CHAPTER - 1

CONCEPTUAL FRAMEWORK
AND
BACKGROUND OF THE STUDY

1.1. INTRODUCTION:

History of taxation throughout the world supports its very existence from an early phase of civilization. With the passage of time it changes its shape as per the demand of the time. But the foremost intentions regarding imposition of taxes are to generate resources to carry on its time-honoured tasks like maintenance of security, law and order, carry out healthy and growth oriented events to gratify the collective needs of the nation. Our country is not an exception. The history of tax system in India provides evidence for the existence of tax system in ancient India as conveyed by "Manu Samhita"[2] and Kautilya's "Arthashastra". Existence of deep-rooted tax system in different colours and different shapes had been long-established right through the various phases of Indian economy which had left behind a long way through the course of continuous reforms. Till then it has made a long journey through the course of modifications, insertions and deletions. From the year 1961 the present system of taxing income i.e. "Income-tax Act, 1961"of India started its journey and kept up its flight all the way through various changes till the date. The main texture of this act updated, restructured, modified and tailored through countless amendments bearing addition, alteration and removal of various clauses. The intension lying behind these amendments can be concentrated on making the whole tax system simplified and better understood, reducing compliance cost and involvedness and broadening the tax base. Taxes are essential to prop up diverse objectives such as enhancing the rate of domestic savings, supporting capital formation, keep going the burden of defense and security expenditure, picking up the pace of economic development and boosting up investments in growth oriented sectors, encouraging welfare and improvement

of the nation India. However, much criticism of the Income Tax Act entails huge involvedness and complexities ensuing large compliance cost, public and private, and the tax gap is massive in spite of the engagement of substantial resources for enforcement. The aspiration for simplification and better compliance encourages further modifications as well as different suggestions for rescheduling, restructuring and reformation of the existing tax system.

Complex tax systems impose a large compliance cost. Consequently, compliance costs and enforcement involvedness necessitates rethinking, restructuring and rescheduling of the tax system. Slemrod [1995] has suggested that if income tax policies are not resolved in terms of equity and efficiency, the evaluation of such modifications becomes complicated. The dearth of an eminent indicator generates hindrances in evaluating the various complexities and the problem of enforcement. For example, removal of a set of deductions would trim down the compliance costs at the expense of equity and efficiency of the tax system. For balancing out the price level, generating resource bulk, encouraging economic development for betterment of social interests designing of the tax structure in a suitable way is therefore indispensable. Comparing the taxation system with a double edged weapon Vaish and Pandikar [1971] have opined that the growth and development of a country depends very much on the formulation of taxation policy. Apt crafting accelerates the pace of growth and development vis-à-vis unseemly formulation generates hindrances to the growth path.

In the national economic scenario of our country corporate taxes has been recognized as one of the most significant tool in the mechanism of economic policy. Rao [1979] visualize corporate taxes as an eminent indicator of fiscal

pattern of the Government. Income Tax Act is known for its progressive rate schedule, an assortment of incentives and exemptions along with their time to time modifications, insertions, deletions, repeals, omissions, notifications. Though such incentives, exemptions and their countless changes are planned for gratifying the canons of taxation, and thereby grabbing an array of socio economic goals but at the same time all these factors make the total tax system multifaceted and raise the imposition cost and involvedness.

A crucial consideration that bears on the decision to grant tax incentives should be their cost effectiveness. This implies that the mere identification of the existence of positive externalities associated with certain type of investment projects is not sufficient for justifying the use of such incentives in all instances. Rather their use should be predicted on the belief that the benefits to the economy that can be expected from an increase in the incentive favoured activities would actually outweigh the total costs of the tax incentives granted. According to the study conducted by Rajaraman and Koshy [1996] corporate bodies have been using various incentives, deductions etc. to reduce their Effective Tax Rates even to zero percentage especially as witnessed in India. Shome (2001) has observed "corporate tax legislation all over the world, no matter how streamlined at the outset, becomes subject to a "creeping incrementalism" with respect to special concessions and provisions over time, typically through excessive depreciation allowances. This is because the corporate sector constitutes a focused interest group with financial backing. A group of so called "zero tax companies" emerges. The result is a higher marginal tax rate for those caught in the tax net". Such a practice amplifies the complicacy and thereby generates compliance problem.

