Need for Taxation Reforms

What is the issue?

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India's tax-GDP ratio is still abysmally low and hence more people need to be brought into the tax net to create more fiscal space.

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What is the status of fiscal deficit in India?

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- The government set up a Committee to review the FRBM Act in 2016.
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- The Committee recommended that the government should target a fiscal deficit of 3% of the GDP by 2020, which should be reduced further to 2.8% in 2021 and to 2.5% by 2023.
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- While the expenditure largely remained on course till November 2018, lower tax receipts would be inflating the fiscal deficit for FY19.
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- The expenditure in the remaining months will further make the expenditure go beyond the Budget estimates.
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- India's fiscal deficit was Rs. 5.9 lakh crore, or 3.5% of the GDP, in 2017-18.
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- The latest available data show that the government has already touched a fiscal deficit of 114.8% of the full-year estimates by the first eight months of this financial year.
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What are the underlying reasons behind the deficit?

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- The absolute volume of Central tax collection increased by 3% in the last 10 years.

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- But the share of direct tax collection in the same period declined by 3%, which has been <u>compensated by the rise in indirect taxes</u>.

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- **Indirect Tax** - Within the indirect taxes, excise duty collections increased at the fastest pace by 80%.

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- This is partly because of excise on crude, which saw multiple increases since 2014 when international crude oil prices were falling.

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- **Direct Tax** - The average direct tax collection since FY09 has been around 55% of the total tax collections.

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- The corporate tax collection has been reduced, wherein its share in direct tax fell from 63% in FY09 to 56%in FY18.

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- However, the personal income tax which is considered as a secured source has seen a healthy rise from 35% to 41% during the same period.

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- This is because the number of taxpayers under the direct tax net increased in the last 10 years.

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- **Tax-GDP ratio** - The tax-to-GDP ratio has not been impressive for India.

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- Ideally with increase in GDP, the tax collection should also increase.

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- If the economy is growing and business is doing well, naturally, profits will be better and therefore taxes should also be higher.

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- In India’s case while the overall tax-to-GDP (Centre and State) increased from 17.45% in FY08 to 17.82% in FY17, the GDP and per capita income have doubled during this period.

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- Interestingly, India’s rate of growth of tax revenues was not in sync with its GDP growth in the post-reforms period.

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- Thus, India must aim to double its tax-to-GDP ratio to achieve the OECD target of about 34%.
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What should be done?

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- **Improving tax-to-GDP ratio** - India has had a comparatively low tax-to-GDP ratio largely due to low direct tax base and an unorganised sector.
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- Direct tax, which primarily involves personal income tax and corporation tax, is more sensitive to GDP growth rate.
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- While the direct tax-to-GDP ratio has grown at an average of 5.67% in the last 10 years, real GDP has grown by 7.78% during the same period.
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- Thus, the direct tax-to-GDP needs to be increased to create more fiscal space and for that, more people need to be brought into the tax bracket.
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- **Increasing tax base** - The Kelkar Committee report mentions the 'missing middle' which include professionals (CAs, lawyers, doctors) who do not pay taxes.
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- However, government has presumptive taxation measure for them.
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- But, unorganised small retailers who are not in tax net have no presumptive taxation.
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- Thus, efforts on more presumptive taxation options to businessmen and professionals in Tier-1 and Tier- 2 cities will aid in widening the tax base.
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- Also, agricultural income has to be taxed beyond a large threshold limit.
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- India should also promote cashless economy as majority tax evasion occurs in cash transactions.
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- Less cash utility will turn the people towards tax compliance.
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- **Revising tax slabs** - Many qualified individuals today directly start their

career at the highest 30% tax bracket at Rs. 10 lakhs.
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- However, their growth in consequent years may not be substantial.
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- Thus, the government can widen the 20% tax slab beyond Rs. 10 lakhs to give relief to such tax-payers and increase their disposable income.
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- **Raising tax deduction** - Section 80C allows individuals and HUFs to claim tax deduction of up to Rs. 1,50,000 from their gross total income for certain investments and payments.
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- These tax limits to these investments, which include provident fund, national savings certificate etc., could be increased further to encourage individuals to save more towards their retirement.
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- Additional deposits into these schemes could help the government garner more resources for long-term projects.
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Source: Business Line

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Presumptive Taxation

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- As per sections 44AA of the Income-tax Act, 1961, a person engaged in business is required to maintain regular books of account under certain circumstances.
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- To give relief to small taxpayers from this tedious work, the Income-tax Act has framed the presumptive taxation scheme.
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- A person adopting the presumptive taxation scheme can declare income at a prescribed rate and, in turn, is relieved from tedious job of maintenance of books of account.
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