SIMSETT Volume 5

Tax Regime in India- boost or hurdle for the country's growth?

The answer seems too obvious, but why? Let's explore!

SATISH TEJANKAR

Marketing-Finance

Batch: 2014-16

"If my mind can conceive it and my heart can believe it, then I can achieve it"

In June 2013, Ernst and Young (E&Y) reported that India's complex tax and regulatory systems put an unnecessary compliance burden on foreign investors. According to the report, private equity investment fell from $9.64bn in 2011 to $7.54bn in 2012 – a reduction of 21.8%. Why will it not? Corporate tax is as high as 40% for foreign investors. Adding fuel to the fire are multiple levels of taxation, complicated tax payment system and uncertainty in tax laws. Let's just keep aside red-tapism and corrupt bureaucracy in the country. These are the same problems which are faced by the Indian investors and corporates as the Corporate Tax of 30% plus isn't less. The government collected around 1,240,000 Crore Rupees(approx. 34% of which is Corporation tax) as per the Annual Budget 2013-2014. Now, where that money has been used or is it being used efficiently, is a different issue altogether.

With the swearing-in of the new government, nation appears to have discovered a light which will show them the way out of the sluggish GDP growth rate it has been experiencing in the previous government's reign. The government has now reevaluated the GDP growth as 7.4%. It is an aftereffect of the policies and approach of the new government (like the MAKE IN INDIA and financial inclusion initiative), in congruence with the investors looking emphatically towards this new government.

But the Tax Regime in our country poses a heavy challenge for this hope to become reality.

One sector which has now come into limelight as a result of the legislature's 'MAKE IN INDIA' crusade is - the Manufacturing sector. It constitutes only 16% of the Gross domestic product however pays more excise duty than Services sector (like the automotive sector pays around 20% to 24% excise duty) which constitutes 60 percent of the Gross domestic product, and pays service taxes of 12%. Excise duty exemptions are region-specific or state benefits granted by the Centre. The issue with an excise tax holiday is that it twists the manufacturing scene. Entrepreneurs use the tax benefit region for packaging and shipping and sit tight for the next region to be granted the benefit for planning their investment. This does not help anyone and needs to change.

Excise benefits need to be linked to the number of jobs created as a percentage of turnover and should not be region-specific. This would level the playing field and at the same time allow labour intensive SMEs to avail of these benefits. Moreover a tax holiday linked to region and a period also inhibits expansion in that location as the entrepreneur is closely watching for the next location of a tax holiday.

Sales tax, Octroi and Entry tax are other taxes that a manufacturing unit bears. Although these taxes, along with other indirect taxes- central taxes such as excise duty, service tax, countervailing duty, special additional duty on customs, all cesses and surcharges and state taxes including value added tax (VAT), entertainment tax, luxury tax, tax on lottery & betting and gambling, will go away once GST is implemented, but it will take no less than 2 years for that to happen as the centre is having issues with states on taxation power. GST will surely simplify indirect taxation as it has the capacity to raise revenue in the most transparent and neutral manner. The target of April 2016 seems blurred. What will happen to these taxes till then? Is there a way for a business to plan its investment or will it have to wait for the GST to be implemented?

Another issue is that the introduction of reform is not able to keep itself in pace with the growing economy and changing market conditions. India does not have a law on how to tax new businesses like e-retailing. Imposition of tax is left to the interpretation of the local authorities. Since sales tax is a state subject, companies working across the country have to deal with different interpretations.

Like Karnataka government served notices to more than 100 third-party merchants, ordering them to stop storing their products in Amazon's storehouses near Bangalore. The notices said that these merchants cannot register Amazon's warehouse as their 'additional place of business', which falls under the purview of sales tax or value-added tax. But in such type of transaction, the company is only a service provider and at no-point it owns the products or sells it.

For the government, there is no loss of income since the duty if not gathered from Amazon, is being consistently gathered from the trader/ the merchant. But these complications hamper the sentiments of foreign investors as well as traders/merchants willing to tie up with them.

Companies will find it difficult to forget the Vodafone tax dispute, Shell India tax dispute and other related cases of 20 MNCs (including IBM and Nokia) and the Indian companies contesting transfer pricing tax order. In relation to this the new government focusing on attracting global investors, deleting the Retrospective Tax amendment made by UPA in 2012 to 1961 Income Tax Act seems a good option as it will subdue investor concerns about possible future claims. The verdict of the Bombay High court in both the cases is welcoming and can be seen as a good sign.

Creating a stable and non-adversarial tax regime that is on par with competing global economies is essential for boosting GDP growth.

While the government faces the dilemma of whether to ease tax for promoting investment or to stick to its primary goal of reducing the fiscal deficit from 4.5% in the previous year to the targeted 4.1%, the middle way out seems the easing of taxes to promote Exports thereby reducing the fiscal deficit. Although according to government data, India's fiscal deficit was 4.39 trillion rupees ($71.5 billion) during April-September, i.e. 82.6 percent of the full-year target, with the falling oil prices having reduced the cost of Imports, this is a very good time to implement it.

