REVIEW

Taxation and Fiscal Policy Space in India

Rohith Jyothish

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THE FINANCE Minister in his budget speech said that tax collections help the government "to provide education, healthcare, housing and other basic facilities to the people to improve their quality of life and to address the problems of poverty, unemployment and slow development". He also said that to achieve these objectives, the government endeavours to "foster a stable taxation policy and non-adversarial tax administration." He went on to say that an important dimension of the tax administration is to "fight against the scourge of black money".

Limited Fiscal Policy Space

The Union Budget 2015-16 with an estimated size of Rs 17,77,477 crore (12.6 per cent of GDP) is Rs 96,319 crore more than the revised estimates of 2014-15. But relative to the size of the Indian economy, the magnitude of Union Budget spending has seen a continuous decline since a peak of 15.9 per cent of GDP in 2009-10.

Even if we combine the budgetary spending of the Centre and States, India's total government spending compared to the size of its economy is only 27.0 per cent (Indian Public Finance Statistics 2013-14), which is much lesser than that of developed and most developing countries. It is also one of the lowest among some of the fastest growing economies in the world, namely, BRIICSAM (Brazil, Russia, India, Indonesia, China, South Africa and Mexico) countries (Chart 2).

The low levels of government spending in India can be attributed to lower levels of revenues, especially tax revenues. When there are more tax revenues, it increases the room in a government's budget so that it can spend more without borrowing. This lower fiscal space is not expected to improve too much over the course of the next few years (Chart 3).

Even when we compare across BRIICSAM countries, India has one of the lowest tax-GDP ratios (Chart 4) which constraints in fiscal policy space.

Does a Stable Tax Policy Account for Loss in Revenues?

The Finance Minister said that "we are considered as having a high corporate tax regime but we do not get that tax due to excessive exemptions" and also that "a regime of exemptions has led to pressure groups, litigation and loss of revenue."

The 'Revenue foregone statement under the Central Tax System' reframed as 'Statement of Revenue Impact

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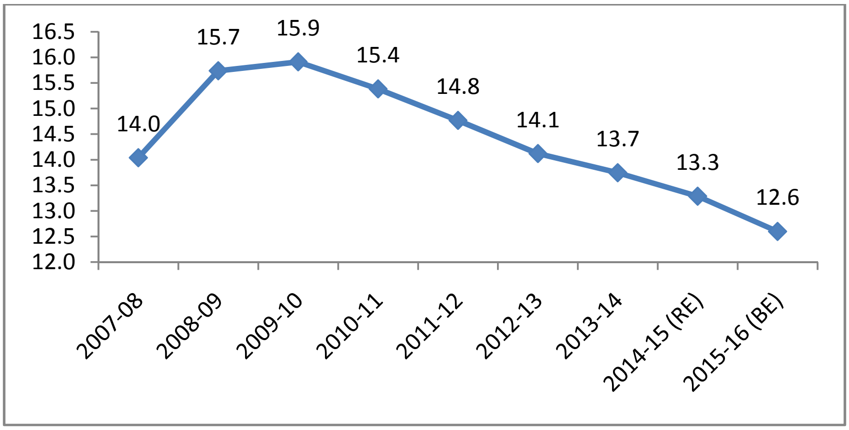
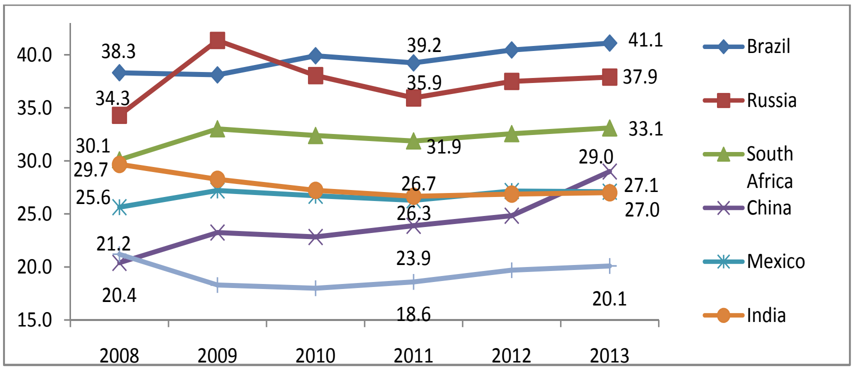
Chart 1: Magnitude of Union Budget Spending in India



