax)	
	Corporate Tax		Dividend Tax	as %age of PBT	as %age of Net Worth	as %age of PBT	as %age of Net Worth
	Rate	MAT	Rate				
2000-2001	38.5 percent	30 percent of book profit as minimum income	11 percent	23.64	0.83	25.95	0.91
2001-2002	38.5 percent	7.5 percent of book profit as minimum tax	22 percent	24.22	0.85	28.15	0.99
Plan-I (2002-2003)	35 percent	7.5 percent of book profit as minimum tax	22 percent	22.10	0.71	25.68	0.82
Plan-II (2002-2003)	30 percent	7.5 percent of book profit as minimum tax	22 percent	19.08	0.61	22.66	0.72
Plan-III (2002-2003)	30 percent	Sum of 0.75 percent of net worth and 10 percent of dividend distributed, as minimum tax	NIL	31.08	1.09	31.08	1.09

* The estimates relate to 1293 profit makinf companies out of the sample of 1816 companies

Source: Group's calculations based on CMIE data of Companies for the year ending 31st march 2000

aluminium). The variability of any one measure as an appropriate base for a minimum tax suggests that the use of some combination might be preferable. A combination of both stock and flow components could comprise such a measure. This combination could be, say, 1 percent of the net worth at the end of the year plus 10 percent of the dividend distributed. This minimum tax could be allowed to be carried forward for set off against future liability in excess of the minimum tax.

This combination is both economically efficient and equitous. It carries an efficiency incentive as in the case of the gross assets tax since it is closely linked to the minimum presumed rate of return on the owner's capital. The incremental tax under this method on actual income is zero until the minimum presumed rate of return is reached. The greater the performance shortfall, the greater is the excess of the implicit tax rate on income actual over the prevailing corporate tax rate.

Since the design provides for offset against MAT payable in years other than the current year, it serves three basic functions. It provides legal protection against the charge that the levy is unrelated to the ability to pay. Secondly, it mitigates the severity of the levy since it would grant relief in the years when it is most needed. Thirdly, it provides an incentive for the accurate reporting of returns even in years where actuals exceed the minimum threshold. Therefore, the method is also inter-temporally efficient.

The method is neutral between retained earnings and dividend distribution. To the extent dividends are distributed, they suffer a higher rate of tax in the year of distribution. If the company chooses to retain its earnings it will be penalized by the capital market and still end up paying tax on it since it would result in an accretion to the net worth. Even though the rate of tax on the net worth is substantially low, the discounted future liability is almost equivalent to the present liability on dividends. Thus both consumption and unproductive savings will be penalized.

Another consequence of the proposed method is its impact on equity. Since depreciation is an allowable deduction in the computation of taxable income, the

company benefits from the tax shield that it provides. Therefore, there is an inherent bias in favour of the manufacturing sector vis-à-vis the services sector. Since the benefit from tax shield will either be distributed or retained within the company and both suffer taxation, under this method it helps reduce the bias against the services sector.

The combined measure of stock and flow as a base is also substantially unaffected by inflation. To the extent the value of net worth is eroded by inflation, the real tax loss is partly compensated by the capital gains tax paid by shareholders. Further, if the assets are revalued periodically, the increase in their value is reflected in an increase in the net worth. If a company chooses otherwise, it will end up paying a substantially larger liability on liquidation.

We therefore recommend that a minimum tax on corporations be continued to be levied. However, the base of the MAT should be changed from book profit to a combination of net worth and dividend distributed. We recommend the minimum alternate tax on corporation should be a tax equal to the aggregate of **0.75** percent of adjusted net worth and **10** percent of dividend distributed. In view of the base for MAT recommended, there would not be any separate tax on dividend distributed by the companies. The adjusted net worth for tax purposes would be the capital employed by the company. The definition of capital employed would be the same as was in the case of section 80J of the Income Tax Act. The minimum tax should continue to allow carry forward and set off against future income tax liability, as provided in section 115JAA of the Income Tax Act. To facilitate the multinationals to avail of tax credit in the country of their origin, the income tax paid by the company should be allowed to be credited against the MAT liability (and not the other way round). However, no refund should be granted if the MAT liability is less than the income tax liability. Our choice of the definition of adjusted net worth is influenced by the consideration of administrative ease. Several judicial pronouncements (including judgments by the apex court) exist on the definition of capital employed and, therefore, would serve well to both taxpayers and the administration. If a pronouncement is not really acceptable, the definition could be suitably amended.

An analysis of the distributional effect of Corporate tax reform (reduction in corporate tax rate, change in the base for MAT and the abolition of dividend distribution tax) based on the financial results of a sample of 1816 companies (including 523 loss making companies) for the year ending 31st march 2000, is summarized in **Table IV.12.** As would be evident there would be a substantial increase in the effective tax liability; from 33.89 percent to 39.92 percent of the profits before tax and 0.90 percent to 1.06 percent of net worth. The contribution of these companies (assuming there financial performance for the year 1999-2000 will continue) to corporate tax will increase from Rupees 16532 crores to Rupees 19474 crores registering an increase of 17.8 percent. The bulk of the increase in tax liability would be at the lower end; at present 523 loss making companies having a net worth of Rupees 163724 crores contribute only 0.03 percent of their net worth to corporate tax. Their liability will increase to 0.76 percent of their net worth but would continue to be lower than the average liability of the corporate sector. This will induce these loss making companies to improve their efficiency and financial performance or in the alternative release the economic assets which they have been holding. Similarly, the tax liability of top twenty companies whose profits before tax is greater than Rupees 500 crores would remain unchanged inspite of the reduction in the corporate tax rates and the abolition of the tax on dividend distribution. Their liability would continue to be relatively higher than the average liability.

The additional revenue gain from the redesigning of the existing MAT on companies is estimated to be Rs. 7000 crores after adjusting for tax loss on the abolition of dividend tax. In the long run, the revenue impact of the MAT is through the buoyancy it imparts to collections under the conventional corporate tax, resulting from the efficiency and accurate reporting incentives, rather than in terms of direct collections under the MAT head which, especially in the presence of carry forward, can be a very small part of the total. It is important to stress this, because the low share of MAT collections in the total can easily become a wrong argument for deleting it, which should be resisted at all cost by the authorities.

Table IV.12: Distributional Effect of Corporate tax Reform

Profits Before Tax (PBT)	Number of Companies	Total Profits before tax (TPBT)	Total Net Worth (TNW)	Total tax Liability (incl. Dividend tax)		Total tax Liability (incl. Dividend tax)as percentage of TPBT		Total tax Liability (incl. Dividend tax)as percentage of TNW	
				Existing	Proposed	Existing	Proposed	Existing	Proposed
(in Rs crores)		(in Rs crores)	(in Rs crores)	(in Rs crores)	(in Rs crores)				
PBT<=0	**523**	**-9952.27**	**163723.55**	**41.16**	**1239.90**	**-0.41**	**-12.46**	**0.03**	**0.76**
0<PBT<=1crs	**345**	**121.15**	**7998.73**	**29.26**	**67.86**	**24.15**	**56.01**	**0.37**	**0.85**
1crs<PBT<=5crs	**365**	**900.02**	**28509.01**	**225.00**	**271.76**	**25.00**	**30.19**	**0.79**	**0.95**
5crs<PBT<=10crs	**150**	**1071.85**	**23373.61**	**262.88**	**268.09**	**24.53**	**25.01**	**1.12**	**1.15**
10crs<PBT<=50crs	**273**	**6261.90**	**183320.30**	**1545.33**	**1904.34**	**24.68**	**30.41**	**0.84**	**1.04**
50crs<PBT<=100crs	**68**	**4909.93**	**170151.60**	**1195.12**	**1612.93**	**24.34**	**32.85**	**0.70**	**0.95**
100crs<PBT<=500crs	**72**	**15511.86**	**557121.46**	**4373.71**	**5248.51**	**28.20**	**33.84**	**0.79**	**0.94**
Greater than 500crs	**20**	**29958.05**	**701516.51**	**8859.20**	**8860.17**	**29.57**	**29.58**	**1.26**	**1.26**
Total	**1816**	**48782.49**	**1835714.77**	**16531.66**	**19473.55**	**33.89**	**39.92**	**0.90**	**1.06**

Source: Author's calculations based on CMIE data of Companies for the year ending 31st march 2000

6. Expansion of Base Through Streamlining Tax Concessions and Trusts/Institutions[10]

A large number of countries provide for tax concessions for charitable donations. There are two theoretical justifications for this. First is the familiar notion that the activities charity finances are not private in the strict sense. Contributions to social and educational organisations not only benefit the donors but others. In other words, these donations create positive externalities. Second, this tax concession allows the flourishing of many non-profit organisations (NPOs) which, in turn, mitigates government's inability to provide adequate amounts and range of public goods.

a. Rationale for Tax Concessions and Role of NPOs

The major effect of tax concessions for charitable contributions is through the tax-price. The tax-price is defined as unity for those who do not itemize deductions from income when calculating taxes and one minus the marginal tax rate for those who itemize their deductions. An increase in marginal tax rates lowers the "price" of giving and therefore may increase contributions. How much they increase will depend upon the price elasticity of giving, defined as the percent change in contributions caused by a one percent change in the price. If this elasticity is greater than unity then allowing a tax deduction for contributions is "efficient" in the sense that less is lost to the exchequer than is gained by charities through increased contributions. Moreover, tax concessions for charitable contributions have "equity" implications, depending upon the magnitude of price and income elasticity of donations across income groups. Empirical analysis reveals that tax concessions for charity have been efficient. However, price elasticities are higher in higher income groups implying serious equity implications.

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[10] This note draws heavily on the report *An Analysis of Tax Concessions for Charitable Contributions and Trusts/Institutions* (NIPFP, October 2000) prepared by Arbind Modi and Hiranya Mukhopadhyay.

Two main characteristics of NPOs are as follows:

(i) **Public benefit purpose:** The first characteristic is that the organisation operates *primarily* for some purpose other than private gain. The emphasis here is not on avoiding the generation of *profit* (in the sense of an excess of revenues from all sources over expenses of all types), but rather on the existence of a substantial *public benefit purpose*. This is often referred to as the "principal purpose" test.

(ii) **Non-distribution of surplus:** It is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees. This characteristic is popularly referred to in the literature as the "**non-distribution constraint**".

The proliferation of NPOs in certain areas of activity and not in others can be explained by numerous factors. Some important factors are described below.

(i) **Response to government failure** (Public Goods argument): In a democracy, which makes choices by voting, a significant proportion of the population believes that the level of public services is too low. As a consequence, some of the dissatisfied people make charitable contributions to private organisations willing to produce incremental units of the collective goods or services. In effect, the NPOs are mainly **conduits** that efficiently convert donations into services demanded by donors.

(ii) **Response to contract failure**: Subject to certain conditions, profit-seeking firms will supply goods and services at the quantity and price that represent maximum social efficiency. Among the most important of these conditions is that consumers can, without undue cost or effort, (a) make a reasonably accurate comparison of the products and prices of different firms before any purchase is made, (b) reach a clear agreement with the chosen firm concerning the goods or services that the

firm is to provide and the price to be paid, and (c) determine subsequently whether the firm complied with the resulting agreement and obtain redress if it did not. In many cases these requirements are reasonably well satisfied. However, either because of the circumstances under which the product is purchased and consumed or to the nature of the product itself, consumers may be incapable of accurately evaluating the goods promised or delivered. As a result, they will find it difficult to locate the best bargain in the first place or to enforce their bargain once made. In such circumstances, market competition may well provide insufficient discipline for a profit-seeking producer; the producer will have the capacity to charge excessive prices for inferior goods. As a consequence, consumer welfare will suffer considerably.