To overcome such an unsound and unbalanced situation various Tax Reforms Committee have been formed. Chelliah Committee [1991], Kelkar Committee [2002] recommended a range of way outs for widen the tax base including revision of tax rate, phasing out some incentives, modification in some exemptions and incentives etc. These examples are only indicative, not exhaustive. While tax reforms have been emphasizing on phasing out many of these incentives, pressure group have been resisted them in spite of decrease in marginal rate of taxes. The Government pressurized with increasing tax revenue and corporate tax buoyancies tend to expand the tax base by imposing additional taxes like Dividend Distribution Tax (DDT), Fringe Benefit Tax (FBT), Security Transaction Tax (STT) etc. All these additional taxes are intertwined in the web of various rules, legislations etc. This generates further problems of tax management and compliance. The Government has justified these additional taxes on the ground of equity and efficiency. Jhavery [2007] in his study focused on the below par tax measures imposed by the Government to pump up the national exchequer by highlighting the problem of awful governance and inept tax management procedures. Bagchi (1995), in his study opined that "base widening has to proceed in two directions, viz, (i) bringing in a larger number of potential taxpayers into the net and (ii) eliminating the numerous exemptions and deductions provided in computing taxable income to serve non tax objectives." Further in India the corporate tax system has been complex due to the numerous fiscal incentives that are intertwined in the maze of various tax legislations. The concept and rationale of fiscal incentives are deliberated in the following sections.

1.2. CONCEPT OF FISCAL INCENTIVES:

Fiscal incentives can be defined as tax preferences which grind down the tax mound of an assessee and generate tax savings by trimming down the effective tax liability and thereby generate some tax savings which in turn stimulate investments and fulfill the growing needs of different economic and social policy of the Government. The rationale of a fiscal incentive is to generate definite worthwhile and encouraging activities by way of improving net profitability, raising the total return on the investment and reducing the capital risks involved there. The international history experienced the presence of tax incentive scheme a long time back. According to the published data, it was first introduced in U.K. in 1945, in Philippines in 1946, in Puerto Rico in 1947, in India 1948, in U.S.A. in 1954, in Malaysia in 1968 and so on [Sarkar, 2004]. Public Finance theorists such as Heller and Kaufman (1963) and Bird (1980) have opined that as the number of fiscal incentives is increased, their collective outcome usually turns out to be weaker and so as to generate a sturdy impact every new incentive requires to instigate an additional potency. However what cannot be denied is that tax reliefs created by fiscal incentives shrink the tax base of companies by allowing some expenditure as deductions either by exempting some part of corporate profits from tax base or levying preferential tax rate. Fiscal incentives thus reduce the effective tax liability and thereby generate some tax savings to companies. Such tax savings represent the utmost revenue loss that would be sustained by the national exchequer.

But these tax incentives have been used to realize an assortment of diverse objectives. Such incentives on the one hand stimulate investment and on the other

hand deal with the growing needs of different economic and social policy. According to their economic considerations Fiscal Incentives are classified into three categories, viz. investment-linked, expenditure-linked and profit linked. Investment linked incentives create benefits for investments made in some selected industrial sector or in backward areas or for some special purpose in general industrial sector. The expenditure-linked fiscal incentives create benefits for specified expenditures already incurred, either in full or partially. Profit-linked fiscal incentives generate tax savings for some specific incomes. The origin of fiscal incentives in India, no matter whether investment linked or expenditure linked or profit linked and their evolution are highlighted in the next section.

1.3. INDIAN TAX SYSTEM AND FISCAL INCENTIVES - A JOURNEY:

It has been truly a time-honoured fact that a lot of tax incentives are offered throughout the world in various shapes and volumes in tune with the aim and the pace of the economy of the concerned country with its prior objective to mobilize savings and to stimulate investment, to accelerate the pace of industrial growth. India is not an exception to this practice. Taxation policy is being treated as a successful device to stir up the rate of nest egg of a country by instigating the voluntary savings through tax incentive packages including tax holidays, tax concessions, tax reliefs etc. With the introduction of tax incentive for the first time in the form of 'Initial Depreciation' through the Income Tax Act of 1922, India stepped into the revolutionary and historic path of mobilizing fund to cater the needs of the development programmes. During post independence period, considering the recommendations of Taxation Enquiry Commission (1953-54),

Kaldor's report and various recommendations of different bodies, the Government of India has undertaken extensive tax incentives programmes for planning development strategy of Indian economy.

As stated before, efforts have been made to bring in a rational system of taxation in India for decades. The introduction of the first Income Tax Act and its metamorphosis vis the present form vis an interesting phenomena which exhibits the efforts of those in the helm of affairs to carve out a system in consonance with the canons of taxation. A brief discussion on the course of evolution of tax system in India vis made with references to pre independence, post independence and post globalization periods.

