

“Study on Recent Trends and Updates on Indian Tax System and Its Effect on Public Finance”

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Abstract – *The Indian tax reorganization experience provided useful lessons for many countries due to the largeness of the country with multilevel fiscal framework, uniqueness of the reform experience and difficulties in calibrating reforms due to institutional constraints. The transition of India from an insular economy in the early nineties to a global economy is indeed remarkable. As we come to grips with being a part of a global economy, it is imperative that the tax policies of the country keep pace with the global tax regime.*

Keywords: Indian Tax System, Investment, Tax Regime

INTRODUCTION

The evolution of the Indian tax system was driven by similar concerns and yet, in some ways, it is different and even unique. Unlike most developing countries, which were guided in their tax reforms by multilateral agencies such as the International Monetary Fund, Indian tax reforms have largely borne a domestic brand. They have been calibrated to changes in the development strategy over time while staying in step with the institutional arrangements in the country. [1] Thus, even when the government sought assistance from multilateral financial institutions, the recommendations of these institutions did not directly translate into an agenda for tax reform. Despite this, the tax system reforms were broadly in conformity with international trends and advice proffered by expert groups and was in tune with international best practices. [2]

REFORM OF DIRECT TAXES

At the central level, the changes in the income tax structure until the mid 1970s were largely ad hoc dictated by the exigencies. The tax policy was central to the task of bringing about a socialistic pattern of society, and in 1973-74, the personal income tax had eleven tax slabs with rates monotonically rising from 10 percent to 85 percent. When the surcharge of 15 percent was taken into account, the highest marginal rate for persons above Rs. 0.2 million incomes was 97.5 percent. In fact, increase in income tax rates to confiscatory levels was completed immediately after the split in the Congress party in 1969 and this seems to be a part of projecting the pro-left image of the party.

The policy was similar in the case of company taxation. The classical system of taxation involved taxation of the profits in the hands of the company and dividends in the hands of the shareholders. A distinction was made for widely held companies and different types of closely held companies and the tax rate varied from the base rate of 45 percent to 65 percent in the case of some widely held companies.

Although nominal rates were high, the effective rates were substantial lower owing to generous provision for depreciation allowance and investment allowance. In fact, some companies were able to make use of generous tax preferences such that they did not pay any corporate tax year after year.

TAX REGIME

- Differential tax regime on taxation of consumers on goods and services has adverse implications for economic neutrality as well as equity. Consumers with relatively strong preference for taxed goods are at disadvantage vis-à-vis consumers with the same income level but preferring consumption of non-taxed / less taxed services. The equity aspect refers to the fact that the higher income household allocates relatively proportion of their incomes on purchase of services.
- Failure to provide full tax offsets to the business firms leads to distortions of choice of methods of production based on the types of differentially

taxed inputs and also impacts household consumption patterns.

- Taxation of capital goods without apt offsets to business is perhaps the most serious consequence of inefficient taxation system. This discourages savings and investment and decelerates growth of productivity.
- Domestic producers face competitive disadvantage in the absence of destination based taxation principle both between India and rest-of-world as well as across states.
- Some states may have more complex tax regime as compared with some other states.
- Lack of proper coordination between the central and the state-level tax administration creates complexities and cost inefficiency.

The taxes paid on intermediate purchases by the business firms get rebates there still exist components which do not get this benefit. While the Central indirect taxes including customs and excise duties get nearly fully reimbursed, the state-level taxes do not get full offsets. Some such state-level taxes include central sales tax (CST), electricity duty, and sales tax on petroleum products, mandi tax, entry taxes, octroi and municipal taxes. The cumulative impact of such un-rebated taxes has been estimated between 3 per cent to 12 per cent of the fob export value depending on the product and its state of origin (Ministry of Commerce and Industry, Government of India, 2009 . [3] These figures include 1 per cent to 9 per cent as electricity duty, CST and sales tax on petroleum products and the remainder on account of mandi tax, entry tax, octroi, municipal taxes and cesses (NCAER 2005). Since all taxes, central as well as state, would be subsumed in GST exports are expected to become tax-free thus enhancing competitiveness of Indian exporters. In fact, all local duties and cesses should also get full offset through the instrument of GST. The tax evasion literature has typically concentrated on under-reporting of self-employment earnings [4], since the withholding and reporting requirements of wage and salaried earnings make under-reporting difficult [5] and thus quantitatively small, particularly in the United States [6] – the typical theoretical models in fact assume no evasion on wage and salary income [6].

CONCLUSION:

A significant number of participants viewed tax as an important determinant of the investment climate in India. As the Government seeks to hasten the pace of

liberalization, the message that seems to be emerging is that while foreign investment will continue to flow into India on account of its inherent economic advantages, tax constitutes an important part of decision making, and not dealing with tax issues appropriately could have adverse consequences.

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