

SUMMARY OF RECOMMENDATIONS

PARA

- 1.21 We recommend that the State establish an E-governance Group within the office of the Chief Minister accountable to him or her. It should be headed by a person with strong e-governance credentials, who should take responsibility, against defined targets, of leading the government's efforts in planning, coordinating and attaining pervasive e-governance on an affordable, cost-effective and self sustaining basis. Inter-State coordination and collaborative cost savings should form part of the tasks entrusted to this Group.

Value added tax on goods

- 2.37 In our view, the proposal to extend Central excises to the wholesale stage and manage it through States will evoke fierce opposition from State governments (because of their unhappy experience with Central management of earlier shared taxes) and thus jeopardise the VAT consensual mechanism, it should not be considered for the initial VAT package.
- 2.40 All parties have agreed that an independent dual VAT system is the only feasible option under current circumstances. From the technical point of view also, it is generally accepted that the eventual objective should be a consumption type VAT which allows input tax credit for both raw material and capital goods; it should be based on the destination principle and use the tax credit or invoice method to compute tax liability.
- 2.43 The VAT which is expected to be adopted in April 2002 will apply only to transactions within the State. A floor rate of 10% has been fixed but States are firming up different revenue-neutral rates. The initial assessment is that it would be high (between 12% and 17%) in southern States which have high tax to GDP ratios and may be low in States like Madhya Pradesh. A lower rate of 4% will be applied to 50 commodities-mainly commodities used by poorer sections. While commodities like sugarcane are to be kept outside VAT, processed salt and toned milk will come under VAT and there will not be separate rates for items sold through the public distribution system. Liquor might be brought under VAT at a special high rate of 20% and petrol, diesel and aviation turbine fuel taxed at a high rate but kept outside VAT (without input credit). Other petroleum products like natural gas, furnace oil etc. will come under the basic rate. 22 commodities (primarily from the unorganised sector) will also be tax-exempt. Lottery tickets will continue to be taxed as at present outside the VAT system. The Commission's recommendations on VAT for petroleum products, sugarcane, sugar, molasses, rectified spirit, arrack and IML are given in Annexure II of Chapter II.

- 2.47 The Commission urges that the preparation of the common commodity classification should be completed very early so that it can be used for training departmental personnel and assisting taxpayers.
- 2.48 The plethora of levies in the State today should be rationalised into a single simple VAT. For Karnataka, rationalisation must commence with merger of the several imposts now on the statute books—sales tax, purchase tax, turnover tax, entry tax and the infrastructure cess—into one common tax with wide coverage, few, moderate rates and no exemptions. In the first report, the Commission had urged that such rationalisation should be done immediately in Karnataka. Further delay can only compound the problem of introducing VAT effectively and successfully.
- 2.51 To tackle the fears and reservations of States, the Commission had, in the first report, formulated a complete frame of reference for Karnataka, bringing all commodities within the three floor rates of 4%, 8% and 12%, removing exemptions and merging commodity taxes. A special rate of 2% was retained only for bullion, specie and gold ornaments and 25% for petroleum products and alcoholic beverages. We had also pointed out that it was possible to rationalise the commodity tax system with little revenue loss or inequity. The framework suggested by us could be easily adapted to the revised modulated rate structure that the Empowered Committee has now firmed up for VAT.
- 2.52 We urge the government to undertake the required rationalisation and simplification of the State's commodity tax structure right away to prepare the administration and taxpayers for the VAT scenario.
- 2.53 Keeping in mind the VAT imperative of generalised commodity taxation with minimal exemptions, the exemption list had been pruned and rationalised in the first report. We recommend that the proposed expansion of the tax base by removal of exemptions be forthwith implemented.
- 2.56 Data is available with the Industries and Commercial Tax departments regarding actual tax benefit eligibility and claims made by units which have commenced production. This information should be compiled by the Commercial Tax department after collecting data from field offices; it should be reconciled with data available with the Industries department particularly for cases in which incentives have been given for expansion and upgradation of industries (where substantial overlap is possible). It is sufficient if the analysis is confined to large and medium industries and mega projects. The departmental MIS should also capture this data on a continuing basis. Once this is done, the extent to which tax benefit claims have already been exhausted by units which have come into production and the size of likely future entitlements can be realistically assessed. This will enable the department to make preparations for handling such commitments when VAT is adopted.

- 2.59 When VAT is adopted, any break in the VAT chain may make it difficult to give tax credit to units which supply inputs to industries which benefit from tax incentives on input purchases. They should be required to file tax returns on the basis of which the tax credit claims of their suppliers could be allowed. The net VAT liability of industries availing of deferral could be permitted to be enjoyed by them for the agreed period. Industries benefiting from sales tax exemption could also be given the benefit of tax deferral. Industries entitled to CST benefits should also be treated in the same way.
- 2.60 The proposal to give all industries entitled to tax benefits the right to retain the *gross* VAT amount collected from consumers under the deferral scheme is not desirable as it would affect the administration of the tax credit mechanism for suppliers to such industries. It would also imply giving an additional benefit similar to input tax exemption to industries which do not enjoy it today. This would go against the decision of the Empowered Committee to put an end to additional or fresh tax incentives for industries in future. We do not, therefore, support such a proposal.
- 2.66 Industries entitled to the deferral benefit must be also given the option of adopting the normal VAT regime like the rest of their competitors. We believe that in today's conditions of low and declining interest rates, there would be little incentive for industries to reduce costs by using the tax-deferral mechanism to cut down drawals on working capital limits from banks, particularly since this would make them ineligible for VAT credit on inputs. By keeping the door open for industries entitled to tax incentives to voluntarily move to VAT, it should be possible to phase out incentives even before their regular expiry date. Incentives given for the purchase of capital goods might have to continue for some time till VAT is extended to capital goods.
- 2.67 Revenue-neutral rates may also need to be computed at the micro level for major productive sectors and assumptions used for macro projections modified on the basis of empirical data. The studies done by us on petroleum products, sugar, potable alcohol and tea at Annexure II to Chapter II are relevant in this context.
- 2.67 For policy planning and revenue projections under VAT, it is essential to prepare an input-output table for the State as a whole. Fresh tables will have to be prepared so that we get a comprehensive overview of the inter-relationships between sectors before VAT is put in place. For this, the quantities and values of inputs into and output from all major sectors have to be compiled and integrated into a total matrix in which imports and exports out of the system will also have to be indicated.

- 2.69 In our view, the department should immediately prepare an input-output table by applying its theoretical framework to actual business practices in major sectors to enable it to forecast with reasonable accuracy the revenue outcomes of various policy measures.
- 2.70 The commodity study made by us at Annexure II of Chapter II throws light on several core issues relevant to the concept and application of value added taxation in the country. It indicates the incentive-disincentive mechanism operating today in the origin-based, cascading commodity tax structure at the State level. It helps us to identify areas for decision and action and provides fairly reliable estimates of the likely revenue from different tax rates. It can be used as a guide for further similar studies by the department which could be eventually put together to construct a complete input-output table.
- 2.71 It is essential that a decision is taken quickly on threshold limits for exemption and composition for dealers so that the task of educating taxpayers and tax collectors is not seriously affected.
- 2.79 Several options have been explored at the level of official committees for managing commodity taxation of inter-State trade when the intra-State VAT is in place and during the transition period before inter-State VAT is introduced. Care must be taken while choosing the appropriate mechanism to ensure that it does not generate perverse tax-induced incentives for procuring inputs from within States, even when this is not the most cost-efficient alternative or lead to fresh methods of distorting commercial transactions or accounting for commercial transactions and spawn further perversities.
- 2.81 From the point of view of long term sustainable reform, the additional effort required to hammer out a consensus on the management of value added taxation of inter-State trade at the commencement of VAT itself appears justified. Such an effort will help to bring to the fore the apprehensions of tax-exporting States, identify feasible mechanisms for providing safety nets in the transitional period and draw forth commitments from the Centre for meeting revenue gaps. It will also compel all players to make administrative arrangements for sharing and validating data.
- 2.103 The final form of inter-State VAT will zero-rate sales made between registered dealers in different States, but sales consequent on “consignment” transfers or those made to unregistered dealers will be treated like local sales to final consumers without the benefit of zero-rating.
- 2.104 To ensure smooth transition to inter-State VAT, a networked information system must be developed for online sharing of inter-State data on registered dealers and their transactions. Agreements are necessary with concerned States for ensuring the authenticity of transmitted data and there should be provisions for excluding States, which do not rapidly furnish reliable

information. Technological innovations available today could be utilised for electronically verifying vouchers and dealers' records when monthly returns are filed and during random checks. A procedure that could be used for the purpose has already been indicated to the Commission and could be examined by the Commercial Tax department. Provision should be made for the inter-State component in data processing systems at this stage itself to avoid problems when inter-State VAT comes into effect. To deter evaders, we also recommend a higher selection percentage of audit cases in respect of dealers with inter-State transactions and severe penalties for evaders.

- 2.110 "Consignment" transfers could offer a fairly painless method of moving from origin-based to destination-based commodity taxation.
- 2.111 Under an intra-State VAT, the existing "consignment transfer" mechanism might be used to reduce tax incidence on inter-State sales since full input credit would be available on local sales. Intra-State VAT may also become less onerous for inter-State transactions if low CST rates are charged on "resellers".
- 2.112 With intra-State VAT we might move gradually to a new equilibrium level with an imperfect commodity tax regime for inter-State transactions built around the practice of "consignment" transfers. Such transfers would more or less be similar to destination-based taxation of inter-State commerce. Goods subject to CST and sales to "resellers" may suffer a slightly higher tax incidence and continue to suffer from cascading. The overall result may not then be worse than the present situation. However, further effort would be required to move forward to true inter-State VAT, particularly since it will imply reversion to CST from "consignment transfer".
- 2.113 We suggest, therefore, that when intra-State VAT is introduced, "consignment" transfers should be relied on to painlessly convert origin-based taxation of inter-State trade to destination-based taxation. The CST rate should be simultaneously reduced to 2% to facilitate "reselling" across States. Over time, this should result in most inter-State transactions being done on "consignment" basis and stabilise destination-based taxation. When a decision is taken to shift to zero-rated inter-State VAT, an option could be given for dealers to shift to inter-State sales from "consignment" transfers by offering them input tax credit. It appears, however, that the Empowered Committee is proposing to encourage CST based transactions in the interim period itself by permitting dealers to avail of input tax credit against CST liability. In our view, this is not desirable as it would not serve the main purpose of inducing States to move to destination-based taxation. We recommend that Karnataka takes the matter up in the Empowered Committee and suggests modification of the present proposal.

