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STANDING COMMITTEE ON FINANCE
(2006-07)

FOURTEENTH LOK SABHA

MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)

DEMANDS FOR GRANTS
(2007-08)

FIFTY-SECOND REPORT

LOK SABHA SECRETARIAT
NEW DELHI

April, 2007/*Vaisakha*, 1929 (*Saka*)

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Presented to Lok Sabha on 28.4.2007
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April, 2007/*Vaisakha,* 1929 *(Saka)*

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COMPOSITION OF STANDING COMMITTEE ON FINANCE (2006-2007)

Shri Ananth Kumar — *Chairman*

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4. Shri T.G. Chandrasekhar — *Deputy Secretary*
5. Shri M.L.K. Raja — *Under Secretary*

INTRODUCTION

I, the Chairman of the Standing Committee on Finance having been authorised by the Committee to submit the Report on their behalf, present this Fifty-Second Report on Demands for Grants (2007-2008) of the Ministry of Finance (Department of Revenue).

2. The Demands for Grants of the Ministry of Finance were laid on the Table of the House on 14 March, 2007. Under Rule 331E of the Rules of Procedure and Conduct of Business in Lok Sabha, the Standing Committee on Finance are required to consider the Demands-for-Grants of the Ministries/Departments under their purview and present Reports on the same to both the Houses of Parliament.

3. The Committee took oral evidence of the representatives of the Ministry of Finance (Department of Revenue) at their sittings held on 2 and 17 April, 2007 in connection with examination of the Demands for Grants (2007-08) of the Ministry of Finance (Department of Revenue).

4. The Committee considered and adopted the Report at their sitting held on 26 April, 2007.

5. The Committee wish to express their thanks to the Officers of the Ministry of Finance (Department of Revenue) for the co-operation extended by them in furnishing written replies and for placing their considered views and perceptions before the Committee.

6. For facility of reference, the observations/recommendations of the Committee have been printed in thick type.

NEW DELHI;
26 *April*, 2007
6 *Vaisakha*, 1929 *(Saka)*

ANANTH KUMAR,
Chairman,
Standing Committee on Finance.

CHAPTER I

REPORT

Introductory

Ministry of Finance — Department of Revenue

The Department of Revenue functions under the overall direction and control of the Secretary (Revenue). It exercises control in respect of matters relating to all the Direct and Indirect Union Taxes through two statutory Boards namely, the Central Board of Direct Taxes (CBDT) and the Central Board of Customs and Central Excise (CBEC). Each Board is headed by a Chairman who is also *ex-officio* Special Secretary to the Government of India. Matters relating to the levy and collection of all Direct taxes are looked after by the CBDT whereas those relating to levy and collection of Customs and Central Excise duties and other Indirect taxes fall within the purview of the CBEC. The two Boards were constituted under the Central Board of Revenue Act, 1963. At present, the CBDT has six Members and the CBEC has five Members. The Members are also ex-officio Additional Secretaries to the Government of India.

2. The Department of revenue administers the following Acts:-

1. Income Tax Act, 1961;
2. Wealth Tax Act, 1958;
3. Expenditure Tax Act, 1987;
4. Benami Transactions (Prohibition) Act, 1988;
5. Super Profits Act, 1963;
6. Companies (Profits) Sur-tax Act, 1964;
7. Compulsory Deposit (Income Tax Payers) Scheme Act, 1974;
8. Chapter VII of Finance (No.2) Act, 2004 (relating to Levy of Securities Transactions Tax);
9. Chapter VII of Finance (No. 2) Act, 2004 (Relating to Levy of Banking Cash Transaction Tax)
10. Chapter V of Finance Act, 1994 (relating to Service Tax);
11. Central Excise Act, 1944 and related matters;

12. Customs Act, 1962 and related matters;
13. Medicinal and Toilet Preparations (Excise Duties) Act, 1955;
14. Central Sales Tax Act, 1956;
15. Narcotic Drugs and Psychotropic Substances Act, 1985;
16. Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988;
17. Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976;
18. Indian Stamp Act, 1899 (to the extent falling within jurisdiction of the Union);
19. Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974;
20. Foreign Exchange Management Act, 1999; and
21. Prevention of Money Laundering Act, 2002.

3. The Department looks after the matters relating to the above-mentioned Acts through the following attached/subordinate offices:-

1. Commissionerates/Directorates under Central Board of Excise and Customs;
2. Commissionerates/Directorates under Central Board of Direct Taxes;
3. Central Economic Intelligence Bureau;
4. Directorate of Enforcement;
5. Central Bureau of Narcotics;
6. Chief Controller of Factories;
7. Appellate Tribunal for Forfeited Property;
8. Income Tax Settlement Commission;
9. Customs and Central Excise Settlement Commission;
10. Customs, Excise and Service Tax Appellate Tribunal;
11. Authority for Advance Rulings for Income Tax;
12. Authority for Advance Rulings for Customs and Central Excise;
13. National Committee for Promotion of Social and Economic Welfare;

14. Competent Authorities appointed under Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 and Narcotic Drugs and Psychotropic Substances Act, 1985; and

15. Financial Intelligence Unit, India (FIU-IND)

16. Income Tax Ombudsman

4. The detailed Demands for Grants of the Ministry of Finance were presented to Lok Sabha on March 14, 2007. The details of the demands of Department of Revenue, Central Board of Direct Taxes (CBDT) and Central Board of Excise & Customs (CBEC) are as under :-

(In thousands of Rupees)

Demand No. 41:	Deptt. of Revenue	Revenue	Capital	Total
	Voted:	5,874,37,00	1,47,00	5,875,84,00
Demand No. 42:	Direct Taxes	Revenue	Capital	Total
	Voted:	1,521,51,00	10,47,00	1,531,98,00
Demand No. 43:	Indirect Taxes	Revenue	Capital	Total
	Voted:	1,689,80,00	1,40,20,00	1,830,00,00

5. The BE, RE and Actuals for the Demands No. 41, 42 & 43 from the year 2004-2005 are as follows:—

(In rupees in thousand)

	BE		RE		Actual	
	Plan	Non Plan	Plan	Non Plan	Plan	Non Plan
	1	2	3	4	5	6
2004-2005						
Demand No. 41- Department of Revenue	—	396,69,00	—	414,60,94	—	398,36,58
Demand No. 42 – Direct Taxes	—	1,247,98,00	—	1,257,59,00	—	1,175,30,29
Demand No. 43 – Indirect Taxes	—	1,461,93,00	—	1,377,62,00	—	1,300,33,17

	1	2	3	4	5	6
			2005-2006			
Demand No. 41	—	5,379,26,00	—	2,831,99,83	—	2,779,58,88
Demand No. 42	—	1,250,00,00	—	1,230,04,00	—	1,209,82,58
Demand No. 43	—	1,648,40,00	—	1,468,50,00	—	1,368,73,85
			2006-2007			
Demand No. 41	—	3,341,15,00	—	4,449,11,10	—	—
Demand No. 42	—	1,334,00,00	—	1,381,35,00	—	—
Demand No. 43	—	1,714,82,00	—	1,632,70,00	—	—
			2007-2008			
Demand No. 41	—	5,875,86,00	—	—	—	—
Demand No. 42	—	1,532,00,00	—	—	—	—
Demand No. 43	—	1,831,00,00	—	—	—	—

6. In the present Report, the Committee have examined the following issues :-

1. Tax Exemptions
2. Double Taxation Avoidance Agreements (DTAAs)
3. Goods and Services Tax (GST)
4. Special Economic Zones (SEZ)
5. Revenue Collections
6. Arrears of Revenue
7. Rent Rates & Taxes
8. Advertising & Publicity
9. Office Expenditure
10. Investments

1. TAX EXEMPTIONS

Central Board of Direct Taxes:

7. The various provisions of Income Tax Act, 1961, relating to area based exemptions/deductions, as furnished by the Government, are as below:-

(a) Section 80 IB(4) of Income Tax Act provides deduction in the case of an industrial undertaking in an industrially backward State specified in the Eighth Schedule.

(b) Section 80 IB(5) of Income Tax Act provides deduction in the case of an industrial undertaking in such industrially backward District as the Central Government may notify in the Official Gazette

(c) Section 80 IB(7) of the Income Tax Act provides deduction for the business if located in a hilly area or a rural area or a place of pilgrimage or such other place as the Central Government having regard to the need for development of infrastructure for tourism in any place, specify by notification in the Official Gazette.

(d) Section 80 IB (11B) of the Income Tax Act, provides for deduction for the business of operating and maintaining hospitals in a rural area.

(e) Section 80 IC of the Income Tax Act, 1961 provides for deduction to undertakings or enterprises in certain special categories States. The States covered under this Section are Sikkim, Assam, Tripura, Meghalaya, Mizoram, Nagaland, Manipur, Arunachal Pradesh, Uttaranchal and Himachal Pradesh.

(f) Section 10(26) of the Income Tax Act provides for exemption for an Income accrues to a member of a Scheduled Tribe as defined in clause (25) of article 366 of the Constitution, residing in any area specified in Part I or Part II of the Table appended to paragraph 20 of the Sixth Schedule to the Constitution or in the States of Arunachal Pradesh, Manipur, Mizoram, Nagaland and Tripura or in the areas covered by notification No. TAD/R/35/50/109, dated the 23rd February, 1951, issued by the Governor of Assam under the proviso to sub-paragraph (3) of the said paragraph 20 (as it stood immediately before the commencement of the North-Eastern Area (Reorganization) Act, 1971 (81 of 1971) or in the Ladakh region of the State of Jammu and Kashmir.

(g) Section 10(26A) of the Income Tax Act, provides for exemption of any income accruing or arising to any person from any source in the district of Ladakh or outside India in any previous year relevant to any assessment year commencing before the 1st day of April, 1989, where such person is resident in the said district in that previous year.

8. The details regarding the period from which each of the exemptions have been in existence, the original period of exemption and extensions, if any, given to such exemptions, as furnished by the Government, are as follows:

"(i) (a) Section 80-IB of the Income-tax Act, which provides for tax concessions to industrial undertakings engaged in manufacture or production of articles or things (other than those in the negative list) or in the operation of a cold storage plant and set up during the period 1.4.1993 to 31.3.2007 in the State of Jammu and Kashmir, has been in existence since 1.4.2000. Prior to that date, the benefit to the State of Jammu & Kashmir was available under Section 80-IA from 1.4.1994. Initially the deduction was available to industrial undertakings set up between 1.4.1993 and 31.3.2000. The terminal date was first extended to 31.3.2002 *vide* Finance Act, 2000 and thereafter to 31.3.2004 *vide* Finance Act, 2002. The terminal date was again extended to 31.3.2005 *vide* Finance (No. 2) Act, 2004 and thereafter to 31.3.2007 *vide* Finance Act, 2005.

(b) Section 80-IC of the Income-tax Act, which provides for tax concessions to undertakings or enterprises engaged in manufacture or production of articles or things (other than those in the negative list) and set up or undertaking substantial expansion in certain notified areas or engaged in thrust sector activities in the entire State or States during the period,—

- 24.12.1997 to 31.3.2007 in the North-Eastern States;
- 23.12.2002 to 31.3.2012 in the State of Sikkim; and
- 7.1.2003 to 31.3.2012 in the States of Uttaranchal, and Himachal Pradesh, has been in existence since 1.4.2004. Prior to its insertion into the Income-tax Act, the benefits to the above-mentioned States, except Uttaranchal, were available from 1.4.1994 under Section 80-IA and thereafter under Section 80-IB. In case of North Eastern States, the deduction was available under Section 10C from 1.4.1999 to 31.3.2004. No extension of the terminal dates has been required so far

for the North Eastern States. However, in case of Himachal Pradesh, the terminal date was first extended to 31.3.2002 *vide* Finance Act, 2000 and thereafter to 31.3.2004 *vide* Finance Act, 2002.

(ii) The above-mentioned area-based tax exemptions have been given to further the Government's policy to bring about a balanced growth within the country. The benefit in the case of Jammu & Kashmir has been repeatedly extended as it is felt that the State has not managed to develop adequately in the wake of militancy.

(iii) In the case of Jammu & Kashmir, Himachal Pradesh and Uttaranchal, the deduction available is 100% of profits and gains of an industrial undertaking or undertaking or enterprise, as the case may be, in the first 5 years and thereafter 25% (30% in case of companies) for the next 5 years. In the case of Sikkim and the North Eastern States, the deduction available is 100% of profits and gains of an undertaking or enterprise for 10 years. No revision has been made in the quantum of deduction available in any of these States.

(iv) The revenue loss figures on account of such area-based deductions are available for financial years 2004-05 and 2005-06. Further, the revenue loss on account of such exemptions in financial year 2006-07 has also been provisionally estimated. The figures were estimated to be Rs. 362 crores in 2004-05 and Rs. 1,531 crores in 2005-06. For 2006-07, the figure has been provisionally estimated to be Rs. 2,215 crores."

9. The Government has called for public views/opinion on various exemptions that exist under Income Tax Law. Major observations made by the public in respect of withdrawal/continuance of existing tax exemption/deductions under the Income-tax act, 1961 as reported by the Government, are as under:—

"Suggestions for continuance in respect of most of the tax deductions/exemptions existing on the statute have been made by all categories of the respondent population. A common refrain in these suggestions has been that the tax concessions constitute a sovereign commitment of the Government based on which different sections of the population have made savings/investment decisions. Withdrawal of the same, particularly if done retrospectively, will be tantamount to breach of trust on the part of the Government.

The salaried class have called for the continuance of the following exemptions/deductions citing reasons of increased service tax burden on the salaried class, inflation, absence of social security measures, high tax rates, low rates of interest on savings etc.:—

(i) Sections 10(10), 10(10A), 10(10AA), 10(10AAA), 10(11), 10(12), 10(13), 10(13A), 10(14) – [Relating to salaried benefits and retirement benefits, *i.e.* Leave Travel Concession, gratuity, leave encashment, commutation of pension, House Rent Allowance etc.]

(ii) Section 24 [house property]

(iii) Sections 80C/80CC/80CCC – [savings/investment avenues qualifying for deduction from income upto Rs. 1 lakh]

(iv) Sections 80D/80DD/80DDB/80U—[Deduction on expenditure incurred/payments made on medical insurance, medical treatment, etc.]

In general, suggestions have been received for withdrawal of the following deductions/exemptions namely,

(i) Section 10(1) [exemption to agricultural income]

(ii) Section 10(17) [Allowances to MPs and MLAs]

(iii) Section 10(33) [Exemption to Unit Trust of India's US-64 Scheme)

(iv) Section 13A [Exemption for political parties]

(v) Sections 80GGB & 80GGC [Deduction for donations to political parties]

(vi) Section 115BBC [Taxation of anonymous donations]

(vii) Section 115JB [Minimum Alternate Tax]"

10. Proposals suggesting alternatives/modifications to the existing exemptions/deductions that have been reportedly received by the Government, are on the following lines:—

(i) Each exemption/deduction provision was inserted in the Act with a specific objective in mind. The efficacy of the tax concession depends on the extent to which it has met those objectives. For this purpose, a detailed cost benefit analysis in respect of each exemption/deduction should be carried out by an Expert Group.

(ii) Section 10(2A) : Indian Partnership Act should first be amended to allow establishment of Limited Liability Partnerships (LLPs), which should be treated on par with incorporated companies, so that any salary/perquisite paid to a partner in whole time employment is an allowable expenditure of the LLP

(iii) Exemption u/s 10(15) (iv) (i) etc. should not be limited to Government employees only

(iv) Section 10(17): Exemption of constituency allowance should be subjected to the discipline to which a charitable trust is subject to. Alternatively, a ceiling has to be placed on exemption

(v) There should be no ceiling on those payments which are essentially terminal benefits; Gratuity limit may be raised to Rs. 10 lacs subject to other limits.

(vi) EET system may be introduced in respect of financial investments under section 80C, interest u/s 10(15)(iv) etc., but it should be made applicable in respect of investments after the date on which the new system is introduced. The already announced tax exempt investments should continue; no new instruments may be added. Under the EET scheme, taxation at the time of withdrawal should not be applied if at that stage the assessee is a senior citizen – provided, the fund has remained in the scheme for a period of say, 10 years.

(vii) Section 16 (ii): The benefit should be extended to private sector employees also.

11. In brief, in terms of the objectives of different exemptions/ deductions, the following views have been reportedly expressed by a majority of the respondents :—

(i) Non-residents and foreign citizens

[Eg. Section 10(4)(ii), 10(6), 10(8), 10(15)(iv)(fa) etc.]

The responses have, by and large, supported the retention of relevant sections.

(ii) Export Promotion

[E.g. sections 10A, 10B,10AA etc.]

In addition to the continuance of the export exemptions, a few other suggestions have also been reportedly made by Chambers of

Industry namely, that the benefits for EOUs and SEZs should be made co-terminus; other exporters should be provided a level playing field incase of artificial cap on permitting the SEZs.

(iii) Social security

[E.g. sections 10(10), 10(10A), 10(10AA), 10(10AAA),10(10B), 10(10C), 10(10D), 10(11), 10(12), 10(13) etc.]

A strong plea for continuance of these deductions has been received by the Government.

(iv) Promotion of savings and investment

[E.g. sections 80C, 80CC, 80CCC etc.]

The responses in general, have called for the continuance of these deductions.

(v) Growth of trade, industry and infrastructure

[E.g. sections 80IA, 80IB etc.]

The Chambers of Commerce & Industry have, in particular, strongly pitched in for not only the continuance of such deductions but also for their extension.

(vi) Scientific research and development

[E.g. sections 10(21), 35(1), 35(2AB), 80GGA etc.]

On an average, the correspondences have called for the continuance of the exemptions/deductions relating to scientific research and development in the interests of promotion of R&D in the country.

(vii) Balanced regional development

[E.g. sections 80IB, 80IC etc.]

These deductions have found support among the Chambers on the grounds of decentralization of industries coupled with balanced regional development. The Madras Chamber of Commerce & Industry is however of the view that the deduction under 80IC (relating to the states of Sikkim, Uttaranchal, Himachal Pradesh and North-East) should not be extended beyond their existing terminal dates.

(viii) Promotion of charitable or religious organizations

[E.g. sections 10(23C), 11, 12, 13, 80G etc.]

a. The responses in this category are fairly mixed. While certain responses call for their continuance on the basis of the charitable nature of activities carried out by such institutions under strict conditions imposed in the sections, others have pointed to the misuse of funds by such organizations for the personal benefit of the patrons/specified persons.

(ix) Deduction of medical and educational expenses

[E.g. sections 80D, 80DD, 80DDB, 80E etc.]

The continuance of the deductions has been recommended by all respondents citing reasons of absence of Social Security schemes in terms of poor public health care facilities in the country, high cost of medical treatment; in the cause of quality education in the country etc.

(x) Welfare of Armed Services Personnel

[E.g. sections 10(18), 10(19), 10(23AA) etc.]

Strong representations have been received from the Ministry of Defence as well as the Forces themselves for non-withdrawal of these sections.

(xi) Promotion of Rural Development programmes and projects and schemes for social and economic welfare/uplift of public

[E.g. sections 35AC, 35CCA, 80GGA etc.]

All-round support has been given for the continuance of these deductions.

Central Board of Excise & Customs:

12. Summary of Area-based Exemption, as furnished by the Government, are as under:

Sl. No.	Area	Date of issue of exemption notification	Modalities of exemption	Revenue foregone 2003-04 Rs. crores	Revenue foregone 2004-05 Rs. crores	Revenue foregone 2005-06 Rs. crores	Whether any sun-set clause has been incorporated for new units to be set up/existing units to substantially expand	Sunset clause and extensions granted
1	2	3	4	5	6	7	8	9
1.	North East Region	08.07.1999	Refund mechanism New and expanded units	1227	1659	2298	No	No time limit

1	2	3	4	5	6	7	8	9
2.	State of Sikkim	09.09.2003	Refund mechanism				Yes upto 31.03.07	Sun set clause was introduced in budget 2004.
3.	Kutchh District of Gujarat	31.07.2001	Refund mechanism, (Exemption is only for new units)	1	185	370	Yes upto 31.12.2005	Last date, for setting up of new units, has been extended thrice, first upto 31.07.04, then upto 31.12.2004 and subsequently upto 31.12.2005
4.	State of Jammu & Kashmir	14.11.2002	Refund mechanism New and expand units	31	115	559	No	No time limit
5.	State of Uttaranchal	10.6.2003	Out right exemption New and expanded units	75	132	1125	Yes upto 31.3.2010	Sun set clause was introduced in budget 2004.
6.	State of Himachal Pradesh	10.06.2003	Out right exmeption New and expanded units	71	683	1496	Yes upto 31.3.2010	Sun set clause was introduced in budget 2004.
			Total revenue forgone 2003-04	1405	2770	5848		

Note:

1. The exemption is available for a period of ten years from the date of start of commercial production. In case of Kutchh the exemption is for a period of five years.

2. Except in case of Kutchh, exemption is also valid for existing units, which undertake substantial expansion by increasing their installed capacity by 25% or more. In case of J&K, existing units, which make new investment resulting in additional employment of 25% or more increase over the base employment (maximum number of regular employees employed at any point of time over last five years).

> "These area-based exemptions (except in case of Kutchh) have been given as per Industrial Policies announced by the Government for the respective States. In case of Kutchh, exemption was given following earthquake in the area. Further, Kutchh exemption has a sunset clause, as per which the exemption applies only to those units which were set up and which started commercial production on or before 31.12.2005."

