Tax Measures

2.37 The principles that have guided the framing of tax proposals in the Budget 2001-02 were the need for growth in revenue, simplification and rationalization of the tax regime, and effective tax compliance. Besides, the surcharges were abolished on corporates and non-corporates in the case of direct taxes and customs to effect rate cut to fuel growth. The emphasis of the direct tax proposals in the budget was to continue with the policy of stability in tax rates, widening the tax base, simplification of tax laws, provide incentives for infrastructure development and promotion of capital market in particular. Tax incentives in the form of tax holidays for development of infrastructure were rationalised and enlarged. New measures to curb tax avoidance by transfer pricing was introduced in the budget. One-by-six scheme for identifying the potential taxpayer was extended to all urban areas in the country as defined by the 1991 census. The details of various direct tax measures are given in Box: 2.3. In the area of indirect taxes, the process of rate reduction, rationalisation and simplification of procedures was further carried forward. The peak level of customs duty was scaled down to 35 per cent with the abolition of 10 per cent surcharge. Budget also signalled Government's resolve to progressively reduce the number of rates to the minimum with a peak rate of 20 per cent within three years. To encourage growth of information technology and telecom sector, duty on these items were reduced to 15 per cent. Basic customs duty were adjusted upwards for a number of agricultural items. The excise duty structure which was rationalised to a single rate 16 per cent CENVAT (Central Value Added tax) in 2000-01 was further improved with the reduction of three special excise duty rates (8 per cent, 16 per cent and 24 per cent) to a single rate of 16 per cent. An additional levy called National Calamity Contingent Duty was imposed on cigarettes, pan masala, biris etc. to garner funds for National Calamity Contingency Fund. Food preparations based on fruits and vegetables were completely exempted from excise duty. Excise duty on petrol which was earlier raised in the Budget were further enhanced. The coverage of service tax at the rate of 5 per cent on the value of taxable service was expanded to include fifteen new services. The details of various indirect tax measures are given in Box 2.4.

Progress in the implementation of State Value Added Tax

2.38 In the Conference of Chief Ministers of States held on 16th November, 1999, it was decided to implement uniform floor rates of sales-tax in the entire country. It was also decided to phase out sales-tax based incentive schemes for industries, reform the Central Sales Tax System and simplify the tax system as prevailing in the States by introduction of Value Added Tax (VAT). It has now been decided that all States and Union Territories would implement VAT from April , 2003. An Empowered Committee of State Finance Ministers has agreed upon the following sequence of steps to ensure introduction of VAT in place of retail Sales-tax system in States: (i) passing of VAT legislation and framing of rules and regulations; (ii) computerisation of dealers who will fall within the ambit of VAT; (iii) training of tax officials, traders and consumer associations; (iv) publicity for consumers and; (v) implementation of VAT, assigning VAT identification numbers to tax payers and; (vi) implementing transitional measures for introduction of VAT.

BOX 2.3

Direct Taxes

Tax Rates

- Stability in tax rates was continued with no changes in rates of personal or corporate tax. However, the maximum marginal tax rate in the case of co-operative societies was reduced to 30 per cent from 35 per cent.
- Abolition of all surcharges except surcharge at the rate of 2 per cent leviable on all non-corporate and corporate assesses except for foreign companies.

Incentives for Infrastructure, Industry and Exports

- The concession of two-tier tax holiday under section 80-IA for development of infrastructure has been rationalized and enlarged.
  - ❑ Ten year tax holiday (out of initial 20 years) for roads, highways, rail, sanitation, sewerage, etc.
  - ❑ Ten year tax holiday (out of initial 15 years) for airport, port, inland port or waterways, industrial park, power generation and distribution.
- Five year tax holiday and 30 per cent deduction for the next 5 years (out of initial 15 years), for telecommunication sector which was available upto March 31, 2000 has been reintroduced retrospectively for units commencing operations on or before March 31,2003. Similar concessions also extended to internet service providers and broadband networks.
- Period of commencement of business for tax holiday to generation of power and new transmission and distribution lines has been extended upto March 31, 2006.
- Tax holiday for five years and 30 per cent deduction of profits for the next five years introduced for undertakings engaged in the integrated handling, storage and transportation of foodgrains u/s 80-IB.
- Tax incentive available to an assessee carrying on the business of growing and manufacturing tea in India has been enhanced from twenty per cent to forty per cent.
- Deduction u/s 80-IA has been extended to enterprises developing SEZ.
- Domestic sales by EOU/EPZ/FTZ and software technology park units to be taxed (10A/10B). Restriction on transfer of ownership u/s. 10A and 10B has been removed in case of public limited companies, companies that become listed and venture capital company (VCCs)/venture capital company (VCFs). Income from onsite services to be eligible software export for purposes of deduction under section 10A/10B.
- Phasing out of deductions u/s 80HHC, 80HHE and 80 HHF changed to 70 per cent for assessment year 2002-03, 50 per cent for assessment year 2003-04, and 30 per cent for assessment year 2004-05.