Source: Union Budget 2015-16

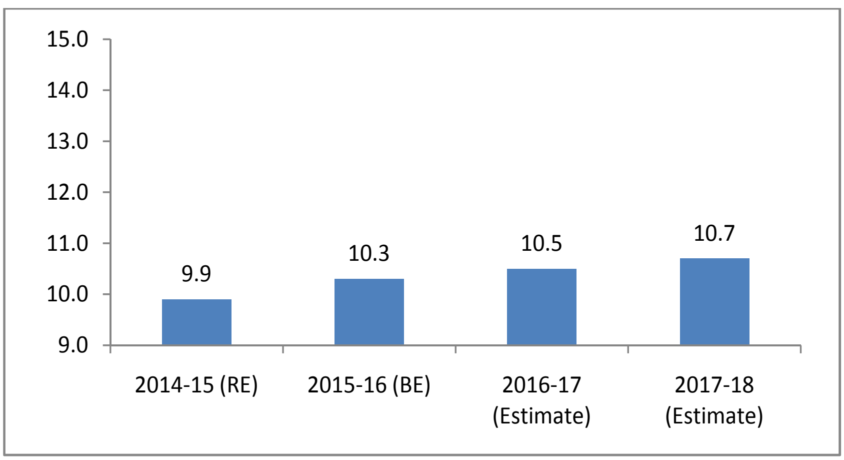
Chart 2: Government Spending to GDP Ratios in BRIICSAM Countries



Source: International Monetary Fund, World Economic Outlook Database, April 2014

Note: Total expenditure consists of total expense and the net acquisition of nonfinancial assets. Apart from being on an accrual basis, total expenditure differs from the Government Finance Statistics Manual 1986 definition of total expenditure in the sense that it also takes the disposals of nonfinancial assets into account

Chart 3: Tax-GDP Ratio (for Gross Central Tax Revenue)



Source: Macroeconomic Framework Statement, Union Budget 2015-16

Note: Gross Central Tax Revenue for 2015-16 (BE) is Rs 14,49740.6 crore out of which Rs 5,23,958.24 crore is transferred to the states

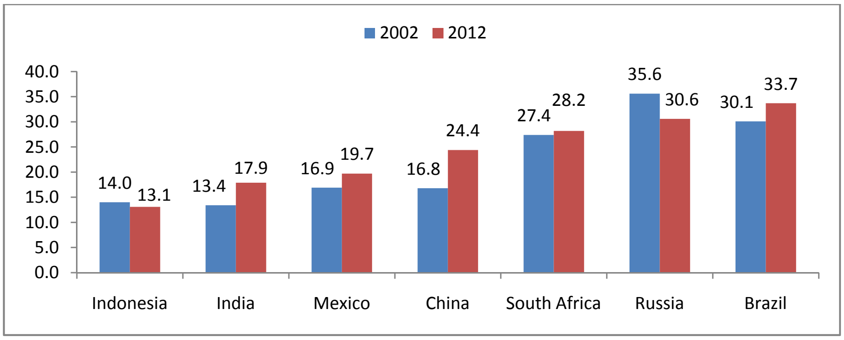
of Tax Incentives under the Central Tax System' shows that aggregate revenue impact of tax incentives is Rs 5,49,984.1 crore for 2013-14 and is projected to be Rs 5,89,285.2 crore for 2014-15. The revenue foregone is estimated to be 43.2 per cent of total tax revenue for the year 2014-15. There is a need for a White Paper on tax exemptions providing detailed sectoral break-up of revenue foregone for different industries, with a comparative assessment regarding objectives of exemptions fulfilled vis-à-vis magnitude of exemptions. The FM announced the phased reduction of corporate tax rate and phased elimination of exemptions from next financial year onwards.

Although it is true that many developing countries have corporate tax rates below 30 per cent, researchers have highlighted this to be a worrying trend. IMF's Keen and Simone (2004)[1] have noted, in their research on tax competition, that downward pressure on corporation tax revenues is more striking in developing economies than developed. Chart 5 compares corporate tax rates across several developing countries.