13. The Government has called for public views/opinion on various exemptions that exist under the Indirect Tax Laws. In respect of many of the exemptions, both under the Customs and Central Excise Acts, representations have been reportedly received for their continuance.

With the announcement of the North East Industrial and Investment Promotion Policy, 2007 (NEIIPP,2007), another excise duty exemption scheme has been notified for the North East Region (including Sikkim). This scheme is valid for a period of ten years, from 2007 to 2017. With issuance of new excise duty exemption scheme, a sun-set clause has been inserted in the existing excise duty exemption scheme for the North East Region.

14. The Government have furnished a 'Note on Tax Expenditures' that has been prepared for the fourth meeting of the Consultative Committee attached to the Ministry of Finance. The same is furnished in the **Annexure-I.**

15. The Ministry in their post-evidence reply stated the following on the issue of withdrawal of exemptions:—

> "Tax exemptions result in revenue loss and, therefore, considered as tax foregone. It is also considered as tax expenditure in the economic literature on taxation.
>
> Prior to 1980s, providing tax exemption was a worldwide popular method to promote various socio-economic objectives through the tax system. These exemptions were essentially substitutes for various economic distortions arising on account of structural and institutional rigidities and market failures. It is now well recognised that tax exemptions are poor substitutes for first best solutions to economic problems. Therefore, since the 1980's, the world wide trend is to eliminate tax exemptions in favour of a simple moderate tax regime intended for the sole purpose of collecting revenues to finance Government expenditure. The tax system has now ceased to be used for promoting various socio-economic objectives. The Indian experience with tax exemptions has been well documented in the reports by various expert committees/groups. Essentially, every expert body in India, which has examined the efficacy of tax exemptions, has recommended their elimination from the statute."

16. The Committee raised a point on the area-based exemptions and their desirability to prolong over a period of time, to which the

Government in their written reply stated as follows:—

> "As regards tax exemptions for development of industrially backward districts in India, tax holiday was first introduced in 1974 for units located in industrially backward district in India, which commenced manufacturing on or after 1 Jan., 1971. This tax benefit continued to be available over the next two decades for all units set up in such industrially backward district by the 31st March 1990. Thereafter, the benefit was reintroduced for units commencing production any time during the period beginning on the 1st day of October 1994 and ending on 31st day of March 2004. Therefore, tax incentive for development of industrially backward district in India has been available for about three decades. The results have been mixed. While there has been movement of industry from other areas to the backward areas wherein infrastructure is relatively developed, there has been no significant impact on the most backward areas. Also, there have been complaints from a number of States regarding de-industrialization on account of movement of industry to the fiscally advantageous States. The policy now is to get away with area based exemptions, as such exemptions lead to shrinkage of tax base and adversely affect buoyancy in revenue collection. They result in breaking of VAT chain. Such exemptions also conflict with the policy of the Government to rationalize the rate structure and minimize the number of exemptions. Such region specific exemptions are also difficult to administer and may lead to misuse and consequent loss of revenue. The durability of investments (induced by such indirect tax exemptions) beyond the tax holiday period is doubtful. Furthermore, such exemptions create economic distortions, resulting in shifting of industry from non-exempted area to exempted areas. They also affect the economic viability of the units located in non-exempted areas."

17. The Committee, during the oral evidence of the representatives of the Department of Revenue, wanted to know whether any study has been conducted to examine if shifting of industries takes place from other parts of the country to the 'tax-exempted areas' and the impact thereof. The Government, in their written reply stated the following:—

> "No studies have been conducted by the Department of Revenue to see the impact of shifting of factories from other parts of the country to the areas entitled for such exemptions."

18. The Committee raised a point during the oral evidence as to why Employee Stock Options (ESOPs) were brought under the purview of taxation. In this regard, the Government, in their written reply stated the following:—

> "As a matter of policy, taxation of income from employment should be neutral to the form in which the employee is remunerated. Tax exemption to any form of remuneration will create a preference for the untaxed form. To the extent all the sectors are not equally placed in remunerating their employees in the untaxed form, labour will shift to sectors which provide remuneration in such untaxed form. This will result in both economic inefficiency, inequity and revenue loss. Since, ESOP is only one of the many forms of remuneration to employees; any exemption to ESOPs will have a distortionary effect.
>
> Generally, ESOPs are granted to employees in the higher tax bracket. Further, all employers do not have equal opportunity to grant ESOPs to their employees. Accordingly, the tax liability of employees of such employers is likely to bear a higher tax burden in comparison to employees at the corresponding income level entitled to ESOPs. Therefore, taxation of ESOPs will promote both vertical and horizontal equity between employees contrary to the view that such taxation is not fair to the employees"

19. The Government in their post-evidence replies furnished the following figures on the revenue foregone due to exemptions during the years 2004-2005 to 2006-2007:—

Revenue Foregone in Financial Years 2004-05, 2005-06 and 2006-07

(in Rs. Crore)

	Revenue Foregone in 2004-05	Revenue Foregone in 2005-06	Revenue Foregone in 2006-07
1	2	3	4
Corporate Income-tax	57852	34618	50075
Personal Income-tax	11695	13550	15512
Co-operative Sector related	1534	1632	Nil
Excise Duty	30449	66760	99690

1	2	3	4
Customs duty	92561	127730	123682
Total	194091	244290	288959
Less Export credit related	35430	37590	53768
Grand Total	158661	206700	235191

Tax exemptions withdrawn/introduced in the Budget 2007 proposals:

The Government in their post-evidence reply stated that under the Direct Taxes four exemptions/deductions have been sunset/restricted and seven new exemptions/deductions have been introduced in the Budget-2007 proposals.

20. The Revenue Secretary during the concluding oral evidence stated the following on the issue of conducting cost-benefit analysis on tax exemptions:—

"The Hon'ble Committee itself had suggested to us that we should conduct cost-benefit analysis of these exemptions. So we have begun that exercise. We have entrusted this task to independent think-thanks-ICRIER and National Institute of Public Finance & Policy. Their reports are under preparation."

21. Further replying to a point raised by the Committee during the concluding oral evidence as to by when the study reports will be ready, the Revenue Secretary stated as under:—

"During the course of the year. They have to do field level study and so on. Then, we will have a clearer idea as to what are the costs and benefits on the basis of which we can move forward."

22. The Committee note that there are many tax exemptions extended both under the Direct Tax Laws and Indirect Tax Laws, prominent of which are the area based exemptions. The Government have been, under their policy of doing away with the tax exemptions that are not considered essential, periodically reviewing and discontinuing certain exemptions. Several of the area-based exemptions available under the tax laws have been reviewed and extended periodically by the Government, with the main consideration of being enabling and promoting balanced regional development in the country. With specific reference to area-based exemptions under the Direct Taxes, the Committee note that the

Government have *inter alia* proposed to extend the applicability of the exemptions under Section 80IC of Income Tax Act for industrial undertakings in the North-Eastern States and Uttaranchal and Himachal Pradesh beyond March, 2007 upto March, 2012. The Committee note in this regard that the revenue loss on account of area based exemptions available under the Direct Taxes have increased phenomenally over the period from a sum of Rs. 362 crores 2004-05 to Rs. 2,215 crores in 2006-07, which is a cause for concern.

23. In the case of area-based exemptions under the Indirect tax laws, the Committee note that while the tax exemptions available have been extended upto March, 2010 in so far as the State of Uttaranchal is concerned, the extension is without any specified time limit for the State of Jammu & Kashmir and the North-Eastern States. The Committee, in this regard, note that the revenue foregone on account of the exemptions extended to these States too has risen phenomenally over the years from Rs. 1405 crores in the year 2003-04 to a sum of Rs. 5848 crores in the year 2005-06. The Committee further observe that as per the Government's submission, such exemptions, if prolonged beyond a stipulated or pre-set period can have the negative effect of migration of established industries from other areas/States to such 'exempted' areas/States. In view of the adverse implications of the exemptions on the revenues of the Government, the Committee recommend for a re-look and thorough analysis of the available exemptions and undertake policy measures *inter alia* aimed at limiting the applicability of such exemptions to a specified period. The Committee, however feel that till such time the exemptions are applicable, the long pending demands for such exemptions from some of the State Governments on geographic basis need to be considered and decided upon objectively and prudently.

24. The Committee take note of the fact that a specific recommendation made by them in one of their earlier reports for carrying out a detailed cost-benefit analysis in respect of each of the tax exemptions has been endorsed by the public; and in pursuance thereof, the Government has entrusted the related study to two independent bodies *viz.*, Indian Council for Research on International Economic Research (ICRIER) and the National Institute of Public Finance & Policy (NIPFP). The Committee desire that the Government report the related findings to them as and when the reports are presented.

25. The Committee also note from the information furnished by the Government that a number of suggestions have been received from the public, which mainly emphasize on the need for continuance of the tax exemptions under Direct Taxes. The Committee expect the Government to decide on the need for continuance of the

tax exemptions after taking into consideration, the reports/findings on the cost-benefit analysis of the exemptions currently being undertaken.

26. The Committee in this regard also take note of the observations as made by the NIPFP in their Working Paper, and as quoted in the Government's 'Note on Tax Expenditures' that 'better infrastructure and transport and interest subsidies rather than direct tax breaks merit consideration in those areas'. Further, they also take note of the observation of the Draft Approach Paper to the 11th Five Year Plan titled 'Towards Faster and More inclusive Growth' which states that "extension of exemption to Himachal Pradesh & Uttaranchal has had an adverse impact on industrial investments elsewhere, including North East, and consideration needs to be given to restrict such incentives only to hilly areas or to replace these incentives by a special programme for roadways and railways in these States".

27. The Committee, therefore, feel that it is perhaps, high time that exemptions are reviewed and limited and that too quickly, as opportunities for raising additional sources through new taxes or higher tax rates are not unlimited and enhanced tax collections are the major contributors towards meeting the target set by FRBM Act for elimination of Revenue deficit. The Government should therefore expedite the move towards a regime wherein tax exemptions are minimal and confined to exceptional cases. The Committee also endorse the view that in the long run, exemptions may be limited to life saving goods, goods of security and strategic interest, goods for relief and charitable purposes and exemption for small scale industries.

2. DOUBLE TAXATION AVOIDANCE AGREEMENTS (DTAAs)

28. The Government have furnished details of various aspects of the DTAAs as follows:

"Central Board of Direct Taxes:

Section 90 of the Income-tax Act empowers the Central Government to enter into agreements with foreign countries for avoidance of double taxation of income. The other objectives mentioned include exchange of information, recovery of income-tax and for granting of relief in respect of income on which income-tax has been paid both under this Act and income-tax law of the other country.

India has entered into 70 such tax treaties, which have helped the Indian residents in avoiding double taxation of their income arising from services, investment and business rendered abroad. Tax treaties are important for good commercial relations between two countries. They have helped in attracting foreign investment into India because they reassure foreign investors about the stability of the framework within which investors will be taxed. They have removed cross-border tax obstacles so as to avoid distortion in trade and investment worldwide.

The existing tax treaties are reviewed and re-negotiated depending upon the developments in the area of international taxation, changes on the OECD Model Convention and the domestic laws of the Contracting States.

Mutual Agreement Procedure (MAP)— Mutual Agreement Procedure (MAP) is a special procedure which is set in motion when a resident of a Contracting State considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the Convention. Such taxpayer may present his case to the competent authority of the Contracting State of which he is a resident. The Competent Authority then invokes the MAP procedure and requests the other Competent Authority to consider the case. The two authorities then exchange the position papers and other relevant documents in relation to the case. The respective positions are discussed in meetings and they endeavour to reach an agreement which is acceptable to both the sides. Once a mutually agreeable decision is reached a resolution order is passed and necessary directions are issued to the assessing

officer to apply the MAP decision. The assessing officer, in the field office gives effect to such a resolution in terms of instruction No.12/2002 issued by CBDT. This instruction lays down the procedure for giving effect to the resolution arrived at in the MAP.

Exchange of Information (EoI)—The Article on Exchange of Information in a DTAA between two countries operates through the designated competent authority who exchanges such information as is necessary to secure the correct application of the provisions of the convention or of the domestic laws of the countries. The information so obtained can be disclosed only to persons and authorities involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes with respect to which information may be exchanged.

In India any request received from the assessing officer is forwarded to the respective competent authority who obtains the information (in terms of the article on exchange of information) as per provisions of their domestic law and forwards the same to the Indian competent authority. If the information is not received after a reasonable time the request is repeated to the foreign authority for expediting the same.

Recovery of tax(Assistance in Collection of Taxes)— DTAAs provide for assistance in collection of taxes from the tax authorities of the country of residence of a non-resident taxpayer where the outstanding taxes have become due for collection with reasonable certainty and no revision or reduction or any appeal is under consideration by any authority in the requesting country. A contracting State is not bound to go beyond its own internal laws and administrative practice in fulfilling its obligations under the assistance in collection article."

India-Mauritius Double Taxation Avoidance Convention:

29. The Committee wanted to know the areas of major concern of the Government in respect of the India-Mauritius DTAC, to which the Government in their written reply stated as follows:—

"Mauritius route has been used by investors from all over the world for making foreign direct investment as well as investment in the Indian stock market. The major concern of the Government *vis-a-vis* the India-Mauritius DTAC is the misuse of Article 13 on

'Capital Gains' of the DTAC through: -

(i) Third country entities using Mauritius as a platform for investing into India resulting in 'treaty shopping';

(ii) Round tripping by Indian entities moving money out of the country and then getting it back into India through the Mauritian GBC-1 companies.

The other area of concern is the lack of effective exchange of information under the DTAC especially with respect to banking information."

Article 13 of the Indo-Mauritius DTAC

30. Further elucidating the point, the Government in their reply stated the following:

"Article 13 of the India-Mauritius DTAC provides for taxation of capital gains from sale of shares in the country of residence of the investors. The country of source (i.e where such Capital Gains arise) has no right to tax such gains. Therefore, capital gains arising to residents of Mauritius from sale of shares of Indian companies are not taxable in India under the India-Mauritius DTAC. Such capital gains are taxable only in Mauritius. Further, Mauritius does not levy any tax on capital gains from sale of shares under its domestic law. These capital gains are therefore not taxable either in Mauritius or in India. The provision of residence-based taxation of capital gains from sale of shares under Article 13 of the India-Mauritius DTAC is the root cause of loss of potential tax revenue to India."

31. The Committee, during the oral evidence, raised a point as to the mis-use of the Mauritius DTAC which is used by Indians to avoid taxation, to which the Government in their written reply stated the following:

"A JWG comprising representatives of the Government of India and the Government of Mauritius was constituted in October 2006 to address India's concerns on the misuse of the India-Mauritius Double Taxation Avoidance Convention (DTAC). In all the meetings of the JWG, India has again and again emphasized its concerns on 'round tripping' as well as 'treaty shopping'. India has also proposed source based taxation of capital gains from alienation of shares as a possible solution to the problem of abuse of the treaty. However, the Mauritian side is not willing to consider this solution as in their view, this would adversely affect their offshore financial

services sector, which contributes almost 11% of their GDP and would hurt even the genuine companies of Mauritius."

32. The Committee raised a point on the judgment *vis-à-vis* the India-Mauritius DTAC by High Courts/Supreme Court to which the Government stated the following:

"The India-Mauritius DTAC was the subject matter of discussion in the judgment of the Hon'ble Supreme Court in Civil Appeal Nos. 8161-62 of 2003 in Union of India and Another *vs*. Azadi Bachao Andolan and Another. The apex court deliberated on various aspects relating to the India-Mauritius DTAC *inter-alia* including the issue of 'treaty shopping'. The Hon'ble Supreme Court upheld Circular No. 789 dated 13.04.2000 issued by the Central Board of Direct Taxes (CBDT) as 'valid and efficacious'.

The Hon'ble Supreme Court also observed that where the DTAC has been entered into under sub-section (1) of Section 90, the provisions of sub-section (2) of Section 90 spring into operation and an assessee who is covered by the provisions of the DTAC is entitled to seek benefits there under, even if the provisions of the DTAC are inconsistent with the provisions of Income-tax Act, 1961."

33. On the issue of 'treaty shopping' the apex court observed as under:

"There are many principles in fiscal economy which, though at first blush might appear to be evil, are tolerated in a developing economy, in the interest of long term development. Deficit financing, for example, is one; treaty shopping, in our view, is another. Despite the sound and fury of the respondents over the so called 'abuse' of 'treaty shopping', perhaps, it may have been intended at the time when Indo-Mauritius DTAC was entered into. Whether it should continue, and, if so, for how long, is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations. This Court cannot judge the legality of treaty shopping merely because one section of thought considers it improper. A holistic view has to be taken to adjudge what is perhaps regarded in contemporary thinking as a necessary evil in a developing economy.

Thus, the Hon'ble Supreme Court has left the issue of 'treaty shopping' to the discretion of the Government without commenting on its desirability or otherwise."

34. The Committee wanted to know whether any specific study/ enquiry has been conducted on mis-use of the DTAC. The Government in their written reply stated as follows:

"An Inter-departmental Committee was constituted in April 2006 to study the taxation and related laws of Mauritius in the context of the India-Mauritius DTAC. The Committee noted that the main vehicles for routing investments into India through Mauritius are the Global Business Category-1 (GBC-1) companies operating in the Mauritian off-shore financial services sector. The GBC-1 companies are treated as 'resident' under the Mauritian Income-tax law in order to enable them to claim the benefit of capital gains tax exemption under the India-Mauritius DTAC."

35. The total amount of foreign direct investments made through Mauritius and through four other leading countries, as furnished by the Government, is as under:—

(Amount Rs. in crores/US $ million)

Rank	Country	August 1991 to March 2003	2003-04 (Apr-Mar)	2004-05 (Apr-Mar)	2005-06 (Apr-Mar)	2006-07 (Apr-Nov.)	Comulative Inflows (from Aug. 1991 to Nov. 2006)	%age with total inflows (in terms of rupees)
1.	Mauritius	31,212 (7,520)	2,609 (567)	5,141 (1,129)	11,441 (2,570)	18,342 (4,012)	68,745 (15,796)	40.78
2.	U.S.A.	13,752 (3,507)	1,658 (360)	3,055 (669)	2,210 (502)	2,640 (579)	23,315 (5,618)	13.83
3.	Netherlands	4,692 (1,162)	2,247 (489)	1,217 (267)	340 (76)	1,992 (438)	10,489 (2,432)	6.22
4.	Japan	7,070 (1,711)	360 (78)	575 (126)	925 (208)	236 (52)	9,167 (2,175)	5.44
5.	U.K.	5,880 (1,446)	769 (167)	458 (101)	1,164 (266)	738 (162)	9,009 (2,141)	5.34

36. The Committee asked whether the Government propose to review/amend all such agreements to plug the loopholes and avoid

loss of tax revenue, to which the Government in their written reply stated as under:

"The Ministry of Finance reviews and undertakes provision of existing tax treaties wherever considered necessary in consultation with the other country. The following DTAAs of India have provisions relating to taxation of Capital Gains which are identical to that in the India-Mauritius Double Taxation Avoidance Convention (DTAC):—

(a) Cyprus

(b) Syria

(c) Tanzania

(d) Thailand

(e) UAE

(f) Indonesia

(g) Zambia

We have also reviewed our DTAA with Singapore in August 2005 to provide for residence based taxation of capital gains on the lines identical to that of the India-Mauritius DTAC. In order to safeguard the capital gains tax concession against possible misuse, the India-Singapore Protocol also provides for anti-abuse provisions in Article 3 which aim at denying benefit of the capital gains tax exemption to shell/conduit companies. The capital gains tax exemption under the India-Singapore DTAA is also co-terminus with similar exemption under the India-Mauritius DTAC. The process of revision of all the 7 DTAAs having identical capital gains provisions as that of Mauritius has been initiated to provide for source based taxation of such gain. We have already revised the Agreement with UAE, while the process of review is on with other countries."

37. The Government in their written reply stated the following on the information sought for from Mauritius and the difficulties faced in this regard:

"Information has been requested from the Mauritian authorities in a number of cases, but the requisite information has not been forthcoming from their side. Mauritius Revenue Authority is not empowered under their domestic law to obtain and share banking information. The income-tax law of Mauritius allows the revenue

authorities to get details of bank accounts held by persons directly from banks only where a person has been convicted of an offence relating to dangerous drugs or dealing in dangerous weapons. The only channel available in the Mauritian domestic law, for obtaining banking information is 'through a Judge in Chamber'."

38. The Government in their written replies have stated the following on the issue of obtaining banking information through the Channel of 'Judge in Chambers':

"The channel of obtaining information through a 'Judge in Chambers' is not available to the Indian government. Only the Mauritius government can approach the 'Judge in Chambers'. We had requested the Mauritius government to inform us regarding the number of cases in which they have approached the 'Judge in Chambers' to obtain banking information on India's request. Mauritius government has not reverted back to us on this issue."

39. The Committee wanted to know as to whether there are any norms that are followed internally in cases where capital gains are exempted in India as well as Mauritius. The Government in their written reply stated the following:

"Double Taxation Avoidance Agreements (DTAAs) provide for distribution of taxing rights between the state of residence and the state of source, with respect to taxes on income. The domestic tax law of the concerned country determines whether the income for which it has been given the right to tax under the DTAA is actually taxed in that country or not.

