

## **Tax Rules in Stimulus** **-Developing Country Perspectives-**

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### Introduction

This paper addresses the problem of domestic resource mobilization as a part of policy to stimulate the economy of developing countries to the 'normal growth path' as they recover from the economic crisis since mid 2008. While the problem can be examined in a larger framework of financing as a part of a strategy of public private partnerships in investment and economic revival, (Y.K.Alagh, 2000, 2001, 2006), the paper has been mandated to concentrate on taxation strategies. The larger context it works within is the framework of economies integrating with the global economy in an economic and fiscal reform mode (For the structure and specific methods of reform at regional, national and global level, see S Upton, Former Swedish PM, Y.K. Alagh and S. Beckam, in UNSSD, 2002). Tax policies are detailed in this context, including better business and technologically efficient models of tax administration. Therefore the well known ongoing efforts at simplifying and widening the tax base are the background.

There are two amplifications, which give an interesting flavour to this discussion. The first set of issues arises from the institutional nature of developing economies. The preponderance of informal sector economic organizations in the developing world has been known from the work of the ILO, as also the Development Center of the OECD (2008, 2002). There is evidence to suggest that this sector is in fact expanding. It is largely seen as a sector which needs support and not as a source of fiscal revenue, with 'thin employment', including below poverty level wages. But it is now also documented that informal sector enterprises may be of different kinds and some are both technologically and in a financial sense, resourceful and expanding ( Y. K. Alagh, ILO, 2008). Taxes are never liked like mothers in law and have adverse incentive effects, but since they are needed, the 'viable' part of the informal sector may be a source of revenue. The difficulty here is assessing the tax base since by nature accounts, at least as per accepted accounting standards, are not kept but 'presumptive assessment' is suggested as a transitory method.

A corollary of this set of issues is the need to examine if there are resource-raising possibilities at the local context in large federal developing economies. Here the orthodoxy is that such possibilities are not there in substantive measure given the rudimentary nature of local self government institutions in developing countries. We reexamine this context using Indian experience (A. Pethe and M. Lalwani, 2008). For if such possibilities exist they release the resource constraint in areas critical for widespread agricultural and rural growth. These resources in a sense are doubly blessed. They add to the resource pool and also give more maneuverability to local authorities, which is an important added gain.

A second amplification is that the downturn itself could lead to domestic policies of a suboptimal kind from the perspective of trade reform. Such policies may be dictated by pressing needs to minimize large employment or output losses, which may need 'distorting' protection. Such protection would need to be kept at minimum and should in any case be of a transitory nature. Alternately the need for such policies may arise in the distortionary nature of some global markets. An example is global agricultural markets in the emerging context of the WTO discussions. If there are welfare distorting economic policies, it would be

legitimate to use tax policies to reap welfare losses as a social dividend rather than allowing them as unearned or rentier private gains (Y.K.Alagh, 2004/2006). We give the example of negative protection and tariff policies as a case. These would also be justified in the case of environmental or social 'bads'( Y.K.Alagh, 2003a) .

### The Need

The importance of domestic resource mobilization particularly by the State, even if stimulus policies are funded by external resources emerges from the need of priority to non tradable infrastructure in any investment programme. This is the so called third gap in addition to domestic savings and external resources (For an algebraic version, with numerical examples see paper by Abhijit Sen in L.Taylor, 1988: for a contemporary version for India see Y.K.Alagh, 2008b). In the stimulus packages in India for example, even though the country had plentiful external reserves and a high savings rate, the details of government expenditure programs required resources with the Government at regional and local levels for investment in infrastructure and agricultural and rural development programs. An FAO study showed that some 'free resources' were necessary to implement high priority agricultural and rural development programs, with local institutions even when such expenditures were largely funded from higher levels of government within the country or external aid ( FAO, 2007, Alagh on FAO,2008c).

