भारतीय प्रबंध संस्थान बेंगलूर
INDIAN INSTITUTE OF MANAGEMENT
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Re-Designing Revenue Agencies in Federal India

A Roadmap for Tax Administration and Institutional Reforms

Praveen Kishore

PREFACE

The Centre for Public Policy (CPP) at the Indian Institute of Management Bangalore is envisioned as the catalyst for new thinking and new directions in public policy and management. The CPP functions as a think-tank to facilitate open debate and dialogue on key public policy and management issues, backed by in-depth research and analysis, and training and teaching programmes. It engages government and non-government actors through seminars, round-tables and conference, both national and international. Its mission is to change closed mind-sets to more open ones, build capacity for rigorous policy analysis and innovative thinking and stimulate creative problem solving.

This series of Occasional Papers is intended to contribute to the debate on public policy in India and internationally. Each paper is reviewed to ensure academic rigour and policy relevance. Papers written by academic are commented on by practitioners and vice versa.

Comments are welcome and may be sent to the author at praveen.irs@gmail.com or praveen.kishore@nic.in

EXECUTIVE SUMMARY

It is widely recognized that 'tax administration is tax policy', especially for developing countries. This applies even more so in the case of diverse, federal and competitive democracies like India. The fiscal-federalism in India is tilted towards union with some important tax powers and an institutional mechanism for mandated devolution to states, which share major expenditure responsibilities. The institutional framework of revenue administration consist of two large union revenue agencies as well as large number of state and local level revenue agencies which coexist together, largely without much harmonization which poses its own challenges and opportunities. An integrated, modernized and harmonized revenue administrative architecture is sin-qua-non for successful execution of ambitious tax reforms agenda. This has to take shape within the overarching landscape of organization, structures and processes of Indian civil service. The political economy and administrative architecture thus plays an important role in institutional reform and reorganizational efforts for redesign of revenue agencies.

India is moving towards next level of tax reforms with proposed goods and services tax at national level in coordination with the states. On the front of taxes on income, which are taxes of future, there are important administrative and political-economy issues to be tackled. In this backdrop, five alternative models of revenue agencies have been examined within the framework of technical suitability, administrative feasibility and political acceptability. These alternatives range from one single revenue agency at national level, responsible for collecting all tax revenue, to multiple agencies at union as well as state level, somewhat akin to the present situation. Technically, it has been concluded that either two or three revenue agencies modeled largely on the tax type basis at national level would be the first best alternative in India for an efficient and effective tax administration. However, due to India's particular federal nature, the historical development of fiscal federalism, perception of revenue powers of states as a very important component of political landscape and also due to organized bureaucratic civil service structure of India, it may not be feasible to shift to this design immediately, though it should be the goal in the long run. As a short term goal, it would be proper to move to a highly harmonized operational structure of revenue agencies largely within the present institutional arrangements, as the second best alternative, with a planned gradual move towards the first over time.

Contents

List of Exhibits

Exhibit

Acknowledgments

Major portions of the study were completed during my stay at Harvard Kennedy School to prepare what is called Second Year Policy Analysis paper as part of MPA/ID degree program under the guidance of Prof. Perry Guillermo and Prof. Matt Andrews, to whom I am grateful for their support and constructive suggestions. I am sincerely thankful to Prof. Monica Singhal at Harvard Kennedy School for useful discussions, guidance and valuable suggestions. Her course on public economics was also quite helpful. I would like to express my deepest gratitude to Mr. Binay K. Jha, Director, Directorate of HRD, Central Board of Direct Taxes, Government of India, New Delhi who was instrumental not only in getting this research endeavor underway but also took great care of me during the summer of 2010. I am also thankful to Prof. M. Govinda Rao, Director, National Institute of Public Finance and Policy, New Delhi, who was kind enough to accommodate me as an intern at NIPFP where I started working on this subject during 2010. Thanks are also due to Prof. Rajeev Gowda, Chairperson, Center for Public Policy, Indian Institute of Management Bangalore, for being instrumental in publication of this study.

Over the years, many friends and colleagues have made important contribution in the form of ideas, discussion and debates. Though the list could be quite long, I would like to make special mention of Mr. Ishtiyaque Ahmed, Additional Commissioner, Income Tax Department; Mr. Ravi Saroop, Director, Tax Research Unit, Central Board of Excise and Customs; Mr. Sibichen K Mathew, Addl. Director, Income Tax Department; Mr. Sunil Chandra Sharma, CEO, Grameen Vikas Trust; Mr. Sambit Tripathy, Addl. Commissioner, Income Tax Department; Mr. Pankaj Jindal, and Sobhan Kar Members, Task Force on Direct Tax Code. Thanks are also due to Ms. Sarita Deshpande, IIMB for excellent editorial help and support.

Though it may seem routine, I wish to express my sincere thanks to my wife Shradha, who put her career on hold for supporting me at Harvard. Without her, neither this work nor my pleasant stay and study at Harvard would have been possible. Indeed, this work is dedicated to Shradha, to whom I owe so much.

Praveen Kishore
5th August 2011

About the Author

Praveen Kishore is a member of Indian Revenue Service of 1998 batch. He has varied experience of handling different assignments with government of India. He has worked in tax administration, enforcement and investigation divisions of Income Tax Department as well as in areas of fiscal and tax policy management in Central Board of Direct Taxes. Since 2008, he has been working in areas of strategic management, policy planning and human resources administration in the Directorate of HRD, CBDT, and was Member Secretary of the committee for cadre review of IRS and restructuring of Income Tax Department in 2009.

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CHAPTER I
Introduction

1.1 India: A Unique Federation

India has a unique federal structure in many senses. On the one hand, there is a strong center controlling such important functions as creation of new states and right to levy most important of taxes. On the other, states in themselves may not be termed weak as they shoulder such humongous responsibilities like law and order and development administration. The uniqueness pervades even to the 'idea of India'. Being the largest democracy in the world, India, even today deeply puzzles political scientists, as it does not qualify to be a candidate for successful federal parliamentary democracy in terms of western understanding. In fact, the preservation of democratic governance in India has presented a standing challenge to theorists of historical and comparative development[1]. The first general election in independent India, held in 1952, was termed by many as 'biggest gamble in history'[2]. Even before that election, it was said that a poor, uneducated, diverse and divided country cannot aspire to become a democracy. For that matter, the very fact that India was a single country was inconsistent and incongruent to the received wisdom. It was, sooner or later, destined to disintegrate into many different nations - like Europe! A landmass so diverse in every conceivable way - with wide differences of language, culture, religion, social structure and practices, ethnicity, climate and topography, food habits and what not - could not be a single country. Despite all such skepticism and doubts, India has remained not only a single country - but also a lively, thriving, intensely competitive democracy and a federal republic, and has continuously strove to improve economic and social condition of its citizens. Understanding India truly has always been difficult as nothing is obviously true for India as a whole. Every generalization that follows could be disproved with evidence to the contrary from India itself[3]. We need to keep this fact in mind before making any broad sweeping proposal for any kind of socio-political, administrative or institutional changes.

On economic front, thought the growth was not very high during the first four decades after independence (in 1947), there has been some rapid growth and widespread transformation in past two decades and India today is considered an emerging economic power. Though there has been unleashing of private sector growth energy, the role of the state in social and economic management of the country is still very significant and would remain so in the foreseeable future due to welfarist nature of Indian state and these ideals enshrined in Constitution of India, a vibrant and completive democracy, perceived active role of the state in development administration and in providing public goods as well as basic human services like health, education, public infrastructure; still prevalent widespread poverty; and significant inequalities in economic, social and regional spheres. For all such purposes, Indian government, in fact all governments need revenue. And the most important source of revenue is taxation.

1.2 Policy Question, Scope, Approach and Limitations of the Study

Under this backdrop the present study probes the question –

What should the organizational and institutional structure of Indian revenue agencies be in light of ongoing and envisaged tax policy reforms and how the required redesign, if any, needs to be approached?

In the process, it looks in to various aspects of revenue mobilization framework, tax policy reforms, institutional structure of tax collecting machinery, organization of government agencies and institution of permanent civil service within the overarching landscape of technical suitability, administrative feasibility and political acceptability, to make policy recommendations which are practical, acceptable and implementable.

Administration reforms and organizational restructuring are huge topics in themselves. Further, any application of these concepts in federal democratic Indian context, even to the narrower scope of revenue administration is, in itself, encompasses numerous complications. Therefore, the attempt here has been on understanding and analyzing the existing institutional, organizational and structural design of revenue agencies of union and state government in India, various issues and factors which have led to the present situation followed by an attempt to delineate an approach for redesign of revenue agencies, so that they are able to face the challenges of future tax administration. Even the scope of redesign of revenue agencies is, in some senses, too wide for the present study and therefore, the study has mainly focused on macro aspects of the broad design and structure and did not generally go into micro-design issues like field, division and unit level functional and operational design and structure; business process analysis of different functions and activities and their restructuring; and organizational hierarchies, their reorganization and restructuring. However, they have indeed been examined occasionally in reference to the broader picture.

Though tax administration is closely linked with tax policy reforms and related economic questions like equity and fairness, efficiency and effectiveness, resource allocation and distribution, tax incidence and decisions by economic agents, etc., such issues have been kept out of the scope of this paper. Nevertheless, some incidental references to them when they have a direct bearing on administrative architecture could not be avoided. In any case, all such references have been kept at minimum. The study is mostly an empirical, yet qualitative exercise and information on tax collections and revenue organization have been used for deriving insights and making analyses. The study focuses more on ideas of organizational design, institutional restructuring, design of executive agencies, government bureaucracies and administrative reforms, and related issues, while placing the whole approach within the broad contextual framework of Indian federal structure, democratic polity and tax policy reforms.

The occasional paper is divided in to seven parts. After introduction, the second part examines Indian federal structure, the distribution of tax powers between union and state governments and the pattern and behavior of revenue collection within tax reform agenda of past two decades. Third part tries to overview some theoretical concepts related to organization of revenue administration and design of revenue agencies. The next part examines institutional and organizational structure of Indian revenue agencies, the organized bureaucratic complex of tax administration and approaches reform and redesign issues from these vantage points. Part five further extends this exercise by considering five possible models of redesigned revenue agencies and carries out a detailed technical, administrative and political analysis in light of proposed goods and services tax, political economy factors for income taxes and local level revenue potential. Part six continues with this analysis within the overall framework by examining fiscal federalism and tax assignment, international experience and personnel administration of civil services. The last part then summarizes the analysis and findings, discusses final recommendations and suggests what to do next.

This policy research paper is only a small attempt to examine a vast area and it draws upon only a tiny fraction of a large and expanding literature on the subject of tax administration. The study has not looked into some areas which may be important for tax policy reform and tax administration like international transactions and international financial flows. The emphasis has largely been on income/asset and consumption/expenditure taxes, which forms the bulk of revenue for Indian government (and for most other governments too). However, there are new, innovative and emerging revenue sources like environment taxes, user charges, cash flow taxes, and taxes on financial and other transactions, the potential effects of which have not specifically been considered here. Further, other important issues like free trade and protectionism, tariff reforms and custom duties, tax treaties and international tax harmonization, risk taking, imperfect markets and theory of second best, etc., many of which have some bearing on tax administration, have largely been beyond the scope of the present study.

CHAPTER II
Indian Federal Structure, Fiscal Federalism and Revenue Resources

2.1 Revenue Powers in Indian Federal Structure and Resource Sharing

2.1.1 Indian Federal Structure

We have already noted the uniqueness of Indian federal structure. The uniqueness is the result of historical, cultural, economic and most importantly political realities and freedom struggle waged for making India independent of British Empire during the nineteenth and twentieth century. One can note two important features of India which makes its structure unique compared to many other federations - first, Indian federalism is not the result of an agreement among constituent states/provinces which decided to form a federation. Rather, it is a 'union of states', where the union government has overriding powers over almost all important matters. It has powers even to create/carve out a new state or alter the boundaries of existing states. Second, the constituent states have no power to secede. These important features make India a quasi-federal system[4].

In case of India (and many other developing countries), any discussion of 'fiscal federalism' has to be carefully qualified with how this term is generally understood in most popular academic literature. Much of the fiscal federalism literature which focus on economic efficiency of intergovernmental competition (in terms of Tiebout model) does not apply to India due to various reasons like failure of voting by feet phenomena, focus on allocation rather than on provision of public goods, possibility of local government capture by local elites and most importantly the issue of redistribution and compensating transfers being much more important in India than questions of efficiency[5]. Indian federalism has been called 'holding together federalism' as against 'coming together federalism' of United States of America (USA) leading to emphasis on such concerns[6]. Further, the typical assumption of fiscal federalism literature of 'low tax = low level of public goods localities' and 'high tax = high level of public goods localities' needs to be qualified. The connection between local revenue and local expenditure is very weak for most of the countries[7]. In most cases, much of the more elastic and progressive sources of taxation are concentrated at federal level thereby giving rise to a considerable degree of vertical imbalance. In such cases, attempts to decentralization has been mainly concerned with providing centrally collected revenues to regional or local governmental units for expenditure rather than looking to empower local units to collect more revenue, though this may also be one of the considerations. The Indian situation beautifully fits this, where the institution of Finance Commission has been mandated by Constitution of India to deliberate and recommend a scheme of rule based system of mandated transfer and redistribution of centrally collected taxes to states vertically and horizontally.

Article 246 of the Constitution of India dealing with union and state government relation divides the powers over different subjects into three lists – Union List, State List and Concurrent List which are enumerated in Schedule VII of the Constitution of India[8]. A perusal of the three lists is sufficient to give us good idea of the nature of Indian federation. The Union list enumerates that the union/central government has the exclusive power on foreign policy, defence, communications, currency, most important taxations (like income, excise, corporate, etc), banking, railroads etc. On the other hand, state governments have the exclusive powers to legislate and administer law and order, public health and sanitation, local government, taxes on agricultural income and many other issues. Further, the Concurrent list gives powers to both union and state governments to legislate on, though generally a union law dominates in case of multiple legislation. Subjects such as criminal law, marriages, economic and social planning, trade unions, social security, education are part of Concurrent list. All the residuary subjects are exclusively the jurisdiction of union government. Although the states exercise either exclusive or joint control over a substantial range of issues, the Constitution establishes a more dominant role for the union government. Nevertheless, it must also be noted that the jurisdiction of states over important subjects of managing public welfare programs and provisioning of various public goods lends state governments into almost exclusive control of development administration.

Although, at first sight, the Indian scheme of distribution of revenue powers between union and states may appear to be unduly biased towards union, the situation in many other developed and developing countries is not significantly different from that of India. For example, in USA, Denmark and France, the percentage of tax revenue collected by sub-national governments were 40, 35 and 13 percent respectively in 2001[9]. The XIII Finance Commission has also noted that most schemes of assigning resources in different country settings tend to be biased in favor of the center in assignment of tax collection powers on efficiency grounds leading to vertical imbalances[10].

2.1.2 Distribution of Taxation Powers and Revenue-Expenditure Mismatch

In India, the assignment of taxation powers is tilted in the favor of the union government as most of the broad based taxes have been assigned to union government. Overall tax powers are assigned on the basis of the principle of separation, exclusively either to the states or to the union[11]. However, exclusivity is only in the legal sense and this gives rise to anomalous situations. Thus the union can levy taxes on production (called excise duty) but the tax on sale of goods is leviable by the states[12]. Exhibit 2.1 gives a list of important entries in the Union, States and Concurrent list relating to taxation powers.

Thought the list is quite elaborate, only few of the taxes dominate on national and provincial level. In fact, five taxes from the union list and one tax from the state list contribute around 85% of total government (union and states combined) tax revenues. These are individual income tax, corporate income tax, broad-based production tax on goods (excise duty), custom duty, service tax (generation/trade of services) at national level and sales tax/value added tax at state level.

If we look at the expenditure side, we note that state governments, on average, spends anywhere between 52 to 57% of total government expenditure. On the other hand, the revenue assigned to states has been yielding, on average, between 30 to 38% of total revenue of the combined government for past many years[13]. In fact, the situation was not very different even in early 1980s when union government collected around 65 to 70% of total tax revenue whereas states governments incurred around 50 to 55% of total expenditure[14]. This is quite understandable in light of the fact that states have been assigned the major responsibility of providing public goods, run welfare centric general administration and are responsible for maintaining internal security and law and order, as well as for implementing most of the union government's developmental schemes.

Exhibit 2.1: Division of Taxation Powers (From Schedule VII of Constitution of India)

List 1 - Union List	List 2 - State List	List 3 - Concurrent List
Taxes on Income other then agricultural income (82)	Land Revenue (45)	Recovery in a state of claim in respect of taxes and other public demands (43)
Duties of custom including export duties (83)	Taxes on agricultural income (46)	Stamp duties other then duties or fees collected by means of judicial stamp (44)
Duties of excise on tobacco and other goods produced in India except alcoholic liquor, opium, narcotics (84)	Succession duties on agricultural land (47)	
Corporation tax (85)	Estate duties on agricultural land (48)	
Taxes on capital values of assets of individual and companies except agricultural land, taxes on capital of companies (86)	Taxes on Lands and Buildings (49)	
Estate duties in respect of property except on agricultural land (87)	Taxes on mineral rights (50)	
Succession duties on properties except agricultural land (88)	Excise duties on alcoholic liquors and opium, etc. (51)	
Terminal taxes, taxes on goods and passengers of rail, sea or air (89)	Taxes on entry of goods in local area (52)	
Taxes other than stamp duties on transactions in stock exchanges and futures markets (90)	Taxes on consumption or sale of electricity (53)	
Stamp duties in respect of bill of exchanges, promissory notes, letter of credit, insurance policies etc (91)	Taxes on sale and purchase of goods other then newspaper (54)	
Taxes on sale and purchase on newspaper and on advertisement published in them (92)	Taxes on advertisement except those in newspaper (55)	
Taxes on sale and purchase/ consignment of goods in inter-state trade (92A, 92B)	Taxes on goods and passengers carried by road and inland waterways (56)	
Taxes on Services (92C)	Taxes on vehicles (57)	
	Taxes on animals or boats (58)	
	Tolls (59)	
	Taxes on profession, trade, calling and employment (60)	
	Capitation taxes (61)	
	Taxes on luxuries (62)	
	Stamp duties (not included in entry 91 of Union list) (63)	

(Number in bracket shows entry number)

Source: Government of India (2006): Constitution of India, Ministry of Law and Justice, New Delhi

2.1.3 Indian Fiscal Reforms

Any entity cannot live beyond its means in long run, and it equally applies to a government. Therefore, in the ideal situation, a government should fundamentally be spending its tax revenues only. A failure to do so may eventually result into reduced Gross Domestic Product (GDP) growth rate and weaken the capacity of governments to respond to various forms of crises and catastrophes. It has been noted that India should try to achieve debt-GDP ratio of 60 percent and then try to reduce it further in the long run as it may not be possible for a country to reduce this ratio sharply in few years[15]. Further, the most important determinant of tax revenues in India is going to be its GDP and the international evidence shows that a country of India's level of per capita GDP finds it very hard to achieve a tax to GDP ratio of above 20 percent[16]. One of the important uses of this resource could be to unburden the government of its debt thereby bringing down the flow of annual interest payment which presently stands at 3.6 percent of GDP (for union government alone)[17]. These suggestions appear reasonable and are generally accepted. However, without further probing this issue, we now turn to the scheme of recourse sharing and devolution in India.

2.1.4 Finance Commission and Resource Sharing

Intergovernmental transfers have been employed to fulfill a variety of objectives and the design of the transfer scheme depends on the purpose for which it is given. In the literature, federal transfers are recommended for (i) closing the fiscal gap (ii) equalization and (iii) spillover and merit good reasons[18]. In Indian structure, all the three reason are identified. Article 275 and 282 of the Constitution of India recognizes the fact of inadequacy of states revenue sources and accordingly provides a mechanism for sharing of tax revenue between the union and state governments. It prescribes for periodic constitution of a Finance Commission, which would be appointed by the President of India every five years or earlier. The Finance Commission is the institution to plan and devise the mechanism and amount of transfer of resources from union to state governments and also the allocation of such amounts among different states. Generally, the Finance Commission considers the following issues[19]:-

(a) the distribution between center and states of the net proceeds of taxes that are to be divided between them under Chapter 1, Part XII of the Constitution of India and the allocation among the states of the respective share of such proceeds,

(b) the principles that should govern the grants-in-aid of the revenues of the states out of the consolidated fund of India and the sums to be paid to the states which are in need of assistance by way of grants-in-aid of their revenues under article 275 of the Constitution,

(c) the measure needed to augment the consolidated fund of a state to supplement the resources of the Panchayat and municipalities in the state on the basis of the recommendations made by the Finance Commission of the state.

