


## ECONOMICS

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# India's Approach to Expanding the Tax Base Enhances Fairness and Efficiency

In article  07:45 PM, Oct 11, 2018

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There are three broad avenues for enhancing the tax base. First, sustained broad-based high growth, encouraging new economic activities and business formation, and creating conditions for new growth nodes.

This avenue may be termed Economy-wide Initiatives (EI).

The second avenue is to progressively bring more number of taxpayers in the tax registry, consistent with the prevailing statutory provisions.

This will narrow the gap between those who should be in the tax registry and those that are actually in the tax registry. Narrowing the gap between the two should be regarded as an important indicator of this avenue. This implies that the tax authorities have acquired

capabilities to make requisite estimates of the gap.

In some cases however, the statutory provisions may be changed to ease compliance costs of the taxpayers and to ease tax administration work-load. Similarly, prevailing provisions may be altered to expand the number of taxpayers.

This avenue may be termed Narrowing Tax Registry Gap. (NTRG)

The third avenue is to gradually increase the proportion of taxable income that is reported to the tax authorities.

Globally, income of small businesses, and professionals such as those in entertainment, doctors and others in health care, in financial and accounting services, and in the tuition academies, have been under-reported. By increasing the proportion of their taxable income, the tax base can be increased. Globally, many large forms, such as Google, Apple, and Starbucks, have practiced tax planning, and shifting of the tax base to low tax or to tax heavens. To the extent base shifting can be reduced, tax base can be expanded. This avenue may be termed as Narrowing Income-Reporting Gap (NIRG)

To obtain the tax revenue generation, tax base should be multiplied by the applicable nominal tax rates. It should be noted that the complexity in tax laws primarily arise from defining the tax base, and not from the rate structure.

Structuring the tax base as broad as possible, while keeping nominal tax rates as low as possible, consistent with given revenue objective, is widely accepted lesson from tax reform experiences globally. From the political economy perspective, however, the experience has been that it is easier to lower tax rates, then to broaden the base.

It is in the above context that the above three avenues to expand the tax base for the personal or individual income tax, corporate or company income tax, and the GST, which are being pursued by India's Union government led by Prime Minister Narendra Modi should be viewed. While this column focuses on the initiatives of the Union government, similar opportunities exist at the state level, and among the urban and rural bodies. In particular there are significant opportunities to expand the tax base of the property tax, land taxes, and excise taxes, as well as the state GST.

### **The Economy-wide Initiatives (EI)**

India has exhibited sustained high rate of economic growth, while keeping inflation relatively low. This, the IMF, In its October 2018 *Global Economic Outlook*, projects India's 2018 real GDP growth at 7.3 percent, as compared to 4.7 Percent for Emerging Markets and Developing countries. For 2019, projected growth in real GDP is 7.4 percent, while the global growth is expected to remain at 3.7 percent in both 2018-19. In 2017, India was the second largest contributor to Global growth. India's inflation rate has been fairly moderate at around 4 percent as measured by the consumer Price Index (CPI), but at around 6 percent for Core CPI. These are within the Reserve Bank of India's inflation targets. This rate of CPI inflation still needs to be brought down further through supply-side measures, and economy-wide

efficiency gains. At the nominal GDP growth rate of around 12 percent per year (real GDP growth plus inflation rate), if sustained, the compound interest formula suggests that India's current GDP of about 170 trillion will double in six years. This will help expand the tax base. India is addressing the current volatile global environment, to which higher than expected oil prices, upward movement in global interest rates, and in yields of government securities, and trade tensions between United States and China have been the contributing factors.

India has also taken several initiatives to broad-base economic activities, develop new growth nodes, and lay solid foundations for future business expansions. The Blue Economy initiative focuses on better utilizing India's coast-line and inland waterways to encourage port-led development and growth nodes. This initiative, along with other infrastructure and related initiatives by the Union and state governments will facilitate the emergence of the Northeast region of the country as a new growth-node.

India established Investment and Infrastructure Fund Limited (NIIFL) in February 2015. It is anchored by the government of India, but operates as a professionally managed to attract funds from Sovereign Wealth Funds, and from multilateral institutions such as Asian Infrastructure Investment Bank (AIIB). Its aim is to facilitate investments in infrastructure, including ports development, in India. NIIFL is contributing to stronger foundations for India's growth.

