EFFECTS OF REDUCTION IN TAX RATES ON OVERALL REVENUE FROM INCOME TAX

Pankaj Agarwal, Assistant Professor (Commerce)
V.R.A.L. Government Girls (PG) College, Bareilly (U.P.)

ABSTRACT

Tax is the major source of revenue for the government, the development of any country's economy largely depends on the tax structure it has adopted. A Taxation Structure which facilitates easy of doing business and having no chance for tax evasion brings prosperity to a country's economy. Direct taxes primarily include income taxes paid by individuals and corporate taxes paid by firms.

Greater revenue collection reflects greater income, both of individuals and corporate entities, which in turn means better employment opportunities and greater ease-of-doing-business in a state. Thus, one can say states which have higher revenue collections are generally also states which have greater avenues for economic activities.

Prime Minister Narendra Modi announced that his government has set a goal of making India a $5 trillion economy by 2024-25. Following PM Modi's announcement, Uttar Pradesh Chief Minister Yogi Adityanath announced he too plans to make his state a **$1 trillion economy**.

Both the goals are ambitious, and if achieved will do wonders for the Indian economy.

In the following paper, the study is purely based on secondary data. Various figures are obtained from the different websites of government of India. In this paper it is observed that how direct tax revenue can affect the Indian Economy and what are the effects of recent tax reductions in direct taxes on overall revenue in India.

Keywords: - Direct Taxes, Indirect Taxes, Tax Rates, Taxation, Tax Collection.

Introduction:

Tax is a mandatory liability for every citizen of the country. There are two types of tax in india i.e. direct and indirect. Taxation in India is rooted from the period of *Manu Smriti and Arthasastra*. Present Indian tax system is based on this ancient tax system which was based on the theory of maximum social welfare.

"It was only for the good of his subjects that he collected taxes from them, just as the Sun draws moisture from the Earth to give it back a thousand fold" –

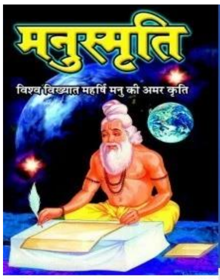
The origin of the word "Tax" is from "Taxation" which means an estimate.

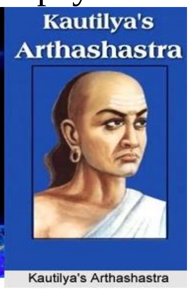
In India, the system of direct taxation as it is known today has been in force in one form or another even from ancient times. Variety of tax measures are referred in both Manu Smriti and Arthasastra. The wise sage advised that taxes should be related to the income and expenditure of the subject. He, however, cautioned the king against excessive taxation; a king should neither impose high rate of tax nor exempt all from tax.

According to Manu Smriti, the king should arrange the collection of taxes in such a manner that the tax payer did not feel the pinch of paying taxes.
Kautilya has also described in great detail the system of tax administration in the Mauryan Empire. It is remarkable that the present day tax system is in many ways similar to the **system of taxation in vogue about 2300 years ago.**

Arthasastra mentioned that each tax was specific and there was no scope for arbitrariness. Tax collectors determined the schedule of each payment, and its time, manner and quantity being all pre-determined. The land revenue was fixed at 1/6 share of the produce and import and export duties were determined on ad-valorem basis. The import duties on foreign goods were roughly 20% of their value. Similarly, tolls, road cess, ferry charges and other levies were all fixed.
Kautilya also laid down that during war or emergencies like famine or floods, etc. the taxation system should be made more stringent and the king could also raise war loans. The land revenue could be raised from 1/6th to 1/4th during the emergencies. The people engaged in commerce were to pay big donations to war efforts.

Kautilya's concept of taxation emphasised equity and justice in taxation. The affluent had to pay higher taxes as compared to the poor.





Brief History of Income Tax in India: In India, this tax was introduced for the first time in 1860, by Sir James Wilson in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857. In 1918, a new income tax was passed and again it was replaced by another new act which was passed in 1922.This Act remained in force up to the assessment year 1961-62
With numerous amendments.
In consultation with the Ministry of Law finally the Income Tax Act, 1961 was passed. The Income Tax Act 1961 has been brought into force with 1 April 1962. It applies to the whole of India and Sikkim (including Jammu and Kashmir).
Since 1962 several amendments of far-reaching nature have been made in the Income Tax Act by the Union Budget every year.

