TAX REFORM ISSUES

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INTRODUCTION

Tax administration reforms have become increasingly complex in a rapidly globalizing economy. Emerging domains of international trade, e-commerce and business operations; aided by sophisticated computers and communication technology, changes in employment patterns, new business structures, innovative financial products, transfer pricing, commoditization of tax schemes etc. pose multifarious challenges to tax administration and compliance.

As far as tax administration issues are concerned, institutional and organizational arrangements, management approaches and practices, procedures for filing of tax returns, payment and assessment regimes for major taxes, administrative powers and procedures of revenue authorities vary significantly across developed and developing countries. Any desirable tax system is broadly built upon certain essential principles i.e. raising revenues needed to source State spending in a simple, equitable and stable manner that is conducive to economic growth. The real test of any well-designed tax reform is that the intended change works in the real world.

This paper begins by highlighting some of the problematic tax administration issues with organizational structures, management approaches, procedures and practices adopted by different developed and developing countries. It then goes on to enumerate major tax reform initiatives in India and also covers International Taxation and Transfer Pricing issues.

TAX ADMINISTRATION REFORM STRATEGY

In order to select an appropriate tax administration strategy, it is inevitable to assess the effectiveness of extant tax administration in a country and diagnose existing problems. The overall effectiveness of tax administration in a country is generally indicated by its tax gap – difference between taxes actually paid and should be paid based on prevalent tax laws and regulations, including tax evasion, tax arrears, shortfall in tax remittance due to misinterpretation of laws and other non compliance issues.

Countries can be categorized into 4 groups based on the magnitude of tax gap: First category countries as Denmark, New Zealand and Singapore have a very effective tax administration with tax gap 10% or lower as Second category of countries also have relatively effective tax administration with tax gap ranging between 10 to 20 percent.

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Amongst these are Canada, USA and some western European countries; Third category countries including both developing and developed countries have relatively ineffective tax administration with tax gap ranging between 20 to 40 percent of the potential tax; and Fourth group of countries are those with even more ineffective tax administration with tax gap ranging between 40 % or more of the potential tax (IMF Working Paper; 1997).

Some of the problematic issues for initiating a comprehensive tax reform include lack of financial and material resources; poorly qualified and poorly trained staff; ineffective procedures; inadequate measures to address noncompliance issues; absence of effective tax payer services; high turn over of technical and management staff; and corrupt practices. The IMF paper identifies 10 major issues encountered by tax administration: i) taxpayer registration with controls to check that no Tax Identification Number (TIN) is assigned to more than one taxpayer, and that only one TIN is assigned to each tax payer; ii) submission of tax returns and payment processing including transfer of payments received directly or through banking system to the treasury account; iii) computerization of tax administration's key procedures including registration, collection, audit, and enforcement along with computerization of major economic sectors like banking, trade and communications; iv) detection of return stop filers due to several factors including outdated data base, errors in TIN, and not properly dealing with stop filing taxpayers and monitoring taxpayers with the highest income or the largest scales of volume; v) delinquent taxpayers and taking swift and effective action to check delinquency; vi) effectiveness of audit in discouraging tax evasion; vii) sanctions and penalty system to encourage taxpayers to settle their tax liabilities promptly and to discourage them from resorting to judicial process; viii) consistent, objective, courteous, and prompt taxpayer services and well designed and targeted publicity campaigns; ix) management and organization issues; and x) effective personnel policies, human resource management, training and deployment of staff.

The 10 guiding principles that can be applied in designing an appropriate overall tax reform strategy, according to the working paper, are: i) political commitment to reform; ii) simplification of tax system with a few taxes, limited number of rates, limited exemptions, and deductions. A broad tax base may enhance effectiveness and efficiency of tax administration and reduce cost of collection; iii) encouraging voluntary compliance by initiating various measures including detection of non-compliance and penalizing tax evaders; iv) formulation of a clear strategy after diagnosing the problems; v) identification of tax and accounting laws that require amendments; vi) taking an integrated approach to the tax collection process comprising registration, collection, enforcement, audit, legal affairs, and tax services; vii) differentiating treatment of taxpayers by size with special units for monitoring, auditing, and enforcing collection for the largest taxpayers, special programmes for controlling medium size and small tax payers; viii) ensuring strong management team accountable to both the government and the taxpayers; ix) determining priorities and establishing a timeframe; and x) commencing fundamental reforms with pilot projects.

