India’s Tax Compliance Levels

What is the issue?

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- While a miniscule population in India files IT returns, it doesn’t imply that a majority of Indians are evading taxes.
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- In this context, the statement by the “Union Finance Minister”, which calls for enlarging the tax net to enhance tax compliance, sounds hollow.
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Is tax compliance among masses really poor in India?

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- **Statistics -** In FY18, just 6.84 crore entities (inclusive of - Individuals, HUFs and Businesses) filed their Income Tax Returns.
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- Among these, there were 6 crore individual assesses - which is just about 4.5% of India’s total population, a miniscule minority.
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- **Government’s view -** Finance Minister feels that there is room for collecting more taxes from people as number of people filing IT returns is still low.
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- Additionally, he has stated the low “Tax-to-GDP ratio” in India to drive his point that the ratio could be improved by another 1.5% points.
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- **The Flaw -** The fact that only few pay direct taxes is used to assert that the culture of tax compliance is low in India and that there is large scale evasion.
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- This is a flawed logic as it ignores the fact that a vast majority of Indians

earn too less to be liable to taxation.
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- Additionally, the fact that “percentage of tax payers” is dependent on the demographic factors like “size of the working age group” is being overlooked.
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What is the demographic breakdown of India’s direct tax net?

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- As per the last Census (2011), only about half of India’s population fell in the working age group of 20- to 59-year olds.
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- Only half of this working-age population in turn, was employed throughout the year (main workers), implying that rest did not find regular employment.

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- Hence, the number of people who are in the working age group and found regular employment accounts for about 33 crore individuals.
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- Indian tax laws offer a complete exemption to agricultural sector, which employs the largest category of India’s working population.
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- The 2011 census tells us that roughly half of the main workers were either cultivators or agricultural labourers.
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- Hence, this effectively leaves just about 16.5 crore people who can be realistically expected to pay taxes.
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- Of this, 6 crore are already in the IT net, despite the extremely low levels of income that the masses earn, which is in fact a good number.
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Do a majority of taxable workers earn below taxable levels?

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- India’s slab system exempts the first Rs. 2.5 lakh of annual income (from all sources — salary, property, business, profession and others) from tax.
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- Census doesn’t provide us with data regarding earning levels of workers or

self-employed folk, which would've helped in devising the exact tax net.
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- But Labour Bureau's "Annual Employment Surveys" do provide anecdotal evidence on the income levels for a large sampling of Indian households.
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- The latest survey in FY16 covered 1.5 lakh households and found that over 87% of the households (across domains) earned less than Rs. 2.4 lakh a year.
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- This effectively means that only 13% of the 25 crore Indian households (about 3.2 crore households), may be earning enough to pay income tax.
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- Hence, number of tax payers is not abysmally below rationally expected levels.
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How does the corporate tax landscape look?

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- Corporate tax collections in India seem to be afflicted by the poor scale and low profits reported by the vast majority of businesses.
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- In India, business is dominated by the 6.3 crore unincorporated enterprises that are mostly run from home and registered companies are just 17 lakh.
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- Of the registered companies, only about 11 lakh are active and about 7 lakh companies filed their I-T returns in FY17.
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- But again, as many as 5.3 lakh of those companies reported an annual income of less than Rs. 2.5 lakh.
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- Between FY14 and FY18, India saw the number of I-T return filers expand by 80% from 3.79 crore to 6.84 crore.
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- But the direct tax kitty grew by a far lower 55% as nearly a fourth of the current return filers fall in the zero-tax bracket.
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What could be concluded from the above?

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- **Inferences -** The above calculations are rough because they are based on the data available in the public domain.
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- But they do suggest that low IT filings may not be the biggest cause of India’s low tax mop-up, as the government seems to believe.
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- Going by the number of taxpayers, at 6.84 crore, the direct tax base is already at pretty healthy levels once we account for legitimate exemptions.
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- Tax collection is low due to poor household incomes, lack of formalisation of businesses and under-reporting by some high-profile assesses.
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- **Way ahead -** Policy makers need to realise that, merely identifying non-filers and scrutinising them might not enhance tax collection significantly.
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- The only logical way to expand tax base at present is to bring agriculture into the taxable net and also tax those earning below Rs. 2.5 lakhs.
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- As both of these could prove politically costly, the finance minister will have to rather focus on methods to improve income levels of the masses and firms.
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- Sustaining the ongoing economic revival, creating more formal sector jobs and formalising small businesses through GST-like reforms is hence the best bet.
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Source: Business Line

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