The Indian Eleventh Plan recognizes that, rule based free devolution of resources or resource mobilization at the local level becomes a constraint for speedy integration of projects in a local plan even when the local bodies have plentiful cash resources from tied aid or devolution from higher levels of government (GOI, 2008, Indira Rajaraman and Y.K.Alagh, 2009).

### Taxing the Informal Sector

An Indian study for the ILO by the present author has conclusively demonstrated both the expansion of the informal sector, the low wage component in this expansion, but also the very dynamic and prosperous sub sectors. Large increments to employment now take place in the unorganized informal sector and the trend of self employment and casual labour in the economy is still predominant, (Alagh, 2008)

In the period 1994/2004, as compared to the earlier decade, organized sector employment collapsed. The deceleration in employment growth between 1993/94 and 1999/00 reversed itself in the period 1999/00 to 2004/05, but the trend of informal unorganized employment continued through this decade. Significantly even in the formal/organized sector of the Indian economy in the recent period of fast manufacturing and overall growth unorganized/informal employment has gone up in a big way from 37.8% to 46.6% of the total.

Self employment and casualisation of the work force in India is persisting with low productivity and earnings in the reform period upto now. According to the 61<sup>st</sup> round of the NSS 49.8% of rural workers and 31.4% of urban workers find their remuneration unremunerative. This is not on account of high expectations, since 57% of rural workers had an expectation of only Rs. 2000 per month (less than US \$2 per day, the MDG poverty line) or less and this percentage in urban areas was 30.4%.

Quality of employment is a major issue in India today. But within the larger context of the informalization of work in Indian industry in the reform and high growth phase, it seems

clear that the MSME clusters are embedded in the received tradition of artisan based industrialization in many cases.(Some earlier studies are Y.K.Alagh, 1991, 2004, Awasthy, 2004).Diamond polishing, specialized textiles and engineering clusters near skill bases are examples. Also there are similar bases emerging from raw material origins like footwear and silk textiles.). India is the largest exporter of diamonds in the World and a million jobs have been created in Surat. There are 112 towns which account for more than two thirds of Indian small industry and they have considerable potential (D.Awasthy, 2004).

These clusters are strongly influenced by historical skills, caste and other networks and market linkages (S.P. Kashyap and R.S. Tiwari, 1985, F.Hullier, et. al., 1994).Dynamic, having competitive strengths and strong market linkages, they seem to be in a tradition of lean production and cost consciousness. Labour costs are kept down and labour standards are not enforced. Job work is common. There is considerable mobility between labour and enterprise and community based training of skills.

In a number of cases there has been strong linkage with global markets in the reform phase, although the process seems in some cases to have predated the reforms. Most of these initiatives are from entrepreneurial efforts and traditional networks of information and market knowledge. Diamond polishing, brass parts and auto parts are examples of linkages with global markets as a source of growth. Linkages are with labour skills and raw material bases rather than with spatially linked firms. In the recent period, some of these firms have established global markets and linkages through acquisitions and mergers. These are not cases of large firms linking with SME's as the literature or policy expectations posit. They are more interesting. They are cases of SME's growing with intrinsic competitive advantages and developing strong global bases. .