1.3.1. Tax System in Pre Independence Period: -

In 1860 the Income Tax was first introduced in India by John Wilson to make a search for the way outs to triumph over the financial hardship having an effect on British India owing to Sepoy Mutiny in 1857. The Income Tax Act of 1860 was changed to License Tax on Trade in 1867. Agricultural Income was excluded from the purview of License Tax in 1867. This License Tax was replaced by The Certificate Tax having almost same texture in 1868. Again this Certificate Tax was replaced by The Income Tax in 1869 where Agricultural Income was included in the tax base. This act was completely pulled out in 1874. Due to the financial crunch caused by great famine of 1876 the British Government was bound to incorporate the system of Direct Tax in 1877. This Act was continued till 1886 comprising of a number of alterations and modifications. During this period the tax rate, its chargeability and assessment procedure was

quite unlike that from today. For the first time the distinction was made between the tax schedule of salaried person and company in 1886. For the first time the concept of charging income tax on aggregated income of various sources was introduced in the Income Tax Act 1918 where six source of incomes were prescribed for the tax purpose, namely, income from salary, income from interest on securities, income from house property, income from business, income from profession and income from other sources.

In 1922 The Act XI was passed keeping in view the recommendations of 'All India Income Tax Committee'. This Act opened up the process of recounting the Income Tax as central item. This Act provided the concept of Assessment Year for the first time. This Act lasted till 1939 in the midst of several changes and modifications. According to the recommendations of Chamber's Enquiry Committee, 1935 The Act XI of 1922 was amended significantly in 1939 which introduced the concept of different types of assessee viz. (i) Resident (ii) Non-resident and (iii) Resident but not ordinarily resident [Sarkar, 2004]. This Act has gone through various changes during pre independence period and post independence period till 1961. Throughout the entire eon the tax system was unlikely for different section of population building disfavours which ultimately had made the total system less cost effective and thus the ultimate aim of the then tax system became far-reaching to grasp revenue of note [Balakrishnan, 1951].

1.3.2. Tax System in Post Independence Period :-

After the independence in 1947, regarding the tax policy, it was the prior intend of the Indian Government to form a tax system which would become well-

liked, down-to-earth, balanced, rational, trustworthy and moreover revenue yielding. To accomplish such a goal Indian Government carried out a comprehensive fiscal revision under the chairmanship of Mr. Nicholas Kaldor according to the recommendations of Direct Taxes Administration Enquiry Committee headed by M. Tyagi in 1959. It was 1958-59 when "Expenditure Tax" was initially brought in as per Kaldor's report [Kaldor, 1956]. But it was put to an end with effect from 1st April, 1962 being treated as unfeasible, unprofitable and less revenue attractive. Again it was reintroduced in 1964-65 and again eliminated in 1966. Our present tax system is the modification of Income Tax Act, 1961 which was initiated through The Income Tax Bill, 1961 presented in Parliament for approval on 24th April 1961. After a long discussion in September 1961 it became a full- blown Income Tax Act with 298 sections and 5 schedules applicable to whole India including Jammu and Kashmir. Finance Minister was empowered for making additions, alterations and modifications as per the demand of the economic set-up. Furthermore, CBDT was authorized for revising rules and rescheduling directives as and when necessary.

The main objective of this Act was to make the tax system rational, feasible, cost-effective, trustworthy and revenue generative. But impediments were created as a result of wooly sketch of the schedules, their recurrent alterations of those schedules, non-compliance and tax evasive tendency of assesses. A tax reform committee under the chairmanship of S. Bhoothalingam was appointed by the Government of India in 1966 with the intention of making the tax composition rational, simple, and feasible. The main recommendation of the Bhoothalingam Committee (1968) was for the designing of "Income Tax

Return" in a simplified way. Despite the entire attempt resource generation was stumpy. After independence it was the foremost challenge of the Government to strengthen the agriculture of India. By encouraging agriculture the Government made an attempt to make the country agriculturally self-sufficient and thereby raising resource generation. This was the reason why agricultural income was exempted from the purview of tax u/s 10(1) of I.T. Act, 1961. To increase the revenue generation "The Direct Taxes Enquiry Committee" was formed under the headship of Justice K.N. Wanchoo in 1970. The committee highlighted sky-scraping tax rates as the main reason of tax evasion and insufficient tax collections [Wanchoo, 1971].

