# Revenue Mobilisation Efforts and the Budget 2017-18

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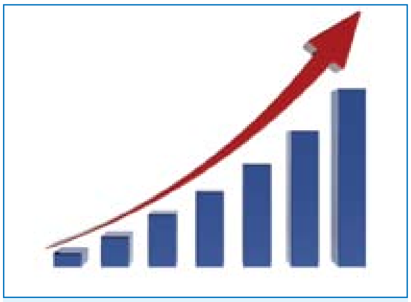

***India's tax structure is regressive with nearly two-third of total tax collected (taking into account tax collections of both the Centre and the States) being accounted for by indirect taxes. Since the Central government collects most of the direct taxes, in general the tax structure of the Central government tends to be more progressive***

In the run up to the Budget 2017-18, coming as it was after the demonetisation drive of the Government, many had the expectation that the Budget will bring forth major changes in tax rates, threshold limit of taxation, tax exemptions, etc. For the Government, on the other hand, reducing tax rates is a tough call to take, given that India has one of the lowest tax-to-GDP ratio among the large developing countries.

However, this year's Budget does contain some changes on the tax front, mainly in the arena of direct taxes. One of the main changes in this regard relates to the reduction in the personal income tax rate from 10 per cent to 5 per cent for those falling in the lowest tax bracket (i.e. Rs 2.5 lakh to Rs 5 lakh). At the same time, in order to avoid duplication of benefits, the maximum rebate of up to Rs 5,000 (under Section 87A) earlier available to individuals with net income up to Rs 5 lakh, has been reduced to Rs 2500. The criterion for availing this benefit too, has been changed and is now applicable to individuals with net income up to Rs 3.5 lakh. In addition to these, income tax filing is to be made easier with the introduction of a simple one-page form to be filed as Income Tax Return, for individuals having taxable income up to Rs 5 lakh other than business income. The simpler filing procedures, along with the reduction in tax rate for those in the lowest tax bracket, are expected to induce more people to come within the tax net.

At the higher end of the personal income tax slab, a welcome move has been that of levying a surcharge of 10 per cent of tax payable on those with annual taxable income between Rs 50 lakh and Rs 1 crore. The existing surcharge of 15 per cent of tax payable for individuals with annual taxable income more than Rs 1 crore, is set to continue.

In addition to these changes in personal income tax, some changes have been made in other direct taxes as well. For instance, the corporate income tax rate for Micro, Small and Medium Enterprises (MSMEs) with annual turnover up to Rs 50 crore, has been reduced by five percentage points from 30 per cent to 25 per cent, in order to improve viability of small companies. Further, changes have been made in the provisions for Long Term Capital Gains (LTCG) with respect to land and building. In this regard, in order to qualify for the concessional LTCG tax, the holding period for immovable property has been reduced to 2 years from 3 years. Additionally, the base year for indexation is also set to shift from April 1, 1981 to April 1,

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2001 for all classes of assets including immovable property.

Some changes have also been brought about with regard to indirect taxes such as customs duty, excise duty, etc. These changes are aimed at incentivising domestic value addition, providing adequate protection to domestic industry, promoting cashless transactions and "domestic manufacturing of devices used therefor".

## Possible Implications for Tax Payers:

The lowering of personal income tax rate for the lowest tax slab, even while maintaining the rates for other tax brackets, is expected to result in reduced tax liability for all tax payers with annual taxable income less than Rs 50 lakh. As the Table below shows, the (annual) gain for tax payees with taxable income up to Rs 3.5 Lakh will be Rs 2,575, with the gain increasing to Rs 12,875 as one goes up the income ladder. Perhaps the most important impact of the changes in personal income tax rates, relates to the expected impact on individuals with taxable income more than Rs 50 Lakh. The introduction of the 10 per cent surcharge is predicted to increase the net tax burden for this category of individuals (Table 1). This arises from the fact that the 10 per cent surcharge will more than offset the gain arising out of the rate cut in the lowest tax bracket. In other words, what this means is that the tax burden of the super-rich will go up.

The changes made in the provisions of LTCG tax mentioned above, is also likely to benefit property holders. The reduction in the holding period for immovable property to qualify to be a long-term asset will mean that property holders can sell their property after two years (instead of waiting for 3 years) and get the benefit of lower LTCG tax (compared to the higher short term capital gains tax rate). Second, the shifting of the base year will reduce capital gain tax liability for those selling their property acquired many years ago, as the price appreciation between the date of acquisition and April, 2001 will now be totally tax free.

