Left Parties' Note

On Resource Mobilization (Submitted to the UPA-Left Coordination Committee Meeting On January 12, 2006)

Resource mobilization, in any economy, entails taxing the rich. Unfortunately, the experience of the past decade-an-a-half has shown that successive Governments at the Centre have not only abdicated their responsibility in this regard, but have handed out largesse to the affluent sections year after year through tax-cuts of all varieties. Besides contributing to rising inequalities, this has also resulted in a significant fall in the tax-GDP ratio in India and constrained the ability of the Government to undertake development expenditure. The UPA Government has to muster the required political will in order to reverse such policies. Some proposals for resource mobilization are suggested below.

1. **Collect Tax Arrears:** Income Tax arrears to the tune of nearly Rs. 99,000 crore and customs and excise arrears of another around Rs. 16,000 crore have piled up till 2005-06. Collection of central and excise arrears had registered significant growth in 2004-05. Stepping up the momentum, the Government should make a determined effort to recover the huge income tax arrears. The recovery of even a fraction of the Rs. 1,15,000 tax arrears would go a long way in generating resources for the Government. **The Government should set an overall target of recovering tax arrears worth Rs. 1,00,000 crore.**

2. **Tap Cash Reserves of CPSUs:** An analysis of 57 Central Public Sector Undertakings having positive net worth and net current assets, based upon the Public Enterprises Survey, 2003-2004, indicated that only 17 PSUs had invested more than 33 % of their Reserves and Surplus in the year 2003-04. The remaining 40 PSUs have invested less than 33 %, and a considerable number have practically not invested at all. In the aggregate, there are 50 CPSUs, which collectively have reserves and surpluses of Rs 2,21,157 crore, amounting to nearly 7.5 % of GDP, but are actively investing only Rs 81,805 crore, i.e. 37 % of the available resources. A part of these reserves are of course lent to the Government by holding securities. However, this disturbing trend towards underinvestment needs to be reversed at once and the CPSUs reinvigorated to undertake massive capital expenditure, diversifying their activities if necessary. The Government should **also seek special dividends from those CPSUs**, which are holding very high levels of liquid reserves, in order to finance expenditure in social sectors or infrastructure. Moreover, they should also be asked to raise the rate of nominal dividends. **The Government should set a target of Rs. 25,000 crore to be mobilized through dividends from the CPSUs.**

3. **Restore Capital Gains Tax:** The abolition of the long-term capital gains tax on traded shares and units of Mutual Funds and the reduction of the short-term capital gains tax to 10 % in Budget 2004 were unnecessary moves, which has led to revenue losses to the tune of thousands of crores and encouraged speculative activities in the stock market. Prof. Amaresh Bagchi of the NIPFP has written, "Since much of economic power accrues to asset owners in the form of rise in

asset values, a tax system that fails to tax capital gains remains gravely deficient and creates a strong bias in favour of the rich. Not taxing capital gains also offends efficiency in that it discriminates in favour of activities like speculation, which beget large gains quickly, as against risk taking in ordinary business...exempting long-term gains from only listed equities, as is now proposed, offends not only fairness but also efficiency by discriminating against the unorganised corporate sector and unincorporated enterprises — the small and medium sector — where the bulk of our economic activities take place. In sum, there is no good reason to exempt long-term capital gains from taxation, and that too selectively for gains from listed equities, or for taxing short-term gains at a rate lower than applicable to other incomes, as has been proposed now. It will grievously damage the income tax base and offend both equity and efficiency. Can the transaction tax be a substitute for a tax on capital gains? The answer plainly is "no"...[it] can in no way replace the income tax any more than a sales tax can." (*Business Standard*, 21.07.04) In order to correct this pro-speculation, pro-rich slant in the tax system, the Government should **tax capital gains at a flat rate of at least 15%.** (It is noteworthy that most investors in the US pay capital gains tax @ 15% with some categories of assets inviting capital gains tax @ 25% to 28%)

