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**Govt. of India**  
**Ministry of Finance**  
**Tax Administration Reform Commission**  
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Date

30/05/2014

To

Shri Arun Jaitley  
Hon'ble Minister of Finance  
Government of India

Sir,

We submit herewith the First Report of the Tax Administration Reform Commission (TARC).

  
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## Preface

Tax revenue yield is influenced by both tax policy and tax administration. While tax policy design ensures responsiveness of potential revenue to overall economic growth, tax base and tax rates, tax administration seeks to secure potential tax revenues effectively and efficiently. It is because the two are inextricably linked that reform in tax administration is as important as that in tax policy.

In India, tax policy reforms have been accelerated since the economic liberalization unveiled in 1991. But no comprehensive reform in tax administration was undertaken in the same depth. Of course, changes in tax administration practices have occurred, *albeit* through a slow and incremental process reflecting the immediate requirements of the organization as opposed to much needed fundamental reform. The two administrative restructurings undertaken in 2001-02 and 2013-14, of the two Boards, the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC), were also aimed at expanding the tax administrations primarily by increasing tax assessment units, thereby giving more promotional avenues to officers and staff. But neither of the two restructurings was aimed at reorganizing the operations or their structures so as to make them oriented towards the needs of taxpayers.

Further, the restructurings have essentially stopped short of recognizing that direct and indirect tax services need to be delivered in a more synergistic manner so that there are gains for both taxpayers and the tax administration that should be buttressed by more rationalized enforcement activity, drawing upon information garnered from both direct and indirect taxes. Even within indirect taxes, service tax and excise duties are dealt with by separate commissionerates under the CBEC even though both are consumption taxes. The tax administration in the above regard did not, by and large, keep the prevalent global practices in view, i.e., it was not a benchmarked approach. Such a non-intersecting approach continues through the current restructuring process. The restructurings, therefore, have lacked a reform flavour. Since the focus is almost entirely on the extent of revenue collection irrespective of prevailing economic realities, any rise in collection could successfully mask the underlying need to fundamentally reform the tax administration. Indeed, the two tax administrations often attributed the gain in tax collection to the so-called restructuring.

What has been overlooked is that the impact of tax administration on revenue collection as opposed to the revenue gain due to economic growth needs to be separately recognized. The year-to-year high nominal growth in tax collection over and above the inflation rate may have generated a sense of complacency regarding administrative performance. One deleterious outcome has been the inexorable rise in disputes, reflecting rising pecuniary and non-pecuniary costs of compliance to the taxpayer. The tax administrations witnessed large tax revenues becoming uncollectible due to disputes emanating from tax demands that were of a protective nature, i.e., issued just to insure the tax officials against future liability. Such disputes were commonly viewed to have had adverse ramifications for the investment climate as business decisions became increasingly difficult in an environment of growing tax uncertainty.

The Commission (TARC), constituted to recommend reform exclusively in tax administration, was specifically mandated “to review *the application of tax policies and tax laws in the context of global best practices* and to recommend measures for *reforms required in tax administration* to enhance its effectiveness and efficiency.” The mandate reflected a deep concern of policymakers regarding the need for fundamental tax administration reform. Accordingly, the TARC tasked itself to address the thus-far missing elements of best practices in tax administration in a comprehensive manner. Such reform should aim at a vision that focuses on taxpayers and their relationship with the tax administration. This vision has to recognize the growing links between direct taxes and indirect taxes as occurring in most modernizing tax administrations in cross-country experience, and show the way to building an administrative structure that will bring accountability in the processes as well as greater outcome orientation. This would require the structure to be overhauled for purposive delivery and be so oriented that officers and staff are empowered while being given key performance indicators to reflect accountability and responsibility at both the individual and organizational levels. Only such a fundamental reform could ensure that the objective of bringing palpable benefits to taxpayers in terms of a transparent relationship and enhanced communication, ease of compliance, and quicker dispute resolution, is achieved.

In order to comply with the above mandate, the TARC identified four terms of reference, based on their relative importance, for immediate attention in its first report out. The selected terms of reference are:

- *To review the existing organizational structure and recommend appropriate enhancements with special reference to deployment of workforce commensurate with functional requirements, capacity building, vigilance administration, responsibility and accountability of human resources, key performance indicators, staff assessment, grading and promotion systems, and structures to promote quality decision-making at high policy levels.*
- *To review the existing business processes of tax administration including the use of information and communication technology and recommend measures best suited to the Indian context.*
- *To review the existing mechanism of dispute resolution, time involved for resolution, and compliance cost and recommend measures for strengthening the process. This includes domestic and international taxation.*
- *To review existing mechanism and recommend measures for improved taxpayer services and taxpayers education programme. This includes mechanism for grievance redressal, simplified and timely disbursement of duty drawback, export incentives, rectification procedures and refunds etc.*

While covering these terms of reference, the TARC decided to address the other segments of the terms of reference in its subsequent reports. Issues such as impact assessment analysis,

economic analytical models and strengthening database are examples of such aspects that are planned to be covered in future reports.

To achieve the desired goal, the TARC sought the views of its stakeholders, including the two Boards and its field offices, and the taxpayers. The TARC held meetings with the two Boards separately and of the officers, staff and their respective associations at the five metros of Bengaluru, Chennai, Delhi, Kolkata and Mumbai. Views from the directorates of the two Boards were separately ascertained keeping in view the policy dimension of their work. The TARC also met newly recruited officers at the National Academy of Direct Taxes and the National Academy of Customs, Excise and Narcotics to assess whether the training - in content as well as regularity, either at the induction stage or later - was sufficient to frame a structure that would be able to deliver in the manner outlined above. It was also imperative for the TARC to meet industry and professional associations at all five metros to ascertain their experience with the tax administrations, their expectations and suggestions for reform. One of the most important aspects of tax administration is the dispute resolution mechanism, since an inadequate or tardily functioning one could impede tax collection and create a climate of distrust. In view of this, the TARC had meetings with the President of CESTAT and Members of ITAT.

A list of such meetings is given at Annexure -I. The TARC is thankful to all the stakeholders for their suggestions and also for the free and frank discussions. These suggestions formed the basis of many of TARC's recommendations. The TARC also acknowledges the co-operation and support of the CBDT and the CBEC in providing information and data that enabled TARC's recommendations to be based on robust foundations.

Looking at the task at hand, which required in-depth analysis of various aspects relating to the four terms of reference, the TARC constituted six focus groups, comprising officers of the two tax administrations – former as well as current – and professionals from the private sector. The topics to be addressed by each focus group were framed after detailed deliberation within the TARC. The focus groups themselves met several times and came up with innovative suggestions by providing a forum for open and frank discussions with TARC Members. In the final analysis, the role of the focus groups in deliberating on various issues in depth and bringing in knowledge of calibrating them with global best practices was crucial in forming the TARC's views. This helped the TARC to successfully thrash out many a new idea and emerge with a critical mass of recommendations. A list of participants in the focus groups is at Annexure -II.

The TARC's recommendations were formulated at many meetings, formal and informal. A list of meetings in which TARC discussions were held is at Annexure – III. The TARC's findings, conclusions and recommendations were unanimous, clearly pointing towards an overwhelming need for fundamental reform in tax administration that should successfully draw the attention of policymakers. Chapter I presents a comprehensive Executive Summary covering TARC's coverage, main findings, conclusions and recommendations for the various aspects of the terms of reference covered in the report. The TARC believes this is the right moment in the light of a new reform environment that is expected to emerge precisely at this point of time.

The TARC places on record its appreciation of the Department of Revenue for providing support. It also thanks the Chief Commissioners of Income Tax and Central Excise and Customs of Bengaluru, Chennai, Delhi, Kolkata and Mumbai for organizing meetings with officers and staff and for providing support in organizing meetings with stakeholders.

The TARC also wishes to recognize the overarching support of the Secretary to the Commission in all aspects. The Director and Under Secretary as well as other support staff were also helpful. The work of three research consultants was important for the background studies that were carried out. The editor's meticulous work at top speed was crucial. But for their intensive efforts, timely delivery of the report would not have been feasible.



Dr. Parthasarathi Shome  
Chairman  
Tax Administration Reform Commission

New Delhi  
30<sup>th</sup> May 2014

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the 1990s, the number of people who have been infected with HIV has increased in almost every country in the world. In 1990, there were 1.5 million people living with HIV, and in 2000, there were 36 million. The number of people who have died from AIDS is estimated to be 10 million (UNAIDS 2001).

There are a number of reasons why the number of people who have been infected with HIV has increased so rapidly. One of the main reasons is that the virus is highly contagious. It can be transmitted through sexual contact, blood transfusion, and sharing of needles. In addition, the virus can survive outside the body for several days, which makes it even more difficult to control.

Another reason why the number of people who have been infected with HIV has increased so rapidly is that there is no cure for the virus. Once a person is infected, they will have HIV for the rest of their life. This means that people who are infected with HIV are often unable to work or to care for themselves, which can lead to poverty and social exclusion.

There are a number of things that can be done to reduce the number of people who are infected with HIV. One of the most important things is to use condoms. Condoms can prevent the virus from being transmitted through sexual contact. In addition, people should avoid sharing needles and should not get blood transfusions from unlicensed sources.

Another important thing that can be done is to educate people about HIV and AIDS. People need to know how the virus is transmitted and how to protect themselves. Education can also help to reduce the stigma that is often associated with HIV and AIDS, which can encourage people to get tested and to seek treatment.

There are a number of other things that can be done to reduce the number of people who are infected with HIV. For example, people should avoid having multiple sexual partners and should not use drugs. In addition, people should get tested regularly for HIV and should seek treatment if they are infected.

It is important to remember that HIV and AIDS are preventable. By taking the right steps, people can protect themselves from infection. It is also important to remember that people who are infected with HIV can live long and healthy lives if they get the right treatment and care.

There are a number of organizations that are working to reduce the number of people who are infected with HIV. These organizations provide education, testing, and treatment. They also work to reduce the stigma that is often associated with HIV and AIDS. If you are interested in learning more about HIV and AIDS, please contact one of these organizations.

UNAIDS  
World Health Organization  
Centers for Disease Control and Prevention

# EXECUTIVE SUMMARY



# Executive Summary

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*...to liberate the potential...you must first expand your imagination...things are always created twice: first in the workshop of the mind and only then, in reality. When you...take control...and imagine...in a state of total expectancy, dormant forces will awaken...to unlock the true potential...to create a kind of magic...forget about the past. Dare to dream that you are more than the sum of your current circumstances. Expect the best. You will be astonished at the results.*

– Robin Sharma, in *The Monk Who Sold His Ferrari*

Public institutions, including government departments across the globe, need fundamental reform at least every decade, if not more frequently. This reflects the likely, and widely experienced, slide in the improvements made in the structure and practice that usually accompany fundamental reform. Tax administration is one such institution. To counter the anticipated slide, some reforming tax administrations have installed departments of change whose exclusive responsibility is to track the slack and sharpen, on a continuing basis, their productivity, accountability, cost effectiveness and, increasingly in a modernizing context, their service delivery. Some countries have developed the practice of subjecting their tax administration structure to occasional external examination to facilitate and introduce corrective measures.

India had not taken such measures in the past and the tax administration has experienced modest improvement that do not necessarily reflect global movement. Several committees suggested measures combining tax policy and tax administration, albeit selectively. Some committees took up overall public administration of which tax administration forms a component. Apparently for the first time, the Tax Administration Reform Commission (TARC) was set up by the government to examine and suggest reforms focused primarily on tax administration. This is a welcome first step.

Chapter I of the TARC's report presents the Executive Summary. It is divided into four sections: first, the coverage of the report that presents the focus of each chapter, second, a detailed section on the TARC's findings, third, a shorter section on the overall thrust of its conclusions and fourth, an elaborate section that lists its main recommendations.

## 1. Coverage

The TARC arrived at the view that taxpayer services must comprise the first focus of a tax administration and that it, therefore, must give prominence to “customer focus” in taxpayer services whose activities must be designed to improve the experience of taxpayers with the tax departments. The activities of the two departments - the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) - should be aimed at lowering the cost of compliance so that existing as well as potential taxpayers find it easier to follow the rules.

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<sup>1</sup> Executive Summary is Chapter I of the TARC report.

To achieve this, a framework has to be designed that should aim to reduce uncertainty in tax laws by providing clarity on tax obligations. Opening two-way communication channels between the tax departments and customers would be another aspect of the strategy. **Chapter II** of the report covers these aspects. It also brings out practices in other advanced tax administrations. Some of the innovative approaches adopted by other countries have been highlighted, including recognising the ‘rights’ of the taxpayers.

