

Small Business Tax Reform in Bihar: Why and How

ITD Conference
New Delhi

The context: Tax simplification reform program in Bihar

- The key objectives of this reform are:
 - Simplification of the tax policy and processes to render it more accessible to entrepreneurs, easier to administer for tax authority
 - Reduction of compliance costs (time and financial) to taxpayers
 - Widening the tax net, spreading the tax burden
- In the long term, the program envisages attaining the following goals:
 - Facilitation of formalization and job creation
 - Reducing avenues for corruption
 - Installation of a tax system which fosters good governance

Methodology – diagnostics and research

Focus Group discussions

- ▶ In-depth discussions with VAT registered businesses, consultants

Survey of consultants

- ▶ Face to face interviews, using a structured questionnaire
- ▶ 280 consultants interviewed

Survey of VAT registered businesses

- ▶ Face to face interviews, using a structured questionnaire
- ▶ Over 1000 registered businesses interviewed

Analysis and Report

Process Mapping

- ▶ Mapping internal processes in Bihar and redesigning them to improve efficiency

Discussions with Tax Authorities

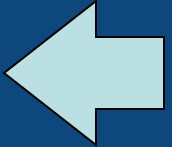
- ▶ Discussion of the tax administration regime in Delhi, Gujarat and UP

Review of VAT laws in other states

- ▶ Study of features and procedures of 10 Indian States

Agenda

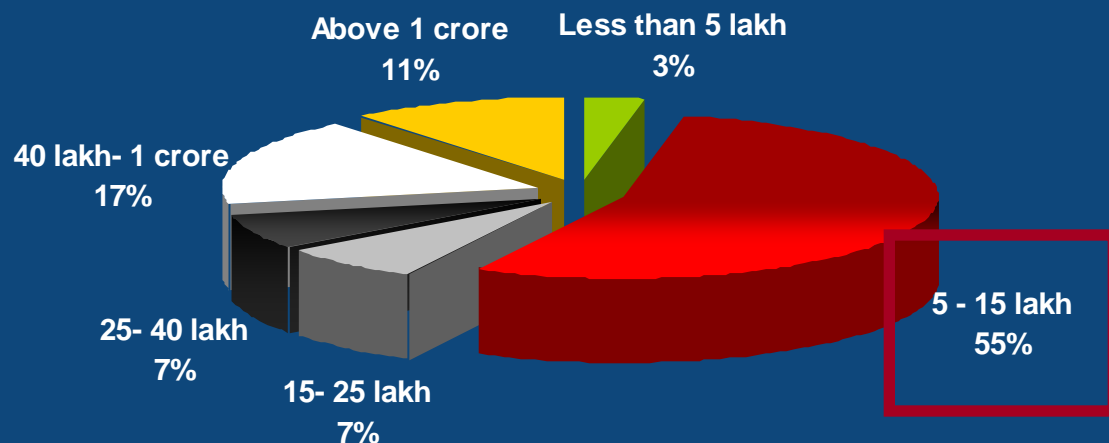
- A. Key features of Bihar's business and tax environment
- B. Simplified regime for small taxpayers
- C. E-governance for medium and large taxpayers



Key features of Bihar's Business and Tax Environment

Majority of businesses in Bihar are small sized trading concerns

Size of businesses basis turnover; Base - 1003



72% of the taxpayers have a turnover less than Rs 40 Lakh

Size of the business	Overall	Manufacturing	Services/ Traders
Base	1003	108	895
	%	%	%
Small sized (5- 20 lakh)	61	42	64
Medium sized (20lakh - 1 crore)	27	38	23
Large sized (Above 1 crore)	11	20	11
Not specified	1	-	2

For the purpose of the report and analysis, small sized businesses are categorized as those with turnover upto Rs. 20 lakh, medium sized as those with turnover from 20 lakh to 1 crore, and large sized as turnover above Rs. 1 crore

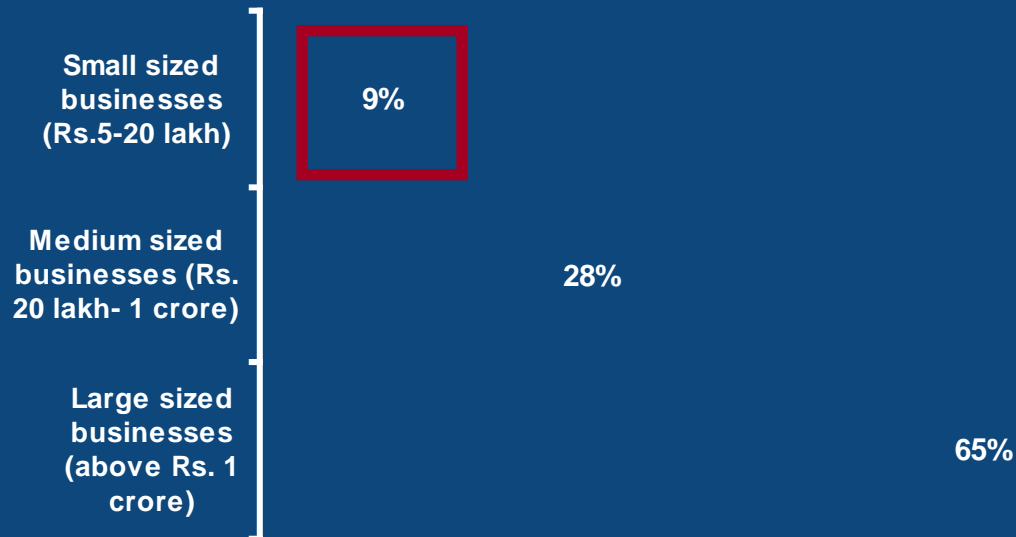
Computer usage is very low in small businesses