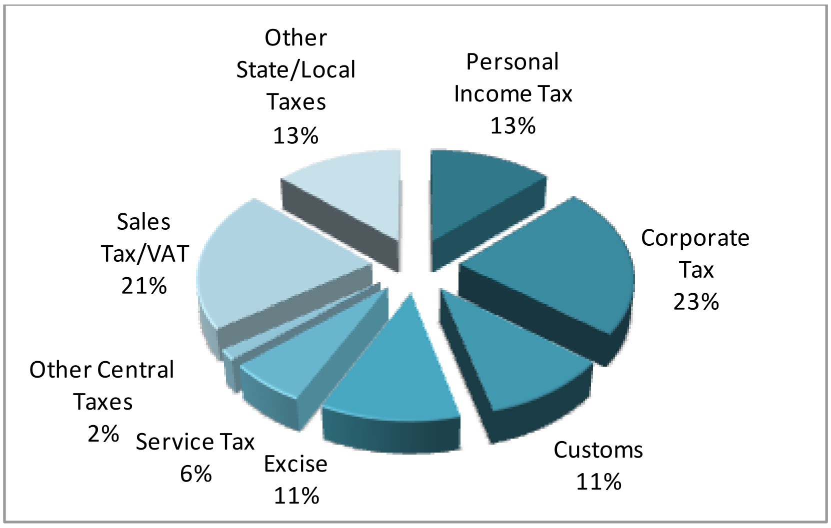
Further, Finance Commission often reviews the financial situation of the union and the states and suggests plans by which the governments can strive to bring about a restructuring of the public finances to restore budgetary balance and to achieve macro-economic stability and equitable growth. Since Independence, thirteen Finance Commissions have been constituted; the last one has submitted its report in December 2009. The process has generated, over time, an elaborate and sophisticated methodology for devolution of union tax revenue to states. The horizontal distribution of taxes to be shared between the center and different states is decided on the basis of a large number of criteria, among which population, income distance, area, index of infrastructure, tax effort are important[20]. It has been estimated by XIII Finance Commission that aggregate transfer (tax devolution and various grants) to states recommended by the Commission works out to around 32 percent of total union government revenues, or close to four percent of estimated GDP[21].

In addition to devolution of shares in union taxes, the union government also gives the states grants-in-aid to cover their revenue deficit. Further, specific grants are also provided to the states for special problems/purposes and also for up-gradation of administrative capabilities. Furthermore, grants for local bodies are also provided[22]. Overall, it is noted that the system of intergovernmental fiscal arrangement in India has served well. It has achieved a significant level of equalization over the years, instituted a workable system of resolving the outstanding issues between the union and the states and among the states inter-se, and adjusted to the changing requirements and thus has contributed to achieving a degree of cohesiveness in a large and diverse country[23].

2.2 Tax Policy Reforms and Revenue Resources: Union and States

World over, tax systems have undergone significant changes during past two decades as many countries, including India, have undertaken comprehensive tax reforms. Though the evolution of Indian tax system was motivated by international concerns, yet in some ways; it is different and even unique[24]. Unlike most developing countries, which were guided in their tax reforms by multilateral agencies, Indian tax reform attempts have largely borne a domestic brand[25]. They have been calibrated in response to changes in the development strategy over time while keeping in tune with the institutional arrangements in the country[26]. The reforms of past two decades have remarkably been successful in many respects. Yet, lot more still needs to be done, especially on institutional and organizational front. Without going into nitty-gritty of tax policy reforms, it would be instructive to look at the pattern of collection, distribution and evolution of revenue resources of India while noting landmark reforms.

Exhibit 2.2: Share of Major Taxes in Government's Total Tax Revenue in 2008-09

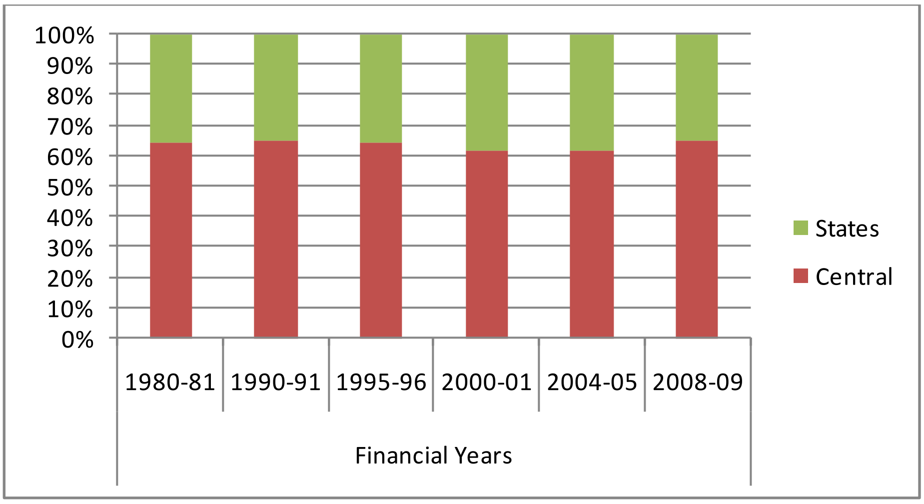


Source: Compiled from Government of India (2010): Economic Survey 2009-10, Ministry of Finance, Chapter 3, and Reserve Bank of India (2010): State Finances: A Study of Budgets of 2009-10, Chapter 3 and Appendix

Exhibit 2.2 gives percentage share of major taxes in national revenue collection for the financial year 2008-09. As already pointed out, six taxes constitute the bulk of tax revenue forming around 85 percent of total. Out of these, five are levied and collected by union government, making salient the preeminent position of union government. In Exhibit 2.2, 'other state/local taxes' include local and municipal taxes like property and house tax, entertainment tax, etc. (In all the subsequent references in this part, state taxes would include local taxes too). However, this being a snapshot of 2008-09, we need to probe further to get trend, pattern of change and evolution as well as additional insights.

Looking at the data of past thirty years, we notice that the ratio of respective share of union and state governments taxes in total tax collection has remained almost stagnant at around 65:35 (Exhibit 2.3). There was a slight dip around late 1990s in the share of union government which bounced back to around 65% of total tax revenue by 2008-09. Though large scale systematic reforms of tax policy and structure started in 1991, the respective share of states have only marginally changed. This has happened due to the very nature of taxes levied by states, mainly being retail sales tax and then Value Added Tax (VAT), which are dependent on economic activity and growth.

Exhibit 2.3: Share of Union and States in Total Tax Revenue Over Years

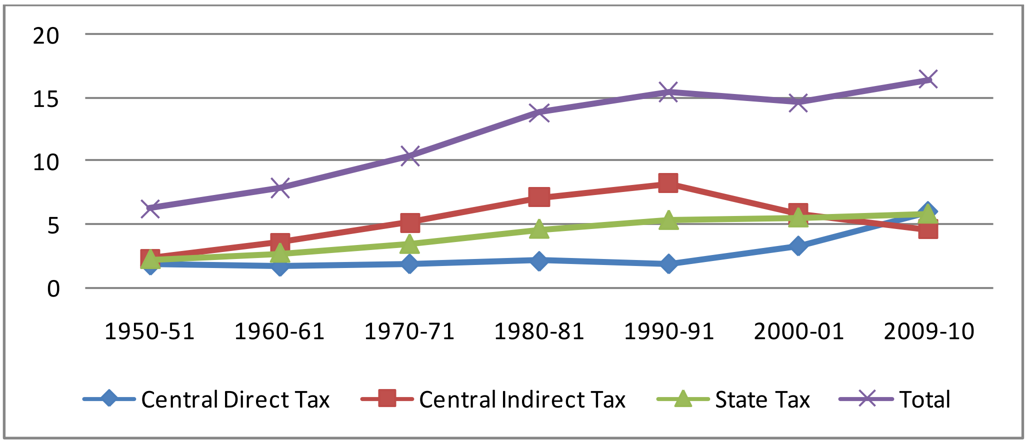


Source: Compiled from Government of India, Ministry of Finance, New Delhi: Economic Survey 2009-10, 2005-06, 2001-02, 1996-97 and 1991-92. These and Economic Surveys of other years are available online at www.indiabudget.nic.in

The real growth in revenue collection can be gauged from long term trend of tax-GDP ratio, which is shown in Exhibit 2.4. As a percent of national GDP, the union government tax revenue was 5.2 percent whereas state government taxes were 2.7 percent in 1960-61. This proportion was 7.0 percent and 3.4 percent respectively in 1970-71 and was 9.2 percent and 4.6 percent of national GDP respectively in 1980-81[27]. Overall, it has shown a growing trend for past 60 years except for the decade of 1990s, which was the time when comprehensive tax policy reforms started. If we look at the components, it is clear that the drop during 1990s has been due to the reducing share of union indirect/consumption taxes (central excise and custom duty) and it should not warn us, being desirable. Further, sharp growth in union direct taxes (taxes on income and wealth) since 1990s is a desirable and welcome change. States taxes have also shown a slow but rising trend, though it appears to be petering out of late.

Overall, tax-GDP ratio has risen from around 6% to 16% in past 60 years, an encouraging sign. However, 16% is still very low compared to many other developed as well as developing countries. This is indicative of the fact that there are significant potential for widening and deepening of tax base, thereby increasing tax collections significantly, especially in case of income and related taxes, as these are still only around 6% of GDP.

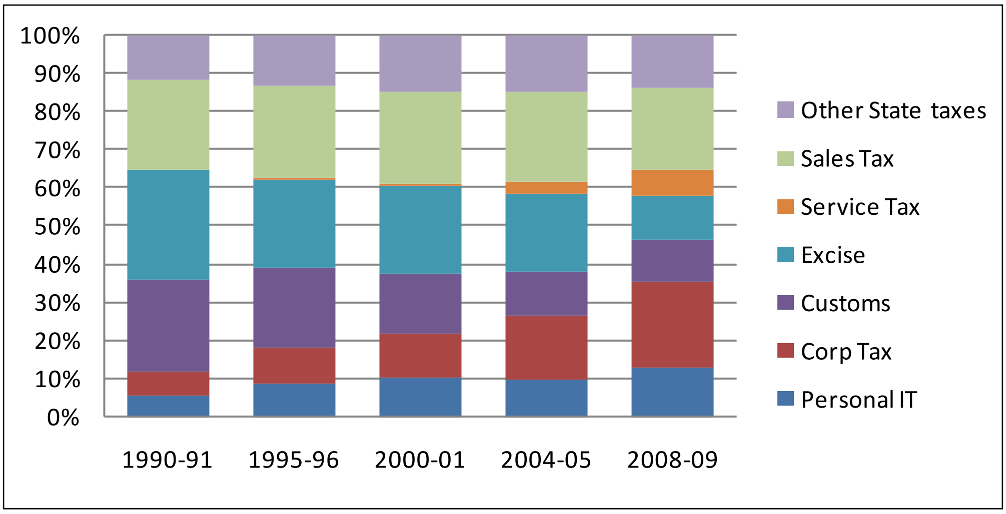
Exhibit 2.4: Historical Trend of National (Union and States combined) Tax-GDP Ratio



Source: Compiled from Rao Govinda and Rao Kavitha (2005): Trend and Issues in Tax Policy and Reform in India, Working paper, National Institute of Public Finance and Policy, New Delhi, Table 1

Exhibit 2.5 shows the respective share of different sources of tax revenue of union and states government combined over the last two decade. As we have already noted, the significant change in relative share of direct and indirect taxes of union government can clearly be seen. Further, the relative constancy of proportion of state sales taxes/VAT can also be noticed along with the constancy of relative share of state government taxes in total tax collection.

Exhibit 2.5: Changing Share of Different Taxes (Union and States) Over Years



Source: Compiled from Government of India, Ministry of Finance, New Delhi: Economic Survey 2009-10, 2005-06, 2001-02 and 1996-97

Now, concentrating only on union government taxes, we see significant changes not only in composition but also growth rate and contribution of different sources of revenue. Exhibit 2.6 shows tax revenue receipts of union government for past five years. In the years 2009-10, direct taxes are expected to be contributing around 58 percent of total union government revenue, whereas this was 43 percent as recent as in 2005-06, and was as low as 20 percent in 1990-91 when indirect taxes contributed rest of 80 percent of union government tax revenue[28]. Within the direct taxes, corporate income tax is the major contributor with around 60-65 percent share. Within indirect taxes, union excise used to be the most important source of tax revenue during 1980s and early 1990s. However, its share has continuously been declining, though it is still the largest indirect tax.

Exhibit 2.6: Tax Revenue Receipts of Union Government for Past Five Years

(Amount in Rs. Billion)

	Financial Years	2005-06	2006-07	2007-08	2008-09 (Prov)*	2009-10 (BE)#
Direct Taxes		1575	2197	2959	3382	3700
Out of which	Personal Income Tax	559	751	1026	1240	1128
	Corporate Tax	1013	1443	1929	2138	2567
Indirect Taxes		1993	2415	2788	2695	2694
Out of which	Customs	650	863	1041	998	980
	Excise	1112	1176	1234	1087	1064
	Service Tax	230	376	513	608	650
Gross Tax Receipts		3661	4735	5931	6097	6411
Net Tax Receipt after Transfer to States		2721	3532	4431	4383	4573

** Provisional Figures*
 # Budget Estimates

Source: Compiled from Government of India, Ministry of Finance: Economic Survey 2009-10, New Delhi, Chapter 3

Another significant development is the emergence of service tax as the new source of indirect/consumption tax with great potential. The introduction of service tax in 1994-95 ushered in a major structural change in indirect tax regime in the form of wider base and facilitated the process of rationalization of excise duties resulting in lower tax burden on productive sectors[29]. Unlike most ad hoc reforms undertaken in response to economic crises of 1990-91, the tax reforms in India were undertaken after a detailed analysis and the reform package introduced in 1991 was systematic, and the direction of reforms has continued[30]. These policy reforms had been introduced along with significant changes in the revenue administrative mechanism by streamlining and rationalizing processes, procedures and structures and by induction and integration of information technology tools for better service delivery to the taxpayers.

Figures for states' tax revenue collection are given in Exhibit 2.7. It may be noted that states' own tax revenue constitutes around 60-64 percent of their total tax revenue, rest being transfer from union government tax revenue as per the formula of Finance Commission. Out of their own tax revenue, the major source of tax for states is Sales tax/VAT, which has been contributing around 60-65 percent of total states' tax revenue over the years. Due to the predominance of sales taxes, any attempt to improve the revenue productivity of states' tax system, therefore, is inextricably intertwined with the reform of sales tax system and in this respect, the recent reform of moving towards a destination based VAT has been extremely important[31].

The gradual move from sales tax towards VAT over past two decades in different states has been, in a sense, groundwork for eventual move towards comprehensive nation-wide Goods and Services Tax (GST).

Exhibit 2.7: Tax Revenue Receipts of States Government for Past Five years

(Amount in Rs. Billion)

** Provisional Figures*

Financial Years	2005-06	2006-07	2007-08	2008-09 (Prov)*	2009-10 (BE)#
Own Tax Receipts	**2123**	**2525**	**2842**	**3277**	**3635**
Sales Tax	1295	1545	1725	2020	2215
Other State Taxes	828	980	1117	1257	1420
Transfer from Union Govt.	940	1203	1500	1761	1838
Total Tax Receipts	**3063**	**3728**	**4342**	**5038**	**5473**

 # Budget Estimates

Source: Compiled from Government of India, Ministry of Finance: Economic Survey 2009-10, New Delhi, Chapter3

Disaggregating state tax collection data state-wise gives us interesting insights especially on institutional and organizational capacity. Exhibit 2.8 shows taxes collected by all 29 states[32] in India (excluding six union territories). It also shows the taxes collected by state governments as percent of their total state gross domestic product (SGDP). This figure can be taken as a rough measure of relative efficiency and effectiveness of states' tax departments. It is noted that whereas on one hand we have states collecting as much as 12% of SGDP as VAT/sales tax, there are states which collect only 2 to 3% of SGDP as taxes. On the whole, economically more advanced states have high tax-SDGP ratios, whereas poorer and less developed states have low tax-SGDP ratio. Though there does not appear to be any reason for this being so, one factor could perhaps be that underdeveloped states also lack the institutional and administrative capacity to effectively and efficiently tax revenue resources.

However, there could be other important socio-economic and political reasons behind such diverse performance. For example, almost all north-eastern smaller states show low tax-SGDP ratio. In any case, it is widely believed that state level tax departments, on the whole, are less efficient and effective than union agencies. In such a scenario, the widespread differences in administrative capabilities of different states' revenue agencies and difficulty of carrying out institutional reforms of these agencies due to various political-bureaucratic reasons can lead to a situation where they become a bottleneck for any wide-ranging tax policy reform at the national level like the envisaged GST, which requires considerable harmonization between union and state government not only in areas of tax base and tax rate, but also tax administration. This, being a crucial issue in comprehensive redesign of revenue agencies, is examined subsequently in detail.

Exhibit 2.8: States' Own Taxes Collection Figures for 2008-09

States	Own Tax Revenue (Rs. Billion)	Percentage of Total of All States	Own Tax as percent of State GDP (2007-08)
Andhra Pradesh	357	10.5	9.2
Arunachal Pradesh	1	0.0	2.4
Assam	40	1.2	4.8
Bihar	63	1.8	4.8
Delhi	125	3.7	10.3
Jharkhand	50	1.5	5.0
Goa	17	0.5	8.3
Gujarat	242	7.1	7.1
Haryana	143	4.2	7.9
Himachal Pradesh	19	0.6	6.1
Jammu & Kashmir	23	0.7	8.0
Karnataka	287	8.4	12.1
Kerala	153	4.5	8.4
Madhya Pradesh	140	4.1	8.4
Chhattisgarh	63	1.8	7.3
Maharashtra	501	14.7	8.2
Manipur	2	0.1	2.6
Meghalaya	4	0.1	4.2
Mizoram	1	0.0	2.4
Nagaland	2	0.1	1.8
Orissa	76	2.2	6.6
Punjab	115	3.4	7.2
Rajasthan	151	4.4	8.0
Sikkim	2	0.1	6.4
Tamilnadu	345	10.1	10.2
Tripura	4	0.1	3.3
Uttar Pradesh	291	8.5	7.2
Uttarakhand	30	0.9	8.0
West Bengal	162	4.7	4.2
Total	**3409**	**100**	

Source: Compiled from Reserve Bank of India (2010): State Finances: A Study of Budgets of 2009-10, Statement 18, 19 and Government of India: Report of the XIII Finance Commission (2009), Chapter 4, Table 4.13

CHAPTER III

Conceptualizing Revenue Administration and Agencies

3.1 Tax Administration and Designing Revenue Agencies

It is widely known that tax policy and tax administration are intricately related. For the design of tax policy to be successful, it must also pay due attention to administrative constraints, and measures to improve tax administration should help to make the implementation of designed tax policies more effective[33]. Thus, whereas idealistic tax policy can complicate tax administration, ineffective tax administration can undermine tax policy[34]. Therefore, sound tax administrative structure and well designed and smoothly functioning revenue agencies are sin-qua-non for any tax reform program.

Restructuring of government organizations has been a constant theme as governments have sought to deliver services more effectively and at a lower cost to citizens. In many cases, traditional government bureaucratic structure (e.g., a government ministry, line department, etc, organized along hierarchical lines) have been viewed as too rigid to respond to the rapidly changing needs of the public and the challenges confronted by government in modern society. While changes in the government have been described as 'evolutionary rather than revolutionary'[35], a developing trend has been for governments to devolve power to agencies or appointed bodies acting on their behalf for carrying out tax functions[36].

3.1.1 Institutional Arrangements and Autonomy

While comparing the institutional arrangement for revenue administration in different countries, an OECD report identifies four broad categories of institutional arrangement[37]. These are:-

i. **Single department/agencies in ministry of finance:** tax administration functions are the responsibility of a single organization/department/unit located within the structure of the ministry of finance (or its equivalent ministry)
ii. **Multiple department/agencies in ministry of finance:** tax administration functions are the responsibility of multiple organizational units/departments located within the ministry of finance
iii. **Unified semi-autonomous body:** tax administration functions are carried out by a unified semi-autonomous body, the head of which reports to a government minister
iv. **Unified semi-autonomous body with board:** tax administration functions are carried out by a unified semi-autonomous body, the head of which reports to a government minister and oversight body/board of management comprised of external officials.

The desirability or otherwise of autonomous revenue agencies has been an issue in many developed countries. It has been argued that an autonomous or semi-autonomous revenue agency is better suited for delivery of superior taxpayer services, improvement in tax collection and compliance mechanism, and for better human resource and organizational management environment. It has also been contested that various problems related to low capacity of government institutions and long spells of non-performance makes for a different form of governance structure and massive level of administrative reforms. However, the claims regarding benefits of autonomous revenue agencies are not supported by convincing empirical evidences despite the fact that the example of Inland Revenue Authority of Singapore is often cited. In any case, there are some valid questions on the desirability or otherwise of autonomous revenue agencies - the foremost perhaps being the question of assigning a sovereign function to an autonomous agency not fully under government control. Further, administrative reforms can indeed be possible within the government structure and can be quite effective. In case of developing countries, there are many additional complications including institutional and capabilities issues. India, being a developing country with a very strong institutional structure of organized civil services and a federal structure, any movement towards truly autonomous revenue agencies need to be placed in this broader framework. For our purpose, the ownership pattern appears largely orthogonal to the analysis of a desirable design and operational structure of revenue agencies. Therefore, the emphasis of this study is not much on the issue of autonomy or ownership structure of revenue agencies but on their institutional and administrative design, redesign and operational structure.