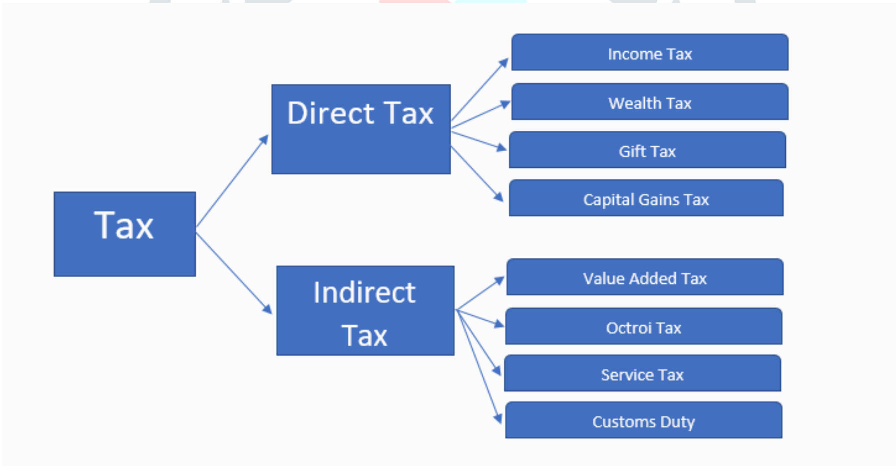
Indian Tax Structure

Tax structure in India is a three tier federal structure. The central government, state governments, and local municipal bodies make up this structure. Article 256 of the constitution states that "No tax shall be levied or collected except by the authority of law". Hence, each and every tax that is collected needs to backed by an accompanying law.

Interestingly, the tax system in India traces its origin to the prehistoric texts such as Arthashastra and Manusmriti. As proposed by these manuscripts, the taxes paid by farmers and artisans in that era would be in the form of agricultural produce, silver or gold. Based on these texts, the foundation of the modern tax system in India was conceptualised by the Sir James Wilson during the British rule in India in the year, 1860. However, post-independence the newly-established Indian Government then soldered the system to propel the economic development of the country. After this period, the Indian tax structure has been subject to a host of changes.

Tax System in India:

The **tax system in India** allows for two types of taxes—Direct and Indirect Tax.



The **tax system in India** for long was a complex one considering the length and breadth of India. Post GST implementation, which is one of the biggest tax reforms in India, the process has become smoother. It serves as an all-inclusive indirect tax which has helped in eradicating the cascading effect of tax as a whole. It is simpler in nature and has led to upgrade the productivity of logistics.

Direct Tax:

In general, a direct tax is one imposed upon an individual person (juristic or natural) or property (i.e. real and personal property, livestock, crops, wages, etc.) as distinct from a tax imposed upon a transaction. In this sense, indirect taxes such as a sales tax or a value added tax (VAT) [now GST] are imposed only if and when a taxable transaction occurs. People have the freedom to engage in or refrain from such transactions; whereas a direct tax (in the general sense) is imposed upon a person, typically in an unconditional manner, such as a poll-tax or head-tax, which is imposed on the basis of the person's very life or existence, or a property tax which is imposed upon the owner by virtue of ownership, rather than commercial use. Some commentators have argued that "a direct tax is one that cannot be shifted by the taxpayer to someone else, whereas an indirect tax can be."

The unconditional, inexorable aspect of the direct tax was a paramount concern of people in the 18th century seeking to escape tyrannical forms of government and to safeguard individual liberty.

The distinction between direct and indirect taxation was first extensively discussed by Adam Smith in his *Wealth of Nations*, as in the following passage:

> “It is thus that a tax upon the necessaries of life operates exactly in the same manner as a direct tax upon the wages of labour. If he is a manufacturer, will charge upon the price of his goods this rise of wages, together with a profit; so that the final payment of the tax, together with this overcharge, will fall upon the consumer.”

The Pennsylvania Minority, a group of delegates to the 1787 U.S. Constitutional Convention who dissented from the document sent to the states for ratification, objected over this kind of taxation, and explained:

> The power of direct taxation applies to every individual, it cannot be evaded like the objects of imposts or excise, and will be paid, because all that a man hath will he give for his head. This tax is so congenial to the nature of despotism, that it has ever been a favourite under such governments.
>
> The power of direct taxation will further apply to every individual, however oppressive, the people will have but this alternative, either to pay the tax, or let their property be taken for all resistance will be vain.