NPOs are granted exemption because they have no income/profit in the sense in which that term is used in tax laws. It is argued that any effort to use ordinary tax accounting to define taxable income for an NPO leads to complications. The concept of taxable income developed for business organisations simply cannot be carried over to NPOs in any meaningful way. However, these difficulties are often overstated. To begin with, many NPOs derive all or nearly all of their income from sales of goods or services that they produce. For such organisations it would be possible to use the same tax accounting that is applied to business firms, i.e. taking receipts from sales as the measure of gross income and permitting the usual deductions for expenses incurred in producing the goods or services sold. The resulting net earnings figure could be taxed just as in the case of a business firm.

Another argument against taxing the income of NPOs is that, in the long run, NPOs will necessarily have no net profits, since, by virtue of the non-distribution constraint, they must ultimately spend all of their income for the purposes for which they were formed, and hence their total expenses must ultimately equal their total income. The strength of this argument depends on several factors, including the detailed accounting conventions employed.

Tax exemption serves to compensate NPOs for the difficulties that they have in raising capital, and such a capital subsidy can promote efficiency when employed in those industries in which non-profit firms serve consumers better than their for-profit counterparts. This is an efficiency rationale for exemption. NPOs lack access to equity capital since, by virtue of the non-distribution constraint; they cannot issue ownership shares that give their holders a simultaneous right to participate in both net earnings and control. Consequently, in raising capital, NPOs are limited to three sources: debt, donations, and retained earnings. These three sources may, in many cases, prove inadequate to provide an NPO with all of the capital that it needs.

It is argued that if tax exemption is to be administered, three conditions should be satisfied before exemption is granted to an NPO in a given industry:

1. Non-profit firms in the industry must not have expanded to the point at which the productivity of the capital they employ is lower than the before-tax rate of return being earned on capital in other industries. This is known as the technical efficiency criteria.

2. From the consumers' viewpoint, non-profit firms must be more efficient producers of the service than the firms motivated by profits because of contract failure. This is known as the economic efficiency criteria. And

3. The non-profit firm should be able to generate investible funds through internal sources.

As a practical matter, it is not feasible to condition tax exemption for NPOs on the basis of the tax administration's judgement as to whether capital investment among non-profit firms in particular industries has exceeded the efficient level. Such a criterion would be extremely difficult to administer. Consequently, the best that can be done in this area is to focus primarily on the last two criteria.

b. Modifications Needed in India

In India, the various provisions of the Income Tax Act 1961 provide for numerous exemptions to NPOs distinguished on the basis of their respective areas of operation. Appendix Table IV.3 lists various tax concessions. Sections 10(23C)(i) to (iii a) and sections 10(23C)(iii ab) to (iii ae) do not impose any kind of non-distribution constraint and therefore are clearly designed inefficiently. These provisions are also inequitable in as much as the NPOs enjoying exemption under these provisions [except sections 10(23C)(i) to (iii a)] co-exist with for-profit organisations in their respective areas of operations.

The design of the provisions of sections 11 to 13 is clearly intended to meet the efficiency criteria for NPOs. These provisions provide for restrictions on the distribution of any part of the income to settlers/owners/trustees and on self-indulgence by managers. However, the provisions confer inequitable benefits in so far as the exemption is enjoyed by NPOs which compete with for-profit firms in their areas of operation, as is generally the case.

There is considerable overlapping of the provisions of sections 11 to 13 and sections 10(23C)(iv) to (vi a) in the sense that non-profit organisations covered under the latter provisions are also eligible for exemption under the former without subjecting themselves to the guidelines of the distributions constraint or accumulation constraint or the compliance burden of having to file annual tax returns. Therefore, the existence of two separate sets of exemption provisions for the same organisation is inequitable. Clearly, there is a case for uniformity in the designing of the two provisions.

Revenue loss under section 80G, which allows deduction for charitable donations to pre-specified organisations, for the financial year 1996-97 (assessment year 1997-98), directly available from the All India Income Tax Statistic, is estimated to be Rs. 715 crores, i.e., about 2 percent of direct tax collection. An indirect estimate has also been made to work out the revenue-foregone figure arising from exempt income of charitable

trusts/institutions. By applying the direct tax to non-exempt GDP ratio of 4.29 percent in the economy as a whole to the GDP from health, education and religious activities during 1996-97, the revenue foregone is estimated to be Rs. 2216 crores. Therefore, total revenue foregone on these two accounts is almost Rs. 3000 crores, which is 8.15 percent of total direct tax revenue, and 0.23 percent of aggregate GDP. Applying this proportion on the GDP for 1999-2000, total revenue foregone is estimated to be Rs. 4417 crores. Of which roughly Rs. 110 crores (2 percent of direct tax revenue) could be attributed to Section 80G and the balance Rs. 3317 crores on account of exemption to NPOs. The revenue foregone in 2000-01 could be as high as Rs. 5750 crores.

The present system, under which donations are deducted from gross income, have been empirically found to be efficient because the revenue loss is likely to be less than exemption induced total donation. However, since price elasticity varies across income groups, the provisions are inequitous. The existing provisions produce tax subsidies that increase with income. Therefore, the simplest alternative is to provide for a tax credit, which reduces the income tax liability of the donor by a designated proportion of his contributions. This could be set by the legislature at the minimum marginal rate of tax of 10 percent on equity considerations. There is also no compelling reason to set a quantitative limit either in absolute terms or as a fraction of the gross income, as is presently set under section 80G.

Given the current scheme of tax exemption for NPOs under the Income Tax Act, both donative and commercial NPOs can, and do, avail of the benefit even though there is no justification in the case of commercial NPOs. Therefore the law should be amended to provide the tax exemption only to donative NPOs. Further, to avoid any controversy on the definition of a donative NPO, it is recommended that the same may be defined as one where 90 percent of the annual receipts is through donations (including lump-sum aid unrelated to any specific activity/project). The corpus donations should be treated as receipts in the year in which it is received. Consequently, it would not be necessary to impose any further conditions on the nature and purpose of their business activity.

Further all provisions should be brought under one section with explicit non-distributional constraint and uniform compliance requirements/burden.

7. Issues in Direct Tax Administration

a. Role and Problems Facing tax Administration

In the most ideal law-abiding society, people would pay the taxes they owe, and tax administration would amount to little more than the provision of facilities for citizens to discharge this responsibility. No such country exists, or is ever likely to exist. Further, resources available with the tax administration are limited and therefore no tax administration can play the role of a policeman for every potential taxpayer. Hence, compliance with tax laws must be created, cultivated, monitored and enforced. A responsible tax administration must be effective and efficient in this task.

Effective tax administration requires establishing an environment, in which citizens are induced to comply with tax laws voluntarily. People would comply with the tax laws so long as they feel that non-compliance may cost more, that is, that the penalties likely to be suffered in case evasion is detected exceed the tax to be paid. Compliance is unlikely to be high if the belief prevails that evasion can be practiced with impunity. The free-rider instinct is universal and an element of coercion seems inherent. How effectively the tax administration can foster compliance would depend ultimately upon their perceived ability to detect and bring tax offenders to book, namely, unregistered taxpayers, stop filers, tax evaders and delinquent taxpayers. The tax administration must deal with all these categories of taxpayers simultaneously; otherwise non-compliance will shift to the gap where the administration exercises weaker control.

Efficient tax administration requires that its task be performed at minimum cost to the community. Tax systems all over the world have, therefore, tended to move towards regimes in which taxpayers themselves determine and report—in other words, 'self-assess'—their tax liability and pay the amount due without any special prodding from tax

authorities. But self assessment will result in high compliance only if accompanied by (i) action of the tax administration that lend credibility to the sanctions prescribed in the law against non-compliance and (ii) quality service to taxpayers.

Therefore, the functions of the tax administration are (1) to detect and penalize non-compliance; and (2) to facilitate voluntary compliance through the provision of quality taxpayers' service. These functions comprise the following separable component activities:

a) Taxpayers' education and service
b) Collection of information
c) Collation of information
d) Dissemination of information
e) Storage and retrieval of information
f) Verification (appraisal/assessment of information)
g) Collection of taxes
h) Taxpayers' grievances redressal system.

Each of these activities must create the synergies for an efficient and effective tax administration which assists the taxpayers to comply with his obligations and persuades him to continue to improve his compliance, mainly because he is aware that the administration is capable of detecting his non-compliance. For this purpose, the tax administration must be able to coordinate and adapt in time the organizational structure and its resources.

Traditionally, the role of the tax administration has been to enforce the tax laws and provide at least minimal taxpayer service. This was understandable in the context of a small potential taxpayer base and the then prevalent practice of administrative assessment. Over time, as the taxpayer base expanded and the scheme of self-assessment introduced, it became necessary for the tax administration to also facilitate compliance through the provision of quality taxpayer service. In most developing countries this shift in role focus is suspiciously viewed as abandonment of its traditional role of enforcement

and softening of the tax administration. Most employees unable to reconcile to their new role continue to resist this shift in the role perception from an enforcement officer to a facilitator.

Tax evaders in most countries, particularly developing countries, can be classified into two categories. The first category relates to those who fail to comply because of information asymmetry (lack of information) and the tax administration's failure to provide this information. Recourse to private sources (tax practitioners) for information entails a relatively high compliance burden. These evaders are sitting ducks for the tax administration and entail a high administrative burden if pursued individually. The second category relates to those who refuse to comply because of deficiencies in the taxpayers information system and supporting institutional setup. Therefore, these also exist because of information asymmetry (lack of information with taxpayers). The compliance burden in this category is relatively low. The first category constitutes the majority of tax evaders but account for a relatively small proportion of taxes evaded. The existence of the first category of evaders creates a general climate of non-compliance. Tax evasion being contagious it spreads wildly. Since the second category is hard to nab and the first category is a sitting duck, the tax administration tends to prey on the first category for easy success. The second category continues to thrive under the umbrella of the first category. It is, therefore, efficient for the tax administration to provide quality taxpayer service and reduce the size of the first category. The limited resources hitherto deployed in the pursuit of the first category could be substantially released and redeployed to the task of tackling the second category.

b. Problems Facing the Taxpayer

The provision of quality taxpayer service must therefore be directed towards provision of information on when and how to comply. A taxpayer has the statutory responsibility to comply with the requirements of the tax laws by specified dates. Often these dates need to be reminded since they vary depending upon the nature of the statutory responsibility. For example the due date for filing tax return in the case of a

salaried employee is 30th June while the statutory date for payment of first installment of advance tax is 15th September. Similarly, the taxpayer needs to be informed about how to comply. For example, what does a taxpayer have do to comply, how does he obtain a tax return and how does he fill up the tax return (since he may not have information on what is the tax law). The taxpayer needs to know various other similar issues, which need to be addressed by the tax administration. More often than not, a common refrain has been the non-availability of tax return forms. The genesis of this problem seems to be the government rule that all tax return forms must be printed in Government press. The cost to the exchequer for sustaining the public sector printing press is extremely high in as much as it creates a poor public image of the tax administration and an excuse for taxpayers at the margin to shirk their filing obligations. The tax administration has to then follow up such non-compliance with notices thereby exerting pressure on its limited resources. Keeping in view the needs of the taxpayer and the computerization program underway, we recommend the following for immediate implementation:

c. Recommendations for Improvement

The sources of information used by the tax administration to build up an information system may be classified into three main categories:

1. Taxpayers' Declaration: Under the system of self-assessment, the taxpayer forms the basic source of information. The taxpayer provides information to the tax administration through returns and accompanying documents. These returns contain valuable information on the taxpayer and his activities. All this information can potentially be used to help gauge the taxes due from the taxpayer. In this regard, it is necessary to address the problem of the design of the return forms, filing requirements and policy, making returns available and sanctions against non-filing of taxpayer declaration. Since any recommendations on this aspect can be made effective only from financial year 2002-2003, we propose to make recommendations in this regard in our final report.