3.1.2 Understanding Design Structure of Revenue Agencies

The specific design of revenue agencies plays an important role in the overall efficiency and effectiveness of the revenue departments. We may analyze the organizational structure of revenue bodies under the framework of three way classification. This approach has been found to be very useful in studying the revenue administration of Organization of Economic Cooperation and Development (OECD) as well as some developing countries[38]. It may also be noted that the organizational design is a dynamic 'process' rather than a static 'form', and there has been continuous reform in the institutional structure and design of national revenue bodies of many countries. The three main models/type of organizational structure that can be identified are:- the 'type of tax' model, the 'functional' model and the 'taxpayer segment' model.

i. The 'Type of Tax' model:

Under this model, the tax administration is based on 'type of tax' criteria and accordingly, there are separate departments/agencies for each major tax. Though, these departments tend to be endogenously multi-functional, they are largely self-sufficient and independent of other department created for other type of taxes. For example, a country can have five separate departments for Income tax, Excise, Custom duties, Sales tax, and Property tax. Each of these departments would be multi-functional in the sense of carrying out all activates related to taxpayer registration, return processing, collection, enforcement, audit, appeals, investigations, etc. Such an organization has often been favored on the ground that different type of taxes requires different type of administrative and operational capabilities and also on the ground that the taxpayers' response to various compliance and enforcement efforts varies according to type of taxes. Though there may be similarities in routine functions across type of taxes, it has been recognized that there could be significant differences, and accordingly significantly different operational requirement, in case of compliance, audit and enforcement operations across type of taxes. A middle path has often been suggested where the administrative structure could be based on few broad type of taxes, like two fold division - income and consumption taxes.

In any case, there are some issues with a dominant 'type of tax' model which need to be considered in any revenue administration design. First, it hinders the possibility of flexible use of staff (especially lower level staff) whose skills ultimately tend to be confined to a particular type of tax. This kind of structuring unnecessarily fragments the management of the tax system, thereby complicating organizational planning and co-ordination. Second, taxpayers with multiple tax liabilities (for example small business, traders, etc., which often are quite a significant proportion of taxpayers) have to deal with different department not only for different type of taxes but also for same kind of issues (like details of credit, debit, balance sheet items, calculation of profits). This often gives rise to increased compliance cost, complications, difficulties and even harassment from multiple agencies. Third, it leads to duplication of functions (being repeated for each type of tax in each of the departments) which often give rise to inefficiency and high overall cost. Independent and self-sufficient department (often functioning in individual silos) gives rise to inconsistent and uneven treatment not only to taxpayers but also of legal and accounting issues – leading to increased confusion and litigation.

ii. The 'Functional' model

In essence, a function based tax administration organizes its work in logical grouping of core functions that encompasses all taxes for which the administration is responsible. This approach allows for the standardization of common work (versus different approaches that could be taken for each different tax in a tax type organization) and simplifies the relationship between the tax administration and taxpayer, i.e., there is one point of contact for service, one point of contact for payment, etc[39]. Thus, in this kind of system, the staff is principally organized along functional lines like taxpayer registration, appeals, audit, compliance, investigations etc. These staff then works across different taxes. This approach has the benefit of allowing greater level of standardization of business processes across taxes. It leads to simplification of work process, easier implementation of information technology and computerization, thereby improving overall operational efficiency. Of late, this model has been seen as offering major improvement over the 'tax type' model and has resulted in wide ranging reform of revenue administration in some of the important countries. It is being seen as offering significant advantages in tax administration performance like single point of access to taxpayers for inquiries, a unified system of taxpayer registration, common approach/ method to tax payments and accounting and more effective management of tax audit and arrear tax collection functions[40]. Further, it has also been noted that such an approach may not be very effective and efficient in managing compliance related activities across different segment of taxpayers due to their widely divergent behavior and attitude towards compliance. Furthermore, in a large, diverse and federal country like India, a single department for all kind of taxes operating purely on functional lines may not be as efficient as it may appear at first.

iii. The 'Taxpayer Segment' model

Under this kind of model, the revenue administration is organized principally around 'segment of taxpayers' like large businesses, small/medium business, individuals, corporate, tax exempt entities etc. The main rational for such an approach of revenue administration is that each group of taxpayers has different characteristic and tax compliance behavior and therefore presents different challenges and risk and concomitantly the need for segmented approach to the revenue organization. Although this approach has been identified as a recent development in the OECD study (USA has been given as an example)[41], some features of Indian revenue administration can be closely identified with such an approach. A major factor in favour of this approach is the need for revenue organizations to develop and implement strategies for service delivery, compliance and enforcement, risk management, targeted audit, etc., specific to such taxpayer groups. It has also been claimed that grouping key functional activities under a specified and dedicated management structure improves the overall service delivery as well as compliance. A close offshoot of this approach is the emergence of Large Taxpayer Units in some of the countries, including India.

In many advanced countries, modern tax administrations are organized along functional lines with particular roles assigned to headquarter and to operational units in regions or districts[42]. While a functional and integrated approach to tax administration leads to better specialization and utilization and deployment of resources than fragmented and outdated structures, there is also a need to recognize the different risks, requirement and contribution to overall revenue of the various segments of the taxpayers' population[43]. In practice, what is often found is a mix of these three models, existing at different levels or tiers of governments and combined in different sequences at national levels as well as within regional, sub-national or provincial levels.

3.2 Organizational and Operational Structure

3.2.1 Organizations and Mintzberg's 'Structure in Five' [44]

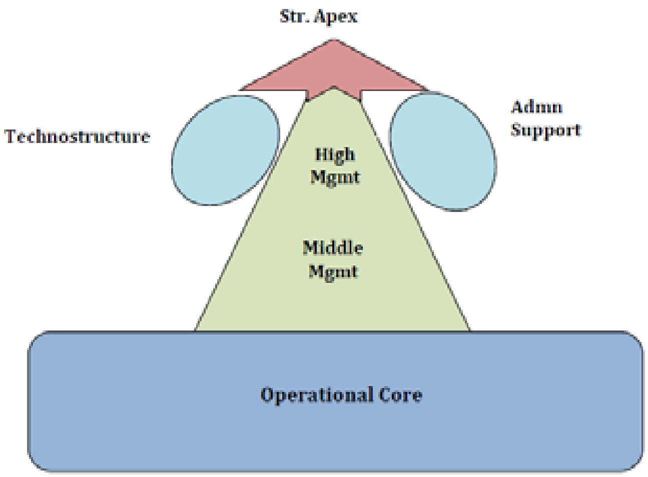
Henery Mintzberg synthesized organizational literature and proposed a framework for organizational design where every organization can be studied as consisting of five parts. These parts do not exist in reality in that specific form but can be immensely useful in understanding and analyzing organizational structures. These five parts of an organization can be called strategic apex, middle management, operating core, technical support and administrative support. These parts may vary in size and importance depending on the organization's external and internal environment, technology, its functional and operational requirements, size and geographical spread, and other factors. The idea of five part organization can quite successfully be applied for analyzing the organizational design of Indian revenue agencies, which we will be doing subsequently. But first, we explain these five parts briefly, as schematically presented in the exhibit below (in a slightly modified from).

i. Strategic Apex or Top Management: It provides directions, strategy, goals and policies for the entire organization. It can be identified as a distinct sub-system, responsible for directing and coordinating other parts of the organization[45]. In very large organizations, it is often meaningful to identify two separate top levels as Strategic Apex, and Top or Higher management, the later forming highest level of operational divisions.

ii. Middle Management: It is responsible for, administration, implementation and coordination of policies and programs at sub-organizational level. These sub-levels could be functional sub-units or geographical sub-units or a mix of these. Often the responsibilities include first level of supervisory control, close monitoring, ensuring execution and mentoring of lower level line managers. It is also responsible for meditating between top management and operating core, information sharing and communication across the hierarchy.

iii. Operating/Technical Core: It is often the largest and most important part of an organization consisting of people who does the basic work of the organization. Many a time, it can be indentified with the line function of a government department and forms the local/regional/field offices of the executive agencies or departments. In a sense, this part is entrusted with the responsibility of producing the goods or services of an organization. This level is often led by cutting edge of operational people, being at junior management level.

Exhibit 3.1: Mintzberg's Five Parts Organizational Structure (Modified)



iv. Technical Support or Technostructure: Technical support function help the organization adapt to the environment[46]. The technostructure is generally attached with the Strategic Apex and entrusted with advising as well as planning and executing technical support functions of the organization.

v. Administrative Support: This is another part of support structure for Strategic Apex, involved mainly in providing administrative, strategic, policy, human resource management, training and other general support function to the apex.

Integrating the Mintzberg's organizational structure within design model gives us some important insights on design of revenue organization and structure.

3.2.2 Operational Structure of Revenue Agencies

The size and spread of revenue agencies is an important factor is overall planning, design and structure of tax systems. Generally, the operational spread of revenue organizations in many countries consists of large number of regional offices and even larger number of field/ local offices to carry out the full range of activities required for effective administration of tax laws. Some of the factors which have driven the need for large network of offices in many countries include large number of taxpayers to be administered, their geographical spread, the felt need of providing accessible tax services and also to widen and deepen the tax base. However, recently a trend seems to be emerging whereby the operational spread is witnessing a significant change in size and nature of office networks[47]. We can note three significant factors behind this:-

- Governments world over are vying for increased efficiency and effectiveness in their operations. The revenue agencies have also been affected by this. Accordingly, the office networks of revenue organizations in many countries are being reorganized in to smaller number of large offices instead of large number of small offices. One of the main ideas behind it is the economies of scale. Further, integrating this process with technological advancement and data management capabilities, it is also hoped that such a structure would be more effective and responsive to the risks being faced by the revenue organizations in most of the countries.

- With the advent of technology, it has now become possible for revenue bodies to concentrate some of the routine and seasonal functions and activities in large dedicated centers by centralizing such work. Some of the most common activities identified for this purpose are return processing and tax refunds.

- Technology is also being used increasingly to improve the delivery of taxpayer services. Thus, many revenue organizations have started actively using not only internet and data networks, but also call centers, taxpayers help center, walk in offices, etc., for delivering services to taxpayers. Most important of such activities being online filing of returns and payment of taxes, use of call centers to answers inquiries have resulted in reduced need for face to face interaction of taxpayers with the taxmen at local tax offices.

A meaningful analysis of revenue organizations can be done keeping the above analytics in mind, namely the type of revenue organization and its relation with the government, the way revenue organization has been designed to carry out its mandated functions and the nature, type and extent of geographic spread and office network of revenue organizations. In the next part, we analyze the structure of Indian revenue agencies at union, state and local level within this broad framework with an eye on the underlying process, structure and arrangement of resources, both human and infrastructural. In this exercise, the role and structure of India's permanent bureaucratic civil service would assume an important place. Subsequently, we also consider various alternative revenue administrative structure and institutional arrangements in reference to the theoretical and technical context.

CHAPTER IV

Organizational Structure, Bureaucratic Complex and Redesigning Revenue Agencies

4.1 Institutional Structure of Revenue Agencies in India

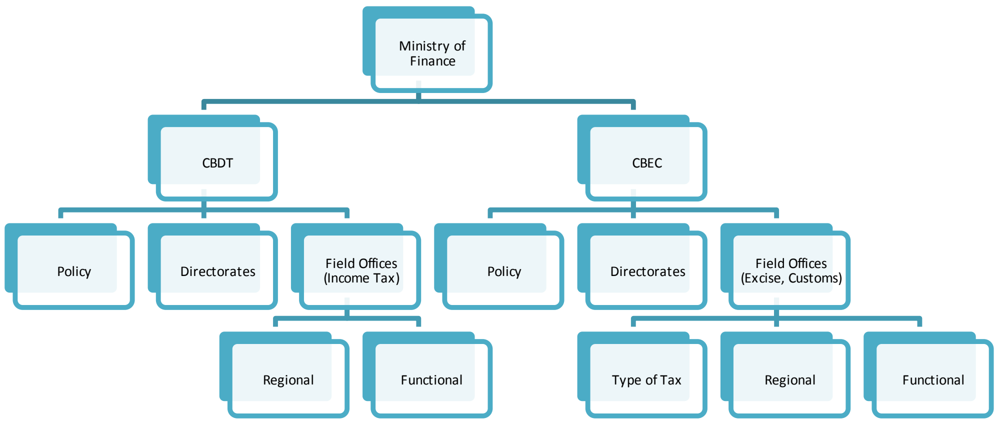
Indian federal structure has uniquely shaped the way revenue organizations have taken roots in India. At the foremost, the division of tax powers between union and state governments has made it imperative to have three layers of organizations, first at the union level, second at the state levels, and third at the local level, though the last one is the least developed. Further, states in India being large independent politico-administrative units as well as socio-cultural entities with democratic form of provincial governments, have their own institutional structure, administrative machinery and large bureaucracy. Thus, we have union government tax departments which function under overall control of union ministry of finance as well as a tax department under each state government which function under ministry/department of taxation of respective state governments with their own structures, processes and bureaucracy, resulting in pulls and pressures of a lively political democracy. Further, there are local level revenue agencies (mainly urban municipalities) which have been entrusted with responsibility for collection of some specific local taxes, (mainly house tax, property tax, entertainment tax, etc.) by the state governments. The overall structure is somewhat akin to 'type of tax' model, where different levels in the government are responsible for different type of taxes and have established separate agencies for this purpose. The broad concepts of taxation economics and suitability of different types of tax instruments for different levels in the government[48] can be found in India.

The upshot is a multiplicity of revenue agencies in India, where taxpayers often have to deal with different revenue agency for different type of tax. It has often the effect of unnecessary fragmentation of tax management system, duplication of functions and inconsistent treatment of legal as well as accounting issues, increased compliance cost, difficulties and even increased harassment for taxpayers. The agenda for a comprehensive re-design and reorganization of revenue agencies assumes all the more importance in this backdrop. From a taxpayer's point of view, it is always desirable to have a single revenue agency taking care of all tax liabilities. However, various political and administrative, as well as technical considerations, come to play whenever such an overhaul is considered. Any further consideration of these issues has to wait as we first need to understand the present institutional structure of the revenue agencies in India in some detail, only after which we would be better equipped to suggest modification and changes in the existing system. Consideration of the present system and institutional structure are important because it broadly delineates, in some sense, landscape on which any re-design idea can be constructed administratively and politically within larger socio-political, institutional and organizational environment. Accordingly, in the following paragraphs, we will consider institutional and organizational structure of union revenue agencies, state and local level revenue agencies, issues related to administrative harmonization and efficiency among different agencies at different levels, the structure of India's permanent bureaucracy at junior and senior levels and their crucial role and complex manner in which they are integrated with revenue agencies and how any re-design of revenue agency is intertwined with reform of civil-services. After this, we would be moving to delineate and analyze alternative scenarios for re-designing revenue agencies (one or more, at different levels etc.) in chapter V and VI.

At the union level, there are two large government organizations, each separately responsible for administration and collection of 'direct taxes' (being taxes mainly on income of individuals and corporate, on wealth and some other taxes like securities transactions tax, fringe benefits tax, etc.) and another responsible for management and collection of 'indirect taxes' (taxes mainly on consumption and production like excise taxes, customs duty and service tax). There two departments function under the overall control of two boards called Central Board of Direct Taxes (CBDT) and Central Board of Excise and Customs (CBEC). These boards are responsible not only for overall supervision and control of the field department, but are also entrusted with all policy making and decision in the areas of union taxation.

These agencies function through their line organizations, field offices, and innumerable specialized bodies often called directorates. CBDT and CBEC together are one of the largest organizations of union government employing as many as 130 thousand people with presence in more than 1000 locations having more than 1200 offices across length and breadth of India[49]. These organizations are integral part of government of India and are staffed by permanent government employees. The highest levels of these organizations are manned by professional permanent bureaucrats called Indian Revenue Service (IRS) officers. The exhibit below gives a schematic representation of revenue institutions at union level.

Exhibit 4.1: National Level Institutional Structure of Revenue Administration



It is clear from above that at the apex level, the organization of revenue administration is done on 'the type of tax' model where direct taxes or taxes on income are clubbed under one agency and indirect taxes or taxes on consumption are clubbed under another agency. Both of these agencies are operationally independent and function under Ministry of Finance of Government of India. However, below this type of tax division, the further operationalization seems to be a mix of 'functional' and 'geographical/regional' division with further 'tax type' segregation in the case of CBEC. Separate legal and appellate structure exist outside and independent of the government, under the institutional arrangement of judicial structure of Indian federation consisting of High Courts (at state/provincial level) and the Supreme court (at the national level) to tackle the legal disputes and appellate issues of taxation, where union or concerned state governments are also a party along with other plaintiffs (often the aggrieved taxpayer). However, before any case goes up to High Court, it has to travel through departmental appellate channels within revenue agencies.

4.2 Organization of Indian Revenue Agencies

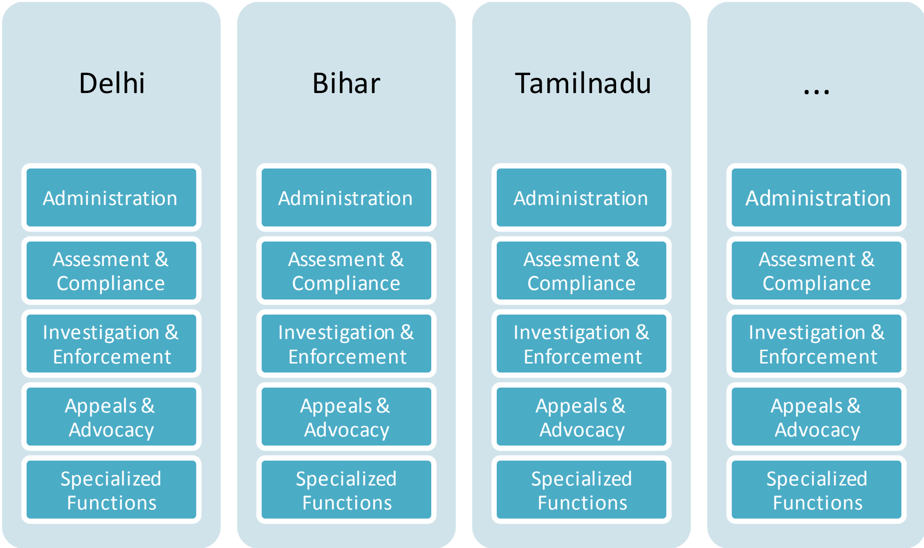
4.2.1 Agencies for Administering Taxes on Income and Wealth

CBDT is the apex body for direct tax policy and administration in India. It functions as a department of Government of India headed by a Chairman who is assisted by six Members - each in charge of different functions. It has a permanent secretariat, with around 500 employees. However, for its smoother functioning, it operates through what is called its attached directorates general, each headed by a Director General. Each directorate general is further divided into a number of directorates, headed by Director/Commissioner and a full contingent of middle and lower management level employees. At present, there are seven attached directorates general of CBDT, under which there are around thirty directorates. The Exhibit below is a schematic representation of CBDT and its support organizations.

Exhibit 4.2: Central Board of Direct Taxes and Apex Support Organizations

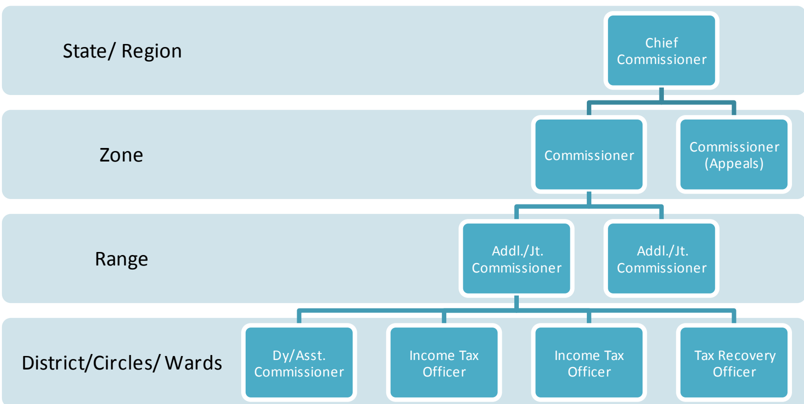
Some of the directorates general are quite huge in themselves, like that of Training, which runs one national academy for direct tax and seven regional training institutes for training and capacity building of the employees of the Income Tax Department (ITD). ITD has around 62,000 employees spread to over 550 locations all over India. The field formations of the ITD are organized in matrix structure on functional and regional/state basis. Chief Commissioners are the regional heads for different functions and thus there are more than one Chief Commissioners for each region/state supervising different functional areas. The most important functional division is tax administration/assessment. Other functions like investigation and enforcement, appeals and advocacy, international taxation, tax exempt entities, withholding of taxes, etc., are slightly specialized in nature and many have only selected regional presence. The ITD is divided in to 18 geographical regions, which normally correspond to one or more states of India, with some exception[50]. Functional and operational imperative of ITD being contingent on economic activity, the regional structure is skewed towards cities, urban centers and areas/ states which have higher level of economic development. Thus, for example, metropolitan cities of Delhi (national capital) and Mumbai (often called financial capital) are regions in themselves. Exhibit 4.3 gives a stylized representation of matrix structure of ITD.