In spite of the Finance Minister's concern that the "fiscal space has not just been reduced, but squeezed", the focus is on maintaining fiscal discipline rather than augmenting resource mobilization. Even the Economic Survey 2014-15 calls for "expenditure compression" to meet the fiscal deficit targets.

In another bid to promote a non-adversarial tax environment, the General Anti-Avoidance Rule (GAAR) –meant to address important issues such as abuse of tax treaties, use of tax havens for the purpose of reducing tax bills and other clever tax avoidance arrangements – has been deferred for two more years. Yet again, India remains behind its BRICS contemporaries with Brazil having introduced GAAR in 2001, South Africa in 2006 and China in 2008. Introducing GAAR would also be in line with current global efforts to

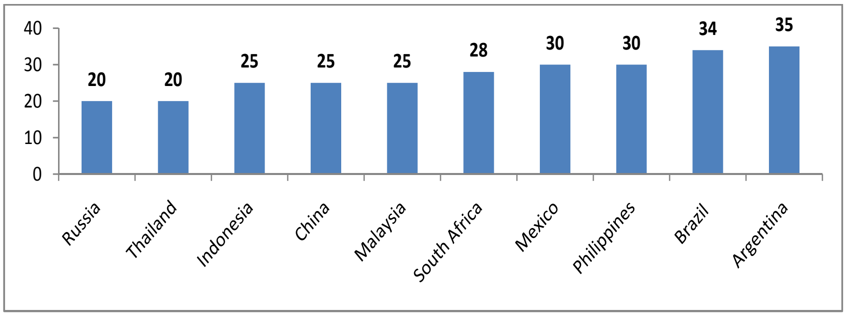
Chart 4: Tax-GDP Ratios across BRIICSAM Countries



Source: Government Finance Statistics Yearbook of various years published by IMF; China Statistical Yearbook 2003 published by National Bureau of Statistics of China; Revenue Statistics in Latin America 2014 published by OECD; Indian Public Finance Statistics 2013-14 published by Ministry of Finance, India

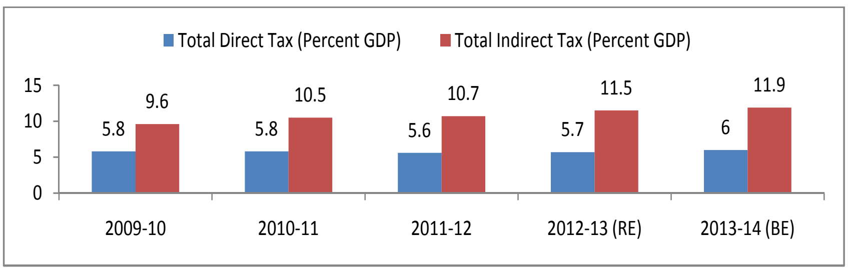
Notes: (1) Figures for Mexico and Brazil are for 2000 and 2011 respectively (2) Figures for India are from 2001-02 and 2013-14(BE) respectively (3) Figure for China for 2002 (4) Figures are for general government except for Indonesia; Indonesia figures are for its central government's budgetary transactions.

Chart 5: Corporate Tax Rates across Select Developing Countries



Source: KPMG Database (as of 28 February 2014)

Chart 6: Direct versus Indirect Taxes in India's Total (Centre and States) Tax-GDP Ratio



Source: Indian Public Finance Statistics 2013-14

address tax dodging by multinational corporations being led by OECD and G20 through the 'Base Erosion and Profit Shifting (BEPS)' initiative. India's involvement in this initiative should in no way hinder efforts to introduce GAAR right now as has been suggested by the Finance Bill 2015.

