State of Voluntary Tax Compliance

Why in News?

The Prime Minister (PM) Narendra Modi recently commented on the state of voluntary tax compliance in India.

What was his comment?

- Only 1.5 crore out of the 130 crore people pay income tax in India.
- Those persons declaring an annual income of Rs 50 lakh are just 3 lakh.
- Only 2,200 professionals declare their annual income of over Rs 1 crore.
- The PM remarked that when lots of people find ways not to pay tax, the burden comes on those who pay their taxes honestly.
- He appealed to all citizens to take a pledge to pay their taxes honestly, saying there was a long way to go in terms of tax compliance in India.

What does data on I-T Return reveal?

- The Income Tax Return Statistics for various assessment years (AYs) reveal that **salary income is the highest source of income** reported by individuals between FY15 and FY18.
- Salary income reported across all income ranges is significantly higher than business income.
- Tax returns filed by individuals over this period indicate that salary income is higher than business income in the slabs above Rs 50 lakh.

What is the situation of the salaried class?

- The gap between salary and business income is increasing year on year.
- The salaried class is subject to **tax deduction at source** on their entire income, even before they get their salary which results in accurate reporting of income.
- No other class of taxpayers is subject to this type of tax withholding, resulting in rampant under-reporting and non-reporting of income.
- For AY17, the income-tax paid by a salaried taxpayer was about three times higher than that of business taxpayer - not a feat to be proud of.
- This is so as the individual business taxpayer doesn’t report their income and they get away with impunity.
- **Under-reporting** of income has been the bane of India’s tax system.

Why the salaried class are penalised with higher taxes?

- This is due to the government's **inability to increase the taxpayer base**, and collect income tax from the non-salaried class.
- Taxes on honest salaried taxpayers have increased over last four years.
- This has resulted in a minuscule 0.1% of individuals contributing about 20% of the tax payable by all individuals between FY15 and FY19.
- In FY21 budget, the **dividend distribution tax has been abolished**, and shareholders are required to pay income tax on the dividend income.
- Individuals earning a gross total income (GTI) above Rs.5 crore have an additional tax impact of 7.94%on dividend received in FY21 and beyond.
- So, the salaried taxpayers are penalised with more tax for being honest.

How do salaried class feel?

- There is **strong resentment** and anger among the salaried class for being penalised for their honesty.
- Many high-income earning, honest, taxpaying citizens are **relocating out of India** due to the growing disparity due to tax evasion.
- There is **very low tax morale** among the salaried class.

How tax evasion is driven?

- Tax evasion is driven significantly by **tax morale**, viz., the intrinsic motivation of taxpayers in a country to pay taxes.
- Tax morale itself is driven primarily by two perceptive factors:
    a. **Vertical fairness**, i.e., what one pay in taxes is commensurate to the benefits one receives as services from the government; and
    b. **Horizontal fairness**, i.e., differences in the taxes paid by various sections of society.

What could be done?

- The government should take concrete steps to increase the taxpayer base, and arrest tax evasion.
- The high spenders and their sources of income need to be scrutinised.
- An examination of various statutory filings available with various government departments (like GST returns) would provide the leads to tax evasion.

Source: Financial Express



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