2. Information returns: this is a more widely used device to collect information. Information returns are declarations filed with the tax administration by persons required to report details of their financial dealings with other taxpayers. Information returns often require listing of all transactions of a certain kind e.g., payments of corporate dividends or transactions beyond a magnitude of other kinds with other taxpayers during a certain period. A wide variety of sources of information can be imagined which could be reached by the tax administration through the device of information returns.

   Under the extant procedure, the Central Information Branch functioning under the Director General (Investigation) within the Directorate of Income tax (Investigation), spread all over the country, collects from predetermined sources information relating financial transactions from various external and internal sources. Sources of information to be tapped in a financial year, are laid down by the CBDT in its instruction No.1943 dated 22nd August,1997. The Director General of Income tax (Investigation) is empowered to revise the ceilings of the monetary limits fixed by the Board for collection of information. Currently, about 37 broad categories of external and internal sources are listed in the long-term action plan for information collection, formulated by the CBDT. Sections 133B (power to call for information) and 131 (power regarding discovery, production of evidence, etc) constitute the main legal base for the process. Under section 133(6) of the Income tax Act, firms, companies, dealers, brokers, agents, banks, etc., can be called upon to provide the names and addresses of persons engaged in transactions with them. The information so collected is collated and then disseminated by the CIB to the assessing officers for verification in the respective cases.

   The process starts with the collection of information, mainly from external sources. However, there are several hurdles in this area. First, the flow of information is not automatic in the sense that the CIB first issues letters to various agencies, calling for information under sub-section (6) of section 133 of the Income tax Act. Though the instruction identifies the source s of information to be

tapped during the year, the specific firms, dealers, brokers, banks, companies, etc., required to be tapped for this purpose are left to the discretion of the officer in the field formation, with the result that the coverage of most sources tapped is incomplete. Secondly, even where information is called for under section 133(6), not all agencies respond promptly. In such cases summons under section 131 are issued. Even then, many agencies try to stall or even resist communication of information. Refusal to part with information by banks and some other financial institutions is a case in point. This strains CIB's resources and delays verification and dissemination of information. Thirdly, because of limited manpower and infrastructure – including, importantly, the lack of automation and also the long delays in furnishing information, the CIB is not able to collect information from even the major external sources every year. The inability to collect annually comprehensive information from all or at least the major sources dilutes the efficacy of CIB verifications.

Under the Income tax Act, deduction at source is required to be made from specified categories of payments like salaries, interest, commission etc. The deductor is required to file with the TDS circles in the Department annual returns relating to deduction of tax at source. These information returns also form one of the important sources of information.

3. Information and evidence collected by the Department during the course of investigation: In addition to information from taxpayers' return and other information returns, a large volume of information also gets collected during assessment, searches and seizures and survey operations.

If the large volume of information that any tax administration receives is to be meaningfully utilized for determining under-reporting or non-reporting of income in tax returns, it is necessary that the information is properly collated, disseminated and verified. At present, because of lack of computerized information system and the absence of a permanent identification system, the information collected is wasted. Even though the permanent identification system in the form of **PAN** has been introduced there is still

no requirement to quote PAN either on economic transactions or on documents/papers submitted to the tax administration. This affects collation, dissemination and verification. The limited success of one-by-six scheme in widening the tax base substantially is also partly attributable to this. This also inhibits the department's ability to identify non-filers.

Further, since there is no requirement under law to quote PAN on tax returns, the system is seriously handicapped in dealing with stop filers. The number of registered taxpayers has undoubtedly increased rapidly from 140 lakh at the beginning of 1996-97 to 250 lakh at the end of 1999-2000. However, the number of stop filers continues to remain at a high of about 72 lakh. This constitutes about 29 percent of registered taxpayers[11] and has considerably eroded the impact of widening of the tax base. The Department estimates to recover **Rs 2800 crores annually** from pursuing these stop filers. This should provide the necessary impetus to the tax buoyancy (about ten percent increase in the buoyancy seen in 1999-2000). The much publicized widening of the tax base could become an exercise in futility if the Department fails to vigorously pursue the stop filers.

Similarly, the delinquent accounts have risen from Rs. 28970 crores at the beginning of 1996-97 to a high of Rs. 55,000 crores at the end of 1999-2000 (see Table 1). The outstanding arrears are almost equal to the annual tax collections. Bulk of these arrears is locked up in appeals at various stages. Yet a large part of the arrears are irrecoverable: the arrear entries in a large number of cases do not contain even the minimum details like the address of the taxpayer. We are also told that there are numerous instances where the same arrear is reflected as outstanding in the Arrear register of two different assessing officers. The genesis of these problems lies in the absence of a computerized information system.

A large proportion of the taxes are collected through TDS. This will continue to occupy prominence in view of the fact that the system provides a continuous flow of resources to the exchequer during the year and also counteracts tax evasion. However, the

[11] Internationally, it is considered a serious problem if the stop filers exceed 10 percent.

ability of the system to counteract tax evasion has been seriously hampered in the absence of a computerized information system. Any further increase in the scope of the TDS provisions should only be done after full computerization of the existing system and consolidating the gains from the existing provisions.

Another aspect relating to collection of taxes is the collection of information regarding tax payments. At present, a taxpayer has to fill three copies of a challan for making any tax payment in the bank. One copy of the challan is returned to the taxpayer as acknowledgement of receipt of tax payments and two other copies are sent to the two different units of the Department : one for the Central Treasury Unit (CTU) in the computer centre and another to the Zonal Accounts Office. The information in the millions of challans received every month is than manually keyed into the computer for building up the data base for tax payments. This manual exercise is cumbersome and not free from errors and delay throwing up opportunities for taxpayer grievances. Further, monitoring of tax payments is also adversely affected. The requirement of filling multiple copies of challan is also burdensome for taxpayers.

Similarly, in the absence of collation and dissemination of information, the effectiveness of the scrutiny process is also adversely affected – it is impossible to design a selection process which is not only fair but also appear to be fair and therefore inspire confidence in the tax system. There have been complaints of corruption in the selection of cases for scrutiny. As a reaction to this the Central Board of Direct taxes has now publicly announced its decision to virtually abandon the scrutiny process except in certain cases where specific information of incorrect income reporting exist. Such a strategy is not conducive to maintaining a minimum deterrence level, which is the key to promoting voluntary compliance.

The storage and retrieval of information (more commonly known as record keeping) is in a dismal state. Every expert Committee has commented adversely on the existing system. There have been newspaper reports of records being stored in

bathrooms. Such dismal state of affairs becomes a fertile ground for corruption and harassment to taxpayers.

The perception from a discussion with a cross section of people is that the response of the tax administration to taxpayers' grievances is substandard. This is particularly relating to issuance of refunds and tax clearance certificates. Over the years, the scope of the TDS provisions has expanded resulting in greater number of refund claims. Given the manual system of processing returns, there is considerable delay in processing refund claims, which in turn results in rent-seeking behavior. We understand that such grievances would be resolved with the induction of technology, which has now got a boost with employees of the Income tax Department withdrawing their resistance to computerization of the business processes.

We are informed that the Department is currently in the process of restructuring to facilitate large-scale induction of information technology. The training of staff is currently in progress and the resistance of staff to the process of computerization has been withdrawn. Consequent to the induction of technology, the department expects to mobilize about Rs 10,000 crores on account of its enhanced capability to deal with stop filers and from recovery of tax arrears. The Government has directed the CBDT to enter into an MOU with the Government for enhanced revenue, better taxpayer service and greater accountability. This is consistent in the international trend and greater transparency in governance.

During our visit to offices of the Income tax Department in Chennai and Calcutta, we found visible signs of enthusiasm amongst officers and staff to computerization. We are quite optimistic about the potential of the tax administration to raise the direct tax-GDP ratio envisaged in this Report. However, we are afraid that the process of computerization and the effectiveness of the tax administration could be seriously constrained by inadequate number of computers for staff members, lukewarm response of the telecommunication authorities to provide lease line facilities for networking of the computers in the different offices of the tax department spread over 450 towns/cities and

inadequate and inflexibility in the use of financial and human resources. The process of restructuring is expected to be in place by the beginning of the next fiscal year. In the interim we recommend that the following steps need to be taken immediately (within this fiscal year):

1. The Department must introduce voice message system to remind taxpayers of important dates. Under this system, the recorded message could be automatically activated when the telephone handset is picked up.
2. The Department must sell pre-formatted programmed floppy diskettes through retail outlets, and should have all the help features required to comply with the law. Such floppy diskettes could be designed for return forms, TDS forms and other information returns. The taxpayer would be required to enter the data only without the need to make any calculations. He could submit the same to the tax administration along with a hard copy, if necessary.
3. The Department should be allowed to print the tax return forms through private printing press and the power to place orders for the printing must be fully delegated to the head of the department in the field. There should be no obligation on the tax administration to undertake centralized printing by the government press.
4. Instead of specifying the sources of information to be tapped every year, the CBDT should prescribe a long-term plan indicating the sources from which information should be gathered. In this regard, the Board should be empowered to make rules to require some classes of persons to furnish information in respect of certain major items, in a prescribed Performa. The classes of persons could include persons who are authorized to issue licenses and sales tax exemption forms, give telephone connections, etc. For example, to begin with, the person responsible for registering industrial units should be required to furnish an annual return containing details of all registered units. In the subsequent years, they could be required to furnish details of only the new registrations during the year. Similarly, the telephone authorities could be required to furnish details of the new telephone connection each year. Since the responsibility would be cast upon the information return filer to file

the relevant information return by the due date, the existing problem of identifying the information return filers and having to issue summons for collection of information would be considerably reduced. Further, information from a particular source would be uniform across the country and a continuous flow would be ensured over time.

