Journal of Accounting and Finance
Volume 24, No. 2
April-September 2010

Impact of Changing Scenario of Taxation in India on Tax Revenue and GDP

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Abstract

Tax revenue is the part and parcel for the growth of Indian economy. India has a well-developed tax structure with a three-tier federal structure, comprising of the Union Government, the state governments and the urban/rural local bodies. The power to levy taxes and duties is distributed among the three - tiers of governments, in accordance with the provisions of the Indian Constitution. The Government of India has been trying to improve the taxation provisions since last many years; tax reform initiatives have produced impressive results. The Center's Tax-GDP ratio has increased to 11.5 per cent in 2008-09 from a low of 9.2 per cent in 2003-04. The healthy growth in tax revenues over the last five years is essentially attributed to growth in direct taxes. The objectives of present study is to examine the impact of tax revenue on India's GDP and to analyze the developments in taxation and impact on tax revenue of various developments. For the purpose of the study we have considered tax revenue percentage in GDP and tax revenue collected by the central government for the five consecutively financial years, i.e. from 2002-03 to 2007-08. Data have been collected from Indian Economic Survey Report, 2008-09. We found that despite recession in Indian economy the center's tax GDP percentage has increased 46 in financial year 2008-09 (BE) from a low percentage of 6.5 in the financial year 2002-03 and both direct and indirect tax have registered continuous growth in tax revenue. It may be concluded that despite several amendments and developments in both direct and indirect taxes, impact is positive on the India's GDP and tax revenue collection.

Keywords: *Direct and Indirect Tax, Gross Domestic Production (GDP), Tax Revenue.*

Introduction

India has a well-developed tax structure with a three-tier federal structure, comprising the Union Government, the state governments and the urban/rural local bodies. The power to levy taxes and duties is distributed among the three - tiers of governments, in accordance with the provisions of the Indian Constitution. The main taxes/duties that the Union Government is empowered to levy are Income Tax (except tax on agricultural income, which the state governments can levy), Customs duties, Central Excise and Sales Tax and Service Tax. The principal taxes levied by the state governments are sales tax (tax on intra-state sale of goods), stamp duty (duty on transfer of property), state Excise (duty on manufacture of alcohol), land revenue (levy on land used for agricultural/non-agricultural purposes), Duty on entertainment and tax on professions and callings. The local bodies are empowered to levy tax on properties (buildings, etc.), octroi (tax on entry of goods for use/consumption within areas of the local bodies), tax on markets and tax/ user charges for utilities like water supply, drainage, etc.

The Government of India has been trying to improve the taxation provisions since last many years, tax reform initiatives have produced impressive results. The Center's Tax-GDP ratio has increased to 11.5 per cent in 2008-09 from a low percentage of 9.2 in 2003-04. The healthy growth in tax revenues over the last five years is essentially attributes to growth in direct taxes.

Objectives

The objectives of the study are as follows:

1. To examine the impact of tax revenue on India's GDP.
2. To analyze the developments in taxation and impact on tax revenue.

Data and Research Methodology

Since the objectives of the study are to examine the impact of tax revenue on India's GDP and to analyze the developments in taxation and impact on tax revenue of various developments, for the purpose of the study we have considered tax revenue percentage in GDP and tax revenue collected by the central government for the five consecutively financial years, *i.e.* from 2002-03 to 2007-08. Data have been collected from *Indian Economic Survey Report*, 2008-09.

Tax System in India and Various Developments (Amendments)

Direct Taxes :

Personal Income Tax

Personal income tax is levied by Central Government and is administered by Central Board of Direct taxes under Ministry of Finance in accordance with the provisions of the Income Tax Act. The rates for personal income tax are as follows:

For individuals, HUF, Association of Persons (AoP) and Body of individuals (BoI):

For the Assessment Year 2009-10

Taxable income slab (Rs.)	*Rate (in percentage)*
Up to Rs. 1,60,000	
Up to Rs. 1,90,000 (for women)	
Up to Rs. 2,40,000 (for resident individuals of 65 years or above):	NIL
1,60,001 – 3,00,000	10
3,00,001 – 5,00,000	20
5,00,001 upwards	30*

*A surcharge of 10 per cent of the total tax liability is applicable where the total income exceeds Rs 10,00,000.

