Tax Rules & The Stimulus
-Developing Economy Perspective-

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Issues

- Resource Mobilization and Taxation as a Part of the Stimulus and Recovery
- Context of Economic and Fiscal Reform in A globalizing economy; Simplifying and widening tax base; technological and business models of tax administration
- Is taxation and resource mobilization possible in the informal unorganized sector? Dualities and Possibilities
- Is significant resource mobilization possible at the local economies in developing countries; raising resources and supporting autonomy
- Special transitionary opportunities in stimulus policies; inverted tariffs ?
- Need: resource mobilization and widening growth from green shoots.

Taxing the Informal Sector

- Trend of informal unorganized employment.
- Even in the formal/organized sector of the Indian economy in the recent period of fast manufacturing and overall growth unorganized/informal employment has gone up in a big way from 37.8% to 46.6% of the total. Quality of Employment the issue, but there are significant dualities
- Dynamic and prosperous sub sectors. Indian diamond polishing industry largely in the informal sector has a remarkable expansion record including very substantial purchase of retail outlets in the US. There are other examples.
- Lack of accounting practices; Presumptive Assessments
- The Indian tax reform in 2009/2010 includes a policy initiative for ;

  "Introducing a new package of presumptive taxation to encourage voluntary compliance by small businesses." The Central Board of Excise and Customs in India introduced in 2009 a production based levy for pan masala and guthka, hazardous stimulants in much demand in India: 'was a huge success' (Chairman, CBE&C, August 25). Incentive for transparency in accounting thru contestation.

Local Resource Raising

- Orthodoxy Local governments in poor countries don’t raise resources; empirically erroneous.
- In about a quarter of the cases as the local economy grew econometric studies showed that resources raised by the local bodies grow at one and a half times the economies growth rate. As compared to the elasticity of own resource raising by local bodies of 0.6 as a whole. A number of examples.
- Investment finance for rural infrastructure is essential. It is essential that non-revenue sources have to be seriously rationalized and properly tapped. Efforts to help create healthy balance sheet for the local institutions will put them in a position to present a rating and a borrowing-risk that is viable if not attractive to the Financial Institutions that can then be approached for underwriting or taking exposure.
- The moral of the story is that:
- If achievements are made models for incentivisation, local bodies would soon meet current expenditures and be in a position to productively borrow if the Treasury does the reform to permit it.
- This is slow. For example a policy for urban borrowing is still under preparation. It is easier to buy the bond of a foreign local body rather than an Indian one.
- Since this is a global problem inter country experience sharing would be useful

Doubly Blessed

- **Financing and credit mechanisms for these newer initiatives are needed; Community collateral and other innovative forms of financing are needed; (UNSSD,2002)**
- **Need of detailed exercises for fiscal consolidation. The better units have to become models for the average. Expert Restructuring Bodies/ Commissions can use them as tax examples, prudence and rule based policies.**
- **Investment finance for rural infrastructure is essential. It is essential that non-revenue sources (fees/capital taxes) have to be seriously rationalized and properly tapped. Efforts to help create healthy balance sheet for the local institutions will put them in a position to present a rating and a borrowing-risk that is viable if not attractive to the Financial Institutions that can then be approached for underwriting or taking exposure.**
- **The fiscal constraint at the spending levels is not largely a resources problem, but a restructuring and devolution problem In the stimulus either the best practices have to be replicated in resource raising and/or free resources made available in formula based assistance. Newer financial structures and institutions at State and local levels need organizational and financial market reform at higher levels like tax rationalization and coordination groups, markets for local securities, community collateral and so on. This reform has a national and global edge**

Taxation in A Stimulus

- **Taxation policies to avoid negative protection. In a partially reforming economy, if the input supplier has not been subjected to competition, even- if a firm is efficient, it will make losses, because the global competitor gets components and equipment at cheaper prices, or his interest rate is lower. Tariff policies in clusters would need to be determined in an harmonized manner taking these configurations into account.**
- **In a distorting trade epoch which to an extent all depressions will be, it is possible to bring in policies of inverted tax structures in a measured and phased manner. India's budget papers, for the 2009/10 stimulus budget describe this policy as indirect tax rates compensating for 'deeper cuts on finished goods as compared to their raw materials'. Peak tariff rates, set by reform of the tax system are not changed, but tariff rates reduced on specified inputs, components and capital goods.**
- **For the agricultural sector expert bodies and a Committee I chaired on economic policies for a WTO trade dominated regime argue for variable tariff rates calibrated to protect the efficient Indian agricultural producer and a number of quantitatively worked out counterfactuals are available. Such a policy would raise revenues. The World Bank has advocated this policy for India as 'working a level playing field'.**
- **Purely temporary and transitional measures and as part of the final reform of the tax system it is projected that an attempt will be made to; 'Review custom duty exemptions and move to a uniform duty structure to eliminated inverted duties.'**