Ownership of computers/ laptops; Base - 1003

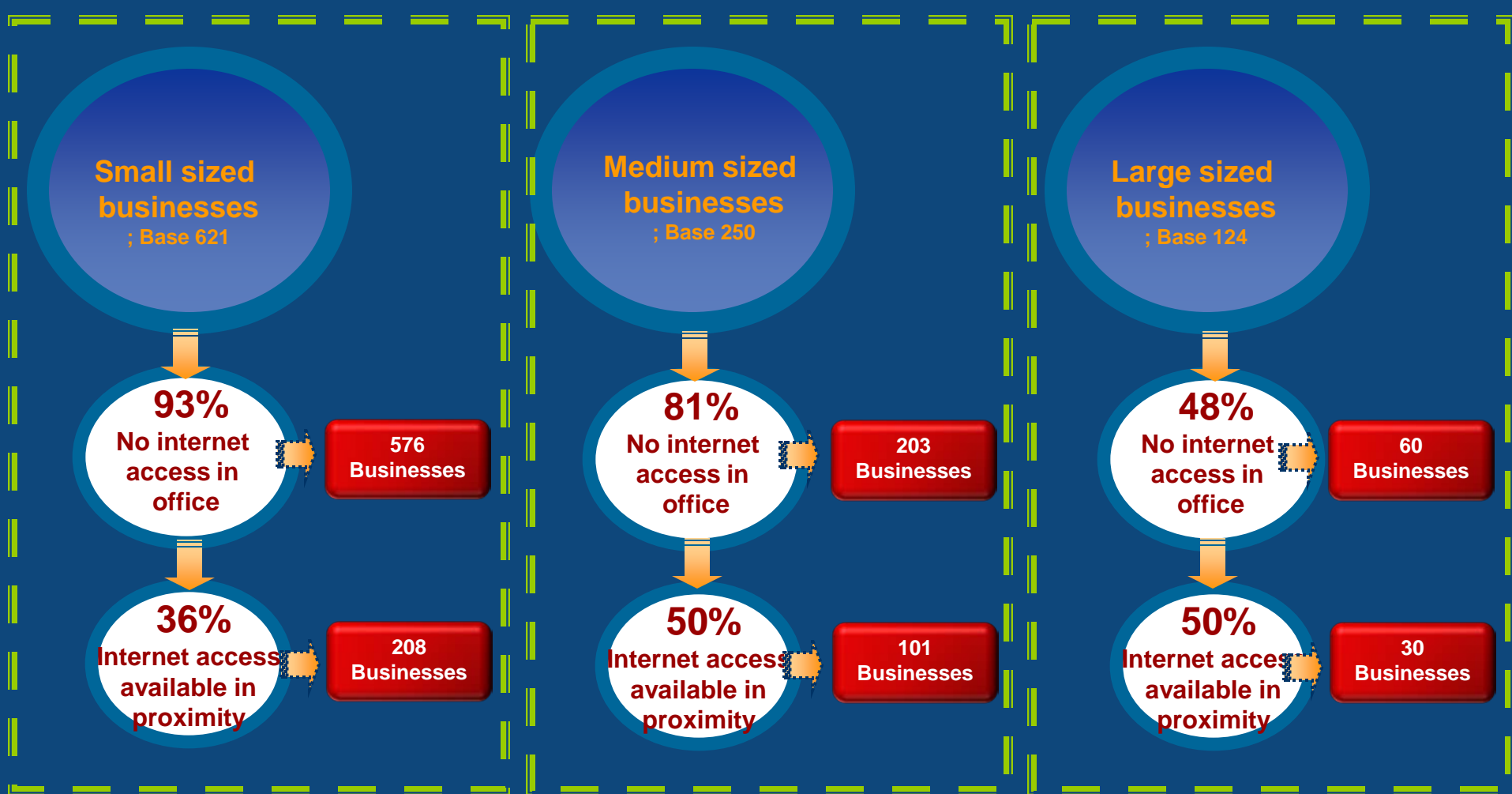
No
79%

Yes
21%

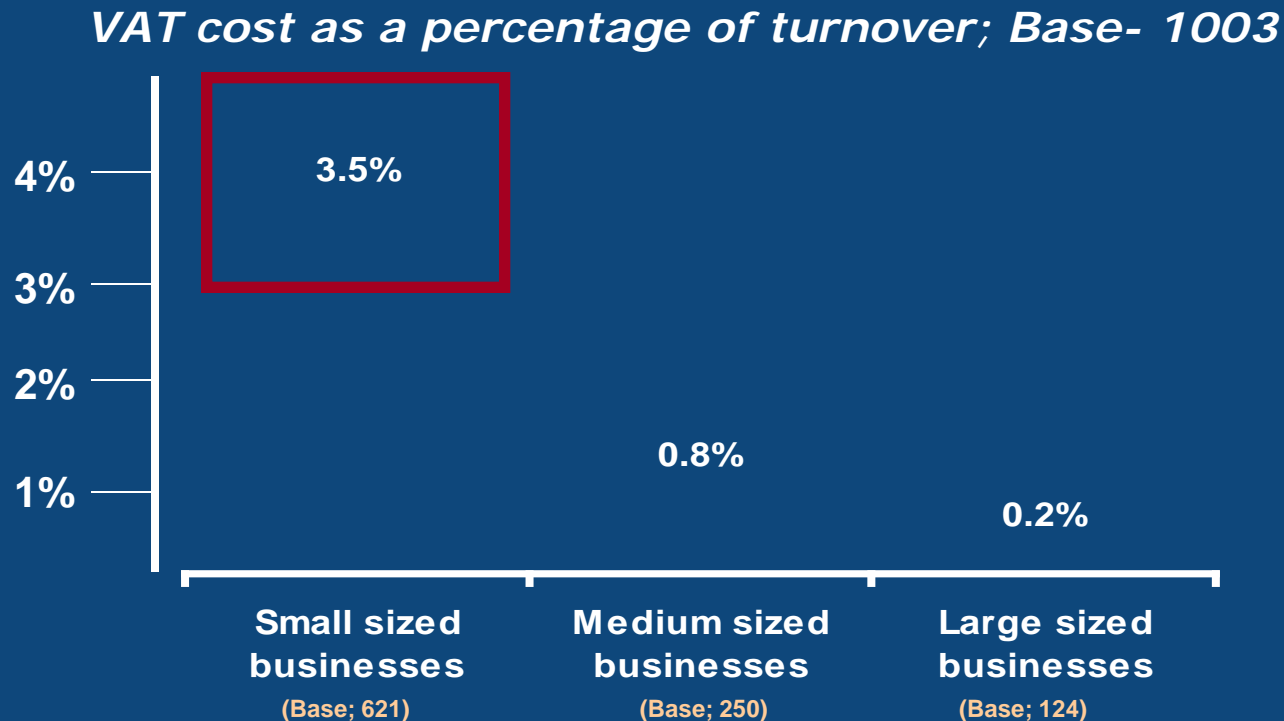
Ownership of computers/ laptops across various sizes of businesses ; Base - 1003



Access to internet is almost non-existent for the majority



Compliance cost burden is much higher for MSMEs



Cost of compliance, as a percentage of turnover significantly higher for small businesses

The small taxpayers contribute *less than 1%*

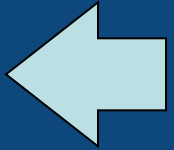
- **81%** of the dealers have turnover below Rs. 50 lakh, and contribute just **0.87 per cent** of VAT collected (2007-08 data)

Turnover	No. of dealers	% of total dealers	Tax deposited (Rs.crore)	% of total tax
below 50 lakh	35058	81	30	0.87
50 lakh- 1 crore	2932	7	21	0.61
1-2 crore	2161	5	34	1.00
2-5 crore	1412	3	60	1.78
5-10 crore	555	1	59	1.73
above 10 crore	1009	2	3191	94.01
Total	43127	100	3394	100

Note that VAT payment of Rs. 62,500 implies a turnover of Rs. 50 lakh (applicable rate 12.5%, gross margin 10%)

Agenda

- A. Key features of Bihar's business and tax environment
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- C. E-governance for medium and large taxpayers



Key recommendation: two regimes

- Vast difference in the capacity to comply with VAT between small and medium/ large taxpayers
- Disproportionately high compliance cost for small taxpayers (as a percentage of their turnover)
- E-governance initiatives impossible for small taxpayers

Two Regimes

Turnover *less than* Rs. 40 lakhs

- Simplified regime for small taxpayers

Turnover *greater than* Rs. 40 lakhs

- E-governance based VAT regime for medium/ large taxpayers

A Simplified Regime for Small Taxpayers

Goals of small business tax reform

- Drastic reduction in compliance burdens for taxpayers
- Efficient use of tax administration resources
 - Shift focus from squeezing the wrong end
- Reducing opportunities for rent seeking and harassment
- Avoid loopholes and ensure fairness
- Lower barriers to formalization, encourage small businesses to sprout, informal businesses to join the economic mainstream