In case the country of residence chooses not to tax the income for which it has been given exclusive rights of taxation under the DTAA, it leads to a situation of double non-taxation of income. However there are no International norms in this regard."

40. In response to the query raised by the committee about the issue of double non-taxation of Capital Gains, the Government in their written reply stated the following:

"The objective of entering into bilateral agreements with other countries is not only to avoid double taxation of income but also to promote mutual economic relations, trade and investment between the two countries. To this end, the Double Taxation Avoidance Agreement provides for allocation of taxing rights over different types of income between the concerned countries. Thus

the country to which taxing right in respect of a particular income is allocated has a right to tax such income. However, a particular country may or may not choose to exercise such a right. If a country chooses not to exercise the right, it leads to a situation of double non-taxation. However, such instances are rare and usually the income is taxable in one of the countries. India does not subscribe to double non-taxation and has generally followed the policy of allocating taxation rights to the source state in her DTAAs."

41. The Committee citing the Supreme Court's judgement on the India-Mauritius DTAC, raised a point whether the 'convention' was signed only with the objective of double taxation with Mauritius to which the written reply of the Government stated the following:—

"The Preamble of the India-Mauritius DTAC with Mauritius reads as under:

'The Government of the Republic of India and the Government of Mauritius, desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains and for the encouragement of mutual trade and investments: have agreed as follows…….'

It is thus apparent that the treaty was signed with Mauritius not only for the avoidance of double taxation but also with the objective of preventing fiscal evasion and encouraging mutual trade and investment between the two countries."

42. The Committee wanted to know as to why such a privilege was extended to Mauritius, to which the Government in their written reply stated as follows:

"It is correct that Article 13 of the DTAC between India and Mauritius provides for residence based taxation of capital gains on sale of shares while most of India's other DTAAs provide for source based taxation of such shares. In this connection, it is relevant to mention that in our DTAAs with Cyprus, Syria, Tanzania, Thailand, UAE, Indonesia and Zambia also the provisions relating to capital gains tax exemption on sale of shares are identical to that of the India-Mauritius DTAC. The India-Mauritius DTAC was notified on 6th December 1983. The original records relating to DTAA negotiations are not traceable in the Department of Revenue for quite some time. Hence, it is difficult to spell out the specific reasons for providing residence based taxation of capital gains on

sale of shares in the DTAC with Mauritius. It needs mention that this fact was also brought to the notice of Joint Parliamentary Committee on Stock Market Scam and Matters Relating thereto in the year 2002."

43. Stating the fact that while a GBC 1 company is treated as a 'resident' under the Mauritian Income Tax Law, it was not considered as a resident under Mauritian FSD Act, the Committee wanted to know the reasons for the contradiction. The Government in their written reply stated the following:

"A GBC 1 Company is a resident of Mauritius under the Mauritius Income-tax Act, 1995. However, "Resident in Mauritius" under the Financial Services Development Act, 2001 has been defined to be either an individual who is domiciled in Mauritius or a body corporate other than a corporation holding a GBC 1 or GBC 2 licence. The purpose of excluding GBC 1 companies from the definition of 'resident' under the FSD Act is presumably to insulate the domestic economy of Mauritius from the offshore financial services sector, whereas the purpose of including such companies under the definition of the term 'resident' under the Income Tax Act is presumably to enable them to avail the tax benefits under the India-Mauritius Double Taxation Avoidance Convention."

44. The Committee wanted to know whether the issue of multiple definition of the term 'resident' under various laws of Mauritius has been taken up with the Government of Mauritius. The Government in their written reply have stated the following:—

"Yes, this issue was taken up with the Mauritius Government. They have informed that there is no all-purpose legal definition of the term 'residence' in Mauritius. According to them, the definition varies with the context in which it is used. They have expressed concerns on the impact of amending their Income Tax Law as is applicable to GBC-1 companies on its offshore financial services sector with the high probability of such companies relocating to other countries having similar treaties with India."

45. The Revenue Secretary during the oral evidence stated the following:

"As the hon. Members are aware, we are extremely concerned about the Double Taxation Avoidance Agreement. As a matter of fact, the NCMP itself says that the misuse of the Double Tax Avoidance Agreement shall be stopped."

46. Further elaborating on the issue, the Revenue Secretary during the oral evidence stated the following:

> "We have, accordingly, approached all the major countries with which we have the Residence Based Capital Gains Taxation Provisions.
>
> I am happy to report to the hon. Committee that there were three major sources. The three major sources are Cyprus, UAE and Mauritius. Now, Cyprus and UAE have already agreed to go to source-based method of taxation. Only Mauritius remains now. We have been piling on a lot of pressure to see whether changes can be brought about. In fact, a Joint Working Group was constituted at our instance with Mauritius. The Joint Working Group had four meetings, one in October, another in November, third in December and fourth in January, where we have again been very strongly expressing our position.
>
> When the hon. Prime Minister of Mauritius came to India, our concern was expressed to him by no less than the hon. External Affairs Minister and the hon. Prime Minister himself. Thereafter, he has gone back and submitted certain proposals. He has sent us certain proposals. He has suggested that there could be a strategic partnership team between India and Mauritius. He has suggested that certain internal measures may be taken aimed at addressing India's concern without amending the DTAA and he has suggested other measures including positioning one of our own officers in Port Louis so that if there are any problems, they can immediately be brought to the notice."

47. Further, explaining about the main area of contention with Mauritius, the Revenue Secretary during the oral evidence stated as follows:

> "Article 13 is about the source-based taxation. That is the main area of dispute. We would like it to go from resident-based to source-based. But Mauritius is till now very unwilling.
>
> As the hon. Members are aware, we need to look at various other factors when we are examining the Double Taxation Avoidance Agreement with Mauritius. It has been a friendly country. It is geopolitically important for us. We need to progress with them and try to achieve an amicable solution to the extent possible. The hon. Finance Minister took a meeting on 7th March recently on this issue. It was attended by the Foreign Secretary,

the Finance Secretary, the Commerce Secretary, Secretary, DIPP and the Chairman, Direct Taxes. We decided that we will prepare a note on various aspects of the Mauritius Agreement and also make certain counter proposals to the Mauritius side. This includes also source-based taxation of capital gains from alienation of shares and denial of treaty benefits to Mauritius GBC-I companies. We have suggested anti-abuse provision into the DTAC. This also includes strengthening the information exchange mechanism. Now, based on these factors we have circulated a note to all the concerned Ministries and on receipt of their response, we are intending to resume the negotiation which will be led by the Ministry of External Affairs because they are the main negotiating agency."

48. When a point was raised during the oral evidence as to why the Government was so particular with this clause of the agreement with Mauritius and not with other countries, the Revenue Secretary, stated as follows:

"It is part of the agreement which was made in the late 1980s. You see what happened in the late 80s'. At that point, we really did not have too much of a problem with that particular agreement. It was in the 90s' that Mauritius changed it because initially they also had capital gains tax. Then they abolished capital gains tax. That is how the problem arose. Since then I am aware that successive Governments have made various efforts to try and bring it back to what we would like and we are continuing the effort as best as we can."

49. Further, the Committee wanted to know whether the Mauritian DTAA was signed to bring in more foreign capital into the Indian stock market, to which the Revenue Secretary during the oral evidence stated the following:

"I would only say that if that had that been the reason, there has been pressure on us from a large number of other countries also, including Singapore to have the same kind of agreement but we have been resisting it. As a matter of fact, if we wanted to bring in more capital, it would have made more sense to widen the scope. On the other hand, we have restricted the scope by moving out Cyprus and UAE and by putting a lot of pressure on Mauritius."

50. The Committee further wanted to know whether we can introduce some regulation on the particular issue. The Revenue

Secretary stated the following during the oral evidence:

> "Basically, under the Income-tax Act, if we have a double taxation avoidance agreement, that will supersede everything else. It is very difficult, unless we try to negotiate with Mauritius and try to sort the problem out."

51. The Committee during the oral evidence wanted to know whether Mauritius has taken any steps in response to the apprehensions expressed by India. The Government in their post-evidence reply stated the following:

> "The Government of Mauritius has informed that several steps have been taken by them independently to address India's concerns which include providing India specific licensing conditions for GBC 1 companies licensed under the Financial Services Development Act 2001. Such conditions, *inter-alia*, include in the case of a Mauritius company promoted by an Indian corporation a restriction on re-investing into India, funds derived from sources within India and an annual requirement of filing a certificate to this effect together with its accounts under section 26(2) of The Financial Services Development Act, 2001. The Government of Mauritius has also issued a circular dated 3rd October 2006 to enhance the procedure relating to issue of Tax Residence Certificate. However, it is felt that these steps may not be effective in preventing 'round tripping' as the funds will normally be routed to Mauritius from India directly."

52. Double Taxation Avoidance Agreements are entered into with foreign countries for avoidance of double taxation of income, for exchanging information, help in recovery of income tax and for granting of relief in respect of income on which income tax has been paid under the Income Tax Laws of both the contracting States. Further, such agreements attract foreign investment and help in removing cross-border tax obstacles in order to avoid distortions in trade and investment between countries.

53. The Committee note that India-Mauritius Double Taxation Avoidance Convention (DTAC) has been a cause of concern for India as the treaty has been used by third country entities to avoid taxation in India. The methods reportedly used to avoid taxes are by means of (i) 'Treaty Shopping' – a situation where the residents of a country instead of making their investments directly in another country, route such investments through a third country which has a favorable treaty with the country in which the investments are made in order

to avail the tax benefits under the favourable tax treaty and (ii) 'Round Tripping' – routing of investments by a resident of one country through another country back to his own country to avail tax benefits of DTAA.

54. The Committee note that the contentious issue India has with the Mauritian DTAC relates to misuse of Article 13 on Capital Gains of the DTAC through which third country entities use Mauritius as a platform for investing in India thereby resulting in 'Treaty Shopping' and 'Round Tripping' by Indian entities moving money out of the country and then getting it back into India through the Mauritian GBC-1 companies. They observe that the misuse of the India-Mauritius DTAC happens because of the fact that capital gains arising to 'residents' of Mauritius from sale of shares of Indian companies are neither taxable in India nor in Mauritius. The worrying factor is that the GBC-1 Companies, which exist only on the files maintained by the management companies that serve as a conduit for routing investments from third countries to India with the objective of taking advantage of the India-Mauritius DTAC, are, treated as 'resident' under the Mauritian Income Tax Laws.

55. The Committee further observe that there are countries such as Cyprus, Tanzania, Thailand, Indonesia, UAE, Zambia and Syria, with whom India has similar agreements where capital gains tax on alienation of shares is not levied on residents under their domestic law. Of these countries Cyprus and UAE have already reportedly agreed to change to the 'source based' method of taxation. In this regard, the Committee note that at the time of signing the India-Mauritius DTAC, Mauritius was taxing Capital Gains and it was only much later in the 90's that Capital Gains tax was abolished in the Country. They further note that Mauritius has not expressed willingness to consider changing over to 'source based' taxation as it feels the change would affect their offshore financial sector and also hurt their genuine companies. Further, issues relating to bilateral/ international relations too reportedly restrict India from pressurizing Mauritius to accept the change over from 'residence based taxation' to 'source based taxation'. Considering this experience, the Committee recommend that the Government should consider incorporating mandatory clauses in such treaties/agreements to the effect that any consequential changes in the domestic laws carried out after entering into such agreements, which have an adverse effect – directly or indirectly— leading to disadvantageous position, particularly with regard to taxation, would give the contracting States the liberty to, at first pursue the matter with the other contracting State, and in case of non-agreement, enable for withdrawal of such agreements.

3. GOODS AND SERVICES TAX (GST)

56. Goods and Services Tax (GST) means taxation of goods and services in an integrated manner, rather than in a separate manner in which it is being done now. The line of demarcation between goods and services is getting blurred, which has made separate taxation of goods and services untenable. Integrated Goods & Service Tax (GST), based on VAT principles, has evolved as the most modern and efficient form of indirect taxation and the same has been adopted by a large number of countries (including Federal countries) around the world. Even in European countries, coverage of VAT includes both goods and services. In India also, the process of indirect taxation has been evolving on the lines of VAT and introduction of an integrated GST would be the natural culmination of the tax reform efforts of last about two decades.

57. The Government in their written reply stated the following as the advantages of having the Goods and Services Act:

> "Integrated GST is a simple, transparent and efficient system of indirect taxation. In the modern world, the line of demarcation between goods and services is getting blurred. Increasingly, services are used or consumed in production and distribution of goods and goods are used or consumed in production or delivery of services. Separate taxation of goods and services often requires splitting of transaction value into value of goods and services for the purpose of taxation which leads to complexities and an element of subjectivity. This is avoided under GST system, where a integrated GST is levied on the total value of the transaction. Such system is simple, objective and transparent and consequently, more efficient and effective. The administrative and compliance costs of such system are much lower. Further, when State and Central taxes are integrated into a single GST system, it will be possible to give full credit for input taxes collected by both Centre and States on goods as well as services. In other words, we would have a national VAT with full input tax credit for all taxes — Central as well as State. Such a modern and efficient tax system shall help in eliminating tax-induced economic distortions and give boost to the economic activity. It will increase the international competitiveness of Indian business. It will make India a truly national common market and a very attractive investment destination."

58. The Government have stated the following as the process that is required for the introduction of GST:

"Introduction of GST would require integration of Central and State Taxes on Goods and Services. Currently, the Constitution of India provides clear demarcation of powers of taxation of goods and services between the Centre and the States. Regarding taxation of goods, the Centre has the powers to levy tax on manufacture of goods (*i.e.*, Central Excise or CENVAT), whereas the States have the powers to levy tax on purchase or sale of goods within a State (*i.e.*, State VAT/ Sales Tax). The tax on inter-State sale of goods is levied by the Centre in the form of Central Sales Tax (CST), but the same is collected and appropriated by the States. Regarding taxation of services, the Centre has the powers to levy tax on services, except for a few services like luxuries, entertainment, etc. which have been specifically assigned to the States. The Central taxes on goods and services are shared with the States on the basis of the recommendations of the Finance Commissions.

The introduction of GST would require that the gradually the degree of integration is increased between the taxes on goods and taxes on services on one hand and between Central and State taxes on the other hand. Centre and the States would need to work closely together to work out common tax base, tax structure, administrative systems etc. The trade-distorting levies which are inconsistent with VAT would have to be done away with. The necessary legal and Constitutional framework for the new tax regime would have to be put in place."

59. To a point raised by the Committee as to whether any road map has been drawn towards the introduction of GST, the Government in their written reply stated as under:

"The Central Government has set 01.04.2010 as the target date for introduction of GST and all actions are now being taken with this goal in mind. Some important requirements/milestones for achieving the goal of integrated GST by 01.04.2010 are as follows:

- Introduction of VAT by all States/UTs.
- Phasing out of the Central Sales Tax (which is a origin-based cascading type tax, completely inconsistent with VAT).
- Increased involvement of States in taxation of Services.
- Simplification and harmonisation of tax structures, *i.e.*, between goods and services and between Centre and States.

- Modernisation and synchonisation of Administrative and IT systems of Centre and States.
- Legal and Constitutional changes.
- Parallel action on the above points will need to be initiated and proceeded with, in a manner that the process is completed before the target date of 01.04.2010 for GST introduction."

60. The Committee wanted to know the extent to which the progress towards introduction of GST has reached. The Government in their written reply have stated the following:

"Implementation of VAT by all States is the first critical requirement, if we have to make any significant progress towards GST. During 2006-07, we have made good process on this front. During the year, 6 more States have implemented VAT. Uttar Pradesh is the only State, which has not yet decided to implement VAT. It is expected that during 2007-08, Uttar Pradesh would also join VAT.

Phasing out of CST is another critical building block for GST, which was evading a solution for quite some time. However, a consensus has now been reached with the States on the roadmap for phasing out the CST by 31.03.2010. The process will begin with reduction of CST from 4% to 3% *w.e.f.* 01.04.2007.

With the above significant developments, the stage has now been set for serious deliberations between the Centre and States on the design of GST. The process will begin shortly. In the meanwhile, the Centre and States have been separately working on reforming their respective taxes. The Central Government has been adopting policies that will eventually facilitate integration of CENVAT, Service Tax etc. in GST. The States have been similarly working on bringing about uniformity in VAT procedures, adoption of HSN System of commodity classification etc. The Central Government plans to implement a Mission Mode Project to help States modernize their VAT Administration in a manner that will facilitate the integration of State taxes into GST."

61. The Government in their written reply stated the following about the 'Mission mode Project' which the Centre has designed and introduced to create a modern state tax administration:

"The Mission Mode Project on 'Commercial Taxes', is one of the e-Governance Projects proposed to be taken up under the National

e-Governance Plan (NeGP), formulated by the Department of Information Technology (DIT), Government of India. An Apex Committee under the Chairmanship of the Cabinet Secretary monitors the implementation of these Projects. 'Commercial Taxes' being a State subject, the Mission Mode Project has been categorised as State MMP under the NeGP Guidelines. Under the Guidelines, in case of State MMPs, the primary responsibility for formulation and implementation of Projects is with the States, but the concerned Central Line Ministry/ Department (Ministry of Finance, Department of Revenue, in this case) is required to coordinate and facilitate the implementation of the Project and to develop the overall broad Framework/ Scheme, so that these projects are implemented in a timely and cohesive manner.

In this context, the Ministry of Finance, Department of Revenue had, in consultation with the DIT, engaged National Institute of Smart Government (NISG), Hyderabad as 'Strategic Consultant' to develop the overall vision and strategy for implementation of Project. NISG has completed the Study and submitted its Report. The Report will now be discussed with the States in a Special Workshop (expected to take place in April, 2007) to finalise the framework for implementation of the Project.

Broadly, the VISION for the Project is "**to create a modern State tax administration** that is efficient, effective and equitable and which is conducive to investment, economic growth and free flow of goods and services within the common market of India." The Project would involve implementation of a number of Business Project Re-engineering (BPR) recommendations including **e-Governance initiatives** like online application for VAT Registration, Online filing of Returns, Electronic Clearance of Refunds, Online Tax Payment, Online Dealer Ledger, Online Dealer Verification, Online issuance of Statutory Forms under CST through TINXSYS and Facility to Dealer to obtain various Online Information Services."

62. Asked to state the efforts of the Government for better harmonization of Value Added Tax, the Government in their written reply stated as follows:—

"State VAT being a State subject, the Central Government has been playing the role of a facilitator for successful implementation of VAT. The Central Government has been closely working with the Empowered Committee of State Finance Ministers (EC) in order to

persuade the States to uniformly follow the design of VAT (including tax structure) finalised by the EC. Even under the package of compensation to the States for revenue loss due to introduction of VAT, the release of compensation has been made conditional on the States following the VAT design finalised by the EC. The Central Government proposes to implement a Mission Mode Project under the National e-Governance Plan, for modernisation of VAT Administration by the States and under this Project also, it is proposed to link the assistance to the States harmonising their VAT systems and procedures."

63. Uttar Pradesh is the only State which has not yet decided to implement VAT. The Committee raised a point as to the contentious issues involved to which the Government in their written reply stated the following:

"It has been informed by the Government of Uttar Pradesh that they have not yet taken a decision to implement VAT. In fact, in some of the Empowered Committee meetings, the representative of the UP Government has mentioned that they have been interacting with the business community in the State in this regard and as soon as they are able to build a consensus, they will implement VAT."

64. The Committee, during the oral evidence, questioned whether the Government are thinking of framing any new policy on VAT in view of the fact that States have taken out most of the items out of VAT to which the Government in their post-evidence reply stated the following:

"VAT, being a tax on sale or purchase of goods within a State, is a State subject by virtue of Entry 54 of State List of Seventh Schedule of the Constitution. An Empowered Committee of State Finance Ministers (EC) has been constituted to deliberate upon all issues relating to VAT (including the tax structure under VAT) and to make recommendations to the States. This EC has finalised the design of VAT, which has largely been adopted by all the States. There are 2 main rates of 4% and 12.5%, besides 1% rate for a few items and a tax-exempt category for a few items of goods. Further, there is a category of 20% Floor Rate of tax in respect of some items of goods which have been kept outside VAT like Petroleum Products, Liquor etc. Since 20% is the Floor Rate, the actual tax rate varies from State-to-State in respect of items in this category. The EC has also decided that each State may exempt 10 items of local importance from tax.

Most of the States have largely been following the EC approved VAT rates structure. There may be some instances of a few States deviating from EC approved VAT rates in respect of some items of commodities, but the EC is monitoring this aspect regularly to ensure that all the States follow the VAT design collectively agreed to by the States in the EC. Since VAT is a State subject, any decision with regard to the structure of tax rates under VAT can only be taken by the EC or the States concerned. The Central Government only has a facilitating role in this tax reform process."

65. Asked about the compensation given to States for the revenue losses due to implementation of VAT, the Government in their post-evidence reply stated as under:

"31 States/ UTs have implemented VAT so far. The tax revenue performance of VAT implementing States is improving consistently. During 2005-06, these States registered 13.8% increase in tax revenue over previous year. During 2006-07 (April-January), the tax revenues have increased by as much as 23.8% over corresponding period of last year. With improvement in revenue performance, the number of States claiming compensation and the amount claimed is declining rapidly. During 2005-06, 8 States claimed total compensation of Rs. 6,891.90 crores. During 2006-07, only 5 States have claimed total compensation of Rs. 1,704.03 crores only. It is expected that the claims will further decline significantly during 2007-08 in view of the encouraging revenue trend under VAT.