Incentives for Research and Development

- Contributions made to persons approved by the Principal Scientific Adviser to the Government of India for scientific research in approved programmes has been allowed weighted deduction of 125 per cent.
- Expenditure for research and development for the business of bio-technology has been allowed weighted deduction of 150 per cent. It has also been provided that 'expenditure on scientific research', in relation to drugs and pharmaceuticals, shall include expenditure incurred on clinical drug trial, obtaining approval from any regulatory authority under any Central, State or Provincial Act and filing an application for a patent under the Patents Act, 1970.

Measures for GDR and External borrowing

- Exemption in respect of interest payable on external commercial borrowings has been done away with for agreements entered into on or after June 1, 2001
- Scope of concessional rate of tax on income from Global Depository Receipts (GDRs) has been enlarged to include GDRs issued against shares disinvested by Indian companies in their subsidiaries and GDRs reissued against redeemed GDRs, as per scheme of Central Government.

Incentives for investment in financial assets

- Tax payable on the distribution of dividends and income in respect of units of Mutual Funds and Unit Trust of India reduced from 20 per cent to 10 per cent.
- It was clarified that income received by unitholders of UTI and mutual fund from transfer of units exempt only if it is received from the UTI or the mutual fund; and not on sale or transfer of such units.
- Deduction limit under section 80L has been reduced from Rs. 12,000 to Rs. 9,000.
- Higher rebate to be allowed under section 88 to those in receipt of salary upto Rs. 1,00,000 in certain cases.
- Long Term Capital gains on securities and units exempt if re-invested in primary issues forming part of an eligible issue of capital, made by a public company and offered for subscription to public.
- Exemption from long-term capital gains tax provided to cases of investment of such gains in specified bonds issued by Rural Electrification Corporation Limited.

Exemption for income of Funds and Institutions

- Exemption of income of VCC or VCF has been made available for initial investment made by VCC/VCF even after listing of venture capital undertaking.
- Exemption of tax on income has been withdrawn for NABARD, National Housing Bank and Small Industries Development Bank of India.

BOX 2.3 (Continued)

Exemptions/concessions, treatment of perquisites & retirement benefits of employees

- Concessional rate of taxation in respect of GDRs purchased by employees of infotech companies under ESOP has been extended to companies engaged in entertainment service, pharmaceuticals, bio-technology and other notified knowledge based sectors also. Concessional rate to be applicable to employees of domestic or foreign subsidiaries also.
- Stock options issued according to guidelines will not be taxed as perk at time of exercise of option.
- Salary to include payments made at the time of joining and leaving employment. Valuation of perquisites in case of salaried employees have been revised. Perquisites to be taxed on the basis of the cost to the employer except for house and car. Employer to file statement of valuation of perquisites.
- Persons responsible for paying income under the head "salaries" to furnish statement of perquisites or profits in lieu of salary.
- Expenditure incurred by way of payment of any sum to an employee at the time of his voluntary retirement, in accordance with any scheme of voluntary retirement, would be allowable as deduction over a period of five years
- Exemption under VRS has been extended to Central and State Government Employees.

Measures/Incentives for non profit organisations/social sector

- Period of accumulation of income of trust for charitable objects and educational & medical institutions reduced from ten years to five years.
- A maximum period of five years was prescribed for accumulation of unspent income over 25 per cent of the income of the funds trusts and institutions u/s 10(23C) on similar lines as that of section 11.
- Provision made for 100 per cent deduction to donations to National Trust for welfare of persons with autism, cerebral palsy, mental retardation and multiple disabilities.

Others

- Level playing field to private insurers accorded by allowing similar benefits to them and their clients as are available to LIC, GIC and their clients.
- One time exemption from capital gains tax provided in cases of transfer of assets of a recognized stock exchange in a scheme of corporatisation.
- Limit for allowable deduction of interest payable on money borrowed for construction/acquisition of self-occupied house property, raised to Rs.1,50,000/- from Rs.1,00,000/-.
- The restriction of 8 years for carry forward and set off of unabsorbed depreciation has been dispensed with. Further, in computing the profits and gains of business or profession for any previous year, deduction of depreciation shall be mandatory. Depreciation allowance on all imported motor cars acquired on or after April 1, 2001 has also been allowed.