With the passage of time it became one of the most important challenges of the Government to promote industrialization and at the same time to strengthen the national exchequer. This intention acted as the rationale behind offering an assortment of fiscal incentives. To boost up the tax collections and to promote industrialization in the early eighties the then Government offered a series of fiscal incentives viz. deductions in respect of profits and gains from newly established industrial undertakings u/s 80-HH, Deductions in respect of profits and gains from newly established small scale undertakings u/s 80-HHA, Deduction in respect of export turnover u/s 80-HHC, Deduction in respect of earnings in convertible foreign exchange u/s 80-HHD etc. Again the computation process regarding deduction u/s 80-HHD has been amended from 1st October, 1991.

As we have looked beyond it has been evident that the Finance Minister under the aegis of the Ministry of Finance revise the tax rates and the incentive

packages almost every year to go well with the growth needs of the country's economy. Though tax incentives have mostly backed up the diverse needs and desires of the tax payers in particular and the needs of the economy as a whole but at the same time such a huge fiscal incentives lower down the Effective Tax Rates (ETRs). To get a control over those exemptions the concept of placing a minimum tax on companies @ 30% of company's book profit was introduced from the A.Y. 1988-89. Again this provision was withdrawn w.e.f. the A.Y. 1991-92 due to computational complexities. In spite of changes made in the tax structure the tax rate prevailing in our country in pre globalization period was obviously very high vis-à-vis effective tax rate is low. Complications and compliance difficulties were generated due to random amendments and modifications. Despite the entire attempts resource generation was still not enough. But in1991 the total scenario was changed due to opening up the Indian economy. Revolution in Indian business world has necessitated the reforms in corporate tax structure to maintain the tempo of globalization.

1.3.3. Tax System in Post Globalization Period: -

At the advent of 1991 with the opening up of Indian economy to the globe entire business world has become a global village for India. Such a drastic change in the corporate scenario has called for the reforms of Indian corporate tax structure to accelerate the fiscal change-over caused by globalization. From such an urge we have observed the initiation regarding tax reform programs in the Union Budget of 1991-92. Consequently Tax Reform Committee was formed by the then Government of India under the chairmanship of Raja J. Chelliah in

August 1991 to scrutinize the tax system prevailing in India, to provide us with the suggestions for making the tax system elastic and broad based, to make comments for simplifying the existing tax system with the objective of facilitating better compliance and getting better enforcement, to eliminate the ambiguities prevailing in our tax system and making it further well-organized and proficient for attracting more and more revenues. The committee supported the global attitude of adopting sensible tax structure intertwined with silky enforcement and enhanced compliance. The committee has suggested the existence of a simple, rational, stable tax structure and discarded the Government's attitude of making frequent changes and juggling with the tax structure. It has also explained the requirement of updated administration and enhanced enforcement regarding tax procedures [Chelliah, 1991]. To cope up with the rapid change in the business scenario the Government had decided on implementing various recommendations made by the committee regarding direct and indirect tax step by step before starting of the new millennium. The committee has put stress on eliminating the irrelevant tax incentives only to encourage proper incentives to maintain the tune of the economic activities.

At early nineties it was the foremost task of the Government to cheer the export business with an intention of opening up the Indian market to the world. Consequently the Finance Ministry of the Government bleached the differences between closely held companies and widely held companies. Again the Government amended section 80-HHC regarding computation technique of deduction in respect of export turnover from the Assessment Year 1992-93. To promote new industry the Government introduced section 80-I from the

Assessment Year 1992-93 for providing incentives in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development. The eligibility criterion for the assessee claiming deductions u/s 80-IA has been changed from time to time. At the time of insertion, priority was given to infrastructural development. From assessment year 2002-03 the road, highway project, water supply project, port, inland waterway, water treatment system, irrigation project, sanitation, solid waste management system were included in the priority sector. Telecommunication sector was given the precedence u/s 80-IA from the A.Y. 1995. From the A.Y. 1999 the priority was given to industrial parks. All the incentives introduced or amended after 1992 have replicated the suggestion of Chelliah committee to endorse the effect of globalization in the corporate sector in a phased manner.

But another significant recommendation designed for scrubbing out the superfluous incentives has not been approved by the Government, ultimately reducing the effective tax rates (ETRs). By captivating numerous benefits of those fiscal incentives several corporate houses were in commanding position in case of bringing down the tax burden even to zero through judicious tax planning techniques. Even large corporate house like TISCO, Ashok Leyland etc. managed to cut down their effective tax rate (ETR) to absolute zero.