Organization for Economic Cooperation and Development (OECD) also studied tax administration issues in OECD and selected non OECD countries and compared the system and procedures across the nations. Some of the key findings in a few selected countries are discussed below in order to have a better appreciation of the international scenario and globally prevalent varied strategies (OECD; 2007).

a) Organizational Arrangements

Depending on inherent variations in the political structure, historical legacy and system of public sector administration, organizational structure, institutional arrangements and the degree of autonomy of national revenue bodies differ significantly across the nations. Some of the discernible trends in existing practices and recent tax reforms are:

- Allocation of responsibility for the administration of both direct and indirect taxes to single unified body;
- Provision of a broad range of autonomous powers to the revenue body;
- Integration of the collection of social contribution with other taxes; and
- Recognition that customs administration is separate and different from other revenue administration requiring its own dedicated leadership, management, and support infrastructure.

While OECD countries, USA, UK, Canada, Australia and Japan have unified semi-autonomous bodies for direct and indirect taxes collection; China has separate body with minister; and India, has separate departments for direct and indirect taxes under a single ministry.

The extent of powers that can be exercised by the national revenue body differs from country to country. In OECD countries like USA, UK, Canada and Australia, revenue bodies have enormous powers such as to give tax law rulings, impose administrative sanctions (penalties and/ or interest) for acts of non compliance, establish internal design/ structure, allocate budget, fix levels and mix of staff, maintain own information technology operation, set service performance levels, influence staff requirement criteria, hire and fire staff and negotiate staff pay levels. In Japan, revenue body has all these powers except establish internal design/ structure, allocate budget, and fix levels and mix of staff. The Chinese revenue body has all the powers listed except remit penalties/ or interest and negotiate staff pay levels.

A formal management/ advisory board comprising externally appointed officials has been established in many countries to provide independent advice on the general operations of the revenue body and tax administration matter in general. For instance, USA has a nine member IRS Oversight Board set up by the Congress under the IRS Restructuring and Reform Act of 1998 to oversee the IRS' administration, management, execution and application of the internal revenue laws. Similarly in Canada; Canada Revenue Agency's Board of Management was created in 1998 as an independent government agency to administer the tax and custom laws.

Indian revenue departments have limited powers of making tax laws and remitting penalties and/ or interest.

b) Planning and Management Approaches of National Revenue Bodies

In the government management process, performance-oriented budgeting and performance management based on formalization of targets and measures have increasingly been adopted to improve efficiency and effectiveness of agencies and ministries. For example, the performance management cycle adopted by the Australian Department of Finance and Administration cites the following 6 cyclical steps:

- Identify the crucial areas of performance in terms of desired results and means of achieving them;
- Establish benchmarks for effectiveness, quality and efficiency;
- Develop information systems to generate appropriate data;
- Report on results and interpret the information to identify areas for improvement;
- Make appropriate changes to improvement structures, delivery mechanisms etc; and
- Revise the relevant benchmarks and/or data collection strategies accordingly

OECD countries such as USA, UK, Canada, Japan, Australia and non OECD countries like China develop and publish multiyear business plan, service delivery standards, and annual performance reports, guided by formal taxpayers' rights in law or official documents.

US Internal Revenue Service (IRS) formulates its strategic plan, annual performance plan and annual performance report. Key elements of IRS Strategic Plan 2005-09 states its vision as "the IRS in 2009 is a 21st century agency with the human capital and technology capabilities to effectively and efficiently collect the taxes owed with the least disruption and burden to taxpayers". The Strategic Plan has also defined its values, goals, objectives, key measures of success and accountability through annual performance report. The Canadian Revenue Agency (CRA) has also clearly laid down its vision, values, mission, strategic outcomes, expected results, and performance measures. It has detailed service delivery standards for sending income tax refunds, VAT refunds, response to tax payers correspondence, telephone calls, visits, complaints and registering a new business. These plans and standards clearly demonstrate commitment to formalized internal planning process, formulation of measurable goals and targets, preparedness to external scrutiny and accountability. Number of countries have not only recognized the tax payers rights and obligations, but also codified these right in tax laws like Netherlands and Russia and some countries have elaborated them in administrative documents or charters like Australia, Singapore and South Africa.

c) Return Filing, Payment, and Assessment Regimes

In case of Personal Income Tax (PIT), different types of income of resident tax payers that are generally withheld by the payer are wages and salaries, dividends, interest, independent personal services, royalties and patents and other income payments.

