

Budget 2012: The tax wishlist

The Union Budget is just around the corner. Debt and taxes are inevitable. For a Finance Minister, Finance Ministry and the economy, which is facing a huge deficit in terms of revenue and obviously political pressures to hand out more to the voting classes, this perhaps must be a very trying time, when he is putting the final touches to his Budget speech.

In an interview to CNBC-TV18, a very esteemed and distinguished panel including Nishith Desai, founder of Nishith Desai Associates (NDA), Parthasarathi Shome, director and chief executive officer of ICRIER, Shyamal Mukherjee, the joint tax leader at PwC India and Satya Poddar tax partner at Ernst & Young discuss taxes as part of Budget agenda 2012.

Below is the edited transcript of the interview. Also watch the accompanying videos.

Q: What are your key expectations from the Budget?

Desai: There are three expectations. One, the government should deal with corruption. That's the topmost issue in front of us today. Two, give me the true state of the financials affairs of the nation. Three, appoint law commission with independent professionals as well as the tax department people and the global renowned expert, have very independent committee.

Q: What are your key high level expectations, given the overall scenario that we are currently in?

Shome: Firstly, we have to put it in the context of where we are in terms of our overall economic cycle. We know that we are in a down cycle. We are hitting a low in comparison with several years now. As a result, we have to put up some incentives-oriented tax measures. But I don't mean discretionary, very small incentives, selective incentives. The economy as a whole needs incentives to really be beefed-up.

What are they? We really have to look at the fact that in this Budget in the current year we will probably hit a real low in terms of our tax to GDP ratio. Between 2004 and 2008, when I was operating in North block, our tax to GDP ratio went up historically at the highest rate of more than 25% real growth for four-five years. Also, in comparison it went up the maximum that any country had ever experienced in that kind of a sustained period of time. We have since then literally come down the proverbial nursery slip. It has gone down tremendously. So, we need some incentives so that the private productive sectors are incentivised sufficiently to produce, have a rate of growth and then produce revenues. So, the first kind of thing I would look for are what are broad measures?

For example, we can give accelerated depreciation across the board. The governments, not just Indian government, but governments in general make very selective judgments of this particular sector, that particular sector followed by several meetings with other sectors, ignored sectors. So, I would look for an accelerated depreciation across the board.

I would also look for lowering of headline rates. Our rates of taxes have been brought down, but our corporate income tax rate is still quite high in international comparison. So, we need a lowering of headline rates. At the same time, we need to get rid of selective incentives. That's the first package that I would say out of your three things. The government should look for generalised incentive policies and removal of selective policies which will expand the tax base, but reduce the tax rates.

Second, I would look for some kind of guidance on what government intends to do with respect to the goods and services tax (GST). While we all want goods and services tax, certain measures, certain kind of elements in the current structure as is being discussed lack clarity.

Third is a kind of a roadmap for modernisation of tax administration. There are tremendous costs, transactions cost of doing business. We as a tax administration have taken several measures, forward measures. But in a benchmarking exercise with other countries, we still are lagging behind. I really think now what we need is not tax administration improvements on a case by case basis reflecting individual tax administrator's skills and abilities, but in an organised manner what is the tax administration going to do in terms of modernisation and reducing the cost of business, cost of doing business in India.

Q: What are your key high level expectations?

Mukherjee: One thing is for sure is obviously it's going to be a difficult time for the Finance Minister when he comes up on the 16th March. He has this fiscal deficit that he has to manage, and what would be important is how much he could actually go out and manage it proactively. The first obviously would be to put up what the right fiscal deficit is; he would have to spend time to see how to expand and protect the tax base. You would also need to have a very effective tax administration.

Another thing is the use of technology; if you really see the use of technology in our tax administration is actually very miniscule. There also is the whole gamut of tax litigation, because over the years I don't think we have spoken so much on the increase in tax litigation or where is it going. So I would very happy if he actually gets into discussing how to adjust this tax litigation issue.

From a business point of view, they see GST in the next year or two. It would be right to understand where the government is on the thinking of GST because that obviously affects businesses and whether at all the government is in a position today to

get the GST rolling.

Q: The GST was supposed to be a key element, but currently it doesn't seem to be going anywhere?

Poddar: Yes that's true, it's not going anywhere, but let me start little differently. I believe that the fundamentals of the economy are very strong in India. Things are going well not because of the government, but inspite of the government. Even though I agree with a thrust of what other panel members here have recommended, I don't think the government is able to deliver on any of those reforms that we wish to see through.

So in the current environment, don't raise your expectations that the government will do something and as a result things will get better. The political environment in India is such today that no matter what they propose they won't be able to deliver.

Investors are looking for a place where they can park their money and for that all that the government can do is make India a hospitable environment. The best incentive you can provide is to welcome people here. I am not looking for tax concessions, I am not looking for lower tax rates, I am not looking for accelerated depreciation. All I am looking is certainty and stability in the policies the government has got.