Measures for widening tax base, strengthening compliance and simplification

- Expenditure incurred in relation to exempt income not to be allowed under section 14A of the Income-tax Act retrospectively with effect from April 1,1962.
- Tax to be deducted at source from-winnings from game shows on television and electronic media and on lotteries by way of advertisement schemes; payments of commission or brokerage exceeding Rs. 2,500 and; payments of interest exceeding Rs. 5,000 as against the earlier limit of Rs. 10,000/- in case of bank deposits and Rs. 5,000 in other cases.
- Rate for tax on windfall income from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting has been reduced to 30 per cent from 40 per cent.
- Provision has been made for every company to file a return of income, even if it incurs a loss.
- "One-by-Six" Scheme criteria introduced in the Budget 1998 for identifying potential taxpayers extended to all urban areas in the country as defined by Census, 1991.
- Quoting of permanent account number made compulsory for the persons deducting tax at source or collecting tax at source and also for persons receiving income from which tax has been deducted or from whom tax is collectible.
- Specific provisions based on internationally accepted principles of 'Arm's length' enacted to check profit shifting by multinational enterprises through transfer pricing mechanism. These provisions relate to meaning of 'associated enterprise', meaning of 'international transaction', determination of 'arm's length price', keeping and maintaining of information and documents by persons entering into international transactions, furnishing of a report from an accountant by persons entering into such transactions. Initial onus has been laid on taxpayer to establish transfer price in accordance with prescribed rules and supported by prescribed documentation. Onus shifts on the Department to show incorrectness and adopt different price. Penalty for non-compliance with documentation requirements, and for fraud/wilful negligence has also been provided for.
- Losses from buying securities or units before the record date and selling them after such date will now be disallowed to the extent of exempt dividends received.
- Rates of interest chargeable from assessees under the Income-tax Act, Wealth-tax Act and Expenditure-tax Act have been rationalized to 15 per cent per annum. Rates of interest payable to the assessees under the Income-tax Act and Wealth-tax Act have been rationalized to 9 per cent per annum.
- As a measure of simplification, the powers conferred upon the Assessing Officers to withhold refunds have been withdrawn.

BOX 2.4
Indirect Taxes

Customs

- The existing four advalorem rates of 5 per cent, 15 per cent, 25 per cent and 35 per cent were retained.
- With a view to rationalise and simplify custom tariff structure the surcharge of 10 per cent was discontinued. With this, peak level of customs duty was brought down from 38.5 per cent to 35 per cent.
- Basic customs duty was raised from 35 percent to 70 per cent on tea, coffee, copra and coconut and desiccated coconut. Similarly, the customs duty was raised from 35 to 55 percent to a uniform rate of 75 percent on crude edible oils and from 45/65 percent to 85 percent on refined oils.
- To encourage growth of Information Technology (IT) and telecom sector and reduce prices of these products, duty on specified IT and telecom products were reduced to 15 per cent. However, concessional rates of 5 per cent customs duty admissible to specified equipment and parts thereof for basic telephone, cellular, radio paging, V-SAT, PMRTS and internet services was extended upto March 31, 2002. In the post-Budget changes customs duty on parts (other than populated printed circuit board (PCB)) and parts (excluding populated PCBs of transmission apparatus other than apparatus for radio broadcasting or television) reduced to 5 per cent. Also customs duty on parts (including populated PCBs) of digital still image video cameras, reduced to 15 per cent.
- Customs duty was also reduced on parts and components of pens and sub-assemblies for ATM from 35 per cent to 15 per cent; Customs duty on specified cinematographic cameras and equipment was reduced from 25 per cent to 15 per cent.
- To help textile industry customs duty on 159 specified textile machines was reduced to 5 percent. Duty was also reduced on DMT, PTA, MEG and caprolactum from 25 per cent to 20 percent, silk waste from 35 per cent to 25 per cent, cotton waste and flax fibre from 25 per cent to 15 per cent and polyester and nylon chips from 35 per cent to 25 per cent.
- Cement and clinkers, from 35 per cent to 25 per cent, Soda ash, from 35 per cent to 20 per cent. Cut and polished coloured gem stones, from 35 per cent to 15 per cent.
- Customs duty of 3 per cent imposed on aeroplanes, simulators of aeroplanes, helicopters and gliders.
- Customs duty on import of used cars, multi utility vehicles and two wheelers was raised to 105 per cent after lifting of quantitative restrictions from 1.4.2001. In the post-Budget changes, customs duty on completely built up units of motor cars/ two wheelers were raised to 60 per cent.
- Customs duty on seconds and defective HR coils was raised from 25 per cent to 35 per cent.
- To curtail smuggling of gold, customs duty was reduced from Rs.400 per ten gms to Rs.250 per ten gms.
- To encourage pollution control measures, customs duty on LPG conversions kits and their parts, reduced from 25 per cent to 5 per cent.
- To phase out exemptions in a phased manner a nominal duty of 5 per cent (without special additional duty SAD) was also imposed on few items.
- Liquefied Natural Gas and wattle extract was exempted from the additional duty of Custom. Concessional rate of 5 per cent was extended to specified parts of wind operated electricity generator for maintenance.
- Legal provisions have been made for charging additional duty of customs (CVD) on consumer goods on MRP basis wherever similar domestically produced goods are charged to excise duty on such basis.
- Section 8-B, & 9-A of customs tariff act has been amended and provisions have been made to exempt anti-dumping duty or safeguard duty on goods imported by 100 per cent export-oriented units, units in free trade zones or in the Special Economic Zones. Provision has also been made for exemption from safeguard duty on Tariff Rate Quota basis.
- Concessional duty of 5 per cent was imposed on metcoke when imported by manufacturer of pig iron/steel using blast furnace.