**Trade offs
between
these goals
require
carefully
weighing
policy
objectives**

Simplified regime for small taxpayers

■ Recommended lump-sum, flat tax payment:

- Single slab of small taxpayers, defined as those with turnovers below Rs. 40 lakh
- Lump sum tax payment – Rs. 10,000 per annum
- Payment in one or two instalments at the option of the taxpayer
- No input tax credit allowed
- Optional scheme

■ Justification for the quantum of lump sum payment

- Current tax range
 - Turnover Rs. 10-40 lakh : VAT Rs. 3,200-40,000*
- Cost of compliance for small taxpayers is approximately Rs. 22,400 as per survey

*Assumptions: Margin 8%; tax rate from 4% - 12.5%

Key features of simplified regime

- Lump-sum tax payment – to be made in 1 or 2 instalments
- Simple format (saral) for filing return
- Basic book-keeping requirements under VAT law
- No scrutiny or audit
- Inspections only based on specific information on tax evasion
- Optional
- No input tax credit available

Benefits of simplified regime

Taxpayer

- Low cost of compliance
 - No requirement for complicated documentation or book keeping
 - No need for expensive outsourcing
 - Annual one-time filing
 - Flexible payment options
- Elimination of frequent interaction with tax department
- Relief from cumbersome scrutiny, audit and inspections
- Less opportunities for rent seeking behavior

Benefits of simplified regime (contd.)

Commercial Tax Department

- No loss in revenue expected
- Lower administrative cost
- Freeing up of resources, allowing more efficient utilization of human resources
- Widen tax net, unregistered businesses to register
- Doing away with unproductive scrutiny of small taxpayers- over 75% of total taxpayers that contribute only 0.8% of tax revenue
- Small taxpayers continue to be registered with Commercial Tax Department

Innovations - more services for small taxpayers

- Need to incentivize unregistered small businesses to register
- Set up “one stop” service centers (Laghu Kadata Seva Kendras) for small businesses run by the commercial tax department, where taxpayers can register for VAT and then become eligible for more services
- All those registering for VAT small business scheme to be provided information and help with
 - Access to bank and other means of finance
 - Information on VAT and simplified scheme and simplified registration
 - Other services

Thank You

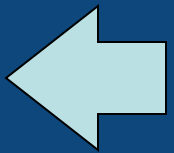


Relevant Notifications that amend the Bihar Value Added Tax Rules, 2005

- S.O. 159, dated 12th August 2010, issued by the Commercial Tax Department, Patna
- S.O. 161, dated 12th August 2010, issued by the Commercial Tax Department, Patna
- S.O. 163, dated 12th August 2010, issued by the Commercial Tax Department, Patna

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E-governance for Medium and Large Taxpayers

E-governance for medium/ large taxpayers

- Define medium/ large as taxpayers having turnover of **Rs. 40 lakh** and above:
 - Requirement to get accounts audited under Bihar VAT and Income Tax Act
 - Now under Income Tax limit raised to Rs. 60 lakh
 - Mandatory e-filing under Income Tax Act since 2007
 - Better access to IT infrastructure – in house or outsourced
- Capacity to comply with e-governance requirements

Key features: e-governance regime

- Intensive use of IT applications for taxpayers
 - E-payment
 - Mandatory e-filing of returns (with details of purchases and sales)
 - Online application and issuance of declaration forms
 - Online application and issuance of way-bills
- IT enabled processes for tax administration
 - Online scrutiny and invoice matching
 - Desk audit for verifying input tax credit
 - IT based risk management

Benefits of e-governance regime

■ Taxpayers

- Time and location independence
- Quick access to information pertaining to VAT payments, returns, declaration forms, refunds etc.
- Speed up, simplify, and reduce interaction
- 24 x 7 access
- Data accuracy
- Lower compliance cost

Benefits of e-governance regime (contd.)