Direct Tax is levied directly on individuals and corporate entities. This tax cannot be transferred or borne by anybody else. Examples of direct tax include income tax, wealth tax, gift tax, capital gains tax.

Income tax is the most popular tax within this section. Levied on individuals on the income earned with different tax slabs for income levels. The term ‘individuals’ includes individuals, Hindu Undivided Family (HUF), Company, firm, Co-operative Societies, Trusts.

Indirect Tax:

Indirect taxes are taxes which are indirectly levied on the public through goods and services. The sellers of the goods and services collect the tax which is then collected by the government bodies.

- **Octroi Tax**– Levied on goods which move from one state to another. The rates depend on the state governments.
- **Service Tax**– Government levies the tax on service providers.
- **Customs Duty**– It is a tax levied on anything which is imported into India from a foreign nation.

- **Goods & Service Tax-** Levied on Goods & Services provided in India based on different rates of taxes on different goods and services.

Review of Literature:

(Dr. S. K. Shrivastava, Dr. Prakash Sharma & V. K. Bhatnagar 2010) In their research paper they examined the impact of Tax Revenue on India's GDP and analysed the development in taxation and impact of Tax Revenue.

(Singh Pratap 2019) In his research paper he examined the Trends and Issues of Tax Revenue in India.

(Emnauel Stephen N. 2018) In his research paper he emphasised the Input of Tax Administration on Revenue Generation in Nigeria.

(R. Nisha 2018) In her research paper she focused on Technical Analysis of Tax Revenue and Non Tax Revenue of India.

Statement of the Problem:

Indian Direct tax structure has gone through many reforms and still it is very far ahead from being an ideal taxation structure. Many problems like Low Rate Tax Collection, Tax Evasion, Reliance on indirect taxes, Black money, existence of parallel economy show that Indian taxation system requires some major reforms in the future ahead to address all this problems.

Objectives:

1) To Study the Tax Structure of India
2) To identify the different taxes collected in different Financial Years
3) To identify the amount incurred on collection of taxes in different Financial Years
4) To identify problems in the existing taxation structure

Research Methodology:

This Research paper is purely based on secondary data. Various figures are obtained from the different websites of government of India and different other Economical websites.

Analysis of Direct Tax Revenue:

The details of total Direct Tax collected over the last three years along with the different component-wise are as under:

Financial Year	Corporation Tax	Taxes on Income	Total (Rs. In Crore)
2015-16	453228	288717	741945
2016-17	484924	346789	849713
2017-18*	571202	431539	1002741

The details of Direct Tax to Gross Domestic Product (GDP) Ratio and Indirect Tax to GDP ratio over the last three years are as under:

Financial Year	Direct Tax GDP Ratio	Indirect Tax GDP Ratio
2015-16	5.47%	5.16%
2016-17	5.57%	5.65%
2017-18	5.98%	5.43%

The total income tax collection over the last three years in absolute terms and as a percentage of total tax collection are as under:

Direct Tax Collections (Rs. in Crore)		Percentage of total tax collection
2594399		51.09%

Source- Press Information Bureau- Government of India (Ministry of Finance)

There are several tax slabs during last financial years at different rates of taxes for different categories of persons defined under Income Tax Act. Here we analyse the rates for three financial years (i.e. 2018-19, 2019-20 and new passed in current budget for 2020-21) :

Income Tax Slabs Rates for Financial Year 2018-19 (Assessment Year 2019-20)
For Individual & HUF (Below the Age Of 60 Years)

Income Tax Slabs	Tax Rate
Up to Rs 2,50,000*	Nil
Rs 2,50,001 to 5,00,000	5% of total income exceeding Rs 2,50,000
Rs 5,00,001 to 10,00,000	Rs 12,500 + 20% of total income exceeding Rs 5,00,000
Above Rs 10,00,000	Rs 1,12,500 + 30% of total income exceeding Rs 10,00,000

Note: An additional 4% Health & Education Cess will be applicable on the tax amount calculated above.