Exhibit 4.3: Matrix Structure of Income Tax Department (Regions x Functions)



The organizational structure of CBDT and ITD can very usefully be understood with the help of Mintzberg's 'structure in five' model. CBDT forms the strategic apex. The top Management of the department consists of Chief Commissioners and Commissioners who works across boundaries and are responsible for overall implementations of government tax and fiscal policies. The positions at the level of Additional and Joint Commissioners can be equated with that of middle management level, which is the first supervisory level, and their responsibilities include close supervision of tax administration to achieve the targets set in term of tax collections, as well as guidance, communication, coaching and mentoring of younger and newer officers. The level of Deputy Commissioners, Assistant Commissioners and Income Tax Officers are at the apex of the Technical core, who works as ground level officers in the capacity of tax administrators and Assessing Officers (AO) carrying out functions of tax assessment, audit, investigation, intelligence, compliance, collections and enforcement. The second level of technical core consists of Income Tax Inspectors who provide executive assistance to these officers. Further below are assistants and clerical support which are crucial for smooth functioning of any organization. As per Mintzberg's description, attached directorates generals can be identified as support structures for technical and administrative functions. Exhibit 4.4 gives a stylized representation of field office structural hierarchy of ITD.

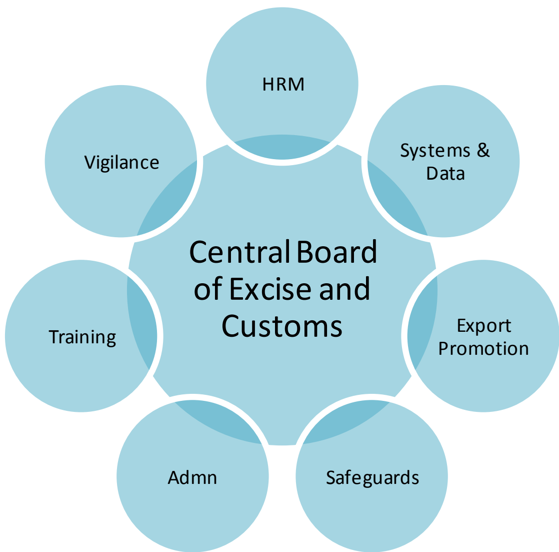
Exhibit 4.4: A Stylized Representation of Regional Hierarchy of Income Tax Field Offices



4.2.2 Agencies for Administering Consumption Taxes

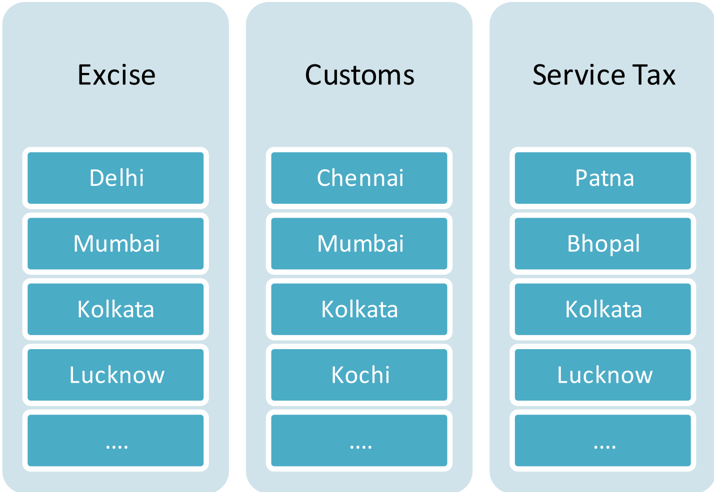
CBEC is the apex body for indirect tax policy and administration in India. Its organizational structure and functioning is very similar to that of CBDT, and both are often called sister departments. It too functions as a department of Government of India headed by a Chairman who is assisted by six Members, each in charge of different functions. It too has a permanent secretariat, and many attached directorates general, each headed by a Director General. Exhibit 4.5 gives the structure of CBEC. Although its directorates performs many of the similar functions as that of CBDT, there are some specialized directorates like Export Promotions and Safeguards, which exists due to special nature of its custom functions. In addition to excise tax (taxes on production), service tax and customs, CBEC is also in charge of preventing smuggling and evasion of duties.

Exhibit 4.5: Central Board of Excise and Customs and Apex Support Organizations



Overall, CBEC functions through its 27 regional offices headed by Chief Commissioners. However, the field structure of CBEC is different to that of ITD in many respects. To start with, it is not exactly a matrix structure, in terms of regional structure followed by functional divisions. On the contrary, here it is 'type of tax' which takes precedent followed by 'regions'. The functional division comes subsequently. Thus the three 'type of tax' - Customs, Excise and Service Tax take precedent. However, in many regions, there are combined Customs and Excise or Excise and Service Tax divisions. There are specialized directorates for investigation and intelligence, and prevention (compliance/enforcement) functions. In terms of overall size, the customs and excise is larger than ITD, with a total of around 67000 employees. Exhibit 4.6 is an attempt to represent a stylized organizational structure, though it must be pointed out that it is too simplistic to catch the complexity of the actual structure, which appears much more hotchpotch then neater ITD.

Exhibit 4.6: Matrix Structure of Central Excise and Customs (Tax Type x Regions x Functions)



In terms of organizational hierarchy and field structure, the similarities with ITD are significant. At the managerial levels, the structure and designations are almost the same, though span of control and office spread do vary at ground level. The apexes of operational core (Dy. / Asst. Commissioners) are assisted by Superintendent of Excise and by Custom Appraisals. Similarly the Mintzberg's structure can easily be identified within the organizational design of CBEC.

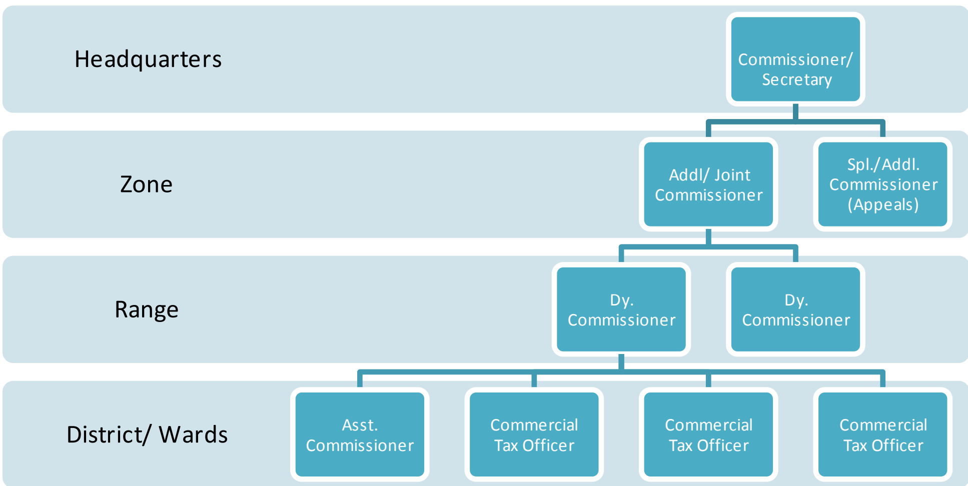
Thus, in case of both CBDT/Income Tax and CBEC, the predominant model is a mix of 'tax type', 'functional' and 'regional structure', though often, in different layering of hybrids. Therefore, one may tend to assume that the 'taxpayer segment' model is largely absent in Indian institutional setting. But that is not correct. At regional/zonal level, taxpayer segmentation had been in existence with separate operational Commissionerate in charge of taxpayers segments like corporate, business and trade, and individual taxpayer. Further, with the establishment of Large Taxpayer Units (LTU) in some metropolitan cities, this approach has made a publicized entry into India, like in many other countries and is expected to consolidate over time. In LTU, taxpayer segment takes precedent over tax-type as both the direct and indirect tax functions are centralized with joint administration by CBDT and CBEC.

4.2.3 State and Local Level Revenue Agencies

At the state level there are generally a single tax department entrusted with management and collection of states' taxes. For all state governments, sales tax/VAT forms the single largest source of tax revenue with a share of more than 60% of total state's tax collection. Accordingly, the departments are generally called Sales Tax or VAT or Commercial Tax department and are responsible not only for sales tax/VAT but other taxes like entertainment tax, entry tax, luxuries tax, and professional tax, etc., as and when levied. However, some specific activity taxes like excise on alcohol, taxes on vehicles, stamp duties, land revenue, etc., are assigned to the respective line departments which are otherwise in charge of such functions. For example, vehicle tax would be generally assigned and collected by Motor Vehicle/Road Transport Department; Stamp duties would be collected by Registrar of Properties and so on. Many of these items contribute small amount as proportion of the total state's tax revenue. In many states, some of the taxes belonging to state list like taxes on land and property have been assigned to local level/municipalities and are thus administered by them.

State level tax departments are integral part of state government machinery and are staffed with permanent government employees of respective states. The middle levels of these organizations are filled with state civil servants and the higher level are managed by both state civil servants as well as professional career bureaucrats of Indian Administrative Service (IAS). The state level tax departments are comparatively smaller with obviously limited jurisdiction within the physical boundaries of the respective states. As the states vary in size, the state agencies do vary in size considerably, employing anywhere from 1000 to 13000 employees. The organizational structure of state level departments is simpler, with basically a 'territorial x functional' structure. Generally, the department is headed by a Commissioner or Secretary/ Principal Secretary who has a secretariat with middle and lower management level support officers and staff. Then, there are field offices of Commercial/VAT tax departments, quite similar to that of ITD or Central Excise. Often the designation and hierarchies are also similar like Commissioners, Addl./Joint Commissioners, Deputy and Assistant Commissioners, Commercial Tax Officers, Inspectors, Assistants, etc., but the span of control and reporting relationships may vary. Further, these also vary across different states. The Exhibit 4.7 is a highly stylized representation of a state tax department structure.

Exhibit 4.7: A Stylized Representation of State Level Tax Departments



The lowest level (district/ward) is the operational core in the field, generally entrusted with functions of tax collection, assessment, audit, investigation, etc. The levels above that are mainly supervisory levels. There is functional segregation; especially the investigation and enforcement functions are kept separate from general tax administration/assessment functions. We hardly see any 'taxpayer type' models in state revenue agencies. Further, most of these agencies can also closely be aligned with Mintzberg's organizational structure. Despite this, different states show large variations in the organizational structure - with differing role and functions, operational spread, size, and other characteristics. In case of some economically advanced states like Maharashtra, Tamilnadu, Gujarat, Andhra Pradesh etc., the state tax department are quite large with significant presence and spread.

Local level revenue agencies does not form an important part of overall revenue structure in India. In fact, the local level financial autonomy and fiscal-devolution is quite limited. Some of the state level tax powers have been assigned to urban municipal government by respective states, and they are responsible for administering such taxes. In any case, there are virtually no local tax powers to rural governments (Panchayati Raj Institutions) even after some recent reforms with third tier of democratic governance. In case of urban municipalities, some taxes like property and house taxes are generally assigned to municipalities, though the total collection is quite small in most cases. There are no separate tax departments; they function only as a division of the municipal government. However, in case of metropolitan cities like Delhi, Mumbai, etc., the collections are significant and there are separate agency entrusted with tax collection, staffed by permanent state government employees, and often managed by state or union level bureaucracy (mainly IAS and IRS officers). It may be noted that the concept of independent, democratically elected city government is largely absent in India. Cities are basically run (often badly!) by permanent state government civil servants through a mix of what may be identified as trans-city public services department as well as city-wide municipalities.

4.3 Administrative Efficiency and Harmonization among Indian Revenue Agencies

4.3.1 Union Revenue Agencies: Harmonization, Coordination and Unification

It has been noted that an appropriate strategy for tax reform would first involve studying the tax structure and setting appropriate policy goals, and then modifying them in the short term by taking cognizance of the associated administrative problems. If the ordering is reversed, and administrative consideration became the binding constraint in tax reform, which by its very nature is a longer term process, the tax system is likely to play only a very limited role in achieving economic policy objectives[51]. These words are good warning - as often it appears that in India, it is the administrative bottlenecks which start playing the dominant role in directing the tax policy.

Organizational structure and operational requirement as well as reorganization of the two union government agencies have always been on the agenda of the various tax reform initiatives. Though it has mostly been tackled as part of larger tax reform initiatives, started by the union government in early 1990s, in themselves, the agencies have often seen major changes in structure, process and organization of not only human and infrastructure resources, but in almost all the areas of tax administration. As a result, there have been some significant changes in tax administration machinery, with some far reaching consequences. The historical change in relative share of direct and indirect taxes is a case in point. If we look at the relative figures for tax collected per employees for these two agencies, we find the direct tax agency to be more efficient, as shown in the Exhibit 4.8 but again, this has happened only recently and may not reflect the whole story. There has been wide ranging technical upgradation program, increasing use of information technology for improving the service to taxpayers and for taxpayer management and automation of routine processes, etc., in both the agencies. As a result, these two agencies are better managed, more efficient and effective than most of the state level tax agencies, where reform efforts have not been very effective due to various reasons.

There has been some important move towards better harmonization, especially on information technology and data management fronts with establishment of Tax Information Network (TIN) and movements towards a common taxpayers register (Permanent Account Number - PAN) database, and establishment of Central Processing Centers (CPC) by CBDT. CBEC has been using PAN database for its excise operations and has also established Indian Customs and Excise Gateway (ICES) and Automation of Central Excise and Service Tax (ACES) platforms for e-delivery of taxpayers' services. But a lot more requires to be done, as both the agencies (CBDT/Income Tax and CBEC/Excise and Customs) are still largely not only operationally and administratively independent but also technologically sitting in vertical silos.

Exhibit 4.8: Staffing and Revenue Collection of Union Government Revenue Agencies

Organization	Staffing/Number of Employees[52]				Tax Collection (Rs. Billion) (2008-09)	Tax Collected per employee (Rs Million)
	Total Staffing	**Senior Officers**	**Junior Officers**	**Support Staff**		
CBDT/Income Tax epartment	**61300**	3000	6000	52300	**3382**	**55.17**
CBEC/Central Excise and Customs	**67400**	2500	10000	54900	**2695**	**39.98**
Total	**128700**	6500	16000	107200	**6077**	**47.22**

Source: *Compiled from Government of India, Ministry of Finance: Economic Survey 2009-10, Annual Report of Ministry of Finance 2009-10 and Comptroller and Auditor General of India: Audit Report of Income Tax and Central Excise and Customs of various years, and personal knowledge of author*

There have always been talks of better harmonization between the two revenue agencies at union level, with speculation even of the potential merger of the agencies (the case of Her Majesty's Revenue and Custom - HMRC in UK could be a motivation) as well as of the cadre of officers and staff. However, there are some serious technical as well as administrative issues. On technical front, it has lately been pointed out that the nature and operational requirement of direct taxes and indirect taxes requires different emphasis and efforts; nature of taxpayers and compliance behavior differ significantly, which may require different approaches. Therefore, it may not be very desirable to have a single agency to handle these two types of taxes. The organizational and operational requirements of 'custom' function is substantially different from other taxes - the reason why it is organized quite independently even within CBEC. Even if a view is taken to have a single agency for administrative ease and other benefits, it would still be advisable to have two (or maybe three) large divisions on the basis of 'tax type' - being the predominant factor behind smooth operationalization. At the highest tier, functional division may not be advisable except for some selected taxpayer segments in some selected regions (like LTU). Further, the large size of resulting merged national entity also questions any notion of increased effectiveness and efficiency. Nevertheless, it is also a fact that there is significant scope for harmonization of processes, systems and structures across the functions, hierarchies, and operations levels even with multiple agencies. Some of them rightly been identified as information technology platform, data and intelligence sharing and tax base management. This has the potential to take care of many ills generally identified with a 'type of tax' model like increased tax compliance cost and many other difficulties to taxpayers, hindrance in the flexible use of professional tax staff, duplication of functions, etc. Further, harmonization also has the potential to reap some of the benefits of functional model like greater level of standardization of business processes, easier implementation of information technology, etc.

Further, on the administrative front, any proposed merger of these two agencies would require merger of different cadres of civil servants which, organized independently, though being part of larger permanent civil services of India, poses its own herculean difficulties. In any case, over the past five years, with the idea of comprehensive GST and its envisaged introduction at union and state level simultaneously, the potential for an effective operational mechanism and harmonization between CBEC and state level revenue agencies has assumed greater importance than between CBEC and CBDT.

4.3.2 State Agencies: Performance, Efficiency and Inter-Agency Harmonization

The power to tax consumption and expenditure is divided between union and states, and these are taxed at both the levels, resulting into existence of revenue agencies at both the levels. With proposed eventual move towards an integrated VAT (or GST) at the national scale, the question of administrative harmonization among union agency and all the state agencies assumes even greater relevance and urgency. But it is a hard nut to crack. As of now, there is minimal coordination and cooperation among these agencies, all functioning independently. A larger question is whether there is actually a need of multiple agencies to administer and collect a comprehensive nationwide GST? It will be examined in the next part, in some detail. What can be mentioned here is the fact that excise/service tax wing of CBEC and state level revenue agencies (VAT departments) would have similar kind of tax base and would require similar processes and even organizational structure and it would not make much sense to have two agencies for the same function, leading to duplication on many fronts.

There are wide differences among revenue agencies of different states not only in terms of their potential for revenue collection but also in terms of size and operational efficiencies which can roughly be measured in terms of tax collected per employee. Although data in this respect is not readily available, calculation has been made for six medium/large states for which some information could be accessed as given in Exhibit 4.9. We can see wide variations in the tax collected per employees from as low as Rs. 20.8 million to as high as Rs. 48.4 million. It must be noted that the highest figures is still less than the figures for all India average of the ITD (being Rs. 55.2 million). Clearly, most of the state level tax agencies are less efficient and effective then union agencies. Further, poorer and underdeveloped states are less efficient than the richer states.

In this backdrop, there have been some questions about the administrative ability of less capable states to take up comprehensive GST and related reforms and how these agencies can be reformed or integrated at the national level. However, these issues have gradually lost their voices in the more clamorous political discourse of fiscal federalism, taxation power of states and respective responsibilities of union and state governments, and widespread feeling in state political leadership that such attempts by union government may lead to encroachment of fiscal turf of state governments. Further, state level bureaucracy dominated by powerful wing of civil service (IAS) has also not been willing to discuss the technical question of an ideal and suitable organizational structure, but more interested in preserving its power, influence and position. More or less, the same can also be said about the union branch of civil service, IRS of CBEC.

Exhibit 4.9: Staffing and Revenue Collection of Few State Government Tax Departments

States	Staffing/Number of Employees[53]				Tax Collection (2008-09) (Rs Billion)	Tax Collected per employees (Rs. Millions)
	Total Manpower	**Senior Officers/ Managers**	**Junior Officers**	**Support Staff**		
Andhra Pradesh	9500	130	2090	7280	357	37.6
Bihar	3020	80	440	2500	63	20.8
Gujarat	5000	180	490	4330	242	48.4
Madhya Pradesh	3500				140	40.0
Tamilnadu	10400	150	2340	7910	345	33.2
Uttar Pradesh	13000				291	22.4

Source: Compiled from websites of states governments' commercial tax or sales tax departments, Tax Collection figures from Reserve Bank of India (2010): State Finances: A Study of Budgets of 2009-10, statements 18, 19

4.4 Organized Civil Services in Revenue Administration

Human resource is the most important resource of any organization. And analysis of human resource structure of Indian revenue agencies is crucial for their redesigning. Further, it assumes importance because Indian revenue agencies are manned by permanent bureaucracy of government of India and of states. This puts it under a different kind of environment for our analysis.

4.4.1 Unified Senior Bureaucracy and Agency Specific Junior Civil Services

Any organizational design and structure come to life through the people who man them. The institution of permanent organized higher civil service in India, members of which though occupies all the managerial level position in revenue agencies at union and states (and even local) level, yet are not always fully coterminous with the agency, play a crucial role in any attempt to re-design revenue agencies. The higher level of tax administration in union government is run by specialized branch of civil service known as IRS. They are recruited through a highly completive, open and fair, combined civil service examination as part of the larger permanent civil service structure of India which includes other branches like Indian Police Service (IPS), Indian Administrative Service (IAS), Indian Foreign Service (IFS), Indian Audit and Accounts Service (IAAS), etc., - all representing group of higher officers responsible for broad functions often spanning more than one departments/agencies/ ministries/level of government. IRS officers occupy all the higher managerial level positions of two union tax departments. They also occupy most of the policy/administrative position in CBDT and CBEC and also serve in many other ministries/organizations in areas of economic and financial management and regulation. However, officers of IRS cadre are further sub-divided into two braches - called IRS (IT) and IRS (C&E) - each concerned with direct and indirect taxes respectively, with almost negligible rotation across CBDT and CBEC. IRS officers thus are the professional tax bureaucrats. On the other hand IAS is the generalist branch, wherein after recruitment, officers are assigned to specific states (called Cadre), where they manages all kind of administrative functions - from district administration and development administration to economic management including managing state tax departments. They are also present in large numbers in union government ministries managing again all sort of responsibilities from rural development to trade and commerce. Being part of the organized bureaucracy of India, IRS, IAS and others form an integral component of the civil services institutional structure and are thus bound by rules, regulations and procedure of Indian bureaucracy like permanent employment, regular rotations, promotions being largely based on seniority, equal pay at same level, etc.

