A way to boost the tax base

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Why in News: Despite increasing growth rate and size of Indian economy, the tax revenue is not rising accordingly due to the narrow tax base

About Tax Base

A tax base is a total amount of assets or income that can be taxed by a taxing authority, usually by the government.

It is used to calculate tax liabilities. This can be in different forms, including income or property.

A Brief about India's Tax base

Even after 75 year of Independence, India's taxpayer base continues to be abysmally small and so does the direct tax-GDP ratio, at less than 6%.

Recently the Finance Ministry had revealed that the number of people who filed income tax returns stood at 6.8 crore in 2020-21This means that only 4.8 per cent of the total population filed IT returns in 2021.

Of these, only 1.69 crore paid tax since 65 per cent of the taxpayers earned less than ?5 lakh. So effectively, only 1.2 per cent of the population pays income tax as of now.

Also, the tax structure is such that the rich among individuals and firms find it easier to save tax, than their low-income counterparts.

About 15 million persons or 1% of the population or a quarter of those who file returns actually pay income taxes. Individual income up to 5 lakh is exempt. However, if income exceeds this threshold, then taxes have to be paid on income in excess Rs 2.5 lakh.

Nine individuals in the country reported the highest annual salary income of Rs 100-500 crore in assessment year (AY) 2019-20 and 35 had such income in the Rs 50-100 crore range.

Salary income which is the largest source among individual taxpayers was shown as nil by 47% of the 55.3 million people who filed tax returns in that year.

The average effective tax rate for domestic companies was 22.54% in FY20, down from 29.49% in FY18, as statutory rates varied between 25.17% and 34.94%.

Firms with profit before tax of over Rs 500 crore have average ETR of 20.19%, as many have shifted to the new 22% tax regime sans exemptions.

Major tax incentives for corporate taxpayers resulted in revenue foregone of about 1.03 trillion in FY21, up from Rs 0.86 trillion in FY17.

Reason for the low tax base

The low base of income tax payers has been debated and discussed about quite often in the past. There are reasons why the number of taxpayers is low in the country.

Of the total population of 140.76 crore in 2021 according to World Bank, only 95 crore people were in the working age group of 18 to 64 years. Now, not all those in the working age are employed.

Many women, for instance are home-makers or care-givers and may not be in the working cohort. The worker population ratio in India is 44.5 per cent, which means that only 42 crore people could be employed in some way or the other in India.

Further, a dominant portion of India’s workforce in employed in agriculture and agri income is exempt under income tax. This results in 45.6 per cent of agri-workers not filing tax returns. So, only 23 crore of the workers in the non-agri segment are liable to pay tax.

Besides these, the tax incidence arises only if the income is above a certain threshold. If we account for people earning under ?5 lakh per annum, that is likely to whittle down the tax payer base further.

According to Statista, 67 per cent of Indian households had annual income under ?6 lakh in 2021. This reduces potential income taxpayers to 7.6 crore.

Given these factors, the current run-rate of IT return filing between 6.5 and 7.5 crore is not low. But how to harness the increasing working age population and take this number higher?

Measures for increasing the tax base

A low-hanging fruit is the agricultural income and many have also been advising the government to bring it in to the tax net. But this happens to be a political hot potato and action on that front is unlikely. There are however two other means through which the number of income tax return filers can be increased.

One, through increasing the formalisation of the economyAccording to a paper, ‘Measuring Informal Economy in India_ Indian experience’, by SV Ramana Murthy, of the total workforce in 2017-18, 90.7 per cent was employed by the informal sector.

The report says that besides agriculture, some sectors such as construction, trade, restaurants, communication and other services too have over three-fourth of the entities operating in the informal sector. Bringing such businesses in to the formal sector could help direct tax collections

This can be done with some help from the GST system. One of the objectives of the GST regime in its original form was to nudge those in the unorganised sector to shift to the formal sector and file GST returns in order to avail input tax credits or to continue supplying to larger buyers.

But leeway provided in the initial phase, such as doing away with invoice matching, dropping reverse charge mechanism etc have diluted this objective. With the GST system now having settled down, implementation of these self-policing mechanisms rigorously could help increase the formal economy.

Collecting tax at source for purchase of certain goods and services is another way to identify those who earn a tidy sum every year but are not paying any taxes.

As of now, TCS is collected for high value goods such as expensive motor vehicles, gold jewellery or overseas remittances. The ambit of TCS can be expanded to consumer durables, domestic luxury travel, stays in expensive hotels etc.

This can help identify those operating in the informal sector and earning high income, yet evading tax. While this could hit honest taxpayers, they can reclaim the tax in their annual return based on the form 26AS.

Conclusion

Administrative procedures and information sharing between the direct and indirect tax wings have helped the number of tax filers increase quickly in recent years. The government should bring further reforms to widen the tax base and to achieve the objective of economic equality