■ Commercial Tax Department

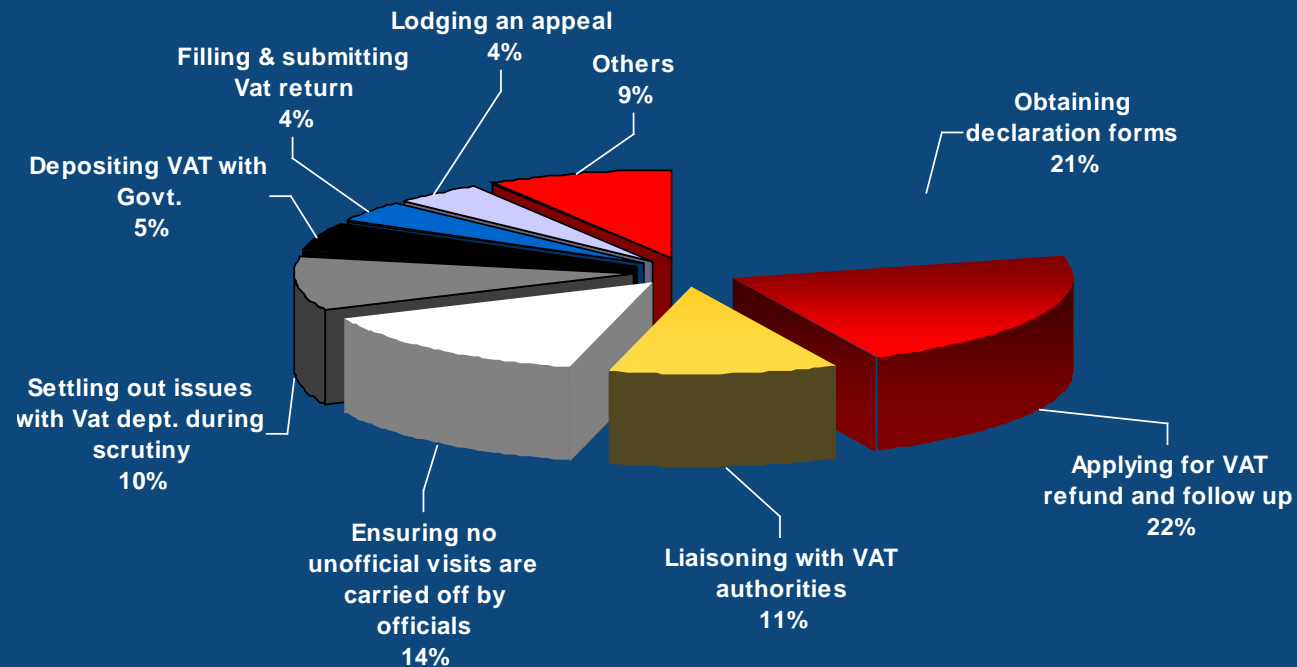
- Effective and easy way of maintaining information and documents
- Right information on real time basis
- Improved accuracy of the information
- Integrated view of dealer's profile
- Summarized and drill down reporting
- Performance evaluation
- Effective correspondence management
- Workflow and case management
- Reduction in administrative cost
- Increased transparency
- Helpful to comply with RTI Act

Background slides

Specific Process Simplification Recommendations

Problematic activities *

Base -281



(The data from question on the most problematic activities (in a ranked manner) was used to analyze this

Registration

No	Suggestion	Best Practice
1	Simplification of the application for filing registration (reduce documentation requirements)	Delhi, Punjab and Maharashtra provide for limited number and specified documents at the time of filing of registration
2	Use online application system	Issue of on-line PAN number by Income Tax Department
3	Common application form for VAT, CST and Entry Tax registrations	Karnataka has same form for different registration
4	Payment of registration fee should be eliminated or fee should be accepted through cash (instead of stamp paper)	No fee for registration under Service Tax, Central Excise laws. Cash payment for registration fee accepted in Delhi. No requirement of stamp paper in many States

Registration (documentation)

Current	Proposed
Documentation and proof of <i>all immoveable property</i> owned by <i>all persons</i> having interest in the business (point no. 9 of form A-I)	To be deleted
Details of any other C&F agency, purchasing/selling agency held by dealer or the business in which dealer has interest (point no. 6 and 7 of form A-I)	Only the details of other business required, no supporting documents to be submitted. Need clarity in form on “interest” in other businesses
Particulars relating to registration, license, permit etc granted under any other law (point no. 12 of form A-I)	Details only for specified registrations (i.e. Central Excise Act, CST, PAN without any supporting document)
Particulars of goods purchased, sold manufactured by the dealer (point no. 14 of form A-I)	For VAT registration, only top 5 commodities traded to be provided
Separate form to be attached providing details of manager (form D-I)	To be included in the application form for registration

Tax payment

No	Suggestion	Remark
1	Authorize more banks/ branches for accepting tax payments	Currently only SBI is authorized to collect tax payments
2	Reduce the number of challan copies (from five to three)	Would help cut down on internal paperwork and time
3	One time lump sum tax by <i>small taxpayers</i>	Currently all the dealers required to deposit tax on a monthly basis; small taxpayers may be allowed to deposit tax on an annual basis

Tax payment: e-payment

No	Suggestion	Benefit	Remark
1	<p>Adoption of e-payment</p> <ul style="list-style-type: none"> — mandatory for tax payment above Rs. 10 lakh — option available for other taxpayers 	<ul style="list-style-type: none"> — Reduced paperwork for tax payer, filing of challan in quadruplicate — Immediate clearance of challan, currently atleast 3 days required for the same — Record of payment easily available — Completion of payment process and supply of challan copies to treasury, bank and circle officer takes over 30 days 	<ul style="list-style-type: none"> - Chhattisgarh, Delhi, Gujarat, Haryana, Madhya Pradesh, Rajasthan, Uttar Pradesh, Uttarakhand, West Bengal, currently using e-payment - Gujarat - After initial nesting period where awareness of the benefits of such a system were propagated, e-payments have been made mandatory for dealers with tax payment above Rs 10 Lakh

