TAX EXEMPTIONS IN INDIA

In 2011-12, the tax GDP ratio was 5.5 percent for direct taxes and 4.4 percent for indirect taxes. These ratios are one of the lowest for any large developing country and will not garner adequate resources for inclusive and sustainable development.

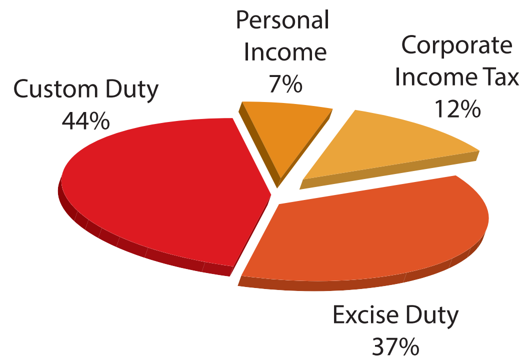
Budget Speech of P. Chidambaram, Minister of Finance, 2013-14[1]

Tax Exemptions refer to the exceptions to the general rule (pertaining to the specific tax law) rather than a complete removal of taxation. These are also referred to as tax concessions, incentives or deductions. In the Indian context, there are many reasons for exemptions to be given in taxes, such as,

- encouraging individual savings (by providing tax reliefs to various savings schemes),
- providing a boost to exports
- achieving balanced regional development
- encouraging infrastructure development
- increasing employment, and
- providing more resources for education, rural development, and cooperatives etc.

Starting with the Union Budget for 2006-07, the Union Government of India has been publishing a Statement of *Revenue foregone under the Central Tax System* as part of the Union Budget documents every year. This document presents a discussion on the exemptions in major taxes levied by the Union Government (or the Centre) and an estimation of the potential tax revenue lost or foregone due to the same.

Revenue Foregone (in Corporate Income Tax, Personal Income Tax, Excise Duty and Customs Duty) as % of Total Revenue Foregone in financial year 2011-12



Source: Compiled from Union Budget 2013-14, Ministry of finance, Govt. of India

KEY FINDINGS

- The total magnitude of tax revenue foregone due to exemptions/ deductions/ incentives in the Central government tax system is estimated (by the Union Ministry of Finance) to be Rs. 5.33 lakh crore in 2011-12 and Rs. 5.73 lakh crore in 2012-13.

- This is a staggering 5.9 % of GDP for 2011-12 and 5.7 % of GDP for 2012-13.

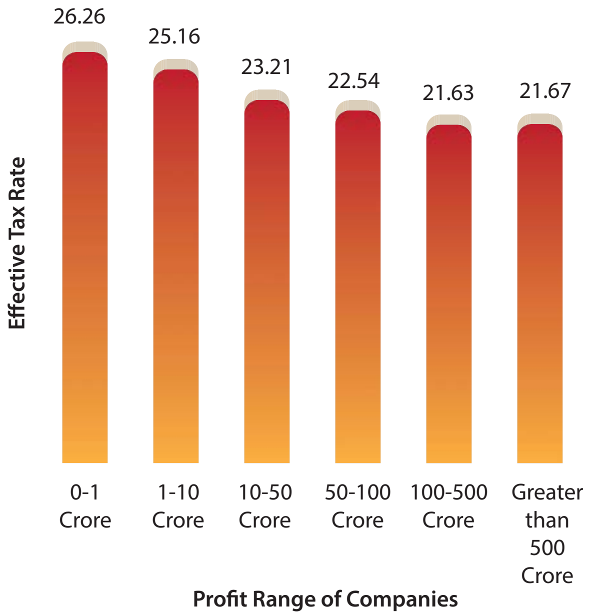
- The actual magnitude of revenue that would get collected if all exemptions in the Central tax system are eliminated could certainly be less than the above stated figures of around 6 % of GDP, since the estimation by the Finance Ministry is based on some assumptions (that are inevitable for such an exercise of estimation); however, the actual revenue potential associated with elimination of tax exemptions cannot be small.

