



# Bank Transaction Tax : An approach to tax reform in India -a clinical review

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## Abstract

Indian economy is undergoing a transformational change in the last few decades which lead to the requirement of reforms in tax system in India. In the era of increasing globalization it is very crucial to have an effective and efficient tax structure to increase revenue, reduce economic distortions, and creating a competitive economic environment.

In the complex tax machinery in India tax reform is the need of an hour. The major issues in tax reforms are Simplifying complexity in present tax system, reducing multiple layers of tax levy and tax collection cost, suggesting ways to get rid of tax evasions. With the necessity for above tax reforms, a proposal for imposition of single tax called Bank Transaction Tax (BTT) was proposed.

The present paper is critical appraisal of imposition of Bank Transaction Tax in India. The paper attempts to review the challenges and opportunities to the government for the practical implications of BTT as well as its impact on salaried individuals and business and industry.

**Keywords:** Tax reforms, BTT( Bank Transaction Tax), Tax Evasion, Money Laundering.

## Introduction-

Indian economy is undergoing a transformational change in the last few decades which lead to the requirement of reforms in tax system in India. In the era of increasing globalization it is very crucial to have an effective and efficient tax structure to increase revenue, reduce economic distortions and creating a competitive economic environment. Kautilya's *Arthashastra* recommends a healthy state treasury. It is important because economic development depends on it to the large extent.

In United Kingdom there are 29 million income-tax payers but the number of references filed in the High Court is only around thirty in a year. In India there are only seven million income-tax payers but number of references filed

in our High Courts is over 6000 a year. These figures reflect the tremendous public dissatisfaction with quality of the law and of fiscal administration. This shows that complexity in the present tax need to be avoided.<sup>1</sup>

In the complex tax machinery in India tax reform is the need of an hour. The major issues in tax reforms are Simplifying complexity in present tax system, reducing multiple layers of tax levy and tax collection cost, suggesting ways to get rid of tax evasions. With the necessity for above tax reforms, a proposal for imposition of single tax called BTT was proposed.

The proposal for a single tax is not a new idea. First time France initiated the idea of imposition of single tax. However in 19th century, Canada and the United States also discussed single tax and in 1990's, Brazil also proposed single tax in a new format, as BTT.

In India the proposal for Bank cash transaction tax was introduced for the first time in the budget for the year 2005-06 with the objective to root out the generation of black money from Indian economy. However the proposal was controversial and faced much criticism. The proposal of single tax again rebirth after several years and exaggerated when BJP's PM Candidate Narendra Modi said, "The present taxation system is a burden on the common man. There is a need to introduce a new system." The present paper is a critical appraisal of imposition of BTT in India. The present paper is critical appraisal of imposition of Bank Transaction Tax in India. The paper attempts to review the challenges and opportunities to the government for the practical implications of BTT as well as its impact on salaried individuals, business and industry.

### **BTT proposal:**

The details of proposal are here given below:

- Withdrawal of existing Taxation System completely (except customs i.e. import duties).
- Every Transaction routed through a bank will attract certain deduction in appropriate percentage as Transaction Tax i.e. Single point tax deducted at source. (Given 2 %). This deduction is to be effected on receiving/credit accounts only.
- This deducted amount will be credited to different Government levels like Central, State and Local at certain appropriate proportion.
- Transacting Bank will also have its share in this amount for facilitating and acting as key agent (about 17.5%).
- Withdrawal of High denomination currency (like 100, 500 & 1000 Rs note).
- Cash transactions will not attract any transaction tax.
- Government should make legal provisions to restrict cash transactions up to a certain limit (given Rs. 2000)

The proposal can be summarized as that everyone has to use credit and debit cards for transactions of higher value and it would be taxed at 2%. The receiving party would be taxed and the revenue would be sent to the

government with the banking intermediary keeping some proportion. To eliminate black money, high denomination notes would be eliminated.

### Critical Appraisal of BTT:

#### Infrastructural necessity: (Challenges Ahead)

- Basis for proposed implementation is a bank. Within India, bank penetration is not even across all states; UP has one branch per 20000 adults whereas Delhi has one branch per 8000 adults however Chandigarh has minimum numbers of adults 3000 per branch while Manipur is highest crowded by 33000 adults per branch.
- The proposed system requires motivating people to avoid paper currency and use more cheques, debit cards, net banking etc. which can restrict cash transactions to the large extent.
- There is need to develop a rigorous electronic payment system where present situation is that 60 percent of people do not have a bank account in our country.
- In the present scenario of increasing cyber crime, the safety and security of banking system become challenge, if Government switches to BTT as the only source of revenue.
- In the proposed regime, the role of Enforcement Directorate and Financial Intelligence Unit will become vital because any slippage of transactions will cause loss of revenue to Government.