5. The information must be procured in a prescribed form on a magnetic media and should be sent directly to the CIB.
6. The Government must immediately notify that no document, in particular, return of income, challans, information returns, rectification applications and appeals, should be received by the tax administration where the PAN is not quoted.
7. Further, the Government must also notify the categories of transactions where PAN should be quoted. It should be mandatory to quote PAN in all banking transactions without which the bank should be prohibited from undertaking the transaction. We do understand that this could pose some problem in the rural sector but since income tax offices are across the are spread over 450 centers across the country and allotment of PAN is now online, a one time visit to the Income tax Office for obtaining the PAN should be construed as a cost towards discharging social responsibilities.
8. The Department should immediately identify the stop filers and issue notices for filing of tax return. There is no reason why this exercise should be delayed given the fact that this is one of the main planks for restructuring. We believe that the Department is unable to issue notices because the Taxpayer Master File is itself deficient. If this is indeed so, immediate steps must be taken to reconstruct the taxpayers master file. The pursuit of the stop filers must become a part of the annual action plan with immediate effect.
9. In the case of arrears, a large of entries relates very small amounts where the cost of recovery far exceeds the benefit. A policy decision should be taken at the Government level to write off arrears above a certain amount, particularly, in all cases where the identity of the taxpayer is doubtful. This will enable the

Department to concentrate on large arrears, which could be pursued vigorously.

10. As regards, scrutiny assessment, we appreciate the concern of the Department to reduce corruption in the identification of cases for scrutiny. However, the Department must maintain a credible minimum deterrence level. Therefore, care should be taken to ensure that a certain minimum percentage of taxpayers are annually scrutinized but the scheme for selection of cases is absolutely secret but fair.
11. The system of income tax clearance certificate under section 230 of the Income tax Act should be replaced by the simple requirement of quoting PAN. The requirement of obtaining income tax clearance before leaving the country must also be done away with immediate effect. It should be sufficient for citizens of India to quote their PAN to airline/shipping agency. As regards, non-citizens are concerned, the Department should depend on the mechanism of international cooperation and assistance envisaged under the Double Taxation Avoidance Agreements with large number of countries. Since the flow of tourists from countries with which India does not have a DTAA is limited, revenue loss, if any, would be negligible and can therefore be ignored. This will enhance the worldwide image of the country and will also encourage flow of tourists to the country. This will reduce a large number of public grievances.
12. Given the system of collection of information regarding tax payments discussed above, we recommend that the banks receiving tax payments should be compulsorily required to furnish the data on a magnetic media which could be immediately uploaded on to the computer system of the tax administration. The Department should introduce this system from 1.4.2001. Once this is implemented, it should not be necessary for the taxpayer to fill multiple copies of challans. Further, the Department should also explore the feasibility of using smart cards for collection of taxes.
13. The Government should provide funds for immediate procurement of high speed computers for **all the Tax Assistants** in the Department so that the

processing of returns, issue of refunds and assistance to taxpayers is immediately computerized. Any delay in providing them with high speed personal computers will nullify the effect of computer training due to inadequate hands-on experience.

14. With regard to lease-line facilities, we recommend that the matter should be accorded highest priority and therefore taken up at the Ministerial level. Implementation should be overseen by a Committee comprising of representatives from both the Income tax Department and the telecommunication Department. The full potential of computerization of the tax administration can only be realised with the successful networking of the workstations to facilitate matching of information.
15. We welcome the decision of the Government to enter into a Memorandum of Understanding with the Central Board of Direct Taxes. We believe this will enhance accountability and responsibilities of both parties to the MOU. However, we must caution that the benefits of the MOU would not be realised fully if the rights and obligations of all parties to the MOU and the supporting institutions are not clearly specified. The MOU must **(i)** specify detailed performance measures for the tax administration, the revenue targets to be achieved, and the amount of resources (both human and financial) that would be made available by the Government to the tax administration; **(ii)** assign to the Central Board of Direct Taxes the complete control over the management and deployment of resources (both human and financial) consistent with the overall guidelines of the Government on the management and deployment of such resources; and **(iii)** indicate the penalty leviable in the event of non-performance.
16. Consequent to the decision to induct large-scale technology in the tax administration, it is important to identify sources, which are a drag on the productivity of the tax administration. Further, the tax administration would need a large number of qualified and trained computer personnel to process the growing volume of information that is expected to flow. It is therefore important that the relatively less productive work force be identified for

retraining and redeployment as computer personnel. Two such categories relate to the employees in the cadre of Notice servers and peons. We recommend that the employees in these two categories should be encouraged to acquire the requisite computing skills. On successful attainment of the skill, they could be placed in the equivalent scale of Tax Assistant (Rs4000-100-6000). The vacancy created at the level of peons and notice servers should, thereafter, be abolished. This will enhance the data entry capacity of the Department and increase productivity.

Appendix Table IV. 1
LIST OF INCENTIVES UNDER THE INCOME TAX ACT

Sl. No.	Section	Nature of Tax concession	Who are entitled	Recommendation	Class of Exemption
1	10(1)	Agricultural income	Any assesses	To be dealt in the Final Report	-
2	10(2)	Amount received out of family income, or in case of impartible estate, amount received out of income of family estate	Individuals as member of HUF	To be continued	-
3	10(2A)	Partner's share in total income of firm	Partner of a firm	To be continued	-
4	10(3)	Receipts of casual and non-recurring nature (Rs. 5,000 in aggregate) [limit in case of winnings from races including horse races : Rs. 2,500]	Any assesses	Provide for a tax credit of Rs 500	
5	10(4) (i)	Interest on securities or bonds notified by the Central Government including premium redemption of such bonds	Non-resident	Delete	**2**
6	10(4)(ii)	Interest received on Non-resident (External)Account	Person resident out-side India (as defined in FERA) and person who has been permitted to maintain said account by RBI	Delete	**2**
7	10(4B)	Interest on notified savings certificates issued by the Central Government and subscribed to in convertible foreign exchange	Individual (Indian citizen or person of Indian origin, who is a non-resident)	Delete	**2**
8	10(5)	Leave travel concession or assistance (subject to prescribed conditions and limited to amount actually spent)	Individual – Salaried employee	Delete	**3**
9	10(5B)	Perquisite of income-tax paid by the employer in respect of the salary income of certain technicians from abroad (subject to certain conditions)	Individual – Salaried employee who was not resident in India in any of the 4 financial years immediately preceding the financial year in which he arrived in India	Delete	**3**
10	10(6) (I)	Passage moneys/value of free or concessional passage received, subject to prescribed conditions	Individual – Salaried employee (non-citizen of India)	Delete	**3**
11	10(6)(ii)	Remuneration received by specified diplomats and their staff	Individual (non-citizen of India)	To be continued	**3**
12	10(6) (vi)	Remuneration received as employee of foreign enterprise for services rendered during stay in India (subject to certain conditions)	Individual – Salaried employee (non-citizen of India)	Delete	**10**
13	10(6)	Remuneration received for services	Individual – Salaried	To be continued	**3**

	(viii)	rendered in connection with employment on a foreign ship (subject to certain limits)	employee (non-resident, non-citizen of India)		
14	10 (6) (xi)	Remuneration received as employee of foreign Government in connection with his training in government offices/statutory undertakings, etc.	Individual – Salaried employee (foreign citizen)	Delete	**3**
15	10 (6A)	Tax paid by Government or Indian concern on royalty/fees for technical services from government or Indian concern under agreement which either relates to a matter included in the industrial policy of the Government and is in accordance with that policy or is approved by Central Government.	Foreign company	Delete	**11**
16	10(6B)	Tax paid by Government or Indian concern under terms of agreement entered into by Central Government with Government of foreign State or international organisation on income derived from government or Indian concern, other than income by way of salary, royalty or fees for technical services	Non-resident (other than company) or foreign company	Delete	**11**
17	10(6BB)	Tax paid by Indian company, engaged in the business of operation of aircraft, who has acquired an aircraft or its engine on lease, under an approved (by Central Government) agreement entered into after 31.03.1997 but before 01.04.1999, on lease rental/income	Government of foreign State or foreign enterprise	Delete	**11**
18	10(6C)	Income by way of fees for technical services rendered in India or abroad in projects connected with security of India pursuant to agreement with Central Government	Notified foreign company	Delete	**11**
19	10(7)	Foreign allowances or perquisites paid or allowed by Government to its employees posted abroad	Individual – Salaried employee (Indian citizen)	To be continued	**10**
20	10(8)	Foreign income and remuneration received from foreign government for services rendered in connection with any co-operative technical assistance programmes and projects in accordance with agreement entered into by Central Government and foreign Government (subject to certain conditions)	Individual	Delete	**10**
21	10(8A)	Foreign income and remuneration received by consultant (agreement relating to his engagement must be	Non-Indian citizen/Indian citizen who is not ordinarily	Delete	**10**

		approved) out of funds made available to an international organisation (agency) under a technical assistance grant agreement between that agency and the Government of a foreign State.	resident in India/non-resident, engaged by the agency for rendering technical services in India		
22	10(8BB)	Foreign income and remuneration received by an employee of the consultant referred to in section 10(8A)	Non-Indian citizen/Indian citizen who is not ordinarily resident in India (contract of service must be approved by the prescribed authority before commencement of service	Delete	**10**
23	10(9)	Income of any member of family of any individual [referred to in section 10(8), 10(8A) or 10(8)B)] which accrues or arises outside India and is not deemed to accrue or arise in India and which is subject to tax in that foreign country.	Individual	Delete	**10**
24	10(10)(I)	Death-cum-retirement gratuity received by Government servants	Individual – salaried employee	To be continued	**3**
25	10(10)(ii)	Gratuity received under the Payment of Gratuity Act, 1972 (maximum Rs.3,50,000)	Individual – Salaried employee	To be continued	**3**
26	10(10) (iii)	Any other gratuity received by employee/legal heirs on retirement, termination of services, death, etc., limited to half month's salary for each year of completed service (subject to certain conditions) [maximum limit Rs. 3,50,000]	Individual – Salaried employee	To be continued	**3**
27	10(10A)	Payment in commutation of pension received from government/Private employer (subject to certain limits)/ LIC Fund u/s 10(23AAB)	Individual – Salaried employee	To be continued	**3**
28	10(10AA)	Amounts by way of encashment of unutilised earned leave on retirement limited to 10 months salary subject to certain conditions) [maximum limit Rs.2,40,000]	Individual – Salaried employee	Delete	**3**
29	10(10B)	Retrenchment compensation [maximum limit under proviso (ii) is Rs. 5,00,000]	Individual – Workman	To be continued	**3**
30	10(10BB)	Payments made under Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 and any scheme framed thereunder (subject to certain conditions)	Any assessee	To be continued	**11**
31	10(10C)	Payment received (not exceeding Rs.5,00,000) on voluntary	Individual – Employee of a public sector	To be continued	**3**

		retirement in accordance with scheme framed in accordance with prescribed guidelines [in case of companies (other than public sector companies)/co-operative societies, scheme should be approved by Chief Commissioner/Director general]	company, any other company, an authority established under a Central, State or Provincial Act, a local authority, co-operative societies, universities, IITs and notified institutes of management		
32	10(10D)	Any sum received under a life insurance policy including bonus on such policy but excluding sums received u/s 80DDA(3) and under a Keyman insurance policy	Any assessee	To be continued	**3**
33	10(11)	Payment from public provident fund/statutory provident fund	Individual/Hindu undivided family	To be continued	**3**
34	10(12)	Accumulated balance payable to employee participating in recognized provident fund (subject to certain conditions)	Individual – Salaried employee	To be continued	**3**
35	10(13)	Payment from approved superannuation fund in specified circumstances and subject to certain limits	Individual	To be continued	**3**
36	10(13A)	House rent allowance (subject to certain limits)	Individual – Salaried employee	Delete	**3**
37	10(14)	Prescribed allowances or benefits	Individual – Salaried employee	To be continued	**3**
38	10(14A)	Exchange risk premium received from person borrowing foreign currency (subject to certain conditions)	Public financial institution	Delete, tax premium at a concessional rate in line with the taxation of premium in the case of general insurance companies	**11**
39	10(15) (i)	Interest premium on redemption, or other payment on notified securities, bonds, certificates, and deposits, etc. (subject to notified conditions and limits)	All assesses	Delete	**1**
40	10(15) (iib)	Interest on notified Capital Investment Bonds	Individual/HUF	Delete	**1**
41	10(15) (iic)	Interest on notified Relief Bonds	Individual/HUF	Delete	**1**
42	10(15) (iid)	Interest on notified bonds purchased in foreign exchange (subject to certain conditions)	Individual – NRI/ nominee or survivor of NRI/individual to whom bonds have been gifted by NRI.	Delete	**2**
43	10(15) (iii)	Interest on securities	Issue Department of Central Bank of Ceylon	To be continued	**2**
44	10(15) (iiia)	Interest on deposits made with schedule bank with approval of RBI	Bank incorporated abroad	Delete	**2**
45	10(15)(iv	Interest received from Government	All assesses who have	Delete	**2**

