



Boosting India's Tax Base

This editorial is based on [“Is there a way to boost the tax base?”](#) which was published in the Hindu Business Line on 18/02/2023. It discusses reasons for the low Tax base in India and steps that need to be taken to address it.

For Prelims: World Bank, Tax base, GST, Collecting Tax at Source

For Mains: Mobilisation of Resources, Government initiatives to check tax evasion

India has **become the most populous country, with a quarter of the population below 15 years old**, making it a youthful nation with a low share of elderly citizens and high fertility rates. The increasing working-age population is an advantage that can drive growth in the future.

With the rise in population, there are many broader policy implications that arise - harnessing this workforce effectively to contribute to GDP, providing them the right skill training, providing jobs, social security etc.

With rise in population, the workforce has grown but the **income tax base has not increased, which needs to be addressed.**

The Finance Ministry had revealed that the **number of people who filed income tax returns stood at 6.8 crore in 2020-21**. This means that **only 4.8% of the total population filed IT returns in 2021**. Of these, **only 1.69 crore paid tax since 65% of the taxpayers earned less than Rs. 5 lakh**. So effectively, only 1.2% of the population pays income tax as of now.

What are the Reasons for Low Tax Base in India?

- **Large Informal Economy:**
 - **India has a significant informal economy**, which means that a significant portion of economic activity is not registered with the government, and therefore, not taxed.
 - Many small businesses, street vendors, and daily wage workers operate in the informal sector, which makes it difficult for the government to track their income and collect taxes.
- **Low Participation of Women in the Workforce:**
 - Another reason for the **low tax base in India is the low participation of women in the workforce.**
 - According to the World Bank report released in June 2022, Indian women's labour force participation has been **steadily declining since 2005 and is at a low of 19% in 2021.**
- **Dominance of Agricultural Sector:**
 - A dominant portion of **India's workforce is employed in agriculture and agricultural income is exempt under income tax.**

- This results in **45.6% of agri-workers not filing tax returns**. So, only 23 crore of the workers in the non-agri segment are liable to pay tax.
- This results in a narrow tax base, which is heavily reliant on other sectors of the economy.

▪ **Income is not Taxable:**

- The tax incidence **arises only if the income is above a certain threshold**, and that a large percentage of Indian households have an annual income under Rs.6 lakh.
- This means that the potential taxpayer base is reduced to a smaller number.
 - According to Statista, **67% of Indian households had annual income under Rs.6 lakh in 2021**, which reduces potential income taxpayers to 7.6 crore.

How can India Harness the Increasing Working Age Population?

▪ **Formalisation of the Economy:**

- The informal sector **accounts for a significant part of India's economy**, but many businesses and workers operate outside the tax net.
 - According to a paper, 'Measuring Informal Economy in India, Indian experience', out of the total workforce in 2017-18, **90.7% was employed by the informal sector**.
- Formalising the economy by bringing these businesses and workers under the tax net can increase the tax base.
- This can be achieved by **providing incentives for businesses to register themselves and comply with tax laws**, and by simplifying tax laws to make compliance easier.
- Also, it can be **done with some help from the GST system**. One of the objectives of the GST regime in its original form was to nudge those in the unorganised sector to shift to the formal sector and file GST returns in order to avail input tax credits or to continue supplying to larger buyers.

▪ **Identifying High-Income Earners in the Informal Sector:**

- Many high-income earners operate in the informal sector, but they are not currently paying taxes.
- Identifying and bringing these individuals into the tax net can increase the tax base.
- This can be achieved by **collecting data on income and assets through various means** such as bank transactions, property purchases, etc. and using this data to identify potential taxpayers.

▪ **Bringing Agricultural Income into the Tax Net:**

- Currently, **agricultural income is exempt from income tax in India**. However, many wealthy farmers earn a significant income from agriculture, but they do not pay taxes.
- Bringing agricultural income into the tax net can increase the tax base.
 - This can be achieved by **setting a minimum threshold for agricultural income to be taxed**, and by incentivising farmers to report their income.

▪ **Tax collection at source (TCS):**

- Collecting tax at **source for purchase of certain goods and services is another way to identify those** who earn a tidy sum every year but are not paying any taxes.
- As of now, TCS is collected for high value goods such as expensive motor vehicles, gold jewellery or overseas remittances.
- The ambit of TCS can be **expanded to consumer durables, domestic luxury travel, stays in expensive hotels etc.**
- This can **help identify those operating in the informal sector and earning high income**, yet evading tax.
 - While this could hit honest taxpayers, they can reclaim the tax in their annual return.

Drishti Mains Question

What are the challenges faced in boosting India's tax base, and what policy measures can be implemented to increase the number of taxpayers and improve tax compliance?

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims

Q. Which one of the following effects of creation of black money in India has been the main cause of worry to the Government of India?

- (a) Diversion of resources to the purchase of real estate and investment in luxury housing.
- (b) Investment in unproductive activities and purchase of precious stones, jewellery, gold, etc.
- (c) Large donations to political parties and growth of regionalism.
- (d) Loss of revenue to the State Exchequer due to tax evasion.

Ans: (d)

Exp:

- The simplest definition of black money could possibly be money that is hidden from tax authorities. It is the money earned through illegal activity and not reported to the tax authorities, and so is black.
- Black money causes financial setbacks, as non-taxed income causes the government to lose revenue, which in turn affects the economic growth of the country.
- Taxation is the primary source of income for the government. Tax revenue can be regarded as one measure of the degree to which the government controls the economy's resources. Therefore, loss of revenue to the State Exchequer due to tax evasion is the main cause of worry to the Government of India.
- Therefore, option (d) is the correct answer.

Mains

Q. Enumerate the indirect taxes which have been subsumed in the Goods and Services Tax (GST) in India. Also, comment on the revenue implications of the GST introduced in India since July 2017. (2019)