Union Budget – sensible yet opportunity Missed

International Tax | Tax voice



28 April 2017

Parthasarathi Shome provides a view of the recent Indian Budget

A nation's Budget should ideally inspire. This one was, instead, workman like, perspicacious in policy aspects while lacking in administrative ones. Reflecting limitation of space, I shall take up only fiscal policy followed by tax policy and administration. To begin, while the Fiscal Responsibility and Budget Management (FRBM) Review committee recommended that fiscal deficit should be 3 percent of GDP, government has fixed it at 3.2 percent for 2017-18. This may seem amiss; however, it reflects capital expenditure rather than revenue (consumption) expenditure of government. Indeed, revenue deficit is projected to decline to 1.9 percent (though FRBM would allow 2 percent), from 2.1 percent in 2016-17. This is fine in an environment of lacklustre private investment.

Concerning the business sector, the prominent salutary measure is reduction of the corporate income tax (CIT) rate to 25 percent for 96 percent of return filing companies. This was direly needed for investment from the (Micro Small and Medium Enterprises) MSME sector. The other 4 percent larger companies enjoy lower effective tax rates but bringing down their headline rate should not be long

postponed from an international competitiveness perspective. Interestingly, the annual revenue loss due to this measure is only Rs 72 billion (approx. £865m) – a miniscule percent of total tax or expenditure. Thus the intelligent follow-up policy would be to make this sector pay their legitimate tax share through expanded taxpayer base which FM assured.

Corporations have to pay the higher of CIT and Minimum Alternate Tax (MAT). MAT's unanticipated extensions to new productive activities have exacerbated uncertainty in business decisions but, if left alone, it is a good tax that enhances equity among taxpayers. The extension of MAT loss carryover from 10 to 15 years is a rational measure for evening out tax payments and improving MAT's acceptability. On the other hand, the change in long term capital gains definition from three to two years is arbitrary for, indeed, it differentiates income and capital gains even more starkly while ideally they should not be separated.

In international taxation, removing taxation of indirect transfers that take place abroad of foreign portfolio investors on India-based assets is welcome. It was long overdue and reflected a flaw in the tax structure. Also, the Indian tax administration's excessive transfer pricing (TP) audit practices is internationally well known. Thus, limiting transfer pricing audit of domestic companies to only those with profit-linked deductions should contain an explosion of domestic TP audit cases. However, a gross omission was any mention of ongoing training for GAAR application from April 1 given the adverse experience with TP application.

Moving to individual income tax, it is not clear why the tax rate was reduced from 10 percent to 5 percent for the Rs 0.25-0.5 million bracket. Just an inflation adjustment would have corrected for fiscal drag. FM read out a long calculation of beneficial tax saving within this group reflecting routine such calculations of the income tax department. It appeared more as an election preparatory item than being based on economic rationale. On the other hand, the 10 percent surcharge introduced for the Rs 5-10 million bracket is justifiable. It is to be conceded that the composite package comprises a direct income transfer from the top to the lower tax brackets.

Now to tax administration. The World Bank ranks India at 172 in the ease of paying taxes among 190 countries. The Budget proposals will not improve this since they contain little fundamental tax administration reform despite the Tax Administration Reform Commission's (TARC) deep recommendations. The group that invented the term 'tax terrorism" is sinking rapidly into it. FM's single sentence, "I would like to

assure everyone that honest, tax-compliant person would be treated with dignity and courtesy" fails to reassure. The one-page Form proposed for individuals with taxable income less than Rs 0.5 million (other than business income) is good on paper. By international standards, however, Individual Tax Return Forms continue to be complex, often not comprehensible, and sometimes perhaps not above the law—for example where asking for information on financial and real assets in a Form for income tax when there is no tax on wealth. This is where lack of conviction or understanding of fundamental tax administration reform reveals itself.

On a salient note, the Finance Minister (FM) frankly reported on GST preparations—albeit a poorly designed tax that does not stand up to international scrutiny—thus indicating what the remaining tasks comprise. When exactly those tasks would be successfully completed was not clear though the indication that GST taxpayers would be informed and consulted from April 1 was welcome—though, if GST is to be implemented from September-October, the stakeholder consultation period is utterly short by international standards.

To conclude, the tax policy announcements and the overall fiscal framework cannot be heavily faulted; indeed, many aspects should be praised. However, tax policy is only one palm. For a namaste, the other palm – tax administration – has to be offered. This part is missing for FM did not delineate it convincingly. Successful demonitisation—other than, as implemented, its deeply harmful effects on the poor—is certainly good for reducing tax evasion. But, again, the quid pro quo has to be ensuring and elaborating on the design of tax administrator behaviour. It is not just putting a distance between taxpayer and tax administrator through policy for, ultimately, that would merely skirt the crux of the problem. FM expressed preoccupation with lagging private investment. It will not improve much without fundamental administration reform.