- 2.114 The economic role of moving to destination-based commodity taxation and mitigating the residual cascading and distortive effects of intra-State VAT played by “consignment” transfers in the transition period should be recognised by States. This should be reflected in the manner in which “consignments” are treated under intra-State VAT. When the final shift to inter-State VAT occurs, definitions of what constitutes “sale” for tax purposes should also be satisfactorily modulated to enable (if feasible) transfers between branches of the same company registered in different States to be treated as inter-State transfers. To a large extent, such preparation will enable the residual tax cascading on “consignment” transfers to be reduced to the minimum.
- 2.115 The procedure for inter-State transactions needs to be rationalised and simplified. It is essential to eliminate the C form requirement for sales to registered dealers, which causes considerable harassment and generates fraudulent practices. In the interests of encouraging the growth of a national market and building up a VAT constituency, it is hoped that at the initial stage itself, the form requirement will be dispensed with.
- 2.117 In our view, there should be a broad overall tax rate ceiling for both government levels (Centre and States) on most commodities, which can be modified only after consultations among all players.
- 2.118 In the interests of simplicity and transparency, it would be advantageous for taxpayers if the commodity groups subject to different rates in Central and State VAT statutes are broadly similar. Definitions, threshold limits and exemptions may require standardisation to some extent between Central and State VATs. The manner in which coordination between the Centre and the States should be ensured and administrative arrangements required for the purpose put into place has also to be clearly sorted out before a true VAT comes into effect at the Central and State levels. We recommend that the State government take this matter up urgently with the Central government since the benefits of VAT cannot be fully reaped by manufacturers and dealers without CENVAT reform.
- 2.120 From the long term conceptual and practical perspective, it may be necessary to consider a Central framework statute under which States and the Centre will be bound to move towards VAT within a system of prescribed rates and practices. Coordination at the level of inter-State committees in which the Centre is also a participant may not be sufficient to bind all parties to implement consensus decisions. Central intervention by legal methods which are cleared by States is desirable to ensure that different governments do not withdraw from the VAT process after commencement. We recommend, therefore, that the State government pursues this initiative at the national level.

- 2.211 A final decision was expected to be taken at the Central level on the three commodities on which additional excise duties are levied at present by the end of September. This must be expedited and existing anomalies rectified while introducing State level VAT in April 2002. The prohibition of State taxation of goods imported into the country under Article 286 of the Constitution also requires immediate amendment; this again was scheduled for a decision by end September.
- 2.122 Action must be taken at the Central level to draft a countrywide framework statute for VAT. This must be supplemented with effective institutional mechanisms for continued coordinated functioning of all governments. Existing arrangements like the NDC and the Inter-State Council may not suffice for constant interaction on administrative and procedural matters. We suggest that the institutional foundation for managing a functioning VAT should be put on the agenda of all State and Central governments.
- 2.123 Government of Karnataka must press ahead with demanding conformity by Union Territories to consensus decisions of the Empowered Committee relating to basic VAT rates, removal of exemptions etc.
- 2.127 In our view, a fund or resources arranged to manage the transition to VAT must be operated to induce States to agree to what is in the best interests of the economy. The problem is how to insulate States against revenue loss without draining the Centre's own strained resources. In the long term, States, as a whole must be given access to productive additional revenue sources. Compensatory tax sources (or grants) to offset immediate revenue losses on account of CST reduction/abolition will also have to be found at once. The only satisfactory solution appears to be enabling States to levy service tax concurrently with the Centre and inducing them to use this fiscal tool to fend for themselves.
- 2.132 The Commission has prepared an e governance framework document for VAT visualising three layers. The first or operational layer covers 6 basic tasks-compliance, processing returns, assessment, demand and collection, refunds, enforcement and inter-State relations.
- 2.133 The second or planning layer, was visualised to consist of 6 tasks-administration, training and motivation, productivity, fraud control, citizen access and citizen satisfaction.
- 2.134 The third or strategic layer was seen as comprising 6 tasks-the collection of economic data, assessing the tax base, increasing revenue, empowerment, inter-departmental co-operation and technology.
- 2.135 Under each task, it is necessary for the department to list out its activities as well as those which need to be computerised, problems foreseen in

introducing and implementing VAT, transitional issues while moving from sales taxes to VAT and issues which need to be resolved before a comprehensive view on e-governance can be taken.

- 2.136 A decision is under way in the Empowered Committee regarding adopting income tax PAN numbers for VAT administration to facilitate data exchange across States. Whether this no. itself should be adopted or whether another no. should be derived from it for VAT purposes may have to be finalised. Numbers might then have to be generated for dealers who are not income tax payers and arrangements made to enable them to be allotted PAN numbers within the income tax system. The link with income tax should not also become a disincentive for dealers to opt for VAT.
- 2.137 The existing data base of around 2 lakh dealers (of whom 1.5 lakh are taxpayers) will have to be ported to the VAT system and numbers generated for fresh applicants. Simple forms will have to be prepared and registration facilitated by opening outlets and even kiosks in departmental field offices and offices of industry associations; online registration could also be considered. The registration procedure is yet to be finalised; it should be kept as simple and direct as possible. The application form may need to mention the legal and economic status of the applicant and the commodity handled by him. Proof of place of business may need to be appended. The applicant's signature could be stored for further recognition purposes when he subsequently files returns and other papers with the department. Data reported by dealers could be validated online using one or two cross-verifications with other reliable databases like registration with the Registrar of Companies, bank account number, passport, driving licence etc., but departmental inspections or security deposit requirements should not be enforced as pre-requisites for registration. Central excise dealer numbers should also be noted where applicable. Registration certificates should be automatically issued and rectification or modification of the original data permitted only to selected persons. The scope and motivations for fraudulent declarations should be considered and the circumstances in which registration should be cancelled laid down.
- 2.138 Security measures using bio-metric methods must be used to prevent pollution or tampering with this basic data base. Parallel servers can provide back-up facilities and a template used to prevent corruption by viruses. Selected subsets of the data base (not original applications) should be accessible to departmental officers concerned with returns as well as those concerned with investigation, intelligence and audit. The basic dealer application may in rare cases be downloaded under strict controls by those concerned with appeals. Within the department, decisions have to be taken regarding the department and the officers who should be authorised to receive and verify registration applications and maintain the data base up to date.

- 2.139 Finally, data mining interfaces and connectivity are required with the Central income tax and more importantly with the Central excise department. Some interface with the external world of taxpayers and others will have to be established through an interactive web site. The persons from other departments who should be given access to data must be clearly specified. This should be limited to few authorised persons. Erection of adequate firewalls to secure critical data and meet other secrecy requirements is a major requirement. Most important is the link that has to be established to data bases in other States which is essential to confirm the registration authenticity of dealers to whom sales are made across States. This is a critical area for evasion and fraud if zero-rating is adopted for inter-State trade since input tax credit will be given at the point of despatch of the commodity before it is actually sold. A dedicated web-server with the required data subset should be used for this interface. The system should envisage more than one area of checking for greater reliability. The dealer master base can be used to generate taxpayer master files which can be fed with data received from returns regarding tax liability and payment.
- 2.140 The commodity classification data base must also be maintained on the computer. It is therefore essential to finalise it quickly and adopt it definitively. Dealer exemption and composition thresholds must also be decided early to develop appropriate registration certificate issue software and operational linkages. Goods kept outside VAT may also need to be identified and linked to the data base to keep track of inputs and outputs entering into their manufacture and distribution.
- 2.141 Various forms under VAT have also to be designed. The invoice form to be used under VAT is a critical item. It must be simple and contain basic essential data. There is no need to duplicate information already stored in the computer or statistics that can be derived from such information except for one or two items for validation purposes. The items suggested for inclusion in the form by the Shome Committee on Tax Policy and Tax Reform for the Tenth Plan (2001) are the name, address and VAT number of the taxable person making the supply, the nature of the supply (the type of supply, the type of goods or services and the quantity supplied), the time of making the supply, payment made for the supply, VAT due, the name, address and VAT no. of the taxable person supplied, the date of issue of invoice and the serial number of the invoice (with identification of the printer). The invoice must also be drafted looking at trade practices and after interacting with dealers and manufacturers. How credit sales should be treated as also quantity discounts will have to be examined. The treatment of “adjustment sales” should also be determined. Invoice authentication by security seals or electronic methods should be looked at.
- 2.142 Return filing should be permitted to be done directly into the system and even online. Returns could also be scanned for easy capture of data into the system.

The return form should be carefully designed keeping in mind essential requirements only. Certification by a Chartered Accountant should not be insisted upon for monthly returns-whether and how audited accounts should be annually sought has to be decided. As far as possible, no additional documents should be sought as attachments to monthly returns. Automatic issue of notices to taxpayers and penalty determination could also be done on the computer for non-registration or non-filing of returns. It is important to decide on the manner in which input tax credit can be claimed every month. Should actual tax paid during the month be set off against actual tax due or should the tax paid on large one-time purchases be set off in instalments over months? These are matters on which decisions must be taken before the system can be designed. How return monitoring and validation should be managed-in a centralised or decentralised manner, for example- and by whom should also be decided. It could be perhaps done by a nominated officer for each jurisdiction, who should be made responsible for notifying defaulters to others.

- 2.143 The manner of processing returns should be direct and simple under VAT. The parameters to be used for validation should be firmed up. The few critical internal (within the return itself) computerised validations to which all returns should be subjected must be identified; on no account should these be left to individual officers or original taxpayer documents demanded for scrutiny; neither should there be local inspections or visits at this stage. Whether returns could be also validated with reference to other external information and linked data bases must be determined. Information furnished in returns should be validated with that received from the treasury relating to tax payment. Only returns randomly selected through pre-determined criteria put into the computer should be subjected to audit.
- 2.144 The audit function should be substantially strengthened and streamlined under VAT. It should be largely officer based with hierarchies fixed only for supervision and guidance. Quotas should be fixed of the percentage of returns under different categories that will be subject to audit. Selection should be based on risk indicators modulated on the likelihood of evasion and fraud in different sectors. The selection criteria should be kept secret and changed only by intervention at very senior levels. Once a list of cases for audit is generated, the audit queue should not be disturbed at the discretion of the officer doing the audit; in fact, the next case for audit could be generated only after the earlier one is examined. Selection software will, therefore, have to be developed with great care. Sectors allotted for audit to different officers may even be rotated from time to time. Supervisory officers in the audit department should determine in detail the procedure to be adopted for audit. This should be based on examination of documents in different phases-the next stage of examination by calling for additional documentation from the

taxpayer should be adopted only on the basis of *prima facie* specific irregularities or doubts raised by the earlier stage of analysis. Measures should be adopted to incentivise the audit function, with the initial eligibility for incentives and the kind of incentive determined from computer-generated data linked to both quantity and quality of performance and taxpayer feedback. Audit must involve verification of documents checked and recorded at border check posts. The audit section may need to have connectivity with departments and agencies outside the Commercial Tax department. These might have to be identified along with the level at which such connectivity should be established.

