SSARSC

Scientific Society of Advanced Research and Social Change
SSARSC International Journal of Management
Volume 3 Issue 1, January-June 2017, ISSN 2349-6975

The Impact of Indian Taxation system on its Economic Growth

C.A. (Dr.) Pramod Kumar Pandey
Associate Professor
National Institute of Financial Management
(An Autonomous Institution of Ministry of Finance, Government of India)
Faridabad, Haryana.
Contact No: 09871316239
Email Id: cadrpramodpandey@gmail.com/pkpandey@nifm.ac.in

Abstract:

Indian taxing system is undergoing revolutionary change today. Tax is one of the most important sources of revenue to the Government and at the same time one of the deciding parameter for economic growth. Whereas direct tax impacts directly the disposable income, the indirect tax impacts the prices of goods and services in the market. The basic objective of this article is to evaluate the impact of both direct and indirect taxes on economic growth of India.

Key words: **disposable income, GDP, inflation rate, revenue**

Introduction

Today Indian taxing system is going a revolutionary change owing to spreading the wings of Indian business into global market. Indian Government is paying its full attention to liberalize the taxing system and at the same time closing the loopholes to disable the intruders to evade the taxing system so as to enlarge the revenue to Government exchequer and flourish the overall business scene. Resent Budget 2014 has also played important role in this direction.

Broadly taxing system may be classified into three parts:

a) Progressive taxation system
b) Regressive taxation system
c) Proportional taxation system

Progressive taxation implies a taxing system where tax rate increases with increase in income, thus if a person has higher income, he will bear more tax burden due to increased tax rate than person having lesser income.

Regressive taxation means a taxing system where tax rate reduces with increase in income and thus a person having lesser income faces lesser tax burden due to facing lesser tax rates.

Proportion tax means a taxing system of charging tax on a fixed proportion irrespective of level of amount on which tax is to be levied. Thus, the same tax rate applies to different persons having different taxable amounts.

Tax may be levied on natural persons like individual, Hindu undivided family artificial entities like Firm, association of persons, company, society etc. and also on goods and services. Thus, another classification of tax we found into direct tax and indirect tax.

Direct tax means a type of tax which is paid by a person directly to the Government. For example income tax and wealth tax in India.

Indirect tax means tax on goods and services which are paid by a person to the producer, seller or service provider who is liable to pay the same to the account of Government. For example customs duty, excise duty, VAT, service tax, entertainment tax etc. in India. Now a modern system of taxing all goods and services "goods and services tax" is about to be introduced. This will replace all existing enactments relating to goods and services.

Taxing system in India

In India, progressive and proportional taxing systems are followed. In Indian tax law, slab wise taxability arises somewhat for income tax while proportional tax is applicable for other taxes, for example excise duty, customs duty, VAT, service tax, wealth tax etc. Further under income tax, lottery income, long term capital gain, and in some cases short term capital gain is taxed under proportional taxation system. Again the income of assesses such as for companies, firms etc. proportional taxation system is applied while for individual and cooperative society, progressive taxation system is followed.

Among **direct tax** only two types of taxes are in existence today, namely income tax and wealth tax

Income tax: Under Indian income tax law both flat rate (proportional tax) and slab rate (progressive tax) applies. Tax is computed on total income. On lottery income, long term capital gain, and in some cases short term capital gain is taxed under proportional taxation system. Again the income of assesses such as for companies, firms etc. proportional taxation system is applied while for individual and cooperative society, progressive taxation system is followed.

Wealth tax: wealth tax is levied at 1% on the net wealth of individual, Hindu undivided family and company if net wealth exceeds Rs.30 lakhs on the valuation date. It is payable in every assessment year based on valuation of net wealth on the respective valuation dates. Valuation date means last day of the corresponding previous year relating to each assessment year. Net wealth is computed as the difference between value of assets and the value of liabilities. Assets include House, Motor car, Jewellery, Urban land, Cash in hand and yatch, boat and air craft.

Among the **indirect taxes** regime important ones are Excise duty, service tax, customs duty and sales tax,

Excise duty: Excise duty is levied on manufacture or production of excisable goods in India at the rates specified in

Central excise tariff act. It is based on value added concept since it includes the provision of input tax credit covered under CENVAT credit rules.