In order to reduce zero taxed companies to nil, to make the tax system more elastic, equitable, vibrant and buoyant the Government introduced the system of Minimum Alternate Tax [MAT] under a new section 115JA w.e.f the A.Y. 1997-98. To make the system of MAT smooth and vibrant and acceptable to corporate house "tax credit" was introduced under section 115JAA w.e.f. the A.Y

1997-98. These two sections were simultaneously continued till 2001. In place of section 115JA, section 115JB was introduced from the assessment year 2001-02. Companies can compute Minimum Alternate Tax under section 115JB w.e.f. the A.Y. 2001-02. 'Companies having capacity to pay ought to contribute a bare minimum sum to the Government's exchequer as corporate taxes'- the rationale behind the MAT has followed the guidelines of Chelliah Committee. The Finance Bill again amended the sec.115JAA for giving the effect of the new system of MAT. Beside all such reforms the Government introduced Dividend Distribution Tax in the Assessment Year 1997-98 with a break of one year in the Assessment Year 2001-02 and brought it back in the Assessment Year 2002-03. Though the main objective of all such reforms was to increase the corporate tax revenue but such a massive juggling with different sections generates a perplexing upbringing regarding the corporate tax management and the Government's intention of crafting a rational, lucid, simple and vibrant tax system. Under such a situation the Government formed the Task Force on Direct Taxes in 2002 chaired by Vijay Kelkar to monitor the financial possibility of the country and to advocate some modifications as regards tax system prevailing in our country.

The Task Force on Direct Taxes, 2002 suggested the removal of many tax exemptions and reduction of schedule tax rate to increase effective tax rates and widening the tax base and thereby to increase the tax revenue [Kelkar, 2002]. Accordingly in the A.Y. 2005-06 section 80-HHB, 80-HHC, 80-HHD were deleted. The rationale behind such deletion was to increase the effective tax rate (ETR). Again the criterion for availing deduction u/s 80-IA has been changed after A.Y. 2002-03. From 2003-04 priority was given to generation and

distribution of power, from 2005 onwards priority was given to IT sector and since 2007 priority was given to SEZs. Laying and operating cross-country natural gas distribution network has been treated as the priority sector from the A.Y. 2008-09. The Government's intention of promoting SEZ has given the birth of section 80-IAB to grab the exemption as regards profits and gains of undertakings engaged in development of SEZ. To encourage industrial research, production of mineral oil, developing housing projects, to promote Food Park, multiplex theatre, convention centre, rural hospital the Government has inserted section 80-IB from A.Y. 2006-07. At the same time various additional taxes was introduced to strengthen the national exchequer. Dividend Distribution Tax being introduced in the Assessment Year 1997-98, rolled back in the Assessment Year 2003-04 due to pressure from different corners. Again Dividend Distribution Tax was brought back in the year 2003-04 for a long term to boost up effective tax rates (ETRs). As additional tax Banking Cash Transaction Tax (BCTT) was introduced in the year 2005-06 and Fringe Benefit Tax (FBT) from the year of 2004-05. It has been proved from the history of the corporate tax structure that quite a few numbers of fiscal incentives have been deleted since 2002-03, to be recommended as necessary by the Kelkar Committee for evading compliance complexities and for increasing ETRs. Beside that to accelerate the pace of economic development the Government has introduced, modified, and restructured several tax incentives at several stages in this period. However, such alterations and modifications in the tax structure have posed some problems for corporate houses regarding tax planning and management activities.

1.4. STATEMENT OF THE PROBLEM:

The Income Tax Act in India is known for its countless modifications, insertions, deletions, repeals, omissions, notifications effected over a long period. Every year several new experimental provisions are introduced in Finance Bill, only to be deleted or modified at some later date. Stability in the system can only be brought if the laws remain consistent for a considerable period of time. "Tinkering with the various provisions of the Act simply corroborates the fact that we lack a stable long term fiscal policy", [Duggal, 2006]. Various tax incentives either investment linked or expenditure linked or income linked have been introduced from time to time to trim down the effective tax liability and to induce tax savings by way of lowering the effective tax rates. These incentives, exemptions, rebates and tax holidays are rescheduled and restructured from time to time are meant to keep proper pace and tuning of the thrust area of economic planning of the Government. For example, the eligibility criterion for the assessee claiming deductions u/s 80-IA has been changed from time to time. Sometimes priority is given to infrastructural development, sometimes to industrial park, sometimes to generation and distribution of power and sometimes to IT sector and now for developing Special Economic Zone. Again, deductions u/s 80-HHB for profits and gains outside India, sec. 80-HHC in respect of export turnover, section 80-HHD in respect of earnings in convertible foreign exchange, section 80-HHE in respect of profits and gains from export of computer software, section 80-HHF for profits and gains from export or transfer of films software, section 80-O in respect of royalties received from certain foreign enterprises were introduced, continued for some years and then gradually phased out. These deductions were