In the two union departments the junior management and support level consist of other larger cadre of permanent government employees from junior civil services and subordinate services who constitute bulk of manpower. Further, except for IRS officers, who have ample opportunity of working in many other departments/organizations of government of India and even in state governments, employees belonging to lower levels work mostly within their respective department (CBDT/ITD or CBEC) with very limited inter-departmental movement. Even regional rotation/transfers for these levels are limited to the state itself. In that sense, an Inspector or ITO of ITD would, for most past of his career, work in one state. On the contrary, IRS officers are expected to serve anywhere in the country and they are rotated/transferred regularly.

The state level tax agencies are also staffed by permanent employees, but they belong to state government. However, other things remain almost the same; including the pay structure. Most of the state government revenue agencies are heavier at bottom, with large number of junior and support employees. The junior management and support level employees are recruited by what is called state level Public Service Commission, again through open competitive merit based examination system. Thus, in term of manpower, union and state government revenue agencies are totally separate with minimal level of across department exposure. Though theoretically it is possible to have such an exchange at the highest level (for IRS and IAS officers), due to inter-service rivalries and political issues, this is rare. In any case, for lower level employees, with them forming an integral part of their parent agency, such movement (cross exposure) is not even envisaged.

In all government ministries/department (union and states), four broad hierarchies of employees are defined. They are called (quite unimaginatively) Group A, B, C and D level employees, with D being the lowest level. Within each group, there are again hierarchies and levels. Generally Group A and B category employees are called 'officers' as these are managerial level positions, and Group C and D category employees are called 'staff' who perform the crucial role of providing executive and clerical support. Higher civil services (IAS, IRS, etc.) exclusively forms group A cadre. Direct recruitment of young people through open competition examinations is generally made at entry level of each group. Further, at each level, some proportion of recruitment is made through promotion of employees from the immediately lower level on the basis of seniority. This proportion of direct recruitment vs. promotional recruitment varies anywhere from 25% to 75%. The idea behind this system is to have a mix of not only young people but also experienced people at all levels in the hierarchy. This system coupled with permanent employment and seniority based promotions, also ensures proper career progression and promotional opportunities.

4.4.2 Complexity of Administrative Reforms

The agenda and gamut for administrative reforms encompasses many issues and area, which is not our primary concern here. But it is closely related to our concern of redesigning of revenue agencies. What would be the mechanism, structure of deployment and assignments of higher civil servants in the alternative design of revenue agencies, what would be respective roles, responsibilities and accountability mechanism, etc., are some of the important questions, but without easy answers.

Despite having some of the best minds, it has rightly been felt that the higher civil service has not been able to keep pace with the changing realities of the time. There have been concerns about its inefficiency, unresponsiveness, failure to execute developmental programs and deliver public goods and services, increasing corruption, favoritism and many other ills. Even within the services, there have been concerns about its closed nature, inter-service rivalry, and dominance of one branch over other, of generalist over specialists and alleged perpetuation of mediocracy at the expense of neglect of performance. There is an increasing feeling that administrative reforms are fast becoming the binding constraint without which India may find it difficult to push itself to the next level of sustained development path. The agenda for administrative reform in India, like many other problems facing India, is complex, span various layers, dimensions and issues, and therefore requires deep analysis, innovative thinking and concerted effort from all the stakeholders.

It has been argued that functioning of civil services in India is characterized by great deal of negativity, lack of responsiveness to what the people want and dictates of democracy. The metaphors of what is called 'bureaucratic behavior' are often associated with civil services in India. The 'administrative structural reforms' are needed simultaneously in various important areas so that the civil services become superb source of expert, objective policy advise; deliver world class, customer focused services; civil servants are honest, objective, impartial and act with integrity; they are accountable, result oriented and transparent in their dealings, and are part of a system where they are proud and passionate about their work, committed to doing what they have to do with the pace India needs with right professional skills and also command confidence and respect of the public they serve[54]. However, to achieve all this, we also need important and far reaching institutional reforms and restructuring in the service organization.

Further, making changes and reforming higher bureaucracy (of IAS, IRS, etc.) may appear easier in comparison to any reform of junior civil services, which constitute most of the operational core in all government departments. Any reform and restructuring in the cadre of junior civil servants become more difficult due to their unionized nature. There are different layers of union organization, with regional department based union and a complete hierarchy of state level, national, departmental, ministry and umbrella union. Many of these unions are affiliated to political parties which make the situation more complex and difficult to reform. These unions are vociferously against any reform proposal which they see as going against their interest, for example any proposal for reduction in number of posts, any proposal of outsourcing and even partial private sector engagement, etc. The situation is better in union government department compared to state government departments. Despite this, over the past decade or so, government has been able to reduce its number in absolute sense by cleverly not recruiting against vacancies arising out of retirements.

The issue of administrative reforms in institution and organization of permanent civil services of India is intricately related to the issue of ownership of revenue agencies - fully owned government department, or autonomous or semi-autonomous revenue agencies. Nevertheless, within this overall framework, it could still be possible to have a personnel policy reform strategy which has the capacity to gel with the envisaged organizational and agency structure. We would elaborate this issue again in chapter VI.

CHAPTER V

Revenue Agencies of Future: Tackling Technical, Administrative and Political Issues

5.1 Considering Scenarios: The Possible Alternatives

On the basis of understanding and analysis of the previous parts, we can now come up with a few alternatives for remodeling revenue administrative structure in India. However, it must be noted here that the proposed alternatives are context specific, for the specific case of India - taking into consideration the federal structure of India as well as many other aspects of Indian reality - social, political, historical and institutional. In any case, the alternatives are not exhaustive, but within the overall framework of what may be 'possible' or 'feasible' in India. We would continue to analyze the issues of suitability, desirability, possibility and feasibility of different alternatives in further detail in this and the following part of the study by taking up various administrative and political as well as institutional and organizational factors into account.

Exhibit 5.1 gives a summary of five possible alternative scenarios/models for institutional organization of revenue agencies in India. These five scenarios are broad possibilities and further modifications are possible within each type. For example, local level revenue organization has largely been kept out of scenario consideration and accordingly various possibilities of organizing local level revenue agencies would give rise to more alternatives within each of these five scenarios, possibly generating large number of alternatives making it unwieldy to have any meaningful analysis. Instead of this, the local level revenue issues have been considered in brief separately, within the overall framework. Further, the scenarios conceived here would largely be implementable under different types of ownership arrangement and functional relation (completely owned departments, autonomous or semi-autonomous agencies) of revenue agencies with the government.

Another crucial point to be noted in the beginning is to have a clear distinction between having a national revenue agency responsible for 'collecting' all taxes (including the taxes which can be 'levied' by the state governments) vis-a-vis collection of state taxes by separate state level agencies. The distinction between power to 'levy' and the arrangement made for administration/collection of some taxes assumes importance. It is possible (and it happens in some countries) to have an arrangement where a tax is levied by state/provincial government but actually is collected by national level agencies (mainly for efficient and effective collection mechanism). It is also possible to have a reverse arrangement, where although a tax is levied by union government; it is collected by local/state level agencies. In this arrangement, there would be only state level revenue agencies/department responsible for administration and collection of all taxes.

Exhibit 5.1: Alternative Scenarios for Organizing Revenue Agencies

Scenario 1: Single National Revenue Agency

- No revenue agency at States level, all collection by federal government
- State's share (mandated and otherwise) trasnfered to States for their expenditure responsibility

Scenario 2: Two (or three) Agencies by Tax Type at Federal Level only

- Two ore more Federal Revenue Agencies, all collection by federal government
- No revenue agencies for States
- State's share (mandated and otherwise) transferred to States

Scenario 3: One Federal Revenue Agency and One Each for States

- One revenue agency at Federal level, for all federal taxes
- One agency in each states, as of now

Scenario 4: Status Quo

- Federal Revenue Agencies by tax types, i.e., two agencies for Direct and Indirect Taxes
- States to have their own single tax agencies

Scenario 5: Status Quo with Resource Sharing

- Sharing of human resources and professional expertise
- Sharing and harmonization of technical and IT infrastructure and informational base

All these scenarios assumes that the agencies would have power only to collect or administer the tax they have been assigned to within their jurisdiction, and not the power to decide on the policy (which would mainly be decisions related to tax base, levy and rates, etc.). In the Indian federal structure, where the power to levy a tax is divided between different levels, and is considered a very important characteristic in the overall scheme of federal structure, any attempt to shift or change these policy powers are big political issues and needs a separate consideration. Therefore, the scenarios here are concerned only with assignment and distribution of 'administrative' powers to revenue agencies.

Further, these alternative scenarios are concerned with broad structural design at the highest level. At the next level, the revenue agencies could further be organized on either tax-type, regional, functional, and/or taxpayer segment depending upon the operational and administrative requirements. In most of the cases, the structure would be a mix of these three considerations leading to a hierarchical matrix of organizations, often on the lines of structure discussed in previous parts. Addressing the lower level design issue for organization of divisions, offices or units here in the analysis would, again, result in cluttering of alternatives making any further meaningful analysis very difficult, though some of these have been mentioned within the scenarios briefly. In addition, some of these design-axes are implicit in alternative scenarios, as for example in the case of scenario 2 where the apex level design is broadly based on 'tax type' and by implication the next levels could be on the basis of 'function' and/or 'region' and then 'taxpayer segment' and/or a mix thereof.

Scenario 1 envisages having only one union level revenue agency which would be responsible for 'collection' of all taxes, whether 'levied' by union or state governments. After collection, the states share would be transferred to the respective states and the mechanism can be perceived as a tool for effective and efficient administration of tax regime. There could be many functional divisions of the agency on the lines of broad class of administrative functions like taxpayer management, audit and compliance, enforcement and investigation, etc. Alternatively, there could be divisions on the basis of taxpayer segment model. Many of the benefits associated with functional or taxpayer segment model could be possible in this scenario. However, a single tax agency for all India would eventually led to large number of divisions and any actual benefits of single agency many not be easy to come by. In such an eventuality, making a strict distinction between scenario 1 and 2 is largely a theoretical exercise. Nevertheless, it assumes importance in light of proposed introduction of dual-GST in India, which is proving so difficult to implement, especially in light of states apprehension that this would severely compromise their power to 'levy' certain taxes and thus is considered an attempt to alter fiscal-federalism of India. We would be examining GST and the required revenue agency for its administration in the next section.

Scenario 2 envisages two or more revenue agencies at union level in charge of 'collecting' almost all the major taxes, with no (minimal) responsibility for state level agency (ideally there would be no need of any state level collection agency). The number of agencies would depend largely on 'type of tax' consideration, and therefore we could have three agency, one each for taxes on income, taxes on consumption (would include excise, service tax and state level VAT, as proposed in combined GST) and for custom, as these are the three major type of taxes in India and their operational and administrative requirements also vary substantially. The next operational level could be on the basis of either 'function' or 'regions' or a matrix of these - with 'taxpayer segment' also forming the second layer in some cases (like LTU for large corporate taxpayers). Such a model with appropriate level of administrative harmonization has the potential to derive most of the benefits of 'type of tax' as well as 'functional' model. However, it is easier said than done. Though technically sound, it would face not only opposition from political leaderships of states (who see any such attempts as eroding state's fiscal autonomy), but also from strong state level bureaucracy. Technically scenario 1 or 2 both appear sound, with scenario 2 a little more favorable to India's federal structure and taking in to consideration the importance of tax administration on the basis of 'tax type' .

Scenario 3 differs from scenario 4 (status-quo) only in the respect that it proposes to have a single revenue agency at the union level by merging the two existing agencies, CBDT and CBEC. Though this addresses the question of cooperation and harmonization at union level, better utilization of IT and other infrastructure and professional expertise of manpower, its overlooks the broader issue of 'tax-type' linkages between the functions of CBEC and state level agencies, assuming more importance in light of impending dual-GST. With continuation of state level agencies separately, it would not bring any improvement in the existing situation. Scenario 4, of course, is to maintain the status-quo, and may have to be retained, if better alternatives are not feasible due to political and administrative consideration. Clearly, there are alternatives preferable to the status-quo, namely scenario 2 and also 5, which we will discuss subsequently.

Scenario 5 is a mix of many things and may appear to be an attempt to derive a compromise. It is basically a hybrid of scenario 4 (status quo) and scenario 2, and tries to incorporate the benefits of latter to improve upon the former. The major deviation with scenario 2 is that it allows state level agencies to exist simultaneous with union agency for consumption taxes, and ultimately both end up doing the same thing - collecting same taxes, on same base, following almost the same processes, and structure. However, to limit the possible inefficiencies of this, it envisages to attain maximum level of harmonization between union and state level agencies - in all the possible areas of tax administration, especially in the realm of human resources and infrastructure sharing, cooperation and coordination in use of information technology tools for taxpayers service, information and tax base sharing and in delivery of taxpayer service (like tax return filing, tax payment, audit, etc.) In this scheme, the second and third level design should be on 'functional' and 'regional' basis with harmonization across these functions and geographical regions as well as with state agencies. After all, in a fiercely democratic federal country like India - on some occasion, what may appear a hotchpotch in the beginning often have the potential to come out as the second-best alternative, which is acceptable to majority with least amount of resistance. This alternative also incorporates the possibility of gradual move towards scenario 2 with increasing harmonization ultimately leading to a situation where existence of two agencies for doing the same work would become totally superfluous.

5.2 Consumption Taxes and GST: Political Economy, Bureaucratic Play and Compulsion of Fiscal Federalism

Indian has been preparing to introduce comprehensive Goods and Services Tax (GST) for past decade, though much still needs to be done. However, one thing that appears reasonably certain at this point of time is its inevitability despite so many roadblocks. GST as a tax policy reform is in itself a huge area and well beyond the scope of this study[55]. What is being attempted here is a brief examination of structure and design of proposed dual GST in India and a suitable administrative agency for its implementation, execution and operationalization.

5.2.1 A Dual-Goods and Services Tax in India

There are many differences in the way Value Added Taxes (or Goods or Services Taxes, as we now tend to call such taxes) are understood and implemented around the world. Nevertheless, there are certain common characteristics of such taxes which can help us in understanding and analyzing various related issues. VAT are taxes on consumption, paid, ultimately, by the final consumer. The tax is generally levied on a broad base (as opposed to e.g., excise duties that cover specific products). The system is generally based on tax collection in a staged process, with successive taxpayers entitled to deduct input tax on purchases and account for output tax on sales. Each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the proportion of tax corresponding to its margin i.e. on the difference between VAT paid out to suppliers and VAT charged to customer. In general, many countries with VAT impose the tax at all stages and normally allow immediate deduction of taxes on purchases by all but the final consumer[56].

The main feature of VAT/GST is their neutrality, irrespective of the nature of product and services, the structure of the distribution chain and the technical means used for its delivery. VAT are also neutral towards international trade according to international norms since they are destination based (even if the rule might be different for transactions made within federations or economically integrated areas). This means that exports are zero rated and imports are taxed on the same basis and with the same rate as local production[57].

The idea of a single unified tax on goods and services administered only by the union government is hugely attractive to many, particularly business. It is widely felt that for operation of a common market, India needs a unified GST levied nationally. It is also widely recognized that administratively a centrally administered VAT/GST is highly suitable for federations. Within the constitutional assignment of tax powers in India and the current political environment, however, purely federal VAT is not considered feasible, even though it may be considered desirable[58]. The power to levy sales tax/VAT constitutes the most important tax powers of Indian states. Further, the power to levy this tax is a ‘power’ in itself and not just revenue power. Taking this away will grievously reduce states fiscal autonomy.

As noted earlier, consumption and production taxes in India are levied both by union and state governments. Thus, union government levies excise (loosely a tax on production, can also be called first stage of VAT) and service tax, whereas state government levies VAT on subsequent sales of goods. The present system is in itself a much improved version of older system of excise and sales taxes, which were often called irrational and complex. Nevertheless, it is widely agreed that a GST is a major improvement over the present system due to many reasons. The excise at manufacturing level gives rise to definitional (what is manufacturing) and valuational issues (cost of production or the value at which the tax to be levied) and makes its effective burden dependent on supply chain[59]. As per constitutional arrangement, state government cannot levy taxes on services. This makes it difficult to tax goods supplied in a composite form bundling both goods and services. In any case, the traditional distinction between goods and services are becoming archaic and often union as well as state governments find it difficult to tax such bundles in a smooth manner as each of them can tax only part of the bundle[60]. Further, with high buoyancy in service taxes, there has been demand from states that they should also have express power to tax services, which today, forms almost 50% of India's GDP. Another problem in the present system of indirect taxation is the tax cascading. The innumerable exemption and partial coverage is the main factor behind this. As of now, oil, gas production, mining, agriculture, wholesale and retail trade, real estate construction and many services remain out of excise and service tax net. And these sectors are not allowed to claim any credit for excise or service tax paid on their inputs. On the state's side too, no credit is allowed for the inputs of the exempt sector. All this increases cost of production and differential treatment of competing products. The whole structure has become quite complex, with high compliance cost, inefficiency and administrative lacunae[61].

Due to all these difficulties, the basic objective of GST reform is to establish a tax system that is economically efficient and neutral in its application, distributionally attractive and simple to administer[62]. We have already seen the complicated and unique situation in India where union and states governments both have powers to tax domestic trade and other economic activities. In such a situation, any move towards comprehensive GST is bound to be complicated. The Task Force on GST of XIII Finance Commission noted that a conventional GST cannot be implemented without the states losing their fiscal autonomy. However, this does not appear to be politically feasible since revenues from state VAT account for substantial proportion of State's revenues. Therefore, the solution has to be found within the existing federal framework where both levels of governments have the concurrent powers to tax domestic trade in goods and services[63]. As the events have actually unfolded, after much deliberations, it has been agreed that India will have a dual GST – concurrent levy to be imposed by center/union (to be called Central GST; CGST) and states (to be called State GST; SGST) separately on the same base and implemented by multiple statutes. However, the basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. would be uniform across these statutes as far as practicable[64]. The CGST and SGST would be applicable to all transactions made for a consideration except for exempted goods and services and below the threshold limit transactions. GST would be paid to the accounts of union and state government separately which will also require utilization of input tax credit paid for union or state separately[65]. An Inter-state GST (IGST) model would be adopted for inter-state transaction of goods and services where IGST equal to sum of CGST and SGST would be levied by union government on all inter-state transactions[66].

5.2.2 Revenue Administration for Dual-GST

Even the Task Force on GST of XIII Finance Commission has not come up with detailed administrative architecture for proposed dual GST and has only concentrated on few issues like registration of taxpayers, GST invoice, periodicity of GST payments and most importantly on administrative structure of GST[67]. The thrust of the administrative recommendation are on maintaining two separate entities for the operationalization of GST at Union and State level.

Thus, it has been recommended to have two department/agencies, one for union and one for each state GST under the control of union and respective state governments. These agencies would be responsible separately for functions like assessment, enforcement, audit/scrutiny etc of their respective portion. However, it has also been recommended that all the process and procedure would be same under both CGST and SGST. Some of the harmonized operational structure could be in the following areas:-

- The jurisdiction between CBEC and state agency need to be properly divided and operationalized. If it can be done in such a manner that a taxpayer has interface with only one agency, it would be ideal. Instead of having one agency, another alternative, though much more difficult to operationalized on various other considerations, is to have a jurisdictional division between the two agencies on some economic criteria like turnover threshold, etc.

- In any case, all the procedure under CGST and SGST need to be uniform. It is important to have a common Information-Technology infrastructure, and this can be done only at the national level. It would also be desirable to have taxpayers' information network (on the lines of ITDs Tax Information Network (TIN) and it should be shared between union and state. All the information should be stored in a common data base. Some progress has been made in terms of devising a GST Network (GSTN) to be set up on the line of ITD's TIN[68]. It also envisages providing of three core services to taxpayers through a common portal - registrations, tax returns and tax payments.

- Various processes and activities like tax payment, transaction reporting etc. should ideally be made through combined payment and transaction reporting statements, and such documents should be common for both levels of agencies.

- Tax return filing should also be common. Further, audit being an important activity for ensuring compliance, it would be ideal if both level of agencies have a structure whereby the same taxpayer is not subjected to simultaneous audit by both the agencies.

- There should be a common taxpayer's registration and identification base. The taxpayer identification number of ITD (called PAN) is already being used by the central excise and it can easily be accepted and modified for the dual GST model. This appears to be the plan also under GSTN[69].

- There is need to have a common and standardized GST invoice system as an invoice forms a primary source of information and is essential for effective control and enforcement as well as audit of the GST.

- As the tax base would be common, it would make sense to have a common appellate structure and similar other authorities like for Advance Ruling etc.