	)(a)	or from local authority on moneys lent, etc., from sources outside India	lent money, etc., from sources outside India		
46	10(15)(iv)(b)	Interest received from industrial undertaking in India on moneys lent to it under a loan agreement	Approved foreign financial institution	Delete	**2**
47	10(15)(iv)(c)	Interest at an approved rate received from Indian industrial undertaking on moneys lent or debt incurred in a foreign country in respect of purchase outside India of raw materials, components or capital plant and machinery, subject to certain limits and conditions	All assesses who have lent such money, or in favor of whom such debt has been incurred	Delete	**2**
48	10(15)(iv)(d)	Interest received at an approved rate from specified financial institutions in India on moneys lent from sources outside India	All assessees who have lent such moneys	Delete	**2**
49	10(15)(iv)(e)	Interest received at approved rate from other Indian financial institutions or banks on moneys lent for specified purposes from sources outside India under approved loan agreement.	All assessees who have lent such moneys	Delete	**2**
50	10(15)(iv)(f)	Interest received at approved rate from Indian industrial undertaking on moneys lent in foreign currency from sources outside India under approved loan agreement	All assessees who have lent such moneys	Delete	**2**
51	10(15)(iv)(fa)	Interest payable by scheduled bank, on deposits in foreign currency when acceptance of such deposits by bank is approved by RBI	Non-resident or individual/HUF who is not ordinarily resident in India	Delete	**2**
52	10(15)(iv)(g)	Interest received at approved rate, from Indian public companies eligible for deduction under section 36(1) (viii) and formed with main object of providing long-term housing finance, on moneys lent in foreign currency from sources outside India under approved loan agreement	All assesses	Delete	**2**
53	10(15) (iv)(h)	Interest received from any public sector company in respect of notified bonds or debentures and subject to certain conditions.	All assesses	Delete	**1**
54	10(15) (iv)(i)	Interest received from Government on deposits in notified scheme out of moneys due on account of retirement	Individual – Employee of Central government/State Government/Public sector company	Delete	**1**
55	10(15)(v)	Interest on securities held in Reserve Bank's SGL A/c No. SL/DH-048 and Deposits made after 31.3.1994 for benefit of	Welfare commissioner, Bhopal Gas Victims, Bhopal	To be continued	**11**

		victims of Bhopal Gas Leak Disaster held in such account with RBI or with notified public sector bank			
56	10(15)(vi)	Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by Central Government	All assesses	Delete	**1**
57	10(15A)	Any payment made by an Indian company, engaged in business of operation of aircraft, to acquire an aircraft or an aircraft engine on lease from the Government of a foreign State or a foreign enterprise (person who is non-resident) under approved agreement entered into on or after 01.04.1999. However, payment made for providing spares, facilities or services in connection with operation of lease aircraft is excluded	Foreign State/Enterprise	Delete	**11**
58	10(16)	Education scholarship	Individual	To be continued	**6**
59	10(17)(I)	Daily allowance	Individual – Member of Parliament/State Legislature/Committee thereof	Delete	**3**
60	10(17)(ii)	Any allowance received by MP under Members of Parliament (constituency Allowance) Rules, 1986	Member of Parliament	Delete	**3**
61	10(17)(iii)	All other notified allowances not exceeding Rs. 2000 per month received by MLA	Individual Member of State Legislature/Committee thereof	Delete	**3**
62	10(17A)(I)	Amount received in pursuance of award (whether in cash or kind) instituted in public interest by Central/State Government or approved award instituted by other body	Any assessee	To be continued	**11**
63	10(17A)(ii)	Reward (whether in cash or kind) received from Central/State Government for approved purposes in public interest	Any assessee	To be continued	**11**
64	10(18)	Pension received by an individual who has won specified/notified gallantry awards and family pension received by any family member of such individual.	Individual – Central State Government employee or his family member	To be continued	**11**
65	10(19A)	Notional annual value of any one palace occupied by former ruler	Individual	Delete since it is no more relevant.	**11**
66	10(20)	Specified incomes of a local authority	Local authority	Delete	**7**
67	10(20A)	Income of housing boards etc.	Statutory corporation	Delete	**7**
68	10(21)	Income of approved scientific	Scientific Research	Delete	**7**

		research associations subject to certain conditions	Association		
69	10(22B)	Income of notified news agency set up in India solely for collection and distribution of news (subject to certain conditions)	News agencies	Delete	**11**
70	10(23)	Income of notified sports or games associations or institutions (subject to certain conditions)	Sports and games associations and institutions	Delete	**7**
71	10(23A)	Income of approved professional bodies other than income from house property, income received for rendering specific services and income by way of interest or dividends (subject to certain conditions)	Professional associations	Delete	**7**
72	10(23AA)	Income received on behalf of regimental fund or non-public fund established by armed forces.	Regimental fund or non-public fund	Delete	**9**
73	10(23AAA)	Income of approved fund established for notified purposes for welfare of member employees or their dependents (subject to certain conditions)	Approved fund	Delete	**9**
74	10(23AAB)	Income of fund set up by LIC under an approved pension Scheme (subject to certain conditions)	Fund set up by LIC	Delete	**9**
75	10(23B)	Income of institution existing solely for development of khadi or village industries (subject to certain conditions)	Public charitable trust/registered society	Delete	**7**
76	10(23BB)	Income of authority established for development of kahdi or village industries	Authority established under State or Provincial Act	Delete	**7**
77	10(23BBA)	Income of a body or authority established for administration of public religious or charitable trusts or endowments, etc.	Body/authority established, constituted or appointed under Central, State or Provincial Act	Delete	**7**
78	10(23BBB)	Income of EEC from interest, dividends or capital gains from investment of funds under specified scheme	European Economic Community	To be continued	**11**
79	10(23BBC)	Income of SAARC Fund for Regional Projects set up by Colombo Declaration issued on 21.12.1991	SAARC Fund for Regional Projects	To be continued	**11**
80	10(23C)(i) to (iia)	Income received by any person on behalf of specified Prime Minister's Funds or National foundation for communal harmony	Any person concerned	To be continued	**11**
81	10(23C) (iiiab)	Income of any university or other educational institution existing solely for educational purposes and not for purposes of profit,. And	University/other educational institution	Delete	**7**

		which is wholly or substantially financed by the Government			
82	10(23C) (iiiac)	Income of any hospital or other medical treatment institution existing solely for philanthropic purposes and not for purposes of profit, and which is wholly or substantially financed by the Government	Hospital/Nursing Home, etc.	Delete	**7**
83	10(23C) (iiiad)	Income of any university or other educational institution existing solely for educational purposes and not for purposes of profit, if the aggregate annual receipts do not exceed one crore rupees	University/other educational institution	Delete	**7**
84	10(23C) (iiiae)	Income of any hospital or other medical treatment institution existing solely for philanthropic purposes and not for purposes of profit, if the aggregate annual receipts do not exceed one crore rupees	Hospital/Nursing Home, etc	Delete	**7**
85	10(23C) (iv)/(v)	Income received by any notified charitable fund or institution and notified public religious/charitable trust or institution (subject to certain conditions)	Charitable/Religious trusts and institutions	Delete	**7**
86	10(23C)/(vi)	Income of any university or other educational institution existing solely for educational purposes and not for purposes of profit, other than those mentioned in sections 10(23C)(iiiab) and 10(23C)(iiiad) and which is approved by the prescribed authority	University/other educational institution	Delete	**7**
87	10(23C) (via)	Income of any hospital or other medical treatment institution existing solely for philanthropic purposes and not for purposes of profit, other than those mentioned sections 10(23C)(iiia) and 10(23C)(iiiae) and which is approved by the prescribed authority	Hospital/Nursing Home, etc	Delete	**7**
88	10(23D)	Income of Mutual Fund registered under SEBI Act, 1992 and notified Mutual Fund set up by public sector bank or public financial institution or authorised by RBI, subject to notified conditions	Mutual Fund registered under SEBI Act, 1992, and Notified Mutual Fund set up by public sector bank or financial institution or authorised by RBI	To be continued	**9**
89	10(23E)	Income of notified Exchange Risk administration fund set up by public financial institutions (subject to	Exchange Risk Administration Fund	Delete	**9**

		certain conditions)			
90	10(23F)	Dividends or long-term capital gains of approved venture capital fund/venture capital company from investments made before 1.4.1999 by way of equity share in a venture capital undertaking (subject to certain conditions)	Approved venture capital fund / venture capital company	Delete	**9**
91	10(23FA)	Any income by way of dividends, other than dividends referred to in section 115-O, or long-term capital gains of approved venture capital funds and venture capital companies from investments made by way of equity share in a venture capital undertaking (subject to certain conditions) (exemption is not available in respect of investments made after 31.3.2000	Approved venture capital fund / venture capital company	Delete	**9**
92	10(23G)	Income by way of dividends, other than dividends referred to in section 115-O, interest or long term capital gains of an infrastructure capital company from investments made on or after 1-6-1998 by way of shares or long term finance in any approved enterprise wholly engaged in the business of (i) developing, (ii)maintaining and operating any infrastructure facility and which satisfies the prescribed conditions	Infrastructure capital fund or infrastructure capital company	Delete	**9**
93	10(24)	Income of trade union under the heads 'Income from house property' and 'Income from other sources'	Registered trade union/associations of registered trade unions	Delete	**7**
94	10(25)	Income on securities and capital gains on sale of securities held by provident fund to which Provident Funds Act, 1925 applies/income received by trustees on behalf of recognised provident fund, approved superannuation fund, approved gratuity fund and deposit linked insurance fund in certain cases	Retirement benefit funds	Delete	**9**
95	10(25A)	Income of ESI Fund set up under ESI Act, 1948	Employees State Insurance Fund	Delete	**9**
96	10(26)	Specified income of member of specified Scheduled Tribes residing in specified areas	Individual (member of specified Scheduled Tribe)	Delete	**6**
97	10(26B)	Income of Central/State Corporation of Government financed body, institution of association established for	Government corporation/body, institution or association wholly	Delete	**6**