#### Opportunities -

- Implementation of BTT would simplify India's complicated tax system.
- It could also eliminate the need to set up several layers of government machinery employed to collect taxes.
- It will change the system of transacting from cash transactions and induce the people to a cheque economy which increases accountability.
- It will reduce complex and reduce documentation and eliminates the chances of tax evasion, manipulations and fraud.
- The BTT would help fight black money, money laundering as high value transactions could be routed through banks only
- It will develop the fair tax habits among the people.
- It is assumed that implementation of BTT will increase tax revenue to Rs 15 lakh crore as compare to about Rs 10 lakh crore currently.

#### Limitations -

- The bank transaction tax is a flat tax – thereby being regressive. “*BTT has no connection with either the asset value or the income level of the person being charged – being a flat tax*” (Supratim Basu of FTI).

- Levy of tax at the same rate on the rich and the poor will widen the inequality gap.
- BTT is a single tax which is assumed to replace all taxes imposed by the Central, State and other municipal corporations in India and revenue is proposed to be shared between Centre, State and the local government. Each state in India is unique and each has its own financial requirements and is responsible for managing its own finances. But under the proposal, RBI will be responsible for determination of Bank Transaction tax; states might not have any say in the determination of the bank transaction tax. Imposition of BTT takes away the power of the state to manage its own financial affair.
- The BTT also produces a cascading effect on economic activity as repeat transactions to complete a single activity would lead to multiple levies.
- Also if the cash is moving within various accounts of same family (for e.g. Father is transferring amount to his son's or daughter's account) then the same amount will be charged a tax at multiple levels.
- The professional like chartered accountants, tax lawyers may also oppose BTT as their business will suffer due to simplification of tax system.
- Tax is not only a source for raising revenue for the government but also a tool to influence consumption, public health, economic conditions, or any such matter. To reduce the consumption of products having adverse impact on public health or economic environment like of tobacco and related product government levy heavy indirect tax under the current regime. At the same time, taxes on certain products are either Nil or exempted, which seems to be practically not possible with BTT proposal.
- In order to evade bank transaction tax, companies may move their payment hub out of India, and might want to switch to offshore banks.
- There may be emergence of parallel systems such as barter trade or dealing in alternative payment systems such as gold, etc
- There may be drastic shifts in the economy such as companies will be switching from external purchase of raw material toward indigenous manufacturing to reduce number of bank transactions and save tax.

## *Practical implications of BTT*

### Impact on Business and Industry

**Table I**

<b>C. P. in Rs.</b>	<b>PROFIT %</b>	<b>S.P. in Rs.</b>	<b>BTT @2% IN Rs</b>	<b>TAX AS % OF PROFIT</b>
100	5	105	2.1	42
100	10	110	2.2	22
100	20	120	2.4	12
100	50	150	3	6
100	100	200	4	4
100	200	300	6	3

Source: Self Composed, C.P. Cost price, S.P. Selling Price

The implications of BTT are presented in above table by taking hypothetical figures. The profit margin on different product varies from industry to industry. The table I reveals that that products having lesser profit margin are subject to taxed with higher rate as product with profit margin of 5% pays tax at the rate 42%, product with profit margin of 10% pays tax at the rate 22%, product with profit margin of 20% pays tax at the rate 12% where as products with profit margin of 50%, 100% and 200% pays tax at the rate of 6% , 4% and 3% respectively.

Table II

NAME OF THE COMPANY	NET INCOME	PBT	PROFIT AS % OF NET INCOME	TAX AS PER CURRENT SYSTEM	TAX AS % OF PBT	OPENING DEBTORS	CLOSING DEBTORS	GROSS RECEIPT	TAX AS PER BTT	TAX AS % OF PBT
COLUME NO	1	2	3	4	5	6	7	8	9	10
ITC	31775.44	10684.2	33.6	3265.9	30.6	1163.34	986.02	31952.76	639.0552	6.0
TCS	50656.53	15703.2	31.0	2916.84	18.6	11202.32	9107.72	52751.13	1055.023	6.7
AJANTA PHARMA	852.02	147.74	17.3	46.62	31.6	135.19	125.42	861.79	17.2358	11.7
RELIANCE	371612	26284	7.1	5281	20.1	11880	8424	375068	7501.36	28.5
APPOLO TYRE	8600.58	474.52	5.5	61.99	13.1	273.14	363.91	8509.81	170.1962	35.9
ONGC	884402.1	30521.3	3.5	9618.64	31.5	6863.72	6194.82	885071	17701.42	58.0
ESCORT	4002.27	87.95	2.2	18.35	20.9	445.44	340.53	4107.18	82.1436	93.4
BLUE STAR	2617.75	-88.45	-3.4	NIL	0.0	695.86	778.59	2535.02	50.7004	

(Source-official websites of different companies F. Y. 2012-13)

To analyze the implication of BTT more, actual data of different companies is taken. The sample of three large cap companies, three small cape companies and two mid cap companies listed in BSE is studied. The above table present their net income earned(1), profit before tax(2), actual tax for the year 2012-13 (4), effective tax rate on profit as per current system (5), as well as effective tax rate on profit as per BTT(10).