Income Tax Slabs for Senior Citizens (60 Years Old or More but Less than 80 Years Old)

Income Tax Slabs	Tax Rate
Income up to Rs 3,00,000*	No tax
Income from Rs 3,00,000 – Rs 5,00,000	5%
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%

Income Tax Slabs for Super Senior Citizens (80 Years Old or More)

Income Tax Slabs	Tax Rate
Income up to Rs 5,00,000*	No tax
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%

Note: An additional 4% Health & education cess will be applicable on the tax amount calculated as above.

Surcharge applicable to the individuals covered in all Above:

Income limit	Surcharge Rate on the amount of income tax
Net income exceeds Rs.50 Lakhs but doesn’t exceed Rs. 1 Crore	10%
Net income exceeds Rs.1 Crore	15%

Income Tax Slabs for Domestic Companies for FY 2018-19

Turnover Particulars	Tax Rate
Gross turnover up to 250 Cr. in the FY 2016-17	25%
Gross turnover exceeding 250 Cr. in the FY 2016-17	30%

In addition cess and surcharge is levied as follows: Cess: 4% of corporate tax

Surcharge applicable:

Income Limit	Surcharge Rate on the amount of income tax
Net income exceeds Rs.1 Crore but doesn't exceed Rs.10 Crore	7%
Net income exceeds Rs.10 Crore	12%

Income Tax Slabs & Rates for Individual Tax Payers & HUF (Less Than 60 Years Old) for Financial Year 2019-20

Income Tax Slab	Tax Rate
Up to Rs 2,50,000*	Nil
Rs 2,50,001 to 5,00,000	5% of total income exceeding Rs 2,50,000
Rs 5,00,001 to 10,00,000	Rs 12,500 + 20% of total income exceeding Rs 5,00,000
Above 10,00,000	Rs 1,12,500 + 30% of total income exceeding Rs 10,00,000

- No tax for individuals with income less than Rs 2,50,000
- 0%-5% tax with income of Rs 2.5 lacs to 5 lacs for different age groups
- 20% tax with income of Rs 5 lacs to 10 lacs
- 30% tax with income above Rs 10 lacs
- A tax rebate under section 87A is allowed to individual taxpayers a maximum amount of:

  – Rs 2,500 for total income up to Rs 3.5 lacs for FY 2018-19

  – Rs 12,500 for total income up to Rs 5 lacs for FY 2019-20
- Investments up to 1.5 lacs under Sec 80C can save 46,800 in taxes.

Note: An additional 4% Health & education cess will be applicable on the tax amount calculated as above.

Income Tax Slabs for Senior Citizens (60 Years Old or More but Less than 80 Years Old) for FY 2019-20

Income Tax Slabs	**Tax Rate**
Income up to Rs 3,00,000*	No tax
Income from Rs 3,00,000 – Rs 5,00,000	5%
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%

Note: An additional 4% Health & education cess will be applicable on the tax amount calculated as above.

Income Tax Slabs for Super Senior Citizens (80 Years Old Or More) for Financial Year 2019-20

Income Tax Slabs	**Tax Rate**
Income up to Rs 5,00,000*	No tax
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs	30%

10,00,000	

Note: An additional 4% Health & education cess will be applicable on the tax amount calculated as above.

Income Tax Slabs for Domestic Companies for FY 2019-20

Turnover Particulars	Tax Rate
Gross turnover up to 400 Cr. in the FY 2017-18	25%
Gross turnover exceeding 400 Cr. in the FY 2017-18	30%
Where the company opted for Section 115BA	25%
Where the company opted for Section 115BAA	22%
Where the company opted for Section 115BAB	15%

In addition cess and surcharge is levied as follows:

Cess: 4% of corporate tax

Surcharge applicable:

Income Limit	Surcharge Rate on the amount of income tax
Net income exceeds Rs.1 Crore but doesn't exceed Rs.10 Crore	7%
Net income exceeds Rs.10 Crore	12%

However, the rate of surcharge in case of a company opting for taxability under Section 115BAA or Section 115BAB shall be 10% irrespective of amount of total income.

Tax Rates in India for Financial Year 2020-21 – Budget 2020 Revised Income Tax Slabs (Assessment Year 2021-22)

In India, income tax is levied on individual taxpayers on the basis of a slab system where different tax rates have been prescribed for different slabs and such tax rates keep increasing with an increase in the income slab.