Customs duty: Customs duty is levied on goods imported or exported from India at the rates specified in Customs tariff act. Import means bringing into India from a place outside India while export means taking out of India from a place outside India. India includes territorial waters of India which extends up to 12 nautical miles from the base line.

Service tax: Service tax is a type of indirect tax which levied on services. It is consumption based destination tax. It is governed by chapter V and chapter V-A of the finance act 1994 as amended to finance act 2012. Service tax is levied @12% of gross value of taxable service. Additionally education cess @ 2% and higher education cess @ 1% is also payable. Thus, the effective rate of tax comes out to 12.36%.

Sales tax: Sales Tax is the older version of VAT. Under Sales Tax system, Tax was levied on entire selling price and not on value added. Thus, there was double taxation effect under sales tax system. Even now sales tax is prevalent in inter-state sales.

VAT: VAT is the short version of value added tax. It is a type of indirect tax which is levied on sale of goods within a state. VAT is a modern system of taxing goods which has been introduced to replace the existing sales tax system**.** Under VAT system tax is levied on the value added at each stage of production or distribution .Thus, it is a multi-point taxation system on value addition. It has been introduced to avoid cascading (double taxation) effect and to check tax evasion.

Goods and Services Tax (GST)

Till now in India, there are separate enactments for goods and services. Efforts are being made to consolidate the taxing system for entire goods and services.

Goods and service Tax has evolved as a modern Taxing system. It is a composite Taxing system which covers all goods and services for specified transactions. This New Act will replace all indirect Taxes being presently levied on all goods and services by central as well as state government. However, this new act is yet to be implemented in India.

<u>Tax Collection pattern in India</u>

Gross tax collection in India is more or less stagnant after financial year 2009-10, if we take it as % of GDP (Table-I). To meet the challenges, the Government is financing its fiscal deficit by cutting down its expenditure. This is not only lowering down the capital formation in the country but also adversely affecting the overall economic growth. The pattern of indirect collection is also not showing any favourable growth (Table-II). Shortfall has not only incurred in tax collection but also in non-debt receipts.

The impact of direct tax on economic growth

The direct tax is one of the important sources of government revenue. Further it also impacts directly the disposable income of individuals. If direct tax rate is increased by the Government, people start saving for investment purposes. Due to this behavior of individual's income generation process of economy is hampered. Particularly this is true for luxury commodities. This decreases the production of luxury commodities in the economy and as a result also adversely affects the GDP and standards of living. However on the positive sides, if proper deductions are allowed based on investments, it leads to capital formation in the country. Thus, broadly following are the positive sides of direct taxes on the economic growth:

- Better capital formation
- Inducement of saving and investment
- Surety of Government's revenue growth
- Increase in planned expenditure of government
- Decrease in inflation rate due to lesser availability of disposable income to persons
- Timely availability of revenue to the Government

Impact of indirect tax on economic growth

Since the burden of Indirect taxes directly fall on the consumers, it directly impacts the cost of goods and services. Thus, indirect tax increases the efficiency of the producers, since to maintain their demand they will have to put their full efforts towards cost cutting measures. Further, this effort of producers also brings proper utilization of resources in the economy. The consumers are at freedom to select products at their choice, thus healthy competition also grows in the economy. Thus, broadly following are the positive sides of indirect taxes on the economic growth:

- Better utilization of resources
- Increase in efficiency of producers
- Growth of healthy competition in the market
- More freedom of choice to the consumers
- Increase in demand for luxury goods
- Increase in standard of living of people

The Road Map of new budget 2014

The new Government has many challenges to face. Food inflation, economic growth, reduction in fiscal deficit, inviting more foreign capital flow, infrastructural development are some of the special emphasis areas.

- Fiscal deficit has been aimed at 4.1% which is expected to reduce to 3% by 2016-17. It is worth noting that fiscal deficit was 5.7% in 2011-12, dropped down to 4.8% in 2012-13 and to 4.5% in 2013-14. Thus, from high peak it is dropping down considerably. However, this reduction in earlier year was basically due to curtailing down the Government expenditure rather than increasing Government Revenue.