2.145 Tax collection procedures should be streamlined as done for other taxes. Payments should be as far as possible through banks through drafts, checks etc. Refunds and tax credits should also be managed on the computer. Detailed procedures for bank reconciliation have already been worked out within the department.

2.146 The Intelligence Wing should also have access to relevant data within the department as well as from the check post for effective functioning. Price and consumption information from external sources would also be critical for this division. Coordination may be required with data from the Motor Vehicles department and the railway transport and freight handling departments, as also with the Central excise department. Appropriate connectivity should be established for the purpose.

2.147 MIS data of different kinds must be generated for continuous monitoring of key variables indicating performance efficiency. Existing computerised outputs should be adapted to VAT requirements. An area that could be given more attention is processing taxpayer data to identify trends and behaviour and use this for further investigation and eventual policy change. Data mining systems need to be installed to facilitate such analysis. Much closer interaction between the Commercial Tax and Planning departments would enable reliable data to be generated on critical macroeconomic indicators for the State. Data bases available from external sources (like those relating to product prices at the national and regional levels) which could be of help must also be accessed and made available to concerned departments as also to planners. A departmental web site would permit interaction with the public and with taxpayers. Apart from online registration, it could also provide information on tax policy, VAT practices, commercial and industrial trends and a chat room for clarification on tax matters.

2.148 A principal challenge to the design of an e-governance approach lies in devising means for cross and multiple, albeit quick, verifications of key facts online. This may in turn require a large multiplexed information system network. It will also be necessary to require taxpayers to adopt modern, electronic, business practices such as the keeping of verifiable records

accessible from the government network, online filing of tax returns and electronic funds transfer.

- 2.149 Careful planning, design, scheduling and education are pre-requisites for successful adoption of VAT. VAT on goods must over time be extended to cover capital goods. In the very long run, it might even have to evolve into a single VAT administered at either the State or Central level.

Service taxation

- 3.21 It is essential to integrate, as quickly as possible, general service tax with VAT on goods, subject services to the same range of VAT rates and administer the tax alongside VAT on commodities.
- 3.22 There is no escape from formulation of a comprehensive statute for an integrated VAT on goods and services at the Central and State levels. A far reaching Constitutional clearing up is essential to lay down the principles for integrating goods and service taxation. The Commission agrees with the view taken by the Expert Group on Taxation of Services that the power to tax services should be enjoyed concurrently by the Centre and the States.
- 3.23 A comprehensive integrated VAT on goods and services concurrently levied by the Centre and the States appears to be the ideal formulation for the country today.
- 3.24 It is essential to work out the modalities of a common VAT framework as quickly as possible. As pointed out by the Expert Group on Taxation of Services, this cannot be done within the existing Central service tax statute, since it requires alignment of the rates of service taxes levied at the State and Central levels with those accepted for the VAT on goods, harmonisation of exemptions and tax bases and development of administrative practices for accountbased assessment, input credit and data base management apart from constitutional amendments and a common “framework” statute.
- 3.26 We have considered the appropriate framework for VAT on services in Karnataka in the light of the suggestions made by the Expert Group. We strongly support the Group’s suggestion of concurrent Central and State VATs on goods and services. We recommend that the Finance and Commercial Tax departments take action right away to prepare for the tax by drafting statutes and regulations, studying revenue productivity and taking decisions on operational issues (covering items like *inter se* input tax credit mechanisms between goods and services, exempted services, return filing, account-based assessment, audit, inspection and appeal). An input-output table for the State’s economy should be prepared for both goods and services; while doing this, some of the pointers given in the case studies appended to Chapter II of this report could be followed. Much more work is required to complete the

services component of such a report and it is desirable to commence the analysis immediately. Substantial variations in macro figures of tax base and gross tax revenue arrived at in existing assessments of the VAT on services cited above indicate the need for a detailed and comprehensive understanding of the tax potential of the service sector. Net revenue figures must eventually be generated after accounting for tax credits.

- 3.27 3.27 Improved departmental knowledge of service taxation should be accompanied by a concerted campaign to build up support for such a measure among taxpayers and the general public. In all discussions, the department should highlight the two major economic advantages of the VAT on services—simplicity and fiscal neutrality. It should stress the fact that the tax would facilitate exports (through easy identification of the tax component of a product) and improve international competitiveness.
- 3.28 The broad framework of the generalised VAT on services in Karnataka should be in line with the rate structure adopted for the VAT on goods; the basic tax rate of 10% should be applied to all services and the lower rate of 4% could be considered for a limited number of selected items. As in the case of goods, for services too, State governments should agree on the items to be taxed at 10% and the few to which 4% should be applied. This agreement should be enshrined within a common national statute enacted by the Central government. Eventually, there should be a single VAT framework law for both goods and services.
- 3.29 States should also agree on the list of exempted services. The threshold level of Rs. 10 lakhs suggested by the Expert Group seems feasible and acceptable at the State level also. In general, the services listed by the Expert Group on Taxation of Services (Annexure I of Chapter III) in respect to the Central VAT on services could be adopted by the State also. However, we see no justification for exempting computer and related services (item B of 1 in the annexure) from service taxation, since this is *the* growing area of the services sector and putting it in the exempted category would affect the neutrality and revenue-productivity of the VAT on services. Nevertheless, keeping in mind current growth constraints in the area, we suggest levying VAT at the lower rate of 4% on such services at the initial stage. Items A and D at 10 in the annexure pertaining to entertainments and sports should be subject to VAT on services at the normal rate of 10% since entertainment tax is already being levied on them. We have referred to this in some detail in our first report. Banking and financial services suggested for exemption by the Expert Group may be kept outside the purview of VAT on services, but other similar services like venture capital financing should be subject to tax.
- 3.30 In the interests of economic neutrality, we concur with the view expressed by the Expert Group on Taxation of Services that VAT should be levied on fares of railway passengers and freight. While dealing with services rendered

across State borders, like road transport, courier services etc. the principle of destination applicable to VAT on goods should be applied and similar accounting and collection procedures followed. Where there is difficulty in allocating tax bases among States, appropriate formulae should be devised by agreement among States.

- 3.31 *Ab initio*, operational methods for the VAT on services should be modern and cost effective. Self-assessment, non-discretionary functioning, fixed penalties for technical offences, provisions for settlements of cases and advance rulings on substantive issues recommended by the Expert Group on Taxation of Services for the Central VAT on services should be adopted at the State level also. Administrative innovations appropriate to service tax include selective audit based on normative parameters evolved on risk basis and compulsory certification by chartered accountants above a pre-determined level of gross receipts. We also strongly suggest that the tax should be administered from inception as an “e tax”.
- 3.34 In our view, if preparations begin immediately, not more than a year’s time is required after the Constitutional power to levy a concurrent VAT on services is given to States for actual adoption of the tax.
- 3.36 States should be permitted to exercise powers to levy VAT on services only after complying with the basic requirements of a harmonised VAT on goods. The amendment must also restore powers to States to tax all advertisements, though the power could be exercised initially only with respect to advertisements on television and radio (to a limited extent).
- 3.39 When intra-State VAT on goods is introduced from April 2002, the segregation of the service element from the amount charged for the contract as a whole will have to continue for determining the VAT liability of works contractors; input credit will also have to be given in respect of the tax paid on goods purchased for contracts. The present composition facility will have to be given up till the composite VAT on goods and services comes into effect. This must be specifically mentioned in the VAT law and sufficient publicity and orientation given for taxpayers. However, when a generalised State VAT on services is introduced, works contracts should be taxed on their gross value at the basic rate of 10% and tax credits given for taxes paid on services and goods used in the contract.
- 3.46 With integration into VAT on goods and services, the electricity duty structure of Karnataka will also have to fall into the general approved VAT rate schedule. This means movement to *ad valorem* rates. We should make the shift even before VAT is introduced and select a rate or rates as close as possible to likely VAT rates. To protect revenue, we recommend a uniform rate of 5% for all categories of consumers. The 10% basic VAT rate should be applied when electricity duty is merged with VAT on services. The State

government should support this stand while negotiating with other States for a common VAT policy for services. Regional perceptions and sensitivities relating to the cost of power should not be allowed to affect selection of the appropriate rate of electricity duty under a VAT on services, since tax credit will be available for all intermediate producers/dealers for VAT paid on both goods and service inputs.

- 3.47 The principle of “immunity of instrumentalities” invoked in federal countries to prevent different government levels from taxing one another should not be extended to commercial operations like the Railways even if they are owned by the Central government. There is a case for appropriate Constitutional amendment and this should be pursued by the State. Since we have recommended that VAT on services should be introduced for rail transport also, the constitutional protection under Article 287 should be removed for the Railways and input tax credit given.
- 3.49 We recommend that duty should be charged on all consumers as and when metering is completed. When VAT on services is introduced, duty should be charged on domestic consumption for connections given under the *Bhagya Jyothi* scheme. Since this is in the nature of final consumption, there will be no tax credit for VAT paid on inputs. For most of the other categories, however, tax credit will be available if the activity is similar to intermediate production or trading.
- 3.51 We suggest that the Commercial Tax and Energy departments work together to prepare estimates of net revenue from electricity duty (after adjusting claims for input tax credit). Such estimates can be prepared at the macro and micro levels. Projections of future consumption by different customer categories made by KPTCL to the KERC could be used for macro estimations with correctives drawn from specific sector studies (like the recent ISEC evaluation of the *Bhagya Jyothi* scheme). At the micro level, industry and trade specific assessments can be done when input-output tables are prepared for the economy as a whole (covering both goods and services). Once prepared, such a comprehensive economic map can become an invaluable policymaking tool.
- 3.53 The Commission recommends that presumptive adjustments of duty due to the government from KPTCL should be given up and electricity duty accounted for on actual amounts collected by KPTCL. When computerisation of KPTCL accounts is completed, this should be possible.
- 3.54 At present, power generated for captive use is not subject to electricity duty, but duty is charged if it is sold to a third party. We suggest that this procedure may continue till the VAT on services gets stabilised. At this stage, the appropriate procedure for taxing captive power generation under the VAT on services could be developed.