The Central Government has been releasing compensation to the States for revenue loss on account of VAT implementation, as per the agreed formula, under which compensation is to be paid @100% of revenue loss during 2005-06, 75% of revenue loss during 2006-07 and 50% of revenue loss during 2007-08. No compensation will be paid thereafter. As stated in preceding Para, the total claims so far have been Rs. 8,595.93 crores (Rs.6,891.90 crores plus Rs. 1,704.03 crores). Out of this, claims for total Rs. 6,563.40 crores have been released so far and the remaining claims are under examination. It is expected that with the current trend of good revenue performance, the revenues of all the States will sufficiently improve by 2007-08 and no State will be incurring revenue loss due to VAT implementation."

66. Goods and Services Tax (GST) is an integrated, single form of indirect taxation of goods and services throughout the country by both the Union and the States. According to Government, once

introduced, the GST would pave way for a simple, transparent and efficient form of indirect taxation throughout the country, doing away with the demerits of the present system. Such a system is expected to minimize costs and disputes apart from facilitating a common market for the whole country thus making the country more attractive for foreign investments.

67. Introduction of such a system requires integration of Central and State Taxes both on Goods and Services. Thus, the process involves integration of taxes on goods and taxes on services on the one hand and of the Central and State Taxes on the other. The Committee observe that the process has already been initiated at both the levels. The States have started moving towards the goal of having an integrated GST by switching over to the system of Value Added Tax (VAT). However, the Committee note in this regard that the State of Uttar Pradesh is yet to join the process and implement VAT. The Committee expect the Government to take up the matter of switching over to VAT System by the State Government vigorously, which would facilitate in introduction of GST as per schedule *i.e.* April, 2010.

68. For facilitating introduction of GST, the Centre has to move towards a single rate of taxation both for the goods and the services. While some initiatives are stated to have been taken in this direction so far, the Committee trust that the Government will spare no efforts to achieve it in time. The other direct effort to be taken by the Centre, the Committee note, is abolition of Central Sales Tax (CST). The Committee note that efforts have already been taken by reducing the rate of CST from 4% to 3% with effect from 01-04-2007 and then reducing the rate by one percent in each successive year so as to do away with CST by the year 2010, when the GST is planned to be introduced.

69. The efforts that are needed to be taken by the States to proceed in this direction include, moving towards the Harmonised System of Nomenclature (HSN) based system of taxation and modernization and synchronization of administrative and Information Technology systems with the Centre. In this regard, the Committee note that the Central Government proposes to implement a Mission Mode Project under the National e-Governance Plan for modernization of VAT administration by the States. Also under this project, it is proposed to link assistance to the States harmonizing their VAT systems and procedures. The Committee wish to be apprised of the developments in this regard on a continued basis.

70. The Committee further note that certain legal/constitutional changes need to be made before the introduction of GST. In this regard, they note that drawing up and passing the legal and Constitutional changes demand considerable amount of time, particularly when the process involves extensive consultations and involvement of the States. Hence, the Committee desire the Government to formulate early the plan of action for bringing in the amendments required, keeping in view the stipulated time frame for introducing the GST by 2010.

4. SPECIAL ECONOMIC ZONES (SEZ)

71. The Government have furnished the following regarding the estimated Loss of Revenue/Duty Foregone due to the various tax exemptions extended to Special Economic Zones (SEZ), which are as under:—

The estimated loss of revenue on account of development of SEZs during 2005 – 2010 has been tabulated as per the following tables. The estimated loss of revenue on account of Indirect Taxes is Rs. 48881 Crores and Direct Taxes is Rs. 57,531 Crores, during the above period. Thus the total estimated loss of revenue is Rs. 106412 Crores.

Total Projected Revenue Loss on SEZs for the period 2005-2010

	Export									
	Base year	Incre-mental Growth	Amount of exports from SEZs	profit rate	Estimated deduction		Revenue Loss on Development of SEZ			Total Revenue loss
	I (Rs. In crs.)	II (Rs. In crs.)	III (Rs. In crs.)	IV (Rs. In crs.)	V (Rs. In crs.)	VI Direct Taxes	VII Customs	VIII Excise	IX Service Tax	X
2004-05	361879		18309	20%	3662	1340	0	0	0	1340
2005-06	434255	72376	36403	20%	7281	2451	0	0	0	2451
2006-07	521106	86851	61734	20%	12347	4156	9075	3168	2693	19092
2007-08	625327	104221	148585	20%	29717	10003	9900	3456	2938	26297
2008-09	750392	125065	247596	20%	49519	16668	5775	2016	1714	26173
2009-10	900471	150078	340352	20%	98070	22913	4950	1728	1468	31059
		GRAND TOTAL				57531	29700	10368	8813	106412

Major assumptions for calculation of total projected revenue loss on SEZs for the period 2005-2010.

Column III: The total exports from SEZ for the next 5 years have been derived through the following assumption: 25% of the incremental exports will shift to the SEZ in the 1st year, 50% in the 2nd year, 75% in the 3rd Year and 100% in the 4th year and 10% of the base year export in 2007-08, 20% in 2008-09, 33% in 2009-10 (Base year = 2006-07).

Column IV: Total average margin of profit on exports has been assumed at 20% to arrive at the estimated deduction in column V. The corresponding direct tax loss has been derived in column VI from the estimated deduction in column V.

Column VII: Detailed assumptions and calculations attached in Annexure - B.

Column VIII: Detailed assumptions and calculations attached in Annexure - B.

Column X: The total revenue loss has been calculated by taking the sum total of direct tax revenue loss, Customs and Excise duty loss on materials used in the development of SEZ from green field stage.

72. The Detail of projected indirect revenue loss are as given below:-

Total indirect revenue loss projected in the next 5 years for development of SEZ (2005-2010)

Year	Total Projected Investment in Crs.	Total land cost component (Assuming land cost to be 20% of the total capital investment)	Service cost component of the projected investment (Asssuming service component to be 20% of the total capital investment)	Net capital goods cost component of the project	Customs Revenue loss on SEZ development (Assuming 50% import component in the total capital cost and 10% average customs duty and 16% CVD)	Excise Revenue loss on SEZ development (Assuming 50% import component in the total capital cost and 16% average Central Excise duty and assuming 60% capital investment by SEZ developer and 40% investment in capital goods by SEZ units)	Service Tax	Total Indirect Revenue Loss on SEZ Develop-ment
	I	II	III	IV	V	VI	VII	VIII
2006-07	110000	22000	22000	66000	9075	3168	2693	12243
2007-08	120000	24000	24000	72000	9900	3456	2938	13356

	I	II	III	IV	V	VI	VII	VIII
2008-09	70000	14000	14000	42000	5775	2016	1714	7791
2009-10	60000	12000	12000	36000	4950	1728	1468	6678
Total	360000	72000	72000	216000	29700	10368	8813	48881

Major Assumptions for calculation of indirect revenue loss projected in the next 5 years for development of SEZ (2005-2010)

Column-I: The total projected investment lined up to the first BOA meeting is around 175000 crores. Taking a conservative estimate and assuming the total gestation and development period to be 4 years, the total projected investment has been calculated at Rs. 360000 assuming that maximum investment will be in the first 2 years and subsequently in the next two years the investments will reduce due to a saturation point being achieved between the demand and supply position of SEZs.

Column-II: The total land cost component has been assumed to be 20% of the total cost of the projected investment in SEZ.

Column-III: The service cost component consisting of engineening consultancy, and other services has been taken at 20% of the total cost of the projected investment in SEZ.

Column-IV: The net total cost of Capital goods have been arrived at by deducting the land cost and the service cost component from the total cost of the projected investment in SEZ.

Column-V: Customs revenue loss has been calculated assuming 50% import component in the project and assuming an average customs duty rate of 10% on capital goods since the customs duty on capital goods range from 12.5% to 5%. Therefore an average customs duty rate of 10% and 16% CVD has been taken on capital goods. Though customs duty rate on capital goods may reduce in future, the rise in service tax collection is likely to compensate the fall on account of reduction in customs duty rates.

Column-VI: Excise duty revenue loss has been calculated assuming 50% indigenous components in the project and assuming 60% of the material procured for SEZ will go into the development of the SEZ by the developer and in the infrastructure of the SEZ units and an average excise duty rate of 16% on capital goods has been taken since the excise duty on capital goods are mostly at 16%.

73. The Government have reported that the following factors have been considered for calculating the loss of revenue:-

"**Indirect Tax:**

- The total projected investment lined up to the first BOA meeting is around 175000 crores. Taking a conservative estimate and assuming the total gestation and development period to be 4 years, the total projected investment has been calculated at Rs. 360000 Crores assuming that maximum investment will be in the first 2 years and subsequently in the next two years the investments will reduce due to a saturation point being achieved between the demand and supply position of SEZs. Ministry of Commerce has not disputed the projected investment of Rs. 360000 crores up to 2009-10 in the presentation made before the meeting of EGoM held on 20th December, 2006.
- The total land cost component has been assumed to be 20% of the total cost of the projected investment in SEZ.
- The service cost component consisting of engineering consultancy, and other services has been taken at 20% of the total cost of the projected investment in SEZ.
- The net total cost of Capital goods has been arrived at by deducting the land cost and the service cost component from the total cost of the projected investment in SEZ.
- Customs revenue loss has been calculated assuming 50% import component in the project and assuming an average customs duty rate of 10% on capital goods since the customs duty on capital goods range from 12.5% to 5%. Therefore an average customs duty rate of 10% and 16% CVD has been taken on capital goods. Though customs duty rate on capital goods may reduce in future, the rise in service tax collection is likely to compensate the fall on account of reduction in customs duty rates.
- Excise duty revenue loss has been calculated assuming 50% indigenous components in the project and assuming 60% of the material procured for SEZ will go into the development of the SEZ by the developer and in the infrastructure of the SEZ units and an average excise duty rate of 16% on capital goods has been taken since the excise duty on capital goods are mostly at 16%.

Direct Tax

- The total exports from SEZ for the next 5 years have been derived through the following assumption:

  25% for the incremental exports will shift to the SEZ in the 1st year, 50% in the 2nd year, 75% in the 3rd Year and 100% in the 4th year and 10% of the base year export in 2007-08, 20% in 2008-09, 33% in 2009-10 (Base year = 2006-07)

- Total average margin of profit on exports has been assumed at 20% to arrive at the estimated deduction in column V. The corresponding direct tax loss has been derived in column VI from the estimated deduction in column V.

- The total revenue loss has been calculated by taking the sum total of direct tax revenue loss, Customs and Excise duty loss on materials used in the development of SEZ from green field stage.

The above revenue loss estimates are based on the projected investment lined up for about 70 SEZs approved by Board of Approval (BOA) initially. Since then BOA has approved more than 300 SEZs and a number of applications are under consideration for approval. Taking into account the number of approvals which have been already granted and pending SEZ proposals for approvals, revenue loss on account of development of SEZs alone could increase substantially."

74. The Government have, in their written reply furnished to the Committee, stated what the Approach paper to the Eleventh Five Year Plan had stated about the SEZs, which are as follows:-

"On SEZs, the Approach Paper to the Eleventh Five Year Plan, while mentioning that the SEZ programme has generated good response and that a large number of applications have been approved in-principle, has observed, "However, there are concerns that SEZs primarily focus on real estate, that there is lack of a level playing field between manufacturing units within SEZs and those in the domestic tariff area, and that there can be large loss of revenue on account of tax concessions for exports of goods and services that are already been exported without such concessions. These concerns would need to be addressed and where necessary adequate safeguards put in place."

75. Asked to elaborate as to how the benefits for EOUs and SEZs can be made co-terminus and what benefits that might accrue if the other exporters are provided with a level playing field in case of artificial cap permitting the SEZs, the Government in their written reply stated the following:

"**CBDT**

The suggestion that the benefits for EOUs and SEZs should be made co-terminus has come from certain Chambers of Commerce.

Internationally, it is well recognized that taxes should not be exported so that exports do not become uncompetitive. Therefore, all countries take effective steps/measures to fully rebate the indirect taxes (i.e., excise duty, VAT, retail sales tax and the like). The levy of corporate tax on profits from exports is internationally recognized as a levy on 'profits' and not on 'exports' and, therefore, such taxes are never rebated. Any rebating/exemption of direct taxes is considered as a subsidy and can be countervailed by the importing country. In such a situation, this leads to transfer of tax revenues to the foreign treasury without any commensurate benefit to the exporters. Our fiscal policy on exports is fundamentally embedded in this economic principle. Accordingly, with the liberalization of the foreign exchange market, the various profit-linked tax incentives under the Income-tax Act were phased out and the indirect tax system reviewed/refined to eliminate the burden of indirect taxes on exports."

76. The Government in their written reply have quoted what the PM's EAC recommended on the issue of taxation of export profit, which is furnished below:

"We recognize the importance of exports to our economy. However, our long-term export competitiveness must be built on comparative advantage and not on the back of tax concessions. There was a case for extending such tax concessions in the pre-reform regime when exporters faced severe disadvantage but that rationale is now thinning out. Also, over the last 15 years, the manufacturing sector has had time to adjust to the global forces of competition and has done so remarkably well. The sunset clause under section 10B will become operational only in FY 2009-10. EOUs have had sufficient notice of this and also there is still time ahead to plan and adjust. Moreover, Department of Revenue's argument about the need to raise the tax-GDP ratio is quite compelling. Under the circumstances, we see no reason for withdrawing the sunset clause under section 10B."

77. The Committee during the oral evidence raised a point on whether the Domestic Tariff Area (DTA) Units are given level playing field *vis-a-vis* the Special Economic Zones (SEZ), to which the Government in their written reply stated the following:

> "However, the SEZ units are also permitted sales in DTA market on payment of applicable Customs duty…..Since the goods and services produced by SEZ are likely to be cheaper than direct imports this may have potential to hurt the interests of the DTA units.
>
> Some of the illustrative examples of comparative advantages of SEZ units over DTA units are as under:
>
> - Developers of SEZ and units located in SEZ are entitled to receive excisable goods, imported goods and taxable services required for authorised operations without payment of taxes. No such facility is available for domestic manufacturers or service providers of similar goods or services. This impact on the cash flow of the domestic manufacturers or service providers on account of payment of input taxes at the time of receipt would increase his cost *vis-a-vis* cost of a product from a SEZ unit.
> - If the goods received without payment of taxes are not utilised within a period of one year, appropriate duty has to be paid as if the goods have been removed to DTA on the date of expiry of the said validity period. If the goods are diverted to DTA, SEZ unit is only required to pay tax after a period of one year without any interest and penalty and whereas the domestic manufacturers in similar cases will have to pay both interest and penalty. It, thus, provides incentive for delayed payment and undue financial accommodation.
> - Goods from SEZ may be removed to the DTA on payment of applicable rate of import duty. Where the import duty on goods supplied by an SEZ unit to DTA is fully exempted or less than the duty on imports, the SEZ unit does not pay any input tax and whereas the domestic manufacturer of similar finished goods would suffer all input taxes and thus be in a competitive disadvantageous position.
> - As per the existing SEZ policies, units in SEZ are eligible to get duty free inputs even if the final products, such as electrical energy, are fully exempt from customs duty. In such cases, the products are zero rated even if they are

cleared for DTA consumption. Domestic units producing such products get only exemption from value addition and no relief of duties on inputs. This makes the domestic producer economically unviable and makes migration of units from DTA to SEZ. At present, zero rating of duties is available only for exports. SEZ provisions virtually extend zero-rating of goods supplied by SEZ unit to DTA where the goods supplied are fully exempted from both customs and excise duties.

- There are large number of products which are fully exempt from both customs duty and excise duty such as life saving drugs, electrical energy, IT products. In all such cases, domestic manufacturers will be in a competitive disadvantageous position.

As regards provision of services from DTA to SEZ and from SEZ to DTA in the absence of clear cut legal provisions to determine place of provision of services, it is difficult to enforce such provisions. It is also difficult to link input services for a given output in view of its intangible nature. This will lead to disputes and misuse. At present, there is no provision under SEZ Act or Rules explaining place of provision of services. It is necessary to provide place of provision of services where the transaction takes place between two taxing jurisdictions. Absence of a clear cut provision on such issue would have adverse impact both on domestic producers of services."

78. The Committee observe that issues relating to Special Economic Zones (SEZs) have given rise to certain problems, which, inter-alia, include problems relating to land acquisition, displacement and rehabilitation etc. There have also been concerns expressed among various trade bodies about the status and benefits that accrue to SEZs and consequential disadvantages to the domestic units.

79. The Committee, in this regard, feel it important to take note of the observation made in the Approach Paper to the Eleventh Five Year Plan which states that there 'is a lack of level-playing field between manufacturing units within SEZs and those in the domestic tariff area, and that there can be large loss of revenue on account of tax concessions for exports of goods and services that are already been exported without such concessions'. Also, from the Government's own admission, and the illustrative examples of comparative advantages of SEZ units over DTA units (Domestic Industries), as furnished, it is very much evident that the DTA units are in very disadvantageous position.

80. From the figures provided on the expected revenue loss on account of tax exemptions extended to SEZs, the Committee observe that the likely loss of tax revenue is expected to rise from year to year and would stand at a whopping one lakh six thousand four hundred and twelve crore rupees by the year 2009-10.

81. In view of the above, the Committee strongly express the necessity to fix strict compliance requirements in such a way that the domestic industries do not stand to loose. Therefore, while noting that the Government have recently revised the guidelines relating to SEZs in respect of size and acquisition of land etc., the Committee are of the opinion that the tax exemptions applicable for SEZs should have definite 'sunset clauses' and strict export obligations.

5. REVENUE COLLECTIONS

82. Revenue Collections of Customs, Central Excise, Service Tax and FTT/IATT during the years from 2001-02 to 2005-06 as furnished by Government are as follows:

Achievement in Revenue collection

(Rs in Crore)

Sl. No.	Head	2001-02	2002-03	2003-04	2004-05	2005-06
1	2	3	4	5	6	7
I	CUSTOMS					
	BE	54822	45193	49350	54250	53182
	RE	43170	45500	49350	56250	64215
	Actuals	40268	44852	48629	57611	65067
	% achievement of BE	73.45%	99.25%	98.54%	106.20%	122.35%
	% achievement of RE	93.28%	98.58%	98.54%	102.42%	101.33%
	% growth over last year collection	-15.30%	11.38%	8.42%	18.47%	12.94%
II	UNION EXCISE					
	BE	81720	91433	96791	109199	121533
	RE	74520	87383	92379	100720	112000
	Actuals	72555	82310	90774	99125	111226
	% achievement of BE	88.78%	90.02%	93.78%	90.77%	91.52%
	% achievement of RE	97.36%	94.2%	98.3%	98.4%	99.31%
	% growth over last year collection	5.88%	13.44%	10.28%	9.20%	12.21%
III	SERVICE TAX					
	BE	3600	6026	8000	14150	17500
	RE	3600	5000	8300	14150	23000
	Actuals	3302	4122	7891	14200	24039
	% achievement of BE	91.72%	68.4%	98.64%	100.35%	131.74%

1	2	3	4	5	6	7
	% achievement of RE	91.72%	82.4%	95.07%	100.35%	100.24%
	% growth over last year collection	26.37%	24.83%	91.44%	79.95%	62.36%
IV	**FTT/IATT** *					
	BE	850	1050	1115	Nil	
	RE	965	1050	900		
	Actuals	1193	1324	1306		
	% achievement of BE	140.35	126.10%	117.13%		
	% achievement of RE	123.63	126.10%	145.11%		
	% growth over last year collection	5.30%	10.98%	-1.36%		
V	**ALL INDIRECT TAXES**					
	BE	140992	143702	155256	177599	192215
	RE	122255	138933	150929	171120	199215
	Actuals	117318	132608	148600	170936	199348
	% achievement of BE	83.21%	92.28%	95.71%	96.25%	103.71%
	% achievement of RE	95.96%	95.4%	98.5%	99.9%	100.07%
	% growth over last year collection	-2.08%	13.03%	12.06%	15.03%	16.62%

* The FTT/IATT has been abolished w.e.f. 09-01-2004.

Note: Revenue Collection for 2005-06 is provisional.

83. Asked to state the reasons for Shortfall in the Central Excise Duty Collection, the Government stated as follows:

> "Actual collection of revenue *vis-a-vis* the estimates/targets depends upon various factors. Revenue collection is a function of industrial growth, inflation rate and fluctuation in the prices of commodities. It is not always feasible to identify any specific reason for shortfall in the collection of revenue. The estimates are based upon certain parameters which, if not achieved in the economy, may result in not achieving the estimates."

84. The Government in a written reply stated that the following important steps have been taken to enhance the buoyancy of Central Excise Duty collections since 2002-03 (and also in the current year):-

- Regular monitoring of revenue trends from the level of range offices in the field up to the Chief Commissioner/Board's office.
- A watch on production and clearance trends of top revenue-yielding commodities.
- Monitoring of defaults in monthly payment of duty.
- A broad correlation between receipt and utilization of principal raw materials and production to guard against misuse of CENVAT facility as also suppression of production and clearances.
- Regular review of CENVAT credit availment and utilization trends and follow up action in cases of any disproportionate CENVAT availment.
- Ensuring that there is no mis-declaration or misuse regarding availment of conditional exemptions.
- A watch on generation of byproducts and wastes/scraps/ rejects to ensure that no dutiable items escape payment of duty.
- More scientific working of anti-evasion parties with better cultivation of informers, collection of intelligence and proper targeting of delinquent units including 100% EOUs etc.
- Identification of commodities and assessees with reference to different modus operandi like suppression of production, clandestine removal, misuse of CENVAT credit and mis-declaration of assessable values for focused enforcement.
- The effective implementation of the internal audit scheme with constant improvement in the quality of audit.
- The ranges, divisions, anti-evasion parties and internal audit parties to work in harmony for achieving the common goal of combating evasion and giving positive guidance to all bonafide assessees.
- Senior officers to frequently interact with important assessees and trade associations so that genuine taxpayers may be helped and tax compliance enhanced.