Excise

- To achieve major simplification in the rate structure and to reduce disputes and litigation, the excise duty structure was rationalised to a single rate 16 per cent CENVAT (with only four exceptions). Also the special excise duty (SED) rates of 8 per cent, 16 per cent and 24 per cent were reduced to a single rate of 16 per cent. An additional levy called National Calamity Duty has been imposed on cigarettes, pan masala, biris and other tobacco products to generate funds for calamity relief.
- To give fillip to processed food industry, excise duty on preparations based on fruits and vegetables (jams, jellies, soups, sauces, ketchups, etc) were completely exempted from excise.
- Items that were earlier charged at concessional rate of 8 per cent now attract 16 per cent CENVAT. Items are laundry soap, woolen yarn, shoddy yarn, wooltops etc. Items that earlier attracted 24 per cent excise duty like glazed tiles and vitrified tiles, scooters and motor cycles, taxis, mattresses and articles of bedding, carpets and textile floor coverings, painted canvas, studio back-cloths or the like, linoleum, textiles wall coverings etc. were subjected to 16 per cent CENVAT. However, duty was increased from 24 per cent to 32 per cent on white cement and other special cements, yachts and pleasure boats, arms and ammunition, manufactures of furskin and artificial fur.
- Excise duty reduced from 40 per cent to 32 per cent on aerated soft drinks, soft drink concentrate, if supplied to vending machines and motor cars. Excise duty was imposed on compressed natural gas at the rate of 8 per cent.
- Excise duty on motor spirit (petrol) was raised from 16 per cent to 32 per cent, and on high speed diesel oil from 12 per cent to 16 per cent in the Budget. Further excise duty on petrol and diesel were increased to 90 per cent and 20 per cent respectively w.e.f. the midnight of the 11th /12th January, 2002. The new rates of excise duty will remain in force only upto March 31,2002.
- Duty on woollen fabrics scaled down from 21 per cent (16 per cent CENVAT + 5 per cent AED) to 16 per cent (8 per cent CENVAT + 8 per cent AED). Exemption from excise has been withdrawn on carton, boxes, containers and cases of corrugated paper or paperboard and subjected to a normal 16per cent cenvat.
- Sixteen per cent CENVAT imposed on ready made garments. Independent textile processors have been subjected to ad-valorem duty of 16 per cent in place of existing system of chamber based compounded duty, with deemed CENVAT credit on inputs.
- MRP based assessment of excise duty was extended to stainers, filters and putties and thinners. Extent of abatement modified in respect of T.V. sets, electric fans, glazed/vertified tiles and aerated water. With a view to widen the tax base, excise duty at the rate of 4per cent (without CENVAT credit) imposed on tooth brush, imitation jewellery, powered goggles, table and kitchenware of glass, black and white T.V. sets, watches and clocks up to Rs.500 per piece and parts, electric bulbs up to Rs.20 per piece, candles.