given for attracting foreign investors and institutions, broadening the scope of export and import of knowledge and technology, development of backward areas etc. The number of tax incentives reintroduced especially after the year 2003-04 includes expansion of the scope of section 80-IB, introduction of section 80-IAB for undertakings engaged in the development of SEZ, introduction of section 80-IC for undertakings in special category states. These examples are merely illustrative and not exhaustive because there are a lot of other incentives that have been introduced during these years in addition to a lot of deductions under section 30 to 44. With the passage of time the corporate tax system in India has become subject to "creeping incrementalism" with respect to fiscal incentives provided in the Income Tax Act. Such insertion and deletion of tax provisions have added to the complexity of the Indian corporate tax system. Direct Taxes Code Bill (2009) has stated that "tax administrators, chartered accountants and tax payers have raised concerns about the complex structure of the Income Tax Act." The DTC has further stated that "the numerous amendments have rendered the Act incomprehensible to the average tax payer." Moreover it has been stated in the DTC that "there have been frequent policy changes due to changing economic environment, complexity in the market, increasing sophistication of commerce, development of information technology and attempts to minimize tax avoidance. The problem has been further compounded by a multitude of judgements (very often, conflicting) rendered by the courts at different levels."

Every year the then Finance Minister, in the union budget, recommends tax rates for all types of assesses for the forthcoming assessment year to be approved by the Government. The tax rate approved by the Union Government is

articulated as Statutory Tax Rate or nominal rate (STR). By virtue of a plethora of tax concessions and fiscal incentives, the Indian corporates have been able to keep their effective tax rates much below the statutory tax rates. The ratio between effective tax liability and the net profit before tax is termed as the Effective Tax Rate (ETR), which is much lower than the statutory rates. Efforts have been made by some organisations to calculate ETRs. The Centre for Monitoring of The Indian Economy (CMIE) has been calculating the ETRs and found that ETRs were far below than STRs. According to them the gap between STR and ETR is 26.39% in the year 1990-91 which has increased gradually and touched the ever highest limit of 34.26% in the year 1994-95. After that the gap between these two started to decrease and the gap was 17.43% in the year 1998-99 and again the gap has increased steadily to 23.95% in the year 2001-02. Till then the gap between STR and ETR has shown a reducing trend and the difference becomes closer as the times passed. One of the reasons to decrease the gap may be the reduction in STRs and availability of bundle of fiscal incentives. So it is needed to further delve into this aspect.

Guha [2007] observed that lowering of effective tax rates below the statutory rates were possible due to tax management by allowing various allowances, reductions, rebates and relieves available in the tax laws. The productivity of these deductions is often questionable. The Indian Corporate Taxation scenario during the eighties witnessed the emergence of a large numbers of high profit yet zero tax companies. These companies could reduce their taxable income to nil by a judicious tax planning system.

To get a control over those exemptions the concept of placing a minimum tax on companies @30% was introduced from the A.Y. 1988-89. Again this provision was withdrawn w.e.f. the A.Y. 1991-92 due to computational complexities. Tax Reforms Committee, headed by Raja J. Chelliah (1991) constituted by the Government for making some valuable recommendations in order to broadening scope of tax base and increasing tax revenue for better compliance, simplification of laws and procedures, rationalization of tax structure, revamping of the administrative set up of the tax department for improving efficiency and correction of structural imbalance. In order to make the tax system more elastic, equitable, vibrant and buoyant the Government introduced the system of Minimum Alternate Tax [MAT] under a new section 115JA w.e.f the A.Y. 1997-98 to reduce the number of zero tax commpanies to nil. In this system, Minimum Alternate Tax was calculated at the statutory tax rate on 30% of book profit, if the taxable income was below 30% of book profit. From the Assessment Year 2001-02, in place of section 115JA, companies can compute Minimum Alternate Tax under section 115JB. Under this section companies can compute Minimum Alternate Tax @7.5% [+SC+EC+SHEC] of tax liability if tax liability under normal provision was less than 7.5% [+SC+EC+SHEC] of book profit. The rational of MAT is that companies having capacity to pay ought to contribute a bare minimum sum to the Government exchequer as corporate taxes. To make the system of MAT smooth and vibrant "tax credit" was introduced under section 115JAA w.e.f the A.Y 1997-98 for the extra amount of tax paid by the company as a result of Minimum Alternate Tax. The Finance Bill again amended the

format. Such a massive juggling with MAT generates a perplexing upbringing regarding the corporate tax management.

Despite all the efforts how the collection from corporate tax has been changed with the passage of time, can be eminent from the following table.