- Through frequent inspections or visits to the lower formations, the senior officers are required to regularly assess the performance and get the deficiencies removed.
- Expeditious finalization of pending appeals with Commissioner and Commissioner (Appeals), and provisional assessments.
- Priority to be given to cases with higher revenue implications and older cases.
- Effective handling of appeals before courts and Tribunal as also applications before the Settlement Commission.
- The targets for recovery of arrears of revenue assigned to each zone under the Chief Commissioners. A multi-pronged action plan for recovery is being implemented. A Task Force under a Chief Commissioner at Delhi and six nodal Commissioners posted at different location across the country created for effective action in this behalf.

85. The system of self-assessment in Central Excise and relaxation of day-to-day procedural controls have placed additional responsibility of compliance verification with audit and anti–evasion wings functions of the department.

86. With regard to Audit, the Department has adopted the following work plans:

- Updation of Central Excise & Service Tax Audit Manual.
- High Impact Audits based on focused selection of assessees.
- Audit of registered dealers.
- Improving Audit Quality by upgrading auditor skills, improving process compliance such as Quality of Working Papers.
- Greater coordination between DG (Audit) and DG (CEI).

87. The following measures as stated by the Government in their written reply are proposed to be taken to improve the performance of Anti-evasion:

- Concentrate on quality cases having large revenue stakes and/or those having recurring effect.
- Replicating cases having distinctive features and revenue potential.
- Strengthening of informer network.
- Developing strategic intelligence for specific units, specific sectors and specific industries.
- Commodity-specific studies with an anti-evasion perspective.

- Maximize voluntary payments during investigation.
- Greater interaction with Commissionerates, particularly for CENVAT credit cases.
- Dissemination of intelligence by issue of *modus operandi* circulars.

88. Deterrence Measures in Central Excise that are stated to have been taken by the Government are as under:

> "Rule 12CC has been introduced in the Central Excise Rules, 2002 and rule 12AA in the CENVAT Credit Rules, 2004 to provide for withdrawing of certain facilities or restricting utilization of credit by units involved in tax evasion of serious nature exceeding Rs. 10 lakh. Facilities such as monthly payment of duty can be withdrawn or utilization of CENVAT credit can be restricted for a specified period. The department can also place the factory of a manufacturer under physical control, if he is found to be indulging in similar offence for the second time and for all subsequent offences. As far as possible within 30 days after the detection of the case, the Commissioner is required to forward the proposal for initiation of such action to zonal Chief Commissioner. The Chief Commissioner, after due consideration of the facts of the case, the evidence relied upon by the Commissioner, will give the manufacturer, dealer or exporter an opportunity to be heard. The final proposal is to be forwarded by the Chief Commissioner alongwith his recommendation to the Member (CX), CBEC (Central Board of Excise and Customs), who will pass the order."

89. The revenue collection from April, 2006 to February, 2007, as furnished by the Government is given below:

(Rs. in crore)

Indirect Taxes	2006-07				
	Budget Estimate	Revised Estimate	Revenue Collection up to Feb. 07 (Provisional)	%age of BE achieved	%age of RE achieved
Customs	77066	81800	77693	100.8	95.0
Central Excise*	117967	116231	101571	86.1	87.4
Service Tax	34500	38169	29801	86.4	78.1
Total	229533	236200	209065	91.1	88.5

Note: Service Tax revenue collection is as per the figures provided by Pr.CCA.
* Excluding cess administered by other departments. BE and RE for the same for 2006-07 are Rs. 1033 crore and Rs. 1035 crore respectively.
If the present trend continues, RE for 2006-07 is likely to be achieved.

90. In their post-evidence reply the Government have furnished the following as the factors affecting growth of Central Excise revenue:—

"The growth of Central Excise revenue since 2000-01 has been 10.7%, 5.9%, 13.4%, 10.3%, 9.2% and 12.2%. The details are tabulated below:

Year	Central Excise Revenue collection (Rs crore)*	% growth over previous year
2000-01	68526	10.7%
2001-02	72555	5.9%
2002-03	82310	13.4%
2003-04	90774	10.3%
2004-05	99125	9.2%
2005-06	111226	12.2%

*inclusive of cesses administered by other Departments.

In the year 2006-07, the growth in the Central Excise revenue is likely to be less than 6%. The main factors adversely affecting the growth of the Central Excise revenue are:

(a) Impact of area-based exemption : The area-based exemption was first granted to the North-Eastern States in July, 1999. Since then it has been gradually expanded to Kutch, Jammu & Kashmir, Uttrakhand, Himachal Pradesh and Sikkim. The revenue foregone is estimated to be Rs. 1405 crore, Rs. 2770 crore and Rs. 5848 crore for 2003-04, 2004-05 and 2005-06 respectively.

(b) The duty payment from CENVAT account has been growing at a faster rate than the PLA payment in the last few years. The reasons for the same include:

Credit of Special Additional Duty of Customs of 4%: This duty has been made applicable to all imports since the 2006-07 Budget. Since credit of this duty is available to the manufacturers, the CENVAT pool has considerably increased.

Credit on input Services: From September, 2004, the cross-utilisation of credit of duty paid has been permitted across goods and services. This has increased the proportion of credit availment.

Impact of exports: Credit relatable to inputs used for manufacturing export goods can be used for duty payment on domestic clearances

and if the same is not possible, it is allowed as cash refunds. This further lowers the revenue receipts.

Cross-utilisation of AED (GSI) credit: In 2003, the credit of Additional Duties of Excise (GSI) was made eligible for payment of other duties (retrospectively from 1.4.2000) as clarified in Budget 2004 giving *inter-alia* rise to utilisation of accumulated credits.

Credit availability on capital goods: Setting up of new units/ plants or technology upgradation would immediately result in greater availability and utilisation of credit on capital goods. Theoretically, this should translate into greater production and revenue, but such effects are delayed due to substantial CENVAT availability.

Liberalization of CENVAT credit scheme: The CENVAT scheme has been progressively liberalized such as condonation of procedural requirements for taking credit, availability of credit on dealers' invoice, no requirement for installation and actual commissioning of capital goods for utilisation of the credit, etc."

91. The Committee take note of the fact that performance of revenue collections in so far as Central Excise Duty is concerned, has not been very encouraging. They also observe in this regard, that Central Excise Duty collections is the only revenue source from which, irrespective of continued lowering of Revised Estimates vis-à-vis the Budget Estimates, the collections have always been on the lower side.

92. The reasons adduced by the Central Board of Excise and Customs (CBEC) for the shortfall in excise duty collection include, industrial growth, inflation rate and fluctuation in the prices of commodities, which the Committee do not find to be convincing. The Committee are of the view that high industrial growth and the rise in prices of commodities should have had the effect of favouring higher duty collections. What the Committee find to be surprising is that despite the many special efforts informed to have been taken by the Department, there has been a continuous shortfall in meeting the collection targets and a downward revision of the targets at the stage of revision of estimates of duty collections. While the Committee acknowledge the submission of the Government on the deemed revenue loss due to the various exemptions provided they also believe that these factors could have been adequately taken into consideration while estimating the particular tax income for various years. The Committee, therefore, expect that valid and demonstrably factual reasons are given for the failure on the part of the Department on this count.

6. ARREARS OF REVENUE

Central Board of Direct Taxes

93. The Committee raised a point to furnish the target for the year 2006-07 for realisation of Income-Tax arrears to which the Government in their written reply stated as follows:

> "An internal target of Rs. 11,741 crore has been fixed for the Income Tax Department for realization of arrears of taxes."

94. Asked about the achievements of the Department in the realization of the arrears, the Government have furnished the following reply:

> "Till December 2006, an amount of Rs. 8,897 crore (76% of the target) has been recovered from the arrears. Considering the present trends, the Income Tax Department is likely to achieve the annual target of recovery."

95. The Committee raised the point as to what are the special efforts that are being taken apart from the regular efforts, to which the Government in their written reply stated as under:

> "Central Board of Direct Taxes is constantly evolving strategies and policies for collection or liquidation of arrears. The strategies as adopted by the Board for the current financial year include the following:
>
> - Identification of worthwhile cases where recovery of arrears can be made during the course of the financial year through special efforts.
> - Identification of high-demand cases pending before the Commissioners (Appeals) and ITAT, particularly the ones where recovery of substantial demand is likely on disposal of appeal and requesting the Commissioners (Appeals) for early disposal of such cases.
> - Liaising with the Settlement Commission for early disposal of cases involving high demand and monitoring collection of resultant demand during the financial year itself.
> - Tax Recovery Officers to exercise the powers for appointment of receiver for business under the provisions of rule 69 of Schedule II of the Income-tax Act for effecting recovery in suitable cases.

- In respect of non-compliant defaulters, the provisions of arrest and detention as per the provisions of rules 73 to 81 of Schedule II to be invoked by the TRO.
- Demand to be recovered forthwith in cases where favourable Tribunal/ Court orders are received.
- Investigation Wings at the important centers to aid the recovery process by way of conducting surveys and/or secret enquiries to identify the assets for recovery in important cases.

96. The Chairperson, CBDT during the oral evidence has explained about the position of Income Tax Arrears as follows:

> "Income-tax arrears as on 1.4.06 were Rs. 1,17,000 crore; as on 1.3.07, they are Rs. 90,069 crore. However, we find that at the end of every year, arrears are increasing. Reasons for the increasing arrears is that in spite of our increasing collections, there are a lot of demand that are under litigation with the courts and the tribunals. Then, there is a lot of demand which is locked up with the special courts; then, the scam cases. Because of these reasons we are not able to make any recovery."

97. Further, the Committee asked about the extent of recoverable arrears out of the total arrears, the Chairperson, during the oral evidence stated as under:

> "Out of Rs. 90,069 crore arrears, we have estimated that the recoverable amount is only about Rs. 5,838 crore."

98. Asked whether the remaining portion of the arrears are under litigation, the Chairperson stated the following:

> "Yes. Cases are before the Settlement Commission, BIFR, under litigation. They are all involved in some or the other cases. We have given the details in the papers as to why demands are difficult to recovery."

Central Board of Excise & Customs

99. The target for realization of indirect tax arrears, as furnished by the Government, during the year 2006-07 are as under:

Central Excise	:	Rs. 1300 crore
Customs	:	Rs. 650 crore
Service Tax	:	Rs. 500 crore
Total	:	**Rs. 2450 crore**

100. Upto December, 2006, the performance of the Department in the collection of indirect tax arrears is as under:

Central Excise	:	Rs. 873.95 Crores	67.23% of Target
Customs	:	Rs. 757.40 Crores	116.52% of Target
Service Tax	:	Rs. 634.39 Crores	126.88% of Target
Total	**:**	**Rs. 2265.74 Crores**	

101. Asked about the special efforts taken by the Central Board of Excise and Customs, the Government in their written reply have furnished the following:

> "The Central Board of Excise and Customs has constituted a Centralized Task force under a Chief Commissioner to coordinate, facilitate, monitor and oversee the efforts of the Customs and Central Excise field formations towards recovery of arrears of revenue. The Chief Commissioner (Tax Arrears Recovery) has formulated an Action Plan for recovery of arrears during 2006-07 and sent to all the Zonal Chief Commissioners for taking suitable action. Regular monitoring is being done at different levels.
>
> Important measures being taken for expediting realization of arrears are as under:
>
> - Immediate recovery of arrears free from restraints.
> - All orders favourable to revenue passed by the Tribunal / Courts are being circulated to the field officers for immediate recovery of connected revenue.
> - Cases strong on merits and involving high stakes of revenue have been identified and miscellaneous applications filed for early listing/hearing of cases in courts.
> - Major adjudication cases involving substantial amounts of Central Excise revenue are being adjudicated on priority basis."

Recovery of Arrears — Central Excise

102. The details of recovery of arrears in Central Excise made *vis-a-vis* the target during the last 3 years as furnished by the Government is as under:

Year	Target (Rs. in crore)	Actual realization (Rs. in crore)
2004-05	2250	1799.38*
2005-06	1682.40	1657.94
2006-07 (upto 31.12.2006)	1300	873.95

*Figures of Service Tax also included.

103. The Government in their written reply have stated about the reasons for non-realization of arrears of revenue as under:

- "Stay orders by Supreme Court, High Courts, CESTAT, Commissioner (Appeals), etc. in cases pending before them;
- PSU cases pending with COD, Cabinet Secretariat;
- Cases registered with BIFR;
- Cases, which are under the control of Official Liquidator or Court Receiver;
- Cases where assets have been taken over by banks or financial institutions;
- Cases where defaulters are not traceable or assets are not available;
- Cases where permissible appeal period is not over or stay application is pending."

104. The Government in their written reply have stated that as part of arrears collection drive, the following measures have been taken to monitor and expedite recovery of arrears:—

- "A special Task Force (Tax Arrears Recovery) under a Chief Commissioner of Customs and Central Excise has been set up to coordinate, facilitate, monitor and oversee the progress in the recovery of arrears. Six Zonal Units of the Task Force have also been set up for local monitoring on regular basis.
- Immediate recovery of arrears free from restraints.
- All orders favourable to revenue passed by the Tribunal / Courts, including stay orders based on pre-deposits by the assessees are being circulated to the field officers for recovery of connected revenue.
- Cases strong on merits and involving high stakes of revenue have been identified for filing of miscellaneous applications for early listing/hearing of cases in CESTAT.
- Major adjudication cases involving substantial amounts of Central Excise revenue are being adjudicated on priority basis."

105. The Committee raised a point about the factual position *vis-a-vis* the year 2006-07, to which the Government in their written reply have stated the following:

"The Budget Estimate for Central Excise arrears collection for 2006-2007 is Rs. 1300 crore. The actual arrears collection upto February,

> 2007 is Rs. 1165.35 crore, which is 89.64% of the Budget Estimate. The Budget Estimate for 2006-07 is expected to be achieved by the end of current fiscal year."

106. The Chairman, Central Board of Excise and Customs, during the oral evidence have stated the following about the position regarding realization of arrears of revenue:

> "Arrears admittedly have been going up from year to year. If I may quote certain figures, as on 1st April, 2005, the total arrears in indirect taxes were Rs. 15659.09 crore. As on 1st April, 2006, arrears amount was Rs. 21,593.43 crore. As on 1st March, 2007 arrears were Rs. 26024.78 crore.
>
> At the same time, I would like to apprise the Committee that concerned about the arrears, the Department has been making efforts to realize the recoverable arrears. These arrears has two portions – stayed and unstayed arrears. For example, as on 1.3.07, out of the total Rs. 26,024.78 crores, Rs. 10,207.80 crore is the stayed arrears and Rs. 10,114.8 is under BIFR/DRT/OL/COD. We come back to the portion which is recoverable. As on 1st April, our recoverable arrears was Rs. 1985.01; as on 1st April, 2006, it was Rs. 3,742.54 crore; as on 1st March, 2007, it was Rs. 4725.12 crore. We have taken the measures to realize the arrears. Finance Ministry has constituted an authority – Tax Arrears Recovery authority under CBEC, which is headed by an officer of Chief Commissioner's rank. I am happy to tell you that the authority has done a good work during the last three years. In 2004-05, we realized Rs. 2,642.87 crore in 2005-06 – Rs. 3,139.65 crore; and in the last year, Rs. 3,466.90 crore. On an average, our recoverable arrears has been around Rs. 3,000 to Rs. 5,000 crore. We have realized about Rs. 3500 crore in 2006-07. We would furnish the figures to the Committee later. We would see that while arrears has been going up, at the same time, our recovery has also been going up."

107. The Committee note that the arrears of revenue, both in respect of direct as well as indirect taxes, have been increasing year after year and huge portion of such arrears are locked up and treated un-realizable due to reasons of pendancy with various adjudicating authorities and settlement mechanisms like Settlement Commission, BIFR etc. The Committee further note that though the respective departments have been making various efforts to realize the arrears, these efforts have not yielded the desired results.

108. Under the Direct Taxes, although the targets fixed for recovery of arrears during 2006-07 are expected to be achieved to a large extent, the Committee are concerned to note that the recoverable portion of such arrears as on 1.3.2007 was just Rs. 5,838 crores which forms a very small part of the total arrears of Rs. 90,069 crores as on date.

109. Under the Indirect Taxes, the Committee note that there has been shortfall in actual realization of Central Excise Duty arrears vis-à-vis the targets fixed during the preceding three financial years despite the various measures stated to have been taken by the Department to overcome the pendancy of cases at various levels.

110. In view of the above, the Committee are of the opinion that much more needs to be done and concerted and serious efforts taken to realize the revenue arrears by expeditious realization of the recoverable arrears; making sincere efforts to have the stays at various appellate bodies vacated; and impressing upon the higher adjudicating authorities to quickly dispose off the cases. Also, the complexity of the tax laws, the Committee feel, lead to such huge amount of litigations and thus such large amounts of tax revenue locked up in various bodies. The Committee, therefore, urge the Government to further simplify the laws and reduce the complexities found in the tax laws in order to reduce the future litigations. In this regard, the Committee desire that the Government bring out the proposed Bill amending the Direct Tax Laws as early as possible, which in their opinion would greatly enhance the effective administration of the Direct Tax Laws and thus reduce the disputes to a great extent.

Demand No. 42.
Department of Revenue
Direct Taxes
Major Head: 2020
Minor Head : 00.001
Detailed Head : 03.00.14

7. RENT RATES & TAXES

111. For payment of rent for the building hired by the Income Tax Department for office accommodation and payment of taxes to local authorities for the building of the Director General of Income Tax (Systems) and Directorate of Income Tax (Organization & Management Services) the following have been provided as under:

(Rs. In thousands)

Year	BE	RE	Actuals
2005-06	31,50	31,20	31,48
2006-07	33,00	50,00	
2007-08	1,00,00		

112. Asked about the actuals for the year 2006-07, the Government in their written reply stated as under:—

> "Appropriation Accounts for the year 2006-07 are yet to be finalized. Actual expenditure for the year 2006-07 is available upto February, 2007 which amounts to Rs. 54,99(000). The increase in expenditure is met out by re-appropriation within the overall RE provision."

113. The reasons for the upward revisions in the RE for the year 2006-07 over the BE of the year, as stated by the Government in their written reply is as follow:

> "The reasons for increase in the RE for the year 2006-07 over the BE of the year is due to enhanced liabilities under Rent, Rates and Taxes committed and incurred by the office of Director General of Income Tax (Systems)."

114. Asked to state why there has been a huge increase in the BE for the year 2007-08, the Government in their written reply stated as under:—

> "The increase in BE 2007-08 is due to the reason that the Budget Estimates are drawn on the basis of anticipated increase in expenditure as compared to the current level *i.e.* Revised Estimates 2006-07. Major reason for the increase is the anticipated liability on account of Aaykar Bhavan, Vaishali, Ghaziabad which is proposed to be developed a modern technology hub of the Income Tax Department."

115. Replying to a query by the Committee whether the rent cannot be assessed beforehand, the Government in their written reply stated the following:—

> "The revision of rent is done on the basis of the Fair Rent Certificate (FRC) issued by the CPWD to be restricted to any specified limit in view of the terms and conditions of the Standard Lease Agreement (SLA). The range of reasonable rent is assessed by the CPWD according to two methods : (a) Recognised Principle of Valuation and (ii) Prevailing Market Rent. The prevailing market rent of a locality is difficult to be assessed beforehand."

116. The Committee observe that the reasons for revising the RE for the year 2006-07 is due to enhanced liabilities under rent, rates and taxes incurred by the Office of Director-General (Systems). However, the Committee do not understand as to why the expenses which can very well be calculated in advance owing to the 'certainty' of their nature have surpassed the BE (2006-07) of Rs. 33 lakhs by almost 70 per cent. Further, they observe that the actual expenditure for the year 2006-07 upto February, 2007 has actually exceeded even the enhanced Revised Estimates. The Committee note that the Government have stated that prevailing market rent of a locality is difficult to be assessed beforehand. However, they do not approve of the very high fluctuation in the expenses. Also, the Government have stated that the increase in expenditure is met out by re-appropriation within the overall RE provision. The Committee do not approve of this kind of adjustment and advise the government to refrain from such transfer of funds.

117. It is also noted that the BE for the year 2007-08 has been doubled viz-a-viz the RE of 2006-07. The reasons adduced for the increase is the anticipated liability on account of Aaykar Bhavan,

Vaishali which is proposed to be developed as a modern technology hub of the Income Tax Department. In this regard, considering the importance of the expenditure, the Committee expect the Government to fulfill the planned expenditure within the allotted resources and in time. They also desire to be apprised about the developments in this regard on quarterly basis.