- More excise duty on Cold drinks and tobacco products
- Reduction in excise duty on packaged food, footwear, LCD/LED TV sets,
- Deduction for housing loan interest raised from 1.5 lakhs to 2 lakhs
- Tax exemption limit raised from 2 lakhs to 2.5 lakhs and for senior citizens up to 3 lakhs
- Investment limit under section 80C rose from 1 lakh to 1.5 lakhs.
- PPF limit has been raised to 1.5 lakhs
- No changes have been made in the tax rates.
- The advance ruling Authority has been strengthened
- The scope of Income tax settlement commission has been enlarged
- It has estimated that net loss due to direct tax amendment will be 22,200 crores.
- Introduction of GST has been given preference

Problem Areas

1. There is no provision for minimum taxes for persons other than Company
2. Even though Government of India has taken initiatives for simplifying the tax procedures, a lot is still required to be done in this behalf
3. The taxation policy of the Government is doing very little in bringing the inflation down. Still it is required to provide more avenues for tax reliefs through investments.
4. High tax evasions, particularly in Business class
5. Multiple taxes and multiple rates has rendered the taxation system a complex one
6. The government is increasing disproportionately the regime of indirect taxes. Now almost all the individuals are covered by indirect taxes, however only 10% to 15% of the individuals of the total population are covered by direct taxes.
7. Our national income is increasing without proportionate increase in taxes; this is enlarging the income inequality gap in India.
8. In India, it is very unfortunate that urban mass is taxed more than the rural mass.
9. High corruption in tax department is encouraging the people to adopt tax evasion and tax avoidance.
10. Due to low level of education and awareness, people feel shy while paying indirect taxes, particularly service tax.

Conclusion and suggestions

1. Government of India is required to open more investment options in Income tax law to increase capital formation in the Country.
2. There is high need to consolidate and simplify the tax laws.
3. Income tax Department should run tax payers awareness programme so that a common person may understand the tax law and procedures.
4. Provision for minimum taxes should also be incorporated for persons other than company except for individuals like for Societies, Firms, and LLPs etc.
5. It should reduce tax rates on edibles so that inflation rate may be brought down on food items.
6. Government should enlarge the tax regime to capture effectively the middle and lower business class.
7. The area of wealth tax needs to be enlarged to cover more people in its regime.
8. The poor people should be tried to be freed from indirect tax regime while more indirect taxes should be imposed on rich class to reduce income inequality gap.
9. Today there is no separate tax provision for limited liability partnership firm. It is treated like other partnership firm. Due to its peculiar feature and being an entity entirely different from partnership firm, separate provisions are needed to tax this entity
10. Today there are two separate boards for direct tax and indirect tax. Central board of direct taxes looks after direct tax and Central board of Excise and customs looks after indirect tax. There is lack of coordination between these two departments and thus it is highly needed that these two departments are consolidated into one.

