Tax Measures

2.28 The emphasis of the direct tax proposals in the Budget was to retain moderate tax rates for corporate and personal taxes, widen the base, provide incentives for infrastructure and housing, revive the capital market, and strengthen enforcement through tapping of high value transactions. The period for availing benefits under section 80 IA was made uniform at 15 years across the infrastructure and core sectors. The Budget also accorded ten year tax holiday for industries in North-Eastern region to promote industrialisation. To promote housing construction activities, it unfolded a package of comprehensive fiscal incentives. Besides, the Budget has acknowledged the need for industrial restructuring to enable companies to better focus on their core activities. To this end, amalgamation/restructuring of companies have been made tax neutral. Direct tax measures in these areas are expected to give fillip to the industrial activity. The details of various direct tax measures are given in Box 2.3.

2.29 In respect of indirect tax measures, the focus was to reduce multiplicity of duty rates, rationalise the rate structure and drastically curtail the scope for discretion by abolishing the power to grant ad hoc duty exemptions in the domain of excise and customs except for goods of strategic nature, or for charitable purpose. An Authority for Advance Rulings for Excise and Customs was set up. This will not only inject greater transparency but provide binding rules which will go a long way in helping intending investors about their duty liability in advance.

2.30 On the excise front, eleven major advalorem duty rates were reduced to three, namely, a central rate of 16 per cent, a merit rate of 8 per cent and a demerit rate of 24 per cent. This was achieved by merging rates of 5 per cent, 10 per cent and 12 per cent into the existing 8 per cent; creating a new rate of 16 per cent by merging the existing 13 per cent, 15 per cent and 18 per cent and; by reducing existing advalorem rates of 25 per cent, 30 per cent, 32 per cent and 40 per cent to 24 per cent. In addition to basic excise duty of 24 per cent, a special excise duty at the rate of 6 per cent, 8 per cent and 16 per cent was imposed on items which were subject to a basic excise of 30 per cent, 32 per cent and 40 per cent respectively. Besides, Budget has emphasised the government's intention to carry forward reform in indirect taxes in a manner which will ensure convergence towards a central rate and a full fledged VAT system in the medium term. In the case of custom duties, a modest reduction in peak rate of protective custom duty from 45 per cent to 40 per cent was effected. This was accompanied by a reduction in seven major advalorem rates of basic customs duty to five through the process of rationalisation and simplification. These rates were an unchanged duty rate of 5 per cent, a 15 per cent duty rate by substituting the 10 per cent rate, a 25 per cent rate by merging 20 per cent and 25 per cent duty rates, a 35 per cent rate by merging 30 per cent and 35 per cent duty rates and unchanged duty rate of 40 per cent. Also the Budget has given indication that customs duty structure will be phased down to Asian levels in five years. The various indirect tax measures announced in the Budget are given in the Box 2.4 respectively.

2.31 The sales tax system in vogue across the states has evolved over the years mostly through changes made for time to time in response to exigencies rather than along canons of taxation, namely, certainty, neutrality and equity. Apart from inherent flows in the structure of sales tax the laws and procedures are complex resulting in prolonged litigation, creating uncertainty for revenue as well as tax payers. In the absence of transparency, it cannot serve the goal of equity either. Such a system causes distortions in the pattern of domestic trade and industry. With a view to reform domestic trade taxes important decisions were taken in the meeting of Chief Ministers and the Finance Ministers of the States held on November 16, 1999 for implementation of uniform floor rates of sales tax by the States and Union Territories (Box 2.5).

Collection rates

2.32 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. Thus Collection rate not only reflects incidence of customs duty but also captures levies/duties other than customs tariff which are not in the nature of protective tariffs.