Demand No. 42.
Department of Revenue
Direct Taxes
Major Head: 2020
Minor Head : 00.101
Detailed Head : 01.00.26

8. ADVERTISING & PUBLICITY

118. For advertising and publicity of Income Tax Department undertaken by the field formations, the following have been provided:—

(Rs. in thousands)

Year	BE	RE	Actuals
2004-05	1,02,68	1,04,00	57,07
2005-06	1,00,00	1,74,50	95,45
2006-07	2,00,00	99,00	
2007-08	1,99,50	-	-

119. Asked about the actuals for the year 2006-07, the Government in their written reply stated as under:—

> "Appropriation Accounts for the year 2006-07 are yet to be finalized. Actual expenditure for the year 2006-07 is available upto February, 2007, which amounts to Rs. 51,81(000)."

120. The Committee raised a point as to why there have been huge variation between BE, RE and Actuals during 2004-05, 2005-06, 2006-07, 2007-08, the Government in their written reply stated the following:—

> "The variation between BE, RE and Actuals during 2004-05 and 2005-06, is on account of less expenditure incurred by the field formations as compared to estimates. However, during 2006-07, the provision has been reduced at the Revised Estimate Stage in line with the trend of expenditure. Budget Estimates 2007-08 have been drawn to meet the enhanced requirement for advertising & publicity campaign for help desks and other schemes, giving advertisements in print as well as electronic media for informing the tax payers about the camps to be organized for accepting the Income Tax Returns. The advertisements are also given in regional languages for educating the tax payers as well as funding for purchases/services etc."

121. The Committee feel that advertising and publicity have an important impact on the public by way of creating awareness about the periodicity and time within which the tax returns are to be filed, punishments that are meted out to tax evaders and as a whole, help in widening the tax base and prevention of tax evasion. The failure to spend the budgeted amount on such an important activity directly impacts the benefits that are derived from such efforts by the Government. The Committee, therefore, regret to note that the Actuals on this account were just half of the Budget Estimates for the years 2004-05 and 2005-06. Moreover, the Revised Estimates is less than half of the Budget Estimates for the year 2006-07 and the Actuals upto February, 2007 is just one-fourth of the Budget Estimates. This the Committee feel, is indicative of failure on the part of the Government to assess the expenditure pattern and fix the Budget Estimates accordingly. The Committee further note that the Government have stated that the Revised Estimates of 2006-07 has been reduced in line with the trend of expenditure i.e. the actuals of the preceding years.

122. The reason given by the Government for the variations between BE, RE and Actuals during the years 2004-05 and 2005-06 is on account of less expenditure incurred by the field formations. The Committee observe that the Government have not done their home work well in assessing the ability and requirements of the field formations, which has resulted in such drastic variations in the Actuals *vis-a-vis* the Budget Estimates. In view of the above, they advise the Government to set pragmatic targets of such expenditure after proper consultation with the field formations and assessment, in future.

Demand No. 42.
Department of Revenue
Direct Taxes
Major Head: 2020
Minor Head : 01.01
Detailed Head : 01.99.13

9. OTHER EXPENDITURE

123. This head is meant is for meeting the expenditure to implement the Comprehensive Computerisation Programme (Perspective Plan) of the Income Tax Department. The programme envisages setting up of all India Income Tax Network connecting all Income Tax Offices in 510 cities in a single database. The following figures have been provided in regard to this head:-

(Rs. in thousands)

Year	BE	RE	Actuals
2005-06	48,00,00	89,40,00	73,46,60
2006-07	138,50,00	74,00,00	35,58,69*
2007-08	142,00,00	-	-

*upto Feb. 2007

124. In regard to the actuals for the year 2006-07, the Government in their written reply stated the following:—

"Appropriation Accounts for the year 2006-07 are yet to be finalized. Actual expenditure for the year 2006-07 is available upto February, 2007 which amounts to Rs. 35,58,69(000)."

125. It is observed from the above table that there have been much fluctuations between BE, RE and Actuals. Asked to state the reasons therefore, the Government informed as follows:—

"The requirement of funds is made keeping in view the progress of computerization programme. However, some of the proposals for purchase of hardware/software and other related equipment could not be finalized before the close of the financial year. Major reason for the fluctuation is on account of delay in finalization of award of the tender for System Integrator (SI) for which a substantial provision was made at BE stage. Similarly, provision

was also made for payments in respect of Taxnet project on account of delays in acceptance of network sites. Accordingly, the projections were re-visited at RE 2006-07 stage and outlay was reduced."

126. The Committee observing that the actual expenditure for the year 2006-07 (upto February, 2007) is Rs. 35,58,69 Thousands, which is less than half of the Revised Estimates for the particular year, wanted to know the reasons for the failure in spending the allocated money. The Government in their written reply stated as under:—

"The actual expenditure for the year 2006-07 upto February, 2007 was Rs. 41, 06,61(000). The amount of Rs. 35, 58,69 (000) does not include the transfer of funds to field offices from out of the funds under the head 01.99.13 (Information Technology). The actual expenditure upto 31st March, 2007 was Rs. 72,89,53(000)"

127. Further, the Committee wanted to know the reasons for delay in finalisation of award of the tender for Systems Integrator, the Government in their written reply stated as under:—

"The delay in award of the tender for Systems Integrator was owing to the fact that the previous tender dated 07.03.2005 had to be cancelled. The fresh tender was issued on 21.08.2006 and has been finalized. The order on the selected vendor has since been placed on 30.03.2007."

128. The Committee note that the expenditure under the Head is to implement the Comprehensive Computerization Programme (perspective plan) of the Income Tax Department which envisages setting up of All India Income Tax Network. The actual expenditure for the year 2006-07 upto February, 2007 amounts to Rs. 35.59 crores which is less than half of the Revised Estimates (Rs. 5.74 crores) for the particular year and just one fourth of the Budget Estimates (Rs. 138.5 crores). The Committee further note that the reasons given by the Government for the much lower Revised Estimates is the delay in finalisation of award of the tender for System Integrator (SI), for which substantial provision was made at BE stage; and on account of delays in acceptance of network sites. However, the Committee are of the opinion that the actual expenditure indicates the failure of the Government to implement such an important programme of computerization, timely implementation of which has been repeatedly emphasized upon by the Government. The Committee have been advising so, considering the advantages that would accrue in the process of Widening of Tax Base, detection and prevention of Evasion of Tax and increasing the tax revenue. Hence, they desire the Government to furnish a status report on the implementation of the computerization programme, explaining the reasons for the delay, within a month.

Demand No.43
Department of Revenue
Indirect Taxes
Major Head: 4216
Minor Head: 01.108
Detailed Head: 01.00.54

10. INVESTMENTS

129. For expenses on acquisition of ready built residential buildings for Customs and Central Excise officials, the following figures have been provided:—

(Rs. in thousands)

Year	BE	RE	Actuals
2004-05	15,00,00	15,00,00	04,82,95
2005-06	20,00,00	10,00,00	5,76,94
2006-07	10,00,00	12,00,00	
2007-08	15,00,00		

130. Asked about the actuals for the year 2006-07, the Government in their written reply stated as under:—

"The actual upto February,2007 is Rs. 2,20,91 thousands. The Final Requirement for 2006-07 is estimated at Rs. 8,50,00 thousands."

131. Break-up of expenditure during the year 2005-06, as furnished by the Government, is as follows:—

(Rs. in thousands)

"(a)	Balance payment in respect of flats at Wadala, Mumbai	5,09,79
(b)	Balance payment in respect of flats at Guwahati	28,92
(c)	Provision of cupboards in flats at Vasant Kunj and Sheikh Sarai, Delhi	11,70
(d)	Maintenance of Raheja Vihar Complex, Pawai, Mumbai	5,84
(e)	Others	20,69
		5,76,94

132. The Government in their written reply stated the following on the expenditure pattern during the year 2006-07 as follows:—

> "During 2006-07, expenditure of Rs. 2,20,91 thousands has so far been incurred in respect of payment of second installment towards flats being constructed by the Allahabad Development Authority. Funds amounting to Rs. 6,16,06 thousands have also been released for various components like upgradation of installations and other facilities in acquired residential quarters."

133. Observing that irrespective of so much less actuals for the year 2005-06 over the BE and RE for that particular year the Committee raised a point as to why the BE for the year 2006-07 was fixed higher. The Government in their written reply stated the following:—

> "BE 2006-07 was fixed keeping in view payment due during 2006-07 in respect of ongoing projects and likely approval for new projects."

134. The Committee asked as to what are the reasons for the upward revision of BE for the year 2007-08 over the BE for the year 2006-07, the Government in their written reply stated as under:—

> "The payment due as per schedule in respect of ongoing projects and stage of approval for new project are the main reasons for provision made in BE 2007-08."

135. The Committee observe that the expenses under the Head are incurred towards acquisition of ready built residential plots for Customs and Central Officers. In this regard, they note that the Revised Estimates (Rs. 12 crores) for the year 2006-07 was raised by 20 percent *vis-a-vis* the Budget Estimates (Rs. 10 crores) of the said year. However, from the replies furnished by the Government, the Committee note that upto February, 2007 only a little more than one-sixth of the Revised Expenditure (Rs. 2,20,91,000) has been actually spent. Further, the Government have stated that the final requirement for the year 2007-08 is estimated at Rs. 8.50 crores which works out to be little more than three fourths of the Revised Estimates for the particular year. This, the Committee feel, breaches the financial discipline required in spending the allocated resources and spread the expenditure evenly throughout the year. The Committee desire that a departmental inquiry be conducted into the trend of expenditure under this Head of account and the report of the inquiry furnished to the Committee within one month.

NEW DELHI;
26 *April,* 2007
6 *Vaisakha,* 1929 *(Saka)*

ANANTH KUMAR,
Chairman,
Standing Committee on Finance.

ANNEXURE I

NOTE ON TAX EXPENDITURES OF THE CENTRAL GOVERNMENT

(Submitted to the Consultative Committee attached to the Ministry of Finance in connection with its meeting held on 10th November, 2006)

I. The FRBM Targets

1.1 The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 requires that Government undertake "appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by 2008-09 and thereafter build up an adequate revenue surplus" The Report of the Task Force on the FRBM Act, 2003 had recognised the fact that due to large revenue deficits and consequential financing of the revenue expenditure of the Government with debt, a major part of the revenue receipts are used up in paying interest on the accumulated debt thus 'crowding out' the legitimate functions of the government. This revenue, which goes towards interest expenditure, could otherwise be spent on the developmental programmes of the government. Further, economists point out that deficit spending can increase inflation, raise interest rates and crowd out private investment.

1.2 The FRBM Act further requires that the revenue deficit must come down by 0.5 percentage points of GDP every year, and the fiscal deficit must come down by 0.3 percentage points of GDP every year, and the fiscal deficit in 2008-09 must be below 3 percent of GDP.

1.3 In this context, the Report of the Task Force on implementation of FRBM gives the base line projections and reform scenario tax projections and under:

Tax	2006-07		2007-08		2008-09	
	Base line	Reform scenario	Base line	Reform scenario	Base line	Reform scenario
1	2	3	4	5	6	7
Direct Taxes	188,283	209,070	229,066	260,565	277,667	320,405
-Income Tax	69,842	74,744	83,299	92,130	99,000	112,042
-Corporate Tax	118,441	134,326	145,767	168,436	178,667	208,363

1	2	3	4	5	6	7
Indirect Taxes	193,764	254,867	210,988	285,735	229,743	320,343
Excise	117,791	130,941	122,733	146,357	140,691	163,507
Customs	59,039	45,342	63,288	48,221	67,843	51,269
Service Tax	16,934	78,584	18,967	91,157	21,244	106,326
Gross Tax collection	382,047	463,937	440,0454	546,301	507,410	643,287
Education Cess	6,432	7,282	7,407	8,575	8,542	10,097
Total Gross Tax	388.479	471,219	447,463	554,875	515,952	653,384
GDP at market price	38,86,039	39,03,426	43,32,934	43,91,355	48,20,389	49,62,231
Total gross tax as % of GDP	10.00%	12.07%	10.33%	12.64%	10.70%	13.17%

2. What needs to be done for achieving FRBM targets?

2.1 The above fiscal prudence goals as enshrined in the FRBM, Act, however, may be difficult to achieve under the existing systems. The following factors need to be kept in view if the FRBM targets are to be achieved:—

- Cumulative impact of tax concessions given (tax expenditure)
- New tax concessions extended
- Increase in subsidies
- Additional funds required for the developmental programmes of the Government.

Among these, tax concessions or tax expenditures are major factors having a strong bearing on revenue collections and thus on revenue and fiscal deficits.

3. What is 'tax expenditure'?

3.1 Tax expenditures are revenue forgone attributable to provisions in the tax laws, which allow a special exclusion, exemption or deduction from taxes or provide a special credit, a preferential tax rate, or defer tax liability. These are also referred to as spending programmes embedded in the tax law having objectives designed to encourage certain kinds of activities, provide incentives or to aid

tax payers in special circumstances. Such tax expenditures, when enacted in the tax code, reduce the amount of taxes to be paid by certain individuals/entities and thereby are foregone tax revenues. In this sense, the fiscal effects of tax expenditure are just like those of direct government expenditure of grants. Tax incentives/exemptions, may thus, be viewed as subsidy payments to preferred taxpayers.

3.2 Various aspects of a tax system including tax concession/ exemptions are reviewed on a continued basis with a goal to improve the fairness, transparency and efficiency of the tax system, meet the priorities of the government and eliminate inefficient and inappropriate tax expenditures. Tax expenditures may be justified when they:

- are more cost effective than a direct expenditure programme
- are appropriately targeted to pursue Government policy
- avoid economic disruptions
- correct market failures
- do not unduly compromise the vertical and horizontal equity principles of taxation
- do not unnecessarily complicate the tax structure.

3.3 To ensure greater transparency and accountability in administration and to present the tax expenditure programmes in the same way in the legislature as other expenditure programmes and budget approval processes, the Finance Minister, while presenting the Union Budget 2006-07, for the first time placed before Parliament a statement of revenue foregone on account of various tax exemptions as part of Receipts budget. This statement clearly indicates that but for the exemptions, the revenue realization would have been much more, and this surely accounts for our low tax to GDP ratio.

4. Tax to GDP ratio:

4.1 Central Tax to GDP ratio, measured using central gross taxes, peaked at 10.6% in 1987-88, and dropped sharply to 8.3% in 1998-99. From this level it has risen to 10.5% in 2005-06. Central Tax collection and tax to GDP ratios for the last ten years are given in *Annexure I.*

4.2 The Task Force on FRBM, which studied 51 major countries with a GDP above 100 million USD (in terms of PPP), found that India's Tax to GDP ratio is one of the lowest in the world. The NIPFP Working Paper "Raising the Tax-Ratio by Reigning in 'tax breaks'—An

Agenda for Action" notes that the tax-GDP ratio is yet to reach the level registered in the late eighties. For example, the Tax to GDP ratio (taking the Centre and states together) was 15.2% in 2004 as against 16.1% in 1988.

5. Need to improve Tax to GDP ratio:

5.1 A comparison of tax to GDP ratio of countries like Brazil, Turkey and China, which had more or less similar Tax to GDP ratios in the pre-1990s, shows that while these countries have made significant strides in achieving a higher tax to GDP ratio in the last few years (1996—2000), India has somewhat lagged behind. Common aspects of reform process in these countries involved expending the tax base and rationalizing and improving the efficiency of the tax structure.

5.2 Broadly stated, there are two ways to improve tax to GDP ratio. First is to increase the tax rates and second is to broaden the tax base. However, high tax rates distort economic decisions and fuel the deployment of resources into tax avoidance and tax evasion. A high tax rate is also self-defeating as it increases costs. Besides, the higher the tax rates, the greater is the need for exemption, as a result of which a smaller base has to bear the entire burden of higher revenue. The second option thus has to be preferred. A rational tax system is one with few and low rates. India has, as part of its tax reform process, rationalized and reduced the corporate and personal income-tax rates. With regard to indirect taxes, on a commodity, both Cenvat as well as State VAT/Sales Tax are leviable. The median rates for most items are 16% for Cenvat and 12.5% for State VAT. The total incidence of indirect taxes (Centre and State) at the point of consumption is, however, not 28.5% but around 21% of the retail sale price. This is because while State VAT is levied on the final consumption price, Cenvat is levied only on the ex-factory price. To illustrate, if the final consumption price, inclusive of all taxes is Rs. 100, State VAT will be Rs. 11.2, but the Cenvat will be Rs. 9.6, as excise duty will be charged on the ex-factory price which on an average is estimated at 60% of the retail price assuming that value added after factory gate would be around 40%. Any comparison of VAT in other countries will be meaningful only when we compare the actual incidence of indirect taxes as percentage of the retail price. When viewed like this, our total incidence of about 21% is not much higher than the VAT rate of 21% (equivalent to 17.4% of the retail sale price) in Belgium and Ireland and 20.6% (equivalent to 17.1% of the retail sale price) in France. That being so, the preferable way to improve tax to GDP ratio is to improve the tax base, which would *inter alia* require bringing in more economic

activities and categories of persons within the tax net and removal of existing exemptions so as to broaden the scope of the tax system and bring within its fold, activities and categories of persons which are presently exempt.

5.3 The Kelkar Committee has also observed "the most direct way to raise tax to GDP ratio is to widen the tax base by reviewing and removing to the extent possible the tax exemptions". Such tax reforms, as the Task Force on FRBM has noted, apart from raising tax revenues also "spur higher GDP growth by removing the existing distortions and misallocation of resources". In this context, the Shome Committee has also observed that a concerted effort is required to tap hitherto untapped potential under corporation and personal income tax, target services as a tax base, increase number of assessees, simplify tax structure, reduce tax burden to encourage compliance and improve the efficiency of tax administration.

6. Why tax expenditures are not desirable

6.1 Tax expenditures result in erosion of precious tax base and often remain unquantified and thus unknown. For many decades, the tax base has been whittled away through a steadily escalating range of exemptions.

6.2 Tax expenditures are often resorted to achieve a variety of objectives, not all of which are equally compelling on conceptual grounds. Quite often multiple objectives are intended to be achieved with overlapping tax expenditures.

6.3 Tax expenditures are often less efficient than direct expenditure programmes in promoting intended socio economic goals. They adversely affect allocative efficiency of resources, undermine equity and reduce the progressivity of tax system by benefiting the taxpayers in the upper part of the income distribution. By eroding the tax base they force Governments to rely on high tax rates for revenue which breed evasion and generate pressures for more 'tax breaks'.

6.4 Tax expenditures result in multiplicity of rates and complexity of law and are accompanied with associated problems like rent seeking, increased litigation, classification disputes, increased cost of compliance and tax administration, tax avoidance etc., and push fundamental fiscal reforms to the background. In many cases, the cost of tax expenditure outweighs the benefits or tax expenditure to the economy (if any).

6.5 Both Tax Reforms Committee headed by Prof. Raja Chelliah as well as the Shome Committee have recommended a thorough review

of the tax exemptions/concessions, which exist on grounds of populism. Kelkar Committee has recommended ending the '*exemption raj*'.

6.6 Task Force on FRBM has also noted that as a general policy, when exemptions are removed but relief is justified, the targeted beneficiary may be assisted by upfront transparent budgetary support based on prior stated objective criteria rather than through tax expenditures. For instance, reviewing region specific tax holidays (area based exemptions), the NIPFP Working Paper has noted that better infrastructure and transport and interest subsidies rather than direct tax breaks merit consideration in these areas.

6.7 The Draft Approach Paper to the 11th Five Year Plan titled 'Towards Faster and More Inclusive Growth' notes that to promote industrial growth, taxes and duties should be made non-discriminatory and internationally competitive. In this context, the Paper also observes that the existing incentive programmes such as those available for the North East, J&K, Himachal Pradesh & Uttaranchal need to be reviewed with a view to assessing their impact on industrialization in these regions. It observes that extension of exemption to Himachal Pradesh & Uttaranchal has had an adverse impact on industrial investments elsewhere, including North East, and consideration needs to be given to restrict such incentives only to hilly areas or to replace these incentives by a special programme for roadways and railways in these states.

The Approach Paper further observes that the higher Plan budgetary support needs to be carefully examined, and in principle the resources needed for the same can be mobilized while maintaining prudent levels of fiscal deficit by some combination of the following:

(a) An increase in tax revenues as a percentage of GDP; and

(b) A fall in non-Plan expenditure (including explicit and hidden subsidies) as a percentage of GDP.

7. Existing direct tax expenditures

The direct tax laws provide for a variety of exemptions. These exemptions/deductions have sought to achieve various historical, social or economic objectives. Given below and the major categories of existing tax incentives:

- Incentives for promotion of savings and investment in financial assets in the form of deductions, in the form of exemptions for income and exemptions from long-term capital gains.

- Incentives for regional/industrial development to encourage industrial growth and for purposes of development of backward areas.
- Incentives for foreign exchange earnings/export of goods and services.
- Exemptions for promotion of charitable, religious organizations and other non-profit organisations.
- Incentives for promotion of scientific research and development.
- Exemption for income of funds on the basis of their being pass-through entities.
- Incentives for promotion of NRI inflows, and inflow of foreign technical assistance etc.
- Honouring of international commitments to provide exemptions to certain international bodies.
- Exemptions for certain financial instruments to enable raising of low cost funds by Government.
- Exemptions for promotion of welfare of armed services personnel.
- Incentives for promotion of rural development programmes and projects and schemes for social and economic welfare/uplift of public.
- Accelerated depreciation for capital investment.

