Revenue effort to be backed by tax reforms

The next financial year will be a tightrope walk for Finance Minister Arun Jaitley, with the mounted challenge of narrowing the fiscal deficit and enhancing tax revenue collections to compensate for higher salaries and pensions and capital spending.

Besides raising tax revenue, Jaitley will have to deliver on the promise of a fair, transparent and non- adversarial tax regime in light of multinational companies such as Vodafone receiving fresh notices for payment of tax dues based on retrospective provisions.

the government has been assuring investors that it will not invoke the retrospective tax clause, there has been no attempt to remove it from the statute.

While personal income tax might not see much tweaking, corporate tax could see a small reduction from the current 30 per cent rate, as the finance minister moves to reduce it to 25 per cent in the next four years, as promised in the previous Budget. Towards that, the Budget will lay down the road map to simultaneously phase out exemptions to the corporate sector, simplify administration and improve India's competitive edge globally. The corporate tax rate is 30 per cent but it is effectively 23 per cent due to many exemptions. In 2014- 15, the government is estimated to have foregone revenue worth Rs.62,400 crore in corporate taxes on account of various incentives, investment- linked and area based deductions will be phased out for both corporate and non corporate taxpayers. Provisions with a sunset date will not be extended or advanced. For incentives with no terminal date, a sunset date of March 31, 2017, will be provided for commencement of the activity or for claim of benefit, depending on the relevant provisions. This will cover tax exemptions for development, operation and maintenance of infrastructure facilities or development of Special Economic Zone (SEZ) units. No weighted deduction will be allowed with effect from April 1, 2017. Weighted deduction allows a taxpayer to claim a deduction that is more than the actual expenditure incurred.

The government is also poring over the recommendations on tax simplification submitted by Judge R V Easwar. These recommendations to reduce litigation and simplify the tax regime for small taxpayers will make it to the Budget.

Taking away from the Easwar Committee recommendations, Jaitley might consider raising the threshold for deduction of tax at source (TDS) and reduction in rates, besides measures to reduce tax litigation that will not have significant revenue implications. Long overdue, the recommendation of revision of the TDS limits, if accepted will come as a big boost to consultants, brokers and depositors. For interest on securities, the committee proposed raising the threshold for TDS to Rs.15,000 from Rs.2,500 annually and halving the tax rate to five per cent.

Similarly, for other interest earnings, the limit is recommended to be raised to Rs.15,000 from the current Rs.10,000 for bank deposits and Rs.5,000 for others. The panel recommended raising the TDS limit for payments to contractorsfrom Rs.30,000 for a single transaction and Rs.75,000 annually to a Rs.1 lakh annual limit. The government will also suitably amend the Income Tax (I- T) Act to ensure that no minimum alternate tax is applicable on foreign institutional investors without a permanent establishment in the country. An attempt or assurance to address ongoing retrospective tax cases in the Budget will help revive investment in the economy. The tax department has extended the bar on UK's Cairn Energy from selling its residual stake in Cairn India till March 31, as the Rs.10,247- crore tax dispute with the company continues. In a fresh notice to Vodafone, the tax department said it might seize the British firm's assets in the country if it failed to pay Rs.14,200 crore in disputed tax.

The Budget will provide Jaitley with the opportunity to assure investors of faster resolution of tax disputes. There are 344,000 income tax lawsuits and 136,000 indirect tax cases pending. The government in the past few months has taken various measures to reduce litigation, including increasing threshold for filing appeals in tribunals and high courts. This is expected to reduce the burden of appeals concerning direct taxes by about 50 per cent in the next three- four months.

The government is also likely to introduce changes related to transfer- pricing provisions in the Budget requiring firms with foreign presence and an annual consolidated revenue more than Rs.5,000 crore, to comply with extensive data reporting and documentation. The legislative changes in the I-T Act will be in line with Base Erosion and Profit Shifting measures unveiled by the Organisation for Economic Co- operation and Development last October to curb tax evasion by multinational firms.

India accounts for the largest number of transfer- pricing lawsuits in the world, with close to 70 per cent of the cases going in the assessee's favour. The Central Board of Direct Taxes has, so far, signed 39 (38 unilateral and one bilateral) Advance Pricing Agreements(APAs), with 30 agreements in the current financial year alone. APAs provide certainty to companies operating in India, help avoid conflict over sharing of taxes, and reduce transfer pricing disputes.

The finance minister is also expected to make safe harbour provisions more attractive by clarifying the definition and lowering the margins.

With the Modi government expected to take a Rs.1.1 lakh crore hit for implementation of the Seventh Pay Commission and one- rank one- pension recommendations, it will likely look at new sources of revenue arising from phasing out of corporate tax exemptions, reducing excise duty exemptions and increasing the service tax rate from the current 14 per cent.

The government is expecting a direct tax shortfall of Rs.40,000 crore in the current financial year, which will be made up by robust collection of indirect taxes. With economic revival looking uncertain, dependence on direct taxes will not be prudent.

The government could attempt to align the indirect tax regime to the proposed goods and services tax in the Budget. The Centre could also reduce the exemption limit for excise duty from the current Rs.1.5 crore to bring it closer to the proposed uniform indirect tax regime, which will have a significantly lower exemption threshold of Rs. 25 lakh. Excise duty has been one of the major sources of revenue for the Modi government in the current financial year with a series of rises in levy on petrol and diesel. Till October, the additional excise levy on petrol and diesel yielded Rs. 40,000 crore revenue for the government, against Rs.25,000 crore last year and the share of excise jumped to 39 per cent of indirect taxes, from 33percentonaverage. However, with uncertainty over oil prices, the government might focus on service tax to generate revenue to balance the higher outgo on pay and pensions.

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