BOX 2.3
Direct Taxes

- The income tax exemption limit retained at Rs.50,000. Across-the-board surcharge of 10 per cent was imposed on corporate tax (except foreign companies) and on all other categories of assessees (except non-residents and those residents in 10 per cent slab).
- For senior citizens deduction for medical insurance premium raised from Rs.10,000 to Rs. 15,000 along with hike in tax deduction for treatment of specific diseases to Rs. 60,000.
- Expenditure towards hostel projects for working women made eligible for deduction under Section 35AC of the Income Tax Act.
- Pension/family pension received by gallantry award winners and their heirs exempted from income tax.
- With a view to expand the tax base, “One-by-Six” criteria introduced in the 1998-99 budget for identifying potential tax assessees was extended to 19 more cities (from 35) having population of more than 5 lakh.
- Full exemption from income tax of all income from UTI and Mutual Funds received in the hands of investors. Further, all open-ended equity-oriented schemes of UTI and mutual funds, with 50 per cent or more investment in equity exempted from dividend tax. However, income distributed by Mutual Funds with equity investment of less than 50 per cent subject to 10 per cent dividend tax.
- Provisions for exempting income by way of dividends and long term capital gains of Venture Capital Funds and Venture Capital Companies were liberalised.
- Income earned by way of dividend and by way of long term capital gains from global depository receipts allotted to the resident employees of the Indian Company engaged in information technology software and services to be taxed at the concessional rate of 10 per cent.
- Long-term capital gains tax for resident Indians on transfer of shares and securities reduced from 20 per cent to 10 per cent, in line with that for non-residents.
- Stock options and Sweat equity offered by management to employees of ‘sunrise’ sectors, to be taxed as perquisite at the time of exercise of option and later as capital gains at the time of sale of security.
- Amount received on buy back of shares to be subject to capital gains tax and not dividend tax.
- Interest on the gold deposit bonds/certificates exempted from income tax and the value of assets deposited in the gold deposit scheme from wealth tax. Capital gains on redemption of such gold deposit Bonds have also been exempted.
- Ten years tax holiday for industries in North-East.
- For undertakings setting up “infrastructure facility”- generating and distributing power, providing telecommunication services and operating industrial parks-the existing two tier fiscal benefits (i.e. 5 years 100 per cent tax holiday and 30 per cent deduction from profit for another 5 years) can be now availed consecutively in ten out of fifteen years. To facilitate restructuring of the State Electricity Boards, Companies formed after 1.4.99 for distribution of power were also allowed two tier fiscal incentives.
- Cold chain for agricultural produce set up anywhere in the country to be entitled to five years tax holiday and 30 per cent deduction from profit for subsequent five years.
- Export entertainment industry products given facilities and tax benefits similar to those for export of goods and merchandise under Section 80HHC.
- Exemption limit on interest on loan from tax for self-occupied property increased from Rs. 30,000 to Rs. 75,000. Also the ceiling on built up areas for dwelling units for approved housing projects was raised from 1,000 sq. ft. to 1500 sq.ft. (in all locations except Mumbai and Delhi) for tax holiday under Section 80IB of the Income Tax Act. Interest income of housing finance companies in respect of bad and doubtful debts to be taxed on actual receipt basis, instead of accrual basis. Besides, depreciation rate on new dwellings purchased by business sector for its employees was increased from 20 per cent to 40 per cent.
- Deduction in respect of provision for doubtful and loss assets allowed to banks as per prudential norms of RBI, subject to a maximum of 5 per cent of such assets, for 5 years. This is by way of option to the existing deduction available.
- The existing provisions relating to amalgamation of companies were rationalised by relaxing the existing conditions under section 72 A for carry forward and set-off of accumulated losses and unabsorbed depreciation. The new provisions making demerger of companies tax-neutral, have been provided. The profits and gains arising from sale of business as a going concern through slump sale, is taxed as capital gains.
- Weighted deduction of 125 per cent of the expenditure made on in-house R&D by corporates extended upto 31.3.2005 and was extended to cover R&D projects entrusted to research laboratories and universities. Hundred per cent deduction for expenditure incurred during 1999-2000 to make the existing computer system Y2K compliant.

BOX 2.4

Indirect Taxes

Customs

- Reduction in peak protective customs tariff from 45 per cent to 40 per cent.
- To bring out a more rational and simplified duty structure, the seven major advalorem rates of customs duty, namely 5 per cent, 10 per cent, 20 per cent, 25 per cent, 30 per cent, 35 per cent and 40 per cent were rationalised to 5 advalorem rates namely, 5 per cent, 15 per cent, 25 per cent, 35 per cent and 40 per cent.
- A uniform surcharge at the rate of 10 per cent of basic duty was imposed on all commodities excluding crude oil and petroleum products, items attracting 40 per cent rate of basic duty, certain GATT bound items and gold and silver.
- With a view to reducing dispersion in customs tariff and accord a minimal protection a basic duty of 5 per cent was imposed on a number of items hitherto exempted from customs duty. However, this category was exempted from 4 per cent special additional duty.
- Import duty structure of project imports rationalised. Power generation, coal mining, refinery, telecom and fertilizer projects were brought under the ambit of 5 per cent customs duty subject to applicable rates of CVD. Mega power projects being an exception.
- An additional customs duty of Re.1 per litre has been imposed on High Speed Diesel Oil.
- To encourage growth of information technology and reduce prices of information technology (IT) products, the import duty on a number of items used in the IT sector has been reduced/rationalised.
- Specified (75 items) machinery for semi conductor manufacture has been fully exempted from basic custom duty.
- Basic customs duty on steel imported for manufacture of specified capital goods was reduced to 25 per cent.