No tax administration reform can be complete without looking deeply at the structure and management of the tax administration. While recognising that there is no unique model of the structure and management of a tax administration, there are some emerging cross-country patterns. The clear movement is towards a common organisation for direct taxes and indirect taxes. The TARC recognised that and decided to propose appropriate changes in the present structure in a calibrated manner where, to begin with, selected functions may be delivered through a common structure. One clear point to initiate this is the administration of large taxpayer units (LTUs). This would accommodate the prevailing LTUs, whose offices – currently in the five metros – perform both CBDT and CBEC functions, although in disjointed silos. Thus, the LTU experiment of structuring operations around a taxpayer segment has till now not gone far, the reasons being many. Another area of gaining such immediate synergy is in making tax laws. A further area of the TARC’s consideration was the need to reorganise the tax administration on a functional basis instead of its present organisation based primarily on territorial jurisdictions. The TARC has taken an approach to reform in a step-wise manner over time in recognition that the two tax administrations must be given time, albeit on a chalked out roadmap, to move to a fully integrated tax administration. But prior to full integration, a unified management structure through a common Board could be achieved in the next five years based on groundwork to be completed on data integration, common delivery structure for the benefit of taxpayers, and training of officers and staff based on comparable and benchmarked parameters. **Chapter III** of the report deals with these aspects.

Tax administrations that do not allow specialisation among its officers and staff suffer in interfacing with high quality tax intermediaries and taxpayers. They also find it difficult to understand complex business transactions that require deep understanding and skill to decipher. These skills do not come with only theoretical exposure but while working on the subject for a minimum of 4-5 years, international experience revealing even periods as long as a decade during which an officer is encouraged to specialize. It is thus imperative to allow tax officers to develop specialisation in their work. Specialisation is not only required in audit functions, as is commonly held, but also in dispute resolution, taxpayer services, and in other functions of tax administrations such as HR, finance, tax analysis and ICT management. **Chapter IV** of the report deals with the people function of the tax administrations, with training and specialisation forming important components. It also focuses on the wider HR needs of staff by identifying the need to introduce practices that have become common in modern tax administrations including mentoring, effective performance evaluation methods, for example, through assessment centres, and e-training.

**Chapter V** deals with dispute resolution and management. The TARC found in its analysis that the present dispute management structure should be converted into a separate vertical

function so that the tax collection functions do not influence the resolution of disputes, which tends to occur at present. The current adversarial approach to disputes also needs to be transformed into one that is more collaborative and solution-oriented. Besides, the dispute structure needs to be modernised by bringing in alternative dispute resolution mechanisms through arbitration and conciliation. This may require legislative change. The role of regular interpretative statements has been emphasized to avoid disputes which otherwise arise due to ambiguity and imprecision in laws, rules and regulations. Equally important is taking due care for greater clarity at the law drafting stage itself.

Processes, by themselves, comprise an integral part of the reform along with structure, people and the use of technology in a tax administration. **Chapter VI** deals with internal processes and the need to design their management structure to bring better delivery to taxpayers as well as to the tax departments. The TARC identified some key processes such as registration, return filing, and tax payment to be further expanded and sharpened. This would be in keeping with the recommendations made in Chapters II and III.

Both the CBDT and CBEC have been among the leading departments in the government in adopting ICT. Both have successfully implemented large projects that have made many processes convenient and transparent for the taxpayers and improved the efficiency of operations. However, there are still many gaps and a large room for improvement. **Chapter VII** is on the need for a deeper penetration of information and communication technology (ICT) in the two tax departments. ICT has to form the backbone of improved service delivery and that could be better achieved through a special purpose vehicle (SPV) as expounded in that chapter.

## 2. Critical Findings

At a macro level, the TARC found, first, that the Indian tax administration is in a vulnerable position due its static structure. For example, the recent “restructuring” of the two departments involved only an expansion in the number of posts without a corresponding reduction or re-allocation of resources away from less productive areas that is a quintessential element of modern restructuring and change. Second, the TARC found that the tax administration remains essentially unable to address rapidly emerging challenges on the domestic or international fronts, reflected in recent decisions that are far removed from international practice. Third, the TARC found that it should make recommendations that may appear to be far reaching and path breaking but are very much desirable and doable in the Indian context since they are benchmarked with prevailing global best practices.

Thus, it is fair to emphasize right at the beginning of this report that the TARC has not suggested any change that it believes cannot be carried out in the Indian context. Indeed, it is imperative that they be carried out given the prevailing tax administration characteristics in India. Some changes should be made with haste and others progressively so. The TARC has made specific suggestions of where the tax administration should make changes immediately, where it should position itself through continuing, self-generated reform in five years and, once appropriately empowered, where it should reach as a world class tax administration in ten

years. In this perspective, a roadmap has been provided for complete and fundamental tax administration reform. Also, the recommendations made in different chapters of this report need to be viewed as a whole and not in isolated fragments, if the reform efforts are to bear the intended fruit. The TARC believes this is the right moment in the light of a new reform environment that is expected to emerge precisely at this point of time.

The major fault lines in the tax administration are listed as follows.

- **Position of Revenue Secretary and autonomy of the two Boards:** The TARC found that these matters are closely related and comprise the crucial shortcoming at the apex level. It also found that earlier taxation committees had addressed the issue time and again – as will be described below – though government action has not followed. The TARC found that its view closely parallels those of the earlier committees, modified however to reflect international experience that has since emerged.

There is a post of Revenue Secretary who occupies the apex position in the Revenue Department and is selected from the Indian Administration Service (IAS). He is likely to have little experience or background in tax administration at the national level and little familiarity with tax, including international tax, issues that are increasingly taking centre stage in emerging global challenges in taxation. yet he is the final signatory on decisions on tax policy and administration matters prior to their arrival for the Finance Minister's consideration. The TARC found that this has translated to the Indian tax administration's attention and concerns – in the form of the Revenue Secretary's control over the CBDT and CBEC - to mainly represent the Revenue Secretary's area of familiarity, i.e., general administration, in which he may be highly competent but which is likely to possess only thin links to the most challenging matters of tax policy making or modernizing tax administration in the light of current global practices. In a sense, this peculiar practice has assigned the ultimate responsibility for administration and financial control lying with the Revenue Secretary – Department of Revenue – rather than to the CBDT or CBEC.

This is not the first time that a government committee has found that this admixture is anomalous, and that the post of Revenue Secretary is superfluous. It was considered by the Tax Reforms Committee, 1992, chaired by Prof. Raja J. Chelliah. The Committee's views were as follows:

*“We recommend that (a) the two Boards should be given financial autonomy with separate financial advisers working under the supervision and control of the respective Chairman; (b) the Chairman of the two Boards should be given the status of Secretary to the government of India and the members of the rank of Special Secretary; and (c) the post of Revenue Secretary should be abolished.” (Para 9.27 of the Final Report Part – I)*

The TARC's finding regarding the role of the Revenue Secretary is congruent. It is surprising that government has so far not visited this matter and, as will be developed in

detail in this report, it is time to give renewed attention to it due to its adverse impact on the efficacy of the tax administration in India.

Interestingly, the Chelliah Committee not only recommended abolishing the post of Revenue Secretary, but also emphasized financial autonomy for the two Boards. To quote,

*“... the Boards should have financial autonomy and that the Chairmen should have a sufficiently high status. We recommend that the two Chairmen should be directly accountable to the Finance Minister insofar as matters relating to tax administration are concerned.” (Para 9.28 of the Final Report Part – I)*

Selected matters relating to the administration/financing structure had been examined in the case of the CBDT by the even earlier Wanchoo Committee, 1971. It recommended making the Board an autonomous body, independent of the Ministry of Finance, with the Chairman enjoying a status equivalent to that of a Secretary to the Government of India as in the case of the Post & Telegraph Board. The subsequent Choksi Committee, 1978, reiterated that,

*“... the Chairman of the Central Board of Direct Taxes should have the status of a Secretary to the Government of India and the Board should have adequate staff assistance and should be provided with personnel having necessary technical background and experience”. (II. 2.16 of Choksi Committee Report)*

The issue of the administrative set up of direct taxes was also examined later by the Estimates Committee of Parliament. In its 10th report (1991-92), the Committee made the following recommendation in Para 3.77 of their report:

*“The Committee note that the existence of Central Board of Direct Taxes as an independent statutory body dates back to 1964 when Central Board of Revenue Act, 1963 was enacted. The Board is responsible for administration of various direct tax laws and rules framed thereunder, and for assisting Government in formulation of fiscal policies and legislative proposals relating to Direct Taxes. They further find that apart from the field offices of the Income Tax Department, a number of attached offices also function directly under the Board and assist it in discharging its responsibilities. At present the Board comprises of (sic) 7 members one of whom is nominated as its Chairman. However, the Committee are surprised to note that the Government have not yet accorded appropriate rank and status to the Chairman and members of the Board....*

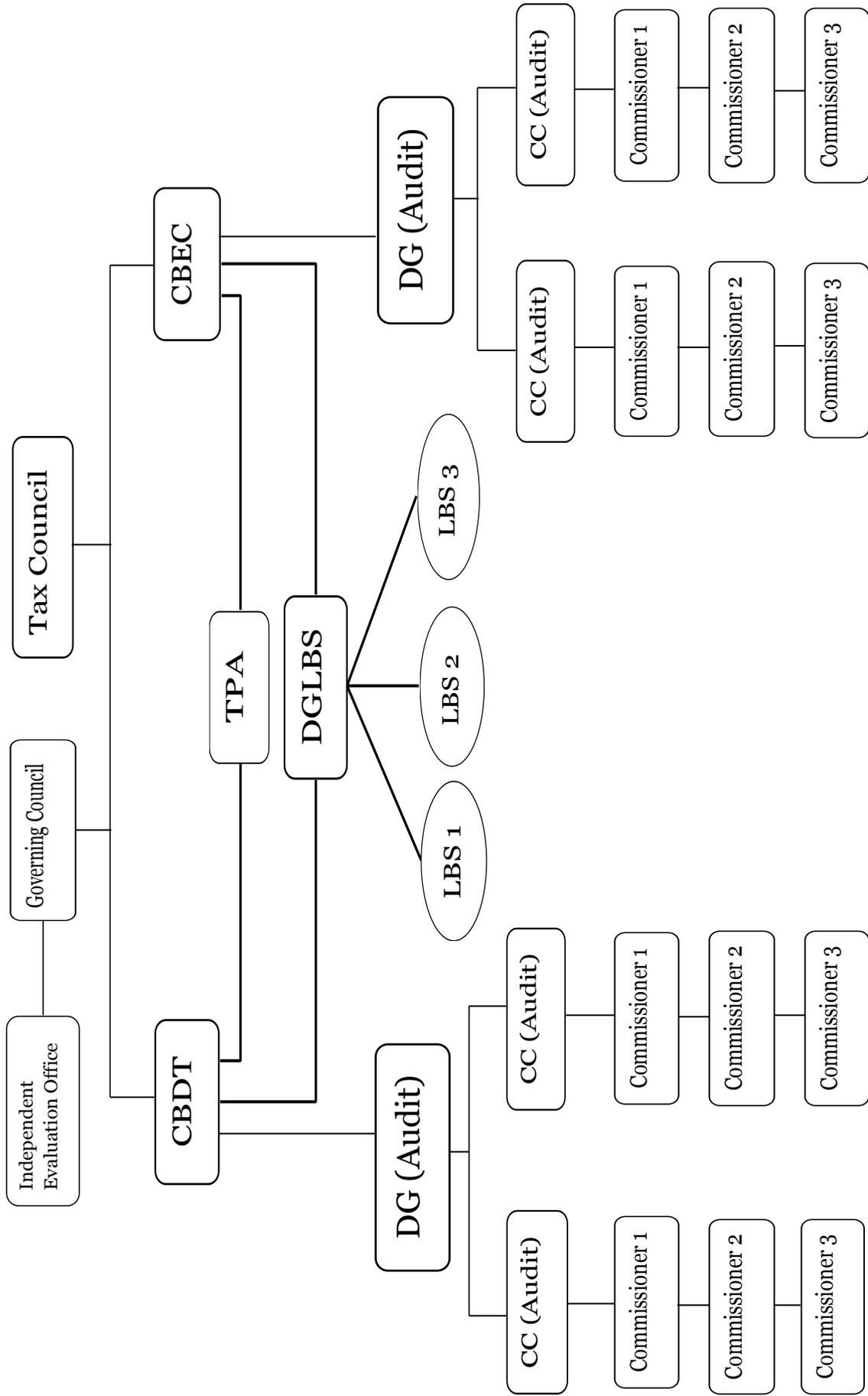
*The Committee wonder why the Chairman of the Board cannot be given the rank and status of Secretary of Government of India. The contention of the Ministry that there ought to be a Secretary, Department of Revenue, to coordinate the affairs of the two Boards, viz., CBDT and CBEC, is unacceptable to the Committee as in their opinion the two areas of Central*

*revenues dealt with by the two Boards are fairly distinct from each other and do not require more coordination than that is necessary between the Ministries of Commerce and Finance, which are headed by independent Secretaries reporting to different Ministers. The Committee feel that at the Secretariat level whatever coordination is necessary can best be achieved through inter-ministerial or inter-departmental Committees and consultations. The Committee are amused at the contradictory stand taken by the Ministry in deeming the two departments viz. Income Tax and Customs and Central Excise to be more important than the Railway Board and simultaneously expressing themselves against conferring upon the head of these organizations the rank and status of a Secretary to Government of India particularly when the Chairman, Railway Board holds the rank of a Principal Secretary to Government of India. The Committee find no reason why similar status cannot as well be given to the Chairman of the Central Board of Direct Taxes and the Central Board of Excise and Customs.”*

With regard to the Committee’s observation that the two Boards are “*fairly distinct from each other and do not require more coordination than that is necessary*”, the TARC notes that since 1991-92 international experience has clearly moved counter to the Committee’s observations and as noted in Chapter III, the dominant global trend is in the direction of unification of direct and indirect tax administrations and treating corporate tax and VAT/GST together as business taxes.