		promoting interests of members of Scheduled Castes, Scheduled Tribes and /or Backward Classes	financed by Government		
98	10(26BB)	Income of corporation established by Government for promoting interests of members of minority community	Government corporation	Delete	**6**
99	10(27)	Income of certain co-operative societies formed for promoting the interests of Scheduled Castes/Scheduled Tribes members	Co-operative societies	Delete	**6**
100	10(29)	Income of marketing authorities	Statutory corporation	Delete	**7**
101	10(29A)	Income accruing or arising to the Coffee Board, the Rubber Board, the Tea Board, the Marine Products Export Development Authority, the Agricultural and Processed Food Products Export Development Authority and Spices Board	Respective Boards and Authorities	Delete	**7**
102	10(30)	Subsidy received from or through Tea Board under notified scheme for replantation/replacement of tea bushes etc.(subject to certain conditions).	All assessees (engaged in business of growing/ manufacturing tea in India)	Delete	**11**
103	10(31)	Subsidy received from or through concerned Board under notified scheme for replantation / replacement of rubber/coffee/cardamom plants, etc. (subject to certain specified conditions)	All assessees (engaged in business of growing / manufacturing rubber/coffee, etc., in India)	Delete	**11**
104	10(32)	Income of minor child clubbed u/s 64(IA) to the extent of Rs. 1,500 per child	Any Individual	Delete	**-**
105	10(33)	Dividends declared/paid by domestic companies and any income of a unit holder received from (a) UTI or (b) a mutual fund specified under section 10(23D).	All assesses	To be continued	**-**
106	10A	Income of industrial units situated in free trade zones, electronic hardware technology parks or software technology park (subject to certain conditions and clarifications)	All assessees	Delete	**5**
107	10B	Income from a 100 per cent export oriented undertaking (subject to certain specified conditions)	All assessees	Delete	**5**
108	10C	Profits and gains from an industrial undertaking which begins to manufacture/produce any article or thing after 31-3-1998 in any Integrated Infrastructure Development Centre or Industrial Growth Centre located in the North	All assessees	Delete	**5**

		Eastern Region			
109	11	Income from Property held for charitable or religious purposes (subject to certain conditions)	Charitable/religious /trust /institution	Delete this and redesign the provision along the lines recommended for taxation of non-profit organization	**7**
110	13A	Specified income of political parties	Registered political parties	Delete this and redesign the provision along the lines recommended for taxation of non-profit organization	**7**
111	16(i)	Standard deduction is to be computed as under : - Where income from salary (before allowing standard deduction) is Rs. 1,00,000 or less – One third of salary or Rs. 25,000, whichever is less - Where income from salary (before allowing standard deduction) exceeds Rs. 1,00,000 but does not exceed Rs. 5,00,000 –Rs. 20,000 - Where income from salary (before allowing standard deduction) exceeds Rs. 5,00,000 -Nil	Salaried assessees	Rationalize	**3**
112	16(ii)	Entertainment allowance [actual or at the rate of 1/5th of salary, whichever is less][limited to Rs. 5,000 for Government employees and Rs. 7,500 for non- Government employees](subject to certain conditions)	Salaried assessees	Delete	**3**
113	16(iii)	Employment tax	Salaried assessees	To be continued	**-**
114	23(1) first proviso	Taxes levied by local authority and bone by owner if paid in relevant previous year	All assessees	To be continued	**-**
115	24(1)(i)	Repairs and collection expenses [1/4th of the annual value	All assessees	To be continued	**-**
116	24(1)(ii)	Insurance premium	All assessees	To be continued	**-**
117	24(1)(iv)	Annual charge [not being capital charge or charge voluntarily created by assessee	All assessees	To be continued	**-**
118	24(1)(v)	Ground rent	All assessees	To be continued	**-**
119	24(1)(vi)	Interest on borrowed capital	All assessees	To be continued	**-**
120	24(1)(vii)	Land revenue or any other tax levied by state Government	All assessees	To be continued	**-**
121	24(1)(ix)	Vacancy allowance [subject to certain conditions]	All assessees	To be continued	**-**
122	24(1)(x)	Unrealised rent [subject to certain conditions]	All assessees	Delete provision relating to	**-**

		In respect of one self-occupied property, these deductions are not admissible, except interest on borrowed capital up to a maximum of Rs. 100000 vide proviso to section 24(2). [This is available also in respect of cases covered under sub-section (3) of section 23]		allowability of interest on borrowed capital for self-occupied property.	
123	30	Rent, rates, taxes, repairs and insurance for premises	All assesses	To be continued	-
124	31	Repairs and insurance of machinery, plant and furniture	All assesses	To be continued	-
125	32	Depreciation on buildings, machinery, plant or furniture, know–how, patents, copyrights, trademarks, licenses, franchises, or any other business or commercial rights of similar nature, being intangible assets – Prescribed percentage on WDV in the case of any block of assets	All assesses	To be continued	-
126	33A	Development allowance – 50 percent of actual cost of planting (subject to certain conditions and limits)(planting should have been completed before 1-4-1990)	Assesses engaged in business of growing and manufacturing tea in India	Delete	-
127	33AB	Tea Development Account – Amount deposited in account with National Bank (Special Account) or in Tea Deposit Account in accordance with approved scheme or 20% of profits of business, whichever is less (subject to certain conditions)	Assesses engaged in business of growing and manufacturing tea in India	Delete	-
128	33ABA	Amount deposited in Special Account with SBI/Site Restoration Account or 20 per cent of profits, whichever is less (subject to certain conditions)	Assesses carrying on business of prospecting for, or extraction or production of petroleum or natural gas or both in India	Delete	-
129	33AC	Reserves for shipping business – Amount not exceeding 50 per cent of profits derived from business of operation of ships computed under the head Profits and gains of business of profession' as is debited to Profit & Loss account and credited to reserve account to be utilised in specified manner	Government company or Indian public company having main object of carrying on business on business of operation of ships	Delete	-
130	35	Expenditure on scientific research for certain specific purposes (subject to certain conditions)	All assessees	To be continued	-
131	35A	Expenditure incurred before 1.4.1998 on acquisition of patent rights or copy-rights [equal to	All assessees	To be continued	-

		appropriate fraction of expenditure on acquisition to be deducted in fourteen equal annual installments beginning with previous year in which such expenditure has been incurred] (subject to certain conditions)			
132	35AB	Lump sum payment made in any previous year relevant to assessment year commencing or before 1.4.1998 for acquisition of technical know-how [consideration for acquisition to be deducted in six equal annual installments (3 equal annual installments where know-how is developed in certain laboratories, universities and institutions)] (subject to certain conditions)	All assessees	To be continued	**-**
133	35ABB	Expenditure incurred for obtaining licences to operate telecommunication services either before commencement of such business or thereafter at any time during any previous year	All assessees	To be continued	**-**
134	35AC	Expenditure by way of payment of any sum to a public sector company/local authority/approved association or institution for carrying out any eligible scheme or project	All assessees	Delete	**7**
135	35CCA	Payment to associations/institutions for carrying out rural development programmes (subject to certain conditions)	All assessees	Delete. Make it a part of section 80G	**7**
136	35CCB	Payment to approved associations/institutions for carrying out approved programmes of conservation of natural resources or afforestation (subject to certain conditions)	All assessees	Delete. Make it a part of section 80G	**7**
137	35D	Amortisation of certain preliminary expenses [deductible in 5 equal annual installments] (subject to certain conditions)	Indian companies and resident non-corporate assessees	To be continued	**-**
138	35DD	Amortisation of expenditure incurred after 31.3.1999 in case of amalgamation or demerger in the hands of an Indian company (one-fifth of such expenditure for 5 successive previous years) (subject to certain conditions)	Indian Company	To be continued	**-**
139	35E	Expenditure on prospecting, etc., for certain minerals [deductible in ten equal annual installments]	Indian companies and resident non-corporate assessees engaged in	To be continued	**-**

		(subject to certain conditions)	prospecting, etc., for minerals		
140	36(1) (I)	Insurance premium covering risk of damage or destruction of stocks/stores	All assessees	To be continued	-
141	36(1) (ia)	Insurance premium covering life of cattle owned by a member of co-operative society engaged in supplying milk to federal milk co-operative society	Federal milk co-operative societies	To be continued	-
142	36(1) (ib)	Medical insurance premium paid by cheque to insure employee's health under an approved scheme framed by GIC of India	All assesses as employers	To be continued	-
143	36(1) (ii)	Bonus or commission paid to employees	All assesses	To be continued	-
144	36(1) (iii)	Interest on borrowed capital	All assesses	However, interest liability during the pre-commencement period and for acquiring capital assets should not be allowed as revenue expenditure. This liability should be required to be capitalized. The amendment to the law must be clarificatory so that the department's point in existing cases does not fall through.	-
145	36(1) (iv)	Contributions to recognized provident fund and approved superannuation fund [subject to certain limits and conditions]	All assesses as employers	To be continued	-
146	36(1) (v)	Contributions to approved gratuity fund [subject to certain limits and conditions]	All assesses as employers	To be continued	-
147	36(1) (va)	Contributions to any provident fund or superannuation fund or any fund set up under Employees' Sate Insurance Act, 1948 or any other fund for welfare of such employees, received from employees if the same are credited to the employee" accounts in relevant fund or funds before due date	All assesses as employers	To be continued	-
148	36(1) (vi)	Allowance in respect of animals which have died or become permanently useless [subject to certain conditions]	All assessees	To be continued	-
149	36(1)	Bad debts which have been written	All assessees	To be continued	-

	(vii)	off as irrecoverable [subject to limitation in the case of banks and financial institutions]			
150	36(1) (viia)	Provision for bad and doubtful debs - Up to 5 percent of total income before making any deduction under this clause and chapter VI-A, and up to 10 per cent of aggregate average advances made by its rural branches - Up to 5 per cent of total income before making any deductions under this clause and Chapter VI-A	Certain scheduled banks and non-scheduled banks but other than foreign banks Foreign banks/Public financial institutions/State financial corporations/State industrial investment corporations	To be continued	-
151	36(1) (viii)	Amounts transferred to special reserve [subject to certain conditions and maximum of 40 per cent of profits derived from business of providing long-term finance for specified purposes]	Financial corporations, public companies of specified nature and corporations providing long-term financeJ for development of infrastructure facility	**Delete**	**4**
152	36(1) (ix)	Expenditure for promoting family planning amongst employees (deductible in 5 equal annual installments in case of capital expenditure)	Companies	To be continued	-
153	36(1) (x)	Contributions towards notified Exchange Risk Administration Funds	Public financial institutions	To be continued	-
154	36(1) (xi)	Expenditure incurred wholly and exclusively by the assessee on or after the Ist April, 1999 but before the Ist April, 2000 in respect of a non-Y2k compliant system, owned by the assessee and used for the purposes of his business or profession, so as to make such system Y2K complaint computer system.	All assessees	**This can now be deleted.**	-
155	37(1)	Any other expenditure [not being personal or capital expenditure and expenditure mentioned in sections 30 to 36] laid out wholly and exclusively for purposes of business or profession	All assessees	To be continued	-
156	37(2B)	Advertisement in souvenir, brochure, tract, pamphlet etc., of political party	All assessees	To be continued	-
157	42(1)	In case of mineral oil concerns allowances specified in agreement entered into by Central Government with any person (subject to certain	Assesses engaged in prospecting for or extraction or production of mineral oils	To be continued	-