8. Existing indirect tax expenditures

8.1 Central Board of Excise and Customs, in the Department of Revenue administers Customs, Central Excise and Service Tax levies. Given below is a brief on existing tax expenditures in the area of these taxes.

A. Central Excise: Central Excise duty exemptions can broadly be categorized as follows:

- Small Scale Sector
- Area Based Exemptions
- Health and family welfare
- Defence and strategic sector

- Goods for educational and R&D/Exhibitions
- Goods manufactured by Rural/Handloom/KVIC Sector
- Supplies to UN projects and diplomatic concessions
- Agro based and food processing sector
- Export Promotion
- Items of mass consumption
- Power generation
- Environmental protection
- Zero rating (exemption to intermediate products when final product is exempt)
- Administrative necessity (like job-work, captive consumption, repairs and reconditioning, technical exemptions, unorganized sector etc.)
- Other miscellaneous exemptions.

B. Customs: Customs duty exemptions can broadly be categorized as follows:

- Items covered under International, bilateral, multilateral Agreements
- Exemption for goods imported by United Nations, International organizations, diplomatic missions etc., projects financed by United Nations, International organizations
- Items relating to health and family planning, rehabilitation aids
- Inputs and intermediates for IT/Telecom sector
- Research and Educational material, computer literacy, sports
- Export promotion related exemptions
- Defence, security related imports
- Machinery, equipment, parts for specific public transport projects, petroleum exploration, R&D etc.
- Technical exemptions, say, re-import
- Other miscellaneous exemptions.

C. Service Tax: Broad categories of major service tax exemptions are as under:

(a) General exemptions

- Services provided to United Nations or other international organizations
- Services provided to of developers of SEZs or a unit located in SEZ
- Services provided to diplomatic mission on reciprocal basis
- Taxable services provided upto a turnover of Rs. 4 lakhs in a financial year, subject to certain specified conditions.

(b) Service specific exemptions

- Services provided in relation to transport of export cargo by aircraft
- Services provided by Goods Transport Agency in relation to transport of eggs, milk, fruits and vegetables
- Interest component of specified banking and financial services
- Business auxiliary service undertaken in relation to diamonds, gemstones and jewellery sectors
- Commercial or industrial construction service in relation to construction of ports
- Activities such as site formation and clearance undertaken in relation to construction of roads, airports, ports and railways.

9. Cost of tax expenditures, method and estimations:

9.1 Estimation of cost (revenue foregone) on account of tax expenditures is the potential revenue foregone that would be realized by removing such expenditures. Estimation of such costs is done based on short-term impact analysis and assuming that the underlined tax base would not be affected by removal of such measures. Cost of each tax expenditure is estimated separately, assuming that all other tax provisions remain unchanged and various tax incentives do not have a compounded impact.

9.2 On indirect taxes side, revenue foregone is estimated as per following formula:

Revenue foregone = Value X (Tariff rate of duty-Effective rate of duty).

Here, tariff rate is the statutory normal rate of duty and the effective rate is the concessional rate of duty.

9.3 On the direct tax side, the major tax expenditures on account of corporate tax, personal income tax and co-operative taxpayers for financial year 2004-2005 are given in the tables below:

Sl.No.	Tax Expenditure	Estimated cost of tax expenditure (Rs. in crores)
1	2	3
	A. Major tax expenditure on corporate taxpayers during financial year 2004-2005	
1.	Export profits of software producing units located in software technology parks (section 10A)	7080
2.	Export profits of units located in Special Economic Zones including Export Processing Zones and Free Trade Zones (section 10A)	1340
3.	Export profits of Export Oriented Units (section 10B)	2320
4.	Profits derived from development of infrastructure facilities, SEZs and Industrial Parks, generation of power, providing telecommunication services (section 80-IA)	5832
5.	Profits derived from housing projects, production of mineral oil, development of scientific research, integrated business of handling, storage and transportation of food grains, industries set up in backward areas (section 80-IB)	11523
6.	Profits derived by units set up in special category states like North-Eastern States, Uttaranchal, Himachal Pradesh and Jammu and Kashmir (section 80-IC)	362
7.	Accelerated Depreciation (section 32)	27077
8.	Weighted deduction for scientific research and development	2318
	Total	57852

1	2	3

B. Tax expenditure on co-operative taxpayers during financial year 2004-2005

1.	Profits of co-operative banks other than primary agricultural credit societies, from banking activities	1534
2.	Profits of primary agricultural credit societies, from banking activities	N.A.
3.	Profits of other primary cooperative societies from milk, marketing of agricultural produce etc.	N.A.
	Total	1534

C. Major tax expenditure on non-corporate taxpayers during financial year 2004-2005

1.	Tax rebate for investment in specified savings instruments	6568
2.	Tax rebate for senior citizens	1446
3.	Tax rebate for women	2121
4.	Interest income on securities, deposits with banks etc.	1560
	Total	11695

9.4 Detailed methodology for estimation of these tax expenditure is given in Annexure 12 of the Receipts Budget for 2006-2007, which forms part of the budget papers laid before the Parliament for the budget 2006-2007. Based on this methodology, the total cost of various revenue expenditures have been estimated for the financial year 2004-05. The projections of tax expenditures for financial year 2005-2006 and 2006-2007 based on a estimation of 20% revenue growth in both the years for both direct and indirect taxes are as follows:

(Rs. in crore)

Sl.No.	Tax	Estimated cost of tax expenditures for 2004-2005	Projected cost of tax expenditure for financial year 2005-2006	Projected cost of tax expenditure for financial year 2006-2007
1	2	3	4	5
1.	Customs	92561		
2.	Central Excise*	12431		

1	2	3	4	5
3.	Service Tax			
4.	Corporate tax	57852	69422	83306
5.	Personal income tax	11695	14034	16841
6.	Cooperative sector related tax payers	1534	1841	Not applicable as incentive has been removed *vide* Finance Act 2006
	Total	176073	85297	100147

*Revenue foregone on central excise side is understated as units, which make only exempted goods, are not registered and are not required to file any returns. Revenue foregone in this case is based on data regarding.

• items, which attract a non-zero effective duty prescribed under a notification.

• fully exempted items, if the unit manufacturing such goods also makes dutiable goods.

Estimated revenue foregone (based on other sources), in respect of certain major excise exemptions during 2004-05 were as under:—

Sl.No.	Details of Exemption	Estimated revenue foregone (Rs. in crore)
1.	Small Scale Industries Exemption.[1]	11,316
2.	Fertilizers.[2]	4,000
3.	Area based exemptions applicable in North Eastern States, J&K, Uttaranchal, Himachal Pradesh and Kuchchh District of Gujarat.[3]	1,502
4.	50% exemption from all duties of excise for North East Oil refineries.3	1,200
	Total	18,018

1. As per a Study conducted by the National Institute of Public Finance & Policy (NIPFP).
2. Estimated on the basis on Crisil Research & Information Services Limited data bank. During 2004-05 sales turnover of 14 major fertilizer Companies was about Rs. 25,573 crore.
3. On the basis of survey floated. Revenue foregone on account of area-based exemptions during 2005-06 was about Rs. 6200 crore (with accompanying loss of about Rs. 1550 crore on direct taxes side).

9.5 SEZ: Apart from the above there will be substantial revenue loss on account of numerous Special Economic Zones. Revenue loss on account of development of SEZs alone for the period 2006-07 to

2009-10 has been estimated at about Rs. 53740 crore for direct taxes, Rs. 48881 crore for indirect taxes. Year-wise details of revenue loss are given in the table below:

(Rs. in crore)

Year	Direct taxes	Customs	Excise	Service Tax	Total
2006-07	4156	9075	3168	2693	19092
2007-08	10003	9900	3456	2938	26393
2008-09	16668	5775	2016	1714	26173
2009-10	22913	4950	1728	1469	31060
Total	53740	29700	10368	8813	102621

Basis for estimating revenue loss due to SEZs is given in Annexure II.

9.6 The above revenue loss estimates are based on the projected investment lined up for about 70 SEZs approved by Board of Approval (BOA) initially. Since then BOA has approved more than 300 SEZs and a number of applications are under consideration for approval. Taking into account the number of approvals which have been already granted and pending SEZ proposals for approvals, revenue loss on account of development of SEZs alone could increase substantially.

9.7 On SEZs, the Approach Paper to the XIth Five Year Plan, while mentioning that the SEZ programme has generated good response and that a large number of applications have been approved in-principle, has observed, "However, there are concerns that SEZs primarily focus on real estate, that there is lack of a level playing field between manufacturing units within SEZs and those in the domestic tariff area, and that there can be large loss of revenue on account of tax concessions for exports of goods and services that are already been exported without such concessions. These concerns would need to be addressed and where necessary adequate safeguards put in place."

10. Review of exemptions:

10.1 Finance Minister in his 2006-07 Budget Speech had stated, "the bane of excise and customs tariffs is the plethora of exemptions", and proposed to remove exemptions (with a few exceptions) that are end-use based or have outlived their utility or need certification or give rise to disputes.

10.2 Government realizes that a number of tax incentives increase the deadweight costs, distort resource allocations and stunt productivity. On the other hand, keeping the need to promote the social and regional development goals of the Government and the need to provide special incentives to targeted groups, tax expenditures may still be justified and on that count some exemptions may be required to be retained for a longer period than others.

10.3 Keeping in view the above guiding factors, Government had undertaken comprehensive review of tax incentives on indirect taxes side in this year's budget and withdrawn a number of tax incentives. Broadly numbers of incentives withdrawn were as under:

Sl.No.	Tax	Number of exemptions
1.	Customs	8
2.	Central Excise	68
3.	Service tax	6

10.4 On the direct tax side, tax benefits available to certain co-operative banks and for income from investment in infrastructure projects and other certain eligible businesses were withdrawn in this year's budget.

10.4 In addition the Government has put 21 customs duty and 54 excise duty exemptions, which can possibly be withdrawn, on website seeking views and comments from all concerned. Once such feedback is received, review of all these incentives will be undertaken.

10.5 As part of its review of the direct tax incentives, the list of exemptions/deductions already existing in the Income-tax Act, 1961 was also posted on the website of the Income-tax department for the purpose of eliciting the views of the stakeholders regarding their continuance/removal. This was intended to generate a public debate on the issue of direct tax exemptions. Several thousand responses were received in this regard. The responses are being compiled in order to carry out a comprehensive analysis of the same.

11. Issues for consideration

11.1 Draft Approach Paper to the 11th Five Year Plan assumes tax to GDP ratio of 13% by 2011-12. Opportunities for raising additional resources through new taxes or higher tax rates may be limited. Tax incentives therefore need to be pruned to achieve the targeted ratio as

also to meet the target set by FRBM Act for elimination of revenue deficit. This will help in increasing the tax base substantially, and would also enable the Government to moderate the tax rates significantly and facilitate movement towards an integrated GST by 2010. The Government plans to have a relook at the existing tax incentives, so as to decide whether such incentives need to be continued in the changed circumstances.

11.2 In conclusion, the essential point is that the greater and deeper exemptions for particular sections of the taxpayers, the greater will be the burden on other sections, resulting in a skewed tax structure. At present, with the existence of a large number of exemptions, we have an anomalous situation in which some sections of the taxpayers at lower levels of income, such as the salaried class, have actually to pay a much higher proportion of their income as tax than others which have the benefit of generous exemptions. In order to achieve an equitable tax structure, based on moderate rates and to generate adequate resources to fund spending on social and physical infrastructure, a close, hard look at the present system of carve-outs and exemptions in favour of particular sections of taxpayers is absolutely essential. As the Mid-Term Appraisal of the Xth Five Year Plan, brought out by the Planning Commission in June 2005, puts it, "tax bases should expand and distorting exemptions further removed." The Task Force on Indirect Taxes had in fact suggested that, in the long run, exemptions may be restricted only to life saving goods, goods of security and strategic interest, goods for relief and charitable purposes, international obligations including contracts and exemption for small scale industries. On the direct tax front, there has been, in recent years, increase in the number of exemptions given sectorally. A national consensus on the approach to be followed, together with a clear time perspective, has become the need of the hour.

STATEMENT OF CONCLUSIONS/RECOMMENDATIONS OF THE STANDING COMMITTEE ON FINANCE IN THE FIFTY-SECOND REPORT

Sl. No.	Para No.	Conclusions/Recommendations
1	2	3
1.	22-27	22. The Committee have noted that there are many tax exemptions extended both under the Direct Tax Laws and Indirect Tax Laws, prominent of which are the area based exemptions. The Government have been, under their policy of doing away with the tax exemptions that are not considered essential, periodically reviewing and discontinuing certain exemptions. Several of the area-based exemptions available under the tax laws have been reviewed and extended periodically by the Government, with the main consideration of being enabling and promoting balanced regional development in the country. With specific reference to area-based exemptions under the Direct Taxes, the Committee note that the Government have *inter-alia* proposed to extend the applicability of the exemptions under Section 80IC of Income Tax Act for industrial undertakings in the North-Eastern States and Uttaranchal and Himachal Pradesh beyond March, 2007 upto March, 2012. The Committee note in this regard that the revenue loss on account of area based exemptions

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		available under the Direct Taxes have increased phenomenally over the period from a sum of Rs. 362 crores 2004-05 to Rs. 2,215 crores in 2006-07, which is a cause for concern.
		23. In the case of area-based exemptions under the Indirect tax laws, the Committee note that while the tax exemptions available have been extended upto March, 2010 in so far as the State of Uttaranchal is concerned, the extension is without any specified time limit for the State of Jammu & Kashmir and the North-Eastern States. The Committee, in this regard, note that the revenue foregone on account of the exemptions extended to these States too has risen phenomenally over the years from Rs. 1405 crores in the year 2003-04 to a sum of Rs. 5848 crores in the year 2005-06. The Committee further observe that as per the Government's submission, such exemptions, if prolonged beyond a stipulated or pre-set period can have the negative effect of migration of established industries from other areas/States to such 'exempted' areas/States. In view of the adverse implications of the exemptions on the revenues of the Government, the Committee recommend for a re-look and thorough analysis of the available exemptions and undertake policy measures *inter-alia* aimed at limiting the applicability of such exemptions to a specified period. The

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		Committee, however feel that till such time the exemptions are applicable, the long pending demands for such exemptions from some of the State Governments on geographic basis need to be considered and decided upon objectively and prudently.
		24. The Committee take note of the fact that a specific recommendation made by them in one of their earlier reports for carrying out a detailed cost-benefit analysis in respect of each of the tax exemptions has been endorsed by the public; and in pursuance thereof, the Government has entrusted the related study to two independent bodies *viz.*, Indian Council for Research on International Economic Research (ICRIER) and the National Institute of Public Finance & Policy (NIPFP). The Committee desire that the Government report the related findings to them as and when the reports are presented.
		25. The Committee also note from the information furnished by the Government that a number of suggestions have been received from the public, which mainly emphasize on the need for continuance of the tax exemptions under Direct Taxes. The Committee expect the Government to decide on the need for continuance of the tax exemptions after taking into consideration, the reports/findings on the cost-benefit analysis of the exemptions currently being undertaken.

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		26. The Committee in this regard also take note of the observations as made by the NIPFP in their Working Paper, and as quoted in the Government's 'Note on Tax Expenditures' that 'better infrastructure and transport and interest subsidies rather than direct tax breaks merit consideration in those areas'. Further, they also take note of the observation of the Draft Approach Paper to the 11th Five Year Plan titled 'Towards Faster and More inclusive Growth' which states that "extension of exemption to Himachal Pradesh & Uttaranchal has had an adverse impact on industrial investments elsewhere, including North-East, and consideration needs to be given to restrict such incentives only to hilly areas or to replace these incentives by a special programme for roadways and railways in these states".
		27. The Committee, therefore, feel that it is perhaps, high time that exemptions are reviewed and limited and that too quickly, as opportunities for raising additional sources through new taxes or higher tax rates are not unlimited and enhanced tax collections are the major contributors towards meeting the target set by FRBM Act for elimination of Revenue deficit. The Government should therefore expedite the move towards a regime wherein tax exemptions are minimal and confined to

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		exceptional cases. The Committee also endorse the view that in the long run, exemptions may be limited to life saving goods, goods of security and strategic interest, goods for relief and charitable purposes and exemption for small scale industries.
2.	52-55	52. Double Taxation Avoidance Agreements are entered into with foreign countries for avoidance of double taxation of income, for exchanging information, help in recovery of income tax and for granting of relief in respect of income on which income tax has been paid under the Income Tax Laws of both the contracting States. Further, such agreements attract foreign investment and help in removing cross-border tax obstacles in order to avoid distortions in trade and investment between countries.
		53. The Committee note that India-Mauritius Double Taxation Avoidance Convention (DTAC) has been a cause of concern for India as the treaty has been used by third country entities to avoid taxation in India. The methods reportedly used to avoid taxes are by means of (i) 'Treaty Shopping' – a situation where the residents of a country instead of making their investments directly in another country, route such investments through a third country which has a favorable treaty with the country in which

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		the investments are made in order to avail the tax benefits under the favourable tax treaty and (ii) 'Round Tripping' – routing of investments by a resident of one country through another country back to his own country to avail tax benefits of DTAA.
		54. The Committee note that the contentious issue India has with the Mauritian DTAC relates to misuse of Article 13 on Capital Gains of the DTAC through which third country entities use Mauritius as a platform for investing in India thereby resulting in 'Treaty Shopping' and 'Round Tripping' by Indian entities moving money out of the country and then getting it back into India through the Mauritian GBC-1 companies. They observe that the misuse of the India-Mauritius DTAC happens because of the fact that capital gains arising to 'residents' of Mauritius from sale of shares of Indian companies are neither taxable in India nor in Mauritius. The worrying factor is that the GBC-1 Companies, which exist only on the files maintained by the management companies that serve as a conduit for routing investments from third countries to India with the objective of taking advantage of the India-Mauritius DTAC, are, treated as 'resident' under the Mauritian Income Tax Laws.
		55. The Committee further observe that there are countries such as

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		Cyprus, Tanzania, Thailand, Indonesia, UAE, Zambia and Syria, with whom India has similar agreements where capital gains tax on alienation of shares is not levied on residents under their domestic law. Of these countries Cyprus and UAE have already reportedly agreed to change to the 'source based' method of taxation. In this regard, the Committee note that at the time of signing the India-Mauritius DTAC, Mauritius was taxing Capital Gains and it was only much later in the 90's that Capital Gains tax was abolished in the Country. They further note that Mauritius has not expressed willingness to consider changing over to 'source based' taxation as it feels the change would affect their offshore financial sector and also hurt their genuine companies. Further, issues relating to bilateral/ international relations too reportedly restrict India from pressurizing Mauritius to accept the change over from 'residence based taxation' to 'source based taxation'. Considering this experience, the Committee recommend that the Government should consider incorporating mandatory clauses in such treaties/agreements to the effect that any consequential changes in the domestic laws carried out after entering into such agreements, which have an adverse effect – directly or indirectly— leading to disadvantageous

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		position, particularly with regard to taxation, would give the contracting States the liberty to, at first pursue the matter with the other contracting State, and in case of non-agreement, enable for withdrawal of such agreements.
3.	66-70	66. Goods and Services Tax (GST) is an integrated, single form of indirect taxation of goods and services throughout the country by both the Union and the States. According to Government, once introduced, the GST would pave way for a simple, transparent and efficient form of indirect taxation throughout the country, doing away with the demerits of the present system. Such a system is expected to minimize costs and disputes apart from facilitating a common market for the whole country thus making the country more attractive for foreign investments. 67. Introduction of such a system requires integration of Central and State Taxes both on Goods and Services. Thus, the process involves integration of taxes on goods and taxes on services on the one hand and of the Central and State Taxes on the other. The Committee observe that the process has already been initiated at both the levels. The States have started moving towards the goal of having an integrated GST by switching over to the system of Value Added Tax (VAT). However, the Committee

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		note in this regard that the State of Uttar Pradesh is yet to join the process and implement VAT. The Committee expect the Government to take up the matter of switching over to VAT System by the State Government vigorously, which would facilitate in introduction of GST as per schedule i.e. April, 2010. 68. For facilitating introduction of GST, the Centre has to move towards a single rate of taxation both for the goods and the services. While some initiatives are stated to have been taken in this direction so far, the Committee trust that the Government will spare no efforts to achieve it in time. The other direct effort to be taken by the Centre, the Committee note, is abolition of Central Sales Tax (CST). The Committee note that efforts have already been taken by reducing the rate of CST from 4% to 3% with effect from 01-04-2007 and then reducing the rate by one percent in each successive year so as to do away with CST by the year 2010, when the GST is planned to be introduced. 69. The efforts that are needed to be taken by the States to proceed in this direction include, moving towards the Harmonised System of Nomenclature (HSN) based system of taxation and modernization and synchronization of administrative and Information Technology systems with the Centre. In this

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		regard, the Committee note that the Central Government proposes to implement a Mission Mode Project under the National e-Governance Plan for modernization of VAT administration by the States. Also under this project, it is proposed to link assistance to the States harmonizing their VAT systems and procedures. The Committee wish to be apprised of the developments in this regard on a continued basis.
		70. The Committee further note that certain legal/constitutional changes need to be made before the introduction of GST. In this regard, they note that drawing up and passing the legal and Constitutional changes demand considerable amount of time, particularly when the process involves extensive consultations and involvement of the States. Hence, the Committee desire the Government to formulate early the plan of action for bringing in the amendments required, keeping in view the stipulated time frame for introducing the GST by 2010.
4.	78-81	78. The Committee observe that issues relating to Special Economic Zones (SEZs) have given rise to certain problems, which, *inter-alia*, include problems relating to land acquisition, displacement and rehabilitation etc. There have also been concerns expressed among various trade bodies about the status and benefits that accrue to