However there is no uniformity in procedures across countries. USA, Australia and Canada follow withholding tax from source only in respect of wages and salaries whereas Japan and China adopt this procedure in respect of other types of PIT. In case of salary and wages which constitute bulk of Personal Income Tax (PIT), majority of countries deduct tax at source. While OECD countries like UK and Japan, adopt cumulative withholding in respect of employee tax payers and free them from filing returns; USA, Canada and Australia and non OECD countries like China follow non cumulative withholding from wages and salaries and insist on filing of returns. In regard to Corporate Income Tax (CIT), most of the countries insist on filing annual returns and advance payment of tax. Self assessed returns are electronically filed in many of the OECD countries.

d) Administrative Powers of Revenue Bodies

Majority of revenue bodies have powers to issue public rulings and/ or private rulings, which are binding. Private rulings are generally provided at the request of tax payers and some of them are empowered to charge a fee for such requests. In UK, Australia and China, revenue authorities have powers to issue binding public and private rulings and time limits have been prescribed for private rulings, though fees for private rulings are not charged.

In most of the countries, revenue bodies have powers to gather information, access tax payers' business premises and dwellings, and seize documents to assess the tax payers' liabilities.

Revenue bodies are empowered to enforce tax debt collection by a) granting extension of time for payment; b) making payment arrangements; c) collecting from third parties who are liable to the tax payer; d) seizing tax payer's assets; e) offsetting tax payer's liabilities to his/her tax credits; and f) initiating bankruptcy. Additional powers have also been provided such as imposition of restrictions on overseas travel by debtor tax payers; withdrawal of business licenses; obtaining lien over tax payer's assets etc.

Most revenue authorities impose penalties for non filing of returns on time, failure to report their correct tax liabilities, and non payment of tax on time. Interest on delayed payment of tax is levied by most of the revenue bodies. Penalties vary, based on the seriousness of the offence: failure to exercise reasonable care, deliberate underreporting or fraud/ criminal offence.

e) Tax Revenue Collections

'Taxes' are recognized as compulsory, unrequited payments to government; for the benefits provided to taxpayers by the government are not generally in proportion to their payments. Aggregate tax revenues for major categories of taxes extending all levels of government as percentage to gross domestic products (GDP) vary substantially across countries. For example, in fiscal year 2003, some European region countries – Austria, Finland, France, Italy, Luxembourg, Norway and Sweden – had tax more than 40% of GDP. In countries like China, India, Mexico and Chile, tax revenue constitutes more than 20% of GDP. In some of the countries like USA, Japan and South Africa, the ratio ranges between 20% and 30%.

f) Operational and Performance Information

In 2003 and 2004, salary constituted the single largest cost item for tax administration in most of the countries ranging from 50 to 90 percent of tax administration cost. Cost of collection ratios – ratio of administrative costs to tax revenue collections as an indicator to compare relative efficiency and effectiveness of revenue bodies vary significantly due to certain unrelated factors. Similarly, comparison of relative staffing levels, staff resources deployed for tax audit and other verification functions appear to vary substantially across countries due to certain factors. Nevertheless, tax audit and verification activities play important role in compliance functions and 30% of staff resources are deployed in tax audit, investigation, and verification activities.

Ratio of aggregate tax arrears – all unpaid taxes, including those where a dispute is involved – to the annual net revenue collections of all taxes for the years indicated – is a measure to gauge the broad trend over time of tax payment compliance. The relative incidence of unpaid taxes varied from 5% to 50% of annual net revenue collections, while some countries were not able to provide this information in their management information systems.

g) Administrative Practices

Comprehensive system of tax payer registration and tax payer identification numbering system, unique for each major tax type are critical features of the tax administration arrangements. Unique tax payer identification numbers (TINs) for registration facilitate matching of data, cross verification of information supplied and other tax administration applications.