BOX 2.5

Major Recommendations of the Advisory Group on Tax Policy and Tax Administration for the Tenth Plan

Direct Taxes

Personal Income Tax Rates

- Maximum marginal rate of personal income tax rate be retained at 30 per cent. Also correction must be made to remove bracket creep from the structure by broad-basing the various brackets/slabs even though it may lead to some revenue loss at existing levels of compliance.

Saving incentives

- Tax incentives under sections 80CCC, 88, 80L and 10(15) of the Income Tax Act be abolished, at least in phases. Tax concessions under Sections 80 D, 80DD, 80 DDB and 80 E be given in the form of tax credit rather than as deduction fom income (to improve equity); and the rollover provision relating capital gains under sections 54, 54B, 54D, 54EA, and 54EB be removed. This reform would enable further reduction in the overall tax rate structure that should enable improved savings behaviour by all tax payers.

Regional/industrial development

- Provisions relating to under Sections 80-1A and 80-1B be deleted.

Corporate Income Tax

- Corporate tax rate should not exceed the maximum marginal personal income tax. Hence, the corporate tax rate should be reduced to 30 per cent to bring it in line with the existing level of maximum marginal personal income tax. Abolition of the distribution tax on dividends and consequent reduction of the tax rate for foreign companies to the level for domestic companies.
- Minimum alternate tax (MAT) should be reconstituted as a tax equal to the aggregate of 0.75 per cent of adjusted net worth plus 10 percent of the dividend distributed. The MAT should be allowed to be carried forward for set-off against future tax liability in excess of the MAT as provided in Section 115JAA.

Indirect Taxes

Reform of Union Excise

- Introduction of two–rate structure of 16 per cent together with a higher rate.
- Definition of manufacture be widened to include the chain of value addition by or on behalf of the manufacturer (undertaken before the marketing of the product) be charged to duty.
- Both capital goods and other inputs “used in the factory of the manufacturer” should be allowed CENVAT credit. Thus, capital goods and other inputs should not be distinguished for purposes of input tax credit.
- SSI units below a turnover of Rs.3 crore should pay a duty of 85-90 per cent of the normal rate if they opt for CENVAT credit. The Rs.3 crore turnover calculation should not exclude exports and exempted goods produced by a SSI Unit. SSI Units must maintain all records and give a declaration. Only really small units with a turnover of Rs.15-20 lakh should be exempted from declaration/maintenance of records. The unutilised credit should lapse once the Rs.1 crore exemption limit is reached.
- Integrate services as early as possible with the CENVAT to arrive at a full fledged VAT at the Centre.

Reform of Customs Duties

- The median tariff rate in India is much higher. At 35 percent, it is still among the highest in the world. This should be brought down to 25 per cent in the 2002-03 budget. The objective should now be to bring down the median tariff rate to 20 per cent in 2003-04 and 15 per cent in 2004-05.
- Remove as many exemptions as possible. Relatedly, the countervailing duty of 16 per cent be levied uniformly without exemptions.
- No need for so many export promotion schemes in the nature of remission, exemption, entitlements, etc. They need to be rationalised by combining them and removing the overlapping.

State Value Added Tax

- States should adopt a consumption type VAT i.e. there should be no distinction between raw materials and capital goods in allowing VAT credit. Only this VAT variant is equivalent to a retail sales tax. The consumption base must be as wide as possible and must comprehensively include manufacturers and dealers of all goods indicated in sales tax schedule.
- A two floor VAT rate structure in addition to the zero rate; one for essential commodities and another for all other items would be best.
- The States must draw up a common exemption list.
- Unprocessed food articles, life-saving drugs and commodities with negative externalities whose consumption needs to be checked should be exempted from State VAT.
- All concessions with regard to the sales tax should be eliminated under the State VAT and benefits if any should be given only in exceptional circumstances through budget based subsidies.
- Small dealers whose annual turnover does not exceed Rs.15 lakh should be exempt from the liability of VAT but subjected to a sales tax of one per cent.
- All international exports should be zero-rated.
- Commodities with negative externalities whose consumption needs to be checked should, however, be subject to the Special Additional Tax (SAT) against which no input tax credit should be granted.
- Luxuries should not be taxed under the SAT. Instead, it would be better to have a common, high, third VAT rate for luxuries.
- The local VAT rates should be close to uniform across States.
- A destination based VAT is recommended for the Indian State level VAT.

2.39 To this end, the endeavour of the various State governments is to reform their sales tax regimes in the following manner:

(a) Convert sales taxes into VAT by moving over to a multi-stage system of sales taxation with rebate for tax on all purchases with only minimal exceptions.

(b) Allow input tax credits for all raw materials and parts, consumables, goods for resale, and production machinery and equipments.