- 3.56 The chain for the VAT on energy should begin with power generators from within and outside the State. Domestic power producers like the Karnataka Power Corporation (KPC), independent power producers (IPPs) etc. should charge VAT on energy sales to KPTCL and claim tax credits for VAT paid on inputs (goods and services). The transmitting and distributing chain should pass on the VAT and claim similar credits. Consuming intermediate producers and dealers in other sectors will also be eligible for tax credits. Tax incidence will then pass on to final consumers-through electricity duty itself in the case of households or in the form of final goods and services produced by manufacturers and service providers.
- 3.57 Inter-State transactions between KPTCL and power generators in other States and Central sector generators like NTPC will be treated like those relating to inter-State commerce on goods. The mechanism adopted for goods-zero-rating, tax credit and clearing house arrangements or any other method-will have to be applied to energy sales also. Taxes paid and recovered can then be incorporated into KERC's price fixation procedure under which input taxes are today computed as per current rates and permitted to be charged to customers as a component of the tariff.
- 3.63 The service and goods components of luxury tax need to be rationalised when VAT is introduced. Goods which are now taxed under this levy can be easily brought under VAT without any need to use the cumbersome entry tax mechanism once "declared goods" and goods subject to additional excise duty are permitted to be taxed by States. They should generally fall under the basic 10% rate and input taxes should be credited. Only tobacco and *gutkha* should be subject to the higher rate of 20% applicable to demerit goods without input tax credit. In the case of electronic goods, better enforcement and the improved compliance expected from VAT will have to be depended upon to control evasion. For services now under the luxury tax, which will come under VAT, we recommend that hotels charging up to Rs. 500/day should be exempt from VAT, the 4% rate should be applied to room rents between Rs. 500 and Rs. 1000/day and the 10% rate for rooms charged at higher rates. For convention and marriage halls, the exemption should apply to those charging up to Rs. 5000/ day, the 4% rate to those charging Rs. 5000 to Rs. 10000/day and the 10% rate to those charging higher rents. This should also give a fillip to tourists and business customers particularly when the sector as a whole is passing through recessionary days. Health clubs should be charged at the basic 10% VAT rate. These rationalisations could be introduced even during the transition period
- 3.68 The betting tax need not be brought within the ambit of the general VAT on services. It should be treated as a tax on demerit goods subject to a special higher rate of 20% without input tax credit facility. There is also a case for regular annual revision of the composition rate for totalisator tax.

Excise duties

- 4.55 Growth in alcohol production need not imply increase in consumption of potable varieties within Karnataka; IML brands could be developed for the foreign market and utilised by petroleum companies when alcohol-linked substitutes for motor fuel are evolved. Regulatory and fiscal policies should be geared to these requirements. The Commission suggests, therefore, that an expert committee should be appointed to look closely into the matter. It should consider the existing molasses surplus and the low capacity utilisation reported by licensed distilleries and determine the potential for utilising surpluses either by adding distilling capacity or by encouraging other alcohol-based production. Installed capacity should be indicated whenever fresh licences are given. For existing units, the committee mentioned above should fix minimum capacity utilisation levels after obtaining an annual declaration of expected utilisation from each distillery. Distilleries which do not achieve the prescribed minimum levels should be liable to cancellation of licences. They should not also be eligible to acquire fresh licences or run additional units. Frequent random checks of capacity utilisation should be undertaken in addition to implementation of the e governance mechanisms indicated by us in the annexure to Chapter IV.
- 4.56 Close examination of relevant indicators could disclose evasion. Energy consumption captured through electricity bills is a fairly useful indicator to assess the capacity utilisation of distilleries. In the case study on potable alcohol done at Chapter II of this report, we have noted that in Karnataka, this will be useful only at the blending and distillery stages, since earlier stages depend upon internally generated bagasse-based power. Some such pointers have been mentioned in the Commission's first report also. Turnover, profit and investment figures reported to statutory authorities for other purposes could also be used to confirm capacity utilisation figures given to the Excise department.
- 4.57 4.57 In view of the high licence fee structure in Karnataka, we recommend reduction in distillery and brewery licence fees to levels prevalent in neighbouring States. We also recommend making the rate proportional to installed capacity as in Andhra Pradesh and Maharashtra. The expert committee suggested above may also consider if incentivisation mechanisms could be developed for ensuring reasonably accurate reporting of capacity utilisation figures. Unutilised production licences should not be routinely renewed by the department. We recommend that since licences lead to pre-emption of production capacity, they should be in the nature of letters of intent as done in some States. The time limit for implementation should be specified in licences and extensions should not be given beyond 3 years. Old licenced projects which have not yet been implemented should be cancelled. If it is decided to add to existing distillery capacity, only integrated distillery-cum-blending units should be sanctioned and they should be as far as possible integrated with sugar factories.

- 4.61 We do not recommend modification of the existing routing of arrack blending to public sector undertakings and the auction system of country liquor vends. We suggest, however, upgradation of the quality of country liquor by making the use of neutral spirit mandatory and insisting on proper maturation of arrack. This should increase to some extent the end price of country liquor and mop up surpluses now accruing to vendors. It would also reduce the price differential between arrack and beer and help to restrain hard liquor consumption.
- 4.62 The ban on alcohol retail outlets near tribal areas should be extended all over the State. It could even be considered for other vulnerable hamlets like Lambani *tandas*. We recommend freezing the number of sale points in villages, which already have more than one outlet. An early decision may be taken on the policy to be adopted for fixing retail licence quotas and the Rules amended if necessary to pre-empt judicial intervention.
- 4.63 Evasion could be controlled and availability improved if mild liquor varieties like beer (below 5% v/v) and wine are permitted to be sold along with items of general consumption in large marketing outlets. Government may consider how this could be done in large metropolitan areas.
- 4.64 We do not propose any change in licence fees for hotels and restaurants for the present. In the case of clubs, however, there is no justification for the existing low concessional rate; we recommend that licence fees for serving liquor in clubs be increased to levels similar to those for hotels.
- 4.65 We recommend increasing the range of choice for consumers of alcohol in rural areas. Liquor varieties with low alcohol content should be promoted to offer competition to arrack. The arrack auction system now in vogue should therefore be extended to cover cheaper varieties of beer with low alcohol content. The two kinds of products should be stocked and sold in common outlets. Under a government notification issued under Rule 15 (3a) of the Bottling of Liquor Rules of 1967, beer varieties below 4.5% v/v are not permitted to be bottled. The notification requires amendment; such low alcohol content varieties of beer should also be brought under the auction system for arrack. The services of an expert external consultant should also be taken to study how auction procedures could be modified so that cartelisation and cornering of bids is prevented.
- 4.66 We recommend auction of IML outlets using the standard mechanism of a reserve price. We also suggest that appropriate auction procedures be adopted to prevent cartelisation of bids.
- 4.69 We propose to modify to some extent the recommendation made for a dual excise duty-VAT mechanism in the first report. We suggest, therefore,

retention of excise duty as a single impost on potable alcohol. However, in the interests of simplicity and transparency, as also for better administration and compliance and the prevention of evasion, we suggest that excise duty should be administered as a multiple of the basic price declared by the producer on which the final sale price should also be determined. The multiples should be fixed differently for mild and strong liquor, which means similar higher tax incidence (in *ad valorem* terms) on country liquor, IML and strong beer and lower incidence on light beer and wine. The structure would be basically similar to the Maharashtra excise duty mechanism.

- 4.70 We do not see any reason to modify the computations and comments made by us regarding evasion of excise duty and sales tax on IML as well as country liquor in the first report.
- 4.72 We have made suggestions in the annexure to Chapter IV for administrative measures which can help to keep track of molasses produced in sugar factories and *khandasari* units.
- 4.73 It is desirable to enact legislation similar to that in Maharashtra on the basis of the draft already pending with government for controlling molasses. The annexure to Chapter IV, which contains detailed suggestions for e governance in the Excise department, gives the minimum feedback required regularly from sugar production units to enable the department to control the escape of molasses from the organised sector. Prescriptions for the maintenance of minimum records of stock and movement and reporting requirements can be legally laid down and official verifications done for molasses only through formal legislation. A Molasses Control Act may be introduced covering these items but it is not desirable to enforce pricing or other distribution controls.
- 4.75 Checking mechanisms in distilleries themselves need to be substantially strengthened. The suggestions made in the annexure to Chapter IV to tighten up administration in distilleries should be implemented to improve the effectiveness of physical controls
- 4.76 It is essential to focus on e governance methods within the distillery itself. We have made some suggestions in this behalf in the annexure to Chapter IV. We also recommend setting up a Joint Committee of the Excise and Industries departments to regularly review the external indicators available to judge the capacity utilisation and functioning of chemical units. Licences given to units, which are proved to be misusing spirit, should be cancelled.
- 4.78 Detailed recommendations for better governance in distilleries and blending units have been made in the annexure to Chapter IV. There is scope for improving existing distillery procedures for accounting for spirit. We recommend that the production ratio for rectified spirit should be reviewed by the technical committee suggested in earlier paragraphs, which is

to be established for determining distillery capacity utilisation, by conducting controlled experiments to ascertain actual average recovery rates. We recommend that meters should be compulsorily installed at different points of the production chain to automatically record the quantities of spirit produced. Meters should be fixed at the point at which spirit moves into pipes and also when it falls into storage VATs. They should also be installed at the point where spirit is loaded into vehicles. Calibrations recorded on such meters should be linked to the departmental MIS. The use of every litre of rectified spirit, neutral spirit and extra-neutral spirit as well as of denatured spirit should be recorded on computers so that it is directly available on the PC of the excise officer stationed at the distillery; these PCs should be part of the departmental network and the data conveyed on line to supervisory officers and the Excise Commissioner. The installation of such machinery must be made mandatory by amending Excise Rules. We also recommend that laboratory checks should be mandatorily applied by the two public undertakings at the entry point of RS into the arrack blending process.

- 4.81 We do not recommend any major change in packaging rules at present. In our view, sacheting may be continued for arrack vending since there is scope for misuse of bottling contracts.
- 4.83 We recommend that a specific severe penalty should be laid down in the Excise Act for the offence of tampering with security seals and a high compounding fee levied to deter offenders.
- 4.84 4.84 We do not propose any modification of existing wastage norms for excisable goods.
- 4.86 If our proposal for levying an *ad valorem* excise duty as a multiple of basic price is implemented, the principle will have to be extended to imported liquor and exemption extended to exported varieties.
- 4.87 We recommend strict enforcement of existing regulations as well as implementation of the e governance measures suggested in the annexure to Chapter IV to control evasion through misuse of transport permits.
- 4.92 We have considered the question of introducing public sector involvement in wholesale liquor distribution. Although this would facilitate revenue realisation to some extent, we do not consider it appropriate for government to assume the role of liquor distributor and take on the responsibility for price fixation, inventory management and other activities, which ought to be determined purely by market forces. Wholesale control is not also likely to eliminate “liquor tragedies”. We suggest instead improved e governance measures for better administration and a tax structure that would provide some incentive for better compliance.