Less than 50% of PIT payers are registered with the revenue body. Most of the revenue bodies use a unique taxpayer identifier like a citizen identification number for PIT purposes and a unique number for business tax purposes. Unique tax payer identifiers are utilized with information relating to wages, pensions, government benefits, interest, dividends, contract income, sale and purchase of assets for verification purposes.

Over the last 15 years or so, revenue bodies are automating tax administration functions through rapid computerization and optimal applications of technological advancements to derive expeditious benefits: a) speedier collection of government revenue; b) improved data accuracy; c) reduced paperwork for tax payers; d) facilitating faster crediting of tax refunds; and e) speedier processing of tax payer data for a range of administration purposes.

TAX ADMINISTRATION REFORMS IN INDIA

India has a well developed tax structure with a three-tier governing structure, comprising central government, state governments and urban/ rural and local bodies' administration. The power to levy taxes and duties is distributed among the three tiers of governments, in accordance with the provisions of the Indian constitution. The main taxes/ duties that the federal government is empowered to levy are PIT except tax on agricultural income, CIT, Customs, Central Excise, Sales Tax and Service Tax. The principal taxes levied by the state governments are Sales Tax (tax on intra-state sale of goods), Stamp Duty (duty on transfer of property), State Excise (duty on manufacture of alcohol), Land Revenue (levy on land used for agricultural/ non-agricultural purposes), Agricultural Tax, and duties on Entertainment, Professions and Callings. The Local Bodies levy tax on properties (buildings, etc.), Octroi (tax on entry of goods for use/ consumption within areas of the Local Bodies), Tax on Markets and Tax/ User Charges for utilities like water supply, drainage, etc. Rural local bodies viz. Panchayati Raj Institutions also have some limited powers to levy duties.

Though tax reforms were initiated by independent India with the implementation of the report of the Taxation Enquiry Committee in 1953, followed by Kalador Committee in 1956, the Direct Taxes Enquiry Committee in 1971, systematic and comprehensive tax reforms at the central level were accelerated only after market based economic reforms were initiated with implementation of the recommendations of the Tax Reforms Committee (TRC) (Chaired by Dr. R.J. Chelliah the noted economist) in 1991. TRC followed the best practices approach and recommended broadening the tax base, reduction of marginal tax rates along with rates differentiation, simplifying the tax structure, laws and procedures and taking appropriate measures to make administration and enforcement more effective. In order to improve the revenue productivity in the long run, major emphasis was on enhancing the comparative contribution of direct taxes; improving the share of domestic consumption taxes; reducing the contribution of trade taxes in total tax revenue and full conversion of taxes on domestic production into a Value Added Tax (VAT). The committee emphasized minimization of exemptions and concessions and the need for developing an information system, computerization of tax returns. Major impetus for tax reforms was given in the new millennium with the recommendations of the Advisory Group on Tax Policy and Tax Administration for the Tenth Plan in 2001, Expert Group on Taxation Services in 2001, the Kelkar Taskforce (KTF) on Direct Taxes and Indirect Taxes, ministry of finance in 2002 and report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act of the Ministry of Finance in 2004.

Consequent to tax reforms, PIT reduced from 11 slabs in 1973-74 to 3 slabs in 1997-98 onwards. The highest tax rate decreased from 85% to 30% during the period. In case of Corporate Income Tax, the highest rate was reduced to 35% in 1997-98; Minimum Alternate Tax (MAT) was also introduced in the same year to curb tax avoidance by 'zero tax companies', insisting on paying tax on 30% of their book profits; and in 2005-06, CIT rate was reduced to 30% and a new tax Fringe Benefits Tax was introduced at 30% rate to tax perquisites provided by companies and other specified persons in the form of entertainment, conference, welfare, sales promotion, conveyance, tour, phone etc. Another new tax - Securities Transaction Tax - is collected on purchase and sale of shares and securities traded through Stock Exchanges and units repurchased by mutual funds. Banking Cash Transaction Tax was charged @ 0.1% on every transaction on any single day being withdrawal of cash from an account (other than savings account) or being receipt of cash on any single day on encashment of one or more term deposits, whether on maturity or otherwise exceeding INR 25000 in case of individual accounts and INR 100000 for others. Another significant area of reform focuses on expansion of Tax Deduction at Source to cover the 'hard to tax' groups. Filing returns was made compulsory in case of individuals living in large cities who own house, cars, have membership of a club, credit card and travelled abroad.

