Resource Mobilization: Did Union Budget Get it Right?

The Finance Minister in his budget speech noted the “urgent need to generate more resources to fuel the economy”. He also pointed out that “the tax to GDP ratio must be improved” and acknowledged that the decline in fiscal deficit was “mainly achieved by reduction in expenditure rather than by way of realization of higher revenue.” The need to increase the country’s tax to GDP ratio was also acknowledged by the previous Finance Minister, Mr. P Chidambaram, in his budget speech in 2013 where he stated that the tax to GDP ratios were “one of the lowest for any large developing country and will not garner adequate resources for inclusive and sustainable development”. This acknowledgement by our Finance Ministers is pertinent considering the consistently low levels of tax to GDP ratio in the country, one of the lowest among G20 countries and the lowest in BRICS.

Tax-GDP Ratio and Fiscal Policy Space

The Economic Survey 2013-14 states that tax-buoyancy (ratio of growth in tax revenues to growth in GDP) “the lower than-budgeted growth in revenues and the growth in taxes, more so in indirect taxes, has not been encouraging and the uphill task before the government is taking measures to augment resources.” But unfortunately, in a fiscally conservative economic environment, successive governments have resorted to expenditure cuts to attain fiscal deficit targets as envisaged in the Fiscal Responsibility and Budgetary Management Act, 2003.

As important as fiscal consolidation is for a sustainable economy, when it is achieved through cutting social sector expenditures, the dynamics of fiscal policy space need to be re-examined. The size of government spending also known as the ‘fiscal space’ enables public provisioning of essential services to address pervasive human development deficits plaguing the country like malnutrition, hunger, poverty, lack of clean drinking water supply and sanitation facilities. It is largely determined by the magnitude of revenue receipts it can garner. India falls far behind developed countries and several comparable developing economies in terms of tax-GDP ratio. As seen in the above chart, Brazil’s tax-GDP ratio is 33.2 per cent of GDP compared to India’s 16.3 per cent of GDP.

The size of the Union Budget is bigger than the Interim Budget by Rs 31,000 crore. The Budget Estimate puts the size of the Union Budget

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Rohith Jyothish is a Research Consultant at CBGA. His areas of interest are political economy, public finance and urban governance. He is currently working on issues of taxation and also contributes to CBGA’s social media presence. Pooja Rangaprasad is a Senior Programme Consultant at CBGA. Her work at CBGA focuses on advocacy and outreach on issues relating to tax justice and transparency and accountability in the global financial system.
at 13.9 per cent of the country’s GDP which is down from a peak of 15.9 per cent in 2009-10. Even if we combine the budgetary spending of both Centre and States, the peak combined budgetary spending of Centre and States was 28 per cent in 2009-10 (Indian Public Finance Statistics 2012-13). The magnitude of government spending relative to the size of the economy is much higher in developed and in several comparable developing economies. For instance, Brazil’s was at 39.9 per cent while the average for OECD countries was at 46.3 per cent in 2010 (OECD Factbook 2014).

The fig. 2 shows the various sources of revenue in the last four budgets presented. As is evident, the shortfall in Tax Revenues is expected to be made up for by the increase in Non-Tax Revenues. The Medium Term Fiscal Policy Strategy Statement states that the 10 per cent increase in Non-Tax Revenues over 2013-14 RE has been planned through “unlocking of resources from out of unspent balances lying in the Public Account such as Guarantee Redemption Fund and Social Infrastructure Development Fund”. Tax revenues were expected to grow at 21.15 per cent in the Interim Budget which has now been revised to 17.24 per cent over 2013-14 RE. Despite the revision, the new expected growth in tax revenues seems ambitious.

Among Non-Tax revenues, major sources are from ‘Dividends and Profits’ (includes Dividends from PSUs as well as Surplus of RBI, Nationalised Banks and Financial Institutions to be transferred to the government) which is Rs. 90,229.28 crore, a 16.8 per cent projection over and above that in the interim budget. ‘Non-Tax Revenue from Economic Services’ (such as, communication services, roads and bridges, and receipts from power, petroleum, coal & lignite, new & renewable energy etc.) is Rs. 79,535.63 crore, a 23.7 per cent over that in the interim budget. It needs to be scrutinized in detail what could be the possible impact of this higher dependence on Non-Tax Revenue from Economic Services in a period of high inflation. Projections for non-debt capital receipts other than recovery of loans and advances (disinvestment proceeds) are estimated at an ambitious Rs. 63,425 crore.