- 4.93 We have studied and adapted some of the elements of the Tamilnadu computerised excise package while making our suggestions for better governance.
- 4.95 An exercise to rationalise the Excise manual should be undertaken and the simplified structure put on a departmental web site in a suitably user-friendly manner.
- 4.96 Techniques for managing State excise duties without direct State intervention need to be further developed. There is a strong case for looking at incentivisation mechanisms to increase departmental commitment to governmental objectives at all levels. In the Commission's first report, we have proposed setting up fully mechanised composite check posts at State borders for the motor vehicles, commercial taxes and excise departments. A possible solution is installation of a similar post in distilleries themselves. Automatised posts should be set up at material despatch points in distilleries and blending units and these should be connected online to the departmental network. It should be made mandatory under the Rules to set up such facilities in production units.
- 4.87 There is a case to increase the powers of enforcement staff who are sometimes exposed to violence when they raid illicit distillation units. We recommend that check posts should be declared as police stations for the purpose of handling excise offences. They should also be provided with better communication facilities. Technical training (in chemical analysis for example) will greatly enhance departmental capabilities. We recommend incorporation of such training in normal departmental HRD programs.
- 4.98 We recommend the establishment of a modern laboratory for analysing material samples for the department. The Drugs Controller has prepared a proposal for setting up such an institution with the capacity to annually analyse 12000 samples. The cost to government of this unit would be around Rs. 2.5 to Rs. 2.7 crs.
- 4.99 Cash collections of excise duties and fees should be avoided and all fees should be collected through banks. It was indicated by the department that banks are reluctant to handle some fee collections since the amounts involved are nominal. This can be negotiated with banks who are getting business on other items.
- 4.100 Other regulatory measures should be strictly enforced like driving under the influence of alcohol through random checks using the latest apparatus available like breathalysers and offenders strictly punished through deterrent fines and endorsements on licences leading to eventual revocation for habitual offenders. We have recommended this in the chapter relating to motor vehicle

taxes. We also endorse the views of the Health Task Force for prohibiting liquor vending outlets on national highways.

- 4.101 Government has established a Temperance Board. We recommend ploughback of a small fixed percentage of excise revenue for effectively running the Board and actively involving NGOs and researchers in publicising the adverse effects of liquor consumption. The Board should fund the preparation of appropriate material to be used in school and college textbooks for spreading the message of temperance among young people.
- 4.102 As regards the minimum drinking age, we recommend amendment of Section 36 of the Act to bring it in line with the Rules.
- 4.103 The Commission concurs with the views of the Health Task Force and recommends that liquor shops and pubs should be kept closed between 11 am. and 4 pm.
- 4.104 All excise licences should have validity for a three-year period. An automatic increase in licence fees of 10% may also be enforced every year.
- 4.105 In the context of VAT, if a decision is taken to restore commodity taxation on liquor to the Commercial Taxes department and administer it in addition to excise duties, it is essential to establish mechanisms for continuing coordination between the two departments. This responsibility should be undertaken by the Finance department at the Secretariat level and appropriate systems established under the supervision of Secretary (Resources) to counter the tendency of each department to deny the other access to relevant data for enforcement purposes.

Stamp duties and registration fees

- 5.3 5.3 We recommend application of the recommendation given in the Model Stamp Act circulated by the Central government to both hypothecation and pledge instruments.
- 5.4 It is necessary to tackle the prevalent practice of transferring ownership without executing a document by making purchasers equityholders in property and shifting only the equity to them which is being used to evade duty on conveyance. We recommend amendment of Section 17 of the Registration Act at the State level to include such transactions under the definition of “conveyance”.
- 5.5 To mitigate the disincentive effects for entities which are developing from firms into incorporated companies for economic and industrial reasons, we may reduce stamp duty and registration fee requirements for firms in which

partners continue to hold controlling shares for a minimum lock-in period of 5 years.

5.6 We recommend introduction of a penalty for non-registration of registrable documents since this is the most common evasion technique.

5.7 Under Section 72 of the Registration Act there is only provision for a single appeal to the Registrar (D.C.) against an order of the sub-registrar refusing to register a document. We recommend that there should be provision for a second appeal to the Revenue Appellate Tribunal. We also recommend that inspection powers in Section 67B of the Stamp Act should be used to examine the records of developers who are suspected of undervaluing property and evading stamp duty.

5.8 A key suggestion that we would like to re-emphasise is the institution of a system of computerised generation of guidance values, for which, as we have already indicated in the first report, much of the preparatory work is practically complete. Concerted action over a six-month period is all that is required to bring in this radical improvement in the effectiveness and user-friendliness of departmental offices. We reiterate our view that computerisation at the superficial level of scanning registered documents or networking offices to improve MIS data would be inadequate to enhance the performance and image of the department. We hope government will move in the direction suggested in the first report as rapidly as possible in the interests of revenue and better compliance. As soon as this stage is reached, duties on conveyance should be brought down to the levels suggested in the Commission's first report.

5.9 A beginning should be made in improving physical infrastructure in sub-registrars' offices. We strongly recommend setting up modern offices spread over a single floor with personnel located in glass cubicles set opposite a comfortable public lounge provided with a computerised kiosk at which data concerning tax rates and procedures can be accessed in a user-friendly manner over the internet. Such offices should be provided with telephones and given powers to incur the expenditure required to purchase consumables for computers and take and preserve registered documents.

5.10 The need to fill up departmental posts which are lying vacant should be assessed after working out requirements after computerisation. Unauthorised persons found in sub-registrars' offices should be kept out after the required personnel are put in place. Recruitment rules should be modified to ensure that personnel with computer skills are preferred for appointment.

5.11 We suggest that the general recommendations on e governance made by us in this and the first report be adopted in this department. Some of the comments made regarding computerisation of the motor vehicles department would also be applicable to the Stamps and Registration department. We reiterate our

view that regular departmental staff should be trained to use computers and used for managing systems when software development is completed. NIC or other special personnel should not be taken on board for routine computer operations; they may be required only for creating a core systems management group attached to the head office for trouble shooting and handling upgradation and similar issues.

5.12 Routine office management in sub-registrars' offices also requires substantial improvement. Since it is possible to precisely specify the verifications required to be done by the sub-registrar for each kind of transaction, check lists could easily be prepared and brought into use. It is heartening to note that the IGR has already prescribed an office inspection schedule and formats for conducting inspections. This should be strictly adhered to and closely supervised. There is also no departmental manual listing out procedures and requirements although there is an internal diary containing much of this information. This should be developed into an easily readable manual which can be used by both departmental staff as well as users. It should be made freely available to members of the public and put on the departmental website. It could also be broken down into brochures documentwise and these could be made available at all offices.

5.14 In the first report, we have already recommended online collection and accounting of duty by most institutions. To this end, officers of the appropriate level should be empowered to endorse documents and accept duty on behalf of the government. This could be routinely done online by financial institutions, stock exchanges, insurance companies and the like. It would, in fact, be a better alternative to stamps than franking. Appropriate verification mechanisms could be prescribed for departmental officers using documents and occasional physical checks. This would eliminate the need for stamps, franking machines and even methods like pass-books and revolving credit accounts which have been suggested in various reports and thoroughly modernise duty collection. Safeguards could be incorporated and powers granted to institutions made liable to withdrawal if they are found to be evading levy and collection of duty. We also recommend abolition of adhesive stamps as a means of collecting duty.

5.15 Measures to reduce such harassment must be explored as it is at the root of non-transparent, user-unfriendly departmental functioning. Whether *affidavits* and strict penalties for false declarations could substitute for the NOCs could be considered. However, removal of such requirements may need to be made contingent on feedback from concerned departments on documents registered. In any case, wide publicity should be given to prescribed procedures, their rationale, exemptions and NOC requirements through a citizen's charter in which time limits for registration and avenues for grievance redressal are indicated.

- 5.16 Online transactions could substantially improve data collection mechanisms and our understanding of the revenue productivity of different documents. For the present, it is preferable, as suggested by the IGR, for the Finance department to collate data relating to drafts collected by sub-registrars for stamp duty and registration fee payment obtained from sub-registrars' offices and information regarding sale of stamps furnished by district treasuries to arrive at a reasonably accurate estimate of revenue realised. This could be reconciled with the Accountant-General's office from time to time.
- 5.17 We do not recommend automatic issue of *khata* after registration by the sub-registrar himself, since the department may not be fully aware of local requirements. There should however be provision for online intimation of registration to concerned *khata* issuing authorities. Since the revenue department and municipal bodies are themselves getting computerised, provision should be made for such interaction when systems are developed. Till something akin to the Torrens system of title insurance is introduced in the country, the sub-registrar's office may only be required to advise visitors to obtain encumbrance certificates before registration and ensure the genuineness of the title to property. Agencies granting lands like local bodies, BDA etc. should be formally authorised to collect stamp duty and registration fees and exercise delegated powers to register documents on behalf of the department. This should be done after they are linked online to the IGR's network and systems are developed for transferring data relating to formal title to property for use by both parties.
- 5.18 In respect of other statutes administered by the Registration department, we must consider how the procedure could be simplified and insulated from harassment and rentseeking.
- 5.20 We recommend that panchayats in rural areas should be given the power to register marriages under the Hindu Marriage Act as soon as they are computerised alongside maintenance of a networked computerised data base of such registrations.
- 5.21 30 days' notice of marriage has to be given under the Special Marriages Act after obtaining an application along with reliable proof of age and residence. To prevent rent-seeking, the procedure should be publicised on the web site, at kiosks and through other methods like posters and brochures within the department, application forms should be freely available within the office (and not offered for sale along with draft certificates through private booths), publication of the marriage notice should not just be on the notice board but by some other more effective method and the certificate automatically issued after expiry of the thirty days. For the present, we do not recommend transfer of this function to local bodies.

