RECENT TAX REFORMS IN INDIA: WHICH WAY ARE WE HEADED?

A Joint Consultative Meeting

by

Oxfam India
&
Centre for Budget and Governance Accountability (CBGA)

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Venue: Seminar Room No. 2 & 3, Kamala Devi Complex

India International Centre, New Delhi

Concept Note

Over the last decade, the importance of domestic resource mobilisation as a means of financing sustainable development has been gaining ground among policy community, especially in the global South. It is widely recognised that domestic revenue moblisation is critical for governments to invest in social sectors, finance development and in the process reduce inequality and secure human rights. Other than the level of revenue mobilised, how taxes are mobilised play a critical role in impacting inequality.

Like in many Asian countries (including some countries in the East Asian region) in India too, the tax to GDP ratio continues to be low at around 17 per cent. In fact India's tax to GDP ratio is not only lower than the average for G20 countries it is also lower compared to the BRICS member countries.

Other than the fact of low tax to GDP ratio, the other aspect of India's tax structure is that it is heavily dependent on indirect taxes, which account for two-third of total taxes collected.

‘Race to the Bottom’ Tax Practices

This is largely a reflection of taxation policies having become increasingly geared to create ‘appropriate’ climate for private investment, both domestic and foreign. India, like other developing countries, have been engaging in aggressive tax competition, reflected in the tax exemptions, tax holidays given to big businesses and MNCs, in order to retain and attract private investment, including foreign investment. These ‘race to the bottom’ tax practices have resulted in a decline in contribution of corporate tax to the total tax in India and in general impeded mobilisation of adequate tax resources. Further, some taxes affecting high-income groups – such as wealth tax, capital gains tax – have been reduced or abolished in the 1990s and 2000s. At the same time, in order to offset the loss of revenue arising from such moves, regressive taxes on consumption, such as Value Added Tax (VAT) were introduced in the mid-2000s. To a large extent, therefore, taxation policies became increasingly regressive and the redistributive function of taxes has been considerably reduced.

While these changes have resulted in the tax structure becoming increasingly regressive and hence placing excessive burdens on poorer sections, the tax to GDP ratio has seen only marginal increase.

For developing counties such as India, the problem of low revenue moblisation is further aggravated by issues such as tax evasion, tax avoidance; i.e. tax abuse. Data leaks in the last few years, such as the Panama Papers, Swiss Leaks and Lux Leaks point towards the underbelly of financial secrecy offered to the rich and powerful through tax havens. While progressive and effective national tax policies are vital to raising domestic resources, the secrecy mechanisms of the shadow financial system limit the ability of governments to raise revenue on their own. Whether it is through anonymous companies or tax havens, or through the lack of effective information sharing between authorities across borders, illicit financial flows have a crippling effect on countries, especially developing countries.

Some Recent Reforms in Tax Policy

In the last couple of years, however, a plethora of reforms have been introduced in order to deal with the problem of low tax mobilisation. The most significant reform in this regard is the introduction of Goods and Services Tax (GST) in July 2017. There is a lot of expectation that GST will result in higher tax collections by increasing tax compliance and broadening the tax base as the unorganised sector comes into the tax net.

With regard to direct taxes too, a number of significant reforms have been initiated, especially since 2015-16. These include the changes made in India's Double Tax Avoidance Agreements (DTAAs) with Mauritius, Singapore and Cyprus. As a result of the amendments to DTAAs, beginning from financial year 2017-18 capital gains realised on investments in India would be taxable in India according to Indian law/rate. Another important change in corporate taxes relate to the phasing out of tax incentives, while simultaneously reducing the corporate tax rate to 25 percent. The latest among the reforms in direct taxes is the re-introduction of long terms capital gains tax on sale of equities in Budget 2018-19.

While many of these reforms are welcome, they also have their fair share of challenges. For instance, the jury is still out regarding how far GST has been successful in increasing revenue generation. Moreover, GST, in particular its attempt to formalise the unorganised sector, is seen to be largely inequalising so far. While attempts are being made to make GST less onerous for the unorganised sector, this can also impact its revenue generating potential. Similarly there are concerns regarding the revenue implications of further reduction in corporate tax rate, given that rate cuts have not necessarily resulted in increased tax collection.

Sources of Progressive Tax Revenue: Important but Largely Forgotten

Last but not the least, several areas in the realm of direct taxes that have significant potential to generate revenue, remain largely neglected. Global experience shows that property and wealth taxes have visible revenue mobilising potential. While India has property taxes, it has not been used effectively for garnering revenue in a progressive manner. Reforming the whole set of 'wealth taxes' can serve the twin purpose of curbing extreme inequality by redistributing income as well as augmenting revenue from direct taxes creating fiscal space for investing in social sector. Similarly, tax on stock market transactions, has been largely ignored, even when several commentators have noted that a small tax rate on financial transactions can finance social sector expenditure.

Purpose of this Consultation

The policy discourse on tax is still confined to technical experts, large accountancy and consulting firms, financial media and the Union Ministry of Finance. The issues related to taxation need to be popularised and requires greater participation of CSOs, community based-organisations, social activists, etc. This would help in democratising the discourse on taxation in the country. It is in this context that Oxfam India and Centre for Budget and Governance Accountability (CBGA) are planning to organise a half-day long consultation meeting titled '**Recent Tax Reforms in India: Which Way are We Headed**' at **IIC, New Delhi** on **September 3, 2018**.