As these firms succeed they get into global strategic partnerships and acquisitions. Diamond polishers starting from artisan skills went on to the domestic retail chain pursuing the value chain. Gitanjali Diamonds, for example acquired Nakshatra in 2000. In late 2006, India made its first conquest in the US jewelers retail segment. Gitanjali Gems, by then a Rs 3,467-crore gems and jeweler outfit, led by Mehl Choksi, acquired Samuels Jewelers Inc, the ninth largest chain in the US in a Rs 200-crore deal. In May 2007 Shrenuj Diamonds acquired an 84% equity stake in SGS (Simon Golub and Sons) for \$22.7 million. The two deals put together made the US market wide open for Indian firms. SGS distributes to 2,400 retail outlets in the US. Similarly, Samuels Jewelers has a wide reach—97 stores across 18 states of the US. Both SGS and Samuels have revenues of about \$150 million each. This gives the Indian firms direct control of 1% of the \$30-billion jeweler market of the US. In Nov.2007, Gitanjali Gems acquired US jeweler retail chain Rogers for an undisclosed sum. This was the company's second largest acquisition in the world's largest jeweler market. Privately-held Rogers is headquartered in Middletown, Ohio and operates 46 retail stores under brand names 'Rogers Jewelers' and 'Andrews Jewelers'. Rogers has revenues of \$80 million. Earlier (Feb.2007) the company bought 70% stake in Tri-Star Worldwide, a Canada mark licensee and a direct customer of BHP Billiton. Gitanjali Diamonds was also entering into strategic partnerships with international firms where the linkages would be from the global firm to them. They were tying up with Italian fashion brands. This tie up would lead to the Mariella Burani Fashion Group and the DIT Group marketing its products through the Gitanjali channels. Ultimately the Italian groups may consider sourcing from the Gitanjali stable also. The Mariella Burrani Group is on record stating that they are looking to leverage the partnership and expand it.

A large number of spatial and sectoral clusters of small firms have historically existed in India. Experience on cluster development has shown fairly conclusively that the tremendous

opportunities made available by the new technology requires groups and systems which can manage its inter-disciplinary nature, since applications cut across areas like biotechnology, communications, market development and computerization. If the preconditions are available it spreads very fast, both through space and sectors of the economy and society. But if the physical and/or human infrastructure is lacking, vast areas will be left out, including some in the World of clusters. There is also the need for quick response. State and para-state agencies find it difficult to perform in this framework.

The practical task is to foster institutional reform with a local area focus like improved capital markets and banking systems in areas with growth potential develop systems which look at non-conventional lending procedures, like community collateral for co-operative/ community projects, lending through a human development cycle: developing lending procedures for infrastructure projects relating to the concerns of value added and distribution relating to first stage agro-processing, artisan based goods and services for local, regional, national and global markets. Another aspect to underline is that reform in the sense of removal of restrictions on such activities is of importance if they are to have access to larger markets. Also similar reforms should relate to the access to improved inputs and services.

There is therefore the larger need for economic reform at fairly decentralized levels. If a hard budget constraint is not operational at local levels, it acts as a barrier to a judicious programme of support or targeted subsidies or access to loanable funds to those who work with their own resources. Give-aways generally act as a major disincentive to self or community supported viable activities. Again there can be private or government funded organizations which are inefficient, cannot cover the last mile and to avoid getting out of "business", will act as bottlenecks to focused support to organizations where producers support themselves.

Financing and credit mechanisms for these newer initiatives are needed; Community collateral and other innovative forms of financing are needed; policy champions are required to be in position to help such experiments when they run into teething problems; institutions which signal global negative trends and help in evolution of response policies in a harmonized manner are needed; economic reform has to be deep routed, otherwise policies of structured subsidies and support to those who help themselves are not possible; demand driven technology policies are required to converge with such initiatives (UNSSD, 2002).

For agro-based sectors Farmers organizations should be strengthened to bargain for associating with such opportunities with their land. Producers Associations for this purpose had been recommended in earlier debates. This was made possible in a legislation we had drafted and which was incorporated in the Companies Act, Second Amendment Bill 2002, which could be used. This recommendation is repeated in the World Bank's WDR, 2008. The FAO has recently suggested Producers Association to bargain for the farmers' rights in agro packages. Tenancy records have to be straightened so that tenants who farm around two fifth of the land can leverage their assets in bargains with the corporates. These sectors have resource mobilization possibilities.

