

THE CHALLENGE OF CATCHING ELUSIVE TAXPAYERS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

India's tax collection is set to decline sharply this year because of the decline in national income and fall in employment due to COVID-19. Simultaneously, expenditures related to the pandemic are ballooning. Thus, the fiscal deficit in the budget is set to rise unless other expenditures are cut. However, there are committed expenditures which cannot be curtailed and the deficit in the budget is set to climb to a new high for 2020-21. So, there is no option but to try and collect more taxes.

The Prime Minister unveiled income tax reforms to make the system faceless, painless and seamless. He stated that 15 million people pay income tax out of a population of more than 1.35 billion. This is the number for the financial year 2018-19. For 2019-20, the number of taxpayers may be similar given that the economy was slowing down and unemployment was at a record high. In 2020-21, the number would drop sharply due to the impact of COVID-19 and massive unemployment in the organised sector.

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The number of tax filers has increased but the number of taxpayers has dropped. This is a result of the tax concession offered in the Budget — those filing a return up to 5 lakh do not have to pay a tax. Interestingly, in 2012-13, a year for which the government had released detailed data in 2016, the number of effective tax payers was 16 million. So, in spite of an increase in population and the laws introduced in the last six years to bring the rich into the tax net, there has been little change in the number of taxpayers. The fact that the direct tax to GDP ratio in percentage terms is stagnating at about 5.5% is another indication of this.

There are two categories of the well-off in the country: those who file a tax return and those who completely escape the tax net. If the former had declared more of their incomes, the tax to GDP ratio would have risen. If those who were outside the tax net had come into the tax net and started filing their returns, there would have been a rise both in the tax to GDP ratio and the number of taxpayers.

A 2016 report says the top 10% of Indians earned 55% of the nation's incomes. If these people could be brought under the income tax net and they paid their taxes honestly, at current tax rates, income tax to GDP ratio alone would have been about 18%. Add to that the collection from other direct taxes, like corporate tax, and the figure would be more than 20%. This figure of 55% does not take into account the black income generation in the country. Clearly a lot of taxes are not paid out of white incomes and none from the black incomes.

Demonetisation was supposed to bring out the black incomes and turn them white so that the tax to GDP ratio could sharply rise. The government made repeated announcements about how many more people had come into the tax net after demonetisation and about how more tax would be collected. No such thing has happened as the Prime Minister's statement implies.

The government has been trying hard to tackle the large black economy. As soon as it started its innings in 2014, the NDA set up a special investigation team under court orders. It renegotiated the tax treaty with Mauritius to get back to India the money held abroad. But nothing seems to budge the rich (say, the top 1% in the income ladder) to pay more tax. Actually, the rich are fleeing the country. More than 23,000 high net worth individuals left the country in five years up

to 2019. Embarrassingly, when the Defence Minister was in France last year to receive the first Rafale fighter jet, the CEO of Dassault Aviation said in a speech that India should not terrorise them with its tax and custom rules.

A considerable part of the tax filing process was computerised when e-filing and, earlier, PAN were introduced. These measures tried to cajole people into filing honest returns. Former Finance Minister Yashwant Sinha introduced the scheme of honouring honest tax payers. The government is again talking of it. The Vivad se Vishwas scheme was introduced to settle tax disputes. But none of these schemes seem to have delivered.

The government is able to trust neither the tax department officials nor the rich. So, it has decided to hand over the process of taxation to computers. The computer will decide who will assess the tax return of an individual. During the different stages of a case, different officers will be involved. That is why the new scheme is said to be faceless and anonymous so that no nexus can be formed between the taxpayer and the officer involved in passing the return, and money cannot be paid to evade taxes.

The department is being reorganised into assessment units, verification units, review units and technical units. There will also be a small unit to take care of past matters. Apparently a pilot project was run last year to assess the efficacy of the new scheme of things. However, there is worry that the software can be manipulated by those who know the system.

There is an administrative problem. The department is grossly understaffed and officers have inadequate time to scrutinise cases. A few thousand officers have to deal with lakhs of cases. What takes a clever Chartered Accountant a few months to prepare cannot be deciphered by an officer in a few hours. Incomes of salaried employees are simple to estimate but the problem lies with estimating business incomes. To estimate them one needs to know the revenue and costs. Both are fudged through under-invoicing and over-invoicing. Businessmen declare their entire household expenditure as business costs. Even if a lot of computerised data are available it may prove to be inadequate. In 2016, before demonetisation, the government had initiated an Income Declaration Scheme. To scare people, the department announced that it had data on 93 lakh high-value transactions and would use it to catch people but this had little impact.

The highest tax rate has been brought down from 97.5% in 1971 to 30% (plus surcharge) now. After 1991, with new economic policies, the controls and regulations were sharply curtailed – the Monopolies and Restrictive Trade Practices Act, the Foreign Exchange Regulation Act, etc. were removed. But the well-off have constantly complained that tax rates are high and there are too many controls; that they pay all the taxes but get nothing in return. This lament is rather unfair since they have gained the most out of the country's development. So, at what level would there be satisfaction that tax rates and regulations are fine?

This is an important pointer to the feeling of social injustice in every section of the population. The well-off who have gained the most complain of it and the poor live with injustice. There is massive alienation in society. The pandemic also points to this – the way vast numbers have suffered and why they do not heed the authorities.

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