- 5.28 The State government could review all cases of special tribunals that have been set up. The basic principle to be considered from the court fee point of view when a matter usually handled by civil courts is transferred to a special tribunal is that the government which furnishes the service should be entitled to determine fee rates and reap revenues.
- 5.29 A feature of special tribunals is that court fee rates are laid down in the constituting statutes themselves. They tend therefore to escape review for long periods of time. The State government should regularly examine such rates with reference to the service rendered and the position before creation of the tribunal.
- 5.31 Since process fee rates have been reviewed as recently as 1999, there may be no case for further immediate increases.
- 5.32 There is a case for closer monitoring of court fees at the Finance department and treasury levels, which should be possible today since these departments as well as courts and major tribunals are being extensively computerised.
- 5.34 It is appropriate to expect judicial fees to defray part of the costs of revenue administration, that is expenditure incurred on recurring personnel and maintenance costs. Capital expenditure on buildings, residential and official as well as on equipment, furniture etc. ought to be met by government out of the general budget. It would be appropriate to realise through court fees approximately half the recurring costs; the above principle may be treated not as a rigid rule, but as a broad guideline to evaluate the working of the system from the financial viewpoint. There is a case to gradually increase revenue realisations from judicial fees to Rs. 50 crs. by streamlining the tax structure. This should be attempted, however, only alongside substantial upgradation and modernisation of infrastructure facilities for the judiciary and litigants. The burden of court fee should also be distributed equitably among litigants in line with benefits received and their ability to pay.
- 5.35 A mix of the concept of vertical and horizontal equity and the benefit principle seems appropriate while allocating the court fee burden among different users. The principle of cost recovery can be applied only at the macro level while determining the share of expenditure on maintaining the civil justice system that should be recovered through court fees. It cannot be used to allocate the fee burden since it is not possible to determine the manhours expended in deciding each case and compute their cost. Benefit can, therefore, be measured only in terms of financial advantage derived from taking up a civil matter in the courts and fees tailored accordingly. Such an approach is also in line with the equity principle. There is also a case for exempting or charging low specific fees when legislative protection is proposed to be given to special beneficiary classes, like accident victims, those whose land has been compulsorily acquired by the government or factory workmen.

5.39 In our view, the court fee structure should be proportional to the value of the disputed property. This would require merger of the existing multiple rates into a single low rate, which should be applied to suit value. We recommend that the rate should be determined by computing the prevailing effective average rate and rounding it off to the nearest integer. The rate might stabilise around 2.5% to 3%. A minimum low floor rate could also be fixed. This will create a simple transparent system that would be comprehensible and acceptable to lawyers and litigants.

5.40 5.40 Other modifications proposed are the following:

- the fee to be raised from 1/8th to 1/4th of the security value in cases of suits for the possession of title documents as in some neighbouring States
- for adoption suits, the fee to be raised to Rs. 50 for cases with market value below Rs. 5000
- drop provisions relating to suits under old statutes like the Bombay and Hyderabad Land Revenue and Mamlatdar Courts Acts
- dropping from the Second Schedule item 2 referring to petitions under Section 26 of the Insolvency Act and Section 95 of the Code of Civil Procedure, for which the present duty level is half that for suits (to discourage frivolous insolvency petitions and applications for arrest and attachment), since Rs. 1000 is the maximum compensation that can be claimed under the provision and Rs. 100 would be the maximum court fee that could be collected.
- At item 3 relating to petitions under Sections 53 or 54 of the Insolvency Act, an across-the-board fee of Rs. 500 could be levied.
- removal of the differentiation between applications filed within and beyond the limitation period at item 5 (applications for review of judgments). Applications for review presented to the High Court, civil courts and KAT could be charged at 5% and those to government at Rs. 100.
- in the case of letters of probate and certificates under the Succession Act, the rate could be 1% up to a value of Rs. 1 cr. and 5% in other cases.
- for undertakings under Section 49 of the Divorce Act, appeals to any court other than the High Court or executive officers, appeals to KAT and government, the fee rate should be Rs. 50
- for appeals to the High Court, the fee should be Rs. 100
- for appeals under the Arbitration Act, the fee should be 1% with a minimum of Rs. 50
- copies of judgments of criminal courts should be charged Re. 1 and those of High Court decrees, Rs. 5
- copies of stamped documents presented in lieu of originals should be charged Rs. 2
- copies of other proceedings should be charged Re. 1/page
- petitions to excise, revenue and municipal officers and to DCs for land leases should not be charged fees
- petitions for lapsed deposits presented after six months should be charged Rs. 5

- other petitions to government as also to DCs should not be charged fees
- petitions to KAT relating to legal powers should be charged Rs. 50 and other cases Rs. 10
- petitions to executive magistrates should not be charged fees
- applications for temporary injunctions presented to a court should be charged Rs. 100 and those to other authorities Rs. 50
- applications for arrest or attachment before judgment (other than to a High Court) should be charged Rs. 50
- applications under Rule 58 CPC in a revenue court should be charged Rs. 50 and in other courts Rs. 100
- applications under Section 47 and Rule 90 CPC should be charged Rs. 50
- applications under Order 17 Rules 1 and 2 CPC in the High Court should be charged Rs. 100 and in other courts Rs. 50
- the fee rate for original petitions not otherwise provided for should be similar to that in Kerala
- the fee rate for applications to set aside arbitration awards and applications for directions to file arbitration awards should be similar to those in Tamilnadu
- revision petitions in the High Court under Section 115 CPC should be charged Rs. 50
- writ petitions in the High Court under Art. 226 (except *habeas corpus*) and under Article 227 should be charged Rs. 500 as also appeals to the High Court
- applications under the Specific Relief Act should be charged Rs. 100
- petitions to the High Court and KAT not otherwise provided for should be charged Rs. 5
- election petitions for membership, presidentship and vice-presidentship of the Taluk Board or *panchayat* (or equivalent) should be charged Rs. 50
- applications to sue as pauper should be charged Re. 1
- applications to appeal as pauper in the High Court should be charged Rs. 2 and in other courts Re. 1
- bail bonds and other other instruments under the CPC and CrPC not otherwise provided for should be charged Re. 1
- copy of power of attorney or vakalatnama filed in any court should be charged Rs. 5
- the lower slab for agreements for question for opinion under the CPC could be dropped from the schedule
- all caveats should be charged Rs. 10

- 5.43 It is desirable for Karnataka to adopt guidance values notified by subregistrars for valuation purposes. A gradual transition to market-linked valuation could be made with fee rates adjusted downwards to prevent undue hardship to litigants on account of sharp increases.
- 5.44 The list of exemptions prescribed under Section 69 is given in Annexure II of Chapter V. The list may be reviewed in the light of the recommendation

made by us further on to remove court fee on applications made to government offices on non-judicial matters.

- 5.45. Since arbitration is governed by the provisions of a Central Act and costs are fully met by the litigants themselves, there is no case for levying court fees.
- 5.46. Matters under the Industrial Disputes Act are dealt with in labour courts manned by judicial officers, but expenditure is not recovered through court fees as a specific exemption notification has been issued by government. Such exemption is justified since these disputes relate to an important component of economic legislation-the protection of workers' rights.
- 5.47. 5.47 Consumer courts are an example of special tribunals that have been set up under a Central Act to decide matters that were once subject to civil legislation. There is a case for levying a fee even if there is an element of social legislation about the disputes handled by such courts. It is suggested, therefore, that an across-the-board nominal fee of Rs. 100 should be charged in consumer courts which could be eventually debited to the losing party.
- 5.48. Since compensation amounts for land acquisition for public purposes are routinely enhanced by courts, there is a case for levying a fee of .5% on the compensation awarded which should be collected after the case is decided while paying the amount.
- 5.49. There may be a case to charge a low fee of .5% on the value of the compensation awarded to victims of motor vehicle accidents, (which is generally paid by insurance companies) to be collected only after the conclusion of the case from the compensation amount itself.
- 5.51. The Commission is of the opinion that the existing procedure of charging stamp duty for petitions and applications made to the government should be given up since this is followed more in the breach than in the observance. It is incompatible with an e governance environment since the revenue realised from fees is disproportionate to the cost of monitoring a plethora of departments. Unless the fee provision is dropped, it could be used in a discretionary manner for rentseeking and harassment by individual officials.
- 5.52. Suggestions have been made for rationalising the number of denominations and aligning them with the schedule to the extent possible, since even today, stamps of higher value are often affixed to documents, due to non-availability of stamps of the required value. This should be done expeditiously. There is also a case for considering (as in the case of non-judicial stamp duties) whether online computerised collection would be possible. Collection and related franking through banking channels could be considered side by side with stamp vending. Over time, more modern methods would drive away

antiquated procedures based on stamp affixation with their attendant problems of artificial shortages and forgery.

- 5.55 From the users' viewpoint, the following improvements could be introduced into the system without much difficulty:
There is a case for a kiosk system under which the document could be scanned and court fee computed for the benefit of users without recourse to the counter. The extent to which connectivity could be used for interaction between personnel at the counter and the back office and the Principal City Civil Judge could be examined.
A citizens' charter could be developed and enforced to ensure processing without delay.
Connectivity could be used for online verification of pendency and delay.
Back office MIS outputs seem to have been developed but they have not yet been put into effect; these could be streamlined for regular outputs regarding fee realised from different kinds of suits and documents and feedback given not only to the Controlling Judge but also to the Treasury and the Inspector-General of Registration. A user-friendly computer manual detailing inputs, outputs and the like could be prepared and made available to all users and personnel. There is a case for developing expert-system software for mechanising scrutiny of documents in the back office to the extent possible.
- 5.56 It appears feasible even without computerisation to obtain regular reports from all tribunals regarding various kinds of court fees recorded by them while receiving documents.
- 5.58 Data relating to refunds was not being netted out for MIS purposes. This could easily be done since connectivity has been established.
- 5.59 Court fee examiners (officers of the rank of Assistant Registrars) can be appointed by the High Court. The Karnataka High Court, which was providing for such inspections every two years, has discontinued the practice recently. There is a case for reintroducing it as provided under the Act.
- 5.60 A penalty of 6 months imprisonment and/or fine of Rs. 500 is prescribed in Section 76 for registered stamp vendors who disobey prescribed rules and for sale of stamps by unregistered stamp vendors. There is no case for any change at present.

Motor vehicle tax

- 6.2 6.2 It is hoped that recommendations relating to progressive denationalisation of passenger bus services, abolition of exemptions for vehicles owned by educational, religious and charitable institutions, pollution control, tax collection through banks and by electronic transfer and eventual reversion to annual tax will be taken up for early consideration.

- 6.6 To use motor vehicles taxation as a fiscal mechanism for achieving the objectives of conservation, pollution and congestion control, it will have to be substantially restructured and such modification might inhibit its use as a tool for compensating for road damage. For the present, instruments like sales tax on vehicles and fuel, tolls, parking fees and the like would have to be employed for achieving these aims. It appears desirable to retain a single simple objective for motor vehicle taxation-realisation of revenue to compensate for road damage.
- 6.7 As for goods vehicles, the existing tax structure is broadly in line with what is desirable from the point of view of energy conservation and pollution control. There is however need to move to less-damaging multi-axled vehicles. From the point of view of congestion, light vehicles are the most congesting; non-fiscal regulations seem to be required to reduce indiscriminate use.
- 6.8 The *inter se* tax structure between goods and passenger vehicles indicates that light passenger vehicles (personal and commercial cabs) are lower taxed than light goods vehicles, but rates on medium and heavy vehicles are much higher for passenger than goods vehicles. (A loaded goods vehicle imposes a greater burden than a loaded passenger vehicle of the same category). This is appropriate given the carrying capacity of passenger vehicles and the importance of goods transport for the economy as a whole.
- 6.14 It is extremely important to collect accurate information on different types of motor vehicles not only to get a clear idea of tax potential, but also to properly administer the motor vehicle tax in the State. We hope that the State Government will take necessary measures to collect this information on a scientific basis to enable proper administration and enforcement of the tax.
- 6.15 The Commission's views regarding eventual return to annual taxation of motor vehicles have already been spelt out in the first report. In our view, as early as possible, once modernisation and introduction of measures of e governance in the department has substantially reduced the need for taxpayers to physically visit departmental outlets, we could revert to the system of annual taxation of motor vehicles.
- 6.18 In consonance with what we have recommended earlier, we would like to reiterate the damaging effects of the policy of nationalised monopoly passenger bus services on passenger safety, convenience and comfort as well on the exchequer. Progressive and speedy denationalisation appears inevitable. This could commence with disinvestment of government's equity holding and proceed to eventual private control. A Transport Regulatory Authority should also be set up by the Central government to regulate different modes of transport.

