

Tax Reform Should Focus on Transaction Tax

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HYDERABAD:

The Economic Survey advocated a simple, predictable and stable tax regime. It said:

‘India’s complex tax system suffers from problems in both structures and administration. Uneven and high tax rates and uneven tax treatment of similar economic activities have induced distortions in the behaviour of firms and households... The manner of functioning of tax administration is imposing legal risk and substantial compliance costs upon households and firms.’

Put simply, it implies tax system is making both tax collectors and taxpayers dishonest and collections more difficult. And as Modi himself said: ‘The present taxation system is a burden on the common man. There is a need to introduce a new system.’ It was hoped that the Modi government would carry out a radical reform as envisaged by the BJP before they came to power. At that time, the party seemed inclined to abolish all taxes (except import duties) and replace them with a 2% tax on all bank transactions. This would have generated twice as much revenue at almost no cost of collection. It would put 3.5 lakh corrupt and inefficient tax officials out of work. All this would galvanise the economy. As the transaction tax would be applied to income (however earned) and expenditure (on whatever spent), it would let prices adjust to normal supply and demand.

The Government needs a huge amount of easily collected tax money to flush out all the fiscal sins of the past in terms of bogus budgets, enormous government debt, stalled capital projects, refinancing of banks, acquisitions for defense and funding for infrastructural projects. With such a large revenue surplus, the pressure on inflation would ease as deficit financing will be avoided. After all deficit financing induced inflation results in an increase in prices through a fall in the value of the currency

Perhaps it is too short a time to make such a radical change for the Modi Government and we may expect this reform in the next budget. But at least the Finance Minister could have put in place a small (0.25%) bank transaction tax to test the model and its workability. We must wait and hope.

(The author is former Dean, ASCI, Hyderabad)

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DR GAUTAM PINGLE
13, PINGLE VENKATRAM BAGH
BEGUMPET
HYDERABAD 500016
INDIA

Telephones: +91-40-6456 0304; +91-40-4017 3050
Mob: +91-98496 39689
E-MAIL: gautam.pingle@gmail.com