It is clear from the above that a well designed and well functioning IT system is perhaps sin-qua-non for a successful GST regime. Further, such recommendations also seem to suggest that if the above types and levels of harmonization are achieved, would then there be any purpose of having two separate agencies. Further, there are many other administrative issues, like establishment of an apex level GST council for policy and highest administrative level coordination between different states and union government. What would be the structure, functions, membership, roles and responsibilities of such a council has not yet been agreed upon - this being a contentious political issue. Furthermore, how and in what manner inter-state transactions should be treated and taxed is still not fully resolved despite a broad agreement on IGST. Furthermore despite these recommendation, the actually progress is way behind. As of now, there are also a number of issues on which no consensuses has been arrived at. These are the rates of taxation, the revenue sharing between union and states, framework for exemption, thresholds and composition. Though the union government has announced that it would be bringing a modified draft of constitutional amendment in budget session of Parliament during March-April 2011, the projected roll out date of GST regime from 1st April 2012 may have to be extended in light of many pending decisions and the still elusive consensus from some state governments (most of which are governed by parties other than the one in power at the union).

5.2.3 The Politics of GST Administration

Despite strong political issues on the nature and structure of GST itself, we can examine how the current skeleton administrative framework envisaged fit our alternative scenarios. It appears that the movement is towards scenario 3 (with talk of achieving scenario 5). In fact, scenario 2 (as for that matter even scenario 1), which is perhaps technically the best in the current situation, already appears to be out of consideration. The reasons clearly have to do much with political imperatives rather than issues of technical soundness and efficiency. The GST policy is being discussed and debated at the highest political level and obviously the question of fiscal autonomy of states and their ability to raise revenue independently has played a decisive role. Therefore, though it may technically have been more attractive to have a unified GST, the consensus has emerged for a dual-GST to be 'levied' both by union and state governments separately. However, on the administrative architecture issue, question of how separable are the power to 'levy' GST and its operationalization for 'collecting' this tax has not got its due attention. It has happened largely due to the presence of strong state level bureaucracy and their rivalries with the union bureaucracy. As we have noted earlier, state level tax agencies are dominated by IAS officers at the highest level and state level civil servants at junior level. On the other hand, union excise and custom is dominated by IRS officers at senior level and junior officer (of union government) at lower level. Therefore, without basically examining what could have been the most efficient and effective way of 'collecting' a dual-GST, the question has been approached on the presumption that both these wings of the government would continue to exist (in the background, the existential threat to entrenched bureaucracies, the threat of their erosion of power and privileges, etc., has played its part), thus devoiding any meaningful examination of this crucial issue. However, it must be noted that implementation of GST with two agencies in charge of simultaneously administering it over the same base may substantially nullify any envisaged benefits of this ambitious tax policy reform.

In such a situation, it appears that the status-quo is a feasible alternative, and the developments till date are certainly pointing in that direction. This basically means that although there are considerable gains to be made by having a single agency to collect/administer dual-GST, it may not be politically feasible. Despite efforts to the contrary, this may ultimately lead to a situation where there would be significant administrative inefficiencies, higher compliance cost and where taxpayers would be forced to deal with two agencies for compliance of even a single tax - a truly unfortunate outcome. Consider the worst situation where a GST payer would be paying GST twice, once to union agency and then to state agency, maintaining two set of records, filing two GST returns and dealing with two agencies at each and every stage of compliance - a truly horrible scenario. The larger issue of having two separate agencies for collecting what essentially is a single tax has to be faced. An improvement over this status-quo approach and which may also be feasible with some efforts and foresight is Scenario 5 which tries to take benefits of unified union agency by ensuring maximum harmonization between union and state agencies. The plan of the government also appears to be towards achieving something like scenario 5. Here, though the two separate agencies may be maintained, there would be considerable harmonization in terms of resource sharing - not only sharing of infrastructure and Information-technology platform (obviously there should be single tax return form and tax payment system, and possibly a joint audit and scrutiny), sharing of information and tax base through common architecture, cooperation and coordination at different levels; but also sharing and utilization of human resources across the agencies, especially at the higher level so that professional expertise in tax administration, in compliance and enforcement operations, etc., can be effectively utilized.

However, it would face resistances from bureaucracies, more from the state level IAS. Being generalist, their claim of managing state revenue agencies as expert tax-professional is not easy to digest. Despite this, as they are powerful not only in state but also in union governments, it would not be easy to get the tax professional manage all tax agencies. The issue of roles and responsibilities of IRS vs. IAS is of wider significance and assumes importance within larger issue of administrative and civil services reforms and we take up this question subsequently in next part. In any case, there is no denying the fact that the best suitable scenario is either 2 or 1 and that needs to be implemented. However, as it may not be politically feasible to shift to either of them right away, scenario 5 with an emphasis on harmonization may be the second best alternative. Further, it should not be considered an end in itself - a destination, but only the first stage in a ‘process’ of gradual move towards scenario 2 through a dynamic harmonization program moving from one higher benchmark to another over a period of time. In this endeavor, some of the Union Territories could be the starting point for having a unified agency for collection and administration of dual-GST.

5.3 Growing Importance of Income and Related Taxes: Political-Economy and Appropriate Agency

While GST appears to be an important factor in designing of revenue agencies as of now, we should not lose sight of long term perspective. We have already noted the growing importance of income taxes in India. In light of above, a suitable agency model which is capable of meeting the challenges of future assumes wider importance. Some of the potential issues of this landscape are analyzed below.

5.3.1 Income and Capital Taxes

As we would note in some detail in the next part, different types of taxes on income should be the largest source of tax revenue for governments, especially for the government of a developing country. In this sense, the Indian tax structure is far from the ideal type, though income taxes now constitute the largest source of revenue for the union government. Still, it has been observed that share of personal income tax is more limited than in countries where the value of the per capita income is not far different from the Indian one. This may be aimed to preserve poverty income from taxation, but unavoidably the poor are then hit by regressive consumption taxes[70]. Exhibit 5.2 gives a snapshot of comparisons of contribution from various taxes as tax-GDP ratio for some major developed and developing countries, including India. As it is amply clear, income taxes have the potential to grow faster in future and should make the largest contribution to the exchequer. For almost all the countries, personal income tax forms the major component, often contributing to more than one third of total taxes, whereas for India, this proportion is around 12%.

Exhibit 5.2: Tax-GDP Ratios of Some Selected Countries (in 2006)

Country	Major Taxes/GDP (in percent)					All Taxes/GDP (in percent)
	Personal Income Tax	**Corporate Income Tax**	**VAT**	**Social Sec. Cont.**	**Specific GST**	
Australia	11.4	6.6	3.9	-	3.6	30.6
Canada	12.1	3.7	3.1	4.9	2.9	33.3
France	7.7	3.0	7.2	16.3	3.2	44.2
Germany	8.7	2.1	6.3	13.7	3.3	35.6
Japan	5.1	4.7	2.6	10.2	2.1	27.9
Mexico	-	-	4.2	3.1	7.2	20.6
UK	10.6	3.9	6.7	6.9	3.6	37.1
USA	10.2	3.3	-	6.7	1.7	28.0
Malaysia	1.8	5.3	-	-	-	11.3
South Africa	8.0	6.3	7.2	-	2.4	25.5
India	1.8	3.4	5.0	-	5.2	15.6

Source: Compiled from Table 16, p 105 of Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series – 2008; Centre for Tax Policy Administration, Organization for Economic Cooperation and Development, Paris, France, 2008; Information for India compiled from Economic Survey of India, 2008-09, Ministry of Finance, Government of India

It is well accepted that the income tax base in India is too narrow, and even shallow. The reforms of past two decades have been quite successful in starting the changes in the desired direction, with Income Tax collection increasing at a continuous rate of around 25% per annum compounded. As a result, the collection has quadrupled in past decade. Nevertheless, more is still pending. After all this, only about 3% of India's population pays Income Tax today. India, being poor and with a large proportion of population depended on agriculture (income from which is not taxable) put a restriction on the potential for increasing the tax base. Yet, 3% is an abysmally low number. It has been argued that in the long run, a gradual evolution of personal income tax to a point where a full one-third of the household of India pay income tax, albeit at a low rate should be a desirable goal[71]. This means an increase in the individual tax base by around three times - from the present level of 30 million to around 80 million. Whereas this figure on the one hand shows the huge potential for widening of tax base, it also makes salient the formidable challenges being faced by direct tax revenue administration. This broad tax base may also enable reduced rate, which strengthen GDP growth by reducing tax-induced distortion and reducing the size of the black economy[72].

Along with the potential for widening the tax base, there are huge potential for deepening of tax base too. Only one statistics would suffice. A study by NCAER[73] has reported that the number of households with income of Rs. 1 million or above in 2005 were around 1.7 million. On the other hand, the comparable figures from the tax records were only 130,000. For the year 2003, this number in tax records was ridiculously low at 70 thousand[74]. Even after agreeing that returned income and household income estimates are not strictly comparable due to exemption and other issues, the differences are huge and only point towards the level of tax avoidance and evasion being practiced by middle and higher income households in India. It is also well known that taxpayers who have large amount of self-generated income are most likely to be the largest evaders (examples could be small and medium traders, manufacturers and business establishment, self employed professionals like doctors, lawyers, accountants and consultants, etc.). In recent years, some significant empirical studies have been conducted[75] which have shown that smaller evasion is the result of lack of opportunity to evade due to tighter enforcement, especially through third party reporting and tax withholdings at source. Such studies have strongly made a case that lower level of evasion in an economic environment is mainly due to the 'inability' of the taxpayers to evade rather than due to any 'unwillingness' to evade. On the positive side, it can be mentioned that the situation has been improving quite rapidly since 2005, with the income tax collection more than doubling during this period. In any case, there is no denying the fact that the potential for deepening of individual income tax base are immense in India, and like the issue of widening of tax base, it is indicative of not only its potential but also of challenges for tax administration.

With the desirable increase in individual income tax collection, it would also be possible to have a rethinking of corporate tax rate - which basically taxes income of individual through a different route[76]. Like many other advanced countries, an increased contribution from individual income tax would help in further rationalizing and lowering of corporate income tax rate. As of now, though the corporate income tax figures may appear reasonable in comparison to other countries, there are many other technical tax policy issues lying deeper, like desirability of corporate tax, its nature and true incidence and its effect on efficiency and equity etc, into which we need not enter here.

Taxation of capital is not significant in India. Only capital assets not put to any 'productive use' are taxed with some generous definition of productive use. As a result, the collection from this particular tax, called 'Wealth Tax' is insignificant. There used to be a tax on inheritance, called 'Estate duty tax' which was withdrawn in early 1990s. It is therefore, amply clear that the emphasis now and in future is going to be on income taxes. Thus, the direct taxes or taxes on income are the taxes of future and any redesign of revenue agencies need to be appreciative of the future lying ahead. In this backdrop and in light of the fact of distinctive operational requirement of administration of income taxes (as noted earlier), it makes sense to have a separate union income tax agency, albeit with considerable harmonization with other revenue agencies of consumption taxes. In terms of scenarios, it leaves us with alternatives 2, 1 or 5 to choose from in that order of preference.

5.3.2 Social Security Taxes: When and How

It is a well know fact that a minimum level of social security net is perhaps one of the most important responsibilities of many national governments. As clear from Exhibit 5.2 earlier, social security tax or contribution is one of the important components of government tax revenue in many developed countries, collecting as much as 16% of GDP in the case of Germany. In the case of India, social security net is virtually absent. And there is nothing which can even loosely be called social security tax. There are some specific programs for specific group of people which may be identified as providing some minimum level of social security, but they are not at all universal. Further, all such program are funded through 'Consolidate Fund of India' where all tax collections are accounted for. Thus, individuals do not pay any social security tax, only income (and wealth) tax on their regular income. However, it also needs to be mentioned that individual tax base is still quite narrow in India (only around 3% of people are registered tax-payers). Nevertheless, some distinction needs to be made here in comparison to other countries. Only a small fraction of workforce is employed in organized sector, wherein government is one of the largest employers. Most of the government employees in India are permanent and are covered by generous pension provisions, which is nothing but a social security scheme. However, since 2004, government of India has moved to contributory pension system. This has been a significant step, a move from 'fully funded' system to 'pay as you go' system[77], but the transition has been made without much public debate, without the needed scrutiny, study and analysis of its long term ramifications not only on the workers directly affected and expected to be affected in future, but also on the wider economy and social structure.

For organized private sector employment (as well as others), there are various contributory pension schemes run by independent financial institutions/banks etc., with government regulation. Organized private sector employees are also covered with provident funds and some other similar compulsory savings schemes under government management. In fact, there is a separate, relatively large federal agency called Employees Provident Fund Organization (EPFO) within the Ministry of Labor and Employment which administers the compulsory provident fund contribution of organized private sector wage earners (with matching contribution by their employers)[78]. The scheme has some similarity with US social security, but the benefits depend on the amount of contribution made as government periodically decide the rate of interest accruing to these savings/contributions. EPFO employs around 20000 personnel with offices spread all over India. Though there is relatively meager inter-agency communication and coordination between ITD and EPFO as two independent federal agencies, the higher management level in EPFO has seen IRS officers working there. Further, another agency called Employees' State Insurance Corporation (ESIC), also within the umbrella of Ministry of Labor and Employment, is responsible for some socio-economic and workplace related protection of employees and their dependents[79]. Recently, a regulatory watchdog Pension Fund Regulatory and Development Agency (PFRDA)[80] has also been established to manage and regulate the rapidly emerging private (as well as existing public) pension sector in India. Ministry of Labour and Employment has, in recent past, come up with social security program for unorganized sector workers too, though it is still in its infancy[81].

Nevertheless, all of this is not a replacement of a comprehensive social security net and in any case, covers only a small fraction of total population. As of today, as much as 60% of India's workforce depends of agriculture for its livelihood, which is largely unorganized and is not covered by any social security structure, being either providing self-employment or wage-labor employment. Large numbers of people are dependent (again either self-employed or wage earner) on non-agricultural unorganized sector activities of local trade and retail, small and medium industry and industrial production, construction and related activities, service sector, and as artisans and handicrafts workers, daily-wage earners, etc, which keeps such people largely outside of any formal social security net.

In any case, even for a comprehensive coverage of social security program administered by whichever agency, the relevant question for us here is the revenue source for funding such a program and the mode and mechanism for collection of such revenue, which in the ideal situation, should be earmarked for provision of social security net to the populace at large. The solution is a kind of social security tax levied on a broad base. Further, with rising economic prosperity, development and widening inequality, India will invariably need broad based comprehensive social security system, sooner the better. But how, in what form and when? These are the crucial policy questions. However, the important question for us is not the type and structure of benefits scheme, but its funding and the needed tax/contribution collection structure, and how a future social security tax is required to be factored in any redesigning of revenue agencies. It is clear that social security tax is generally a tax on income and is most efficiently collected together with income taxes. In this sense, social security tax is often considered part of income tax itself and administratively dealt in that manner.

It has been observed that integration of social security and income tax function are highly desirable due to commonality of core processes, efficient use of resources, core competencies of tax and social organizations, lowering of administrative costs and taxpayers/contributors compliance cost[82]. Accordingly, it makes sense to have this factor salient in considering the design of revenue agency. However, the related question here is of how the functional overlap of ITD and EPFO can be harmonized and made more effective and efficient. What are the possibilities, benefits and potential problems of merging or integrating EPFO with ITD or a redesigned agency in charge of administering taxes on income as well as social security taxes? In any case, it appears that miscellaneous taxes on different type of income and wealth would require realignment, restructuring and rationalization in not so distant future. This means that the direct tax/income tax function of the government would have to be geared for this scenario. Further, as income taxes are best administered at national level, it makes sense to maintain a separate agency for taxes on income and related taxes like social security, etc., especially if its coverage is planned to be extended from organized sector wage earners to public at large. For our purposes, the best alternatives appear to be scenario 2 or 5 or 4 in that order, though we have not been able to address the social security issue in much detail here.

5.3.3 Taxing Agricultural Income

Another peculiar feature of Indian revenue structure is that agricultural income is not taxed. In fact, as we have noted in part I of this study, agriculture income tax is in state list and therefore states have the power to tax agriculture income. However, no state in India has put it to tax. There are certain reasons and consequences of this fact. First, in most of the states, agriculture does not produce a handsome surplus to make is attractive for tax purposes as agriculture in most parts of India is largely of subsistence type. It is also widely believed that most of the farmers are poor and it would neither be appropriate nor administratively effective and efficient to bring them under tax net. Still there are wide regional variations. In agriculturally well developed states of North-West, West, and South India, there are large numbers of well-to-do farmers deriving substantial income from agricultural activity[83]. However, politics comes to play here. As only states government can levy tax on agricultural income, and there are strong farmers lobby in agriculturally developed state, it has become almost impossible to introduce such a tax. Further, due to inter-state competition also, such levy becomes difficult.

This all has given rise to large amount of tax evasion, where businessmen, trades and professionals have falsely shown substantial income from agriculture and claimed it exempt. Though there are provisions in income tax laws which clubs agricultural income into non-agricultural income for 'tax slab purposes', thereby moving up the 'tax bracket' of the tax-payer, it helps only marginally. In any case, it is now being felt that agricultural income, above a minimum exempt amount need to be taxed. But how and when - are again the most important questions. It is also being realized that to make any such effort effective, it need to be done by union government. These are again contentious question, though even now, the union government is including agricultural income for bracket creep as explained above. Despite this, what is important to realize that if agriculture income is brought to tax, it can only be done by making it part of total income and therefore, its clubbing with overall 'income' would be necessary - thereby giving a preeminent role to the union government. This again points towards the fact of additional function for income tax agency in future and may force us towards scenario 2, 4 or 5. Scenario 2 may be technically better, but there are important political issues here. States, naturally, would not like to lose this source of potential revenue, even if none of them would be tapping it. Making changes in the power to tax would require amendment to constitution, which would prop up similar political negotiations and games as are being witnessed presently in the arena of GST. Even if no changes are made into constitution, and only the administrative power to 'collect' the tax on agriculture income is vested with the union agency, there could be some political and administrative issue. But these do not appear to be as important as in the case of GST. Further, administrative feasibility also does not appear to be an important issue here as bringing agriculture into tax net would not pose any serious challenge to the existing administrative mechanism in terms of process. It can conveniently be done by making income from agriculture as part of total income to be collected by union agency. However, operational requirement may necessitate geographical spread and considerable expansion looking at the widespread, decentralized and largely unorganized nature of agricultural operations in India.

5.4 Roles and Responsibilities for Local Level Revenue Agencies

As we have noted earlier, local level fiscal decentralization is still not developed in India. Only in urban centers, property and house tax form a somewhat important source of revenue and are generally entrusted to municipal authorities for administration. In our analysis of alternative scenarios, we have kept out the desired structure of local level revenue agencies. Nevertheless, local revenue is a potential source and it needs to be considered seriously. Further, it is widely believed that potential sources of local revenue are numerous and their tapping would be effective and efficient only with a local agency[84]. It has also been largely agreed that the core function of local government should be allocation. The financing of local government may come from user charges, taxes, central government grants and borrowings[85]. The assignment of taxes to lower levels of government need not necessarily led to their determined efforts to generate revenue, particularly in developing countries[86]. In such a scenario, a good local tax would be one whose burden cannot be exported by the local jurisdiction. Land and Property tax seem to satisfy the criteria best, whereas income tax may be the worst candidate for local taxation.

India is urbanizing fast, with as many as 30 percent of its population now living in cities. With this, urban governance is fast emerging a very important issue in public policy. On revenue front, it has been emphasized that ways for augmenting the resources of municipal authorities need to be found fast. Reform of property taxes and adequate exploitation of user charges and fees for various services delivered has been identified as two sources with promising potential[87]. A city-specific piggyback surcharge on proposed GST has also been suggested[88]. In addition, what is also needed is strengthening, even a revamp of mechanism of transfer of resources to urban government, especially from state governments which is presently largely ad-hoc, discretion based and non-transparent. Perhaps possibility of direct resource transfer from union to large urban governments also needs to be examined.

In such a case, we can safely assume that local level revenue agencies (mainly municipal agencies in cities and towns of today) need to be maintained, and reformed. However, being part of state government bureaucratic structure, most of them are in drastic need of organizational overhaul and restructuring. They need to be made professional, responsive, responsible and accountable. Here again, the usefulness of a harmonized operational system cannot be emphasized more. A structural arrangement and administrative mechanism which is able to use and share information, tax base, data bases, information technology application and other relevant information is the minimum requirement. Further, it should also be designed to benefit from other resources of national and state revenue agencies like professional expertise, infrastructure and more. As we have already noted, in large metro cities of Delhi, professional tax bureaucrats do manages the municipal tax agency for collection of property and house taxes and these are certainly better administered than smaller municipal corporations. In a sense, these third tier of revenue agencies can continue to exist and administer local sources of revenue, which are growing in importance, but they also need to be fully ‘integrated’ with the larger ‘grid’ to derive important benefits of a harmonized tax network.