Excise

- Eleven major advalorem rates of excise duty were reduced to 3, namely, a central rate of 16 per cent, a merit rate of 8 per cent and a demerit rate of 24 per cent. Besides, two slabs of surcharge of 6 per cent and 16 per cent were fixed over the rate of 24 per cent on commodities which carried a rate of duty of 30 per cent and 40 per cent.
- The cap on MODVAT credit of 95 per cent of the admissible amount was lifted and restored to 100 per cent. Now the manufacturers can avail full credit of the duty paid on inputs.
- Excise duty on machinery and capital goods sector raised from 13 per cent to 16 per cent. However, these are eligible for MODVAT credit.
- An additional excise duty of Re 1 per litre has been imposed on high speed diesel oil. The proceeds from this levy would be utilised for road development and for initiatives in rural development and social sector.
- Maximum retail price (MRP) based excise levy has been extended to 27 more items.
- Goods developed and patented by National Laboratories, public funded research institutions, colleges and universities and manufactured by Indian companies have been extended exemption from excise duty for a period of three years.
- A major procedural change for factories paying duty of more than Rs. 5 crore in a year was introduced. The requirement for maintenance of statutory excise records has been done away with and the manufacturers' private records would be accepted for excise purpose.
- The general small scale sector (SSI) exemption scheme was extended to cotton yarn not containing synthetic staple fibre. The scheme of duty exemption for SSI units manufacturing cosmetics and air conditioning/refrigeration equipment was modified to provide full exemption upto a clearance limit of Rs.30 lakh (as against Rs.15 lakh earlier), and a concessional duty rate of 50 per cent of the normal duty for clearances between Rs.30 lakh to Rs.50 lakh. The eligibility limit for availing the exemption has been enhanced from Rs.50 lakh to Rs.100 lakh.
- The procedure for payment of duty for the SSI sector has been greatly simplified. SSI units have been allowed the facility to pay excise duty on monthly basis.

BOX 2.5

Reform of Domestic Trade Taxes

- Implementation of uniform floor rates of sales tax by states and union territories from January 1, 2000. As per this decision, the States are required to adopt four general floor rates, namely zero per cent, 4 per cent, 8 per cent and 12 per cent and two special floor rates 1 per cent and 20 per cent for the specified category of items.
- Phasing out of sales tax based incentives schemes and also such incentives offered to industries as per the revised definition of backward area by January 1, 2000. The variants of the sales tax concession offered by the states are mainly in the nature of tax exemption, tax waiver, tax deferral, tax loan and refund of sales tax. These incentives are usually offered to new industrial units set up after a notified date or sector specific or size specific or pertain to industries located in identified backward areas. The plethora of sales tax concessions lead to tax competition among states which generates little or uncertain benefit but entails significant revenues losses.
- It was decided that VAT will be implemented by all the States and Union territories from April 1, 2001. The interim period shall be used for preparation, training and computerisation and publicity. The Government of India will provide financial help for these activities. Besides, it will also compensate States if they lose revenue due to the introduction of VAT in the initial period.
- Though designed primarily as a regulatory measure to prevent evasion and bring some order in the taxation of inter-state sales, the central sales tax (CST) has turned out to be a significant component of the sales tax revenues of the states. However, it has also become a hurdle to inter-state trade. With a view to rationalise CST it was decided that National Institute of Public Finance and Policy (NIPFP) would further study the issue and subsequently another conference of Chief Ministers will be held to arrive at a decision in this regard.
- These decisions will be monitored by a Standing Committee of State Finance Ministers.

For instance CVD on imports of goods is essentially an offset against excise duty incidence on similar domestically produced goods. Besides, indigenously produced goods are subject to sales tax and other local taxes/ levies which imported goods escape. Special additional duty on imports to some extent mitigate the disability domestic trade taxes other than union excise inflict on the indigenous goods vis-à-vis imported goods. Keeping in view these considerations, levels of collection rate not only reflect element of protection due to custom duties but incidence of other duties/ levies which are in the nature of offsets and attempt to provide a modicum of level playing field to the domestic producer by mitigating the incidence of domestic taxation. 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.

2.33 Table 2.6 shows customs duty collection rates for selected import groups during the period 1990-91 to 1998-99. The average collection rate has fallen by 24 percentage points from 47 per cent in 1990-91 to 23 per cent in 1998-99. The collection rate in particular for man-made fibers, metals and capital goods edged upwards in 1998-99 compared with the preceding year. The gap between the maximum collection rate (51 per cent) and minimum collection rate (11 per cent) at 40 per cent points across the broad commodity groups is still very large. This gap needs to be compressed so as to reduce distortions arising out of tariff rate structure.