The second important point is that on the tax front the fiscal situation is bad. We don't want to become Greece of tomorrow, we don't want to become Portugal of tomorrow, and things can get out of control very quickly. There is need for fiscal consolidation, which in my view should come from very simple, straight-forward tax measures. You have to create fiscal room of Rs 1 lakh crore; half of it must come from expenditures and half will come through tax side. On the tax side around the world, all the governments who are facing need for fiscal consolidation they are going for indirect taxes, so the government has no choice but to increase excise tax rates. I don't think they need to go with less than 2%. 2% is the absolute minimum increase in excise duties and service tax.

PAGEBREAK

Q: There is a sense of expectation that the Finance Ministry may resort to doing something on GAAR as well as the control foreign company. Would this be the right thing to do? Would this send out the right kind of signal in the current environment to global investors?

Shome: I do think that a lot of homework and discussion and dialogue with stake holders has to take place before a Budget proposal is simply installed. I really think that it is not just a question of the current economic environment; it's an issue of dialogue with stake holders and design – that's more important.

Q: Why should the common man bear the brunt of a hike in indirect taxation? How can the Finance Minister reconcile these two different sides of the coin?

Shome: It's a relatively straight forward issue in the sense that we cannot have control foreign company in laws installed in an ivory tower. We are very interconnected with the rest of the world, so we have to follow a similar pattern of corporate taxation with the rest of the world.

Q: You want to comment on that?

Poddar: The best thing I remember about design of the tax system is a comment made by Yeshwant Sinha when he was Finance Minister. He said that the ultimate test of a good tax system is a system with no discretion, no discrimination.

GAAR is an ultimate negation of that principle. It is highly discretionary, highly discriminatory. If you don't like certain provisions, amend the laws explicitly instead of going about it indirectly through a method called GAAR. GAAR will bring the most uncertainty in the tax system and tax administration, which will scare the investments away.

Q: But the Standing Committee of Parliament also seems to have recognized this principle and made several remarks about the need for GAAR?

Desai: Before you introduce GAAR you must create conditions so that the GAAR can be implemented fairly. It is so subjective, it is so perception based and therefore it will provide an instrument of fiscal terrorism in the country.

Mukherjee: I think the fear that comes from rule like this is on the administration of law. I think the confidence of a tax payer on the tax administration to administer a law is not right at the top.

Q: What do you think the Finance Minister will do as far as indirect taxation is concerned? Do you think he will bite the bullet on raising rates?

Shome: I have a feeling that probably the service tax rates maybe increased and that more services will come into the base. I also feel that excise rates probably will not be touched because of the recent experience with manufacturing sector growth rates.

Q: Including the IIP data?

Shome: Yes. The other thing is that whatever is the rate of tax on the excises, because it is up to the manufacturing stage,

one has to understand that if you added the wholesale and retail levels into the base, the rate of tax is actually not that high.

Therefore, there is some room for increasing the rate. However the fact of the matter is that is not always understood or interpreted in the right way. So I don't believe that excise rate will go up but service tax will be affected both in terms of rate and as well as in terms of base.

PAGEBREAK

Q: There are some comments about the negative list that is perhaps likely going to be introduced. We have seen certain preparatory moves towards that. There is also this number that has been floated around, 22 items a part of that, 35 items, some say just 10. Are we prepared to introduce a negative list for service tax, given all the inefficiencies in the system? Is it a step that is being proposed ahead of its time?

Poddar: Actually it is the opposite. The negative list concept is too little too late. Over the past 10-15 years government has already brought in all kinds of services within the tax space. All that is left to be done is bit of a cleaning up.

The items, which are really significantly base broadening, politically I don't think this government has the courage to bring them in. Medical services are outside, education service is outside, rail transportation, bus transportation is going to be outside. At the same time, if you bring in the negative list right now, you will have to fight between the center and the states, you already are having a fight.

Q: In your expectations, are we going to see a new tax being introduced because that's not happened for many years?

Desai: I don't think they will introduce new taxes. It's only a speculation. Whatever we have, let us make best out of it. If that is our thinking then possibly we will focus more on cleaning up our existing system than introducing new taxes.

Q: Is it easy to introduce a new tax, we introduced the CTT - never notified it and it died a natural death?

Shome: I don't think it died a natural death, it was actually removed. But what will happen in this Budget is they will try to provide a roadmap for both the direct tax code and the goods and services tax.

Q: Let me get you back on the specifics. We have a securities transaction tax, there has been some move to sort of look at it. We also have long-term capital gains taxation, which is a key issue. Any expectations as far as these two things are concerned?

Desai: I don't have any particular expectations on capital gains at the moment. On CTT, I think that eventually that probably it might be considered in the context of G-20 because we have promised to G-20 that we will take some structural measures including tax measures. So, whether it's a carbon tax or a financial transactions tax of this nature something will be discussed at some point.

Q: Do you think that something will happen as far as rates are also concerned?

Mukherjee: There are two things. I think something will happen on the rates. Let me start with corporate tax rate, I do not believe top rate would move from 30%, but I would believe that the MAT rate will move.