Tax Revenue Collections

(INR in 10 million)

Components of Tax Revenue							
Period	**Total Gross Tax Revenue #**	**Corporation Tax**	**Income Tax**	**Custom duties**	**Excise duties**	**Service Tax**	**others**
1992-2007	195222	43559	29883	44730	66021	3009	4312
VIII Plan (1992-1997)	96533	13567	12575	30273	37014	465	2638
IX Plan (1997-2002)	166087	29508	25353	43418	60838	2317	4652
X Plan (2002-07)	323047	87602	51720	60497	100210	17373	5645
2002-03	216266	46172	36866	44852	82310	4122	1944
2003-04	254348	63562	41387	48629	90774	7891	2105
2004-05	304958	82680	49268	57611	99125	14200	2074
2005-06	366151	101277	55985	65067	111226	23055	9541
2006-07	473512	144318	75093	86327	117613	37598	12563
Average Annual Rate of Growth (per cent)							
1992-2007	12.95	20.41	15.94	7.73	10.49	*	4.46
VIII Plan (1992-1997)	15.89	21.71	24.72	18	10.45	*	-2.5
IX Plan (1997-2002)	9	17.15	18.58	1.61	11.41	19.19	-30.18
X Plan (2002-07)	21.31	31.59	18.83	17.36	9.60	73.21	68.93
2002-03	15.61	26.12	15.19	11.38	13.44	24.83	-16.28
2003-04	17.61	37.66	12.26	8.42	10.28	91.44	8.28
2004-05	19.9	30.08	19.04	18.47	9.2	79.95	-1.47
2005-06	20.07	22.49	13.63	12.94	12.21	62.36	360.03
2006-07	29.32	42.50	34.13	32.67	5.74	63.08	31.67

**** Service Tax was introduced in 1994-95*** ***# Includes figures of taxes/duties assigned to States/UTs.***

(Source Table 2.7 of CAG's Report No. 13 of 2007)

In respect of import duties, nominal tariff rate of 125% and peak rate of 355% were brought down to 20% in 2004. Quantitative restriction on imports was reduced to 90% of imports in 1991. There has been substantial simplification and rationalization in central excise duties as well. Apart from cutting down number of slabs, the tax has been progressively converted from specific duties into ad valorem levy and the facility to credit on input taxes under the CENVAT has been extended to about 80% of taxed commodities. CENVAT credit has also extended to tax on services.

Replacement of state sales tax with state level VAT in 2005 is a major initiative in case of states. Evolving a manufacturing stage VAT on goods and services at the centre, Converting the state sales tax into VAT at the states level by permitting input tax credit not only for intra-states sales and purchases but also for interstate transactions may take some more time. Levying the tax on services and integrating it with VAT on goods with a view to develop comprehensive goods and service tax system is an important area of further reforms.

Tax/ GDP Ratio of Major Taxes

Period	Gross Tax Revenue	Corporation Tax	Income Tax	Customs Duties	Excise Duties	Service Tax
1992-2007	9.50	2.12	1.45	2.18	3.21	0.33
VIII Plan (1992-1997)	9.32	1.31	1.21	2.92	3.58	0.04
IX Plan (1997-2002)	8.65	1.54	1.32	2.26	3.17	0.12
X Plan (2002-2007)	10.07	2.73	1.61	1.89	3.12	0.54
2002-03	8.80	1.88	1.50	1.82	3.35	0.17
2003-04	9.20	2.30	1.50	1.76	3.28	0.29
2004-05	9.75	2.64	1.58	1.84	3.17	0.45
2005-06	10.26	2.84	1.57	1.82	3.12	0.65
2006-07	11.48	3.50	1.82	2.09	2.85	0.91
Average Annual Rate of Shift in the shares						
1992-2007	0.65	7.31	3.33	-4.00	-1.53	*

* Annual Rate of Shift not worked out as Service Tax was introduced in 1994-95
(Source Table 2.10 of CAG's Report No. 13 of 2007)