The Indian tax reform in 2009/2010 includes a policy initiative for: "Introducing a new package of presumptive taxation to encourage voluntary compliance by small businesses"(Government of India, 2009, p.37). In the agricultural, first stage agro processing sector and plantations for example, the characteristics of land and water availability can be used to structure a tax design. Land revenue surveys use a system of a

'hundred cents' for defining a 'standard' piece of land in a particular soil and irrigation class as a standard according to which a particular tenant is assessed for potential income or production assessment. A better method is for the tax authorities to access the data base for estimating agricultural yield statistics, which in India are based on crop cutting experiments. These would yield directly output estimates. In the case of non agricultural products, electricity consumption or use of purchased inputs could provide the basis.

The assessee would always have the right to contest the presumptive assessment by providing standard accounts which would have other benefits for the economy in terms of transparency and policy making exercises. The Central Board of Excise and Customs in India introduced in 2009 a production based levy for pan masala and guthka sectors which are hazardous stimulants in much demand in India and according to their Chairman this 'was a huge success' (Personal interview, August 25).

### Local Resource Raising Capabilities

Given the focus on decentralization in implementing rural development and social sector priorities, India's Plans are largely structured around big ticket Centrally Sponsored or Central Schemes in agriculture, rural development, education, health and urban development. *Also, more important newer financing and organizational principles are enunciated.*

The Eleventh Plan has the following to say in its chapter on spatial development and regional imbalances;

- "It needs to be remembered that that, in fact, the significance of the *NCA amount has got substantially reduced since 2005-06*, the year from which the Central Government ceased to provide the loan component of NCA"(GOI,Vol.1, p.143).

Thus formula based assistance has gone down. (NCA is Normal Central Assistance)  
However as a counterfactual the Eleventh Plan states:

"The Central Government also transfers substantial resources to the States in the form of CSS and ACA for State Plan Schemes."(Ibid., p.143)

The 'Problem' is *not resources* but *devolution of autonomous resources* in the devolution process. Resources under the rule based devolution process formulas have dwindled. (Vol.1, pp.141-143) and the slack is taken by tied assistance.

This was the argument earlier (Y.K.Alagh, 2006, in A.K.Singh, 2007 and Y.K.Alagh, et.al.,SOPR, 2008a,2009) and interestingly now the Eleventh Plan repeats it with a major emphasis and rule base devolution is the major concern of the Thirteen Finance Commission (Indira Rajaraman, 2009).The Planning Commission lays a central role for decentralized implementation structures and provides rules for accessing resources.

The notion that local bodies do not raise resources is incorrect. There is wide variation in performance. In fact resource raising local bodies are more than just 'Best Practice Cases'; However it is quite clear that more needs to be done. Some of the important issues to be addressed in resource raising are:

- Measuring Success in Resource Raising
- Lessons from the Successful

- Non Sovereign Guaranteed Borrowing for Investment
- Efficiency in Expenditure
- Tied and Untied Resources: The Devolution Index: Role of Finance Commissions
- Resource Raising and the Global Recession

Resource-raising local bodies are more than just 'Best Practice Cases'. At the aggregate level the good news was that in about a quarter of the best cases as the local economy grew econometric studies showed that resources raised by the local bodies grow at one and a half times the economies growth rate. The elasticity of own resource raising by local bodies was 0.6 as a whole. However we requested the authors of this work to rerun the equations for the better financially run bodies and for them the elasticity was estimated at 1.4. (Pethe and Lalwani, 2008)

These results were corroborated by many field examples. In the state of Tamil Nadu 22% of Village Panchayat (local bodies) resources in 1996/97 came from tax and non tax resources and another 6.5% from miscellaneous receipts. In the same year the average expenditure of a Village Panchayat was Rs. 1.06 lacs(lac=1,00,000: 1Euro=Rs.69 approximately). The story was not dissimilar in the beginning of this century. The average expenditure went up to Rs.3.64lakhs, incrementally financed from grants and deficits. The modal own income group moved from ten thousand to fifty thousand and then from fifty thousand to one lakh Rs. Around a quarter of gram panchayats had income between one to two and a half lakhs and forty six above one crore(ten million). While the expenditure was above three lakhs around a quarter of the Village Panchayats had own resources between one to two and a half lakhs of Rupees. These kinds of facts suggest the need of detailed exercises for fiscal consolidation. The better units have to become models for the average local bodies. State Finance Commissions can use (G.Paluntharai, 2008, Table .9) The story was not dissimilar in other States (Y.K.Alagh, V.Bhandari and P.Misra, 2008a, Ch.2)