### Budget Highlights

The government has committed to the introduction of Goods and Services Tax (GST) within a year and to review the current Direct Taxes Code (DTC) Bill based on comments received from all stakeholders. In keeping with their electoral promise of a stable, non-adversarial tax regime, some measures have been introduced with an aim to minimize tax disputes. The option to obtain an advance tax ruling in respect of income tax liability has been extended to resident tax payers as well. The importance of Advance Pricing Agreements (APA), a vehicle for tax authorities and the concerned firms to agree well in advance of an audit on a particular transfer pricing methodology and the way that it will be applied, in minimising tax disputes has been acknowledged in the budget. A ‘Roll Back’ provision has also been introduced so that an APA entered into future transactions may also be applied to international transactions undertaken in previous four years in specified circumstances. In addition, the range concept to compute arm’s length price and the use of comparable prices of similar

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**Fig 1**

A Comparison of Tax-GDP Ratio and Total Government Spending as per cent of GDP: India, Brazil and OECD Average (as of 2010)

![Bar chart showing Tax-GDP Ratio and Total Government Spending as % of GDP](chart.png)

Source: Has the Tide Turned? Response to Union Budget 2014-15, Centre for Budget and Governance Accountability

**Fig 2**

Major Sources of Revenue for the Government (in Rs. Lakh Crore)

![Bar chart showing Major Sources of Revenue](chart2.png)

Source: Compiled by CBGA from Union Receipts Budgets of various years
A transaction for multiple years was also announced. Though these transfer pricing measures have long been recommended by trade and industry groups and multinationals, the possible impact on revenue generation needs to be examined closely.

There was pressure to roll back the retrospective amendments with respect to indirect transfer of a capital asset situated in India, introduced in 2012 by the previous government. The retention of these amendments is a welcome move against the background of aggressive tax dodging gaining global attention, including the recently launched project by G20/OECD countries examining international tax reforms needed to address tax dodging by MNCs, called Base Erosion and Profit Shifting (BEPS). While the Finance Minister clarified that this government will not normally resort to retrospective amendments in future, all cases arising from the earlier amendments will be further reviewed by a High Level Committee to be constituted by the CBDT before decisions are taken.

In a relief to personal income tax payers, the exemption limit has been increased from Rs. 2 lakh to Rs. 2.5 lakh. The surcharge on the income tax of the super-rich introduced last year has been retained, which is also a welcome move. On the indirect taxes front, there has been a 5 per cent hike in excise duty to be levied on aerated drinks with added sugar and an 11 per cent to 72 per cent hike in excise duty on tobacco products.

The recently constituted Special Investigation Team (SIT) on black money, as per Supreme Court orders, has been allocated Rs. 8.93 crore in this Budget for managing infrastructure and logistical requirements. In addition, the re-introduction of Kisan Vikas Patra (KVP), a savings option for small savers, is seen as a potential instrument to address black money in the system which needs further scrutiny.

**Structure of Taxes**

The Finance Minister announced a net loss of Rs 22,200 crore as a result of Direct Tax proposals while a net gain of Rs 7,525 crore is envisaged through indirect tax proposals. Unlike Indirect Taxes, which affect the rich and poor alike, Direct Taxes are linked to the tax-payer’s ability to pay, and hence are considered to be progressive. Ideally, the tax structure in a country like India should be progressive, i.e. the proportion of tax levied on the individual, group of individuals, organizations or companies should increase as their net wealth or income or returns from property increase. Progressivity in the tax structure is born out of the principles of equity and justice and the share of Direct Tax revenue in the total tax revenue of the country is one of the indicators of the same.

Piketty and Qian (2009), in a paper comparing income tax reforms in China and India, note that progressive taxation is “one of the least distortionary policy tools available that controls the rise in inequality by redistributing the gains from growth”.

Table 1 and Fig 3 show the composition of the total (both centre and states) Tax-GDP ratio in India. As is evident, indirect taxes are 11.6 per cent of GDP while direct taxes account for only 5.7 per cent of GDP.