Table 1.1
Revenue Collection from Corporate Taxes in India in Different Years
[all figures are in rupees in crores]

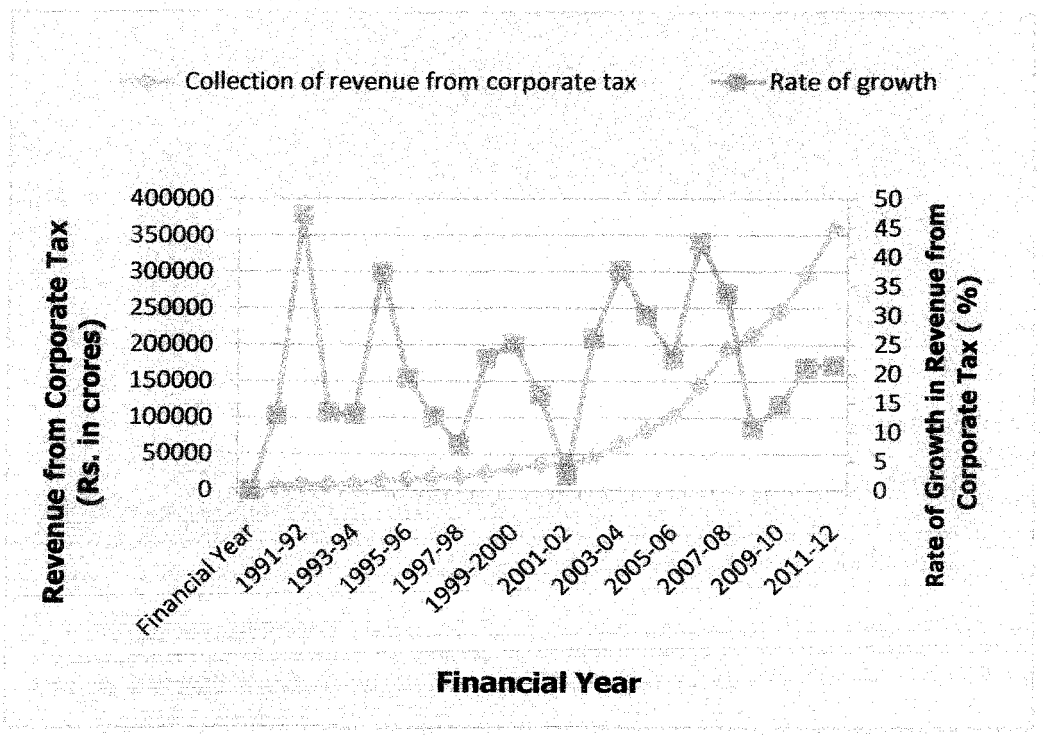
Financial Year	Collection of Revenue from Corporate Tax	Rate of Growth in Collection of Revenue from Corporate Tax (%)	Corporate Tax as a Percentage of Gross Tax Revenue
1990-91	5335	12.81	9.27
1991-92	7853	47.20	11.66
1992-93	8899	13.32	11.92
1993-94	10060	13.05	13.28
1994-95	13822	37.40	14.98
1995-96	16487	19.28	14.82
1996-97	18567	12.62	14.42
1997-98	20016	7.80	14.38
1998-99	24529	22.55	17.06
1999-2000	30692	25.13	17.87
2000-01	35696	16.30	18.93
2001-02	36609	2.56	19.57
2002-03	46172	26.12	21.35
2003-04	63562	37.66	24.99
2004-05	82680	30.08	27.11
2005-06	101277	22.49	27.66
2006-07	144318	42.50	30.48
2007-08	192911	33.67	32.52
2008-09	213395	10.62	35.25
2009-10	244725	14.68	39.19
2010-11	296377	21.11	37.66
2011-12	359990	21.46	38.61

Source: Compiled from the data collected from CMIE bulletins and the website www.mf.gov.in/revenue

The table is self explanatory. It can be observed from the above table that revenue collections from the corporate tax in different years exhibit an increasing trend. When the ratio between revenue collection from corporate tax and gross tax

collection in different years are obtained it has been found that the ratio between these two reached the ever highest percentage of 39.19 in the Financial Year 2009-10 from 9.27% in the Financial Year 1990-91. Such a huge percentage of revenue collection from corporates (almost about 40%) as compared to gross tax revenue speaks the significance of itself. We can get the trend line of the revenue collection from corporate tax and its growth in various years from the Financial Year 1991-92 onwards from the following figure.

