

Review of the Tax Administration Reform in India – Spirit, Purpose and Empowerment Govt. of India, Ministry of Finance, Tax Administration Reform Commission, 2014, 1264 pp¹

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The Indian Tax Administration Reform Commission, chaired by Dr Parthasarathi Shome, was mandated “to review the application of tax policies and tax laws in the context of global best practices and to recommend measures for reforms required in tax administration to enhance its effectiveness and efficiency’. The resulting four part report is a comprehensive review of tax administration reforms in India, lucid and well-structured, with a remarkable coverage of practice and theories. It is an essential reference work for those concerned with tax reform in South Asia, India in particular. The report has four substantive parts, each being comprised of several terms of reference discussed on three major themes – reviewing current status, identifying gaps compared with international best practice, and recommending actions.

Part I addresses the reform issues of organizational structure, business process, dispute resolution and taxpayers services. Currently, the tax administration structure of India is divided into direct and indirect tax wings, based on a tax-type territorial jurisdiction, with little administrative and financial autonomy. Lack of robust accountability structure and operational business model are argued to be the major reasons for organizational inefficiency. Suggested reforms include segmenting taxpayers into different groups, large and small, and designing a functional work structure. Integration of direct and indirect taxes through data sharing is proposed as the immediate best solution instead of unification, which will take place over the next five years. Around the axis of integration and unification attention is drawn on lateral entry to infuse expertise in the tax administration and defined careers progression for civil servants with a well-framed code of ethics. In the case of business process: where the present system of registration and assessment are separate for direct and indirect taxes- a system of unification and integration is essential– most effectively through the development of e-systems and digitalization to streamline collection and refunds. Equally, simplification in documentation and audit procedure are essential to ensure that the customs clearance and cross border transactions run properly; the mere existence of a manual system is not enough. Tax disputes have been mounting, owing to the lack of accountability in making arbitrary demands by the assessing officers, who enjoy huge discretionary powers. Retrieving confidence among taxpayers, with a collaborative approach and improving legislative clarity with sufficient staff training are recommended. In respect of taxpayer service: the present service structure is ‘individual tax officer-driven’ accompanied by ad-hoc roll-out of some services without any feedback from taxpayers. Specialized service delivery mechanism – supported by adequate budgetary allocation, independent jurisdictional Ombudsman and customer focused citizen charter would be essential to make things better. Pre-filing consultations ‘used to assist

¹ The original publication for this review can be found at http://finmin.nic.in/the_ministry/dept_revenue/index_tarc.asp

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taxpayers when they need it rather as an enforcement tool after the event' (p.57), as in the case of the UK, Australia and Italy, are considered important. The point is that taxpayers are to be seen as valued customers, not as robbers, to make the tax system responsive and responsible.

Part 2 reviews the capacity building and database issues for the customs department. Given the resources, emphasis on user-friendly modern technologies backed by risk management tools is needed to prevent fraud and smuggling, which requires massive regional and international cooperation. To make the database readily analysable and exchangeable, legislative enactments with layered authorisation should be in place.

Part 3 deals with three crosscutting issues –impact assessments, widening the tax base and enforcement mechanisms. An underdeveloped area of India's tax administration is that 'neither of the two Boards carries out an ex-ante impact assessment' (p.735). The tax base is narrow and overwhelmed with inadequate enforcement efforts. The Commission recommends ex-ante and ex-post stakeholder consultation, using both quantitative and qualitative methods, to identify the potential impact of tax policy changes. For the tax base to expand, suggestions include increased attention to withholding taxes, high net individuals, presumptive taxes, and bringing large agricultural firms and other informal sector business into the tax net. The synergy in base expansion and tax collection would be higher if the enforcement schemes focus on both enhancing trust and a collaborative relationship with the taxpayers along with verification audits of complex transactions tracked down using risk rating tools. Search and seizure can only be used in special cases.

The final substantive part is part 4, which has chapters on developing forecasting models for revenue targets and fraud detection as well as overall research capacity building for the tax administration. In the case of revenue and arrears forecasting, a combination of short and long term conditional/causal tax specific models, using transparent data with periodic review of macroeconomic changes, could be applied to replace the current unstructured budget making practices. Similarly, the currently practised silo data and skills management pools need to be better integrated and buttressed with risk based analytical tools, knowledge sharing and mutual cooperation. Practical research for tax policy making, except for some scattered and sporadic attempts, is at a budding stage in the tax administration of India. A multi-disciplinary evidence-based research body, funded adequately and linked with external research bodies, is recommended to carry out meaningful works on all important areas, ranging from compliance tracking to tax disputes. Knowledge gaps and training needs have been focused as usual in revitalizing the research units.

These are the bare bones of the analysis and recommendations made in the report. The power of the report is in the simplicity of presentation and painstaking coverage of the tax administration, not as much in the theoretical originality of tax reform literature: none of the recommendations is new – deriving much from international best practice, without seriously delving about the usability of the reforms proposals in the Indian context. For this reason, this review will probably have less impact, while being a useful reference work.

The report's single structural weakness is that it is top-heavy. While 'impact assessment' is a useful addition for tax reform, and 'forecasting models' have proved themselves significant, several other recommendations seem redundant: 'research in tax governance' could be the single platform to conduct all predictive analysis on policy impacts and forecasting revenue targets. The chapter on tax research governance is not an improvement over 'impact assessment' and forecasting models, and the same issues arise repeatedly – staff training and knowledge gaps, collaboration and trust, integration and mutuality of interest, data management and techniques, funds and budgetary allocations. All of them could be discussed precisely in a single chapter for a more user-friendly presentation and to develop a common conceptual understanding. Taxpayer services, as a concept, are used loosely and have been much emphasized without drawing a borderline between service and enforcement, in a country of widespread tax evasion 'with a population of over 120 crore ..., only 3.3 per cent ...pays tax', (p. 775), and massive tax administration corruption. The report did not add much on the depth and levels of corruption, an issue India has been long combating.

Two weaknesses in the report are apparent: First, the fragility of the integration argument rather than unification, a concern more with civil service reforms than the tax administration. The report remains silent about the inter-cadre rivalry in India and the vehement opposition to unification, owing to seniority conflicts and related pecuniary benefits. The VAT-tax merger in Bangladesh failed mainly because of the strong commotion and the apparent 'superior to thou' attitude of the VAT administration. Moreover, the provision for lateral entry in the civil service, an HR practice mainly followed among the Semi-Autonomous Revenue Authorities, and CFO rather provoke and entrench the segregation of the income tax and customs wing even further. Second, India's tax legislation is notoriously complex, one of the lengthiest in the world, recently overtaken by the UK. Tax complexity issues have been treated rather lightly, accused of overconcentration on enforcement oriented approach (p.881), and portrayed as a sub-topic of compliance management (appendix chapter XII), a chapter borrowed heavily from international literature, and added almost nothing around the political dynamics on tax simplification in India. India has yet to find a way to end its protracted complex tax system, and the tax revenues that are lost as a result.

Despite these few weaknesses, this review should end by re-affirming the overall strength of the report, which lies in the wealth of well-documented, practical and theoretical discussions across the range of tax reforms issues.