Finally, the tax concession provided to small companies, for increasing their viability is a positive move. However, it also needs to be noted that since this is applicable for only those MSMEs which register profits, a large percentage of such companies may not benefit much from this move as many earn just enough to cover their costs.

**Table 1: An Illustration of Impact of Changes in Personal Income Tax in the Budget 2017-18**

| Annual Taxable Income | Existing Tax | New Tax | Gain/Loss |
|---|---|---|---|
| Rs. 2.5 Lakh | - | - | - |
| Rs. 3.5 Lakh | 5,150 | 2,575* | (+) 2575 |
| Rs. 5 Lakh | 20,600 | 12,875* | (+) 7725 |
| Rs. 10 Lakh | 1,28,750 | 1,15,875 | (+) 12875 |
| Rs. 50 Lakh | 13,64,750 | 13,51,875 | (+) 12875 |
| Rs. 60 Lakh | 16,73,750 | 18,26,963 | (-) 1,53,213 |
| Rs. 75 Lakh | 21,37,250 | 23,36,812.5 | (-) 1,99,562.5 |

*Note: * Includes changes made under Section 87A mentioned above.*

## Revenue Projections and Tax - GDP Ratio:

The reduction in some of the tax rates and the ensuing loss in revenue not with standing, Budget 2017-18 projects a significant increase in revenue with tax revenues (i.e. gross central taxes) increasing by more than Rs. 2,00,000 crore in 2017-18 Budget Estimate (BE) when compared to 2016-17 Revised Estimate (RE). Further, a large part of the projected increase in tax revenues is to come from direct taxes, with personal income tax accounting for the bulk of the increase in central gross tax revenue (Table 2).

**Table 2: Increase in Projected Tax Receipts in 2017-18 (BE) over 2016-17 (RE) (Rs. crore)**

| Tax Components | Increase |
|---|---|
| Gross Tax Revenue | 2,08,336.5 |
| Corporation Tax | 44,821.2 |
| Taxes on Income | 88,081.6 |
| Customs | 28,000.0 |
| Union Excise Duties | 19,531.4 |
| Service Tax | 27,500.0 |
| Taxes on Union Territories | 402.3 |

(*Source:* Union Budget 2017-18.)

As a result of these projections, not only is the Gross Central Tax-to-GDP ratio estimated to cross the 11 per cent mark, even the direct tax-to-GDP ratio (within central taxes) is set to be one of the highest in many years. Despite such optimistic projections, concerns regarding lack of progressivity in India's tax system remain. As is known, India's tax structure is regressive with nearly two-third of total tax collected (taking into account tax collections of both the Centre and the States) being accounted for by indirect taxes. Since the Central Government collects most of the direct taxes, in general the tax structure of the Central Government tends to be more progressive. However, as the table-3 reveals, even in the case of tax collected by the Central Government, the gap between direct tax-to-GDP ratio and indirect tax-to-GDP ratio has been reducing in the last couple of years. That is, progressivity of taxes even when only Central Government tax receipts are considered has been on the decline. What is significant, is that, even the much higher projection for direct tax collections in 2017-18, is not likely to alter this scenario much. Thus, even when the projected direct tax-to-GDP ratio (within central taxes) is set to be one of the highest in many years (Table 3), it cannot be expected to improve progressivity in central Government tax structure much. If, on the other hand, the projections for direct tax do not actually materialise, then the situation is likely to be even worse.

In fact, there are a number of reasons to believe that the revenue projections may be unduly optimistic. As past experience shows, there is usually a shortfall in the revised estimates of tax collections compared to the budget estimates (Table 4). However, unlike previous years, in 2016-17 the revised estimated are equal to the budget estimates. It is not clear how the budget estimate and the revised estimate figures are exactly equal given that the government had less information for the current year (because of the presentation of the Union Budget being advanced by a month) for arriving at such estimates. A part of the quantum jump in direct tax collections can perhaps be explained by the use of demonetised notes to pay advance taxes. However, if this is indeed so, then it cannot be taken as a basis for projecting tax collections for the entire year.