These kinds of facts suggest the need of detailed exercises for fiscal consolidation. The better units have to become models for the average Panchayats. State Finance Commissions can use them as examples for prudence and rule based policies. Investment finance for rural infrastructure is essential. It is essential that non-revenue sources have to be seriously rationalized and properly tapped. Efforts to help create healthy balance sheet for the local institutions will put them in a position to present a rating and a borrowing-risk that is viable if not attractive to the Financial Institutions that can then be approached for underwriting or taking exposure.

The moral of our story is that:

- If these are made models for incentivisation, PRIs and CBOs would soon meet current expenditures and be in a position to productively borrow if the Treasury does the reform to permit it.
- But it is slow. For example a policy for urban borrowing is still under preparation. It is easier to buy the bond of a foreign local body rather than an Indian one.
- Financial reform for local bodies and SHGs, newer financial product companies for rural areas is urgent

Local bodies will have to make the rupee go far. Recent Studies where Panchayats are placed as alternatives to others and relative effectiveness measured need attention. (P. K. Das and S. Mukhopadhyay, 2009) There are, however also larger reform issues at the national and global level.

## Crises, Urgency of Response and Reform

President Obama has a constituency of farmers, small businesses and small industry. Financial restructuring needs institutions which build instruments, collateral, facilitation for communities and the small producers on whom the real and not the derivative economy rests. This market is very robust in India today as the experience of groups like Basix and IFMR shows. These kinds of arguments are central to global reform in the financial sector (See Cooper and Anteciwiez, 2008 and John Kirton and Madeleine Cross, 2008 on the author's description of the relevance of the Indian experience).

Four years ago we worked it out in a UN meet with the former Swedish PM Ulsten (UNSSD, 2002). Obama will push that agenda forward as also the point we made in the L20 volume in 2003 that the World must have early warning systems for crisis. Colin Bradford makes the same points in these volumes (C. Bradford, 2008). There are synergies between releasing the constraint in local level spending and the current rate of Indian development getting out of crisis.

The current problem of releasing the fiscal constraint at the spending levels is not largely a resources problem, but a restructuring and devolution problem For State and local bodies to spend along desirable lines, rather than digging and filling up ditches or spending mechanically on central schemes, either the best practices have to be replicated in resource raising and/or free resources made available in formula based assistance. Newer financial structures and institutions at State and local levels need organizational and financial market reform at higher levels like markets for local securities, community collateral and so on. This reform has a national and global edge

## Taxation Opportunities in A Stimulus

A case in point of the kind of opportunities that arise is taxation policies to avoid negative protection. India has some experience of this. It is now recognized in the growth debate that India was growing reasonably fast in the Eighties, when it designed an extensive programme of reform emphasizing internal competition initially. In the mid eighties around two thirds of organized Indian industry was removed from price and quantitative controls to tax and tariff rate interventions. From firm level controls the economy moved to industry level interventions with strong schemes of incentives and disincentives. These would discriminate between industries, but not between firms. The policy framework was seen as a transitional regime, leading later to more general opening up of the economy. A group that was set up under my supervision to work out a strategy of phasing out import substituting industries discovered that around half of Indian industry was globally efficient in the sense that at international prices of outputs and inputs, firms would make profits ( $DRC's < I$ ), but at market prices they suffered losses. In a partially reforming economy, if the input supplier has not been subjected to competition, even- if a firm is efficient, it will make losses, because the global competitor gets components and equipment at cheaper prices, or his interest rate is lower. Clusters of industries would need to be reformed together and tariff policies would need to be determined in an optimal manner taking these configurations into account. The Indians were seen in some of the literature as following this path, sequencing and phasing reform. According to the World Bank in 1992, "Policies that reward cost reduction and technical change and place pressures on domestic manufacturing to bring about such change would have to be implemented. Protected markets make enterprises soft and encourage obsolete technologies. Y. K. Alagh refers to a study of the Indian tire industry for the 1981-84 period where price increases were higher than increases in material