CHAPTER VI

Revenue Agencies of Future: Managing Institutional and Organizational Paradigm

6.1 Fiscal Federalism, Tax Assignment and Revenue Agencies

6.1.1 Fiscal Federalism and Decentralization

Government do comprise of many tiers, there is no denying of this fact. Accordingly, different taxes have to be assigned to different levels. Further, revenue from a particular source of tax is often shared across tiers. We have already noted that fiscal structure in Indian federation is characterized by both vertical and horizontal imbalances. In a sense, vertical imbalance with concentration at union level has been necessary to address horizontal imbalances, where there are wide differences in the level of development of different states/regions and therefore differences in their capacity to raise revenues. Left to themselves, poorer regions would not have been in a position to generate adequate revenue which would have perpetuated their disadvantaged status. Therefore, the institutional arrangement in India is characterized by strong fiscal fungibility and a system of devolution to lower levels through a complex mix of rule based mandated sharing and transfers, grants-in-aid and other modes (in all of which the Finance Commission plays an important role), which is largely independent of a state's revenue contribution. In this structure, the states have obviously limited sources of revenue. Nevertheless, states are in themselves independent democratic, administrative units, often representing sub-national identity of distinct culture, language and social structure. In such a case, any move towards further centralization of revenue raising powers is always seen as attempts by union government to curb the fiscal autonomy and independence of states. Further, as we have noted, states are the sub-unit charged with substantial expenditure responsibility requiring fiscal transfer from union to states. In light of above, it is not surprising that we often hear of demands for more fiscal devolution (power to tax) to states.

Of late, decentralization has become a buzz word world over. Though third tire of governance structure in the form of Panchayati Raj Institutions and district level boards/councils have also been entrusted with some significant expenditure and service delivery responsibilities, they are largely dependent on transfer of funds from state government (and also union government). Here a distinction between fiscal federalism and decentralization needs to be made. Different people mean different things by decentralization. Distinction among three kinds of decentralization may be useful here - decentralization and devolution of political decision making; administrative delegation of functions of union governments to regional or local branches; and fiscal decentralization[89]. Within the last one, two further sub-divisions are possible, decentralization of public expenditure decision and decentralization of revenue/tax powers[90]. In most cases, more so in India, decentralization has been concerned more with first two types, i.e., devolution in the areas of political decision making and in administrative delegation[91]. We are here more concerned with centralization or decentralization of revenue powers. It is well in line with the fiscal argument and worldwide observation that often certain level of revenue centrality is necessary for administrative, efficiency and effectiveness ground.

In such a scenario, where the question of revenue collection and expenditure responsibilities of resources are largely segregated, we are interested in the questions of best possible arrangement of revenue agencies for administering and collecting different taxes. It has also been argued on the question of designing the tax, that while tax rates can be left to local taxing powers, the tax base should be determined at the central level since determining the base involves distributional considerations and consequences and differences in base across localities would reduce transparency and accountability[92]. Though the idea may not strictly be applicable in India, once allowance is made for federal structure, it can lead us to a situation where scenario 1 or 2 may appear to be more suitable. Again, in both the cases, the base for consumption taxes can be common for union and states, but the decision about rate could be the decision of the states. Further, collection mechanism, nevertheless, can be assigned to the union agency.

6.1.2 Tax Instruments and Efficiency vs. Equity/Redistribution Question

Tax assignment and appropriate revenue agency issue is intricately linked with the question of taxing income or expenditure - being two side of the economy equation. The argument for the expenditure side that income taxation would tax investment has been tackled by providing exemption for investments made out of income. Next, the superiority of the progressivity of income tax has been attempted to be countered by designing progressive expenditure taxation, but without much success. In any case, proponents of income taxation rely on the Haig-Simons definition of income as accretion of power to consume and therefore think of income as the proper equity criterion for taxation[93]. Further, the expenditure is seen as a payroll tax from a lifetime perspective excluding bequests and inheritance and, therefore, causes undue burden on wage earners[94]. It has also been noted that some traditional argument of economic theory - i.e., that the income tax is not adequately saving preserving and might induce supply disincentives - is not consistent with the situation of Indian economy[95]. On the question of level of government and appropriate tax assignment, it has been observed that decentralized level of government should avoid non-benefits taxation of mobile units or decentralized government should tax mobile economic units with benefits levies[96]. Therefore, efficiency requires that decentralized jurisdiction actively engage in benefits taxation where public sector provides services to these units. The public sector must, for various reasons, rely to a substantial extent on non-benefit taxes[97]. Redistributive programs that provide assistance to the poor simply transfer income[98]. But such programs are not well suited to use at decentralized levels of government. Therefore, non-benefit taxes are best employed by higher levels of government[99].

Though this debate of income versus consumption taxes is old and still ongoing among economists, there are certain facts on which a wider agreement is clearly present. Income taxes are certainly better from the perspective of equity, fairness and distribution, though there could be some dispute over efficiency arguments. The final verdict is not yet out (nor any way expected from economists, as usual!), but the arguments appears to be tilted in favor of income taxation, especially for a developing country like India where equity and distributional issues are certainly vital. However, taxes on income are difficult to implement, administer and collect, especially in developing countries due to weak institutional and administrative mechanism.

Looking empirically, in USA, income taxes play a major role, with a grossly undeveloped consumption tax/VAT structure - though it is often cited as not an ideal structure. But even in most of the European countries, which have seen a major shift towards VAT in past three-four decades, the share of taxes on income is still very high (see Exhibit 5.2). In India, though both types of taxes have been in existence even before independence, for the most part, it has been the expenditure/consumption taxes (in the form of excise, sales tax, custom duties, etc.) which were dominant. The revenue agencies did evolve within this broad tax assignment framework. One of the reasons for relying on expenditure taxes have been the relative ease with which they can be conceptualized, implemented and collected. VAT is getting popular in many countries including India because of its cross-control feature. The practice of taxation reflects a combination of what is implemented with intermittent incorporation, in the form of tax reform, of concepts developed through the progress of tax theory[100]. Thus, it has always been common to tax both income and expenditure, using all revenue sources alike. India being no exception, what we need to keep in mind is the fact that often it is the actual execution and administration of tax policies through revenue agencies which determines the actual efficiency, equity and effectiveness of a tax structure.

6.1.3 Tax Assignment, Level of Government and Revenue Agency

International experience has shown that the existence of separate tax departments for VAT and income tax perpetuates inefficiencies and duplication of staff, facilities, resources and efforts, and is not conducive to taxpayer compliance[101]. With two separate tax departments, taxpayers may be subject to multiple audits from different departments, in the same year and on occasion, at the same time[102]. Separate collection officers, exacerbated by the absence of a single taxpayers account, may independently pursue the same taxpayers for different arrears. These characteristics are neither efficient for tax administration operation nor conducive to taxpayers' compliance[103]. In light of this, it appears that the best alternative is to go for a single revenue agency responsible for collecting all taxes.

In actually evaluating a design of tax administration, what often becomes important from technical point of view is how tax administration architecture is designed to handle intended tax policy. The issue of concern would therefore be statutory versus effective tax system resulting from actual implementation of tax laws and provisions, management of taxpayers and the intended service delivery mechanism. From these considerations, it appears that there is a good case for having three (or at least two – the 'custom duty' question is discussed in next section) revenue agencies on the basis of type of taxes (taxes on income, taxes on consumption and custom duty) for collection of taxes – and ideally all three should be at the union level – responsible for 'collection', with levy decision being taken by respective level of government, being either union or states. This leads us to scenario 2 or 5. Here again, further narrowing down has to be decided in light of actual political consideration of fiscal-federalism and bureaucratic politics. On the other hand, there could be a case for having a predominant 'taxpayer segment' model, at least for some large taxpayers, which would more suitably be operationalized within scenario 1 where all taxes would be administered together by a single agency/division. However, an across the board application of such a scheme may not be administratively efficient in all cases and in all regions. Further, a 'taxpayer segment' model can possibly be designed to coexist with an overall 'type of tax' model for different part of the country or for different taxpayers types in different parts of the country. However, all this assumes that the administrative structure is fully harmonized and exists with optimal level of coordination, cooperation and information sharing.

6.1.4 The 'Custom Duty' Question

As we have noted earlier, in India, administration of custom duty functions have been assigned to CBEC, within which it has largely been organized in a 'tax-type' model with a separate operational structure for its smoother administration. Like taxes on income, many of the operational requirements of custom function (including tax base as well as operational spread and location pattern) do vary substantially from requirement for other taxes on consumptions, which favors a separate agency or division for its administration. As historically, this function has been assigned to CBEC, it is easy to come out with an argument that this needs to be continued, especially when there are no compelling reasons for not doing so. However, a counter argument could be that the role and importance of this source of revenue is continuously declining and with increasing globalization, free trade and economic development, it would eventually become a very small source of tax revenue. However, the ‘custom’ function, as a responsibility of having a check and regulation on the national borders in respect of movement of goods in and out of the country and national security would remain important. And this function would have many similarities with the similar responsibility of management of movement of humans across national boundaries. In that sense, it may be the case that custom function would more naturally be aligned with border security/migration function of the Indian government. This argument would than lead us to a situation where it would make sense to divest CBEC of its ‘custom’ function and shift this responsibility to the agency in charge of migration/border management (In case of India – this responsibility is with Ministry of Home Affairs).

However, there are some important questions on the validity of this argument. First, custom duty is still an important source of tax revenue. Even in the future, it would not be a negligible source, but would certainly be contributing respectable amount to national tax revenue. More importantly, even now, it is being operated as a separate division/department within the CBEC with dedicated personnel, infrastructure, system and structure. In such a case, the above proposal implies only putting this separate division under a different ministry. What also needs to be noted that there are good opportunities for harmonization of ‘customs’ with other tax functions, in terms of activities and processes like taxpayer registration, filing of returns and other routine operations and work processes, as well as in areas of compliance, investigation and enforcement. This again pushes us towards an administrative architecture with a separate agency for managing custom function, and it makes sense to let this function remain with CBEC (or its successor agency) in the union government. Further, we need not forget the high level of integration and harmonization required between the custom duty agency and consumption tax agency, especially as the tax base largely remains the same. Furthermore, there are many benefits of having a close coordination among these agencies in this globalizing world with increasingly open flow of goods and services and with the question of parity of domestic and foreign trade taxes in an open economy.

6.2 Experience of Other Countries

In this section, we try to look at the organization, structure, size and functional assignment of revenue agencies in some other countries, try to make comparison with India and attempt to derive insights applicable to different scenarios. The analysis is only broad in nature and qualitative, within the larger realization of importance of underlying context in all structure and design.

6.2.1 Size and Operational Spread of Revenue Agencies

In terms of size of revenue agencies, our emphasis is mainly on its operational spread in national, regional and local/field offices which can give us some idea of pattern of centralization or decentralization and what kind of regional decentralization is generally observed internationally. As Exhibit 6.1 shows, there is wide variation and it is difficult to derive broad generalization. Nevertheless, some observations can be made. China’s revenue agency is huge and widely dispersed with large number of field/local offices. India’s also appears to be dispersed especially in terms of number of officers. Germany and Japan, despite being not very large in size, appear to have quite a large number of dispersed smaller field offices. On the contrary, structure of USA’s IRS and UK’s HMRC appear to be more compact with good concentration at regional offices and much emphasis on ‘other offices’, which are mostly in call centers. One of the reasons for this appears to be high level of technical and IT enabled services provided by USA's IRS and UK's HMRC for improving deliver of taxpayer services. As we have noted in part II, this also reflects a move towards smaller number of large offices to derive economies of scales. Mexico's case appears to be one of high level of federal concentration without any regional structure, going directly to the field level local offices.

In case of India, we have some information only about union level agencies. Though information about states is not easily available, they more or less follow the union pattern. The Indian case appears to be more evenly spread at all the three levels, with minimum deployment in other offices (being call centers, etc). However, there is a move towards concentration of offices in large places and also towards centralizing some routine and seasonal functions in large dedicated centers by establishment of Central Processing Center (CPC) in public-private partnership mode by Income Tax Department, the fist one is already operational in Bangalore.

Exhibit 6.1: Size of Revenue Bodies in Some Selected Countries

Country	Total Staffing	Head Quarter	Regional Offices		Field/Local/ Branch Offices		Other Offices*
			No.	**Staffing**	**No.**	**Staffing**	
Australia	20877	3168	37	15746	14	211	1752
Canada	38179	8160	5	109	46	20228	9676
France	127907	na	19	na	211	na	na
Germany	111988	1075	8	3675	568	104648	4312
Japan	56159	675	12	10736	524	43932	1216
Mexico	32729	8336	0	0	115	24130	265
UK	88943	7814	86	15241	280	14917	51021
USA	92017	18390	130	24392	55	18317	30120
China	739700	500	61	13000	682	724000	2200
Malaysia	8981	1217	11	188	54	7054	532
South Africa	14548	2188	11	853	44	2248	9255
India (only Union)**	130000	3000	40	4000	1000	122000	500

* Other offices includes National/Regional data processing centers and Call centers
** These are approximate numbers only as no concrete data is available.

Source: Compiled from Table 8, 14 and 15 of Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series – 2008; Centre for Tax Policy Administration, Organization for Economic Cooperation and Development, Paris, France, 2008

In terms of number of employees' per capita, India ranks very low, with revenue agency size of 130 thousand employees for 1.2 billion people, compared to China's revenue agency employing more than 739 thousand people for 1.3 billion people. Though it may not be desirable to derive any concrete conclusion with this broad data set, it may be said that in India, there is still scope for increasing the size and reach of revenue agencies especially in light of narrow and shallow tax base and relatively low tax-GDP ratio, though the high level of dispersion may not be extended further and concentration should be more on having small number of large offices with maximum utilization of information technology and harmonization across agencies and levels.

6.2.2 VAT/GST Administration in Other Countries[104]

There has been a worldwide trend towards some sort of VAT/GST and it would be instructive to note as to how some of the countries have managed the administration of reformed tax regime. In countries with two or more layers of governance, various political-economy factors come to play important role in such decisions and some compromise has to be achieved. China has recently moved towards a centralized VAT regime with revenue sharing with the provinces. It has been ensured that provinces got as much revenue as under the previous arrangement, plus a share of the increment[105]. In effect, the levy as well as collection, both are administered by central authority. Australia also has introduced a GST. There, GST is a single national levy and all GST revenue is collected by the center. Subsequently state's share is returned to respective states. In Canada, there is a system called Harmonized Sales Tax, where the tax is levied at a combined federal and provincial rate in the three participating provinces. Tax design and collection are controlled by the center, but provinces have some flexibility to vary their tax rate. The revenues collected are shared among the participating provinces on the basis of consumer expenditure data for the participating provinces[106]. In Germany and Austria, the tax design is controlled by the center, but states collect the taxes. This has led to incentive problems and tax administrative measure has been found to be used for tax policy goals[107].

In Mexico, the establishment of a VAT at the center replaced state sales tax, but had to be part of a political-economy compromise that assured the states an automatic share of the revenue generated from all federal taxes[108]. VAT was introduced in Mexico as a federal tax mainly to harmonize taxes between federal and local governments by substituting more than 300 local taxes with VAT[109]. Brazil is a highly fiscally decentralized state and historically, VAT has been most important tax source for state governments in Brazil. However, it has posed difficult horizontal tax coordination problem. It has been observed that though state and local sources of revenue must be preserved, some limitation on sub-national government taxing powers is unavoidable[110]. The various problems related with decentralized VAT in Brazil have often generated demands for its federal administration.

All these examples show that there is a tendency towards centralized administration/ collection machinery for GST/VAT, which is important and required for achieving a national level efficiency and common market objectives, minimizing distortions. A national GST holds a great appeal from the perspective of establishment and promotion of common market in India but the political realities of India are different and it is now certain that India is not going to have a single national GST, but a dual-GST (as we have already noted). Due to this very factor, the need for administrative harmonization at revenue agency level assumes even more importance as harmonization at tax base and tax rate level would be hard to come by in Indian federal structure.

6.2.3 Taxes and Beyond: Functional Assignments in Other Countries

If we look at other countries for what kind of revenue and non-revenue functions are assigned to them, it gives some interesting insights. Exhibit 6.2 gives tax assignment of national revenue agencies in some selected countries. It shows the assignment of only national revenue agencies, but many of these countries do not have a truly federal structure, except larger ones like USA and China. What is to be noted here is that VAT/Sales Tax is assigned to the national agency in China, but not in USA, being two comparable countries for India.

Further, in case of excise, France and Germany do not assign it to national agency, but we also need to be clear about the nature and type of excise taxes levied in these countries.

Social Security Tax is assigned to national agency in USA, United Kingdom (UK), and Canada as well as in China, but not in Japan, Germany and some other countries. Interestingly real property tax, which is largely a responsibility of local government in India, is assigned to national agencies in countries like China, France, UK and Germany. However, as expected, in all the countries, personal income tax and corporate income tax is the responsibility of national agency. Further, China's system appear to be quite centralized as most of the taxes listed in the table are the responsibilities of national agency, which points towards low level of fiscal independence of regions/provinces. In effect, what can be inferred from these comparisons is the fact that such assignments are really context specific and it may not be possible to derive any meaningful generalization.

In many countries, revenue agencies have been assigned non-tax responsibilities, most common of it being custom duty management including prevention of smuggling and related illegal activities. India is one such country where custom management is entrusted to the union agency CBEC. Further, some non-tax functions, which in a strict sense, are disbursement of benefits to individual, or what is called 'negative tax functions' have also been assigned to revenue agencies. Some common examples are disbursement of child care benefits, students loan programs, other welfare programs and property valuation functions. However, any consideration of such additional functions to our proposed redesign scenarios would not decisively affect the decision here

Exhibit 6.2: Tax Assignment of Selected National Revenue Agencies

	PIT	CIT	VAT/ GST	Excise	Real Prop. Tax	Wealth Tax	Social Fund Tax	Motor Vehicle
Australia	Y	Y	Y	Y	N	N	-	N
Canada	Y	Y	Y	Y	N	N	Y	N
France	Y	Y	Y	N	Y	Y	N	Y
Germany	Y	Y	Y	N	Y	N	N	Y
Japan	Y	Y	Y	Y	N	N	N	Y
Mexico	Y	Y	Y	Y	N	N	N	Y
UK	Y	Y	Y	Y	Y	N	Y	N
USA	Y	Y	N	Y	N	N	Y	N
China	Y	Y	Y	Y	Y	Y	Y	Y
Malaysia	Y	Y	N	N	Y	N	N	N
South Africa	Y	Y	Y	Y	N	N	N	N
India	Y	Y	N	Y	N	Y	N	N

Source: Compiled from Table 3 of Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series – 2008; Centre for Tax Policy Administration, Organization for Economic Cooperation and Development, Paris, France, 2008, Information for India inserted separately

6.3 'Indian Revenue Service' and Refurbishing Personnel Administration

As we have discussed previously, the personnel aspect of revenue administration, which operates within the larger civil services structure, throws its own challenges and opportunities in any scheme of redesign of revenue agencies. We would here discuss only broadly how the personnel administrative structure could be reorganized under the assumption that the proposed revenue agencies (scenarios 1 to 5) would largely continue to function as wholly owned departments/agencies of the government within the overall civil service institutional structure. Managing and organizing personnel administration for modern revenue architecture can broadly be considered under two categories - higher civil services structure and the support and operational personnel structure. In terms of numbers of employees presently at union and state level agencies, the top structure consists of around eight to ten thousand officers (which includes IRS officers at union level and IAS and other state service officers at state level), and around 250 -260 thousands subordinate officials[111]. In terms of size, even under scenario 1, with only one revenue agency at national level responsible for administering all taxes, the resulting agency with around 250 thousand employees does not appear to be too big in India (Indian railways have around 1.5 million and department of post has around 500 thousand employees on its rolls) and can be considered manageable. Therefore, more than size, other considerations like organization and personnel management assumes more importance here.

6.3.1 A Unified Higher Management Structure

The higher management level (strategic apex, higher and middle management, top of operational core as well as higher level of technostructure and administrative support in terms of Mintzberg's structure) of revenue agencies is presently manned by officers of IRS at union level and IAS and state civil service officers in states. An important step towards a better harmonized, effective and efficient tax administration is the management of revenue agencies by professional civil servants, who has specialized knowledge, experience and expertise in handling revenue functions. Whereas union agencies do have such a structure, state and local agencies confirm only weakly to this. Therefore, it makes perfect sense to have a cadre of professional civil servants who are responsible for running revenue agencies not only at the national level but also at state and local levels. As we have noticed, as we move up in hierarchy, at the middle and upper management and strategic level, the role and responsibilities of revenue administrators start getting complex, wider and involves more of supervision, mentoring, communication across levels and agencies, as well as across boundaries of agencies, departments and ministries. Therefore, a unified cadre of professional managers makes more sense at these levels. On the other hand, the core operational level involves more of specialized (and some routine) functions where such broad approach and exposure may not be so crucial. Accordingly, the personnel structure of the revenue administration can be designed where the top managerial level can move across agencies, tax types, functions and tax-payer segments, whereas the operational core is more concentrated towards its core-competency. The present structure at union level is somewhat like this, where IRS officers are able to move across functions and regions (though limited across tax-types) and junior and lower level employees do specialize in one or few functions and are assigned to single region/ state.

