Doing Business Report 2018

Measure-Payment of Taxes

Notes for Respondents

March 2016

DB 2018 – Payment of Taxes- issues relevant to respondents.

One of the measures used by World Bank to rank the overall Ease of Doing Business is Payment of Taxes. In this measure India is ranked 172 out of 190 countries. There are 4 indicators of the measure:

i. Number of Tax Payments
ii. Time taken to File Returns
iii. Total Tax Rate
iv. Post Filing Index (This is a new measure started from this year)

The summary for India is shown below:

Indicator	Mumbai	South Asia	OECD high income
Payments (number per year)	25.0	31.8	10.9
Time (hours per year)	241.0	283.9	163.4
Total tax rate (% of profit)	60.6	40.9	40.9
Postfiling index (0-100)	4.3	38.8	85.1

Analysis and issues to be considered by Respondents

1. Number of Tax payments:

Since the corporate tax and dividend tax payments are fully electronic they are considered as 1 payment each as per the World Bank Methodology. This is the best that can be achieved. EPF and ESIC payments are completely available ONLINE. This should be mentioned by Respondents. This will cut the number of payments for EPF from 12 to 1 and ESIC from 4 to 1 since if any Tax Payment is made electronically then irrespective of the number of times payment is made it is considered as 1 payment only. There is no payment of Fuel tax, so this should be reduced from 1 to zero. Further, tax on Insurance contracts (ie service tax) is a part of the sales invoice paid to the insurance company. The service tax is actually remitted by the Insurance Company and not by TaxpayerCo which is the Case Study Company.

Therefore, from the 25 tax payments considered for India in the previous study, the number of Tax payments should reduce to 9.

2. <u>Time taken to file returns</u>

Since all Corporate Income Tax returns are filed electronically under Digital Signature, the entire process of filing takes only a few minutes. Most Companies with Turnover similar to Case Study use Basic Accounting Software such as Tally or MS Excel. As per the World Bank Survey Instructions the following has to be carefully understood:

"Accounting is compliant with applicable generally accepted accounting principles, or GAAP (local or international, depending on your country's laws). This includes, for example, the International Financial Reporting Standards/International Accounting Standards (IAS/IFRS) regime, if applicable to your country.

Always use the most favorable method for the company for computing the taxes, i.e. minimize taxes within the legal constraints and by making reasonable assumptions where necessary. Please state any such assumptions clearly in the "NOTES" corresponding to the relevant data input cell. The information provided should be based on a typical or normal business of a similar size in your country.

In some cases tax laws or tax authorities may also require companies to keep additional books and records specifically for tax purposes—books and records that are over and above those kept for the accounting and audit processes and that are not required for the financial reporting processes. The questionnaire's sections on compliance time include an entry under each of the 3 tax categories for time related to maintaining mandatory tax books and records. <u>Please disregard in those entries any time spent on books and records that are also used for financial accounting or audit purposes.</u> ***<u>Please only include time associated with additional books and records specifically required for tax purposes.</u>****"*

Therefore, the time taken to prepare the return cannot be as high as 45 hrs since this is a small company which is compliant with laws and very little adjustments are required. The only Tax Adjustment to be made is for Depreciation as per Income Tax Act. No other adjustment is required. Further, Income Tax Department has provided free return preparation software has the facility for pre-filling the tax and TDS payments and the software automatically calculates all tax and interest.

Similarly, the number of employees is only 60. The maximum income paid is only Rs 1.8 Lakh, so no TDS is required. Calculation of Labor related compliances such as EPF and ESIC are very straightforward and can be done in Excel from which Payroll is maintained.

Since, purchase invoices already include details of input VAT or CST and all sales is retail, it is straightforward to compute CENVAT/sales Tax specially since a small company like this would use accounting software such as Tally which can produce Sales Tax or CENVAT Reports.

Therefore, these key points may be carefully considered to correctly estimate time taken.

Corporate Tax

- Data gathering from accounting records to prepare return does not involves a **time period of 12 hours** as the procedure is non-technical.
- Analysis of accounting information to highlight tax sensitive items – Involves basic adjustments and preparation of Depreciation chart as per tax. **(Need revision to 4 hours from 16 hours)**
- Completion of tax return form involves filing of ITR-6 excel utility. However assistance in automatic updating of TDS detail and importing of previous version details of company further ease the process.

Labor Taxes

- Data gathering from accounting records to prepare details of ESIC and EPF does not involves a time period of 24 hours as the salary sheet is prepared by company. **(To be revised from 24 to 4 Hours)**
- Calculation of tax payment involves extraction data from accounting records and use of spreadsheet. However time for extraction has already been included and preparation of spreadsheet involves minimal time.
- Payment of taxes has been changed from online to manual making the procedure further simple, easy and results in saving of time.