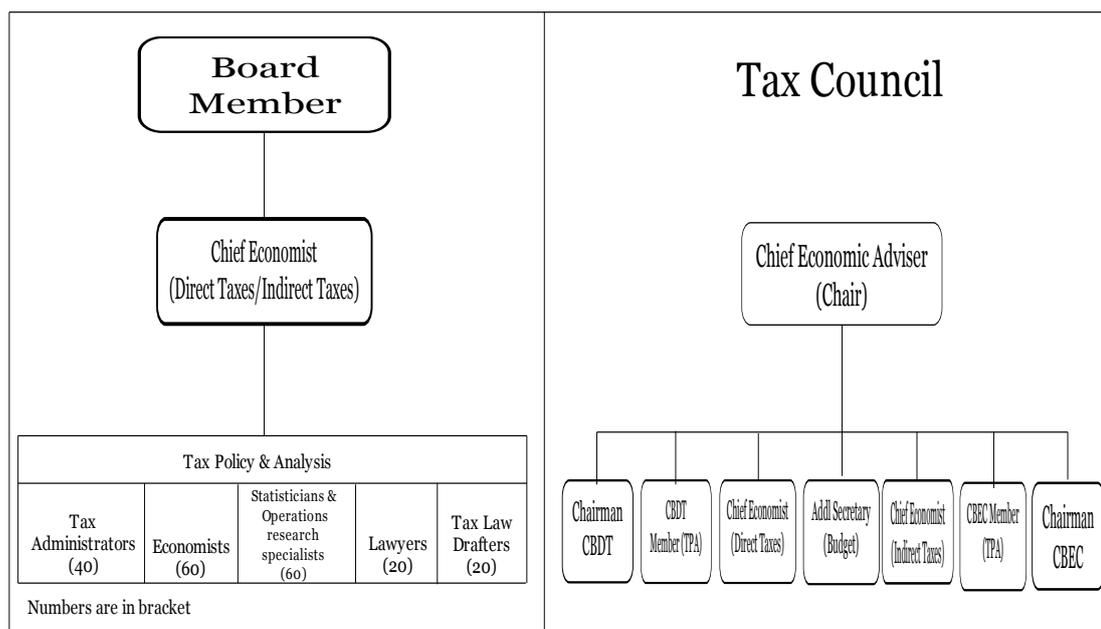
The TARC has worked along similar lines. First, it agrees that the post of Revenue Secretary does not merit presence in a modern tax administration. Instead, a Governing Council should be introduced with the chairs of the Boards alternating as its chairperson. In this manner, the TARC adds to the tenor of the Chelliah Committee in that India should benchmark itself with modernizing tax administrations by not only removing the position of Revenue Secretary but by replacing it with a Governing Council that should include members from the non-government sector as well. The Governing Council will oversee the functioning of the two Boards and approve broad strategies to be adopted by the tax administration to fulfil the objective of a more co-ordinated approach to the administration of the two taxes – direct and indirect – and create a structure which is independent. Such a co-ordinated approach also improves the focus of the tax administration towards its customers, or taxpayers. A depiction of the desired governance structure for large business service is given in Diagram 1. This has been discussed in detail in Chapter III of the report.

**Diagram 1: Desired governance structure for large business services**



Second, synergy in tax policies and legislation between the two tax areas is to be achieved through a Tax Council, headed by the Chief Economic Adviser (CEA) at the Ministry of Finance. The Tax Council will bring the rigour of economic analysis and high precision in legislative drafting to tax laws so that tax laws are not only of assured quality, but are also coherent across tax types. Structure of the Tax Council and the Tax Policy and Analysis (TPA) unit, described in greater detail in Chapter III, is given in Diagram 2 below.

**Diagram 2: Structure of Tax Council and Tax Policy and Analysis Unit**



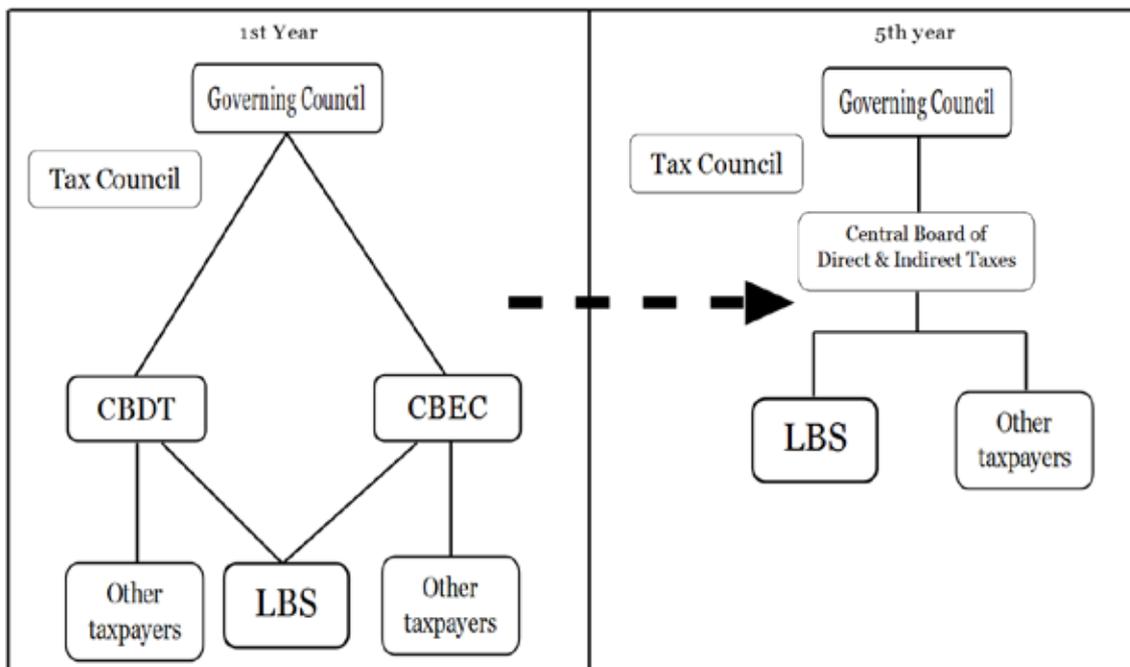
The TARC found that the CEA is more equipped to deal with the links between tax and economic policies than the Finance Secretary (who was given a role by the Chelliah Committee). This new pattern reflects prevalent global practice in which tax and the economy are recognized to be intrinsically linked. That link needs to be established in India rather than linking it with external administrative control, apparently to accommodate an administration oriented service.

The proposed structure would result in more autonomy in the functioning of the tax administration, which is unlikely to be achieved in the present structural framework as it fails to empower tax departments to carry out their assigned responsibilities efficiently. The Kelkar Committee, 2003 also recommended that both the CBDT and CBEC should be given requisite autonomy. The present functions of the DoR could easily be handled by the two Boards. The TARC could not identify the rationale for entrusting such functions to a separate body. Functions such as prevention and combating abuse of narcotic drugs and psychotropic substances and illicit traffic therein, Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, and the administration of central sales tax can be looked after by the CBEC while the enforcement of the Foreign Exchange Management Act, 1999, and Prevention of Money Laundering Act, 2002, can be looked after by the CBDT. The administrative functions relating to the Authority for Advance

Ruling, Settlement Commission and Ombudsman can be delivered through the respective Boards.

The Governing Council and Tax Council will operate as single entities over both Boards to achieve better tax governance. The Councils anticipate the eventual convergence of the two Boards. Over the next five years, the two tax departments would move to a unified management structure, i.e. a common Board and operate the services for both taxes, as shown in Diagram 3 below. This would pave the way over another five years to a fully integrated tax administration with corporate tax, excise duty and service tax, together comprising taxes on business. When major functions of the tax administration are organized along functional lines, and not on merely tax lines, it will enhance taxpayer as well as staff convenience. This reflects current global practice. This would, of course, not be at the cost of specialisation in different tax types. The description above is a snap-shot of the structure described in greater detail in Chapter III and the same is depicted below.

**Diagram 3: Towards a unified structure of the two Boards in 5 years**



- Artificial separation of two tax Boards:** The tax administration is divided into two Boards – CBEC and CBDT – whose Chairs and Members are selected from career tax officials, and who report to the Revenue Secretary. There are several crucial difficulties with the nature and practice of the two Boards. First, there is no rationale for a functional separation that fails to reflect the common global practice of the day. This is because many of the Members’ functions on the two sides repeat the same function that could be carried out ideally and optimally by the same official. This separation appears to accommodate the comfortable existence of Board Members rather than serve the interests of government in a sharp tax administration. Combining at least certain functions immediately would yield more Member positions in currently neglected areas. The Chelliah Committee had also

recommended that the two Boards should operate in close co-ordination with each other. To quote:

*“With the abolition of the post of Revenue Secretary some arrangement would have to be made to ensure supervision and coordination of the activities of the two Boards. While alternative institutional arrangements could be considered, it is necessary to ensure that two basic conditions will be satisfied; the first is that the two Boards or the Tax Departments should not act independent of each other; as we have stressed earlier, it is extremely important that the tax system is structured and managed as a harmonious whole and that other inputs besides knowledge of tax administration are brought into the formulation of tax policy.” (Para 9.28 of the Final Report Part – I)*

**Routine placement of officials in the two Boards** (with little relation to length of tenure): Second, the selection of Chairs does not take into account the length of their remaining tenures prior to retirement. The selection is based almost entirely on seniority. As an indicator, in 2014 alone, there are likely to be four Chairs of CBDT and three Chairs of CBEC. For Members, there is a requirement of one year of residual service. Otherwise, the selection process is the same. With such rapid turnover and short tenures, there is little leadership in the Boards and, consequently, scant attention and time being devoted to directing national tax policies or providing administrative guidance – their quantity as well as quality have been reduced to random outcomes of ephemeral Chairs and Members.

**Board assignment has little relation to experience or link to specialized areas:** Third, the assignment of functions among Members does not necessarily reflect their work experience. Additionally, some areas that comprise crucial matters in modernizing tax administrations are given inadequate attention – for example, information and communication technology (ICT). Indeed, in such a specialized area, it is possible that people elevated to the post of Member ICT may have spent hardly any time during their earlier career on this matter. It, therefore, is unlikely that such a Member will be able to manage the area or take dynamic essential steps to keep the tax administration abreast of the latest developments in ICT applications that would be beneficial to the system.

**Members making policy have little policy experience:** Fourth, most Members emerge primarily or exclusively from field functions while, at the Boards, they are expected to design policy. Introduced policies, therefore, are often unrepresentative of the best available and experimented policy options from across tax administrations internationally. This happens even as top taxpayers express willingness to adhere to a rational tax administration framework while increasingly protesting against prevailing practices that do not compare with their experiences in dealing with tax administrations elsewhere.

**Members’ risk aversion leads to low productivity or low motivation to provide guidance or clarity:** Fifth, positioned beneath a Revenue Secretary picked from another Service, the Boards have tended not to assume a leadership posture, their views and

decisions increasingly revealing extreme risk aversion. The outcome is that the Boards' decisions or pronouncements in the form of legislative changes, binding circulars, clarificatory guidance notes or press releases are few and far between, and that too under external force, in contrast with other tax administrations elsewhere.

- **Risk aversion permeates down, and leads to, infructuous tax demands:** The stance of inaction has permeated down to Chief Commissioners and even Commissioners who are averse to taking strong or even correct decisions that would counter infructuous demands made by lower level officers who have been given the role of a quasi-judicial authority. On the other hand, when an officer is convinced about a demand s/he has made but the Controller and Accountant General's (CAG) auditor has disagreed with it, the Boards have issued standing instructions that a "protective demand" must be issued by the officer to the taxpayer. Thereafter, the departments persist in such futile litigation imposing completely avoidable costs on the taxpayer. The CAG has nowhere stated that such protective demands should be issued and it is entirely up to the Boards not to do so. Non-issuance could lead to their being called to explain by the Public Accounts Committee (PAC) of Parliament; this was not uncommon in earlier years. Where a considered view has been formed on CAG's observations, the Boards ought to display the courage to defend their decisions before the PAC should such a need arise, instead of transferring the risk to the taxpayer. The Board's standing instructions, therefore, reveals excessive risk aversion that could only have an adverse effect on the taxpayer who is left in a completely uncertain and trying position in terms of current cash flows and business decisions for the future. The deleterious ramifications for the economy can only be surmised but not exaggerated.
- **Taxpayers express helplessness against rude or arbitrary behaviour of officers with little assigned accountability in practice:** The continuing impact on the taxpayer who has been relegated to a position of helplessness is unprecedented internationally. The confusing, if not arrogant, environment that they have to face on a daily basis was reported by high finance officials of major Indian corporations who are some of the largest Indian taxpayers. This occurred during the TARC's stakeholder consultations at five Indian metros – Bengaluru, Chennai, Delhi, Kolkata and Mumbai. They did not complain about the disagreements of the quantum decisions as much as about the rudeness in communication, non-maintenance of appointment time, passing on accountability to another location, and going so far in some instances as informing the taxpayer that a demand is being made to obviate "vigilance" – internal audit against the officer – and the taxpayer should take recourse to the appeals process available to him. This matter is detailed further as it has cropped up time and again during consultations with taxpayers in different contexts.
- **Complete absence of economic, statistical, behavioural, or operations research-based analysis of policy or of taxpayers prior to making major or minor legislative or subordinate legislation-based (rule-based) decisions:** Administrative decisions and tax policy making are both based on nil analysis by international standards. No "impact assessment" is carried out before introducing major legislative changes. Even changes in rules that Boards announce have no reference to what background analysis has preceded

the decision. Pre-budget discussions are usually back-of-the-envelope calculations of revenue impact. The impact on a taxpayer is considered in a cursory manner, if at all. Retrospective amendments clustered during 2009-12 may reflect this lackadaisical approach. In turn, this reflects complete lack of accountability at any level except on grounds of lagging behind in revenue collection.