Filing of returns

No	Suggestion	Remark
1	Need for simplification and redesign of return form	Simpler forms used in Delhi and other States
2	No sign-off by tax officials for filing returns	Requirement of sign-off leads to more time for tax officials as well as taxpayers

Filing of returns: e-filing of returns

No	Suggestion	Remark
1	Specified format may be provided for return as well as sale and purchase details that can be filled offline but uploaded through an internet interface	<ul style="list-style-type: none"> – Chhattisgarh, Delhi, Gujarat, Karnataka, Maharashtra, Punjab, Tamil Nadu currently using filing – Gujarat, Maharashtra allow for uploading of details in prescribed format. Income tax returns can also be similarly uploaded
2	By using internet interface, e-filing can be incentivized	<ul style="list-style-type: none"> – Date of e-filing to be treated as the date of filing the returns – Income tax returns can be mailed within 30 days after e-filing. – No requirement of filing paper return after e-filing in the States of Maharashtra, West Bengal and Gujarat
3	Integrate e-filing with other statutory document requirements	<ul style="list-style-type: none"> – In Maharashtra, and West Bengal, utilization and request for obtaining declaration forms also made online – Subsequent to online submission, forms delivered by post

Obtaining declaration forms and road permit

No	Suggestion	Remark
1	Treat CST return filed electronically or manually as an application for issue of declaration forms	<ul style="list-style-type: none">— Instead of requiring separate applications for declaration form, same should be integrated with the filing of return— Gujarat treats CST return as application for issuance of declaration forms— Andhra Pradesh and Maharashtra, provides for the submission of details online in a specified format
2	Standardize procedures and documents required for issue of forms	<ul style="list-style-type: none">— All circles must follow uniform practices

Obtaining declaration forms and road permit (contd.)

No	Suggestion	Remark
3	Allow Issuance of forms in advance for “ good tax payers ”	<ul style="list-style-type: none"> – Kerala, Orissa and Rajasthan allow for the issuance of form in advance at the discretion of the Revenue – The Directorate General of Foreign Trade has adopted a scheme under which Star Export Houses avail specific benefits such as <i>clearance of imports/ exports on self declaration basis</i>
4	Requirement of route permit only for specified goods	<ul style="list-style-type: none"> – Maharashtra and Delhi do not require route permits at all – Andhra Pradesh and Tamil Nadu require the same only in case of specified goods such as DG sets, parts and accessories of automobiles
5	On-line application for issuance of route permits (way-bills)	Gujarat follows online system for applying and downloading route permits

VAT refunds

No	Suggestion	Remark
1	Ensure refunds are granted to exporters	<p>Under the current regime, no incentive for exporters to set up facilities in Bihar, as absence of refund, increases cost of output. The problems faced are:</p> <ul style="list-style-type: none">– Process of granting refund cumbersome and time consuming– Prone to dishonest practices– Very few refunds being granted– Adversely affecting exports from Bihar

VAT refunds (contd.)

No	Suggestion	Remark
2	Time specification for grant of refund	<ul style="list-style-type: none">– Gujarat allows 75% refund (90% to SEZ units) within 15 days from filing of refund application– Andhra Pradesh requires that claim be reviewed within 90 days– Maharashtra specifies that refund to be granted within 3 months, additional documents can be requested up to a period of 1 month after filing of application– Delhi specifies that refund to be granted within 1 month or 2 months dependant on the tax period, 1 month or quarter, respectively– Haryana specifies that interest payable if payment not made within 60 days

VAT refunds (contd.)

No	Suggestion	Remark
3	Issuance of refund amount against indemnity bond to <i>“good tax payers”</i>	<ul style="list-style-type: none"> – Punjab allows that if application of refund based on monthly returns, then refund of 75% of the amount allowed immediately, on furnishing of indemnity bond – Delhi requires that refund to be granted within 15 days of furnishing of security – The Directorate General of Foreign Trade has adopted a similar scheme, export houses are identified as 1-5 star export houses
4	Refund banker scheme on the lines of Income Tax Department scheme	Future directions for remittance of refund amount directly by bankers to taxpayers

Audit, inspection & scrutiny

No	Suggestion	Benefit	Remark
1	<p>Introduction of risk management principles for case selection</p> <p>- Computer based case selection model may be developed</p>	<ul style="list-style-type: none"> — Most evasion prone cases are selected and honest taxpayers spared — Enhance effectiveness of audit, scrutiny etc. — Reduction in number of cases selected leads to lesser workload — Good dealers would undergo fewer audit, inspection and scrutiny — Ensure timely completion of audit — Objective case selection (reduce opportunities for corruption) 	<ul style="list-style-type: none"> — Gujarat and Delhi undertake their audit, assessment and scrutiny based on risk management indices. The parameters for audit assessment are: <ul style="list-style-type: none"> • Annual turnover exceeding Rs. 10 crores • Annual tax exceeding Rs. 25 lakh • Industrial incentives and special category dealers • ITC exceeding 20% from previous year

Audit, inspection & scrutiny (contd.)

