

WHO PAYS TAXES AND WHO DOESN'T

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Taxation & Black Money

The Central Board of Direct Taxes has released the latest data on income tax collections. Several interesting facts emerge from the data. The number of taxpayers has increased drastically over the last four years. The number of tax returns filed has surged to 6.85 crore in FY 2017-18, an 80% growth since FY 2013-14. Also, the number of taxpayers reporting income greater than 1 crore has reached 1,40,139, an increase of 60% between assessment year (AY) 2014-15 and 2017-18.

However, the [tax collections](#) have not shown commensurate increase. Collections have grown at a decent compound rate of about 13% per annum. More surprisingly, the average income reported by rich Indians (those in the highest tax slab) has decreased. In fact, over the last five years, the share of the richest top 1% in the total tax collected has decreased by almost four percentage points. The same is the case with the top 5% income earners (graph 1). In contrast, relatively low income groups are paying a larger proportion of the tax collected. How can this be, given that the number of taxpayers has increased across all the tax slabs and more individuals report income in crores than ever before (graph 2)?

While for the low tax slabs, the average reported income has also increased, this is not the case with high income groups. After 2016, the average income reported by those in the highest tax slab is 13% less than their average just before 2016. Apparently, a number of high-income individuals (HIIs) grossly under-report their income. Clearly, the Income Declaration Scheme of 2016 and other official measures announced to stem tax evasion by the rich have failed to achieve the desired results.

Direct tax collections grow 18.2%

The Global Wealth Report 2018, by Credit Suisse, provides estimates of wealthy Indians. Even by a rather conservative approach towards the wealth-income ratio, it suggests that at least 3,400 Indians have an annual income of more than 50 crore each. But only 179 of them reported this level of income to the taxman in AY 2017-18. Similarly, out of more than 1,500 Indians with an expected annual income of more than 100 crore each, only 61 reported to the taxman.

Besides, the share of reported non-salary income in the gross income of individuals has declined over the years, to 43% in 2017-18 from 48% in AY 2012-13. This suggests that the tax base has not deepened among professionals such as lawyers, doctors, accountants and those running private educational institutes, who continue to under-report their income.

Tax avoidance/ evasion by companies also remains an area of serious concern. In AY 2017-18, a mere 7% of corporates reported profit before tax of more than 1 crore. Again, the problem of under-reporting is serious with professional and the other service sector entities, which account for more than one-third of all corporates. As a consequence, the share of direct taxes in the total tax collection has remained low.

The tax collection figures for this year look better. Some of the apparent improvements will be due to cooking of the books by companies, facilitated by schemes like the Presumptive Taxation Scheme. This allows an assessee to take full benefit of past evasion and escape without scrutiny, simply by paying a turnover tax. By increasing the threshold from 1 crore to 2 crore, the government has made the scheme even more attractive. No wonder, the number of filers under the scheme shot up to 1.17 crore on August 31, 2018, from 14.93 lakh on August 31, 2017 — a

stupendous growth of 681%!

However, things are expected to improve with proper implementation of the Goods and Services Tax (GST). This tax generates trails of transactions across value and income chains. Reports emanating from leading business centres like Surat indicate a significant increase in tax collections, for direct as well as indirect taxes. While implementation of the GST will surely help stem tax evasion by semi-formal and mid-size companies by formalising their transactions, it cannot address the main problem: tax evasion and avoidance by HIs and big corporates.

Several reforms are needed in the tax law. The extant tax law does not require filing of returns if the income is below the taxable threshold (2.5 lakh). This means that many professionals who can easily manipulate their accounts never appear on the radar of the taxman. The law should mandate filing of returns by all professionals and proprietorship businesses regardless of their profit. This will increase compliance by enabling the taxman to scrutinise suspicious cases. There is also a case for the wealth tax. Compared to income, the wealth level is harder to manipulate; therefore, the tax is harder to evade.

For companies, the tax law allows offsetting of past losses against future profits. Besides, definition of admissible expenditures are susceptible to easy manipulation. These provisions are widely misused by corporates by claiming bogus expenses, to artificially reduce their profit and hence their tax liability. Unsurprisingly, for AY 2017-18, as much as 46% of corporates reported either losses or nil profit. Another 47% reported profit less than 1 crore. These provisions need re-examining. As such, a large number of companies showing negligible or no profit points to a continued prevalence of shell companies and other dubious structures which require systematic investigation.

Moreover, the numerous tax exemptions also come in handy for tax avoidance. Big corporates benefit more from these exemptions. Consequently, smaller companies face a higher effective tax rate compared to larger corporates. This makes the tax regime regressive. Going by the Budget papers 2018, the effective tax rate of companies with profit greater than 500 crore was only 23.94%, while it was higher at 29.43% for companies with profits less than 1 crore.

There is also a need to enhance the deterrence power of the law, which depends on the likelihood of punishing tax evaders along with imposing a fine. At present, the Income Tax Department has a very poor win rate before the appellate tribunal and the higher judiciary. As a result, the law does not bite enough to hurt the tax offender. The odds of punishing the offenders can be increased by integrating the GST, the income tax and the Ministry of Corporate Affairs' databases. These measures will go a long way in deepening the tax base among high-income groups and professionals.

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