costs, and the top four companies consistently maintained their share of production, while the technology used was obsolete." The Indian example was seen as a counterfactual. Lance Taylor(1994) in a fairly widely quoted paper described an MPS ( Multifaceted Price System ) as a "transition from an administered towards a market regime" and argued that the Indians had switched industry successfully from firm level controls to an industry level efficiency policy, linked with economy level strategic objectives. By 1992, India moved away from this policy stance to that of a uniform tariff rate and reducing that rate.

In a distorting trade epoch which to an extent all depressions will be, it is possible to bring in policies of inverted tax structures in a measured and phased manner. India's budget papers, for the 2009/10 stimulus budget describe this policy as indirect tax rates compensating for 'deeper cuts on finished goods as compared to their raw materials'. Peak tariff rates, set by reform of the tax system are not changed, but tariff rates reduced on specified inputs, components and capital goods (GOI, 2009, p.36).

For the agricultural sector expert bodies like the Commission on Agricultural Costs and Prices, the Finance Ministry's Economic Adviser and a Committee I chaired on economic policies for a WTO trade dominated regime argue for variable tariff rates calibrated to protect the efficient Indian agricultural producer and a number of quantitatively worked out counterfactuals are available in the Indian policy literature (Y.K.Alagh, 2004). Such a policy would obviously raise revenues. The World Bank has advocated this policy for India as 'working a level playing field' (World Bank, 2008). The Government of India however keeps its options open, both for giving it elbow room in the ongoing WTO negotiations and of keeping domestic food prices in control.

These are seen as purely temporary and transitional measures and as part of the reform of the tax system it is projected that in the long run an attempt will be made to; 'Review custom duty exemptions and move to a uniform duty structure to eliminate inverted duties.'(GOI, 2009a, p.29).

#### Business Processes and Tax Administration

The Indian tax system has been implementing since 2002 extensive information and administration systems advances using information technology solutions and reengineering of business processes in its working. In this process it has been aided considerably by the country's software system skills. This period has also been one in which non government consultancy skills have been used extensively for designing new solutions to tax administration. This has fostered a less intrusive tax system and encouraged voluntary compliance, such that effective tax rates have gone up in a dramatic manner.

While the details are available in the Finance Ministry's Economic Survey and web sites of the Central Board of Direct Taxes and the Central Board of Excise and Customs, the main initiatives have been filing of E returns, E payment of taxes, the establishment of a state of the art Centralized Processing Centre, Issue of Refunds through ECS, Refund Bankers, including private sector banks, Computer Aided System of selection of cases for scrutiny based on transparent criteria and an effective Taxpayer Information System with increasing interactive procedures.

In addition to being a part of a massive exercise of evolving an electronic system of personal identification of each member of India's 1.2 billion population, being developed by the Chairman of its largest Software Systems Company, the globally known Infosys, who has been appointed in the Government with the rank of a Cabinet Minister, Tax administration is

introducing this year a unique computer based Document Identification Number (DIN) to assist correspondence. The larger system is called UID (Unique Identification Number). The Authority has been set up with a time bound task of a unique identification of each citizen. Another business process initiative underway is the development of communication systems in the tax administration using IT tools for interaction with the tax payer.