No	Suggestion	Remark
2	No scrutiny of small tax payer returns	<ul style="list-style-type: none">– Freeing up of resources, allowing more efficient utilization of human resources– Lower administrative cost– Focus on providing better services to medium/ large tax payers, and ensuring better compliance– Doing away with unproductive scrutiny of small taxpayers, as over 75% of total taxpayers that contribute only 0.8% of tax revenue
3	Limited inspections, audit for small tax payers, based on: -Specific information on tax evasion -5% taxpayers on random case selection	Effective deterrence against tax evasion

Assessment & appeals

No	Suggestion	Benefit	Remark
1	Payment only of admitted tax amount prior to appeal (no requirement of pre-deposit)	<ul style="list-style-type: none">– Reduced risk of corruption– Reduction of financial burden on tax payer– Procedure of obtaining refund is avoided	<ul style="list-style-type: none">– Several States (e.g., Kerala, Haryana, West Bengal) requires payment only of admitted amount prior to appeal to Commissioner
2	Non-inclusion of disputed amount in target achieved of officials till final settlement	<ul style="list-style-type: none">– Reduces tendency of high pitched assessments– Increase trust in the Revenue	

Gujarat: invoice matching

Data Collection

- All sale and purchase details, including invoice specific details are provided in the return
- Information used to identify
 - Unregistered dealers
 - Value of transactions undertaken by unregistered dealers
 - Commodities transacted by unregistered dealers
- Information used to identify prospective dealers for registration
- Identify defaulters
- Targeted enforcement drives can be undertaken

Taxpayer facilitation

No	Suggestion	Benefit	Remark
1	Create Citizen Charter/ Tax Payers Guide or	<ul style="list-style-type: none"> – The Charter would provide information on common dealer interfacing activities, and provides complete information on forms required, fees applicable, supporting documents, step by step process involved for each activity and other relevant information – This introduces both transparency and consistency 	Punjab, Tamil Nadu, Karnataka and Delhi already provide such detailed handbooks
2	Create awareness on e-payment and e-filing	<ul style="list-style-type: none"> – Information dissemination and hand holding required to encourage dealers to move towards this mode – Conduct training sessions, workshops etc. for dealers and intermediaries. 	Gujarat provides manuals on e-filing and e-payment in Gujarati

Taxpayer facilitation (contd.)

No	Suggestion	Benefit	Remark
3	Implementation of a good taxpayer scheme	<ul style="list-style-type: none">– The quality of services provided to honest and regular taxpayers would be improved– Reduced administrative burden on the Commercial Tax Department	Delhi provides for such a scheme

Half of the dealers are outside the tax net

Percentage of businesses registered (above turnover of 5 lakh); Base 1003*

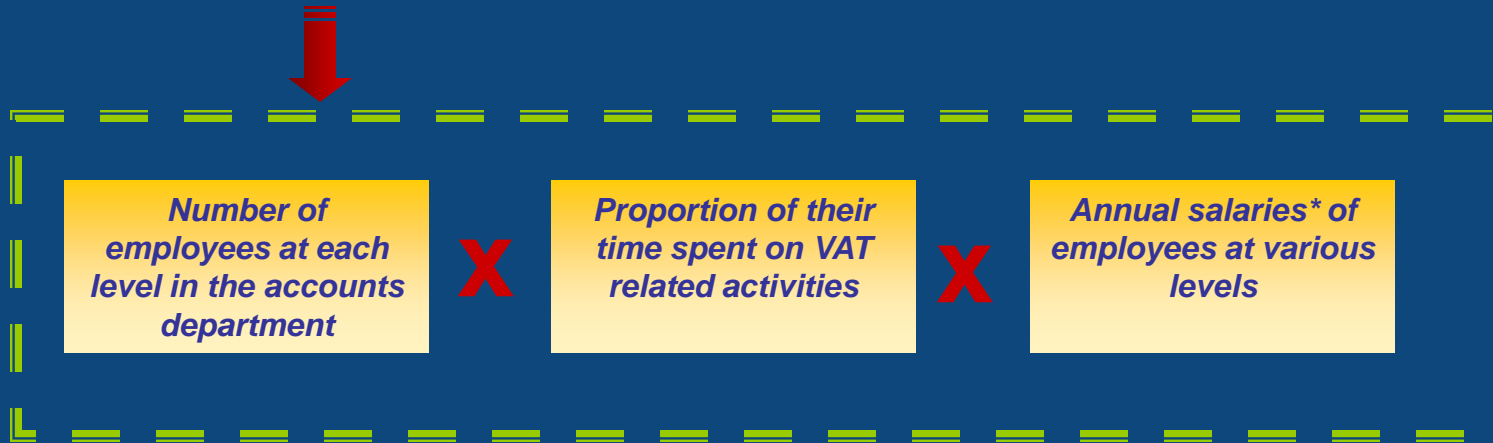
Unregistered
business
50%

Tax net covers only 50% of the
potential taxpayers

Registered
business
50%

** Opinion based responses*

Calculation of overall cost of VAT compliance process...