Such tax slabs tend to undergo a change during every budget.

Further, Budget 2020 has announced a new income tax regime following which individuals will have the option to pay taxes as per new tax slabs from FY 2020-21 onwards.

There are three categories of individual taxpayers:

- Individuals (below the age of 60 years) which includes residents as well as non-residents
- Resident Senior citizens (60 years and above but below 80 years of age)
- Resident Super senior citizens (above 80 years of age)

Income Tax Slabs for individuals below 60 years of age under new tax regime – Applicable to FY 2020-21 (AY 2021-22)

Income Tax Slab	Tax Rate
Up to Rs 2.5 lacs	NIL
Rs 2.5 lacs to Rs 5 lacs	5% (Tax rebate of Rs 12,500 available under section 87A)
Rs 5 lacs to Rs 7.5 lacs	10%
Rs 7.5 lacs to Rs 10 lacs	15%
Rs 10 lacs to Rs 12.5 lacs	20%
Rs 12.5 lacs to Rs 15 lacs	25%
Rs 15 lacs and above	30%

- The tax calculated on the basis of such rates will be subject to health and education cess of 4%.
- Any individual opting to be taxed under the new tax regime from FY 2020-21 onwards will have to give up certain exemptions and deductions.
- Here is the list of exemptions and deductions that a taxpayer will have to give up while choosing the new tax regime.

1. Leave Travel Allowance (LTA)
2. House Rent Allowance (HRA)
3. Conveyance
4. Daily expenses in the course of employment
5. Relocation allowance
6. Helper allowance
7. Children education allowance
8. Other special allowances [Section 10(14)]
9. Standard deduction
10. Professional tax
11. Interest on housing loan (Section 24)
12. Chapter VI-A deduction (80C,80D, 80E and so on) (Except Section 80CCD(2) and 80JJA)

- Points to remember while opting for the new tax regime:
    1. Option to be exercised on or before the due date of filing return of income for AY 2021-22
    2. In case of a taxpayer having business income, the option once exercised can be withdrawn only once. Further, if the taxpayer withdraws the option, he will never be able to opt-in the option again.

According to the current income tax laws in India, the income tax rate on resident individuals varies based on their age. There are different tax slabs applicable to the individuals for the financial year 2018-19 and 2019-20. For instance, a resident individual, aged below 60 years, with an income less than Rs 2.5 lacs is exempt from paying income tax.

Interpretation:

The effect of tax cuts :

Lower income tax rates increase the spending power of consumers and can increase aggregate demand, leading to higher economic growth (and possibly inflation). On the supply side, income tax cuts may also increase incentives to work – leading to higher productivity.

However, the effect of tax cuts depends on how the tax cut is financed, the state of the economy and whether low tax rates actually increase productivity and the willingness to work.

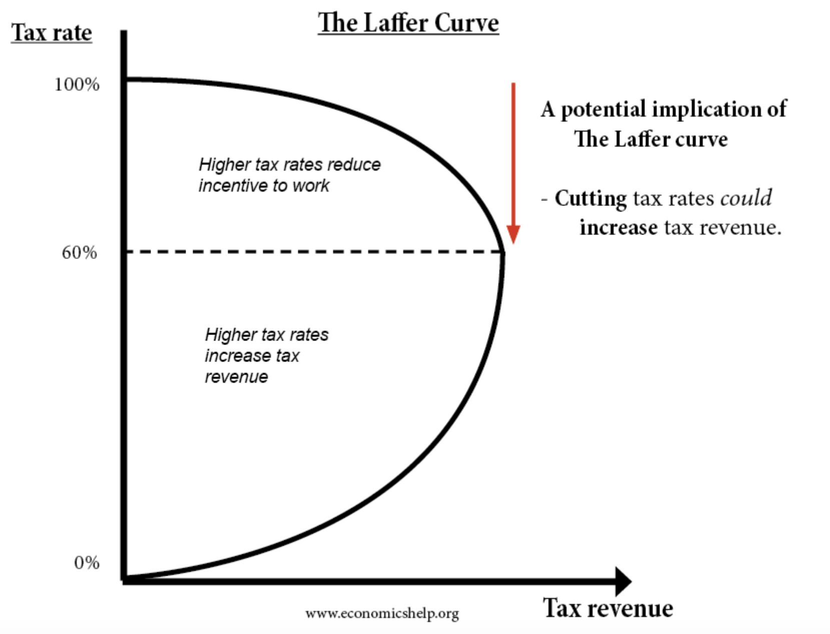
The effects of reducing income tax rate :

