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Taxing issues about taxes

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TAXATION: PRINCIPLES AND APPLICATIONS

Parthasarathi Shome
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Parthasarathi Shome is a global authority on taxation. The volume does not purport to be a systematic treatise on the principles of taxation. Nor is it a comprehensive compendium on the practice of taxation worldwide. Yet it covers virtually every important aspect of tax policy or tax reform, and these are discussed within a rigorous framework of the principles of taxation. Moreover, the discussion is animated with illustrations from across the world: Latin America, Canada, the United States, Europe and the transition economies, Australia and Africa, India and South Asia, East and Southeast Asia. This richness is a reflection of the author's long and distinguished career in the field of taxation.

The overview in part one is followed by several case studies on tax incidence and the distributive effects of taxation in part three. These cases illustrate how the ultimate long-term incidence of a tax on the basic factors of production - labour, capital and land - may be quite different from the immediate distributive effects captured in expenditure surveys.

The main purpose of any tax or tax system is to raise adequate revenue to finance the expenses of a government. However, in designing the tax (or tax system), several competing goals come into play: equity, efficiency, macroeconomic stability, simplicity and ease of administration. How to balance these competing goals is at the heart of the discussion on direct and indirect taxes in parts three and four respectively, supplemented by the discussion of some new taxes in part five.

The discussion on direct taxes summarises the challenges in designing a robust income tax: the trade-offs between equity (progressivity) and efficiency (adverse incentive effects and inducement to evasion); the problem of double taxation; the treatment of interest costs for debt financing versus dividends for equity financing; problems of defining taxable income in the financial sector, and the special challenges that arise from globalisation - intra-multinational company shifting of tax liability to low-tax countries through transfer pricing, among others.

The discussion on tax incentives and the impact of tax structure on corporate behaviour and foreign direct investment (FDI) is particularly interesting. The evidence suggests that corporate investments can be quite sensitive to corporate tax rates. Also, in the context of FDI, it turns out that the business environment in the host country - policy stability and growth prospects, infrastructure quality, etc - are more important than tax incentives in attracting FDI. However, other conditions being similar between competing host countries, tax incentives will help to attract more FDI. Finally, in the context of developing countries where the reach of tax administration is limited, Mr Shome recommends a minimum alternative tax as a simple alternative for ensuring substantial revenue flows from hard-to-tax entities pending comprehensive tax reforms.

The chapters on indirect taxes are predictably focused on the value-added tax or the goods and

services tax (GST). The GST has been increasingly adopted by many countries as a principle source of revenue because of its simplicity in administration and its record of ensuring better compliance. However, successful introduction of this tax requires careful preparation. Drawing on the experience of several countries, Mr Shome illustrates the many complexities of introducing the GST, especially in federal countries.

This part also discusses the retail sales tax, excise duties and Customs tariffs. The last have fallen dramatically since the advent of the World Trade Organization. However, protectionist tendencies do emerge, especially during periods of severe recession, and there is still a long way to go before tariff barriers are eliminated from international trade. Meanwhile, a thumb rule Mr Shome recommends is that there should be only a few low tariff rates, if not a single rate. The rates should be lower on intermediates than on final consumption goods, and lowest on capital goods.

There is an excellent discussion of tax reform experiences in several countries, including India, in part six. A sobering message is that tax reform by its very nature is a gradual and long-drawn process. Experience also shows that if policy makers prepare the ground carefully and persist in their efforts, tax reform does succeed. Policymakers and tax administrators would also find the chapters on tax administration, countering tax evasion and reform of tax administration in part seven useful. They provide a background to the recent recommendations of the Tax Administration Reform Commission, which Mr Shome chairs.

The concluding chapter draws together the lessons discussed in the volume in the outline on an ideal tax system. I would have preferred to see the threads being drawn together in the specific context of a tax reforms road map for India. Admittedly, this is not a volume about India. But it does draw a great deal from Mr Shome's long engagement with tax reform efforts in India.

To conclude, I would not recommend this volume for the general reader. But for the specialists - scholars, researchers, and tax policymakers, administrators and practitioners - I would strongly recommend this volume as essential reading.

The reviewer is member, 14th Finance Commission