India’s Tax Net Paradox

What is the issue?

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- The Finance Minister in his Budget speech this year claimed that India is “a tax non-compliant society and too many people evade taxes”.
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- Prime Minister stated that “only 24 lakh Indians reported an income greater than 10 lakh rupees.
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- Former Finance Minister in his 2013-14 Budget speech said that “only 42,800 persons admitted to an income of more than Rs.1 Crore per year”.
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What is the reason behind this scenario?

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- India’s per capita GDP is roughly Rs. 1 lakh, i.e. the average Indian earns a lakh of rupees every year.
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- However, the income tax exemption threshold in India is Rs. 2.5 lakh, i.e. anyone earning below Rs. 2.5 lakh need not pay income tax.
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- A majority of Indians earn less than Rs. 1 lakh.
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- Therefore an income tax exemption threshold of Rs. 2.5 lakh leaves a vast majority out of the tax bracket
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- NSSO survey says that the average income of the richest 20% of Indians is Rs. 95,000.
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- This means that even a large majority of the richest 20% of Indians do not qualify to pay income taxes.
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- Thus the low tax compliance turn out of only 3% of Indians pay tax, is not because of a large number of Indians avoiding tax, as portrayed.

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- It is merely due to the fact that India is a poor country with a high income tax exemption threshold.
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- Adding to this is India’s large income inequality - a greater majority of Indians earn less than Rs. 1 lakh while a small number at the top earn a very large amount.
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Why India has less people in Income tax bracket?

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- India has increased the income tax exemption threshold from Rs. 40,000 to Rs. 2.5 lakh in the last two decades.
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- China has only doubled the threshold from 10,000 Yuan to roughly 20,000 Yuan in the same period, in spite of faster growth.
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- It is the only large economy with an income tax exemption threshold that is 2.5 times the average national per capita income.
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- In emerging economies such as China, Brazil and Argentina, anyone earning 1.5 times the average national income falls under the income tax bracket.
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- If India lowers its income tax exemption in line with the rest of the world more Indians will fall under the tax bracket.
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- But given the income levels, this reduction will not fetch any meaningful extra tax revenues for the government but will merely bring more people into the tax bracket.
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What is the global scenario?

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- Even in the much richer United States, only 12.5 lakh people out of nearly 20 Crore adults reported an income greater than 10 times the per capita GDP of the U.S.
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- In the United Kingdom, only 2 lakh people out of an adult population of 4

Crore reported an income of greater than 10 times the average annual income
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- The developed nations examples proves the existing low tax compliance issue in India
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- Therefore it is wrong to conclude that India’s small number of taxpayers is entirely a result of some genetic and cultural trait of dishonesty of Indian society at large.
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- The proclamation of India as a tax non-compliant society can be true only when India is much richer than her GDP numbers.
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Source: The Hindu

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