VAT and CST

- Payment of taxes is made through online options which makes the procedure quite simple, easy and time saving.
- The category 'other activities' does not specifies the functions due to which the extra time would be charged in filing of returns. The extra time allocated under this category proves out to be burdensome and irrelevant.

3. <u>Total Tax Rate</u>

The methodology for computation of Total Tax Rate is complicated and as computed by World Bank the Total Rate is 60.6% (ie taxes are Rs 60.6 out of Rs 100 of profits). However, out of this the Direct tax element is only 24.91% which Includes tax on profit (equivalent to Corporate Tax) computed at 20.93% and Dividend tax computed at 3.98%. This is quite comparable to most advanced countries.

<u>However, the methodology for calculating tax rate (60.6%) is such that it includes not only corporate tax as a % of the Book Profit but also Labor taxes (EPF and ESIC) and CST (which is based on some assumptions – it has been assumed that CST of 2% is levied on 80 % of all purchases (effective CST rate as % of Book Profit is calculated as 14.14%).</u>

If the Out of State purchase on which CST is paid is taken as 11.34% then the effective CST is calculated at 2%. Accordingly, the calculation of taxes payable as per case study would be as under:

Profit before tax (PBT)	**36,12,817**	
Add back above the line taxes borne:		
Tax on money market account interest (e.g., withheld by the bank)	-	**0.00%**
Tax paid by company for check transactions	-	**0.00%**
Social Security Contributions paid by employer	7,32,741	**15.35%**
Other taxes and mandatory contributions on labor paid	2,55,733	**5.36%**
Deductible sales tax	95,680	**2.00%**
Pollution certificate	400	**0.01%**
Property tax	63,172	**1.32%**
Insurance tax	12,415	**0.26%**
	-	**0.00%**
	-	**0.00%**
	11,60,140	
Profit before all taxes borne (commercial profit)	**47,72,957**	
Corporate income tax on PBT after necessary adjustments	(11,67,318)	**24.46%**
Dividend tax	(2,21,820)	**4.65%**
Capital gains tax (if not included in the CIT computation)	-	**0.00%**
Above the line taxes borne (EPF, ESIC borne by Employer +CST etc)	(11,60,140)	**24.31%**
Total taxes borne	**(25,49,278)**	
Profit after all taxes borne	**22,23,679**	
Total Tax Rate = total taxes borne / commercial profit	**53.41%**	

4. **Post-Filing Index**

In this indicator World Bank has given a score of only 4.3 out of 100 which is very low. This is a new indicator started from this year and is based on four components—time to comply with VAT or GST refund, time to obtain VAT or GST refund, time to comply with corporate income tax audit and time to complete a corporate income tax audit.

In the DB 2017 report, the time reported by World Bank for the time to comply with corporate income tax audit for India is 54 Hrs. The measurement based on the methodology adopted for calculation of time taken to amend/revise a corporate tax return appears to be incorrect if a comparison is made to the Case Study taken for Slovak republic is taken into account (given below). In India as well the filing of the corporate return and for tax payment is completely electronic. **Therefore, this time is grossly overstated and needs to be corrected by World Bank. It may be mentioned that this methodology was not shared with CBDT by World Bank and the working has to be immediately contested.**

In India, if there is a voluntary revision of income and additional taxes are paid, that, by itself is not a criteria for selection of a case for scrutiny (audit). In India, selection of a case for scrutiny is based on several parameters under the Computer Aided Selection for Scrutiny (CASS) program.

For easy reference the Methodology is reproduced below:

Time to comply with corporate income tax audit

Time is recorded in hours. The indicator has two parts:

- *The process of notifying the tax authorities of the error, amending the return and making additional payment. Time includes: time spent by TaxpayerCo. gathering information and preparing the documents required to notify the tax authorities; time spent by TaxpayerCo. in submitting the documents; and time spent by TaxpayerCo. in making the additional tax payment.f*
- *The process of an audit if the case scenario is likely to trigger an audit. Time includes: time spent by TaxpayerCo. on gathering information and preparing any documentation (information such as receipts, financial statements, pay stubs) as required by the tax auditor; and time spent by TaxpayerCo. in submitting the documents requested by the auditor.*

An estimate of half an hour is recorded for submission of documents or payment of the income tax liability due if the submission or payment is done electronically and takes several minutes. An estimate of zero hours is recorded in the case of a field audit if documents are submitted in person and at the *taxpayer's premises*. ***In the Slovak Republic, for example, taxpayers would submit an amended corporate income tax return electronically. It takes taxpayers one hour to correct the error in the return, half an hour to submit the amended return online and half an hour to make the additional payment online. Amending a corporate income tax return per the case study scenario in the Slovak Republic would not trigger an audit. This brings the total compliance time to two hours.***

Time to complete a corporate income tax audit

Time is recorded in weeks. Time includes the time spent by TaxpayerCo. interacting with the auditor from the moment an audit begins until there are no further interactions between TaxpayerCo. and the auditor (including the various rounds of interactions between TaxpayerCo. and the auditor). Time also includes the time spent waiting for the tax auditor to issue the final tax assessment—from the moment TaxpayerCo. has submitted all relevant information and documents and there are no further interactions between TaxpayerCo. and the auditor.