- **Lack of use of Information and Communication Technology (ICT) based data by the Tax Policy and Legislation (TPL) Unit and the Tax Research Unit (TRU):** The two departments on both direct and indirect tax sides have made impressive advances in the installation of ICT and its use in the process function. What has not occurred is data mining. The masses of data generated, for example through the expansion of electronic filing, remain essentially unutilized. In modernizing tax administrations, modelling of taxpayer behaviour to obtain nuanced taxpayer behaviour patterns prior to the formulation of tax administration policy has become common practice. India has not yet begun even rudimentary attempts in this direction. Given its current size and officer backgrounds, in fact, no essential tax policy or tax administration policy analysis is carried out at either TPL or TRU. They function essentially to interpret and draft the law. There is no officer who is, or could be, entrusted to carry out *ex ante* or *ex post* policy analysis. This points to the urgent need to overhaul these units on the basis of a total reformulation in their objectives and scope.
- **Adverse impact of revenue target on tax officer equilibrium:** Revenue target is the sole criterion that is effectively used to assess performance. Targets are set in the Union Budget in a static context. No attempt has been made by the Boards to undertake any post mortem study that would analyse whether the projections were correct over a period of time when placed against the economic trajectory during the past year. Instead, the Boards pressure Chief Commissioners, who pressure Commissioners, who pressure lower level officers to meet fixed revenue targets, irrespective of the prevailing condition of the economy. Officers complained bitterly during the TARC's consultations in the five metros about the anxiety that they go through on account of the revenue collection pressure and some even went to the extent of pointing to the need for mentoring, coaching and psychological support.

**Blind revenue target causes unjust pressure on good taxpayers:** Modern tax administrations do not use a fixed or static revenue target. A revenue projection is made at the time of the budget reflecting the condition of the economy at that point. The projection is changed during the year reflecting the changing economic outlook. This is compared against what revenue is actually being collected. The difference is called the "tax gap". This is continually minimized through better collection efforts by reducing or eliminating tax evasion rather than by putting pressure from the top on officers below who, in turn, pressure even good taxpayers to contribute more revenue or postpone making due refunds in particular during the last quarter of the financial year. Such policies would be illegal in other law abiding societies. Consequently, instead of formulating policies with respect to tax administration and tax policy, several Board Members take on the role of tax collector. The consequence, unsurprisingly, is twofold: first, a dearth of meaningful tax policy or tax

administration policy and, second, an inequitable pressure on the good taxpayer. Indeed, the TARC observed, other than helplessness, deep and openly expressed anger amidst even top taxpayers in several metros.

**Wrong use of tax avoidance instruments for revenue generation:** In the direct tax area, ordinarily, transfer pricing examination between associated enterprises should be used as a tool to minimize tax avoidance. In India, transfer pricing measures are used for revenue generation, which comprises a completely wrong approach. This is revealed through the allocation of revenue targets to transfer pricing officers (TPOs) from transfer pricing adjustments. This is unheard of internationally. Accordingly, India has clocked by far the highest number of transfer pricing adjustments, demanding adjustments even for very small amounts. There is also a high incidence of variation among TPOs in their adjustments for similar transactions or deemed transactions. Taxpayers reported that they often succumb to such adjustments simply to carry on with business activity for, otherwise, they would have to allot or divert huge and unavailable financial and staff resources to such activities. Several other avoidance measures are also interpreted by the administration to be used for revenue generation, which comprises wrong policy.

**Defective formulation and implementation of tax law and rules to generate revenue:** On the indirect tax side, since the introduction of the “negative list” of services – only listed services are not taxed while all others are - has wreaked havoc among taxpayers due to poor management of change by the CBEC, reflecting lack of knowledge, preparedness or Board guidance to field officers leading to multiple interpretations combined with the usual lack of accountability for timeliness in clearing up confusion through circulars or guidance notes. The practice of delaying refunds by asking for irrelevant information reveals an undesirable and non-transparent practice to avoid refunding what is legitimately due to the taxpayer. Such artificial devices to garner revenue reflect an unethical approach to revenue collections.

**Lack of quality in fiscal deficit reduction:** Revenue target policy is usually set to achieve a better fiscal target figure. The TARC observes that the revenue target policy has been erroneous inasmuch as it is not just the numerical figure of fiscal deficit that counts but its quality. If a fiscal deficit is reduced through coercive government action in an era of global information, international rating agencies are going to take note of the overall business environment. Merely reducing the quantified fiscal deficit is not sufficient since the focus turns also to the quality of deficit reduction. Herein lies the fallacy of pursuing a blind deficit reduction policy. It has to be matched, instead, with appropriate approaches towards revenue collection both from tax administrator and taxpayer point of view. Indeed, some countries today are so concerned about the impact of tax policy and tax administration on the taxpayer that they have virtually removed the word “taxpayer” from the lexicon, replacing it with “stakeholder” and “customer”, recognizing them as partners with the administration in generating revenue. India remains a long distance from such an approach.

While revenue target is often achieved due to economic factors, identification of tax administration impact or tax-base impact is not separately attempted. Thus, the overall

impact assessment is confined to a year, and no gainful change is made in the tax administration or conscious efforts made to widen the tax-base.

- **Escalation of disputes and poor recovery from demands:** Lack of accountability in raising tax demands without accompanying responsibility for recovery has led to an unprecedented situation in India, which is experiencing by far the highest number of disputes between the tax administration and taxpayers with the lowest proportion of recovery of tax while arrears in dispute resolution are pending for the longest time periods. Thus, dispute management comprising dispute prevention and dispute resolution is at a nadir. It has also become a profession in its own right in a backdrop where, in modern tax administrations, disputes are entered into only as a last resort.
- **Virtual absence of customer focus:** Much of the modernizing tax administrations across the world have changed their stance towards taxpayers in a visible change in the approach to dealing with them, which is to treat them as partners. Segmenting taxpayers according to their tax behaviour enables the tax administration to develop strategies appropriate for such behaviour and improve the collection mechanism. In India, no customer focus strategy has been developed based on segmentation analysis.

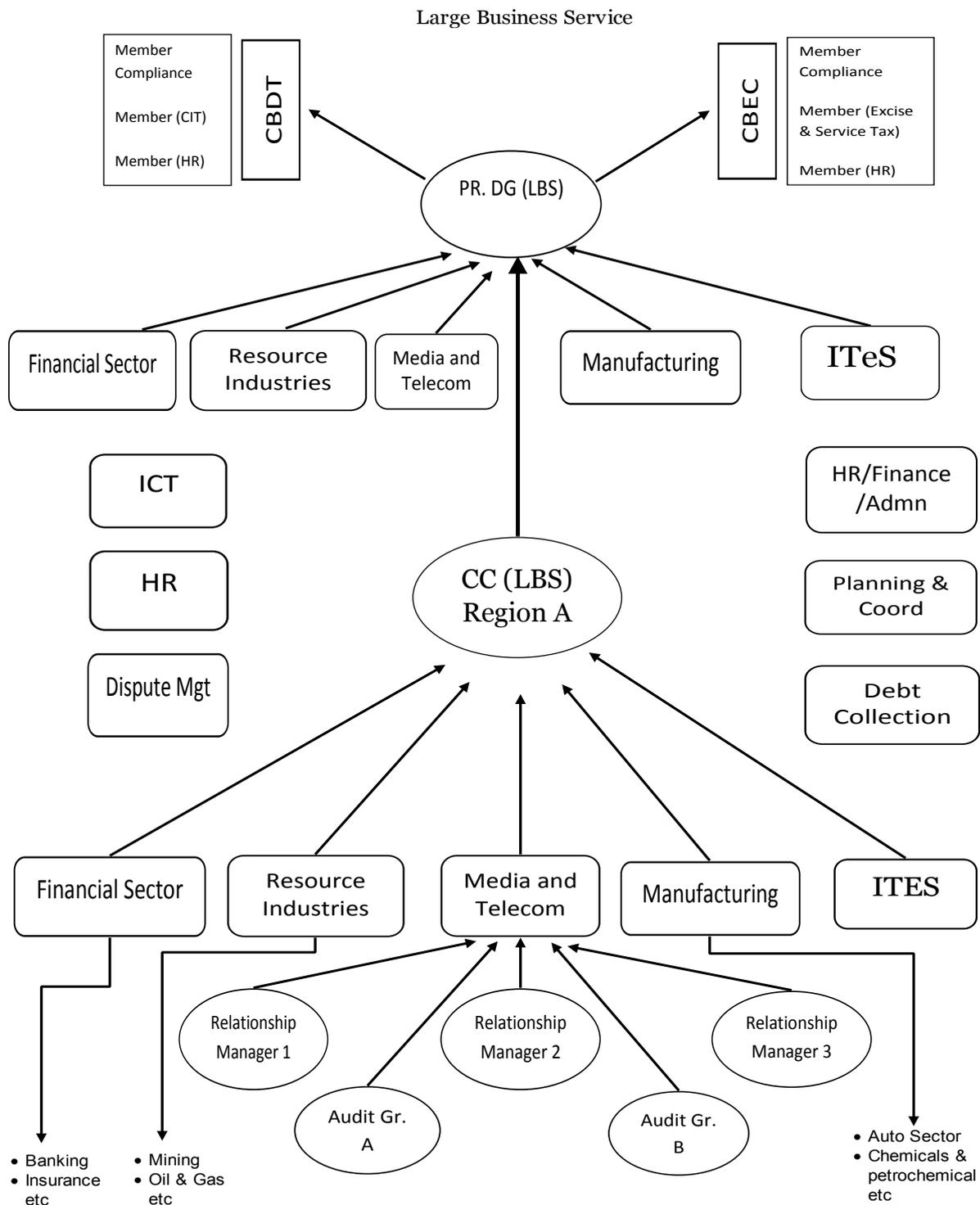
**Examples of customer focus are few and there is no training for it, reducing taxpayers to a subservient status:** It is true that numerous Aayakar Seva Kendras (ASK) are being set up at locations all over India so that a taxpayer can register a question and follow how the matter is progressing through the system. However, selected visits indicated a wide variation in implementation. Second, through installed ICT software, a taxpayer can log in to see whether and how much his tax deduction at source (TDS) has been credited. However, many lacunae remain in terms of non-matching and the system has been slow in correcting anomalies. Third, other than TDS, there are significant cases of mismatch between the ICT-based Centralized Processing Centre (CPC) and the information percolating from there to a taxpayer's Assessing Officer (AO). Although the taxpayer suffers as a result of the mismatch, the lack of responsibility or accountability, leave alone timeliness in resolution, between the ICT and the AO for redressal of the mismatch is striking, despite ardent pleas from affected taxpayers, the latter sometimes even being subjected to scrutiny. Fourth, a common complaint made during the TARC consultations by high and low taxpayers alike was that the Indian tax administration was virtually the opposite of what is understood globally as customer focus orientation in terms of congenial attitude and polite approach to the taxpayer, or in terms of timeliness in decision making.

**Instances of egregious tax officer behaviour:** Taxpayers are subjected routinely to rude and arrogant behaviour, are made to wait hours – being called to appear in the morning though met many hours later, sometimes even in the afternoon – are asked to make photocopies of information already sent to the administration again during the visit without availability of copying machines, CEOs of companies being asked to appear when the CFO or an accounts official from the company would suffice. These characteristics signify practice that has descended to unprofessional levels, to put it mildly. There is no departmental training to behave differently; there are no guidelines or framework of rules

for accountable behaviour. Yet the vision and mission statements of the departments pronounce their intention to care for the taxpayer by incorporating taxpayer perspectives to improve service delivery. The prevailing situation is so far from common global practice that, in the judgment of the TARC, there is likelihood of a tax revolt in the not so distant future unless emergency and compulsory training is conducted for officers, with strong cues from the leadership. Contextually, while Ethics, as a subject, forms a part of probationers' training, Customer Focus is not addressed as a topic at any point in the officer's career. This decidedly reveals how the tax administration has functioned, and continues to function, in isolation and in a feudal manner, protected by systemic job assurance and assessed highly as long as revenue targets are met. The distance of this framework and manner of functioning from authentic customer focus could not be greater. The need for remedy could not be more urgent.

