Post-Demonetisation Indian Economy

What is the issue?

\n\n

\n
- The former RBI Governor has recently commented on the ill effects of demonetisation. Click here to know more.
\n
- It becomes imperative at this point to look at the post-demonetisation Indian economy.
\n

\n\n

What are the government claims?

\n\n

\n
- Demonetisation has sharply lifted tax buoyancy.
\n
- It has ushered many new return filers into the income tax net.
\n
- It has dealt a blow to terrorism, corruption and counterfeiting.
\n

\n\n

How is the tax compliance scenario?

\n\n

\n
- **Tax Collections** - India managed a second consecutive year of strong growth in its direct tax collections in FY18.
\n
- Net collections largely fall around Rs. 9.9 lakh crore.
\n
- This is an increase by around 17% in the just concluded fiscal year.
\n
- Notably, FY17 saw a 14.6% increase.
\n
- The figures are better than that of FY15 and FY16, indicating a healthy

trend.
\n
- This is despite the fact that income tax rates had largely stayed put in the last couple of years.
\n
- There were only minor increases in the surcharge and cess components.
\n

\n\n

Is demonetisation a reason?

\n\n

\n
- From a historical perspective, a 14% or even 17% annual increase is not that extraordinary for the Indian economy.
\n
- In FY11, direct tax collections had expanded 18% and in FY14, it rose 14.3%.
\n
- Clearly, these numbers were achieved without any moves with high-value currency notes.
\n
- So, the **current trend in tax collections is uncertain to be attributed to demonetisation.**
\n

\n\n

Is tax collection the right measure?

\n\n

\n
- Not all of the direct taxes come from citizens willingly paying up.
\n

\n\n

\n
- Direct tax collections put out by Central Board of Direct Taxes (CBDT) include mandatory deductions by way of TDS.
\n
- Tax deducted at source (TDS) accounts for a third of the collections each year.
\n
- So, a better way to measure voluntary tax compliance, and to strip out the impact of TDS, is to look at the Income Tax (IT) returns.
\n

\n\n

What do IT returns suggest?

\n\n

\n
- IT returns are filed by taxpaying entities such as individuals, small businesses and companies.
\n
- From FY14, IT returns filings saw a 15% addition over the next two years to FY16.
\n
- The latest CBDT data (provisional) shows that the number of filings zoomed to around 6.8 crore by the end of FY18.
\n
- This is an increase of 57% in the last two years, with around 2.4 crore new filings.
\n
- But notably, IT returns are typically filed for the previous financial year.
\n
- So, the filings at the end of FY18 would only fully capture the demonetisation impact.
\n
- Apparently, the **recent boom in IT returns could not wholly be attributed to demonetisation effect**.
\n

\n\n

What is tax buoyancy?

\n\n

\n
- Direct taxes both for individuals and businesses are levied as a percentage of their annual income.
\n
- So, it is reasonable to expect tax collections to be in line with GDP growth.
\n
- And tax buoyancy is a way of measuring this change.
\n
- It divides the growth in tax collections for each year by the nominal GDP growth.
\n
- A higher number indicates better tax compliance and vice versa.
\n

\n\n

How is tax buoyancy at present?

\n\n

\n
- In the 7 years from FY08 to FY14, direct tax buoyancy hovered between 0.5 and 1.1 times.
\n
- It thus averaged out at 1 for the entire period.
\n
- In other words, every additional rupee of nominal GDP growth yielded an equivalent new rupee of direct taxes for the Centre.
\n
- After hovering at 1.0 until then, in FY15 and FY16, direct tax buoyancy unaccountably slumped to 0.8 times and 0.6 times.
\n
- But, tax buoyancy has indeed picked up post-demonetisation.
\n
- Direct tax buoyancy doubled from 0.6 times in FY16 to 1.3 times in FY17.
\n
- It accelerated further to 1.7 times in FY18.
\n
- This is favourable, because India’s nominal GDP growth has been below historical levels in the last two years, due to low inflation.
\n
- If nominal growth picks up and the new-found tax buoyancy sustains, the Centre’s direct tax coffers could fill up even faster.
\n

\n\n

How does the future look?

\n\n

\n
- The new found improvement in **tax compliance** is appreciable.
\n
- Better compliance would eventually provide headroom for the Centre to prune down income tax rates.
\n

\n\n

\n
- The latest Budget has pegged India’s current direct **tax base** at 8.27 crore taxpaying entities.

\n
- However, the new return filers have mostly joined the bottom of the pyramid where tax rates are nominal or nil.
\n
- Hopefully, as India’s income levels improve over the next few years these can graduate into the higher tax slabs.
\n
- This should pave the way for the government to relax its anti-evasion measures and lower its sky-high income tax rates.
\n

\n\n

\n\n

Source: The Hindu

\n