(c) Replace the structure of tax rates with two or three rates within specified bands, applicable in all States and Union Territories.

(d) Remove the exemptions except for a basic threshold limit and items like unprocessed food and also withdraw other concessions like tax holiday.

(e) Zero-rate exports out of the country.

(f) Tax inter-State sales to non-registered persons as local sales.

(g) Modernise tax administration, computerise operations and the information system; and simplify forms and procedures.

2.40 It is expected that with the introduction of the VAT regime by the States and Union Territories, a uniform common market will develop in the country.

2.41 The Planning Commission constituted an Advisory Group on Tax Policy and Tax Administration for the Tenth Plan in July 2000 to study tax policy and tax administration issues and make appropriate recommendations. The Group submitted its Final Report in May 2001. Major Recommendations of the Advisory Group on Tax Policy and Tax Administration for the Tenth Plan are summarised in Box 2.5.

2.42 An inter-Ministerial Group was set up by the Ministry of Finance in July 2001, on the customs tariff structure. The Group has made some observations which among others include: higher protection should come through exchange rate depreciation rather than through higher tariffs. The former helps producers of exports and imports competing products, while the latter helps only import competing producers. High tariff protection leads to a high cost economy and erodes the competitiveness of the economy; The customs duty structure is still riddled with end use exemptions. These need to be eliminated at the earliest and all exemptions phased out over the next five years. A tariff exemption can be justified on national security grounds; A single uniform rate of customs duty on all imports has many attractive features. It ensures that the nominal protection for all imports is the same thus eliminating all classification problems and disputes. It also makes it much easier to administer the duty free regime for exporters. With a single, uniform nominal duty the effective protection rate is also identically equal to this rate. The rate of effective protection is therefore neutral and equal for all value added by domestic producers.

Collection Rates

2.43 The collection rate is defined as the ratio of realised import revenue (including additional customs duty/countervailing duty (CVD), and special additional duty) to the value of imports of a commodity. Therefore, collection rate not only indicates incidence of customs duty but also reflects levies/duties other than customs tariff which are not in the nature of protective tariffs. The incidence of these levies raises the level of collection rate which not only shows element of protection due to custom duties but incidence of other duties/levies which are in the nature of offsets to mitigate the impact of host of domestic levies for which producers cannot avail of any credit. A pure measure of protection would take account of basic customs duty to the exclusion of other duties/levies and would be lower than the all inclusive collection rate seems to suggest.

2.44 Table 2.7 shows customs duty collection rates for selected import groups during the period 1990-91 and 1995-96 to 2000-01. The collection rate at aggregate level shows a marginal decline of one per cent point to 21 per cent in 2000-01 but non-POL category has shown a marginal increase of one per cent point from 22 per cent in 1999-2000 to 23 per cent in 2000-01. The fall in collection rate at the aggregate level reflects a sharp fall in the collection rate for POL category.

TABLE 2.7
Collection Rates* for Selected Import Groups
(in Per cent)

S.No.	COMMODITY GROUPS	1990-91	1995-96	1996-97	1997-98	1998-99	1999-200	2000-01 (Prov.)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1	Food Products	47	23	19	16	15	15	31
2	POL	34	30	32	29	29	23	16
3	Chemicals	92	44	49	37	34	36	38
4	Man-made fibres	83	36	36	36	49	64	49
5	Paper & newsprint	24	8	11	13	11	9	8
6	Natural fibres	20	12	13	17	22	24	18
7	Metals	95	52	45	44	51	55	49
8	Capital goods	60	33	39	41	42	36	37
9	Others	20	13	14	15	11	12	12
10	Non POL	51	28	31	27	23	22	23
11	Total	47	29	31	27	23	22	21

* The collection rate is defined as the ratio of realised import revenue (including additional customs duty/ countervailing duty (CVD), and special additional duty) to the value of imports of a commodity.
S.No. 1 includes cereals, pulses, tea, milk and cream, fruits vegetables, sugar and animal fats.
S.No 3 includes chemical elements, compounds pharmaceuticals, dyeing and colouring materials, plastic and rubber
S.No. 5 includes pulp and waste paper, newsprint, paperboards and manufactures and printed books, newspapers and journals etc.
S.No 6 includes raw wool and silk
S.No. 7 includes iron and steel and non-ferrous metals.
S.No. 8 includes non-electronic machinery and project imports, electrical machinery