- **Large Taxpayer Units (LTUs):** The concept of LTUs was introduced in 2006 following comparable practice in more than 50 countries. There should be a double dividend from the functioning of LTUs. On the one hand, large taxpayers defined according to their size of advance income tax or previous year's excise tax or service tax payment, can pay all taxes –direct and indirect – at one window. On the other, the tax administration can be fully informed of all taxes filed by a single taxpayer – corporate or any other business – enhancing the sharpness of scrutiny and audit functions and their consistency across taxes. It is happenstance that in India, as explained above, direct and indirect taxes are divided into parallel departments with effectively little information passing from one to the other. The institution of LTUs was expected to bridge this gap at least for large taxpayers. This has simply not happened. While large taxpayers get the single window facility, the two tax departments have continued to operate as silos, desisting from sharing information even with respect to LTU participants. To protect their respective turfs, they have bypassed the advantages to be reaped from sharing information even when the revenue ramifications from such exchange could only be positive. Thus, so far, the advantage that should accrue to the tax administration by operating LTUs has not accrued at all. No viable explanation was received by the TARC as to why, despite the introduction of an institution at the highest policy making level, the administrative system could basically ignore the policy intention without the slightest retribution except, once again, to point to the complete absence of accountability in the system. The TARC has found that, were the functioning of LTUs to be revived to a pre-eminent status, they could form the fountainhead of tax administration reform in India. Chapter III of this report describes how the joint working between the two Boards in large taxpayer operations can transform the present working of the LTUs into a large business service. Diagram 4 below demonstrates that.

**Diagram 4: Large Business Service**



- Irrational approach to vigilance over officers:** Perhaps the most fundamentally diagnostic finding of the TARC is the almost absurd approach, by global standards, to vigilance over tax officers and the continuance of the system without the slightest revealed interest to change it from within i.e. by the Boards. A primary responsibility of the Boards is the welfare of and justice to their officers. Yet these officers are subjected to anonymous charges against them that could be ruinous to their careers. Vigilance action against them

emanating from such anonymous complaints can drag on for years or be kept in abeyance only to be revived for unrelated future adverse steps that may be taken against them if the system so desires. It is not surprising that correct, fearless decisions cannot be expected from officers in an environment of such uncertainty. Instead, the safe course of action is to relentlessly follow the “revenue protection” goal that is inculcated in them as the primary motto of operation.

**Fear of vigilance in management:** The TARC found that a similar fear of vigilance lurks even in the higher echelons of management, rendering the administration devoid of bold or corrective action where needed or even where obvious. Unresponsive to taxpayers’ legitimate concerns, slow to undertake corrective action, on the contrary, instructing that protective demands be issued to taxpayers automatically on the basis of the CAG’s observations and ignoring its own officers’ assessment, the Boards – comprising top management of the tax departments – have succumbed to the fear of vigilance. The management is functioning to protect itself even while the taxpayer becomes its sacrificial lamb, revealing a lack of accountability towards the taxpayer. In this context, customer focus as enunciated in the vision and mission statements remains relegated to paper. Management becomes doubly irresponsible – towards both its officers as well as to taxpayers.

**Fear of vigilance as a consequence of external pressure and external head:** Possibly the subservient status of the two Boards reporting to an officer from a different service and, more so, without essential background or knowledge of tax matters, is leading to the Boards shirking from taking bold steps or corrective action, or being unwilling to face the legislative or judicial branches as needed, or being unwilling to take initiatives in the building of infrastructure or, last but not least, failing to empower the institution and, instead, remaining inert towards its own officers and taxpayers. All of this characterizes the Indian tax administration of the day. It is clear that unless it is given its own autonomy, the Indian tax administration can never rise to its full potential.

- **HRD – or People – function:** First, while the need is to create a high-performing organisation, the HR policies of the two departments seem to work against the creation of a meritocracy. The promotion, transfer and placement policies do not adequately address the need for recognising merit, developing specialisation and creating a motivated and highly competent and professional work force, which is capable of effectively addressing the emerging challenges and also serving the taxpayers satisfactorily.

Second, several officers mentioned that there is a culture of supervisors doubting and questioning correct decisions merely because they are perceived as customer-friendly. This demotivates even diligent and honest officers and induces them towards risk-averse decisions, thereby passing on an unfair burden on the taxpayer as that would be an easy way out from being subjected to further questioning by management. In short, the common management stance being one of distrust of the junior officer, rather than his empowerment, sows the seed of a chasm between an officer and the management. The former eventually succumbs to the laid out approach expected of him by the system.

Third, the **transfer policy of tax officers** is routine if not archaic. The transfer policy needs to balance the needs of the organisation with the needs of an individual to maintain high morale. The argument that the Indian Revenue Service is an all-India service should not lead to the installation and functioning of a structure that ignores the need for specialisation. Transfers are given first priority over acquiring specialization in any subject that may be quintessential in carrying out acutely specialized tasks in a global context. An officer may be placed in TPL, TRU, systems, or international taxation, directly from the field without prior training merely to adhere to the transfer policy. Nevertheless, there are enough caveats in the policy to accommodate special ‘silver spoon’ cases. Indeed cases appeared to the TARC where circular transfer requests (pertaining to a group of officers) that are entirely ‘Pareto optimal’ – where there are gains without anyone being worse off – are ignored even where the transfer policy is apparently not compromised. Presumably this may reflect an underlying fear that such requests, if conceded to, may be repeated by others, not realizing that meeting such continuing requests would only enhance people welfare. The need for a transfer policy that is meaningful in its fairness and encouragement towards professional specialization cannot be over-emphasized.

Fourth, another oft ignored aspect of the people function is the **implementation of leave policy**. This appears to be randomly applied at least in selected observed cases. The policy has broad scope for leave accumulation, but granting of leave appears inexplicable and unrelated to the accumulation of leave. Rather, it appears to be linked to the professional relationship between an officer and his superior. The right of the officer to take accumulated leave has sometimes been ignored, revealing a lack of information or of training of managers in modern management principles in which rights such as the days of acquired leave, or stipulated number of days of training, comprise the right of a worker and has nothing to do with a work relationship. There is no redressal for the worker in such circumstances. What is worse, there is no accountability assigned to the errant superior. The TARC gathered the impression that the management tends to wield a tough stick on an officer who falls foul inter-personally of the system.

Fifth, an issue that cannot be ignored and appears to work in the reverse direction is that of **moral hazard**. Taxpayers openly complained during the TARC’s consultations about their helplessness against demands for bribes to make refunds, to hold back infructuous demands, or speed up processes from dormancy. While no officers’ names were mentioned for fear of retribution, the TARC views that the open claims made by stakeholders is a cause for deep concern. Even senior officers admitted their ineffectiveness in controlling this growing phenomenon. On the one hand, a toothless institution may suffer from various such maladies as almost a *quid pro quo* for the powerlessness that it endures. On the other hand, if the institution is responsible for delivering a public good and is intended to be the primary institution for generating funds for public expenditure, then bribery represents a leakage from public funds. Whatever tax is not paid and is shared instead between an errant taxpayer and a corrupt officer is an amount that does not enter the exchequer. This institutional disease, to the extent that it exists, cannot be ignored and a solution must be found.

- **Key internal processes:** Glaring gaps prevail in internal processes. Some among those found by TARC are listed here: (1) a basic lack of harmony between direct and indirect tax departments; (2) relatedly, the issuance of PAN, its non-use thus far as a Common Business Identification Number (CBIN) and the lack of provision for de-registration, cancellation or surrender, and slowness in real time verification of PAN; (3) absence of possible consolidation of direct taxes on returns, for example, income tax and wealth tax; (4) continuation of jurisdiction specific returns for direct and indirect taxes; (5) lack of harmony even within indirect taxes, i.e., between customs, central excise and service tax, (for example, not combining audit of customs, excise and service tax paid by the same taxpayer, or not treating a business as a whole and instead treating it as individual audit units); (6) absence of e-invoicing and commensurate monitoring of CENVAT credit flow; (7) absence of audit protocols that separate different scrutiny procedures and protocols for different types of audits; and (8) the virtual absence of risk-based scrutiny selection for income tax despite the use of Computer Assisted Scrutiny Selection (CASS) due to lack of pre-selection data cleansing or systems-based checks and analysis.

A particular gap remains in an interface function with the taxpayer; this is in processing and **making refunds**. (1) In the case of income tax, there is no time limit within which an AO needs to process the refund in case it could not be issued by the CPC. The insistence on manual filing of TDS certificates before the AO for verification of a refund claim stalls the process. (2) Where eligible refunds emanate from Commissioner (Appeals), Income Tax Appeals Tribunal, a high court or the Supreme Court, again, the AO faces no prescribed time limit for issuing the refund. (3) In the case of service tax, a consistent complaint was that of refusal to pay due interest to domestic suppliers and to service exporters under different pretexts – including repeated demands for additional documentation or the use of a provision entitled “unjust enrichment” – by the department. The latest available data reveal that, in 2010-11, interest on refunds was 0.01 per cent and 0.02 per cent of refunds for customs and excise respectively, which may serve as an indicator of the realism of the complaints. (4) It was reported by officers to the TARC that it was routine to receive instructions from above to slow down or stop making legitimate tax refunds in the last quarter of the financial year.

**Tax fraud, intelligence and criminal investigation** comprise another deficient area. The TARC found that: (1) “Search and Seizure” and its legal backing need to be made clearer. Drafting of prosecutable issues and highlighting the offence and the evidence to be adduced either do not exist or are carried out not in a fully professional manner. A dedicated vertical assisted by lawyers is currently lacking and needs to be embedded in the administration. (2) The directorate in charge of investigation of criminal activity on the direct tax side is inadequately linked to other agencies and, remarkably, not even to the indirect tax side. This once again reveals the deep and inexplicable chasm that continues to exist between the two tax departments and is simply tolerated despite obvious synergies that would ensue if common functions were jointly performed.

- **Role of ICT:** ICT today is the most critical underpinning for tax administration reform. All modern tax administrations see it as a key component of their strategy to improve the

efficiency and effectiveness of their operations, be it customer services, internal business processes or effective interventions in the area of audit and enforcement. They are also focusing on enhanced use of analytics to support their actions in diverse areas such policy making, customer segmentation and risk management.

While the two Boards' achievements are creditworthy, and provide a robust basis for future progress, in the TARC's opinion, there is a long road ahead of both the Boards before they could be said to have achieved comparable global benchmarks, of a modern 21st century tax administration, for full and effective utilization of the potential that ICT offers. And in order to reach that destination, they will have to chart a new path as TARC has outlined in Chapter 7 of this report.

ICT does not appear to be fully internalized in the thinking and working of the departments and there is not enough appreciation of its strategic importance as opposed to viewing it merely as a means of automation of transaction processing. The absence of integration of the ICT and business domains at the highest levels has led to sub-optimal realization of the benefits of ICT projects and systems. Greater attention is needed on the part of the senior leadership to the opportunities that ICT offers for re-engineering business processes to do things differently and more productively. Further, there is insufficient focus on the use of data analysis for developing policies and for making informed and evidence based decisions. It is true that the CBEC has already implemented, and CBDT is implementing, a data warehouse that will provide much better access to data as well as powerful analytical and reporting tools. However, in the absence of data sharing between the two Boards, the data warehouses will only provide data from their respective systems, and thus only a partial version of the truth, thereby limiting its utility. Further, merely providing technology is not sufficient. If the required human capacity to use the technology tools to perform advanced analyses is not developed, the potential of ICT will remain unrealized. There appear to be no efforts planned to create such capacity and develop an institutional framework for undertaking research and analysis in either of the Boards.

The implementation so far has been in the project mode, meaning that individual projects were conceived, designed and implemented at different points of time for meeting different needs. There has been no clearly articulated ICT strategy, derived from an overall organizational strategy and vision, forming the basis of the project development. This weakness has been compounded by the absence of a robust ICT governance framework that would have encompassed sound programme and project management, closely linking business goals with ICT implementation. It has also led to heterogeneous approaches to ICT implementation, with systems being developed along different implementation models and not adequately catering to the need of interoperability.

There are also gaps in the ICT implementation. These are either because some processes have not been covered in the scope of automation or because the sub-systems or modules that provide for digitization have are not been implemented. This is true of the core applications of both the direct and indirect tax administrations. The result is that data are

incomplete and the Boards are still dependent on reports from the field, which, besides often being inconsistent and inaccurate, impacts on the efficiency of field operations.

Missing pieces in digitization of operations also means that the Boards are unable to make meaningful performance measurements at the organizational as well as at team or individual officers' levels. Consequently, they are unable to effectively manage performance at all levels.

There also appears to be a communication gap between the DG (Systems) and the officers in the field, leading to difficulties in implementation as users do not seem to adequately perceive value in ICT implementation.

Many administrations adopt suitable ICT maturity frameworks, to assess their progress in ICT implementation, as also the comprehensiveness, depth and effectiveness of such implementation. No such use of framework has been adopted by the two Boards.

The most critical shortcoming of the current implementation arises from the two Boards operating in separate silos and a total absence of data sharing between the two. A big opportunity for radically improving both taxpayer services and enforcement actions is being missed on this account. An opportunity to reduce duplication of efforts and resources too is being missed.