Towards a Regressive Tax Structure

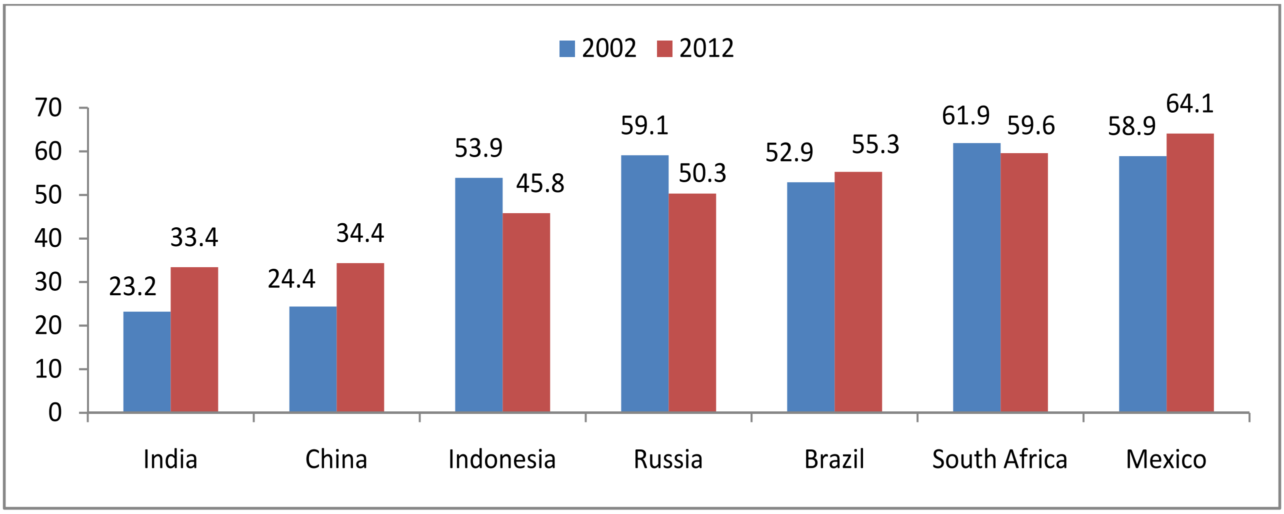
A progressive structure of taxation implies that individuals and corporations pay taxes according to their ability to pay. In India, for every Rs 100 collected as tax revenues, approximately Rs 30 comes from direct and the rest is from indirect taxes, respectively i.e. a major proportion of tax revenues are collected from those on goods and services while the rest come from taxes on income, profit, capital gains, property, goods and services etc (Chart 6).

As is evident from Chart 6, the share of direct taxes in the total tax-GDP ratio has remained stagnant between 5.8 and 6.0 per cent since 2009-10 while the share of indirect taxes has been increasing in an already decreasing overall tax-GDP ratio.

Comparing India's tax structure across BRIICSAM countries (Chart 7), while India has managed to increase its share of direct tax revenues in total tax revenues in the last decade or so, in the last two budgets, there has been a noticeable shift towards augmenting more indirect tax revenues at the cost of direct tax revenues. A regressive tax structure such as this is at a cost to the poor and most vulnerable sections of society.

The major direct tax proposals announced were in the form of exemptions through health insurance etc. according to which an individual taxpayer could get benefits upto Rs 4,44,200 lakhs while among indirect tax proposals, the FM expects the Goods and Service Tax (GST) to "add buoyancy to our economy by developing a common Indian market and reducing the cascading effect on the cost of goods and services." In order to move to a GST regime, service tax will be raised from 12 to 14 per cent subsuming the Education Cess and Secondary and Higher Secondary Education Cess on a date yet to be notified while excise duties on several goods including petrol and diesel will be revised to align with revenue-neutral rates. The direct tax proposals amounts to a revenue loss of Rs 8, 315 crore whereas proposals in indirect taxes are expected to raise Rs 23, 383 crore, the net impact of all tax proposals is a revenue gain of Rs 15,068 crore. This will further aggravate the already regressive tax structure.

Chart 7: Direct Tax Revenue as a Percentage of Total Tax Revenue



Source: Government Finance Statistics Yearbook of various years published by IMF; China Statistical Yearbook 2003 published by National Bureau of Statistics of China; Revenue Statistics in Latin America 2014 published by OECD; Indian Public Finance Statistics 2013-14 published by Ministry of Finance, India

Notes: (1) Figures for Mexico and Brazil are for 2000 and 2011 respectively (2) Figures for India are from 2001-02 and 2013-14 (BE) respectively (3) Figure for China for 2002 (4) Figures for Indonesia, Russia and South Africa for 2012 and China for 2011

Black Money

There were three major announcements to deal with the scourge of black money: (i) The Black Money Bill intending to criminalise tax evasion in relation to foreign assets with imprisonment upto 10 years and penalty of 300 per cent among other features; (ii) Concealment of income/ evasion of income in relation to a foreign asset to be made a 'predicate' offence under Prevention of Money Laundering Act, 2002; and (iii) Benami Transactions (Prohibition) Bill to be introduced to curb domestic black money.