National Food Security Act: Mounting Subsidies

The Food Security Act: A problem for the government or a solution to the poor

Persis C Bharucha

Human Resource – Finance

Batch 2014-2016

Don't underestimate the power of vision.

"Our goal for the foreseeable future must be to wipe out hunger and malnutrition from the country" these were the words of the Congress Party Chief Sonia Gandhi later formulated as National Food Security Act 2013. In accordance with the Global Hunger Index India is ranked 65 out of 75 so no academia can doubt the importance of these goals. The essence of the bill lies in providing physical delivery of essential food commodities at nominal price to 75% of rural population and 50% urban population. This number covers around 67% (1.2 billion people) which will range 1-3% of the GDP. The bill attempts to identify additional beneficiaries such as inclusion of lactating women, pregnant woman and those to-who live in remote areas. This will result in the world's largest welfare scheme starting in the year 2015 which will tend to increase the crevices in our fiscal deficit.

Food Basket

The food security basket will comprise of rice, wheat, coarse cereals per individual at a fixed price of Rs 3, 2, 1, respectively. The total receipts of the government for the year 2013-2014 are projected at Rs 11,22,799 crore. The government's estimated cost of food security comes at 11.10%(Rs 1,24,723 expressed as a % of Rs 11,22,799 crore) of the total receipts. Now once we have correlated cost of food security as a percentage of the total receipts of the government during the current financial year, we can now comprehend how huge the cost of food security really is. Hence Food security will also mean a higher expenditure for the government.

A higher expenditure will mean a higher fiscal deficit. Thus Fiscal deficit is defined as the difference between what a government earns and what it spends – spending being greater than earnings.

Circular Chain

The question lies in how the government is going to finance the ever rising fiscal deficit. The way out is an increase in taxation and private borrowing. This in the long run will result in money getting diverted away from the private economy as banks and companies start lending at a higher rate of interest which is not good for the economic growth. Now let’s consider RBI Governors’ focus on inflation targeting, which is to bring inflation in acceptable limits. Minimum support prices are declared by the government every year on rice and wheat. At this price, it buys grains from farmers. This grain is then distributed to those entitled to it under the various programs of the government. This assured procurement of wheat and rice acts like an incentive for the farmers to produce specified cereals rather than diversify their product basket. This in course leads to food inflation tampering the production of vegetables and other cereals. It has been recorded that the average Indian spends half of his income on food whereas the poor spends around 60%, this acts as a strong hidden tax on the poor. Post 2008, food inflation contributed to over 41% to the overall inflation in the country. The circular chain of rise in food prices will mean higher inflation, reduction in saving as people end up spending more on daily household items rather than expenditure on capital goods, thus leading to the economic slowdown.

Lower saving will have an impact on the current account deficit as it is expressed in terms of difference between national saving and investment. When the rate of saving falls below that of investment, it will hamper the future investment in the country and hence India will have to borrow capital from abroad. These borrowings need to be repaid in dollars which will create additional pressure on rupee. The main leakage pertaining to National Food Security Act is the distribution mechanism. A recent study by Jha and Ramaswami showcased that 70 % of the poor received no grain through the pubic distribution system while 70% of those who did receive it were not poor. A round figure of around 55% of grains supplied through public distribution system leaked out, whereas only 45% was sold to actual beneficiaries through fair price shops.

As there are two parties involved in this act -the farmers and the government, the production side will be supplemented with a heavy dose of subsidiaries, which amounts to 67,310 crore. It is vital to note that the act is an open ended scheme which means no expiry date which covers around two third of the population and government expenditure will grow as the population of country continues to expand.

PDS Mechanism

Though PDS is known to be leakage prone and ineffective, there are still a few states which have proved this as an exception, these includes states like Tamil Nadu, Andhra Pradesh, Himachal Pradesh. Even the poor states such as Orissa and Chhattisgarh are caught up in the league of effective distribution mechanisms. The state which has dramatically out-performed is Bihar which a decade back was ranked as a highest leakage and lowest population state accessing the PDS, now having reduced its leakage to a mere 12% in 2013 -2014. The success story of Tamil Nadu relies on heavy ground work done by the government officials who distribute rice, wheat, pulses along with sugar and kerosene oil to 1.97 core ration card holders in

32 districts. The innovative techniques implemented by the government have led to effective distribution such as technological interventions, drawing up innovative fool-proof delivery mechanisms, old-fashioned policing, surprise checks and constant reviews, and fixing responsibility at each level.

Food security is a fundamental right of every individual. To turn the Food Security Act to an economically viable scenario in the country, the government should indeed go for the option of direct transfer of cash. This cash should be directly wired into the individual account through the Jan Dhan Yojana scheme. This facility would instill trust in the citizens and enable them to buy any product of their choice from the open market. Thus food security will take us one step forward in the economic growth of our country.

SPECIAL ECONOMIC ZONES

Initiating an exclusive area for production and service definitely gives an edge to a business, But in reality is it that easy to set up and produce results at the same time?

