**2. Taxation**

**Highlights**

1. Tax for individual assesses with taxable income of Rs.2.5 lakh to Rs.5 lakh reduced to 5% from 10%

2. A surcharge of 10% of tax payable on categories of individuals whose annual taxable income is between Rs. 50 lakhs and Rs. 1 crore. The existing surcharge of 15% of tax payable on people whose annual earning is more than 1 crore is to continue.

3. Income tax rate has been reduced from 30 percent to 25 percent for Micro, Small and Medium Enterprises (MSMEs) with annual turnover of up to Rs. 50 crore.

4. Time period for Long Term Capital Gains tax for property reduced to two years from earlier 3 years. The base year for indexation is proposed to be shifted from 1.4.1981 to 1.4.2001 for all classes of assets including immovable property.

5. A simple one-page form to be filed as Income Tax Return for the category of individuals having taxable income up to Rs. 5 lakhs other than business income.

6. Basic customs duty on LNG reduced from 5 percent to 2.5 percent.

**Introduction**

Following the demonetisation drive of the government and the ensuing hardships faced by a wide section of the population, many had expected that the Union Budget 2017-18 will bring forth major changes in tax rates, threshold limit of taxation, tax exemptions, etc. Indeed the Budget does contain some changes on the tax front, mainly in the arena of direct taxes. The most important of these is the tax relief provided in the form of reduction in personal income tax rates levied on the lower-middle income tax payees. At the other end of personal income tax rate, a welcome move has been the levying of a surcharge of 10 percent on those whose annual taxable income is between Rs. 50 lakhs and Rs. 1 crore. Another move in the positive direction relates to the reduction in income tax rates for MSMEs with annual turnover up to Rs. 50 crore.

**Revenue Projections and Tax-GDP Ratios**

The reduction in some of the tax rates notwithstanding, there has been a significant increase in revenue projections of the government, with tax revenues alone increasing by more than Rs 2,00,000 crore in 2017-18 (BE) when compared to 2016-17 (RE). Further, nearly 64 percent of the projected increase in tax revenues is on account of direct taxes such as corporation tax and personal income tax. As a result, as Table 1 shows, not only is the Tax to GDP ratio estimated to cross the 11 per cent mark, the projected direct tax to GDP ratio is also one of the highest in many years. However, the picture of progressivity in taxes when considering only Central Government tax receipts can be misleading. In this context, it should be noted, that when the overall tax collections of both the Centre and the States is taken into account, nearly two-third of total tax collected is accounted for by indirect taxes, implying that the tax structure continues to be extremely regressive.

**Table 1: Gross Central Tax- GDP Ratio (in %)**

|  |  |  |  |
| --- | --- | --- | --- |
| Year | Gross Tax-GDP Ratio | Direct Tax-GDP Ratio | Indirect Tax-GDP Ratio |
| 2012-13 (A) | 10.4 | 5.6 | 4.8 |
| 2013-14 (A) | 10.1 | 5.7 | 4.4 |
| 2014-15 (A) | 10.0 | 5.6 | 4.4 |
| 2015-16 (A) | 10.6 | 5.4 | 5.2 |
| 2016-17 BE | 10.8 | 5.6 | 5.2 |
| 2016-17 RE | 11.3 | 5.6 | 5.7 |
| 2017-18 BE | 11.3 | 5.8 | 5.5 |

*Notes:*

1. Direct taxes such as estate duty, gift tax have not been taken into account as they form negligible proportion of direct taxes.
2. Taxes on Union Territories also have been taken into account in the calculation.

*Source:* Compiled by CBGA from Union Budget documents, various years.

**How reliable are the Projected Revenue Figures?**

There are several reasons to question the huge increases in the revenue projections. For one, as past experience shows, there is usually a shortfall in actual tax collections compared to either the budgetary estimates or even the revised estimates. This was true for the year 2015-16 too in the case of direct taxes. Therefore, in all likelihood even the projections for 2017-18 (BE), especially in the case of direct taxes, are likely to be on the higher side. Second, the likelihood of the projected numbers being on the higher side is further compounded by the fact that this is the first year that the revenue data provided by the government is based only on the first nine months of the year. Third, a part of the quantum jump in the rate of growth of direct tax collections at around 35 percent can perhaps be explained by the use of demonetised notes to pay advance taxes. If this is indeed so, then it cannot be taken as a basis for projecting tax collections for the entire year. Even the projections for indirect tax collections are questionable. This is because while in the previous year a large part of excise duty collections were due to windfall provided by higher global oil prices, the slowing down of the economy in the post-demonetisation period is likely to dampen tax collections from this source.