The TARC also finds that a key risk to the ICT implementation lies in the HR policies of the two departments, which are overly oriented towards a generalist approach. Effective ICT implementation requires specialized skills and capacities and all modern tax administrations recognize this. In India, on the other hand, the transfer policy results in situations in which crucial resources get moved out the ICT function, at critical points of time simply because of the prescribed tenures, and new (and often unprepared and unwilling) persons get inducted. Combined with the absence of a reliable process of knowledge transfer, this continues to pose a serious risk to ICT implementation. Compared to the size of the projects, the two DG (Systems) are also understaffed.

Considering the complexity and scale of the tax administrations' operations, and the challenges confronting them in a rapidly changing environment, the task of complete digitization of their operations is an onerous one. This, coupled with the need to take the implementation out of the silo-based approach that has constrained the realization of the full potential of ICT hitherto, would indicate that the DG (Systems) as they are currently configured and structured are ill-equipped to meet the future needs effectively. Only a purpose built organization that will take on the full responsibility for ICT implementation, with full operational freedom and flexibility to be run in an independent and professional manner, and yet be under the strategic control of and accountable to the two Boards, can successfully meet the challenge.

### 3. Conclusions

The critical findings delineated above, when combined, lead to the TARC's overarching conclusion that, if an institution could have spirit, then the current Indian tax administration lacks that spirit. Functioning in a vacuum, it has lost its purpose as revealed in its behaviour, for its stated vision and mission are scarcely observed in its operational style. Its singular objective of protecting revenue without accountability for the quality of tax demands made is commonly believed to have severely affected the investment climate in India and in investment itself. This view reflects strongly the pleas, complaints and anger expressed by high and low taxpayers alike during the TARC's stakeholder consultations. Thus, overall, the Indian tax administration is at its nadir. A fundamental and deep reform is urgently called for. There is no time to lose if investment is to be revived and its full potential reached, and an eventual tax revolt through capital flight or other direct protests is to be averted.

Deconstructing, the conclusions may be summarized as follows:

- A crucial deficiency is a fundamental **lack of customer focus** in the Indian tax administration, which is in stark contrast to modernizing and reforming tax administrations. The randomness and uncertainty in tax demands, the rudeness and abrasiveness in tax officer behaviour towards taxpayers, totally obviating the latter's stakeholder role, the inconsistency in demands made on similar tax matters without accountability, and the often poor quality of show cause notices have combined to project the tax administration in its poorest light in the eyes not only of the taxpayer but of society at large. Yet there is no place for customer focus thus far in the training syllabi of either branch of the tax administration. Indeed, recently, the phrase "tax terrorism" has appeared in the gathering commentary on the Indian tax administration.
- The present **structure of the tax administration** – (i) headed by a non-tax official imported from another public service stream that has no link to taxation, (ii) artificially separating the tax administration into direct and indirect taxes headed by two parallel Boards for common functions, ignoring, for instance, even the functional commonalities in LTUs that were established for the very purpose of reaping benefits from exchange of information between the two tax areas, (iii) living with a selection system into the Boards that has no or little link to the length of tenure, work experience, or specialization, and (iv) risk aversion arising from an externally imposed vigilance over the entire officer structure – has led to a management functioning at a suboptimal quality and below its potential capacity.
- The risk averse behaviour of the tax administration has routinely led to infructuous tax demands on the taxpayer, often with the full knowledge that eventually such demands would not be able to withstand or pass the judicial process. In addition, a contrary view from the CAG on an AO's assessment is directed by the Boards to be assimilated through a 'protective demand' on the taxpayer, despite knowing that it is likely to lead to a dispute. The resultant **number of disputes and the time taken to resolve** these have surpassed heights that are globally incomparable. The rules of appeal by the tax departments that

elongate the process prior to final resolution and a high proportion of cases that end in eventual defeat have led to a miniscule proportion of recovery compared to demand. Yet there is no accountability regarding recovery for the concerned officer. While raising a demand is praised, there is no punishment for infructuous demands. The loser is the taxpayer in terms of time lost, advance payment required of the disputed amount resulting in deleterious effects on the cash flow of business, and the length of staff time and expenses associated with a long drawn-out dispute resolution process.

- The **HRD or people function**, or the approach to handling staff, is grossly inadequate. First, the pressure to meet **exogenously imposed revenue targets**, irrespective of the condition or prospects of the macro economy, has not only made it tough for taxpayers to make business decisions, it has also led to significant worsening in the officers' work environment. Second, the tax administration subjects its staff to an **irrational practice of vigilance** in which anonymous complaints against them are given equal status to direct evidence. Vigilance emanates also from external agencies, which is not common practice in many other tax administrations. The outcome of the vigilance process can linger for years, truncating the possibilities of success in many careers. This fear starts from entry to termination of a career. The result is extreme risk aversion. Thus, an AO is likely to issue an order despite knowing that it would not withstand the judicial process, and higher tax authorities are unlikely to modify it for the same fear of vigilance. The loser is again the taxpayer. Third, the **transfer policy and leave policy are irrational**. They discriminate and tend to work against the good intentions of officers who have acquired rights to leave or have a genuine desire to specialize in a subject. Several officers expressed anguish over their dire need for counselling or psychological support. Such conditions are unheard of in modern tax administrations.

At the same time, accusations of **moral hazard and demand for bribes** cannot be ignored by the TARC. On the one hand, this could be partially explained through the administration operating as a subservient entity to another public service stream so that, despite an evidentiary slide in the morals of the institution, management does not feel directly responsible for it. On the other hand, given that the ultimate sufferer from corruption is the taxpayer – while recognizing that he has to necessarily be at least a passive participant – there is no gainsaying the fact that there is need for the tax administration's management to take extraordinary steps to contain and obviate this institutional disease since it has a direct impact on society, its productivity and on the economy's measured GDP.

The TARC, therefore, concluded that the people function of the Indian tax administration is in a very undesirable state. Even as the staff continue to exhibit competence, if not brilliance, at an individual level, the system tends to defeat them from performing at their full potential. Certainly, it tests them on erroneous premises and subjects them to archaic management practices. This situation demands immediate correction through compulsory training in modern management practices at the Commissioner and higher levels of seniority, who currently are subjected to little or no requirement for continuing management education. It also demands people policies that are designed to recognize and reward high performance, ethical conduct and identify leaders early and groom them for

leadership positions so that they can lead the organisation to high performance. The TARC is, therefore, making recommendations in relation to this function which have transformative potential and which are radically different from the current processes.

The TARC recognizes that the question may be asked whether it is appropriate and feasible that a radically different HR dispensation should be operated in the tax administration *de hors* rest of the government. The TARC is making its recommendations after carefully deliberating over this question. The TARC believes that, with far-going reforms like the Direct Tax Code and the Goods and Services Tax on the anvil, the tax administrations are poised at an inflection point requiring strong leadership and bold action. The need for transforming the tax administrations is so stark that only radical measures can bring about the needed transformations. The measures that the TARC is recommending is based on the principles and practices which are already being operated in other tax administrations, both in developed and developing countries, for long. In India too, these practices exist, *albeit*, largely in the private sector high performing organisations. The TARC is recommending these measures for the two departments because that is what its remit is. However, the TARC fully believes that unless the HR policies in the government at large are also transformed along the lines of its recommendations, the administration in India will continue to remain a severe constraint against its growth and development. Somewhere a beginning must be made and it is the TARC's conviction that the transformed IRS can become a beacon for rest of the civil services.

- The TARC concluded that rapid rationalization of **key internal processes** is called for whether they be in the case of PAN – its generation and termination, or its wider rationalized use for more taxes – consolidated filing of returns for different taxes, harmonization of computerized processing at the CPC with that of the AO, making refunds of direct tax and indirect tax credit, risk-based selection scrutiny using ICT, or consistency checks across direct and indirect taxes in the case of search and seizure, and intelligence and criminal investigation.
- In the case of **ICT**, the TARC concluded that the Boards must commit themselves to full digitization and work towards building comprehensive systems, covering all key processes, in which everyone, from the top leaders to the frontline employees, works in a digital environment. In other words, ICT must get embedded in the DNA of the organization.

There is a clear need to articulate an ICT vision and strategy, derived from business strategy that reflects the departments' vision and mission, which will provide an overarching setting for the design of the ICT architecture. This will provide consistency and coherence across different ICT projects, systems and sub-systems and bring about much greater interoperability, ensuring better customer satisfaction.

There is an equally urgent need to embrace a sound ICT governance framework, along with rigorous adoption of programme and project management methodologies, so that there is deeper business-ICT implementation and effective ICT risk management.

HR policies need to be aligned with ICT requirements. This means they must promote specialization, allow the necessary length of tenures to allow development of the required skills and their application in the relevant areas, and allow personal growth for qualified officers according to their suitability and inclination and organizational needs. HR policies need to cater to the lateral entry of specialists where such skills are not available internally. Further, the policies need to specifically take into account the stages of the project lifecycle while considering transfers of staff who may be engaged with those projects.

In order to enhance business-ICT interaction, the Boards need to adopt structures and process to establish a working relationship between business owners and DG (Systems) officers that will align ICT implementation with business needs and priorities.

To promote better analytical support for policy development as well as operations, a specialist organization, the Knowledge Analysis and Intelligence Centre, needs to be set up for which the ICT function will provide the necessary platform and tools. KAIC will be the repository of highly specialized analytical and other related skills. Its remit will be to address highly complex problems with strategic implications. Good analysis will have to continue to happen within each functional vertical, which the ICT function needs to support through appropriate technological tools.

In short, to be able to shape themselves into a modern 21st century tax administration, the two Boards need to adopt the agenda of a complete digital transformation. The TARC believes that for fulfilling such an ambitious agenda successfully and sustainably, it is essential that a single SPV with operational freedom and flexibility to take quick decisions should be established for servicing the ICT needs of the two Boards. It should be set up as a company with professional management and a sound business model that would make it financially self-reliant.

The SPV can also be tasked to set up the ICT platform for the KAIC and also support it through ICT specialists, who can be seconded from the SPV to the KAIC.

Accordingly, the TARC's main report is organized sequentially, comprising Customer Focus, Organizational Structure, Dispute Resolution, People Function, Other Internal Processes, and Information and Communication Technology (ICT). The recommendations that follow in the next section are also similarly ordered.

#### **4. Recommendations**

In what follows, the TARC lists its main recommendations in the full belief that they can be instituted if the willpower exists at the top policy level. Such changes have occurred in other countries including the one that bequeathed India her prevailing bureaucratic structure that has seen its best days and has outlived itself. It is now time to confront what is bad and change it for the better to reflect the expectations of India's new and future generations that have the desire to work and be productive rather than facing and combating high costs of compliance. Only recommendations that are desirable and doable along these lines are listed below. Also, the recommendations should be considered as a package and not on a pick-and-choose mode.

That would not work; it would be better to set aside the recommendations *in toto* and reconsider them at a future date when India may be ultimately ready to make serious changes that are needed but is not up to facing them as of now.

Diagram 5 gives road-map for implementation of the TARC's main recommendations.

#### 4.a Customer focus

A taxpayer is the entity that approaches the tax administration and thus comprises the latter's customer. Yet the prevailing treatment of the taxpayer by the tax administration requires much to be improved in reflection of global practice. **Customer Focus** reform therefore is the first need. It comprises **Chapter II** and the first set of recommendations

The TARC recommends that:

- There should be a dedicated organisation for delivery of taxpayer services with customer focus for each of the Boards. There should be an exclusive Member in each Board for the taxpayer services. The taxpayer services vertical under each Board would be headed by an officer of the rank of Principal Chief Commissioner, who would be responsible for delivery of taxpayer services. This implies dedicated resources and personnel for this vertical. (Section II.6.c)
- Taxpayer service delivery will be located under one umbrella for large taxpayers, i.e., the CBDT and CBEC will jointly function for large taxpayers through Principal DG (LBS). For other taxpayers, i.e., medium and small, the operations of the CBDT and CBEC will continue in separate chains. (Section II.6.c)
- Officers and staff at all levels of tax administration should be trained for customer orientation. Further for people posted in this vertical, the training in customer focus need to be more specialized and intensive. This training should be appropriate to the areas in which such officers are deployed such as customer relationship, measurement of customer satisfaction, taxpayer education, etc. (Section II.6.a)
- In line with the international practice of spending 10-15 per cent of the administration's budget, a minimum of 10 per cent of the tax administration's budget must be spent on taxpayer services. At least 10 per cent of the budget for tax administration should be allocated and spent for ICT-based taxpayer services. (Section II.6.a)
- Sufficient funds must be allocated to conduct customer research including, in particular, on customer surveys. (Section II.6.b)
- In redressing taxpayer grievances, the decision of the Ombudsman should be binding on tax officers. To bring independence and effectiveness to the office of the Ombudsman, non-government professionals should also be inducted in the post. (Section II.6.b)

- Pre-filled tax returns should be provided to all individuals. The taxpayer will have the option to accept the tax return as it is or modify it. In either event, the filing process would be completed with the submission of the tax return electronically. (Section II.6.b)
- There is an urgent need to revisit the present citizen's charter to make it more meaningful and customer focused. The citizen's charter should be renamed the taxpayer's charter to focus on all categories of taxpayers. (Section II.6.c)
- There should be a regular stakeholder consultations on the issues of tax disagreements and tax law changes. The Commission recommends a permanent body for stakeholder engagement. The recent experience of the Forum through which many issues were resolved between stakeholders and the tax departments should become a continuing activity. (Section II.6.b)
- There should be a system for online tracking of *dak*/grievances/applications for refund etc. It should be made mandatory to receive all *dak* through a central system generating a unique id. The ASK software implemented by CBDT provides such a mechanism in a limited manner. This needs to be extended to all offices. The functionality to enable the taxpayer to track the status of his application/grievance online should be added to the ASK system. Similar system for online receipt of application should be enabled on the indirect tax side. (Section II.6.c)
- Continuous benchmarking of the tax administration, particularly in relation to delivery of taxpayer services, with that of other tax administrations should be done to highlight the area of focus. (Section II.6.c)

#### 4.b Structure and Governance

As the customer faces and enters the tax administration, how well s/he is treated and how smoothly his job is accomplished is dependent on the structure and governance of the tax administration. This therefore comprises the second area of reform. For example, TARC found the lack of synergy between the two tax departments even for LTUs despite their establishment in 2006 to be a telling reflection of the administration's lackadaisical approach to installed policy. Structural reform is therefore recommended using LTUs as the anchor for which common functions need to be immediately consolidated for the two tax departments. Many other structure and governance from deep within are also needed if operations are to be rationalized. **Structure and Governance** comprises **Chapter III** and the next set of recommendations.