Rakshita Dubey

Finance core

Batch 2014-16

"Do what you love, and love what you do"

Background of SEZ

Indian economy witnessed a change when the Export Processing Zones (EPZs) established in 1965, were replaced by Special Economic Zone (SEZ). The SEZ Act of 2005 outlined a huge change in the rules and regulations. The reduction in the number of controls, clearances, regulations and increase in tax deductions of the firms operating within the SEZ paved the way to the entry of new and large private players too, who while earning revenue for the government, would also bring world-class technology, technical expertise and aim at greatly improving the infrastructure of the continent. The major reason for the development of a proper systematic framework for businesses in the form of a Special Economic Zone Act 2005 was to attract larger foreign Investments in India.

SEZs technically means an area kept typically aside for businesses, who want to start up manufacturing/ sale of services in the interests of the country. However it also includes Free trade Zones (FTZ), export Processing zone (EPZ), Industrial Parks, free Ports, Bonded Logistics park (BLP) and business enterprise parks. The main objective of such a step by the government was to generate economic activity by promoting exports of goods and services, generation of employment, development of infrastructure and promotion of investment from domestic and foreign players. The SEZ rules provide for a simplified, single window clearance with least amount of documentation for setting up industries in the SEZs. The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs are as under:-

1. Duty free import/domestic procurement of goods for development, operation and maintenance of SEZs and the units within the SEZ.
2. 100% Income Tax exemption on export income for SEZ units under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years.
3. Exemption from Central Sales Tax upto certain percentage for 5years.
4. Exemption from Service Tax upto certain percentage for 5 years.
5. Exemption from State sales tax and other levies as extended by the respective State Governments.

Present scenario of SEZ

Despite the privileges of easy setup, export exemptions, and tax deductions etc, the SEZs have not been an effective solution as such. Since their inception, the Government of India has spent approximately Rs. 22,000 crore with an average spending of Rs. 100 to 200 crores per year on 196 companies in SEZ (data as on 5th December 2014). However, contrary to the expectations, generation of revenues has been low, conversion of the units into sick units or inability to get operational clearances due to red tapism or corruption has been avid, leading to reduction in foreign investments and thus a loss in GDP and change in the BOP status of the country.

No doubt there is a need to develop India; the current Prime Minister also aims to make India a manufacturing hub through his "Make in India" strategy. What better way to start than to set up an SEZ? But prudently looking at SEZs contribution to the National Income in terms of exports for the past nine years, it's clearly evident that there has been a reduction in the growth of exports over the years. Even after the tax exemptions and all other benefits, the companies have been unable to generate as much revenue as was expected out of them. Though looking at the past performance in terms of employment generation and FDI, the statistics indicate that there has been an increase in the employment levels of the nation.

SEZs are needed because it is expected that creation of a completely secluded priority driven area will create or trigger a large flow of foreign and domestic investment in the country in terms of improvement/enhancement of the infrastructure, employment generation while giving unfair competition to the domestic producers.

A recent CAG audit (29th Nov 2014) indicated that SEZs have had negligible impact on any aspect of the growth of our country even after the provision of Rs 1000 crores of ineligible taxes as exemptions while availing tax concessions upto Rs 83,000 crore. Moreover it was also found that only 38% of the SEZs had become operational after their notification and there was a decline in the manufacturing sector in the SEZs. It also alleged that the achievements of the SEZs are contributed by a few SEZs located in some developed States, which were mostly established prior to enactment of the SEZ act.

SEZ have also come into limelight due to various businesses that are set up there; to develop at the expense of the farmers by promising the farmers proportionate compensation for part of their land for the purpose of set up. But in reality no money is paid to them or whatever is paid to them id not at current price. One of the examples was the case of farmers from Kalinganagar in Orissa where the money given was disproportionate to as high as 1:10 with respect to the market rates. Another case is of the Adani group which was in news because the land given to Adani was at Rs. 1 to 32 per square meter for the country's largest SEZ project in Kutch District's Mudra Block. However, there have been foreign investors who have shown keen interest in the setup of SEZ despite the cumbersome procedures, in developed states like Maharashtra, Andhra Pradesh, Tamil Nadu and Gujrat due to their conducive climate and ease of setting up businesses.

Suggested Remedies for a better performance

Taking into account the advantages of these establishments, there appears to be a felt need to develop a policy considering the existing tax incentives and ensuring a revamp in the tax rebates/ reliefs for the operational businesses and not to all the sanctioned SEZ's. There is an urgent need of a committee that regulates the actual working of the businesses by keeping a track of the license bearers. Moreover the "Make in India" policy can come into picture only through effective implementation of the already framed policy rather than wasting time, effort and money on creating a new one. Also the suppliers to these business houses must be given certain benefits in order to inculcate the habit of domestic supply of raw material rather than import dependency which would definitely help in reducing the CAD.

India is a developing nation and having witnessed the growth rate of India having surpassed that of other nations (especially china) it is required that there is more inflow of FDI and FII in the country. However, we must try to analyze as to how prudent it is to continue the existence of such restricted areas of operations. In order to develop the economy keeping the long term perspective in mind, setting up of an SEZ is only half the work done. It's not the decision to set up the SEZ which is important, but the extent of ease with which it can operate. Problems of corruption and red tapism still exist despite provisions within the Act. There is more to be done than just verbal measures in order to help increase the exports and get a favorable Balance of Trade position.