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		SEZs and consequential disadvantages to the domestic units. 79. The Committee, in this regard, feel it important to take note of the observation made in the Approach Paper to the Eleventh Five Year Plan which states that there 'is a lack of level-playing field between manufacturing units within SEZs and those in the domestic tariff area, and that there can be large loss of revenue on account of tax concessions for exports of goods and services that are already been exported without such concessions'. Also, from the Government's own admission, and the illustrative examples of comparative advantages of SEZ units over DTA units (Domestic Industries), as furnished, it is very much evident that the DTA units are in very disadvantageous position. 80. From the figures provided on the expected revenue loss on account of tax exemptions extended to SEZs, the Committee observe that the likely loss of tax revenue is expected to rise from year to year and would stand at a whopping one lakh six thousand four hundred and twelve crore rupees by the year 2009-10. 81. In view of the above, the Committee strongly express the necessity to fix strict compliance requirements in such a way that the domestic industries do not stand to loose. Therefore, while noting that

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		the Government have recently revised the guidelines relating to SEZs in respect of size and acquisition of land etc., the Committee are of the opinion that the tax exemptions applicable for SEZs should have definite 'sunset clauses' and strict export obligations.
5.	91-92	91. The Committee take note of the fact that performance of revenue collections in so far as Central Excise Duty is concerned, has not been very encouraging. They also observe in this regard, that Central Excise Duty collections is the only revenue source from which, irrespective of continued lowering of Revised Estimates *vis-a-vis* the Budget Estimates, the collections have always been on the lower side.
		92. The reasons adduced by the Central Board of Excise and Customs (CBEC) for the shortfall in excise duty collection include, industrial growth, inflation rate and fluctuation in the prices of commodities, which the Committee do not find to be convincing. The Committee are of the view that high industrial growth and the rise in prices of commodities should have had the effect of favouring higher duty collections. What the Committee find to be surprising is that despite the many special efforts informed to have been taken by the Department, there has been a

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		continuous shortfall in meeting the collection targets and a downward revision of the targets at the stage of revision of estimates of duty collections. While the Committee acknowledge the submission of the Government on the deemed revenue loss due to the various exemptions provided they also believe that these factors could have been adequately taken into consideration while estimating the particular tax income for various years. The Committee, therefore, expect that valid and demonstrably factual reasons are given for the failure on the part of the Department on this count.
6.	107-110	107. The Committee note that the arrears of revenue, both in respect of direct as well as indirect taxes, have been increasing year after year and huge portion of such arrears are locked up and treated un-realizable due to reasons of pendancy with various adjudicating authorities and settlement mechanisms like Settlement Commission, BIFR etc. The Committee further note that though the respective departments have been making various efforts to realize the arrears, these efforts have not yielded the desired results. 108. Under the Direct Taxes, although the targets fixed for recovery of arrears during 2006-07 are expected to be achieved to a large extent, the Committee are

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		concerned to note that the recoverable portion of such arrears as on 1.3.2007 was just Rs. 5,838 crores which forms a very small part of the total arrears of Rs. 90,069 crores as on date.
		109. Under the Indirect Taxes, the Committee note that there has been shortfall in actual realization of Central Excise Duty arrears *vis-a-vis* the targets fixed during the preceding three financial years despite the various measures stated to have been taken by the Department to overcome the pendancy of cases at various levels.
		110. In view of the above, the Committee are of the opinion that much more needs to be done and concerted and serious efforts taken to realize the revenue arrears by expeditious realization of the recoverable arrears; making sincere efforts to have the stays at various appellate bodies vacated; and impressing upon the higher adjudicating authorities to quickly dispose of the cases. Also, the complexity of the tax laws, the Committee feel, lead to such huge amount of litigations and thus such large amounts of tax revenue locked up in various bodies. The Committee, therefore, urge the Government to further simplify the laws and reduce the complexities found in the tax laws in order to reduce the future litigations. In this regard, the Committee desire that

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		the Government bring out the proposed Bill amending the Direct Tax Laws as early as possible, which in their opinion would greatly enhance the effective administration of the Direct Tax Laws and thus reduce the disputes to a great extent.
7.	116-117	116. The Committee observe that the reasons for revising the RE for the year 2006-07 is due to enhanced liabilities under rent, rates and taxes incurred by the Office of Director-General (Systems). However, the Committee do not understand as to why the expenses which can very well be calculated in advance owing to the 'certainty' of their nature have surpassed the BE (2006-07) of Rs. 33 lakhs by almost 70 per cent. Further, they observe that the actual expenditure for the year 2006-07 upto February, 2007 has actually exceeded even the enhanced Revised Estimates. The Committee note that the Government have stated that prevailing market rent of a locality is difficult to be assessed beforehand. However, they do not approve of the very high fluctuation in the expenses. Also, the Government have stated that the increase in expenditure is met out by re-appropriation within the overall RE provision. The Committee do not approve of this kind of adjustment and advise the government to refrain from such transfer of funds.

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		117. It is also noted that the BE for the year 2007-08 has been doubled *viz-a-viz* the RE of 2006-07. The reasons adduced for the increase is the anticipated liability on account of Aykar Bhawan, Vaishali which is proposed to be developed as a modern technology hub of the Income Tax Department. In this regard, considering the importance of the expenditure, the Committee expect the Government to fulfil the planned expenditure within the allotted resources and in time. They also desire to be apprised about the developments in this regard on quarterly basis.
8.	121-122	121. The Committee feel that advertising and publicity have an important impact on the public by way of creating awareness about the periodicity and time within which the tax returns are to be filed, punishments that are meted out to tax evaders and as a whole, help in widening the tax base and prevention of tax evasion. The failure to spend the budgeted amount on such an important activity directly impacts the benefits that are derived from such efforts by the Government. The Committee, therefore, regret to note that the Actuals on this account were just half of the Budget Estimates for the years 2004-05 and 2005-06. Moreover, the Revised Estimates is less than half of the Budget Estimates for the year 2006-07 and the Actuals upto

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		February, 2007 is just one-fourth of the Budget Estimates. This the Committee feel, is indicative of failure on the part of the Government to assess the expenditure pattern and fix the Budget Estimates accordingly. The Committee further note that the Government have stated that the Revised Estimates of 2006-07 has been reduced in line with the trend of expenditure i.e. the actuals of the preceding years.
		122. The reason given by the Government for the variations between BE, RE and Actuals during the years 2004-05 and 2005-06 is on account of less expenditure incurred by the field formations. The Committee observe that the Government have not done their home work well in assessing the ability and requirements of the field formations, which has resulted in such drastic variations in the Actuals *vis-a-vis* the Budget Estimates. In view of the above, they advise the Government to set pragmatic targets of such expenditure after proper consultation with the field formations and assessment, in future.
9.	128	128. The Committee note that the expenditure under the Head is to implement the Comprehensive Computerization Programme (perspective plan) of the Income Tax Department which envisages

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		setting up of All India Income Tax Network. The actual expenditure for the year 2006-07 upto February, 2007 amounts to Rs. 35.59 crores which is less than half of the Revised Estimates (Rs. 5.74 crores) for the particular year and just one fourth of the Budget Estimates (Rs. 138.5 crores). The Committee further note that the reasons given by the Government for the much lower Revised Estimates is the delay in finalisation of award of the tender for System Integrator (SI), for which substantial provision was made at BE stage; and on account of delays in acceptance of network sites. However, the Committee are of the opinion that the actual expenditure indicates the failure of the Government to implement such an important programme of computerization, timely implementation of which has been repeatedly emphasized upon by the Government. The Committee have been advising so, considering the advantages that would accrue in the process of Widening of Tax Base, detection and prevention of Evasion of Tax and increasing the tax revenue. Hence, they desire the Government to furnish a status report on the implementation of the computerization programme, explaining the reasons for the delay, within a month.
10.	135	135. The Committee observe that the expenses under the Head are incurred towards acquisition of ready built residential plots for

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		Customs and Central Officers. In this regard, they note that the Revised Estimates (Rs. 12 crores) for the year 2006-07 was raised by 20 percent *vis-a-vis* the Budget Estimates (Rs. 10 crores) of the said year. However, from the replies furnished by the Government, the Committee note that upto February, 2007 only a little more than one-sixth of the Revised Expenditure (Rs. 2,20,91,000) has been actually spent. Further, the Government have stated that the final requirement for the year 2007-08 is estimated at Rs. 8.50 crores which works out to be little more than three fourths of the Revised Estimates for the particular year. This, the Committee feel, breaches the financial discipline required in spending the allocated resources and spread the expenditure evenly throughout the year. The Committee desire that a departmental inquiry be conducted into the trend of expenditure under this Head of account and the report of the inquiry furnished to the Committee within one month.

APPENDIX

MINUTES OF THE NINETEENTH SITTING OF STANDING COMMITTEE ON FINANCE

The Committee sat on Monday, 2 April, 2007 from 1100 hours to 1400 hours and 1500 to 1830 hours.

PRESENT

Shri Ananth Kumar—*Chairman*

MEMBERS

Lok Sabha

2. Shri Jaswant Singh Bishnoi
3. Shri Gurudas Dasgupta
4. Shri A. Krishnaswamy
5. Dr. Rajesh Kumar Mishra
6. Shri Madhusudan Mistry
7. Shri Rupchand Pal
8. Shri P.S. Gadhavi
9. Shri R. Prabhu
10. Shri K.S. Rao
11. Shri Jyotiraditya Madhavrao Scindia
12. Shri A.R. Shaheen
13. Shri G.M. Siddeshwara
14. Shri M.A. Kharabela Swain

Rajya Sabha

15. Shri Santosh Bagrodia
16. Shri Yashwant Sinha
17. Shri Mangani Lal Mandal
18. Shri C. Ramachandraiah
19. Shri Vijay J. Darda
20. Shri S. Anbalagan

SECRETARIAT

1. Shri P.K. Grover — *Joint Secretary*
2. Shri S.B. Arora — *Deputy Secretary*
3. Shri T.G. Chandrasekhar — *Deputy Secretary*
4. Shri M.L.K. Raja — *Under Secretary*

Part I
(1100 to 1400 Hours)

WITNESSES

Ministry of Finance (Department of Revenue)

1. Shri K.M. Chandrasekhar, Revenue Secretary
2. Dr. Parthasarathy Shome, Adviser to FM

HQ Division (DOR)

1. Shri K. Mohandas, Additional Secretary (Revenue)
2. Shri Mukul Singhal, Joint Secretary (Revenue)
3. Shri L.K. Gupta, Joint Secretary (States Taxes)
4. Ms. Jagjit Pavadia, Narcotics Commissioner
5. Shri Ajesh Kumar, CCF

Central Board of Excise and Customs (CBEC)

1. Shri V.P. Singh, Chairman (EC)
2. Shri Sushil Shingal, Member (P&A)
3. Shri P.C. Jha, Member (CX/ST)
4. Shri A.K. Raha, Member (L&J/Comp.)
5. Shri J.K. Batra, DG (Safeguards Trade Facilitation)
6. Shri A.P. Kala, DG (Revenue Intelligence)
7. Shri Y.G. Parande, DG (System)
8. Shri Gautam Ray, Joint Secretary (TRU-I)
9. Shri R. Sekar, Joint Secretary (TRU-II)
10. Shri Sushil Solanki, Commissioner (Central Excise)

Central Board of Direct Taxes (CBDT)

1. Ms. Indira Bhargava, Chairperson
2. Shri R. Prasad, Member (R&V)
3. Shri R. Ranvijay Singh, Member (IT)
4. Shri P.K. Misra, Member (Inv.)
5. Shri B.M. Singh, Member (P&A)
6. Shri A.J. Majumdar, Member (L&C)
7. Shri S.S. Gandhi, DG (System)
8. Ms. Anita Kapur, J.S. (TPL-I)

9. Shri Arbind Modi, J.S. (TPL-II)
10. Ms. Poonam Dutt, J.S. (FT & TR-II)

Integrated Finance Unit

1. Shri Deena Dayalan, JS & Financial Adviser (Finance)
2. Shri A.K. Vajpayee, Director (Finance-DT)
3. Shri Sanjai Singh, DFA (EC & Rev.)

Department of Economic Affairs

Dr. M.C. Singhi, Economic Adviser

2. At the outset, the Chairman, welcomed the representatives of the Ministry of Finance (Department of Revenue), to the sitting of the Committee and invited their attention to the provisions contained in Direction 55 of the Directions by the Speaker.

3. The Committee then took oral evidence of representatives of the Ministry of Finance (Department of Revenue) on Demands for Grants (2007-08) and other related matters. The points discussed during the meeting broadly related to Tax-GDP Ratio, FRBM targets, Special Economic zones (SEZ), Double Taxation Avoidance Agreements (DTAA), Widening of Tax Base and Evasion of Tax, Banking Cash Transactions Tax (BCTT), Permanent Account Number (PAN), Anti-Smuggling Efforts, Exemptions/Tax Exemptions, Service Tax, Annual Information Report (AIR).

4. Thereafter, the Chairman requested the representatives of Ministry of Finance (Department of Revenue) to furnish notes on certain points raised by the Members to which replies were not readily available with them during the discussion.

5. A verbatim record of proceedings has been kept.

The witnesses then withdrew.

Part II
(1500 to 1830 hours)

6. ** ** ** ** ** **

7. ** ** ** ** ** **

8. ** ** ** ** ** **

9. A verbatim record of proceedings has been kept.

The witnesses then withdrew.

(The Committee then adjourned to meet again on 3 April, 2007 at 1100 hours.)

MINUTES OF THE TWENTY-FIRST SITTING OF STANDING COMMITTEE ON FINANCE

The Committee sat on Tuesday, 17th April, 2007 from 1100 hours to 1400 hours, 1430 to 1550 hours.

PRESENT

Shri Ananth Kumar—*Chairman*

MEMBERS

Lok Sabha

2. Shri Jaswant Singh Bishnoi
3. Shri Vijoy Krishna
4. Shri Bartruhari Mahtab
5. Shri Rupchand Pal
6. Shri P.S. Gadhavi
7. Shri R. Prabhu
8. Shri K.S. Rao
9. Shri Jyotiraditya Madhavrao Scindia
10. Shri A.R. Shaheen
11. Shri M.A. Kharabela Swain

Rajya Sabha

12. Shri Santosh Bagrodia
13. Shri Raashid Alvi
14. Shri Yashwant Sinha
15. Shri Mahendra Mohan
16. Shri S. Anbalagan

SECRETARIAT

1. Dr. (Smt.) P.K. Sandhu — *Additional Secretary*
2. Shri P.K. Grover — *Joint Secretary*
3. Shri T.G. Chandrasekhar — *Deputy Secretary*
4. Shri M.L.K. Raja — *Under Secretary*

Part I
(1100 to 1400 Hours)

WITNESSES

(Department of Economic Affairs)

1. Shri Vinod Rai, Secretary—Financial Sector
2. Smt. Sindhushree Khullar, Additional Secretary (EA)
3. Dr. Ashok K. Lahiri, Chief Economic Advisor
4. Shri Amitabh Verma, Joint Secretary (Banking)
5. Ms. L.M. Vas, Joint Secretary
6. Shri G.C. Chaturvedi, Joint Secretary, Insurance Division
7. Shri Arvind Mayaram, Joint Secretary (Infrastructure)
8. Dr. Anup K. Pujari, Joint Secretary (FT)
9. Shri Shankar Bannerjee, CAA&A

(Department of Revenue)

1. Shri K.M. Chandrasekhar, Revenue Secretary

Revenue Headquarters

2. Shri K. Mohandas, Additional Secretary (Revenue)
3. Shri L.K. Gupta, Joint Secretary (States Taxes)

CBEC

4. Shri V.P. Singh, Chairman (EC)
5. Shri Devendra Dutt, Member (Customs)
6. Shri P.C. Jha, Member (CX/ST)
7. Shri A.K. Raha, Member (L&J/Comp.)
8. Shri R. Sekar, Joint Secretary (TRU-II)

CBDT

9. Smt. Indira Bhargava, Chairperson
10. Shri A.J. Majumdar, Member (L&C)
11. Smt. Anita Kapur, Joint Secretary (TPL-I)
12. Shri Arbind Modi, Joint Secretary (TPL-II)
13. Smt. Poonam Dutt, Joint Secretary (FT & TR-II)

IFU

14. Shri M. Deena Dayalan, Joint Secretary & FA (F)

2. At the outset, the Chairman, welcomed the representatives of the Ministry of Finance (Departments of Economic Affairs and Revenue) to the sitting of the Committee and invited their attention to the provisions contained in Direction 55 of the Directions by the Speaker.

3. The Committee then took further oral evidence of the representatives of the Ministry of Finance (Departments of Economic Affairs and Revenue) on Demands for Grants (2007-08) and other related matters. The points discussed during the meeting broadly related to issues such as, FRBM targets, Special Economic zones (SEZ), Double Taxation Avoidance Agreements (DTAA), Widening of Tax Base and Evasion of Tax, Tax Exemptions, Rate of interest on crop loans, crop insurance scheme, inflation, investment of public sector banks and insurance companies in stock market, foreign exchange rate etc.

4. Thereafter, the Chairman directed the representatives of Ministry of Finance (Departments of Economic Affairs and Revenue) to furnish notes on certain points raised by the Members to which replies were not readily available with them during the discussion on or before 19 April, 2007.

5. A verbatim record of proceedings has been kept.

The witnesses then withdrew.

Part II
(1430 to 1550 hours)

6. ** ** ** ** ** **

7. ** ** ** ** ** **

8. ** ** ** ** ** **

9. A verbatim record of proceedings has been kept.

The witnesses then withdrew.

The Committee then adjourned.

MINUTES OF THE TWENTY-SECOND SITTING OF THE STANDING COMMITTEE ON FINANCE

The Committee sat on Thursday, 26 April, 2007 from 1330 to 1630 hrs.

PRESENT

Shri Ananth Kumar—*Chairman*

MEMBERS

Lok Sabha

2. Shri Rupchand Pal
3. Shri R. Prabhu
4. Shri K.S. Rao
5. Shri Magunta Sreenivasulu Reddy
6. Shri A.R. Shaheen
7. Shri M.A. Kharabela Swain

Rajya Sabha

8. Shri Santosh Bagrodia
9. Shri C. Ramachandraiah
10. Shri Vijay J. Darda
11. Shri S. Anbalagan

SECRETARIAT

1. Dr. (Smt.) P.K. Sandhu — *Additional Secretary*
2. Shri P.K. Grover — *Joint Secretary*
3. Shri S.B. Arora — *Deputy Secretary*
4. Shri T.G. Chandrasekhar — *Deputy Secretary*
5. Shri M.L.K. Raja — *Under Secretary*

Part I
(1330 to 1500 hours)

DISCUSSION WITH DELEGATION FROM INDONESIA

2. ** ** ** ** ** **

3. ** ** ** ** ** **

4. ** ** ** ** ** **

Part II
(1515 to 1630 hours)

CONSIDERATION AND ADOPTION OF DRAFT REPORTS ON DEMANDS FOR GRANTS (2007-08)

5. ** ** ** ** ** **

6. The Committee then took up for consideration the draft report on Demands for Grants (2007-08) of the Ministry of Finance (Department of Revenue) and adopted the same with the modifications/amendments as shown in *Annexure II.*

7. ** ** ** ** ** **

8. ** ** ** ** ** **

9. ** ** ** ** ** **

10. The Committee authorized the Chairman to finalise the Reports in the light of suggestions received from the Members and also make consequential verbal changes arising out of factual verification by the concerned Ministries/Departments and present the same to Parliament.

The Committee then adjourned.

ANNEXURE II

[MODIFICATIONS/AMENDMENTS MADE BY STANDING COMMITTEE ON FINANCE IN THEIR DRAFT REPORT ON DEMANDS FOR GRANTS (2007-08) OF THE MINISTRY OF FINANCE (DEPARTMENT OF REVENUE) AT THEIR SITTING HELD ON 26 APRIL, 2007]

Page No. 19, Para No. 23, Last Line

After 'to a specified period.'

Insert 'The Committee, however feel that till such time the exemptions are applicable, the long pending demands for such exemptions from some of the State Governments on geographic basis need to be considered and decided upon objectively and prudently.'

Page No, 36, Para No. 55

Delete 'after a specified time period'

Page No. 70, Para No. 117

For 'They also desire to be apprised about the developments in this regard at regular intervals'

Substitute 'They also desire to be apprised about the developments in this regard on quarterly basis'.

Page No. 76, Para No. 128

For 'Hence, they urge the Government not to delay the programme any further and implement it in right earnest'.

Substitute 'Hence, they desire the Government to furnish a status report on the implementation of the computerization programme, explaining the reasons for the delay, within a month'.

Page No. 79, Para No. 135, Last Line

For 'The Committee wish to be apprised of the reasons for planning to spend such a huge portion of the Revised Estimates in the last month of the financial year and urge the Government to plan and spread the

expenditure properly so as to have an ever-spread of the allocated expenditure.'

Substitute 'The Committee desire that a departmental inquiry be conducted into the trend of expenditure under this Head of account and the report of the inquiry furnished to the Committee within one month.'