General Studies-3; Topic: Indian economy – mobilization of resources

Increase in Direct Tax Collections

1) Introduction

- India's direct tax to GDP ratio hit a ten year high of 5.98 percent in the fiscal year 2018.
- The total direct tax collection is estimated to be over ₹10 lakh crore in 2017-18, an increase of about 18% from the previous year.

2) Reasons

- GST collections was not as expected and that can be one of the reasons for the increase in direct tax-GDP ratio.
- The number of salaried taxpayers, whose taxes are diligently deducted at source, is rising at a faster pace than the non-salaried.
- This shows higher level of compliance resulting from various legislative and administrative measures taken by the government, including effective enforcement measures against tax evasion.
- **The rise in tax compliance has been attributed to the various measures taken by the Union government including**
  a. The effect of demonetisation.
  b. Increase in the use of information being collected digitally and being used by the tax department.
  c. Movement towards digital assessment and decrease in the number of cases being picked up for scrutiny.
  d. Ease of getting refunds, majorly by small and medium taxpayers.
  e. Lowering of various other tax compliance costs.

3) Highlights

- The steps taken by the Union government over the last few years to widen its tax base may finally be yielding some rewards.
- Contribution of direct taxes to the total amount of taxes collected by the government is currently 52.29%.
- The total number of tax returns filed in the country increased by over 80% over the last four financial years, according to data released by the Central Board of Direct Taxes.
- The number of persons filing income tax returns also increased by about 65% during this period.
- The direct tax to GDP ratio rose to 5.98% in 2017-18, the highest it has been in the last 10 years.
- The average income reported by individual and corporate taxpayers also witnessed a significant rise in the last three years.
- With tax growth rate surpassing the growth in GDP, the tax buoyancy factor rose to 1.81.
- Number of taxpayers (including corporates, firms, and Hindu Undivided Families) declaring an income above ₹1 crore a year also saw a sharp growth over the three years.

4) How to increase tax collection?

- Rewards could be more effective in motivating people to pay tax like reduced public transportation fares or special privilege in government-operated hotels, hospitals, and airlines.
- South Korea considers allowance to airport, VIP rooms, and free parking in public parking facilities.
- Providing tax-compliance certificates to firms to help them build an image.
- Making tax certificates mandatory to renew certain licenses.

- Good financial behaviour needs to be celebrated publicly
- Government could consider an insurance scheme for informal sector business tax payers by providing financial support in times of distress.
- Quick settlement of disputed cases.
- For creating conducive tax administration there is a need to introduce academic courses on ethics and business practices for business graduates, chartered accountants, company secretaries, auditors and legal experts.

5) **What is Direct Tax?**

- Direct taxes are levied on a person's or a firm's income or wealth.
- The incidence and impact of the direct tax fall on the same person.
- Example: Income Tax, Corporation Tax, capital gains tax and Wealth Tax.
- The impact is not Inflationary.
- Social objective of direct tax is the distribution of income. A person earning more should contribute more in the provision of public service by paying more tax.

6) **Advantages of Direct Tax**

- A further increase in the share of direct taxes will help the government to lower regressive indirect taxes that impose a significant burden on the poor.
- Direct taxes are better for economic efficiency as they help avoid the severe distortionary effects of indirect taxes such as the Goods and Services Tax.
- Direct taxes tend to be progressive – people in the higher income group pay a greater percentage than poorer people.
- If the government is fighting inflation it can impose, for example, high levels of income tax to restrict consumer demand.
- If the government is concerned about unemployment it can reduce the levels of income tax to increase consumer demand and increase production.
- Direct taxes constitute an important source of government revenue. Their collection charges are also low.
- A direct tax increases the civic sense of the people. When the people are fully aware of the payment of taxes, they are also conscious of the way the government spends the money.

7) **Demerits**

- Direct taxation discourage savings because, after paying tax, individuals and companies have less income available to save.
- This means that investment, which relies on the level of savings, is low and this could cause less production and employment.
- When the rate of personal income tax or corporate profit tax is raised, criticism from those affected becomes very strong.
- Sometimes they are evaded by submitting false returns.
- Many business ventures are not undertaken on the ground that a large part of the income will have to be spent on taxes.

8) **Concerns / Challenges**

- The share of direct taxes in the total is still low.
- It is also far too low when compared to its peak of over 60% in 2009-10.
- Delay in drafting a new direct tax code due to bureaucratic delays.

9) Way Forward

- The share of direct taxes in total tax collections must go up as indirect taxes are relatively regressive.
- Proper implementation of GST creates audit trails across the income and value chains will generate a broader base for direct taxes.
- Making compliance easy and taking tough action against evaders.
- Tax evasion is more common among the self-employed and in the unorganised sector. So, the need is to bring large section of the informal sector under GST and make them formal.
- The government must raise the income threshold for the maximum marginal income tax rate of 30%, rather than lower the tax rate.
- India's corporate tax rate must come down to below 20%, to ASEAN levels if it wants to maintain its stature as an attractive investment destination.
- It will create an incentive for individuals to incorporate their businesses and become more transparent.
- Reforms must aim at doubling the tax collections by the Centre and the states combined that stands at around 17% of GDP.
- The government must address the delay in drafting direct tax code.