		conditions and terms of agreement)			
158	42(2)	In case of mineral oil concerns expenditure incurred remaining unallowed as reduced by proceeds of transfer	Assesses whose business consists of prospecting for or extraction or production of petroleum and natural gas and who transfers any interest in such business	To be continued	**-**
159	43B	Any sum which is actually paid, relating to 9I) tax/duty/cess/fee levied under any law , (ii) contributions to provident fund/superannuation fund/gratuity fund /any fund for employees' welfare.(iii) bonus/commission to employees and (iv) interest on loan/borrowing from any public financial institution, State Financial Corporation or State Industrial Investment corporation/interest payments to scheduled banks on term loans. Deduction will not be allowed in year in which liability to pay is incurred unless actual payment is made in that year or before the due date of furnishing or return of income for that year.	All assesses	Since the provision is a deviation from accrual method of accounting to the cash system of accounting in respect of payments covered under this provision, there is no rationale for allowing payments made after the close of the previous year but before the due date for filing of tax return, as deduction in the earlier previous year. This introduces unnecessary burden on the tax administration and also complicates compliance. In any case what is paid after the close of the financial year, can always be claimed as deduction in the subsequent year.	**-**
160	44A	Expenditure in excess of subscription, etc., received from members (subject to certain conditions and limits)	Trade, professional or similar association	To be continued	**-**
161	44c	Head office expenditure (subject to certain conditions and limits)	Non-resident	To be continued	**-**
162	48(i)	Expenditure incurred wholly and exclusively in connection with transfer of capital asset	All assessees	To be continued	**-**
163	48(ii)	Cost of acquisition of capital asset and of any improvement thereto (indexed cost of acquisition and indexed cost of improvement, in case of long-term capital assets)	All assessees	To be continued	**-**
164	54	Long term capital gains on sale of	Individual/HUF	Restrict it to a case	**6**

		residential house and land appartenant thereto invested in purchase/construction of another residential house (subject to certain conditions and limits)		where the taxpayer on the date of the transfer does not own any other house property.	
165	54B	Capital gains on transfer of land used for agricultural purposes, by an individual or his parents, invested in other land for agricultural purposes (subject to certain conditions and limits)	Individual	To be continued	**11**
166	54D	Capital gains on compulsory acquisition of land or building forming part of an industrial undertaking invested in purchase/construction of other land /building for shifting /re-establishing and undertaking or setting up new industrial undertaking (subject to certain conditions and limits	Any assessee	To be continued	**6**
167	54EA	Net consideration on transfer of long-term capital asset made before 1-4-2000 invested in specified bonds, debentures, share of a public company or units of notified mutual funds (subject to certain conditions and limits)	Any assesses	Delete	**1**
168	54EB	Long-term capital gains on transfer of any long-term capital asset made before 1-4-2000 invested in specified long-term assets (subject to certain conditions and limits)	Any assesses	Delete.	**1**
169	54F	Net consideration on transfer of long term capital asset other than residential house invested in residential house (subject to certain conditions and limits)	Individual/HUF	Restrict it to a case where the taxpayer on the date of the transfer does not own any other house property.	**6**
170	54G	Capital gain on transfer of machinery, plant, land or building used for the purposes of the business of an industrial undertaking to a non-urban area) invested in new machinery, plant, building or land, in the said non-urban area, expenses on shifting, etc. (subject to certain conditions and limits	Any assessee	To be continued	**6**
171	57(i)	Any reasonable sum paid by way of commission or remuneration for purpose of realising dividend	All assessees	To be continued	**-**
172	57(i)	Any reasonable sum paid by way of commission or remuneration for the purpose of realising interest on	All assessees	To be continued	**-**

		securities			
173	57(ia)	Contributions to any provident fund or superannuation fund or any fund set up under Employees' State Insurance Act, 1948 or any other fund for welfare of employees, if the same are credited to employees' accounts in relevant funds before due date	All assessees	To be continued	**-**
174	57(ii)	Repairs, insurance and depreciation of building, plant and machinery and furniture	Assessees engaged in business of letting out of machinery, plant and furniture and building on hire	To be continued	**-**
175	57(iia)	In case of family pension, 33 1/3 per cent of such pension or Rs. 15,000, whichever is less	Assessees in receipt of family pension on death of employee being member of assessee's family	To be continued	**-**
176	57(iii)	Any other expenditure (not being capital expenditure)expended wholly and exclusively for earning such income	All assessees	To be continued	**-**
177	80CCC	Contributions to certain pension funds of LIC (up to Rs. 10,000) (subject to certain conditions)	Individual	Provide for a tax credit at the rate of 10 percent upto a maximum of Rs1000.	**1**
178	80D	Medical insurance premia (up to Rs. 10,000) (Subject to certain conditions)	Individual/HUF	Provide for a tax credit at the rate of 10 percent upto a maximum of Rs1000.	**6**
179	80DD	Deduction of Rs. 40,000 where any expenditure has been incurred for the medical treatment (including nursing), training and rehabilitation of a handicapped dependant or any amount is paid or deposited under any scheme framed in this behalf by the Life Insurance Corporation or the Unit Trust of India	Resident Individual/HUF	Provide for a tax credit at the rate of 10 percent upto a maximum of Rs4000.	**6**
180	80DDB	Expenses actually incurred on medical treatment of specified diseases and ailments subject to certain conditions.	Resident Individual/HUF	Provide for a tax credit at the rate of 10 percent upto a maximum of Rs4000	**6**
181	80E	Amount paid out of income chargeable to tax by way of repayment of loan or interest on loan taken from financial institution/approved charitable institution/approved charitable institution for pursuing higher	Individual	Provide for a tax credit at the rate of 10 percent upto a maximum of Rs4000	**6**

		education (subject to certain conditions) (maximum deduction : Rs. 25,000 in a year : for a maximum period of 8 years).			
182	80G	Donations to certain approved funds, trusts, charitable institutions/donations for renovation or repairs of notified temples, etc.	All assessees	Provide for tax credit at the rate of 10 percent of the contribution.	**7**
183	80GG	Rent paid in excess of 10% of total income for furnished/unfurnished residential accommodation (subject to maximum of Rs. 2,000 p.m. or 25% of total income, whichever is less)(subject to certain conditions)	Individuals not receiving any house rent allowance	Delete	**3**
184	80GGA	Certain donations for scientific, social or statistical research or rural development programmes or conservation or natural resources or afforestation or for carrying out an eligible project or scheme or National Urban Poverty Eradication Fund (subject to certain conditions)	All assessees not having any income chargeable under the head 'Profits and gains of business and profession'	Merge with Section 80-G	**7**
185	80HH	Profits from newly established industrial undertakings or hotel business in backward areas where manufacture has commenced before 1-4-1990 (20 per cent of profits)(subject to certain conditions)	All assessees	Delete since no more required on the statute.	**4**
186	80HHA	Profits from newly established small scale industrial undertakings in certain areas where manufacture has commenced before 1-4-1990 (20 per cent of profits)(subject to certain conditions)	All assessees	Delete since no more required on the statute.	**4**
187	80HHB	Profits from projects outside India (50 per cent of profits)(subject to certain condition)(w.e.f. 1-6-1999 assessee to furnish certificate from chartered accountant that deduction has been correctly claimed)	Indian company/ non corporate resident assessees	Already under phase out.	**5**
188	80HHBA	Profits and gains from execution of certain housing projects aided by World Bank (50% of profits)(subject to certain conditions)	Indian company/ non corporate resident assessees	Delete . the source of the funding should not be any criterion for exemption	**6**
189	80HHC	Profits derived from export of specified goods or merchandise if sale proceeds are receivable in convertible foreign exchange (100 percent of profits)(subject to certain conditions)	Indian company/non corporate resident assessees engaged in business of export	Already under phase out.	**5**
190	80HHD	Income of approved hotels/tour operators or of travel agents for services provided to foreign tourists	Indian company/non corporate resident assessees	Already under phase out.	**5**

		if receipts are in convertible foreign exchange and subject to specified conditions (50 per cent of profits of such services plus 50 percent of such profits of the relevant previous year debited to profit and loss account and credited to reserve account)			
191	80HHE	100% of profits derived from export out of India of computer software or its transmission from India to a place outside India by any means or in providing technical services outside India in connection with the development or production of computer software(subject to specified conditions)	Indian company / non corporate resident assessees	Already under phase out.	**5**
192	80HHF	100% of profits and gains derived from export transfer of film software television software, music software and television news software, including telecast rights, proceeds of which are received in convertible foreign exchange (subject to certain conditions)	Indian company/non corporate resident assessees	Already under phase out.	**5**
193	80I	Profits from industrial undertakings, ships hotels and cold storage plants set up after 31-3-1981 (subject to certain conditions and limits)(available up to assessment year 1991-1992)	All assessees	Delete	**4**
194	80IA	Profits and gains from industrial undertakings engaged in infrastructure facility, telecommunication services, industrial park, power undertakings, etc.	All assessees	Delete	**4**
195	80IB	Profits and gains from industrial undertakings, cold storage plant, hotel, scientific research & development, mineral oil concern housing projects, cold chain facility, ships, etc.	All assessees	Delete	**4**
196	80JJA	Entire income from business of collecting and processing or treating of biodegradable waste for generating power or producing bio fertilizers, bio pesticides or other biological agents or for producing bio-gas , making pellets or briquettes for fuel or organic manure (for 5 consecutive assessment years)	All assessees	Delete	**4**
197	80JJAA	30 per cent of additional wages paid to new regular workmen	Indian company	Delete	**11**

		employed in the previous year for 3 assessment year relevant to the previous year in which such employment is provided (subject to certain conditions)			
198	80L	Interest on Govt. securities, interest on NSC VI/VII Issue, interest on NSC VIII Issue, interest on notified bonds/debentures, interest on deposit under NSS, interest on deposits under Post Office (Time Deposits)/(Recurring Deposits) Schemes, interest on deposit under PO (Monthly Income account) Rules, interest on bank deposits/deposits with financial corporation, etc. (maximum limit for assessment year 1997-98 onwards : Rs. 12,000 (in addition, special deduction of Rs. 3,000 is allowed in case of interest on Government securities)	Individual/HUFs	Delete	**1**
199	80O	Any income received by the assess from the Government of a foreign State or foreign enterprise in consideration for use outside India of any patent, invention, design or registered trade mark, etc., in convertible foreign exchange and brought into India in accordance with any law (50 per cent of income) (subject to certain conditions)	Indian companies/Non-corporate resident assessees	Already under phase out.	**5**
200	80P	Specified incomes [subject to varying limits specified in sub-section (20]	Co-operative societies		**11**
201	80Q	Profits from business of publication of books (20 percent of profits)(subject to certain conditions) [for five years commencing from assessment year 1992-1993]	Any assessee	Delete	**11**
202	80QQA	Professional income of authors of text books in India languages (25 percent of income) (subject to certain conditions)	Resident individuals	Delete	**11**
203	80R	Remuneration from certain foreign sources in the case of professors/ teachers, etc. 75% of such remuneration as is brought into India in convertible foreign exchange with 6 months (for extended period) from the end of the previous year) (subject to certain conditions)	Individuals-Indian citizens	Already under phase out.	**5**

