Not Quite There For Big Time Reforms

THE FINANCIAL WORLD

Chandigarh, Wednesday, November 13, 2002

Given the shortage of housing in the country, one may wonder if it is prudent to withdraw tax sops in this sector

THE Kelkar committee on direct taxes has recommended a one-stroke cleaning up of all Income-tax exemptions (including standard deduction for salaried employees), significant reduction in tax rates and sweeping liberalisation. The proposal at a glance suggests that for Individuals, there would be:

- No tax on dividend Income.
- No tax on long-term capital gains on equity.
- No tax Incentives for savings. 0 No standard deduction for salaried class.

Besides, stating that all exemptions would go except on those meant for handicapped persons and medical expenses of senior citizens.

The committee has provided zero tax on income up to Rs l lakh, 20 per cent on income In the range of Rs l lakh to Rs 41akh, and 30 per cent on Income in excess of Rs 4 lakh. Wealth tax is proposed to be abolished. And the committee has also proposed to tax farm income at rates applicable to individuals.

Ramification: The recent interest rate slide and the tax sops on housing loan schemes had triggered substantial Interest In the middle class segment in planning their own dwelling units.

The committee's proposal to withdraw the tax benefits in this regard would leave a dent on many such plans. At the broad level, given the shortage of housing across the country, one may wonder if it is prudent to withdraw such fiscal sops.

The committee has also not provided for inventives to boost savings, a necessary ingredient in an 8 per cent growth propelling recipe. Indeed, tax sops for boosting savings would not only be important from the social obligation standpoint but also for the economic growth viewpoint.

Further, the proposal to apply normal tax rates of 30 per cent on capital gains in excess of Rs 4 lakh would prove to be too burdensome.

For the corporates, the committee has proposed to reduce corporate tax to 30 per cent as compared to current level of 36.75 per cent and reduce tax on foreign companies to 35 per cent as compared to current level of 40 per cent. Companies would pay tax on income delared to shareholders.

The other suggestions are:

- Depreciation allowance to be restricted to the allowance charged to profit & loss account in line with the Companies Act.
- Minimum Alternate Tax (MAT) to be scrapped.
- All exemptions to be eliminated.
- Unabsorbed depreciation to be merged with business loss; which may be carry forward indefinitely.

Impact: There is no doubt that the tax system is presently hedged with a variety of incentives which have little economic content, but one stroke withdrawal is no solution.

The recommendations \ire suited for a developed country.

Ours is a developing nation where different sectors are at different stages of development and hence need different levels of fiscal support. Removal of all exemptions at one stroke would tantamount to extending the same treatment to all sections irrespective of their strengths.
Level playing is fine but is the timing appropriate?

One stroke with. drawal of exemptions would affect investment in large projects, such as power and telecom. The project calculation!1 would go haywire. And the consequent increase in project cost would result in higher burden on the taxpayers.

Withdrawal of deductions under sections 10A, 10B, 80-1A, 80IB, etc. may even destabil1se the business models of software, infrastructure, housing sector companies and other such enterprises built on the premise of allowance of these deductions.

Such sweeping changes may also arouse fears in the minds of investors over the tax laws, leading to fall in investor confidence.

As per newspaper reports, the Kelkar committee has said that all exemptions have to go for the sake of weeding out corruption and abuse of the system.

This is a misplaced opinion. Prudence lies in thorough investigation in case of abuse of the system and not in abrogating all such provisions at one stroke.

An eminent personality had once remarked that the Indian Income Tax Act is like the Indian Railways.

Every year some provisions are added and some are deleted like passengers boarding and deboarding at every station. The Kelkar Committee recommendation is nothing short of asking all the passengers to deboard irrespective of whether they hold valid tickets for the journey ahead.

One school of thought opines that with the elimination of incentives and uniformity in tax rates, many crucial economic decisions would be left to the people. Taxation would be neutral and would not influence the consumer or the investor about how much to save, what to consume, where to invest, how much profit to distribute and so on. So do we presume that the government backed with its enormous think-tank is going bankrupt of ideas and wants to wash its hands off the responsibility to lead from the front?

It seems that the recommendations are far ahead of their times and experience has taught us that anything ahead of time is impractical. .