4. **Strengthen Securities Transaction Tax:** The primary purpose of the Securities Transaction Tax (STT) is to check speculative activities and prevent volatility in the capital market. What the Government seeks to achieve through differential rates for short-term and long-term capital gains (i.e. to discourage short-term speculative activities) can be attained through the STT, provided it is executed properly. The proposed rate of the STT in Budget 2004 was 0.15 %, to be paid by the buyers in all segments of the market (equities, bonds, government securities, and derivatives). Due to protests from market players and intermediaries, the rates were reduced. It was decided that 0.075 % STT would be charged both on the buyer and the seller for equities in the case of delivery-based transactions, a paltry 0.015 % for day traders, 0.01 % for the derivatives segment, and nil for bonds and government securities. The Government lost hundreds of crores because of this dilution of the STT brought about under pressure from the speculators and brokers. The STT for day traders was increased from 0.015 % to 0.02 % cent in Budget 2005. Experience has shown that the doomsday scenario painted by the critics of the STT were wrong, with the stock indices surpassing all future highs even after the STT has been introduced. However, if the objective of the STT is to reduce market volatility and encourage long-term investments in the stock market, there is no good reason why the rates of the STT should not be the same for all kinds of stock transactions, be it delivery-based or non-delivery based, especially since more than half of the total trading volume in the Indian stock market is non-delivery based (day-trading). **A flat rate of the STT should be fixed at least at 0.10 %** for both delivery-based as well as non-delivery based transactions. There is **no good reason to exempt bonds, derivatives and government securities** transactions from the STT and the same rate should apply to them as well. **The proposed rate of STT, along with the proposed 15% capital gains tax, can together contribute an additional Rs. 5000 crore to the exchequer.**

5. **A Nominal Tax on Foreign Exchange Outflow:** The Government should consider imposing a nominal tax on all foreign exchange outflows. This can be done easily by levying a **nominal 0.5% tax on all purchases of foreign exchange** in India with an exemption limit of $5000. Overseas aid and debt repayments made by the Government should of course be exempted. The Government can also exempt items of essential imports from its purview. This small tax would not only generate substantial revenue but also help to stabilize 'hot' money flows into our economy and provide some protection against capital flight. This would also discourage capital flight through overinvoicing of imports. **A sum of Rs 5000 crore can be mobilized through this tax.**

6. **Rationalize Corporate Tax Exemptions:** Despite having a scheduled corporate tax rate, which is comparable with developed countries, the effective tax rate for the private corporate sector in India continues to be low due to the myriad exemptions. Although some steps were taken in Budget 2005 to do away with some of the corporate tax exemptions, the corporate tax rate itself was slashed at the same time. This was avoidable. The various tax exemptions that exist today need to be rationalised. **The Government should urgently review the tax incentives under Section 80IA and 80IB of the Income Tax Act.** Currently, 100% profits are exempted from taxation for a period of 10 years for infrastructure projects like Highways and Ports, provision of Telecommunication services, development, operation and maintenance of Industrial parks and Special Economic Zones and generation, transmission and distribution of Power. **The rate of deduction as well as the period of the tax concession can be reduced** for these **infrastructure projects** as well as **for industrial undertakings set up in the industrially backward states. Moreover, exemptions that have been allowed for sectors like Housing, Shipping, Hotel, Oil Refining etc. should be phased out.**

7. **Review Export Incentives:** The existing set of export incentives also needs to be reviewed. An estimate made by the Revenue Department suggested that total duty foregone on account of export incentives was Rs. 39,704 crore, which was 13.6% of total export revenue in 2003-04 (*Business Standard*, 08.08.04). Multiplicity of export incentive schemes has also led to their misuse. The Government should immediately **phase out schemes like the DEPB and EPCG besides curtailing revenue losses on account of Drawbacks and Advance Licence**. Moreover, the **tax incentives provided to the SEZ units under the SEZ Act 2005 also needs to be revisited**. Since SEZ units enjoy customs and excise duty exemptions any way, the case for providing 100% exemption from tax on profits for the first 5 years and 50% for the next 5 years does not seem to be justifiable. The Exim Policy of Government also **allows duty concessions to the SEZ units for conditional sales to the Domestic Tariff Area (DTA)**, which clearly discriminates against exporters outside the SEZs. Such concessions **should be phased out**. **Overall, the Government should be able to mobilize Rs. 10,000 crore through the rationalization of the corporate tax exemptions and export incentives.**