A first ever investor summit in the state of Uttarakhand in the northern part of the country, held on October 7 and 8, 2018, illustrates how even smaller states (its population in 2018 is estimated to be 10.5 million) are being encouraged to act as growth-nodes. Uttarakhand aims to emerge as spiritual and ecological tourism hub. The state plans to set up infrastructure and other facilities to develop 13 new hill stations for tourism. It also aims to brand itself as an organic farming state, with a view to diversify crops, and enhance value of its crops and medicinal plants. India's online services enterprises are encouraging greater professionalism and widening markets for home services such as for carpenters, plumbers, wedding photographers, and others. As an example, Urban Clap is India's largest home services marketplace, with over 0.1 million professionals, who have already served over 2 million customers across cities in India ([careers.urbanclap.com](http://careers.urbanclap.com)) It has expanded outside India, such as Dubai. Such enterprises are increasingly swelling India's middle class, and expanding the tax base.

The PMMY (Pradhan Mantri MUDRA Yojna), launched in April 2015 for providing loans up to INR 1.0 million to the *non-corporate, non-farm* small and micro-enterprises, is setting a solid platform for expanding business activities and entrepreneurship in the country. MUDRA is an acronym for Micro Units Development and Refinance Agency. The loans are provided through various banks. The quality of loans is however crucial to minimize any excessive burden either on the banks or on the government finances.

Since its inception, (up to September 30, 2018), the cumulative number of loans under this scheme have numbered 140 million, with cumulative disbursement of INR 6460 Billion. There is accumulating evidence from various parts of the country that suggests that some beneficiaries are expanding their businesses and becoming livelihood providers. (See handle

of @MudraCampaign managed by Department of financial services of the Ministry of Finance for the success stories). The Start-Up India scheme was launched in January 2016 by the Union government. It also leverages global funding such as from the Soft Bank of Japan to invest in India's start-ups. Several state governments, such as Kerala and Goa, have also undertaken their own start-up initiatives to leverage on the Union Government's scheme. As of September 2018, there have been more than 14000 tech start-ups. Some of the future successful entrepreneurs are likely to emerge from this group as well.

These and other initiatives are also significantly increasing India's middle class, helping to expand the tax base. For the future, 5500 Atal Tinkering Labs (ATLs) have been established. Under ATL, young school children get opportunities to work with tools and equipment to understand the concepts of STEM (Science, Technology, Engineering, and Mathematics). The target is to reach one million children by 2020.

### **Narrowing Tax Registry Gap (NTRG) and Narrowing Income-Reporting Gap (NIRG)**

These two avenues for expanding the tax base are discussed together as available data are not sufficiently disaggregated and robust to distinguish between the two. The data do provide strong indications that India's GST (Goods and Services Tax), and income tax base have expanded rapidly, with prospects for greater expansion of the base in the coming years. Because of lack of data, expansion of tax base for the corporate income tax is not discussed. This expansion has been aided by several factors.

First, there has been increasing focus on enhancing tax capacities, aided by technology of the income tax department.

Second, sound design of the GST, and establishment of GSTN (GST Network) that acts as a technology backbone for administering the GST. GSTN is registered as a company, and is owned jointly by the Union and the state governments.

Third, increasing use of digital mode of payments has helped in greater formalization of the economy, and in tracking unaccounted or unrecorded wealth and income in a dynamic manner. Currency swap (popularly known as demonetization) has also helped in this regard.

Fourth, there has been increasing use of data analytics and data mining in tax administration. Indeed, the income tax department has reportedly requested access to GST data to assist in the income tax administration.

The reporting of tax data needs to be substantially improved. The income tax department and the GSTN should make easily accessible, disaggregated data for personal income tax, company income tax, and GST available on their web sites.

With increasing digitization of tax administration, the data are there internally, but currently not accessible to the public, foregoing opportunity to benefit from rigorous research from differing perspectives. This will also help improve the quality of tax policy discussions.

**Indicators:** The income tax department has issued nearly 380 PAN numbers, of which nearly 370 million have been to the individuals. The distribution of PAN cards between males and females is 65 and 35 percent respectively.

The individual income tax returns filed for Financial Year 2018 (up to August 31, 2018) were 54.2 million, as compared to 31.7 million for corresponding period for Financial Year 2017, an increase of 71 percent. This figure does not include those who contribute to income tax only through tax deducted at source (TDS), and do not file returns. The expectations are that the Financial Year 2019 will exhibit another substantial increase.