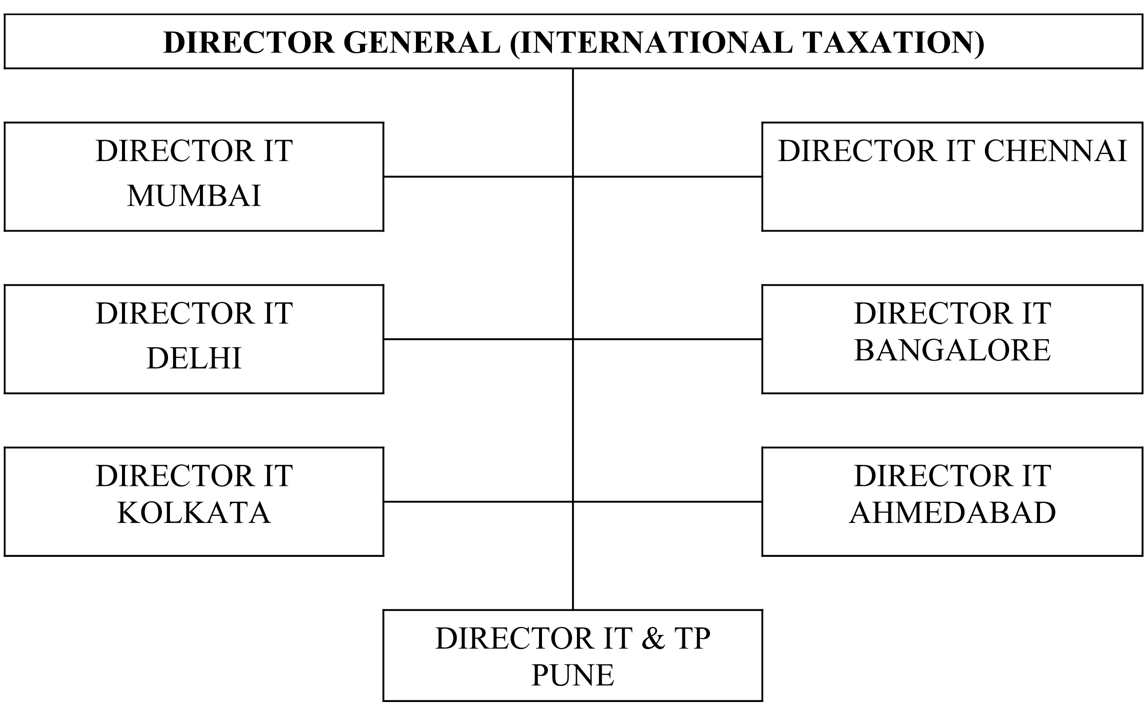
Economic reforms accompanied by tax reforms resulted in revenue growth. During the tenth plan (2002-07), there had been consistent growth in tax revenue, reaching 20.07% in 2005-06. There were changes in tax structure as well. During the early 1990s, direct taxes constituted 27%, indirect taxes 70% and other taxes 0.48% whereas in 2005-06, contribution of direct taxes increased to 43%, indirect taxes 48% and service tax 6% of the total tax revenue. Tax revenue of the central and states governments combined had a buoyancy of 0.93 during 1985-2006 which shows that tax revenue grew only 93% compared to every percentage point increase in GDP. Buoyancy of direct taxes comprising CIT and PIT was greater than 1 and that of indirect tax consisting central excise and customs accounted for only 48%. Tax-GDP ratio increased from 6.3% in 1950-51 to 16.1% in 1987-88 and continuously declined thereafter reaching 13.8% in 2001-02 and improved to 15.2% in 2003-04. Contribution of Tax Deduction at Source (TDS) increased from 41.75% in 1990-91 to 64.03% in 2003-04((Public Finance Statistics, Ministry of Finance, 2003-04). Low levels of compliance and high compliance cost are major issues in tax collection in India. Absence of adequate reliable database is a major hindrance and consequently compliance cost is high. In case of PIT, it is 49% and in respect of CIT, it ranges from 6% to 15% of the tax paid, with substantial legal cost of compliance. Non filing of returns by TDS assessees reduced from 80% in earlier years to 40% in 2003-04 (CAG Reports).