**Table3: Gross Central Tax- GDP Ratio (per cent)**

| Year | Gross Tax-GDP Ratio | Direct Tax-GDP Ratio | Indirect Tax-GDP Ratio |
|---|---|---|---|
| 2012-13 (A) | 10.4 | 5.6 | 4.8 |
| 2013-14 (A) | 10.1 | 5.7 | 4.4 |
| 2014-15 (A) | 10.0 | 5.6 | 4.4 |
| 2015-16 (A) | 10.6 | 5.4 | 5.2 |
| 2016-17 (BE) | 10.8 | 5.6 | 5.2 |
| 2016-17 (RE) | 11.3 | 5.6 | 5.7 |
| 2017-18 (BE) | 11.3 | 5.8 | 5.5 |

*Notes:*

*(i) A refers to Actual; BE refers to Budget Estimate; and RE stands for Revised Estimates;*

*(ii) Direct taxes such as estate duty, gift tax have not been taken into account as they form negligible proportion of direct taxes;*

*(iii) Taxes on Union Territories also have not been taken into account in the calculation.*

(*Source:* Compiled from Union Budget documents, various years.)

**Table 4: Comparison of Budget Estimates and Revised Estimates of Select Direct Tax Receipts (Rs. crore)**

| Year | Corporation Tax | Taxes on Income |
|---|---|---|
| 2013-14 (BE) | 4,19,520 | 2,40,919 |
| 2013-14 (RE) | 3,93,677 | 2,36,194 |
| **2014-15 (BE)** | **4,51,005** | **2,78,275** |
| **2014-15 (RE)** | **4,26,079** | **2,72,607** |
| 2015-2016 (BE) | 4,70,628 | 3,27,367 |
| 2015-2016 (RE) | 4,52,970 | 2,99,051 |
| **2016-2017 (BE)** | **4,93,923.5** | **3,53,173.7** |
| **2016-2017 (RE)** | **4,93,923.5** | **3,53,173.7** |
| 2017-2018 (BE) | 5,38,744.73 | 4,41,255.3 |

(*Source:* Compiled from Union Budget documents, various years.)

Likewise, even the revenue projections for the year 2017-18 seem very optimistic, particularly in the case of direct taxes. For instance, the impact of demonetisation in terms of slowing down of GDP growth (and hence tax collections) is still not clear. Given that these effects are yet to be captured, the revenue projections for the year 2017-18, especially with respect to personal income tax, are likely to be on the higher side.

The projections for indirect tax collections, however, are less ambitious particularly in the case of union excise duty, as collections expected from this source are much lower than GDP growth rate. This may be on account of the fact that in the previous year a large part of excise duty collections were due to windfall provided by higher global oil prices. The slowing down of the economy in the post-demonetisation period is likely to dampen tax collections from this source.

While the discussion above refers to projected tax revenue, even the projections for miscellaneous capital receipts, comprising disinvestment receipts, strategic disinvestment and others (listing of insurance companies), seem to be on the higher side. This is owing to the fact that only a small part of the strategic disinvestment projected in 2016-17 (BE) actually fructified in 2016-17 (RE) (Table 5).

## Tax Administration:

Given these challenges, it is not clear how far the projected revenue

**Table5: Union Government's Miscellaneous Capital Receipts (Rs. crore)**

| | 2015-16 (A) | 2016-17 (BE) | 2016-17 (RE) | 2017-18 (BE) |
|---|---|---|---|---|
| Disinvestment Receipts | 42,131.7 | 36,000 | 40,000 | 46,500 |
| Strategic Disinvestment | ... | 20,500 | 5,500 | 15,000 |
| Others (Listing of Insurance Companies) | ... | ... | ... | 11,000 |
| Total | 42,131.7 | 56,500 | 45,500 | 72,500 |

(*Source:* Compiled from Union Budget documents, various years.)

increases can be taken at face value. However, it may well be argued that a part of the increase in revenue projected 2017-18 (BE) can be explained by the improved tax compliance following demonetisation. In this context it needs to be mentionedthat human resource for tax administration plays an important role in improving tax compliance. The shortage of human resources[1]in the Income Tax Department, with the overall vacancy being as high as 30 per cent of the sanctioned strength[2], may also derail tax compliance and hence tax collections. Thus, unless the government takes measures to address these challenges, the voluminous growth expected in overall receipts and direct tax collections in particular, may not bear fruit.

## Endnotes

1 This is true for officials at various levels such as additional tax commissioner, deputy tax commissioner and income tax officials.

2 Cited in Sruthisagar, Yamunan, 2017, 'Demonetisation adds to Income Tax Department's Workload, even as it struggles with a Staff Crunch', January 3, available at: https://scroll.in/article/821881/demonetisation-adds-to-income-tax-departments-workload-even-as-it-struggles-with-a-staff-crunch. ❑

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