The TARC recommends that:

- The two Boards must embark on selective convergences immediately to achieve better tax governance, and, in next five years, move towards a unified management structure with a common Board for both direct and indirect taxes, called the Central Board of Direct and Indirect Taxes. For a unified management structure, apart from the common Board, the functions that can easily support the framework would be in the areas of human resource

management and vigilance, finance, ICT, infrastructure and logistics, and compliance verification. (Section III.4.e)

- The convergence can begin for large business segment by setting up of a large business service (LBS) which will be integrated and operated jointly by both the Boards. This will be a taxpayer segmentation by the tax administration, and joining LBS will not at the option of the taxpayer. All the core tax functions will be managed jointly by officers of both the Boards. (Section III.4.b)
- The tax administration needs to have greater functional and financial autonomy and independence from governmental structures, given their special needs. (Section III.7)
- The post of revenue secretary should be abolished. The present functions of the Department of Revenue should be allocated to the two Boards. This would empower the tax departments to carry out their assigned responsibilities efficiently. (Section III.7)
- A Governing Council, headed by chairperson of the two Boards, by rotation, and with participation from outside the Government, should be set up at the apex level to oversee the functioning of the two Boards. (Section III.4.c)
- An Independent Evaluation Office (IEO) should be set up. Its main work would be to monitor the performance of the tax administration, promote accountability, evaluate the impact of tax policies and assess all factors that affect tax administration. IEO will report to the Governing Council so as to ensure its independence. (Section III.4.c)
- A Tax Council should be set up to develop a common tax policy, analysis and legislation for both direct and indirect taxes. The council will be headed by the Chief Economic Adviser of the Ministry of Finance. (Section III.4.d)
- Common Tax Policy and Analysis (TPA) unit comprising tax administrators, economists, and other specialists such as statisticians, tax law experts, operation research specialists and social researchers should be set up for both Boards. The existing TPL in CBDT and TRU in CBEC should be subsumed in the common TPA. TPA will report to the Tax Council through the concerned member of each Board. TPA will be responsible for all three major components of tax policy formulation – policy development, technical analysis, and statutory drafting. (Section III.4.d)
- Each rule, regulation and other tax policy measure such as exemptions should be reviewed periodically to see whether they remain relevant to the contemporary socio-economic conditions and meet the changing requirements. For this, a robust process should be institutionalized. As a first step, a thorough review of the existing rules, regulations and notifications should be undertaken. Going forward, it should be a standard practice to build sunset clause in each rule, regulation and notification. (Section III.4.d)
- The present Boards are not aligned to various needs nor are they geared to respond to emerging and future challenges in an effective and efficacious manner. Keeping that in

mind, the two Boards should be expanded to have ten Members, apart from the Chairperson. (Sections III.5)

- The two Boards would be responsible only for policy dimensions of tax administration, while the directorates under them would be responsible for operations in the field formations. These directorates would have a vertical and horizontal alignment with functions, and would interact with each other in a matrix-like structure of responsibilities and accountability. (Section III.5)
- The field formations are currently organized to handle all key functions in a particular geographic region. In order to bring about a functional orientation, field offices will need to be restructured along the core functions of taxpayer services, compliance, audit, dispute management, enforcement and recovery, etc. (Section III.5)
- A functional orientation would promote specialization in the respective area of tax administration. For these reasons, specialization should be encouraged by selecting suitable officers and providing them sufficient tenures to develop specialized knowledge in key sectors. (Section III.5.d)
- A common approach for developing robust and comprehensive enterprise risk management framework should be adopted by the two Boards. This should be approved by the Governing Council to bring coherence. (Section III.5.a.i)
- There should be one Knowledge, Analysis and Intelligence (KAI) centre for both the Boards and its role should be recognized and used for policy and operational effectiveness. (Section III.6)

#### 4.c People Function

Another area that does not compare internationally is that of HRD or the People function. Staff are not empowered to take independent or correct decisions for fear of retribution and vigilance, the exclusive objective being to “protect the revenue”. They are made to collect revenue irrespective of the condition of the macro-economy that should indicate how much tax may be correctly collected. They therefore tend to make decisions well knowing that a tax demand or dispute will not pass the test of judicial processes. At the same time they are subjected to promotion, training, transfer, and leave policy that are fundamentally non-reflective of global practice. At the same time, senior management is subservient to the top Revenue official who, over the years, is imported from another Union Service that has no direct link to revenue or taxation. The overall outcome is a subdued tax administration that is far from dynamic. Indeed, over recent years it has acquired the notoriety of corruption. Empowering the staff, or **People Function**, comprises **Chapter IV** and TARC makes several significant recommendations towards empowerment.

The TARC recommends that:

- Both the departments should shift all their key operations to the digital platform so that performance can be reliably measured. (Section IV.3.d)
- A system of limited departmental competitive examinations should be introduced by earmarking 33 per cent of the vacancies in the promotions quota in Group B as well as Group A, so that relatively more meritorious and younger officers in the feeder grades can get a fast track in promotions. (Section IV.3.c)
- Recruitment needs to be made on the basis of carefully drawn recruitment plans that balance the short and long term needs and career aspirations of officers. (Section IV.3.c)
- Provision should be made for lateral entry of experts in key roles and specialized areas. While they may be on contract for 5 years, subject to their suitability and willingness they should be able to integrate with the organisation at the end of the contract period. (Section IV.3.c)
- The CBEC needs to develop a human resource management system, as has been done by the CBDT; collaboration and knowledge exchange between the two DGs (HRD) will enable CBEC to get such a system going in shorter time. (Section IV.3.b)
- A comprehensive performance management system needs to be set up for both tax administrations by revisiting and reconstructing the RFD. (Section IV.3.d)
- Key performance indicators, detailing the performance areas, objectives, key initiatives, performance indicators and performance targets, should be arrived at using the Balanced Scorecard methodology. (Section IV.3.d)
- The performance appraisal process needs to be made more wholesome and reliable by making it more open and by introducing a mid-year review. (Section IV.3.d)
- The tax administrations should extend the performance appraisal system to elements of 360° appraisal to include feedback from subordinates. (Section IV.3.d)
- The outcome of discussions during the performance appraisal process should result in the superior taking responsibility for juniors by putting in place an improvement plan to overcome their weaknesses. (Section IV.3.d)
- Performance needs to be recognized through non-pecuniary measures such as giving important assignments in chosen areas of work or specialization. (Section IV.3.d)
- To facilitate renewal of talent and professional growth, officers should be allowed to move outside the departments for defined periods of time. (Section IV.3.d)
- The career of IRS officers should be divided into three phases:
  - The first 9-10 years should be spent rotating through different functional areas to gain familiarity
  - The next 8-9 years should be in two or more specialist areas

- Persons showing the ability for top leadership will go into the third phase and constitute the pool from which selection will be made for top positions (Section IV.3.d)
- A common assessment centre for the two Boards needs to be set up by the people function to make a thorough, all round assessment of officers at the first transition point. (Section IV.3.d)
- In view of a different promotion system being recommended, the UPSC should be consulted for exempting these promotions in the IRS from their purview like some other services, e.g., the Indian Foreign Service, Indian Railway Services and Indian Audit and Accounts Services are exempted. However, if the UPSC is willing to be associated with the altered promotion scheme, that option should be considered. (Section IV.3.d)
- A formal mentorship programme may be set up, with carefully selected mentors. (Section IV.3.d)
- The transfer and posting policy should be recast to promote specialization and accommodation of individuals' choices in professional growth and should bring about predictability, stability and certainty to placements. Personal difficulties of officers should receive due consideration. (Section IV.3.e)
- DGs (HRD) should assist the Boards in transfers and postings and they should be member secretaries of the placement committees. The administration section should have no role to play. (Section IV.3.e)
- Learning and development should occupy a central place in people advancement and all officers must undergo a minimum 10 days of training every year. (Section IV.3.f)
- NADT and NACEN infrastructure should be substantially upgraded and the academies need to keep themselves updated in terms of the contemporariness of course content, pedagogy and use of ICT in training and they should be treated on par with LBSNAA. Their budgets should match the stipulation of the National Training Policy, i.e., 2.5 per cent of the salary budget of the departments should be earmarked for training and should be treated as plan expenditure. (Section IV.3.f)
- More emphasis in training needs to be given on customer focus and value education. (Section IV.3.f)
- A code of ethics needs to be developed, congruent with the values in the vision and mission statement. (Section IV.4.a)
- There should be more proactive approach to preventive vigilance. (Section IV.4.b)
- The provisions of Rule 56(j) of the Fundamental Rules should be effectively utilized for weeding out officers who are inefficient or of doubtful integrity. The criterion for review should be changed to completion of 20 years of service. (Section IV.3.d)
- CVC should have a Member who has been an officer of either of the IRSs and there should be at least one Joint Secretary/Additional Secretary level officer posted in the secretariat of CVC. (Section IV.4)

- No cognizance should be taken of anonymous complaint as laid down in the existing DoPT instruction. (Section IV.4.d)

#### 4.d Dispute Management

The lack of accountability in the system is represented by infructuous demands raised by the tax administration with impunity as well as massive escalation, non-resolution and non-recovery of such demands by global standards. Getting a handle on dispute management is crucial for retrieving stakeholder confidence and for saving much needed staff and financial resources of the tax administration. **Dispute Management** comprises **Chapter V** and includes a set of recommendations.

The TARC recommends that:

- For clarity in law and procedures, a process based on best practices outlined in Section V.4.b should be followed. (Section V.4.b)
- Retrospective amendment should be avoided as a principle. (Section V.3.e)
- Fundamental approach should be collaborative and solution oriented. (Section V.3.d)
- Both the Boards must immediately launch a special drive for review and liquidation of cases currently clogging the system by setting up dedicated task forces for that purpose. The review and liquidation should be completed within one year and the objective should be to decide all cases pending in departmental channels for longer than a year as on the start date of the action plan. (Section V.6)
- Dispute management should be a functionally independent structure with adequate infrastructural support. (Section V.4.a)
- Officers posted in the dispute vertical must receive adequate induction training and on-the-job training on areas. (Section V.4.a)
- To minimize the potential for disputes, clear and lucid interpretative statements on contentious issues should be issued regularly. These would be binding on the tax department. (Section V.4.b)
- The current practice of raising demands irrespective of merits should be discontinued. Call book in CBEC should be abolished. (Section V.4.b)
- The process of pre-dispute consultation before issuing a tax demand notice should be put into practice.(Section V.4.b)
- Disputes must get resolved in time as the times lines as mentioned for decisions in the respective enactments. The law should also prescribe the consequences of not adhering to the time lines, which would be that the case in question would lapse in favour of the taxpayer. (Section V.5)
- Ordinarily appeal should not be filed against appeals of Commissioner (Appeals), except where the orders are ex-facie perverse. (Section V.5)

- The present structure of Commissioner (Appeals) should be changed to two forums, namely, single Commissioner (Appeals) and 3-member Commissioner (Appeals) panel. If the case is not decided within the prescribed time frame, the taxpayer's appeal would be deemed to have been allowed. (Section V.5)
- The DRP in income tax should be made full-time panels. Their mandate should be expanded to include corporate cases of resident cases as well. Same mechanism should be introduced in indirect taxes also, where collegium of three Commissioners would be deciding complex cases involving extended period of limitation, related party transactions and taxability of services. (Section V.4.e)
- ADR processes, Arbitration and Conciliation, should be statutorily introduced in both direct and indirect taxes legislations. (Section V.4.f)
- The jurisdiction of AAR should be made available for domestic cases also. More benches of AAR should be established at Mumbai, Bangalore, Chennai and Kolkata, with the principal bench at Delhi. (Section V.4.c)
- The Settlement Commission should act as part of taxpayer services, and be made available to the taxpayer to settle disputes at any stage. There should also be an increase in the number of benches of the Settlement Commission. It should be manned by serving officers to enhance its accountability. (Section V.5)
- Appeals to high courts and the Supreme Court should only be on a substantial question of law. (Section V.5)
- Authorized representatives from the departments should be carefully selected and given sufficient incentives and necessary infrastructural support to perform their duties effectively. They should also be given specialized training before they are asked to appear for the department. The administration of the DR function should also be in the dispute management vertical. (Section V.5)
- On disposal of a case by Supreme Court/High Court and if the judgment is accepted by the Department, an instruction should be issued to all authorities to withdraw appeal in any pending case involving the same issue. (Section V.6)

#### 4.e **Key Internal Processes**

There are several internal processes in the tax administration with respect to management of PAN, consolidated filing of returns of different taxes, assessment, timely refunds, risk-based scrutiny and others that cannot be ignored. Such **Key Internal Processes** comprise **Chapter VI** and associated recommendations are made.