Tables

Table-I

Pattern for Gross tax collection in India

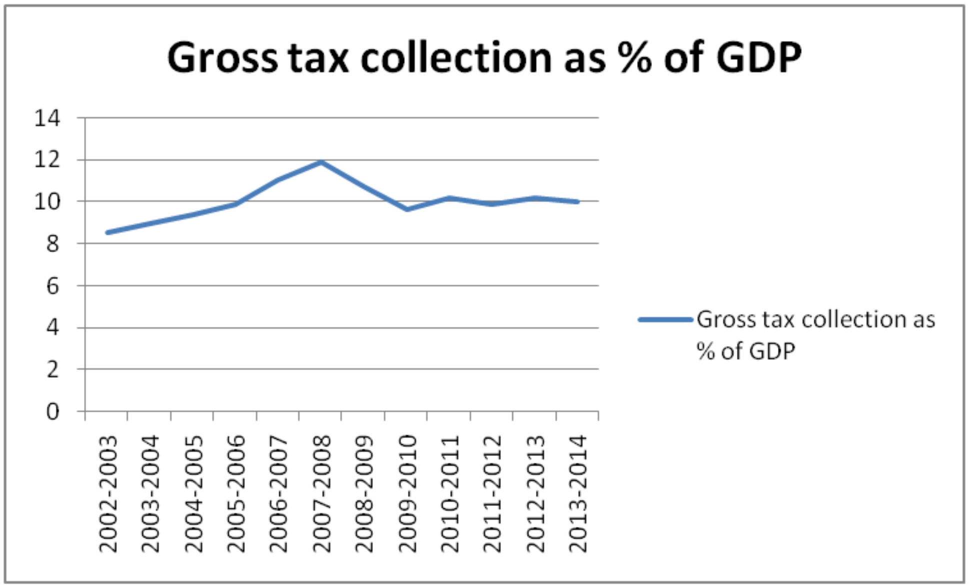
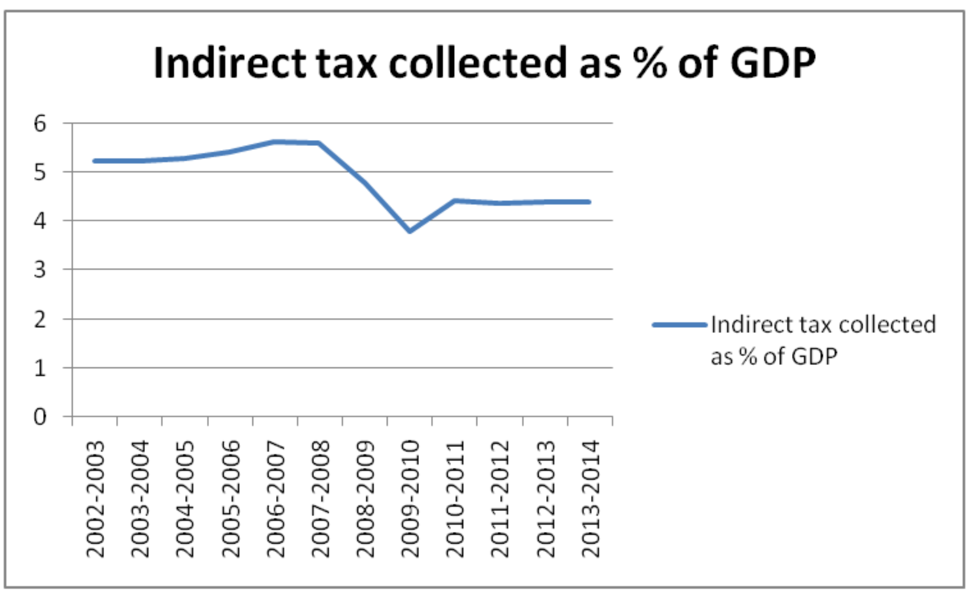


Table-II

Pattern for Indirect tax collection in India



References

1) How to save income income tax through tax planning, R. N. Lakhotia and Subhash Lakhotia, vision books Delhi, 27th edition, 1 – 24
2) Students guide to income tax, Dr Monica SinghaniaDr. Vinod K Singhania, Taxmann, 47th edition, 200 – 213
3) A practical approach to income tax, Ravi Gupta, Girish Ahuja, Bharat Law House, 47th edition, 98 – 107
4) The income tax root of all evils, Frank Chodorov, Literary Licensing, Llc, 123-130
5) Administration of income tax in India, Rekha Mehta, Neha Publishers & Distributors, 12 – 17
6) Compendium of Indian taxes, K L Chandak, Sanjau , Young Global Publications, 70 – 81
7) Income Tax Policy Design and Implementation in India—Individual Assessees AttitudeGlobal Business Review June 2010, 135-152,
8) Direct tax reforms and various schemes of income tax in India, Asia pacific Journal of Research in Business Management, year 2010, Volume: 1, issue: 3, 131-140
9) R.V. Deshpandey, (2012), Tax reforms in India, Indian Streams Research Journal, Vol.II, Issue VII, 1-2
10) Syed Mohd Ali Taqvi, Amit kumar Srivastava, Ravindra Kumar Srivastava Challenges and Opportunities of Goods and Service tax (GST) in India Indian Journal of Applied Research, Vol. III, Issue V May 2013, 413-415
11) Nishita Gupta, (2014), Goods and service tax: its impact on Indian Economy, CASIRJ, Volume:5, issue:3, 10-13