- The proportion of tax revenue foregone is the highest (at 44 % of total revenue foregone) in case of exemptions in Customs Duties, followed by an almost equally high proportion of revenue foregone (around 37 %) in case of exemptions in Excise Duties. Exemptions in Corporate Income Tax have accounted for a much smaller 12 % of the total revenue foregone, while that in Personal Income Tax have accounted for 8 % of the total revenue foregone in the figures pertaining to financial year 2012-13.

- As per the Statement of *Revenue Foregone under the Central Tax System*, companies with higher levels of profits are paying lower ETR than those in the lower

[1] *These ratios are for Gross Central Taxes only. The combined ratios for Central and State Taxes is 5.99% for direct tax and 10.65% for indirect taxes (2011-12)*

Effective Corporate Income Tax Rate: Small vs. Large Companies (in per cent) [2012-13]



Source: Compiled from Statement of Revenue Foregone under the Central Tax System, Union Budget 2013-14, Ministry of Finance, Govt. Of India

range of profits. For instance, companies making profits in the range of Rs. 0-1 crore paid an ETR of 26.26 %, whereas companies making profits in the range of Greater than Rs. 500 crore paid an ETR of 21.67 % (for the year 2012-13)[2].

- Revenue foregone on account of deduction of export profits for STPI Units (software technology industries), Special Economic Zones (SEZs) and accelerated depreciation are substantial within the total revenue foregone in respect of Corporate Income Tax.

- With regard to tax exemptions, committees on tax policies set up by the government over the last two decades (e.g. Chelliah, Shome and Kelkar committees) had recommended rationalisation and minimisation of the exemptions system pertaining not only to direct taxes but also indirect taxes, and stressed that tax exemptions should be justified with sound social and economic reasons.

Table 2: Effective Tax Rate (including surcharge and education cess) for Sample Companies across Industry (in Corporate Sector) for financial years 2006-07 to 2011-12 (in percent)

Ind./ Financial Year	Automobile and Auto Parts	Engineering Goods	Printing and Publishing	Tobacco	IT Enabled Services, BPO Service providers
2006-07	26.0	25.5	28.0	30.6	7.4
2007-08	24.0	30.0	31.0	25.0	15.0
2008-09	23.4	27.1	28.8	27.0	13.1
2009-10	25.1	27.6	30.5	28.0	15.1
2010-11	26.5	30.2	29.5	29.5	21.3
2011-12	21.2	29.0	29.0	28.0	24.3

Note: *Figures rounded to the nearest decimal.*
Source: *Compiled from Statement of Revenue Foregone, Union Budget (2008-09 to 2012-13), Ministry of Finance, Govt. of India*

POLICY RECOMMENDATIONS

- Periodic review of such exemptions by the government would be necessary to eliminate excessive exemptions/ incentives or superfluous tax breaks to investors for preventing the loss of public revenue.

- In-depth industry-level review of the extent to which the anticipated benefits of tax exemptions are being fulfilled in certain industries, e.g. software development agencies, power and energy, and petroleum and petrochemicals etc. given that the effective tax rates (ETRs) for these are much lower.

- There is a need to review the extent and nature of tax exemptions provided to Special Economic Zones (deduction of export profits of units located in SEZs), diamond and gold (precious stones and jewellery), mineral fuels and mineral oils and the power sector, among others.

- The policy measures by the government could focus more on infrastructure and communication facilities etc. instead of relying heavily on tax breaks.

- Tax breaks need to be project-specific, and should not be treated as a "cost-saving" source for corporations seeking sustained tax holidays.

[2] Given the difference in number of companies for each profit range, the comparison may not be perfect, but the Effective Tax Rates (ETRs) of large profit-making companies are lower compared to their profits for the data given.

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This note is based on the CBGA discussion paper,* Tax Exemptions in India- Issues and Challenges, *by Sankhanath Bandyopadhyay
Available at: www. cbgaindia.org