The TARC recommends that:

- **Registration**
  - The present permanent account number (PAN) should be developed as a common business identification number (CBIN), to be used by other government departments

also such as customs, central excise, service tax, DGFT and EPFO. A better regulatory system should be put in place to enhance its robustness and reliability.

- Both central excise and service tax should be covered under a single registration as both the taxes are administered by the same department and cross utilisation of credit is permitted between central excise and service tax under the CENVAT credit rules.
- It is necessary to provide for de-registration, cancellation or surrender of registration numbers and PAN.

- **Tax payments**

- Banks should be left to authorize their branches to collect taxes, and the present process of selection of banks needs to be purely standards-based and transparent.
- Payment gateways should be increased for better customer convenience.

- **Filing of tax returns**

- I-T returns should also include wealth tax return so that the taxpayer need not separately file wealth tax returns. These returns should also be processed together in the CPC at Bengaluru.
- The disclosures in the return should include a brief mention of the issues on which there has been an on-going litigation between the tax administration and the taxpayer, and should indicate the factual and legal position adopted while computing taxable income for a year. This is to protect taxpayers from allegation of non-disclosure, suppression, escapement of income, etc., which often results in the initiation of penal provisions.
- Taxpayers should give information on their compliance experience at the time of filing returns; this information should be used to improve taxpayer service bringing in customer focus.
- Territorial jurisdiction should be dispensed with and industry-based assessment should be introduced in line with recommendations in Chapter III of this report.
- The CBEC should set up centralized processing units in line with the CPC, Bengaluru, and CPC-TDS at Ghaziabad for processing central excise and service tax returns.
- There should be a common return for excise and service tax.
- The CBEC should set up an e-portal and all invoices should be issued from that portal. This portal should be linked and made compatible with SAP ERP systems, which a majority of the companies use for their own invoicing. E-invoice would simplify credit/refund procedures, which would become automatic.

- **Scrutiny in direct taxes and audit in indirect taxes**

- Hearing in all tax cases by personal presence should be avoided, and data can be sought through an e-system. The taxpayer can upload the data on the e-system. Personal hearing should be sought only in complex cases.
- There should be specialization in scrutiny/audit work as recommended in Chapters III and IV of the report. Capability should be developed through training and re-training. The two Boards should also develop a standard audit protocol, with clear emphasis that the AOs must follow the principles of natural justice and respect the taxpayer rights to privacy and dignity.
- Audit Commissionerates in the CBEC should undertake integrated audit covering central excise and service tax together and the onsite customs post clearance audit (OSPCA) in case of accredited clients (ACP), as the records and books to be verified are common to all the taxes administered by the CBEC. In major cities where exclusive Central Excise or Service Tax Commissionerates are functional, the audit function should be assigned to a specific Audit Commissionerate for carrying out integrated audit of customs, central excise and service tax.
- Joint audits should be undertaken by field formations of the CBDT and the CBEC to shorten the examination processes and reduce costs, both the for tax administration and for taxpayers. This may require a change in procedures for the CBDT as at present, the I-T Act does not have a provision for open audit as is done in indirect taxes.
- Broad-based selection filters for the risk assessment matrix should be put in place. There is also a need to set up a standard operating procedure which recognizes the iterative method, testing them ex-post, to develop effective and efficacious parameters for the risk assessment matrix.

- **Tax deducted at source**

- The insistence on manual filing of TDS certificates before AO for verification of refunds claim should be done away with.
- The tax deductor's duties and obligations in terms of making information compliance and also depositing the deducted amount is onerous and they are not compensated for that. Therefore, some compensation for them should be considered. This can be in terms of a small commission to be deducted as business expenses by them to fulfil their obligations.
- The CPC-TDS should allow correction in the name of the deductees to avoid multiple submissions of TDS forms. Even a single error requires the deductor to submit the entire return afresh. The process of uploading the entire file for one or two corrections is cumbersome and disproportionate to the gravity of the error. This adversely impacts

taxpayer services. Subject to the required checks and validations, there is a need to widen the scope of online error rectification service.

- A passbook scheme for TDS may be adopted with some safeguards. Once TDS is deducted from a payment, TDS should get credited to the taxpayer's account. This should be like an account with running balance, to be utilized by the taxpayer at his option to set off his tax liabilities.
- To assist small and marginal tax deductors in preparing and filing their TDS returns, either existing tax return preparers or a separate system of TDS return preparers should be initiated with more training and a better remuneration structure than at present.

- **Refunds**

- Refunds should be issued within a strict time frame. There should be a separate budgetary head for refund of direct tax and indirect taxes in the annual budget out of which refunds should be issued so that there is transparency. Adequate allocation should be made by the government under this head.
- Refunds sanctioned should be paid along with the applicable interest automatically as is done in the case of income tax and not on demand by the taxpayers. As in the case of direct taxes and customs duty drawback, the refund and interest payment should be directly credited to the bank account of the taxpayer.
- The rate of interest on refunds should be the same as the interest charged by the tax department. This would ensure equity between the two interests and would not disadvantage the taxpayer unduly.
- Refunds arising after a favourable appeal should be paid in time or the tax payer should be allowed to set-off the advance tax liability or self-assessment tax liability of subsequent years against the refunds due.
- The test to determine whether there is unjust enrichment in indirect taxes should be limited to cases of refunds where there is direct passing on of amounts claimed as refunds. In any other situation, this concept should not be applied.
- Refund claim subjected to pre-audit verification should be issued within a specified time. The post-audit verification of refund claim should be risk-based.
- An easier and simplified scheme should be introduced for service exporters. The entire refund filing and processing mechanism should be online.

- **Foreign tax credit**

- The CBDT should come out with clear FTC guidelines, which should also cover the timing differences between different tax jurisdictions.

- **Tax collections**

- There should be a separate vertical for tax collection as recommended in Chapter III of this report. To improve the efficiency of debt collection activities, both the Boards should work on setting up risk assessment models to compute risk scores for each new tax debt case that reflects the likelihood of the taxpayer paying their debt based on objective criteria.
- Stay of demand information should be uploaded electronically on the central server of the departments so that tax collectors can have system generated prior intimations regarding the expiry of stay orders.
- The power to write off dues should be raised at different levels of the organization and made uniform for both direct and indirect taxes. Full powers should be vested in the respective Principal DGs in charge of recovery in the respective Boards. Write off should be done in concurrence with the CFO at the headquarters level and his nominee at the regional/zonal level.

- **Related party transactions**

- Both Boards should frame detailed documentation requirements for transfer pricing as well as custom valuation, keeping in view that such documentation should be reasonable, to bring certainty and predictability for the taxpayers.
- There is a need to align the process in India with global best practices and to do away with the current process. With self-assessment in place, import transactions should only be subjected to post-clearance audit. Valuation risks would be an important component of the risk matrix for audit selection.

- **Trade and business facilitation**

- As a trade facilitation measure, on-site post clearance audit should be developed fully to enable Indian customs to move closer to international best practices. Intervention in the cargo clearance should be made on the basis of a risk matrix.
- Documentation requirements for non-resident taxpayers for a certificate under Section 197 of the I-T Act should be well-publicized. The taxpayer should be told a priori the time that will be taken for the issue of the certificate. That time period should be reasonable. A certificate issued in an earlier year from any other tax office in India to an assessee/payer should be attached with other documentation. There should also be a facility for electronic filing of these papers so that the need for the physical presence of the taxpayer is, to the extent possible, obviated.
- The system of E-invoicing similar to that prevalent in most Latin American countries should be introduced. Using this system a taxpayer should generate an electronic

invoice through the Department's system. Sufficient preparation and consultation with the industry and trade associations should be done before introducing this system.

- **Enforcement Administration**

- There should be a dedicated structure for prosecution matters for more focused attention to this important area so that the unexploited potential for creating deterrence against tax evasion is realized.
- The working of the Directorate of Intelligence and Criminal Investigation should be ICT based and should be given a good complement of personnel and other resources to make it realize the potential.

- **Non-profit sector**

- CBDT needs to put in the public domain a national database of the non-profit sector to bring transparency.

- **Manual of tax departments**

- Departmental manuals should be annually updated and put up on the website for easy downloading by both taxpayers and tax officers.

#### 4.f **Information and Communication Technology**

ICT constitutes the backbone of a modern tax administration. India has made progress in this area. Nevertheless there are caveats that have to be recognized and corrected so that the system could meaningfully move forward to enable quicker processes, automatic correction of errors and inconsistencies, upgrading of software and hardware, convergence of ICT functions of the two tax departments. **Information and Communication Technology** and recommendations thereof comprise **Chapter VII**.

The TARC recommends that:

- For full realization of the potential of ICT, it must get embedded in the DNA of the organization. Both the design of policies and implementation should make full use of ICT (Section VII.3.a)
- The leadership must ensure that where systems are available, employees should not have the option to work in a paper environment (Section VII.3.a)
- Both Boards must commit themselves to achieve a fully digitized environment and work towards comprehensive ICT system(s) in which everyone from the top leader to the last person on the frontline works in a digital environment (Section VII.3.a)
- The Boards must regularly use maturity frameworks to assess their ICT maturity and map out the path towards greater maturity (Section VII.3.a)

- Automation should follow business process re-engineering to avoid the danger of getting trapped in an outdated mode of governance (Section VII.3.a)
- All decisions should be taken with ICT compatibility in mind. Similarly, all legislation should be ICT-compatible (Section VII.3.b)
- The Boards must create structures and processes to enhance working relationships between business owners and DG (Systems) to ensure that ICT initiatives are aligned with business needs, priorities and capabilities (Section VII.3.b and d)
- Boards should adopt a robust ICT governance framework and practices, and rigorous programme and project management frameworks (Section VII.3.b)
- Project planning and approvals must include the required number and quality of human resources (Section VII.1.b)
- Movement of personnel should have a linkage with project implementation and there should be a process of knowledge transfer (Section VII.1.b)
- A service oriented architecture and approach should be adopted to promote integrated systems, greater “value for money” and customer focus (Section VII.3.b)
- HR policies must be aligned with the need for specialization and officers should be allowed to grow in the areas in which they specialize. Routine transfers should be avoided (Section VII.3.d)
- Special training for officers in key areas of ICT should be arranged for officers of DG (Systems) (Section VII.3.e)
- DG (Systems) should ensure proper training for operational staff at the roll out of any new application (Section VII.3.e)
- DG (Systems) should have authority and funding to depute officers for specialized courses, seminars and events and engage with professional networks and academic institutions (Section VII.3.e)
- The discussions for data sharing between CBDT and CBEC should be speeded up and sharing must begin quickly (Section VII.4)
- A shared knowledge, analysis and intelligence centre, headed by an expert professional, should be set up for advanced data analytics and research. The SPV can support it by providing the platform, tools and technologies, and expertise (Section VII.4)
- A common special purpose vehicle (SPV) should be set up for servicing the ICT needs of the Boards (Section VII.5.a)

- It should be incorporated as a company with limited liability under the Companies Act and should have a private ownership of 51 per cent and government ownership of at least 26 per cent. It should have operational independence and institutional flexibility even as government retains strategic control (Section VII.5.c)
- The SPV should preferably have a net worth of around Rs.300 crore. This will ensure that the SPV is well-capitalized, can hire the best people at competitive salaries, and invest adequately in infrastructure to manage large-scale national projects.
- The relationship between the departments and the SPV should be a complementary one. The tax administration would develop an overall strategy with the ICT inputs provided by the DG (Systems). The SPV will develop the ICT strategy within the framework of the overall strategy, which will be approved by the Boards. The DG (Systems) of the two Boards will continue to exist, and will perform more strategic roles and be the Boards' interface with the SPV (Section VII.5.e)
- It should aim to be financially self-sustaining through an appropriate business model (Section VII.5.f)
- It should be operationally aligned and maintain relationships with the concerned entities in DG (Systems) to ensure effective ICT service delivery (Section VII.5.h)
- The Boards, DG (Systems) and the SPV together should work out the plan for the transformation to “digital by default” status. The plan should begin with a visioning exercise to define the end state and should be programme, as opposed to project, oriented.

**Diagram 5: Road-map for implementation of the TARC’s main recommendations**