While the above refers to projected tax revenue, even the projections for miscellaneous capital receipts, comprising disinvestment receipts, strategic disinvestment and others (listing of insurance companies), seem to be high given that only a small part of the strategic disinvestment projected in 2016-17 (BE) actually fructified in 2016-17 (RE). Further given the unfavorable investment climate in the country, the actual disinvestment receipts might be very different from the figures projected in 2017-18 (BE).

**Table 2: Miscellaneous Capital Receipts (Rs. crore)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | 2015-2016 (A) | 2016-2017 (BE) | 2016-2017 (RE) | 2017-2018 (BE) |
| Disinvestment Receipts | 42131.69 | 36,000 | 40,000 | 46,500 |
| Strategic Disinvestment | ... | 20,500 | 5,500 | 15,000 |
| Others (Listing of Insurance Companies) | ... | ... | ... | 11,000 |
| Total | 42131.69 | 56500 | 45500 | 72500 |

*Source:* Union Budget 2017-18.

**Tax Administration**

While some may well argue that a part of the increase in revenue can be explained by the improved tax compliance following demonetisation, it also needs to be kept in mind that human intervention for tax administration plays an important role in improving tax compliance. However the, the huge shortage of human resources in the Income Tax Department, with vacancy being as high as 30 percent of the sanctioned strength, may further derail tax collections. In short, the voluminous growth expected in overall receipts and direct tax collections seems like a tall claim and the final numbers may well be quite different.

**Revenue Foregone**

**Some Important Declarations in Budget 2017-18**

|  |  |
| --- | --- |
| Tax incentives | Revenue Foregone (Rs. crore) |
| Tax rates for MSMEs with turnover up to Rs. 50 crore reduced | 7,200 |
| Personal income tax rate cut for those falling in the tax slab between 2.5 lakh to 5 lakh | 15,500 |
| Total net revenue foregone because of exemptions in direct taxes | 20,000\* |

*Note*: \*The government expects to raise Rs. 2,700 crore out of the 10% surcharge on annual taxable income between Rs.50 lakh to Rs. 1crore and 15% surcharge on income above Rs 1 crore.

*Source:* Budget Speech, Union Budget 2017-18.

**Revenue Foregone and Fiscal Policy space**

The total revenue foregone is projected to be Rs. 3.18 lakh crore in the year 2016-17, which is estimated as 2.1 percent of India’s GDP. The trend in revenue foregone as a percent of GDP is presented in the figure below.

Figure 1: Trend of Revenue Foregone as a % of GDP (2011-12 to 2014-15)

*Source:* Compiled by CBGA from Union Budget documents, various years.

Figure 2: Trend in Revenue Foregone as a percent of GDP (2015-16 to 2016-17)

*Source:* Compiled by CBGA from Union Budget documents, various years.

As is clear from Figure 1 and Figure 2, there has been a sharp drop in the revenue foregone to GDP ratio from 4.5 percent in 2014-15 to 2.1 percent in 2016-17. This decline is primarily owing to lower estimates of revenue foregone on account of excise duty and customs. Between 2014-15 and 2015-16 tax foregone on account of excise duty fell from Rs.2 lakh crore to 70,000 crore and in the case of customs, tax foregone fell from Rs.2.4 lakh crore to Rs.80,000 crore. As mentioned in the Union Budget 2017-18, the shortfall is mainly due to a change in the methodology for estimating excise and customs revenue foregone. Therefore, the revenue foregone estimates in the year 2014-15 and the subsequent years are not strictly comparable.

As mentioned earlier, the total revenue foregone in the year amounts to 2.1 percent of GDP. When compared to the projected fiscal deficit of 3.2 percent of GDP in 2017-18 (BE), the revenue foregone does seem like a largesse which may not always be justified. The purpose of providing tax incentives is sometimes self-defeating, as all tax incentives do not necessarily lead to development. There is no doubt that if some of the tax incentives provided (particularly to the Corporate sector) could be rationalised, it would have significant impact on total revenue earnings of the government and additional fiscal space permitting enhanced expenditure allocations.