Revenue Trends

2.34 The tax reforms have induced structural shift in the composition of tax revenue (Table 2.7). The share of direct taxes in the gross tax revenue has increased from 19.1 per cent in 1990-91 to 32.2 per cent in 1998-99 and is expected to improve to 33.5 in 1999-2000(BE). In contrast, share of indirect taxes declined substantially from 78.4 per cent in 1990-91 to 66.8 per cent in 1998-99 and is expected to marginally fall to 65.9 per cent in 1999-2000(BE). The share of excise revenues in gross revenues has declined from 42.6 per cent in 1990-91 to 36.9 per cent in 1998-99, and is estimated at 36.1 per cent in1999-2000(BE).

2.35 The direct tax revenue as a percent of GDP has increased from 2.1 per cent in 1990-91 to 2.6 percent in 1998-99 and is estimated to increase to 3.1 per cent in 1999-2000(BE). On the other hand, the share of indirect taxes as a per cent of GDP declined from 8.4 per cent in 1990-91 to 5.5 per cent in

TABLE 2.6

Collection Rates for Selected Import Groups

(in per cent)

S. No.	COMMODITY GROUPS	1990-91	1994-95	1995-96	1996-97	1997-98	1998-99
1	Food Products	47	22	23	19	16	15
2	POL	34	31	30	32	29	29
3	Chemicals	92	44	44	49	37	34
4	Man-made fibres	83	18	36	36	36	49
5	Paper & newsprint	24	11	8	11	13	11
6	Natural fibres	20	9	12	13	17	22
7	Metals	95	53	52	45	44	51
8	Capital goods	60	38	33	39	41	42
9	Others	20	11	13	14	15	11
10	Non POL	51	29	28	31	27	23
11	Total	47	29	29	31	27	23

S.No. 1 includes cereals, pulses, milk and cream, fruits, vegetables 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.

TABLE 2.7

Sources of Tax Revenue

	1990-91	1995-96	1996-97	1997-98	1998-99@	1999-2000 (BE)
Tax Revenue as a Percentage of Gross Tax Revenue						
Direct (a)	**19.1**	**30.2**	**30.2**	**34.7**	**32.2**	**33.5**
PIT	9.3	14.0	14.2	12.3	14.0	15.2
CIT	9.3	14.8	14.4	14.4	17.0	17.4
Indirect(b)	**78.4**	**69.1**	**69.1**	**64.5**	**66.8**	**65.9**
Customs	35.9	32.1	33.3	28.9	28.6	28.5
Excise	42.6	36.1	35.0	34.5	36.9	36.1
Tax Revenue as a Percentage of Gross Domestic Product						
Direct(a)	**2.1**	**2.8**	**2.9**	**3.2**	**2.6**	**3.1**
PIT	1.0	1.3	1.3	1.1	1.1	1.4
CIT	1.0	1.4	1.4	1.3	1.4	1.6
Indirect(b)	**8.4**	**6.5**	**6.5**	**5.9**	**5.5**	**6.0**
Customs	3.9	3.0	3.2	2.7	2.3	2.6
Excise	4.6	3.4	3.3	3.2	3.0	3.3
Gross Tax Revenue#	**10.8**	**9.4**	**9.5**	**9.2**	**8.2**	**9.2**

(a) also includes taxes pertaining to expenditure, interest, wealth, gift, estate duty and VDIS for 1997-98 & 1998-99; **(b)** also includes service tax; # includes taxes referred in (a) & (b) and taxes of Union Territories and “other” taxes. Tax revenue figures for the year 1999-2000 are budget estimates and for the years 1997-98 and earlier these are actuals.

@ : Tax data based on Provisional unaudited tax figures as per Controller General Accounts

Note : 1. Ratios to GDP at current market prices for the year 1990-91 use old series (Base 1980-81) and from 1995-96 onwards use new series (Base 1993-94) of National Accounts Statistics released by the Central Statistical Organisation (CSO).

2. The ratios to GDP at current market prices for 1999-2000 are based on CSO's Advance Estimates.

1998-99 and is budgeted to increase to about 6.0 per cent in 1999-2000(BE).

Revenue Performance

2.36 The data available for gross collections from major direct and indirect taxes for the first nine months (April-December, 1999) of the current year show recovery in indirect tax collections. In case of direct taxes, collections from personal income tax and corporation tax at Rs.33976 crore were higher by 15.3 per cent over the same period of the previous year. Collections from excise and custom duties were at Rs.76877 crore during April–December, 1999 and posted a growth of 19 per cent compared with an increase of only 1.9 per cent in April-December 1998.