Time to complete a corporate income tax audit is recorded as zero if the case study scenario is unlikely to trigger an audit.

Accordingly, the following issues may be carefully considered by all respondents:

i. Revised returns can be filed for an original return.
ii. Procedure involves making correction in the original return, payment of taxes and filing of returns.
iii. **Procedure for filing revised returns is completely online**, similar to original returns and could be performed easily in minimal time as only limited errors need to be rectified.
iv. Income Tax Department however does not mandate audit/ assessment of revised returns in each cases.
v. Only 2% of the revised returns are taken up by for the scrutiny procedures, that too only if other risk parameters are attracted, not because the return is revised, making a return highly unlikely for selection for scrutiny.

Assessment Year 2015-16	Filed	Selected for Scrutiny*
Total Corporate Tax Returns	688,316	75,395
Original Tax Returns	680,566	73,843
% Original	**99%**	**98%**
Revised Tax Returns	7,750	**1,552**
% Revised	**1%**	**2%**

vi. The percentage of returns selected for Audit is based on risk criteria independent of the mode of filing return -original and revised returns.
vii. As per the Case Study methodology of World Bank, Slovak Republic follows similar method for Revised Return and gets a top score in this criteria as compared to a low score for India

Table- Comparison of India with other countries based on previous DB Report 2017

Sl	Economy	Ease of Doing Business Rank	Starting a Business	Paying Taxes	Payments (number per year)	Total Time (hours per year)	Time for Corporate Tax Return only	Total tax rate (% of profit)	Profit tax (% of profit) excl dividend tax	Labor tax and contributions (% of profit)	Other taxes (% of profit)	Time to comply with a corporate income tax audit (hours)	Time to complete a corporate income tax audit (weeks)	Postfiling index (0-100)
1	New Zealand	1	1	11	7	152	34	34.3	30	2.5	1.6	4	0	96.9
2	Singapore	2	6	8	5	66.5	24	19.1	1.8	16.2	1.1	17	12.6	73.4
3	Denmark	3	24	7	10	130	25	25	19	3.2	2.8	4.8	0	92.6
4	United Kingdom	7	16	10	8	110	37	30.9	18.3	10.9	1.6	6.5	8.3	87.4
5	United States	8	51	36	10.6	175	87	44	28.1	9.8	8.6	9	0	93.1
6	Sweden	9	15	28	6	122	50	49.1	13.1	35.4	0.6	5	0	90.8
7	Australia	15	7	25	11	105	37	47.6	26	21.1	0.5	2.3	0	95.4
8	Germany	17	114	48	9	218	41	48.9	23.2	21.3	4.4	5	0	97.5
9	Canada	22	2	17	8	131	45	21	3.9	12.8	4.5	16	12.7	76.4
10	Malaysia	23	112	61	9	164	26	40	22.7	16.4	0.9	5.3	20.6	64.3
11	France	29	27	63	8	139	28	62.8	0.4	53.5	8.7	4	0	92.4
12	Japan	34	89	70	14	175	62	48.9	26.2	18.4	4.2	24	5.4	78.9
13	Russia	40	26	45	7	168	53	47.4	8.8	36.1	2.6	2.5	0	87.6
14	Mexico	47	93	114	6	286	122	52	25.6	25.5	0.9	14.5	35	42.6
15	Italy	50	63	126	14	240	39	62	17	43.4	1.9	5	0	48.4
16	South Africa	74	131	51	7	203	96	28.8	21.7	4	3.1	14	25.1	58.6
17	China	78	127	131	9	259	60	68	10.8	48.8	8.2	4.5	0	48.6
18	Brazil	123	175	181	9.6	2038	486	68.4	24.9	40.2	3.9	38.5	35.1	8
19	**India**	**130**	**155**	**172**	**25***	**241**	**45**	**60.6**	**20.9**	**20**	**15.7**	**54**	**27.7**	**4.3**
20	Pakistan	144	141	156	47	311.5	40	33.3	18.5	13.8	1.1	28.5	0	37.6
21	Slovak Republic	33	68	56	8	192	46	51.6	10.5	39.7	1	2	0	89.9

*** Corporate Tax payment and Dividend Tax payment account for only 1 each out of the total number of 25 Tax Payments mentioned above**