As per cent of total tax revenue, direct taxes account for only 37.7 per cent in India which is far below the G20 average of almost 50 per cent. Even developing countries such as South Africa (57.5 per cent), Indonesia (55.85 per cent) and Russia (41.3 per cent) have a more progressive tax structure. Property Taxes (which include tax on wealth, tax on immovable property and estate, inheritance and gift tax) constitutes only 0.40 per cent of total tax revenue of the country as opposed to 4.85 per cent (BRICS average) and 7.60 per cent (G20 average).

**Table 1**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Direct Tax (per cent GDP)</th>
<th>Total Indirect Tax (per cent GDP)</th>
<th>Tax-GDP Ratio (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>5.9</td>
<td>10.5</td>
<td>16.4</td>
</tr>
<tr>
<td>2009-10</td>
<td>5.8</td>
<td>9.7</td>
<td>15.5</td>
</tr>
<tr>
<td>2010-11</td>
<td>5.8</td>
<td>10.5</td>
<td>16.3</td>
</tr>
<tr>
<td>2011-12 (RE)</td>
<td>5.6</td>
<td>10.7</td>
<td>16.4</td>
</tr>
<tr>
<td>2012-13 (BE)</td>
<td>5.7</td>
<td>11.6</td>
<td>17.2</td>
</tr>
</tbody>
</table>

**Source:** Indian Public Finance Statistics 2012-13
Against this background, reforms in our property tax regime would have been useful, especially focusing on re-introducing inheritance tax and reforming wealth tax. Unfortunately, there’s nothing in the budget that addresses the lack of progressivity in our tax structure.

**Tax Exemptions**

The total magnitude of revenue foregone in the Central government tax system has seen a marginal decline from 5.9 per cent of GDP for 2011-12 and 5.7 per cent of GDP for 2012-13 to 5.0 per cent of GDP for 2013-14. Although, the Ministry of Finance has noted that in terms of the absolute magnitude of revenue foregone, there has been an upward trend. These tax exemptions (also known as tax concessions or incentives or deductions) refer to the exceptions to the general rule, pertaining to specific tax laws, rather than the complete removal of taxation.

Contrary to popular opinion, the highest proportion of tax revenue foregone is not on account of Corporate Income Tax but Customs Duties, as indicated by Fig 4.

These exemptions/deductions also explain the lower effective or actual tax rates being paid as opposed to the statutory taxes notified in the law. For instance, larger profit-making companies are noted to be paying a lower Effective Tax Rate (ETR) than lower profit-making companies. Despite a Statutory Tax Rate of 30 per cent, companies that made a profit greater than 500 crore paid an effective tax rate of only 20.97 per cent. The fig 5 provides details of actual or effective tax rates being paid by small versus large companies.

Against this background, the need to review all tax exemptions is important to understand which incentives are still justified with sound economic and social reasons. A cost-benefit analysis for each type of exemption needs to be institutionalised on a periodic basis to understand their effectiveness in terms of the basic objectives of such exemptions.

It is pertinent to note here that this exercise of estimation of revenue foregone by the Ministry of Finance is based on certain assumptions and it cannot be assumed that the actual revenue that could be collected if all such exemptions are removed would be around 5 or 6 per cent of GDP. The Economic Survey 2013-14 has also recommended the need to review the exemptions in the Central government tax system, expressing the need for caution in interpreting the data.

**Conclusion**

Overall, the tax proposals in the Union Budget 2014-15 have been seen as investor friendly with a focus on addressing the increasing tax disputes towards fulfilling their intent to provide a stable tax regime. The retention of retrospective amendments and the surcharge on income tax for the super-rich are welcome proposals in augmenting revenues. Additional efforts towards raising revenues through direct taxes such as property taxes (inheritance tax, wealth tax etc) could be considered by the government. There is a need to review exemptions in the Central government tax system (5 per cent of GDP in 2013-14), as recommended by the Economic Survey 2013-14 as well.

(E-mail: rohith@cbgiindia.org
rpoojia@cbgiindia.org)

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Fig 4

Revenue Foregone due to Exemptions in Specific Taxes as a per centage of Total Revenue Foregone (in 2013-14)

- Corporate Income Tax: 7%
- Custom Duty: 46%
- Excise Duty: 34%
- Personal Income Tax: 13%

Source: Compiled from Union Budget 2013-14, Ministry of Finance, GoI

Fig 5

Effective Income Tax Rate: Small Vs Large Companies (2012-13)

Source: Compiled from Statement of Revenue Foregone, Union Budget 2014-15, Ministry of Finance

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