Gross receipt of revenue is calculated by the formula-

$$\text{Gross receipt} = \text{Net income} + \text{opening debtors} + \text{closing debtors}$$

(Assumed that most of the sales are made on credit basis)

- The table shows that companies generating high percentage of profit on their income like ITC (33.6%), TCS (31.0%), Ajanta pharma (17.3%) are paying lesser tax with BTT system only 6 to 11% of their profit as compare to current tax structure which is around 30% of the profit.
- Whereas, companies having lesser profit margin like Appolo Tyre (5.5%),ONGC(3.5%), ESCORT(2.2%) will be paying tax at a higher rate of 35.9%, 58.0%, 93.4% respectively.

Thus companies with low profit margin will be exposed to more tax burden and high profit margin companies will pay tax with very mild effective tax rate.

- The company BLUE STAR incurred loss during FY 2012-13. Practically no tax imposed as per current system but since BTT is imposed on revenue earned the company will have to pay the tax. Thus loss making concern will go in more loss because of high tax burden.

### Impact on individuals

**Table III**

SALARY INCOME p.a.	TAXABLE SALARY p.a.	EXEMPTIONS	EXEMPTION AS PER 24-B	TAXABLE SALARY AFTER EXEMPTION	TAX AS PER PRESENT SYSTEM	% TAX ON INCOME AS PER CURRENT SYSTEM	TAX AS PER BTT	% TAX ON INCOME AS PER BTT
200000	200000	200000	NA	NIL	NIL	0	4000	2
300000	200000	200000	NA	NIL	NIL	0	6000	2
400000	300000	300000	NA	NIL	NIL	0	8000	2
700000	500000	300000	150000	50000	5000	0.71	14000	2
11,00,000	800000	300000	150000	350000	40000	3.63	22000	2
15,00,000	1100000	300000	150000	550000	80000	5.33	30000	2
2000,000	1500000	300000	150000	1050000	215000	10.75	40000	2
60,00,000	5000000	300000	150000	4550000	12,55,000	20.91	1,20,000	2
10000000	8000000	300000	150000	7550000	23, 70,500	23.70	2,00,000	2

Source: Self Composed. The figures of the above table are hypothetical.

Assumptions: The data in the table and calculations are subject to following assumptions:

- Only income from salary is taken for calculation of tax as well as It is assumed that an individual is availing tax exemptions as per sec 80(C) and sec 24 (B) of Income Tax Act 1968 to avoid complexity of calculations and making it easily understandable.
- It is assumed that a portion of salary is paid as some fringe benefits which is not taxable in current income tax law.
- Tax is calculated as per the Income tax slab for the FY 2013-14.

- The Income Tax is paid by individuals typically on Salaries, House Rent and Other Incomes subject to some exemptions.
- The analysis of table III clearly reveals that as per the existing tax system those who are earning high are imposed to higher tax however in proposed BTT system the rate of taxation remains constant for all. Hence those earning high salary are comparatively paying very less tax as compared to low salary earner.

In the present tax structure Income Tax is paid on the profits of the manufacturing, service providers and trading community subject to a multitude of allowances, disallowances, abatement and additions. Those entities that do not have profits or incomes do not pay taxes and is progressive in nature.

But the above analysis proclaims that BTT is a regressive tax regime as more tax is imposed on poorer section of the society as compare to richers. A tax in which the poorer (or less wealthy) sections of society pay the same share as the wealthy, is iniquitous (25 per cent of a poor person's income being taken away harms him far more than 25 per cent of the rich man's income being taken away).

Thus it seems that proposed tax regime BTT is against the *canon of Equity*.

### **Conclusion:**

At last, it can be concluded that tax reforms are need of the hour but proposal for tax reforms which includes abolition of direct taxes and gradual migration to BTT suffers from many limitations and challenges., this tax would have a higher impact on the poorer and middle class households, rather than the richer households, who would be able to pay for planning more efficiently.

There are many issues which are untouched in the proposal like status of Double taxation agreement with different countries, intra bank lending, status of the business houses which are acting as clearing houses, stock brokers, or any other business which receives money on behalf of their customer etc.

There have been experiments with such tax earlier in Australia, Argentina, and Brazil where such flat tax structure served as a temporary revenue booster but had to be eventually abolished, therefore a very detailed groundwork and well defined control machinery is required before such a migration.



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