However, increase in non-POL category reflects sharp spurt in the collection rate of food products. It is noteworthy that the collection rate for food products showed more than two fold increase from 15 per cent in 1999-2000 to 31 per cent in 2000-01. This escalation was mainly due to the fact that a large number of agricultural products were subjected to peak customs tariffs of 35 per cent plus surcharge consequent to the lifting of quantitative restrictions. Besides, effective ad valorem rates of customs duty were set far in excess of peak customs tariff for many agricultural items like rice, wheat, sugar, edible oils etc. At a disaggregated level, collection rates for chemicals and capital goods show marginal increase during 2000-01 over 1999-2000 levels. Inspite of reduction in the aggregate collection rate from 29 per cent in 1995-96 to 21 per cent in 2000-01, the range between the maximum and minimum collection rates was 44 percentage points in 1995-96 and 41 percentage points in 2000-01. The existence of very high dispersion in collection rates vitiates the incentive structure for the domestic industry and points towards further scope for reforms in the customs duty regime.

Revenue Trends

2.45 The tax reforms have induced a structural shift in the composition of tax revenue (Table 2.8).

2.46 Although the overall tax to GDP ratio has declined compared to the beginning of 1990s the ratio of direct tax to GDP component has shown significant improvement. This enhancement in direct tax to GDP ratio has been outweighed by a decline in indirect tax to GDP ratio. The decline in excise to GDP ratio reflects lowering of rates and extension of input credit system under MODVAT/CENVAT, while the fall in customs revenue to GDP could be explained by a steep decline in the peak customs tariff of above 300 per cent prior to reforms to 35 per cent as of now and substantial reduction in average collection rates. Besides, in the case of indirect taxes rate reduction were not accompanied by removal of concessions and exemptions. As of now, while end-use exemptions have been largely eliminated from the excise system with the introduction of CENVAT, the customs duty structure is still riddled with them. Also the role played by the structural changes in the composition of GDP in favour of services on

TABLE 2.8
Sources of Tax Revenue

	1990-91	1995-96	1997-98	1998-99	1999-2000	2000-01 (PU)	2001-02 (BE)
			Tax Revenue (Rupees crore)				
Direct (a)	**11024**	**33563**	**48274**	**46600**	**57959**	**68194**	**85275**
PIT	5371	15592	17097	20240	25647	31674	40600
CIT	5335	16487	20016	24529	30692	35685	44200
Indirect(b)	**45158**	**76806**	**89741**	**95871**	**112449**	**118559**	**140142**
Customs	20644	35757	40193	40668	48419	47623	54822
Excise	24514	40187	47962	53246	61902	68350	81720
Gross Tax Revenue#	**57576**	**111224**	**139220**	**143797**	**171760**	**188365**	**226649**
			Tax Revenue as a percentage of Gross Tax Revenue				
Direct (a)	**19.1**	**30.2**	**34.7**	**32.4**	**33.7**	**36.2**	**37.6**
PIT	9.3	14.0	12.3	14.1	14.9	16.8	17.9
CIT	9.3	14.8	14.4	17.1	17.9	18.9	19.5
Indirect (b)	**78.4**	**69.1**	**64.5**	**66.7**	**65.5**	**62.9**	**61.8**
Customs	35.9	32.1	28.9	28.3	28.2	25.3	24.2
Excise	42.6	36.1	34.5	37.0	36.0	36.3	36.1
			Tax Revenue as a percentage of Gross Domestic Product*				
Direct (a)	**1.9**	**2.8**	**3.2**	**2.7**	**3.0**	**3.3**	**3.7**
PIT	0.9	1.3	1.1	1.2	1.3	1.5	1.8
CIT	0.9	1.4	1.3	1.4	1.6	1.7	1.9
Indirect (b)	**7.9**	**6.5**	**5.9**	**5.5**	**5.8**	**5.7**	**6.1**
Customs	3.6	3.0	2.6	2.3	2.5	2.3	2.4
Excise	4.3	3.4	3.2	3.1	3.2	3.3	3.6
Total#	**10.1**	**9.4**	**9.1**	**8.3**	**8.9**	**9.0**	**9.9**

includes taxes referred in (a) & (b) and taxes of Union Territories and "other" taxes. Tax revenue figures for 2001-2002 are budget estimates, and for 1999-2000 and earlier years these are actuals.
PU Based on Provisional unaudited figures as per Controller General of Accounts.
* Refers to gross domestic product at current market prices. The ratios to GDP for 2001-02 are based on CSO's Advance Estimates

Note: (a) also includes taxes pertaining to expenditure, interest, wealth, gift, estate duty and VDIS for 1997-98 & 1998-99;(b) also includes service tax;

the decline in tax-GDP ratio is quite significant. As the share of services sector increases, the tax base becomes narrower, aggregate buoyancy of the tax revenues is eroded and the tax GDP ratio falls. In view of rapid expansion of the services sector it is imperative to enlarge the scope of taxation of services so as to augment the tax GDP ratio.