8. **Broaden Service Tax Base:** Although the Service sector accounts for 52 % of India's GDP, tax mobilization from this sector is a small proportion of total tax revenue. The increase in the rate of the Service Tax to 10% in the Budget 2004-

05 and the broadening of the Service Tax net in 2005-06 were steps in the right direction. However, the Service Tax target for 2005-06 remained at Rs. 17,500 crore only. M. Govinda Rao of the NIPFP had quoted estimates by a Government appointed Expert Group to show that the size of the tax base in respect of some key services like transportation and storage, post and telecommunications, banking and financial institutions was likely to be almost Rs 70,000 crore in 1999-00 (*EPW*, October 20, 2001). He had suggested **broadening the Service Tax base to cover all services except a well-defined negative and exemption list. The Government should move fast in this direction.** While drawing the exemption list, the Government should be cautious in avoiding further concessions for sectors, which already enjoy the benefits of tax incentives, like the Information Technology Enabled Services. **The Government should set an immediate target of mobilizing an additional Rs. 10,000 crore by broadening the Service Tax base.**

9. **Mobilize more Wealth Tax:** The rate of the Wealth Tax **should be increased from the current 1 % to 3%**. The base of the Wealth Tax should also be broadened. It is evident from the collection of only Rs 265 crore on account of Wealth Tax in 2004-05 that a lot of scope remains to improve upon the collection efficiency as well. In rural areas, the base for Wealth Tax is very low since agricultural land is exempted from being a taxable asset. The Government should consider the **imposition of a land ceiling beyond which Wealth Tax exemption should not be granted**. Moreover, **a tax on conversion of agricultural land for non-agricultural purposes** may also be considered.

10. **Introduce Inheritance Tax:** India does not have any inheritance tax, while almost all developed countries do. The Government should consider imposing a progressive Inheritance Tax with a base level of 1% and an exemption limit of Rs. 15 lakhs. **An additional Rs 5000 crore can be mobilized through the Wealth and Inheritance Tax.**

11. **Increase Excise Duty on Luxury Vehicles Run on Diesel:** Diesel prices in India are kept low through subsidies in order to facilitate affordable public transport, low-cost carriage of goods across the country and benefit the farmers who use diesel in running pump-sets and tractors. The price differential between petrol and diesel, however, is exploited by the auto industry to produce diesel run models of their popular cars, which have less running costs. These private vehicles running on diesel get undue advantage from the subsidy. Besides, this segment should be taxed with a higher rate in order to discourage private cars and encourage public transport, keeping in mind the immense damage that vehicular pollution is doing to the environment in our cities. **The Central Excise Duty levied on luxury cars and SUVs run on diesel should be increased from the current rate of 24%. The customs duty on imported cars as well as imported components for luxury cars should be increased as well.**

12. **Increase VAT/Sales Tax Rate on Items of Luxury Consumption:** Luxury consumption has to be taxed at a higher rate. A Schedule of luxury items, which are consumed only by those who are very rich, like diamond jewellery, luxury cars etc. should be drawn up by the Government. Consumption in places like

Five-Star Hotels should also be included. **This Schedule of luxury consumption items should invite a higher rate of sales tax/VAT.** Over 400 shopping malls are currently operating in India and many more are likely to come up in the near future. These large organized retailers earn huge profit margins because of economies of scale. Small unorganized retailers find it difficult to compete with them. **A surcharge on the sales tax/VAT payable at shopping malls** should be levied, which besides generating revenue, would also help in creating a level playing field for small retailers.