6.19 As a beginning, we recommend transition to denationalised operation by shifting from area nationalisation to route nationalisation (as done in most States) and freezing grant of future routes to the KSRTC. Routes thus released should be made available for private operation to enable increase in government revenues, economic activity and passenger security and comfort.

6.21 Goods vehicles to which trailers can be attached, could be rationalised. It would be desirable to charge Rs. 100 for every 1000 kgs. or part for this vehicle category.

6.22 For haulage vehicles, at present there are 7 slabs, which are proposed to be reduced to two-with gross laden weight below and above 7500 kgs. For the former, the quarterly tax proposed is Rs.1000 and for the latter Rs. 2000 with an additional Rs. 25 for every 250 kgs. over 15000 kgs. In the case of cranes no amendments are proposed. As for fire engines and sprinklers, there are 9 slabs at present. Since most vehicles in this category are owned by government, they would be in any case tax exempt. The few private fire engines owned by industries or utilities for inhouse use could be tax exempt; only sprinklers could be charged Rs. 1000 for every 40 kgs. of GLW or part. This rate mechanism could be applied also to trailers attached to sprinklers.

6.23 Data regarding the revenue earned from temporary users, could be collected easily once checkpoints are linked to the department's data base. It would be useful to do this as a part of policy planning exercises. Inter-State agreements have resulted in notifications by all States providing tax exemption for personal vehicles coming from other States using roads within the State for less than a month. Schedule B needs to be amended to take note of this situation. Keeping in mind the need to align Schedule B closely with Schedule A, we recommend the following modifications:

-items 1 and 2 in the schedule (personalised cars, scooters and invalid carriages) may be dropped for reasons indicated earlier

-item 3 relating to goods vehicles, for which there are 10 slabs, should be categorised into 5 slabs-those with gross laden weight up to 3000 kgs., 5000 kgs., 12000 kgs. and 15000 kgs. and those above 15000 kgs. The tax liability for a week and for a month for each category should be as below:

	Rs.	up to 7 days	from 8 to 31 days
up to 3000 kgs.		100	300
3001 to 5500 kgs.		200	600
5501 to 12000 kgs.		300	900
12001 to 15000 kgs.		450	1400
Above 15000 kgs.		460	1380
		+75/250 kgs.	+160/250 kgs.
		over 15000 kgs.	over 15000 kgs.

6.24

When these vehicles are used to haul trailers, for every 1000 kgs., the tax rate could be Rs. 25 for a month's use of the State's roads and Rs. 75 for a week's use.

-no modification is necessary in respect of multi-axled vehicles (item 3A)

-for motor cabs, the present range of 5 slabs could be reduced to three: for vehicles carrying up to 5 passengers excluding the driver, the proposed rate is Rs. 10 for a week and Rs. 30 for a month/passenger; for those carrying between 6 and 12 passengers, it may be kept at the present rates of Rs. 75 for a week and Rs. 150 for a month per passenger.

-no modification may be necessary in the present scheduled items 5 (motor cabs carrying more than 12 passengers for whom the tax rate is Rs. 250 for a month's use and Rs. 100 for a week's use per passenger) and 6 (luxury buses carrying more than 12 passengers for whom the tax rate is Rs. 400 for a month's use and Rs. 200 for a week's use per passenger).

-for omnibuses and private service vehicles, there are at present 5 slabs linked to floor area, two linked to ownership by schools and other educational institutions linked again to floor area and one linked to ownership by driving training schools based only on floor area. The department is of the opinion that the number of such vehicles coming from outside the State is limited and that it would be cumbersome and impractical for check post staff to measure floor area. Since 1958, the State has been exempting omnibuses from Tamilnadu, Kerala and Maharashtra from taxation by notification. It has been suggested that tax should be reintroduced on seating basis with three slabs: for vehicles carrying up to 12 passengers, Rs. 75 for a week and Rs. 150 for a month per passenger, for those carrying more than 12 passengers, Rs. 100 and Rs. 200 respectively per person and for educational institutions, Rs. 10 and Rs. 30 per person respectively. We agree with this suggestion.

-for ambulances and hearses it is proposed that there should be no tax as in the case of such vehicles registered within the State (item 9)

-for haulage vehicles, the existing 7 slabs could be reduced to two; for vehicles weighing more than 7500 kgs., the tax could be Rs. 300 and Rs. 900 respectively for road use of a week and a month and for those below 7500 kgs., it could be Rs. 150 and Rs. 400 respectively. However, no change is required for tractors and trailers (item 11)

-for fire engines, there need be no tax while for sprinklers and other similar vehicles, the existing 9 slabs could be rationalised and two tax rates prescribed at Rs. 10 for a week's use and Rs. 30 for a month's use.

-no change is required in respect of drilling rigs (item 13)

-for imported and company cars for which there are four categories and several slabs today, it is proposed to merge them into item 16 (campers' vans) and levy tax on all these kinds of vehicles at the rate of Rs. 75 for a week's use and Rs. 200 for a month's use per 1000 kgs. or part of unladen weight. Vehicles used to haul campers' trailers would bear a tax of Rs. 10 for a week's use and Rs. 30 for a month's use per 1000 kgs. of unladen weight.

-no change is required for the tax applicable to cranes (item 17).

- 6.27 On the question of fines for overloading, the present Karnataka rate should be reduced to Rs. 500 for the first tonne and Rs. 600 for additional tonnes. However, this reduction should become operable only after the composite computerised check post is set up. A record of violations can also be built up over time and increase in fines and other penalties contemplated for frequent violators.
- 6.28 Provisions relating to fines for violation of the obligations of conductors and drivers of passenger transport vehicles-that is refusal to transport a passenger, indulging in drug or other trafficking, demanding excess fare etc.-and fines for passengers unauthorisedly occupying seats reserved for women might require review if government controls over transport rates are eliminated.
- 6.29 For different categories of fines, we have given at Annexure I of Chapter VI suggestions for change
- 6.30 6.30 After due consideration, the Commission suggests that the present situation regarding intimation of non-use could continue and attempts made to improve information-sharing arrangements with other States by electronic and other means.
- 6.31 Acceptance of “lifetime tax” paid in other States and removal of re-registration and refund provisions can simplify matters and improve compliance. This is possible only if low-tax States like Goa and Union Territories like Pondicherry align their rates with those generally in vogue in the country. We have already made a reference to this in the first report. The issue may be taken up in inter-State fora and in the Transport Development Council.
- 6.34 A Road Fund should be set up at the State level provided with adequate resources from the budget to meet maintenance requirements, compiling an accurate central data base of roads of all kinds using GIS if required, strict adherence to rules concerning contract size and award of tenders and prohibiting works taken up under the Road Fund from being funded from any other source. The different elements of this package must be implemented together to ensure effective use of revenues raised to repair roads.
- 6.38 In the citizens’ charter, two kinds of time limits have been set for performing key functions in computerised and non-computerised offices. It is necessary to enforce them rigorously and obtain regular feedback from customers. An effective arrangement to regularly update and run the site should be set up and queries of visitors attended to promptly. There is a case for online processing of applications in selected areas. The matter may be studied by the department and a decision taken.
- 6.39 Areas which require greater attention are preparation of users’ manuals for each office, (which should be readily available to all members of the staff) and

setting up an effective group and procedures within the department to support the computerisation effort. Posts of programmers and systems personnel created for the department should be filled up using own staff or contract staff instead of looking for persons to be taken on deputation.

- 6.40 Connectivity should be established between data bases of the Motor Vehicles department and the police and treasury departments as well as with data bases of other States. Smart cards incorporating the data available in RC books are proposed to be introduced after GOI finalises standards which can be uniformly applied to all States.
- 6.41 There is a case for improving the ambience of RTOs' and other offices through user-friendly information boards, clean and cheerful surroundings, better seating and waiting arrangements for the public, queue management to reduce delays, parking arrangements and a well-laid out hall for holding the written component of driving tests. Ergonomics in RTOs' offices needs improvement; a model office could be laid out using the services of a consultant in Koramangala or Indiranagar. The department is also in urgent need of open area for conducting fitness inspections and holding driving tests.

Taxing agricultural income

- 7.39 Constitution has permitted it to encroach into State fiscal territory. This seems to have happened in the case of coffee in the current year's budget. The few large coffee producers whose incomes were hitherto subject only to State taxation will divert part of their tax payments to the Central treasury when the 60-40 income apportionment formula mentioned above is made operational by an appropriate amendment in the State Act. The Finance department should be alert to such modifications, estimate the likely revenue loss and move the matter with the Union Finance Ministry to protect State tax inflows. Coffeegrowers who now benefit from the composition facility under the State Act, will under the current amendment become liable to return based assessment if they undertake non-farm gate activities since composition is not possible under the Central Income Tax Act.
- 7.62 In the short term, therefore, we see little justification for a return-based tax on all agricultural crops particularly if it is designed to replace land revenue like the Agricultural Holdings Tax of K.N.Raj.
- 7.63 We propose for immediate adoption is amendment of the Land Revenue Act to permit annual indexation of rates. The price index that we would suggest for adoption is the Consumer Price Index for Agricultural Labourers (CPIAL) that is regularly prepared on a monthly basis by the Simla Labour Bureau. Arrangements will, however, have to be made to make the annual indexation as transparent, objective and public as possible to ensure that even the smallest taxpayer is not at the mercy of unscrupulous officials to know his tax

liability. The announcement of rates should also be done before the main *kharif* crop season commences in June. The computerised information network proposed for district revenue and panchayat administration should be used to disseminate assessment rates. Remissions now given for small holders should also be removed and cesses merged with the main tax.