While India's metros and smaller towns are well wired up, in a major OECD Development Center meeting on technology for poverty removal in 2002, the survey had shown hardly any general IT service providers in rural areas in the developing world, unlike bio technology products which were diffusing. The situation has now changed and a pilot project I had reported of the wiring of fifty five villages has this year been given a State level award for application of IT for rural development. It is one of many initiatives and it is likely that smaller settlements will increasingly use E support for tax administration and compliance. It may be noted that about a quarter of the firms with the highest global standards accreditation are Indian. (See Braga de Macedo and T. Chino, 2002) South South collaboration should be actively promoted in this area.

### Simplifying the Tax System

This is a complex area in taxation practice and yet is very important. Regarding indirect taxes over the past several years, significant progress has been made to improve the tax structure, broaden the base and rationalize the rates

Notable among the improvements made are:

- Replacement of the single point state sales taxes by the VAT in all of the States
- Reduction in the Central Sales Tax rate to 2 per cent, from 4 per cent, as a part of a complete phase out
- Introduction of service tax by the Centre, and a substantial expansion of its base over the years.
- Rationalization of the CENVAT rates by reducing their multiplicity and replacing many of the specific rates by ad volorem rates based on the maximum retail price (MRP) of the products.

In defining options for further reform, the starting point is the basic structure of the tax. The Empowered Committee of State Finance Ministers (EC) in November 2007 had recommended a "dual" GST, to be levied concurrently by both the Central and State Governments. The dual GST option permits both levels of government to apply the tax to a comprehensive base of goods and services and eliminates tax cascading.

GST would facilitate greater vertical equity in fiscal federalism, reduce cascading nature of commodity taxes and through shift to value addition as the basis for assessment unify the market for goods and services. The target is to commence GST from the financial year 2010/11. The EC (which was instrumental in the operating of the state level VAT) in consultation with the Central Government constituted a Joint Working Group (JWG) consisting of officers of the Centre and State Governments to examine the various models and options for GST. The JWG presented its report to the EC on November 19, 2007. The EC has sent its recommendations to the Government of India in the form of "A Model and Road Maps for Goods and Services Tax in India" in April 2008 which included an outline of the GST design proposed. In September 2009 a dual tax rate system has been accepted by India's States with a standard GST rate and a lower rate for 'essentials'. This was a major advance.

Foresighted changes have also been contemplated for direct taxes. The Finance Ministry has introduced a Direct Tax Code for discussion. This rationalizes the structure of direct taxes and suggests simplifications of exemptions.

The corporate tax regime in India has a higher base rate, set off with sector specific tax incentives (exemptions/deductions). This complicated the effective tax computation as also resulted in protracted litigation. The Code seeks to rationalize corporate taxation in a big way. The corporate tax rate has been proposed at a lower 25% and tax incentive provisions have been largely eliminated. The code proposes to replace the current business profits with specified adjustments basis of computing income from business to an income expense model, as prevalent in certain developed and other Asian countries.

The code proposes to introduce the Exempt-Exempt-Tax (EET) method of taxation for savings. Contributions and interest accumulation/accretions will be exempt; however, all withdrawals will be subject to tax in the year of withdrawal.

The code materially seeks to re-alter the provisions relating to capital gains taxation. First, the code seeks to bifurcate capital assets as investment assets and business assets. Income arising upon transfer of an investment asset would only be taxable as capital gains. Second, the code would eliminate the distinction between short-term and long-term assets, by providing for taxation of gains arising on transfer of any investment asset.

India therefore has a road map for indirect tax reform with 2010 as a target, by now seen as realizable and a Direct Taxes Code draft to encourage discussion. It should be possible to make progress on the former during the stimulus revival, while giving a deadline for the latter is problematic, although the process has begun. The indirect tax structure should be stimulus friendly and lead both to a wider tax net and a payer friendly system

## Conclusion

There exist possibilities of tax revenue mobilization in a reform compatible manner. All of them need thinking out of the box and would lead to resistance. However it should be possible to build core support since the structures would soften the impact of the melt down. In particular detailed proposals available with a practical road map of implementation during the revival period would stand better chances of acceptance.

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