204	80RR	Professional income from foreign sources in certain cases (75% of such income as is brought into India in convertible foreign exchange within 6 months (for extended period) from the end of previous years)(subject to certain conditions)	Resident individuals authors, playwrights, artistes, musicians actors and sportsmen	Already under phase out.	**5**
205	80RRA	Remuneration received in foreign currency for services rendered outside India (75% of such remuneration as is brought into India in convertible foreign exchange within 6 months (for extended period) from the end of the previous year (subject to certain conditions)	Individuals-Indian citizens	Already under phase out.	**5**
206	80U	Income of partially or totally blind, mentally retarded, or physically handicapped persons as specified in rule 11D (subject to maximum of Rs. 40,000)	Resident individuals	Provide for tax credit at the rate of 10 percent upto a maximum of Rs 4000.	**6**
207	88	Rebate at the rate of 20 percent on investment made in certain specified categories of savings instruments.	♦ Individual • HUF	Delete	**1**

Appendix Table IV.2
Main Provisions Relating to Incentives for Savings

S.No	Section	Nature of Instrument	Who are entitled
1	10(4) (i)	Interest on securities or bonds notified by the Central Government including premium redemption of such bonds	Non-resident
2	10(4)(ii)	Interest received on Non-resident (External)Account	Person resident out-side India (as defined in FERA) and person who has been permitted to maintain said account by RBI
3	10(4B)	Interest on notified savings certificates issued by the Central Government and subscribed to in convertible foreign exchange	Individual (Indian citizen or person of Indian origin, who is a non-resident)
4	10(15) (i)	Interest premium on redemption, or other payment on notified securities, bonds, certificates, and deposits, etc. (subject to notified conditions and limits)	All assesses
5	10(15) (iib)	Interest on notified Capital Investment Bonds	Individual/HUF
6	10(15) (iic)	Interest on notified Relief Bonds	Individual/HUF
7	10(15) (iid)	Interest on notified bonds purchased in foreign exchange (subject to certain conditions)	Individual – NRI/ nominee or survivor of NRI/individual to whom bonds have been gifted by NRI.
8	10(15) (iii)	Interest on securities	Issue Department of Central Bank of Ceylon
9	10(15) (iiia)	Interest on deposits made with schedule bank with approval of RBI	Bank incorporated abroad
10	10(15) (iv)(h)	Interest received from any public sector company in respect of notified bonds or debentures and subject to certain conditions.	All assesses
11	10(15) (iv)(i)	Interest received from Government on deposits in notified scheme out of moneys due on account of retirement	Individual – Employee of Central government/State Government/Public sector company
12	10(33)	Dividends declared/paid by domestic companies and any income of a unit holder received from (a) UTI or (b) a mutual fund specified under section 10(23D).	All assesses
13	54	Long term capital gains on sale of residential house and land appurtenant thereto invested in purchase/construction of another residential house (subject to certain conditions and limits)	Individual/HUF
14	54B	Capital gains on transfer of land used for agricultural purposes, by an individual or his parents, invested in other land for agricultural purposes (subject to certain conditions and limits)	Individual
15	54D	Capital gains on compulsory acquisition of land or building forming part of an industrial undertaking invested in purchase/construction of other land/building for shifting/re-establishing said undertaking or setting up new industrial undertaking(subject to certain conditions and limits)	Any assessee

16	54EA	Net consideration on transfer of long-term capital asset made before 1-4-2000 invested in specified bonds, debentures, share of a public company or units of notified mutual funds (subject to certain conditions and limits)	Any assesses
17	54EB	Long-term capital gains on transfer of any long-term capital asset made before 1-4-2000 invested in specified long-term assets (subject to certain conditions and limits)	Any assesses
18	80CCC	Contributions to certain pension funds of LIC (up to Rs. 10,000) (subject to certain conditions)	Individual
19	80D	Medical insurance premia (up to Rs. 10,000) (Subject to certain conditions)	Individual/HUF
20	80DD	Deduction of Rs. 40,000 where any expenditure has been incurred for the medical treatment (including nursing), training and rehabilitation of a handicapped dependant or any amount is paid or deposited under any scheme framed in this behalf by the Life Insurance Corporation or the Unit Trust of India	Resident Individual/HUF
21	80DDB	Expenses actually incurred on medical treatment of specified diseases and ailments subject to certain conditions.	Resident Individual/HUF
22	80E	Amount paid out of income chargeable to tax by way of repayment of loan or interest on loan taken from financial institution/approved charitable institution/approved charitable institution for pursuing higher education (subject to certain conditions) (maximum deduction : Rs. 25,000 in a year : for a maximum period of 8 years).	Individual
23	80L	Interest on Govt. securities, interest on NSC VI/VII Issue, interest on NSC VIII Issue, interest on notified bonds/debentures, interest on deposit under NSS, interest on deposits under Post Office (Time Deposits)/(Recurring Deposits) Schemes, interest on deposit under PO (Monthly Income account) Rules, interest on bank deposits/deposits with financial corporation, etc. (maximum limit for assessment year 1997-98 onwards : Rs. 12,000 (in addition, special deduction of Rs. 3,000 is allowed in case of interest on Government securities)	Individual/HUFs
24	88	• Life insurance premium for policy : - in case of individual, on life of assesses, assesses spouse and any child of assesses - in case of HUF, on life of any member of the HUF ▪ Sum paid under a contract for a deferred annuity : ▪ In case of individual, on life of individual, individual's spouse and any child of the individual ▪ Sum deducted from salary payable to Government servant for securing deferred	♦ Individual • HUF

		annuity or making provision for his wife/children [qualifying amount limited to 20% of salary] ▪ Contributions made under Employees Provident Fund Scheme ▪ Contribution to Public Provident Fund account in the name of : - In case of individual, such individual or his spouse or any child of such individual - In the case of HUF, any member of the family ▪ Contribution by an employee to a recognised provident fund ▪ Contribution by an employee to an approved superannuating fund - Sum deposited in Post Office Savings Bank (cumulative Time Deposit) – 10 year or 15 year account in the name of : - In case of individual, such individual or a minor of whom he is the guardian - In the case of HUF, any member of the family ▪ Subscription to any notified security or notified deposit scheme of the Central government. ▪ Subscription to notified savings certificates [National Savings Certificates (VIII Issue)] - Contribution for participation in Unit-linked Insurance Plan of UTI : - In case of an individual, in the name of the individual, in the name of the individual, his spouse or any child of such individual - In case of a HUF, in the name of any member thereof ▪ Contribution to notified unit linked insurance plan of LIC Mutual Fund [Dhanaraksha 1989] - In the case of an individual, in the name of the individual, his spouse or any child of such individual in the case of a HUF, in the name of any member thereof ▪ Subscription to notified deposit scheme or notified pension fund set up by National Housing Scheme [Home Loan account scheme] ▪ Certain payments (up to Rs. 10,000) for purchase/construction of residential house property ▪ Subscription to notified schemes of 9a) public sector companies engaged in providing long-term finance for purchase/construction of houses in India for residential purposes/(b) authority	

	88B	constituted under any law for satisfying need for housing accommodation (other than schemes interest where under qualified for tax rebate under section 80L) ▪ Sum paid towards notified annuity plan of LIC ▪ Subscription to any units of any notified Mutual Funds or the UTI up to maximum of Rs. 10,000 ▪ Contribution by an individual to any pension fund set up by any notified Mutual Fund or by the UTI ▪ Subscription to equity shares or debentures forming part of any approved eligible issue of capital made by a public company or public financial institutions ▪ Subscription to any units of any approved mutual fund referred to in section 10(23D) provided amount of subscription to such units is subscribed only in 'eligible issue of capital' referred to above. Amount of tax rebate is 20 percent qualifying amount (maximum Rs. 60,000) (Rs. 70,000 in case of authors, playwrights, artistes, musicians, actors or sportsmen) of deposits Tax rebate of 100% of tax payable or Rs. 10,000, whichever is less	20 20A Resident individuals of 65% years of age and above

Appendix Table IV.3
Selected Tax Incentives for Charitable Trusts/Institutions and Contributions

Incentive (Section No.)	Eligibility	Conditions	Duration and Rate of Relief
10(23BBA)	Income of the authorities or bodies constituted by the Central, State or Provincial Act for the administration of public, religious, charitable trusts, endowment or societies for religious or charitable purposes.	Income of the societies, trusts or endowments referred under this section is not exempt from tax.	100 per cent for the unlimited period.
10(23C)	Income of: (a) certain national funds, (b) charitable funds or institutions notified by the Central Government, (c) religious trusts or religious institutions notified by the Central Government, (d) educational institutions, and (e) hospitals.	**Conditions for (b) and (c):** Application must be made in Form 56. Income must be applied wholly for the purpose for which it has been established. Exemption is not available for business income not directly related to the primary objective(s). Can invest only in pre-specified instruments specified in Section 11(5). Exemption is available for voluntary contribution subject to the condition that such contributions are not held otherwise than in any one or more of the modes specified in section 11(5). **Conditions for (d) and (e):** These institutions are existing solely for these purposes and not for profit. Wholly or substantially financed by the Government or the aggregate receipts do not exceed Rs. 1 crore or it is approved by the CBDT subject to the conditions mentioned above for (b) and (c). Exemption is available for voluntary contribution subject to the condition that such contributions are not held otherwise than in any one or more of the modes specified in section 11(5).	100 per cent for the unlimited period.
11, 12 and 13	Income of a charitable trust. Charitable purpose is defined under section 2(15) as relief of the poor, education, medical relief and the advancement of any other object of general public utility.	The property from which income is derived should be held under a trust and wholly for charitable or religious purpose. The trust should not be created for the benefit of any particular religious community or case. Benefits should not accrue to a specified person or a group of specified persons.	100 per cent for the unlimited period.

		Exemption is confined to only such portion of the trust's income which is applied to charitable or religious purpose. Voluntary contributions or donations will be deemed to be part of income derived from property held under trust with some minor exceptions. Charitable trusts or institutions must use at least 75 per cent of the income for charitable or religious purpose to avail full exemption. Application of income may fall short of 75 per cent if a part of income is saved for future use in India subject to the approval of the authority. Such income so accumulated or set apart will not be included in the total income of the trust in the year of receipt. Trusts may be granted an extended time to spend the unused income. Subject to some pre-specified conditions, a capital gain will be regarded as having been applied for religious or charitable purpose. The account of the trust should be audited. The trust shall apply for registration with the commissioner. A charitable trust or institutions can carry out business activities if business activities are incidental to the attainment of its objectives and separate books of accounts are maintained. Funds of such institutions may be invested only in pre-specified saving instruments.	
80G	Donations to pre-specified charitable trusts or funds.	No upper limit for the qualifying amount. However, for certain donations qualifying amount in excess of 10 per cent of the adjusted gross total income of the assessee is ignored. Double deduction is not permissible. A donor cannot claim deduction under section 80G as well as under section 35. Proper proof of payment must be submitted to claim deduction.	100 per cent deduction (entire qualifying amount) from income for the unlimited period for sixteen pre-specified donations. 50 per cent of the qualifying amount for another ten pre-specified donations for unlimited period.