- 7.64 Price-indexed land revenue rates should be introduced only when computerised RORs are made easily available through kiosks in villages to facilitate the paperwork required for agricultural lending. The Commission recommends that resurvey of agricultural land should also be done using modern techniques like GIS and digitised aerial and satellite mapping. Village records for a large part of the State could, therefore, be brought up-to-date with concerted effort. Special attention may have to be given, however, to metropolitan areas and Bangalore and its suburbs might present insurmountable problems. The Commission believes that resurvey would offer an excellent opportunity to consider partial adoption of the Torrens system of title insurance, which, as we have mentioned in our first report, is essential for taxpayers to willingly seek registration of documents relating to property transactions and pay the accompanying fees and duties. It is desirable to set up a high-level committee at the State level to oversee the entire resurvey and settlement process. We also recommend removal of the statutory provision excluding income realised from improvements made on the land by the landowner in the period between settlements while determining land revenue rates.
- 7.65 We believe that there is a strong case for putting in place a levy based on self-assessment (with provisions for presumptive taxation) for occupations like horticulture, floriculture, social forestry, pisciculture and similar activities as quickly as possible. This will supplement the basic restructured land revenue suggested above. We recommend immediate action to undertake the required surveys and develop productivity parameters for such avocations. Data available with financial institutions, which lend for such activities or refinance them like NABARD, could be used for computing presumptive taxation.
- 7.66 We do not recommend increase in rates
- 7.67 In the interests of horizontal equity, we believe that as far as possible taxation of agricultural and non-agricultural income should be done in a similar manner with identical rates, exemptions and procedures. We therefore recommend that effective tax rates for agricultural income tax should be brought on par with those applicable to non-agricultural income tax. The rate and method of depreciation should also be similar. There may be no case for providing fiscal incentives for exports undertaken by grower-exporters (direct exporters) similar to those available for industries under 80 HHC of the IT Act or for investments made in R&D, since there is already a replanting allowance and such fiscal incentives are themselves not justified in

tax administration. While not recommending increase in the composition limit from 150 acres to 500 acres as in Kerala, we suggest annual determination of composition rates to ensure that price fluctuations for each season are taken note of and undue hardship to cultivators avoided. The replanting allowance which was fixed several years back should be revised keeping in mind inflation over time. The State government should take measures to arrest the declining productivity of coffee. Schemes for promoting investment in the sector (like the Investment Deposit Scheme of 1995) are worth examination.

7.68 We suggest that whenever a taxpayer declares agricultural income above a fixed limit in his income tax assessment, it should be treated as such under the Agricultural Income Tax Act and subject to tax. This would be in line with the present judicial position that agricultural income determined under the Central Income Tax Act must be treated as such by State assessment officers. We suggest that the legal provisions required for this be introduced into the State Act to prevent evasion, raise revenue and enforce other regulatory statutes. The Finance department should assess the financial and other implications of the amendment introduced in the last Central budget allocating income derived from coffee on presumptive basis as agricultural and non-agricultural and take appropriate action from the point of view of revenue as well as taxpayer compliance.

7.70 In our view, land revenue is suited for levy by *panchayats*. Local knowledge is needed for applying the tax and if taxpayers perceive a close relationship between tax payment and benefits received, compliance and fund utilisation improve. We suggest, therefore, that government seriously consider transferring the levy to *panchayats* to strengthen their financial responsibilities.

Taxes on mines and minerals

8.21 It is desirable if information relating to exploitation costs for different minerals is regularly shared with States so that the royalty determination logic becomes transparent and scientific.

8.23 A solution which could be explored to ensure equity as well as stability might be to shift to royalty on *ad valorem* basis. Administratively, therefore, it should be possible to move to an *ad valorem* rate. Government may, therefore, make an indepth examination of the matter of fixing an *ad valorem* royalty rate for iron ore and take up the issue if necessary with the Centre after building up support from Orissa (the other major State concerned with this issue).

- 8.24 The State government could consider conversion of this rate also to an *ad valorem* rate and take it up with the Centre after obtaining the support of other affected States.
- 8.28 Considering current rates in some neighbouring States and keeping in mind the fact that royalty and dead rent have not been revised in respect of minor minerals in Karnataka for some time, increases have been proposed at Annexure II.
- 8.29 Keeping this in mind, further revisions have been proposed for certain items at Annexure III. It is also recommended that the proposal already made in the Karnataka Mineral Policy to amend Rule 19(a) of the Rules to permit transfer of leases for minor minerals on payment of 20% of the annual dead rent as premium may be implemented early.
- 8.30 Reviewing royalty rates for minor minerals
- The Commission believes that it is necessary to streamline the existing mechanism. A statutory body consisting of officials and experts should be set up to regularly study quarrying costs and methods in respect of minor minerals. It should suggest appropriate royalty rates as well as procedural and administrative changes. This will enable the State to generate revenue in a scientific and environmentally sound manner.
- 8.32 In today's liberalised environment there may be a case for reconsidering this decision, but only in the context of strict regulation of quarrying operations by the forest and mines and minerals department.
- 8.33 There is a strong case for amending the Land Revenue Act to introduce a reasonable conversion fee for mining on agricultural land and dropping the saving clause of Section 70.

Concluding remarks

- 9.2 In the first report, we have suggested the establishment of a permanent review mechanism under the Secretary (Resources) for this purpose. A framework for diagnosing tax systems has been developed at the World Bank, which is given in this chapter to guide them in such assessment.
- 9.3 We do not believe that uniformity of rates and administrative practices is essential for all State levies. The degree of coordination needed to manage VAT has already been determined. The same extent of levelling may not be required for the other major State taxes. We do not, for example, see any need for States to adopt more or less identical tax schedules and regulatory requirements in the case of State excise duties as demanded by producers of potable alcohol. In the case of stamp duties and registration fees also, State

governments are entitled to exercise their discretion to determine tax rates and revenue-raising methods within the existing statutory and Constitutional framework. Welfare-enhancing fiscal competition among different jurisdictions may even be desirable for efficiency and accountability to the taxpaying constituency.

- 9.4 The basic principle that should be applied when considering harmonisation is ensuring that tax incidence falls on those who benefit from State expenditure, that is limiting the impact of State taxes to those who live within their borders. Avoidance of “tax exportation” should be a major objective of tax policy. Uniform procedural sameness is not, however, essential in the sphere of tax administration as in other areas. A major advantage of autonomic State policymaking has always been the freedom to innovate; a new initiative that succeeds in one State is easily picked up and used by others.
- 9.5 While Andhra Pradesh has effectively put in place a computerised system for the sub-registrar’s office, Tamilnadu seems to have succeeded in doing this for State excise administration. Karnataka has done similar work in the motor vehicles department. It would be convenient for southern States to draw on these experiences and even use the system and programs developed by their neighbours to rapidly modernise their own departments. Closer coordination among southern States for exchanging technical and administrative competence would benefit them all.
- 9.6 Taxation departments figure at the top of the list of government departments crying out for reform.
- A great deal of improvement can come from overhauling the tax structure itself, reducing rates and slabs and removing exemptions as well as from publicising taxpayer obligations and departmental procedures.
- 9.7 We note, however, that several posts lie unfilled in major tax departments like registration and motor vehicles. We suggest that the post-reform requirements of these departments be assessed in depth and recruitment rules overhauled to meet their new needs. There are two areas to which particular attention should be paid: the first is the induction of persons with computer skills by modifying recruitment rules for all levels, the second is developing an economic and public finance perspective by alerting personnel to the consequences and effects of tax policies on SDP growth and welfare. Staff who are already in place must be given intensive in-house training in both these areas.
- 9.8 Administrative reform must also be focused on improving accountability for the department as a whole, for its different sections as well as for individual personnel. Timebound targets must be specified for all of them, which should be as objective, focused and simple as feasible. Such targets must also be

linked to promotions and other incentives. Fixation of targets must be done with a clear understanding of the kind of behaviour that would be promoted by each of them. At the departmental level, budgets and other facilities could be linked to macro performance ratios. There is a case for linking the provision of some additional amenities to achievement of a few pre-determined targets. Targets should not only be linked to revenue realisation; performance should be judged as much by improvement in taxpayer compliance and public satisfaction as by quicker and more effective audit and successful imposition of prescribed penalties. Incentivisation techniques must be explored for taxpayers as well as personnel. A major advantage of VAT is the inbuilt incentive for better compliance. We stress the need to ensure that this feature is not diluted when adaptations are made to introduce value added taxation in the transitional stage

- 9.9 It is essential also to specially combat the vulnerability of tax departments from the point of view of corruption. Strategy to combat corruption must limit the motives and opportunities for public officeholders to abuse their positions. There should also be focus on the supply side of bribes. Caution must be exercised while offering incentives for revenue officials to ensure that they do not lead to overzealous harassment of taxpayers. Negative incentives should therefore complement positive ones. Independent taxpayer surveys will help identify elements of the organization or tax offices that harbour severe corruption. Studies like recent ones undertaken by the Public Affairs Centre at Bangalore on ranking government offices on a consumer satisfaction index should be encouraged and their findings used for judging departments.
- 9.10 Internal audit divisions and anticorruption units within the department should be supplemented by effective judicial support, external reviews (including external audits) and interaction with taxpayer associations. Contact between officials and taxpayers could be reduced through withholding taxes, using third party data for tax assessment and account-based assessment. The last two are inseparable from value added taxation. In addition to these measures, we strongly recommend setting up an independent enforcement agency for all tax departments as a whole similar to the Bangalore Metropolitan Task Force now working in Bangalore city.
- 9.11 Corruption can be also kept under control by improving taxpayer awareness of rights and obligations by publicising procedures through brochures, web sites (regularly and correctly upgraded by an institutionalised system), kiosks and the like and enforcement (not mere announcement) of citizens' charters. As far as possible, payment mechanisms should be integrated into normal commercial methods by collecting tax through banks. On line filing of returns should be facilitated and taxpayers permitted to ascertain the processing stage of pending applications, the reasons for delay etc. Enquiries must be conducted swiftly on complaints received against departmental personnel and

penalties enforced without delay. We must also guard against newer forms of corruption that could enter by the back door even after modernised systems are put into place. A common method of introducing middlemen into tax departments is by preventing the public from having access to the required forms. Apart from encouraging on line interaction, we must also arrange for forms to be automatically printed out at kiosks and other sale points.

9.12 Reform must be ushered in through a package of measures that cover statutes, procedures and administrative culture. The aim should be to set up a structure that would respond satisfactorily to growth in Gross Domestic Product. This would eventually be the test of success of the reform agenda.

9.13 There are identifiable stages in the reform process starting with dissemination of the reform message and proceeding through consultation and compromise and conversion of decisions into timebound activities to the final phase of consolidation and maintenance. Unless the stretch is fully covered, the reform cannot be considered to be complete.