At state levels, the case is totally different for higher level officers, who move from, for example public health department to tax department, two totally unrelated functions, which often requires different expertise, exposure and outlook. This system does not make any sense, and has been prevalent only due to political reasons and historically dominant positions of IAS in government. The often cited claim that the highest level functionary should be a 'generalist' rather than a 'specialist' does not carry much weight in modern world where governments have come to perform highly complex functions. World over, it is the 'specialist' manager who is in charge of overall supervision and direction. In a sense, what is required is a 'generalist specialist' manager who has been a specialist in a broad 'domain' area. The approach of functional specialization of different 'branches' of services has been recognized and accepted by the Second Administrative Reform Commission which has come out in favor of not only 'domain' specialization of different services[112] but also recommended that IAS need to be made a 'specialized' service by moving it away from its generalized nature[113] so that the civil services in India can truly be made professional and experts in handling increasingly complex governance functions and in delivering wide verities of services to the citizens.

Therefore, it is important to have a unified cadre of professional civil servant to manage 'revenue' domain of union and state government. IRS naturally fits this requirement. To achieve this, the following could be the structural changes required in present IRS:

- The two separate branches of IRS, IT and CE, should be integrated or merged into one and their cadre structure needs to be rationalized and restructured.
- IRS officers should be responsible for managing union as well as state level revenue agencies. They would be truly a functional branch of the civil service who would manage the 'revenue' function at all levels of government (be it union, state or local) specializing in broad area of fiscal-revenue management.
- If state level agencies are retained (scenarios 3 to 5), the IRS officers should be assigned/ posted/deputed to state governments for managing state level agencies. Technically the status of IRS would then become something like that of IAS, IPS or IFS, who spent their career both with state as well as with union government. However, one distinction would have to be made, whereas IAS and IPS are expected to spend most (two thirds or more) of their career within their assigned state 'cadre', the case of IRS would be reverse. As the union government would continue to collect substantial portion of the revenue, the officers would spend most of their time with union government and therefore there may not be any need to follow the 'cadre' assignment structure as in the case of IAS and IPS. In case state government agencies are not retained (scenario 1 or 2), the need for movement between union and state level would not arise.
- Within IRS, officers can be encouraged for further 'tax-type' specialization with relatively larger exposure to one type - taxes on income, taxes on consumption or customs during the first seven to ten years of service, when IRS officers make the top tier of operational core often working at the cutting edge of crucial functions like tax payer management, bulk operations, assessment and audit, tax collection, compliance, investigation and intelligence etc.
- Recruitment through promotion to IRS should be made out of feeder cadre of officers not only from CBDT and CBEC, but also from state level civil services (where officers at present do not have much promotional avenues, as most of them have very poor prospects of entering into IAS[114]). It would not be easy to come out with a scheme of such an entry from three different branches of junior civil service to a single service (IRS). These junior branches are unionized and there would certainly be claims and competing counterclaims for methodology and structure of entry, proportion of recruitment to be made by promotions, respective shares of different branches and issue of inter-se seniority vis-a-vis other junior branches. Nevertheless, this has to be devised.

What should be the ideal size of this merged cadre? This is a difficult question. Some would argue that with increased responsibility of state level revenue functions, the strength of IRS cadre needs to be increased from the present level of around 6800 officers (around 4100 IRS(IT) and 2700 IRS(CE) officers). On the other hand, the counter argument is that the idea of a restructuring is to achieve higher level of operational and functional efficiency, and better coordination and management of human resources and therefore, when we can achieve that, there may not be any need for more IRS officers. This argument also gets support from the fact that the cadre strength of some other larger services are less than the present combined strength of IRS (IAS is around 6000[115] and IPS is around 4700[116]) and also from the fact and feeling that the present union tax departments are slightly top heavy (6800 officers manning two department with combined strength of around 130,000 employees[117]).

Integrating this analysis within our five alternatives under consideration, we sense that the issue of personnel administration is largely orthogonal to the choice of scenarios. Nevertheless, the most administratively suitable one appear to be scenario 1 or 2 where only union agencies would be responsible for collection of different taxes. However, even under scenario 3, 4 and 5, the proposed personnel structure would be able to function largely smoothly, as the underlying idea is to have a unified higher management cadre of officers who could oversee and manage one or many revenue agencies across levels of government. Actually, it can be argued that such a cadre would even be necessary for managing a structure with multiple agencies at different levels and it would help in achieving a uniform administrative standard, common knowledge and experience pool, with higher management exposed to different functions and responsibilities and professional expertise. This would further smoothen movement towards higher level of administrative harmonization among different agencies.

6.3.2 Personnel Structure for Middle and Junior Level Employees

In case of junior officials; scenario 1 and 2 would require that the state government employees become union government employees. Although in theory it may be simple, there could be some issues. In a system where even central government employees remain region/state bound (as they are in case of CBDT and CBEC) this change should not pose any serious challenge. In fact it may be welcome as generally employment with union government is considered better than state governments employment. However, if due to integration/ merger of state and union level agencies for administration of VAT/GST, there is a possibility of retrenchment of employees, it could be a difficult issue, as even any mention/perceived situation of retrenchment has always been quite a sensitive matter in the past. Some ambitious move by union agency towards e-Governance initiatives and use of Information Technology for better management of various functions and activities and for improved delivery of taxpayer services like implementation of TIN network and establishment of CPC by CBDT and introduction of ICES and ACES by CBEC have met with stiff resistance from junior and lower level employees unions. Nevertheless, it has to be recognized that IT systems are one of the most important enabler for better management of modern revenue agencies. Further, it also needs to be appreciated that many non-core functions may be better handled by different agency and management design - like public private partnership, management contract, joint venture projects and corporations, etc. Therefore, any retrenchment issue has to be dealt carefully and approaches like retraining, redeployment, not filling of retirement vacancies, etc., may be useful alternative strategies.

As mentioned above, in case of scenarios 1 and 2, it would be advisable to have region (which will largely correspond to a state) specific employees' base at middle and junior level (what is called Group B, C and D category employees) for one or multiple revenue agencies envisaged in scenario 1or 2. As is the practice now, this system will ensure that they remain based in their respective region and liable to rotation within that region. They would become part of all India cadre of IRS only on promotion. However, the envisaging merger of state and union level agencies will throw cadre restructuring and related issues of inter-se seniority, positions, roles and responsibilities, and respective share in promotion to a higher level which would merge more than one stream/cadre of employees. As of now, CBEC has at least three streams of group B level officers (Custom Appraisers, Excise Superintendent, Excise Superintendent (preventive)) from which entry into IRS is made on the basis of promotion and these cadres have different proportion in which they are allotted the vacancies to be filled by promotions. This scheme has always been a bone of contention between different streams and some issues are still being fought in different High Courts. The situation becomes more complicated as these are region specific cadres with their own seniority and promotions system and recruitment from below as well as directly through competitive examination process. In case of CBDT, the situation is better as there is only one entry cadre in to IRS, i.e., by promotion of

ITOs. A scheme with opportunity for state level junior finance/tax civil servants also to enter IRS would further complicate this issue. In a unified cadre of IRS, how and in what manner, the entry from the junior civil service cadre of union and state government would be regulated and managed is certainly going to be a difficult issue and it may not be easy to resolve. This may be easy to manage in case of scenarios 4 or 5 as the state departments would continue to exist. Further, in case of scenario 3 where the two union level agencies would have to be merged/unified, the issues related to merger of junior cadre and related issues like relative seniority, etc., would still pose difficulties, but can be sorted out with proper handling.

What is perhaps most important, is to have a strategic vision and a comprehensive and long term human resource plan with appropriate restructuring for managing the personnel aspects of these agencies. In any human resource strategy, one of the most important factor which needs to be kept in mind is the crucial role information technology tools, process and systems would come to play not only in delivery of taxpayers services but also in organization of revenue administration in terms of management of its core and bulk processes, compliance and enforcement operations, data management and information sharing. Another important issue would be to integrate the revenue administration and civil services structure with the evolving and more efficient forms of organizations of government activities through public private partnerships, joint ventures, outsourcing and similar other processes. Administrative reforms, not only at the highest level of civil service (IRS and IAS), but also at junior management level would play a crucial role in the successful transition towards a world class revenue administrative machinery in India.

CHAPTER VII

Summary of Findings and Recommendations

7.1 Summarizing Alternatives

In light of our discussion of preceding chapters, we have summarized the five alternatives models in the following paragraphs. This has been done by grouping the major decision variables into three main categories:- technical evaluation, administrative feasibility and political acceptability[118] for clarity of presentation. In previous discussion, although we examined not only technical but political as well as administrative issues in all possible detail, we did not necessarily done that separately.

Traditional policy analysis approach has often emphasized too much on technical suitability of an approach and strategy. However, experiences from many developing and developed countries have shown that technically superior policies have also failed in real life. It is now increasingly being realized that, though technical soundness is indeed very important, administrative capabilities, institutional structure and flexibility of concerned institutions as well as political feasibility of the proposed policy are no less important. Any policy does not and should not operate in a vacuum. It is part and parcel of a complex socio-economic environment being influenced by myriad of factors – and in many instances, political and administrative factors completely stymie an excellent initiative. On the other hand, some enthusiasts have been taking the argument too far – to the extent of emphasizing only the political feasibility and administrative capability aspects of a policy decision to the neglect of the technical correctness based on sound logic and research. This is also not the way forward. Administrative capability is not a static constraint, it can and should be improved and reformed over time. Similarly, the argument of political unacceptability can be a convenient scapegoat for not taking hard hitting decision. In India, where the role of the higher civil servants extends to that of a policy planner as well as of an executive, it is desirable that the technical superiority of a policy proposal should be taken quite seriously, and every attempt is made to achieve a political consensus around such policy proposals.

Now coming to the scenarios, the fist one is about a single revenue agency for all major taxes. Though it may be technically suitable for many countries in terms of giving benefits of operational ease, efficiency and effectiveness, and taxpayers service, its technical usefulness in case of large, diverse federal country like India may be slightly limited, as it may fail to take into account the basic difference in nature and operational requirement of income and consumption 'type of taxes' which generally requires significantly different approaches in large diverse countries. In many advanced countries, income and consumption taxes have been kept separate. In any case, it ranks only slightly below the scenario 2 in terms of its technical suitability. However, this faces strong opposition from political and bureaucratic circles, making it very difficult to be politically feasible.

Exhibit 7.1: Summarizing Scenario 1

Scenario - 1	Only One National Revenue Agency Responsible for (Collecting) Major Taxes, No Revenue Agency for States
Technical Evaluation	• benefits of scale of operations may be there, but doubtful due to huge size of India • benefits of harmonized administration, resource sharing and information access • clubbing of income and consumption taxes not always advisable - may limit the benefits of effectiveness and efficiency
Administrative Feasibility	• coherent policy, vision and mission possible • unified administration, policy and execution possible • too large, increased bureaucratic complex • merger of two union agencies may pose some problems on HR front
Political Acceptability	• perceived as against federal nature of Indian state (though actually may not - if restricted to collection function only) • perceived as vesting too much power with union government • strong opposition from political leadership of almost all states • strong opposition from influential state bureaucracies

Scenario 2 is an improvement over 1 and is technically and administratively the most desirable. It takes into consideration the technical aspect of operational differences of income and consumption type of taxes, and also considers the future need and requirement of income vs. goods and services taxes in terms of administrative and operational arrangements. However, a single agency administering proposed dual GST in India for both union and state government (even though it can be made responsible only for 'collection' function, not for 'levy' and related policy) faces stiff resistance not only from political leadership but also from state level bureaucratic interest. Thus, its superior merit on technical and administrative front faces a roadblock in the form of being strongly opposed by political as well as state bureaucratic interests. Nevertheless, this is what is ideal for India and the efforts are need to make it a reality. The evaluation of scenario 2 is shown in Exhibit 7.2

Exhibit 7.2: Summarizing Scenario 2

Scenario - 2	Only Union Agencies (Two or Three) on Tax-Type Basis for (Collecting) Major Taxes, No Revenue Agency for States
Technical Evaluation	• benefits of scale of operations along type of taxes • benefits of harmonization possible, coordination, cooperation, resource sharing and information access also possible though not ensured • professional specialization and domain benefits • perhaps best for a dual- GST in federal structure, taxpayer service centric • technically more effective and efficient
Administrative Feasibility	• coherent policy, vision and mission possible • unified administration, policy and execution on tax-type basis, also benefits of functional model but not possible without changes • Not too large- easy, effective and efficient administration, oversight and enforcement, but require changes and modifications in stages • transfer of proceeds to states possible without much difficulty
Political Acceptability	• perceived against federal nature of Indian state (though actually may not - if restricted to collection function only) • perceived as vesting too much power with union government • strong opposition from political leadership of all states • strong opposition from very influential state bureaucracies

Exhibit 7.3: Summarizing Scenario 3

Scenario -3	One Union Revenue Agency for All Union Taxes, and One Agency for Each States
Technical Evaluation	• some benefits of scale of operations at union level • coordination, cooperation for consumption taxes at union and states absent • clubbing of income and consumption taxes at union - unwieldy and ineffective • high compliance cost, possibility of increased difficulties and harassment
Administrative Feasibility	• coherent policy, vision and mission at union possible • unified administration, policy and execution at union but may be too large to be efficient • problems of inter-states and union-state harmonization, difficult to cooperate and information sharing • duplication of efforts and resources at union and state levels, inconsistency
Political Acceptability	• Almost no opposition from political leadership • some opposition from bureaucracies at union level

Scenario 3 considers the proposal for having a single agency at union level for both type of taxes and a separate agency in each state (as is the case at present) for state level taxes. However, it has two serious deficiencies. First, by having a single agency, as in case of scenario 1, it fails to consider different operational and administrative requirements of taxes on income vis-a-vis taxes on consumption. Further, by proposing two levels of agencies for administration of proposed dual GST without any harmonization mechanism, it fails on the other front also. In effect, technically it appears to be missing both the axes. Politically, it would face not much resistance, expected only from certain section of union tax bureaucracy. Administratively, though it may not be too difficult to operationalize, it may result in a revenue environment which is quite complex, inefficient and ineffective, as the difficult issues are being eschewed. In any case, due to its limited technical merit, it does merit serious consideration.

Maintaining status quo as in scenario 4 appears to be quite an attractive option, especially in view of the political and bureaucratic opposition to better options like scenario 2 and 1. The case for having two (or more) revenue agencies at union level is understandable. But on the other hand, with existence of multiple union and state agencies for consumption taxes; any move towards a better arrangement is filled with stiff resistance. In such a case, maintaining the status quo of having separate union as well as state level agencies for dual-GST (as is the case now, with state level commercial tax departments metamorphosing as state GST departments) could be a workable option.

Exhibit 7.4: Summarizing Scenario 4

Scenario - 4	Maintain Status Quo - Two Agencies at Union Level, Each State with Its Own Agency
Technical Evaluation	• no benefits of scale of operations • no benefits of harmonization, coordination, cooperation, resource sharing and information access • no possibilities of professional specialization and cross exposure • technically not effective and efficient for consumption taxes • Not taxpayers friendly, repetitive work, increased cost of compliance
Administrative Feasibility	• difficult to have coherent policy, vision and mission • No unified administration, policy and execution, confusing, coordination problems • implementable with least resistance and least change
Political Acceptability	• not perceived as against federal nature of Indian state, as the states retain their respective departments • minimal opposition from political leadership of all states • easiest to get acceptability from bureaucracies at union and states

However, a simple choice like this hides considerable costs - especially in terms of failure to move towards a better tax regime. It would be quite costly for the taxpayers, adversely impacting not only compliance cost and enforcement mechanism but also resulting into wastage of resources, duplication of efforts, and virtually not bringing any benefits from dual-GST regime.

Exhibit 7.5: Summarizing Scenario 5

Scenario - 5	Status Quo with Resource Sharing - Professional Expertise, Technical Infrastructure and Information Base
Technical Evaluation	• possible to have benefits of harmonization and of coordination, cooperation, resource sharing and information access • possibilities of benefits of professional specialization • technically effective and efficient
Administrative Feasibility	• coherent policy, vision and mission possible • effective and efficient administration, oversight and enforcement possible • possible to have taxpayer service centric with proper harmonization • possible to have benefits of large agency while maintaining separate existence • most of the advantages not possible without proper harmonization
Political Acceptability	• broadly acceptable to political representatives of all states • some opposition from bureaucracies (esp. state level), but can be managed

The scenario 5 is a hotchpotch of scenario 2 and scenario 4 (status quo). It is an attempt to bring the harmonization in the administration of not only dual-GST but also the entire tax administrative structure and agencies. It appreciates the political realities of a federal India where there are competing political interests and competing bureaucratic interest, yet efforts are being made to reach a compromise formula and structure. In any case, the scenario gives only broad contours in the sense of inspirational administrative harmonization (as a dynamic 'process' rather than a static 'event') and the detailed mechanism needs to be worked out. There would be three agencies; two at union level and one each for each state, but the way they would be administered has to be significantly reformed - especially for union level and state level consumption tax agencies so that maximum level of administrative harmonization becomes possible. This would also not face much resistance from political leadership, though achieving a significant level of harmonization would largely depend on how bureaucratic politics plays out. The role of national as well as state level political leadership would be crucial in this whole process. What is required is a true formula for sharing of resources - all kind of resources at the disposal of revenue agencies - technical and infrastructural, knowledge, information base, tax base, administrative mechanism, process and structure and managerial and professional talents.

Exhibit 7.6 summarizes all the alternatives giving a bird's eye view of these scenarios.

Exhibit 7.6: Summarizing all Scenarios

Scenarios/Alternatives		Technical Evaluation	Administrative Feasibility	Political Acceptability	Recommended
1	**Single National Revenue Agency**	Sound, but not the best for large, federal India	Difficult to administer effectively	Strong political & bureaucratic opposition, federal concerns	**No**
2	**Two (or three) Agencies by Tax Type at National Level only**	The best option	Feasible, but in stages	Strong political & bureaucratic opposition, federal concerns	**Yes, The Best**
3	**One Union Revenue Agency and One Each for States**	Not sound	Possible	Acceptable, with some resistance	**No**
4	**Status quo - Two Union Revenue Agencies and One Each for States**	Misses on harmonization	Sure, just keep going	Yes, least resistance politically & from bureaucracies	**No**
5	**Status quo with Resource Sharing**	Hotchpotch of 2 and 4, benefits of Harmonization	Possible, but efforts required	Some resistance, esp. from bureaucracies	**Yes, Now**

7.2 Concluding Thoughts

Thus, it is clear that scenario 2 is the best option, though it is the most difficult one to implement due to political and bureaucratic play. A start could be made by opting for scenario 5, and then gradually transitioning to scenario 2 in due course of time. Though scenario 5 is not the best in terms of technical parameters, it can be considered the second best solution, which is administratively implementable and politically acceptable. By intelligently utilizing and adapting some of the crucial benefits of the technically soundest scenario, scenario 5 could be the stepping stone towards a truly harmonized structure of scenario 2 in the future. It is expected, especially in light of learning from experience over time that ultimately the benefits of fully integrated tax machinery would be apparent to all. It would, then, be possible to achieve an institutional design of scenario 2 for operationalization of a revenue administrative structure fully capable of providing world class service to taxpayers with effective compliance and enforcement mechanism, collecting due taxes effectively and efficiently and truly integrating national economy and markets for equitable and inclusive growth of India.

It should also be realized that underlying all these scenarios is a very strong need for nationwide integrated Information Technology (IT) network as it has been found world over an enabler and a powerful tool to achieve the expected change, as a means to an end. The union agencies have been on the forefront of implementing large complex IT projects. It has been envisioned that these agencies have to keep building on sound durable IT systems for better management of service delivery, for building institutional capacity and for supporting and sustaining these networks on an ongoing basis, and these have rightly been considered an integral part of the ambitious National Information Utility (NIU) framework[119].

In this study, we have not paid detailed attention to the question of design of second and lower level organizational structure and operational mechanism. Of course, these are very important parameters to be considered in any re-design strategy. However, the scope of the present analysis has been limited to the study of macro and highest level organizational design issues. Taking up micro level re-design challenge is left out of this limited study and should be taken up separately – especially because it is equally, if not more, important. However, we have pointed out in chapter V and VI as to how ‘functional’, ‘regional’ and ‘type of taxpayer’ models can be applied for further micro-design of organizational structure of revenue agencies. Here, it would be sufficient to note that the present micro-organizational systems, operational and functional processes as well as bureaucratic structure of the revenue agencies of union as well as states follow quite a similar pattern as pointed out in previous chapters, and this gives us a good grounding to further dwell and ponder over this issue in detail. Despite this, we have also noted that there are ‘particularities’ beneath the broad ‘generalities’ of requirements for different ‘type of taxes’, which need to be duly taken into consideration in any micro-organizational design strategy.

Transformative structural and organizational changes are taking place in revenue agencies and civil service system across the world in response to the realization that revenue agencies are one of the most important arms of the government entrusted with the sovereign responsibility of collecting taxes. Many of the organizational redesign and restructuring proposals along with administrative, institutional and organizational issues delineated and discussed in previous pages could be a guiding force for reforming and reconstituting government agencies and bureaucracies in general, and revenue agencies in particular, in other countries too.

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