April 2018 data by the income tax department suggests that the new income tax return filers during 2017-18 were about 10 million, on top of 8.6 million such filers in 2016-17. The official figures suggest that for 2018-19 (up to September 2018), the gross collections were INR 5.5 trillion, 17 percent higher than the corresponding period for the last year. The net collection, after refunds, was INR 4.4 trillion, an increase of 14 percent. For 2018-19, corporate income tax collections increased by 18.7 percent; while for the personal income tax, the increase was 14.9 percent. During the first half of 2018-19, about two fifths of the income tax revenue expected in the Union Budget has already been collected.

The number of GST taxpayers has also increased sharply.

As of July 2018, 6.37 million taxpayers migrated from the old system of plethora of consumption taxes, while nearly 5 million new taxpayers registered for the GST. Thus, the total number of GST taxpayers by end July 2018 was 11.3 million. This number is also expected to grow. The addition of nearly 5 million new GST taxpayers is a remarkable achievement. The design of GST makes it essential for businesses to register and to declare fuller sets of transactions than before.

The average monthly GST revenue collection in 2017-18 was INR 899 Billion. During April to August 2018, the average monthly revenue collection was INR 967 Billion. There are also indications that the compliance rates for GST are increasing. The increase in GST revenue in 2018 has occurred in spite of numerous reductions in tax rates, and in some cases (e.g. Assam) sharp increase in the exempted turnover. The potential for expanding the base of personal taxpayers (and of GST) through both these avenues is illustrated by a news item in the Navbharat Times dated October 6, 2018. It reports that in Ludhiana, Punjab, a small shopkeeper selling chat ("pakodawala" in popular language) disclosed INR 0.6 million to the tax authorities. This was made possible by the tax department discreetly surveying the premises for income being generated at the shop in the preceding days.

More systematic and wider occupation and location specific surveys could help expand the tax base through both NTRG and NIRG avenues. This manner of expanding the tax base enhances fairness, particularly for the salaried class, and for those businesses, professionals, and manufacturing firms, and others who take their obligation to pay tax seriously.

The above method of expanding base enhances both fairness and efficiency by creating less uneven field among businesses, thereby compelling them to compete on the basis of utilizing economic resources more productively, rather than on the basis of tax avoidance and evasion.

## **Conclusion**

The three avenues outlined above are contributing to enhancing fairness and efficiency of resource use. They therefore constitute sustainable basis for generating revenue to provide needed public amenities and services to whole population. This approach particularly benefits the current and emerging middle and aspirational class, and deserves their support.

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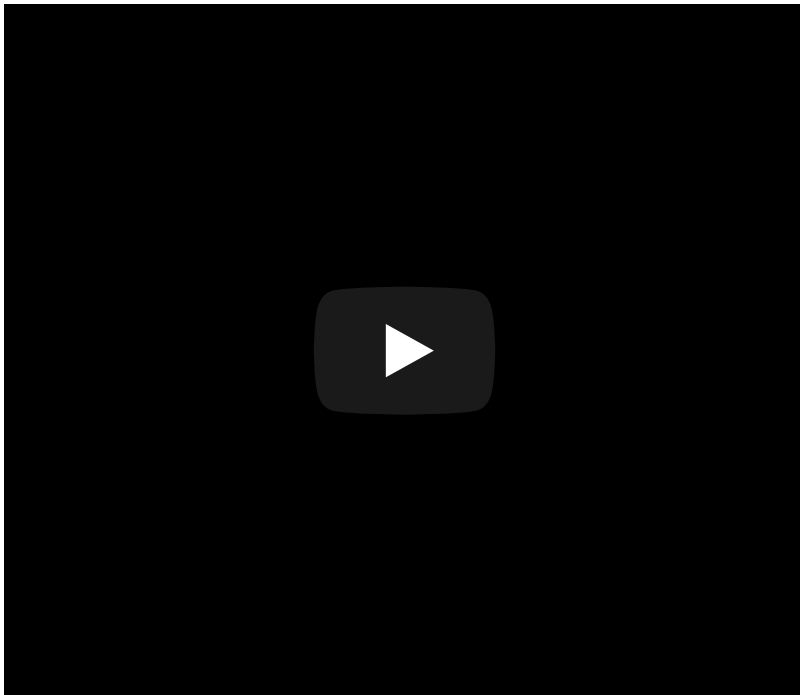
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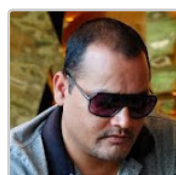


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