Business Processes and Tax Administration

- India specializes
- Filing of E returns, E payment of taxes, State of the art Centralized Processing Centre, Refunds through ECS, Refund Bankers, including private sector banks, Computer Aided System of selection of cases for scrutiny,Taxpayer Information System with increasing interactive procedures.
- Computer based Document Identification Number(DIN) to assist taxcorrespondence. Id part of a larger system UID (Unique Identification Number).Authority set up with a time bound task of a unique identification of each citizen. Another business process initiative underway is the development of communication systems in the tax administration using IT tools for interaction with the tax payer.
- While India's metros and smaller towns are well wired up, the situation has now changed and a pilot project I had reported of the wiring of fifty five villages has this year been given a State level award for application of IT for rural development. It is one of many initiatives and it is likely that smaller settlements will increasingly use E support for tax administration and compliance. South South collaboration should be actively promoted in this area.

Simplifying the Tax System

- Progress has been made to improve the tax structure, broaden the base and rationalize the rates
- Notable among the improvements made are:
- Replacement of the single point state sales taxes by the VAT in all States
- Reduction in the Central Sales Tax rate to 2 per cent, from 4 per cent, as a part of a complete phase out
- Introduction of service tax by the Centre, and a substantial expansion of its base over the years.
- Rationalization of the CENVAT rates by reducing their multiplicity and replacing many of the specific rates by ad valorem rates.
- In defining options for further reform, The Empowered Committee of State Finance Ministers (EC) in November 2007 had recommended a “dual” GST, to be levied concurrently by both the Central and State Governments. The dual GST option permits both levels of government to apply the tax to a comprehensive base of goods and services and eliminates tax cascading.
- GST would facilitate greater vertical equity in fiscal federalism and through shift to value addition as the basis for assessment unify the market for goods and services. The target is to commence GST from the financial year 2010/11.

Simplifying indirect Taxes More

- **The EC (which was instrumental in the operationalization of the state level VAT) in consultation with the Central Government, has sent its recommendations to the Government of India in the form of "A Model and Road Maps for Goods and Services Tax in India" in April 2008, which included an outline of the GST design proposed. Work is apace and agreement has been reached on uniform rates at the State level, one uniform rate and another lower one for essential goods.**
- **A Reform Structure and Road Map helps.**

Direct Taxes Code

- The Finance Ministry has introduced a Direct Tax Code for discussion. This rationalizes the structure of direct taxes and suggests simplifications of exemptions.
- The corporate tax regime in India has a higher base rate, set off with sector specific tax incentives (exemptions/deductions). The corporate tax rate has been proposed at a lower 25% and tax incentive provisions have been largely eliminated.The code proposes to replace the current business profits with specified adjustments basis of computing income from business to an income expense model, as prevalent in certain developed and other Asian countries.
- The code proposes to introduce the Exempt-Exempt-Tax (EET) method of taxation for savings. Contributions and interest accumulation/accretions will be exempt; however, all withdrawals will be subject to tax in the year of withdrawal.
- The code materially seeks to re-alter the provisions relating to capital gains taxation. First, the code seeks to bifurcate capital assets as investment assets and business assets. Income arising upon transfer of an investment asset would only be taxable as capital gains. Second, the code would eliminate the distinction between short-term and long-term assets, by providing for taxation of gains arising on transfer of any investment asset.

Conclusions

- **India therefore has a road map for indirect tax reform with 2010 as a target and a Direct Taxes Code draft to encourage discussion. It should be possible to make progress on the former during the stimulus revival, while giving a deadline for the latter is problematic, although the process has begun. The indirect tax structure should be stimulus friendly and lead both to a wider tax net and a payer friendly system**
- **There exist possibilities of tax revenue mobilization in a reform compatible manner. All(some) of them need thinking out of the box and would lead to resistance. However it should be possible to build core support since the structures would soften the impact of the melt down.**
- **In particular detailed proposals available with a practical road map of implementation during the revival period would stand better chances of acceptance.**