*Monthly salaries used in calculation for an average sized business in Bihar :

- Senior level accountant INR 12,000 /-
- Middle level accountant INR 8,000 /-
- Clerical Staff INR 4,000 /-

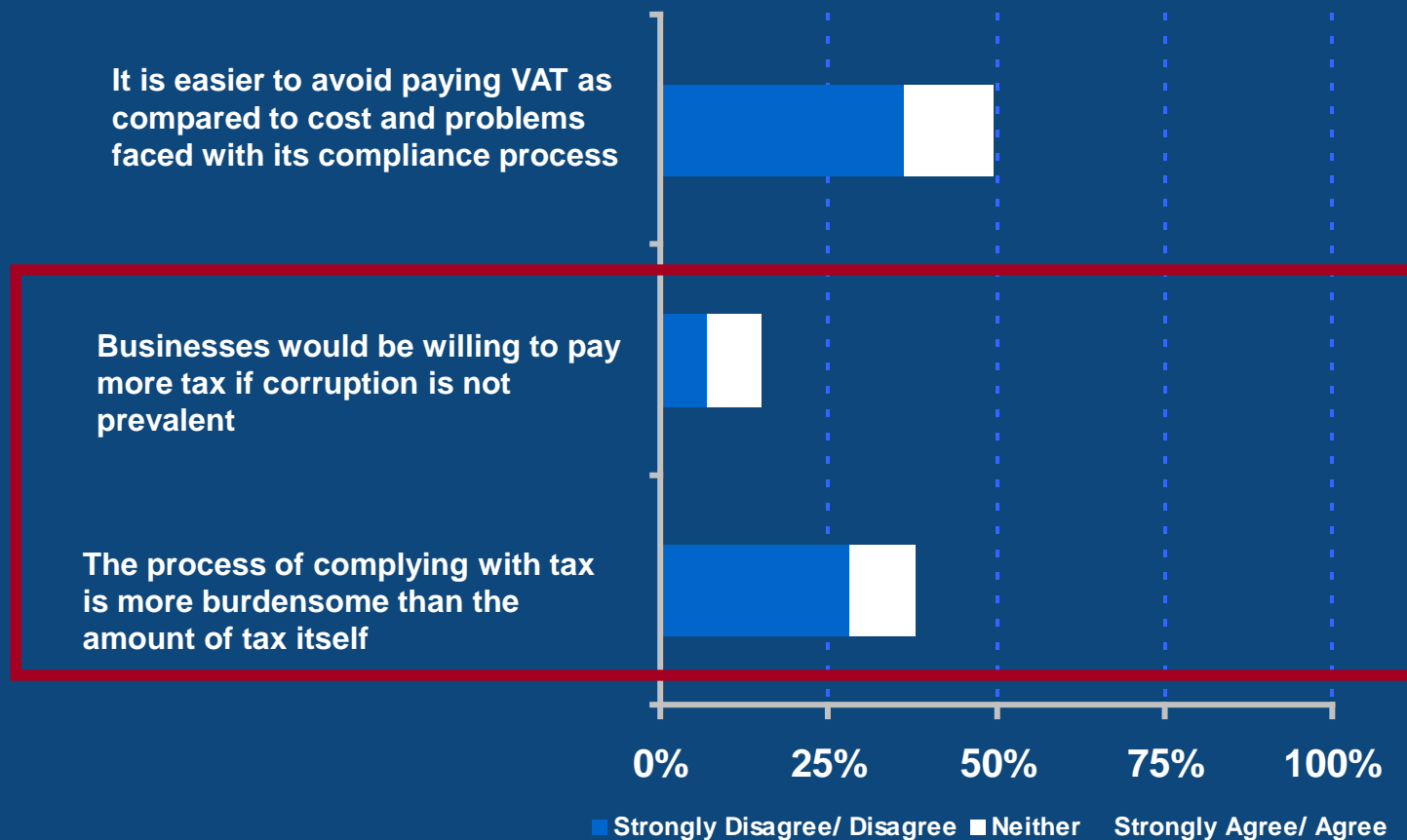
Cost implication of VAT compliance process for businesses

Businesses on an average spend **Rs. 30,000** per year for complying with the VAT process*.

Small sized businesses Base 621	Medium sized businesses Base 250	Large sized businesses Base 124
Rs. 22,444	Rs. 32,454	Rs. 57,059

*Amount includes the cost for the activities done in-house by employees of business as well as the cost paid to outside professionals for certain activities. **Overhead costs not included**

Compliance cost and corruption a strong disincentive to compliance



Usage of composition scheme

Type of VAT payment method; Base - 1003

Regular
payment
method
84%

*Breakup of turnover for businesses under
composition/ compounding scheme; Base - 163*

Composition/
Compounding
scheme
16%

**Only 16% of taxpayers are
utilizing the composition
scheme**