Figure 1.1
Graph Showing The Collection of Revenue from Corporate Tax in Different Years and Its Growth Path



Source: Table-1.1

The diagram also points out towards the increasing trend of revenue collection from corporate tax. Though a continuously rising trend has been

observed in the collection of revenue from corporate tax, but the rate of growth in corporate tax collection is very uneven. The Task Force on Direct Taxes, 2002 under the chairmanship of Vijay Kelkar suggested the removal of many tax exemptions and reduction of schedule tax rate to increase the effective tax rate and widening the tax base and thereby to increase the tax revenue. Though only a few insignificant deductions were removed yet the Government introduced various additional taxes such as Fringe Benefit Tax [FBT] in 2004-05, Dividend Distribution Tax [DDT] in1997-98 with a break for one year in 2002-03, Banking Cash Transaction Tax [BCTT] from the A.Y. 2005-06. Under FBT privileges, facilities, services provided by the employer collectively, not attributable to any particular employee would be taxable in the hands of the employer in addition to the perquisites being taxed under the head "salary" in the hands of the individual employee [Kamath, 2006]. Fringe benefits which are employee allocative continue to be taxed under salary income and non attributable FBT are taxed at the hands of employer. This leads to computational complexities for the assessee. These additional taxes increase the tax liability of the company and therefore its effective tax rate. These taxes therefore also contribute to the collection from corporate tax for the Government. The importance of the taxes can however be judged from the proportion of contribution given by them in comparison to corporate taxes. The following table highlights these aspects. Moreover both in New Zealand and Australia (the pioneer of FBT) the cost of providing FB as well as FBT is deductible expenses. In India no such deduction is available, thereby liquidating the scope of reducing gross taxable income (GTI) [Jhavery, 2007].

Table 1.2
Collection from FBT, STT, BCTT, DDT in Different Years

[figures are in rupees in crores]

Component of Additional Tax		Financial Year		
		2005-06	2006-07	2007-08
FBT	Total Collection	4772	5323	6743
	% of CT	4.81	3.68	3.53
STT	Total Collection	2559	4648	8577
	% of CT	2.58	3.22	4.50
BCTT	Total Collection	3210	5020	5730
	% of CT	3.24	3.47	3.01
DDT	Total Collection	20159	16509	17150
	% of CT	20.35	11.43	8.99

Source: Compiled from the data collected from the website of CBDT
Note: CT denotes Revenue Collection from Corporate Tax
The figures after the Financial Year 2007-08 are not available

The periphery of the definition of fringe benefits u/s 115WB and its chargeability was under a process of ongoing change to enhance the tax base. Though the collection of FBT showed an increasing trend but the trend of FBT as a percentage of CT was not so much. Moreover, random change in the periphery of defined fringe benefits created complicacy in corporate tax planning and also for the management strategies as regards providing benefits and amenities to employees and made the overall compliance process difficult. FBT was therefore removed from the Assessment Year 2011-12.

Despite the fact that tax revenues from STT and BCTT point towards a positive note, these two also creates computational problems and compliance complicacy. Under DDT dividend distributed by any company will be taxed in the hands of the distributing company. Though this additional tax has widened the tax base, simultaneously it has created a problem to the management in making decision about the dividend payout. "Observations regarding the tax break up of

the IT sector makes it clear that many companies do not pay tax at all except DDT. Without DDT the amount they have disbursed as dividend is a portion of the untaxed profit" [Bagchi, 2007]. However such policies of widening the corporate tax base were observed to be principally unsound by James & Nobes [1998]. Moreover rates of Dividend Distribution Tax being unstable during the last few years have added more difficulties for the corporate sector in framing long term dividend policies. In addition to this, BCTT - a new tax system to levy tax on banking withdrawals exceeding Rs.100000 has increased the compliance complexities further.

The above discussion is only indicative of how multiplicity of fiscal incentives, additional taxes and their frequent modifications, introduction of MAT, withdrawal of MAT credit and subsequent reintroduction has made the corporate tax system perplexing (Detailed discussions in this respect will be made in the following chapters). Not only that but as an upshot of additional taxation the company has to rethink, revamp and revisit the dividend policy, policy of disbursing perquisites and non cash benefits to human resources, policy of endorsement, security transaction, cash withdrawal system etc. The contradiction and confusion between these two opposite dimension of corporate taxation makes the corporate tax system dusty, opaque and generates hardship in tax planning and strategy making and increases compliance cost and even induces non compliance. Since stability and simplicity are the sine-quo-non for effective tax planning, management and compliance, it is necessary that attempts to be made to suggest a system which will to a large extent be free from the problems mentioned above.

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