2.47 The share of direct taxes in the gross tax revenue has increased from 19.1 per cent in 1990-91 to 30.2 per cent in 1995-96 and edged up to 36.2 per cent in 2001-01(PU) and is expected to improve to 37.6 per cent in 2001-2002(BE). In contrast, share of indirect taxes declined substantially from 78.4 per cent in 1990-91 to 69.1 per cent in 1995-96 and declined further to 62.9 per cent in 2000-01(PU) and is estimated at 61.8 per cent in 2001-02. The direct tax revenue as a percent of GDP has increased from 1.9 per cent in 1990-91 to 2.8 percent in 1995-96 and further to 3.3 per cent in 2000-01(PU) and is estimated to increase to 3.7 per cent in 2001-2002(BE). On the other hand, the share of indirect taxes as a per cent of GDP which declined from 7.9 per cent in 1990-91 to 6.5 per cent in 1995-96, fell further to 5.7 per cent in 2000-01(PU) and is budgeted at 6.1 per cent in 2001-2002(BE).

2.48 During the past decade the overall tax-GDP ratio for the Centre has suffered erosion. To augment tax-GDP ratio, it is necessary to tap the growing potential of the services sector. Service sector has not only grown but has diversified and shown resilience. The growing importance of the service sector in the GDP calls for additional tax effort with focus on the service sector.

Service Tax

2.49 As the services sector continues to expand faster than the other sectors, it is necessary to expand the ambit of tax on domestic goods to include the services sector also. The reasons for doing so are many. First, as the share of industry in GDP decreases while that of services expands, the tax base shrinks, aggregate buoyancy of excise tax revenue declines and the excise tax/GDP ratio fall. Second, failure to tax services distorts consumer choices, encouraging spending on services at the expense of goods and savings. Third, untaxed services mean traders are unable to claim VAT on their service inputs. This causes cascading, distorts choice and encourages business to develop in house services, creating further distortions. Fourth, as most of the services that are likely to become taxable are positively correlated with expenditure of high income households, subjecting them to taxation will improve equity. The prevailing rate of the Centre's service tax at 5 per cent is low because it is based on turnover without input tax credit.

2.50 The power to levy a tax on services is not mentioned either in the State List or Concurrent List of the VII Schedule to the Constitution. However, by virtue of Entry 97 in the Union List, which gives power to the Centre for levy and collection of "any tax not mentioned in either of those Lists" (that is State List or the Concurrent List), the Union Legislature is competent to levy a tax on services. Further under Article 248 of the Constitution, the Parliament has exclusive powers to make any law with respect to any matter not enumerated in the Concurrent List or the State List and such power includes the power to make any law imposing a tax not mentioned in either of those Lists.

2.51 Accordingly in the 1994 Budget, a tax on three specified services, namely, telephone, general insurance and stock brokerage, was introduced. Over the years number of services have been brought under the ambit of service tax. In the Budget for the year 2001-02, the service tax levy was extended to 15 more services. Thus at present, 41 specified services attract the service tax levy. Service tax is levied at the rate of 5 per cent on the value of taxable services.

2.52 While the revenue realised from service tax was initially Rs.407 crore when it was first introduced in 1994-95, it has registered substantial growth over the years. Between 1994-95 and 2000-01, service tax has shown more than six fold increase while the number of service tax payees increased by about twenty nine times between 1994-95 and 1999-2000. Service tax as a proportion of GDP originating in the service sector (excluding public administration and defence) has remained a minuscule fraction all these years (Table:2.9). The budget estimate for Service Tax for the year 2001-02 is Rs.3,600 crore.

TABLE 2.9

Service Tax

	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02 (BE)
No. of tax payees	3942	4865	13981	45991	90455	114358	N.A.	N.A..
Revenue (Rs. crore)	407	862	1059	1586	1957	2128	2585	3600
Service tax as per cent of service sector GDP*	0.12	0.21	0.22	0.29	0.31	0.29	0.33	0.41

Note: *Service sector GDP (at factor cost) at current prices comprises of trade, hotels & restaurant, transport, storage & communications, financial services, real estate & business services and community, social and personal services excluding public administration, defence and quasi-government bodies.