1. **Increased spending** : Workers will see an increase in their discretionary income. With lower income tax rates, they would keep more of their gross income, so effectively they have more money to spend.
2. **Higher economic growth** : With lower tax rates, we could expect to see a rise in consumer spending because workers are better off. Because consumers spending is a component of aggregate demand (AD) (roughly 60%), then a rise in consumer spending should cause a rise in AD, leading to higher economic growth.
3. **Government borrowing** : Tax cuts will, ceteris paribus, lead to lower tax revenue and this is likely to cause higher borrowing. Though some economists believe income tax cuts can increase productivity, which offset this fall in revenue.

Impact of tax cuts on productivity

If we take a cut in income tax, it could also affect the supply side of the economy.

- Lower income tax rates may encourage people to work longer. Overtime is more worthwhile if you get to keep more of your income. Lower income tax rates may encourage people to move to that particular country. This is the substitution effect – work is more attractive with lower tax rates.
- However, there is also the income effect. With lower tax rates (and effectively higher wages), it is easier to get your target income by working fewer hours. Therefore, tax cuts may not increase labour supply because people don't need to work more if work is more highly paid.



A controversial economic argument is the "Laffer Curve". This argues that if you cut income tax rates, then the tax cut increases the incentive to work so much, that the government can actually gain more tax revenue. It seems to offer the best of both worlds – lower tax rates and higher tax revenues.
There is a debate about the extent to which tax cuts increase productivity and economic growth. If marginal income tax rates are very high, e.g. 80%, then cutting tax rates is likely

to increase labour supply and productivity. But, with tax rates of 20 or 30%, cutting income tax rates is no guarantee of increasing productivity and growth.

Conclusion

India faces first fall in direct taxes in at least two decades

Income Tax Collection in 2019: Direct tax collections for this year could end up roughly 10% below fiscal 2019.

Given the state of the economy, income tax officials are not hopeful about corporate and income tax collection

India's corporate and income tax collection for the current year is likely to fall for the first time in at least two decades, over half a dozen senior tax officials told Reuters, amid a sharp fall in economic growth and cut in corporate tax rates.

Prime Minister Narendra Modi's government was targeting direct tax collection of 13.5 trillion rupees ($189 billion) for the year ending March 31 - a 17% increase over the prior fiscal year.

However, a sharp decline in demand has stung businesses, forcing companies to cut investment and jobs, denting tax collections and prompting the government to forecast 5% growth for this fiscal year - the slowest in 11 years.

The tax department had managed to collect only 7.3 trillion rupees as of Jan. 23, more than 5.5% below the amount collected by the same point last year, said a senior tax official.

After collecting taxes from companies in advance for the first three quarters, officials typically garner about 30-35% of annual direct taxes in the final three months, data from the past three years shows.

But eight senior tax officials interviewed by Reuters said despite their best efforts direct tax collections this financial year were likely to fall below the 11.5 trillion collected in 2018-19.

"Forget the target. This will be the first time that we'll see a fall in direct tax collection ever," said a tax official in New Delhi.

He estimates that direct tax collections for this year could end up roughly 10% below fiscal 2019.

Direct taxes typically account for about 80% of the government's projections for annual revenue, and the shortfall may leave the government needing to boost borrowing to meet expenditure commitments.

The tax officials also say that a surprise cut in headline corporate tax rate last year aimed at wooing manufacturers and boosting investment in Asia's third-biggest economy is another key reason behind the sluggish tax collections.

"We'll be very happy if we can even breakeven with what we collected last year," said another senior tax official in the financial capital Mumbai, the biggest tax generator, accounting for about a third of revenues from direct taxes. "But given the state of the economy, I'm not too hopeful."

Suggestions:-

1) Government should focus more on structural reforms than policy reforms.

2) GST should be implemented soon to reduce the number of indirect taxes and facilitate ease of doing business in India.
3) There should be effective implementation of Anti Tax evasion Bill.
4) Administrative expenses incurred on Tax Collection needs to be brought down by making reduction in the number of taxes and tax collection authorities.

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