INTERNATIONAL TAXATION AND TRANSFER PRICING

The 1990s was marked by liberalization of the Indian economy since and has made India one of the attractive destinations for foreign investments. The inflow of foreign investments has increased from USD 103 million in 1990-91 to USD 59288 million in 2007-08 (Source RBI document). The ever increasing transnational investment and trade imply a potential conflict of tax jurisdictions. Central to this conflict is the issue of sovereign right of two or more jurisdictions to levy tax on one and the same transaction or one and the same taxpayer. Improper conduct of taxpayers could aggravate the jurisdictional conflict when there are mismatches between national tax laws. Jurisdictional conflicts can be resolved unilaterally under national tax laws, or bilaterally and even multilaterally under "tax treaties" or "Double taxation avoidance agreements" (DTAA). The paramount issue underlying all international tax considerations is how to appropriately allocate income and equitably divide or share the revenues between host and home countries. The resolution of this issue is the main purpose of DTAAs, which seek, inter-alia, to set out detailed allocation rules between the "source" and "resident" countries for different categories of income.

India has entered into DTAA with over 70 countries including countries like U.S.A., U.K., Japan, France, Germany, etc. These agreements provide for relief from the double taxation in respect of incomes by providing exemption and also by providing credits for taxes paid in one of the countries. These treaties are based on the general principles laid down in the model draft of the Organization for Economic Cooperation and Development (OECD) with suitable modifications as agreed to by the other contracting countries.

In view of the larger number of non-resident assesses in and huge volume of transactions in the cities of Mumbai, New Delhi, Kolkata, Chennai, Bangalore, Ahmedabad and Pune, the department has restructured its set up in these places by creating Directorates of International Taxation and Transfer Pricing.



Transfer Pricing

Transfer Pricing law has been enacted for Income Tax purposes in 2001 by amending the Income Tax Act, supplemented by Transfer Pricing Rules, which are broadly based on OECD Guidelines. Transfer Pricing under the Income Tax Act is administered by the Directorate General of Transfer Pricing in the Income Tax Dept.

The Income Tax Act was amended in the Finance Act, 2001, incorporating suitable provisions in sections 92 to 92 F, and section 27 to regulate Transfer Pricing. Supplementary provisions in Income Tax Rules were incorporated to prescribe the procedures on Transfer Pricing controls.

As per CBDT instruction No.3 of 2003 dated 25/03 wherever the aggregate value of international transaction exceeds Rs.5 crores the case is transferred by the regular jurisdictional assessing officer to the Transfer Pricing Officer (TPO).

SAI, India's efforts in the area of International Taxation

In the face of growing significance of international taxation and the emphasis given by the Revenue Departments to issues relating to this area, the Supreme Audit Institution, India is also intensifying its efforts to keep audit abreast with the latest developments in this area and highlight significant audit findings in respect of foreign companies and other non-resident assessees. In the year 2004-05, SAI, India had conducted a systems appraisal of Double Taxation Avoidance Agreements entered into by India with various countries with special emphasis on the Indo-Mauritius treaty. The report highlighted how the special consideration bestowed in the Indo-Mauritius treaty on business entities of Mauritius led to establishment of conduit companies in Mauritius through which investors of third countries routed their investment, which in turn led to concern among tax authorities in India about the loss of rightful revenue. Efforts are being made to form dedicated Local Audit Parties for audit of International Taxation Circles equip these teams with training on the nuances of international taxation and transfer pricing. In the Audit Report for the year 2006-07, the SAI, India had compared the quantum of outflows or payments to residents abroad on account of payments such as salaries, commission, royalties, dividends etc. which are liable for tax deduction at source subject to the conditions specified in the Act and the tax at source actually deducted and pointed out a huge gap in the tax deductible at source and the tax actually deducted at source.

CONCLUSION

Tax administration reforms and compliance risk management are inextricably interlinked, assuming critical significance in the new millennium, characterized by e-commerce, innovative business practices across the borders, emergence of new products and services. While India has taken significant steps towards simplification and rationalization of its tax laws and administration system, substantial work is yet to be done for enforcing effective tax compliance and reducing tax gap.

Having a three tier federal polity with centre, states, urban and local bodies with identified domains of tax revenue jurisdiction, it is a herculean endeavour to streamline and modernize tax administration. Complexity of reform strategy intensifies taking into account the multiparty political system functioning in different combinations at centre, states and local bodies, with divergent political interests and goals. Nevertheless, tax reforms have been accelerated despite having change in governments over the years. Reforms have also been accompanied by comprehensive computerization drives at all levels, encompassing administration of direct and indirect taxes at the centre and states and even at urban and local bodies.

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