Although, the increased focus on money held in offshore accounts, especially by the Special Investigation Team on Black Money appointed by the Supreme Court is welcome, there is still a lack of a comprehensive policy, mapping sectors generating black money in India and the corresponding reforms required. The intent in the budget to curb generation of black money in real estate is a step in the right direction.

Implementation of existing or new legislations in relation to black money requires that the administrative machinery is significantly strengthened. But according to the White Paper on Black Money published by the Central Board of Direct Taxes (CBDT) in 2012, staff shortage across various agencies such as CBDT, Enforcement Directorate, Financial Intelligence Unit, Central Board of Excise and Customs, etc. has been estimated to be 30,000. A report by Asian Development Bank (ADB 2014), which analysed tax administration in Asia and the Pacific, noted that India has one of the most under-resourced and understaffed revenue bodies, in proportion to the size of the population.

Against the backdrop of concerns of round tripping and revenue losses due to misuse of tax treaties, a comprehensive review of all Double Taxation Avoidance Agreements (DTAAs) is required. Currently, no data is available detailing transactions that avail of treaty benefits to analyse the costs and benefits of signing these treaties.

Even with the renewed drive towards offshore tax evasion, there are gaps that could be addressed further. While the G20 leaders' commitment to address these issues is welcome, India has the opportunity to take the lead among emerging economies by translating this to national commitments.

1. Ministry of Corporate Affairs & Ministry of Finance in consultation with SEBI/RBI should put in place central public registers of beneficial owners of companies and other legal entities, with adequate safeguards (such as trusts, foundations etc.)
2. India's leadership on improving information exchange standards globally is noteworthy. While the G20 has adopted Automatic Exchange of Information as the global standard, there are concerns that jurisdictions would be allowed to choose with whom they want to engage in automatic information exchange, rather than being truly multilateral. This could leave developing countries at a disadvantage with more powerful countries refusing to share information. Additionally, non-reciprocity of information sharing should be explored in favour of low income countries unable to send information at present.

3. If companies were required to report sales, profits, and taxes paid in all jurisdictions in their audited annual reports, it would make it difficult to hide money off shore. Though, the G20 has committed to country-by-country reporting, specifically through Action 13 of the G20/OECD Base Erosion and Profit Shifting, India should commit to making this public. Making this information public would enable tax administrations in the poorest countries to easily access this vital information to address BEPS in their contexts.

Availability of data for Income Tax/ Indirect Tax

Since 2001-02, the Union Budget documents have stopped providing information on how much tax revenue is being collected through indirect taxes (like, Customs Duties, Excise Duties, Central Value Added Tax, and Service Tax) from various items or commodities. Provision of such information would facilitate an assessment of the implications of India's indirect taxes on different sections of population (for instance, taxes collected on items of mass consumption vs. taxes collected on luxurious goods) to better inform policies on these issues. India also discontinued publishing category-wise details of income tax payers through the All India Income Tax Statistics (AIITS) in 2000.

According to Thomas Piketty, "India's income tax administration has almost given up compiling detailed income tax statistics, although detailed yearly reports called All-India Income Tax Statistics are available from 1922 to 2000. This lack of transparency is problematic because self-reported survey data on consumption and income is not satisfactory for the top part of the distribution and income tax data is a key additional source of information in every country."

Professor R. Vaidyanathan of IIM Bangalore in 2013 suggested that the Income Tax Department should bring out bulletins as wells as annual reports for providing insights into the nature of direct tax segments. Such details are relevant to understand the nature and extent to which people, commodities and services are covered by taxation and help augment revenues.

This article is based on the CBGA publication, 'Of Bold Strokes and Fine Prints: An Analysis of the Union Budget 2015-16'

Endnotes

1 Keen and Simone (2004), Tax Notes International, Special Supplement. ❑

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