Note :

- *Education cess is applicable @ 3 per cent on income tax, inclusive of surcharge, if there is any.*
- *A marginal relief may be provided to ensure that the additional IT payable, including surcharge, on excess of income over Rs 10,00,000 is limited to an amount by which the income is more than this mentioned amount.*
- *Agricultural income is exempt from income-tax.*

Corporate Income Tax

For domestic companies, this is levied @ 35 per cent plus surcharge of 5 per cent, whereas for a foreign company (including branch/project offices), it is @ 40 per cent plus surcharge of 5 per cent. An Indian registered company, which is a subsidiary of a foreign company, is also considered an Indian company for this purpose.

For the Assessment Year 2007-08

Description	*Existing Rate* (%)*	*Proposed Rate* (%)*	*Difference + - = (%)*
	Domestic Company		
Regular Tax	33.6	33.9**	+0.33
MAT	11.22 (of book profits)	11.33 (of book profits)	+0.11
DDT	14.025	16.995	+2.97
	Foreign Company		
Regular Tax	41.82	42.33#	0.41

Note:

**It includes the applicable surcharge and the education cess.*

***If the income is equal or less than Rs 10 million, it is 30.9* per cent.

#If the income is equal or less than Rs 10 million, it is 41.2 per cent.

Withholding Tax for NRIs and Foreign Companies:

For the Assessment Year 2007-08

Name of Income	*Rate* (in percentage)*
Dividend**	20
Interest received on loans made in foreign currency to an Indian concern or Government of India.	20
Income received in respect of units purchased in foreign currency	20
	For Agreements entered into:
Royalty fees or technical fees	• After 31.05.97 but before 01.06.05 - @ 20% • After 01.06.05 - @ 10%
Interest on FCCB	10

**The rates further increased by surcharge and education cess.*

***Other than dividends on which Dividend Distribution Tax (DDT) has been paid.*
***Note:-** If the NRI has a Permanent Establishment (PE) in India and the royalty or the fees for technical services paid is effectively connected with such, the same could be taxed at 40* per cent *(+ surcharge & education cess) on net basis.*

Tax Holidays in some Sectors in India

- A five-year tax holiday for setting up hospitals anywhere in India specially in tier-II and tier-III towns to serve the rural population. Certain specified urban agglomerations will not be covered. This window will be opened for a five-year period from April 1, 2008, to March 31, 2013.
- A five-year tax holiday for two, three and four star hotels established in specified districts, which have UNESCO declared World Heritage sites. The hotel should be constructed and start functioning between April 1, 2008, and March 31, 2013.

Developments in Direct Tax

1. Section 80-DD has been amended and the limit of the Rs. 75,000 increased to Rs. 1,00,000 in respect of maintenance, including medical treatment, of a dependent who is a person with severe disability.
2. Deduction in respect of export profits is available under sections 10A and 10B upto the financial year 2010-2011.
3. In order to incentives the corporate sector to undertake research and development work, the provision of weighted deduction has reached upto 150 per cent.
4. Minimum Alternate Tax (MAT) has increased to 15 per cent of book profits from the rate of 10 per cent.
5. The New Pension System (NPS) has been introduced in the development of a suitable, efficient, voluntary and defined contribution pension system in India.
6. The Commodity Transaction Tax (CTT) has been abolished from the Financial Year 2009-10, which was introduced by the Finance Act, 2008.
7. Section 80E which provides deduction in respect of interest on loan taken for perusing higher education in specified field, will also include vocational studies.
8. From the Assessment Year 2010-11, small taxpayers will enjoy the benefit of their declaration of income, either they declare the 8 per cent income from their business or show the turnover limit upto Rs. 40 lakh in financial year and enjoy exemption from the compliance burden of maintaining books of account. They are also exempt to pay advance tax on their income.

Sales Tax/ VAT

Sales tax is levied on the sale of movable goods. Most of the Indian states have replaced Sales tax with a new Value Added Tax (VAT) from April 01, 2005. The much awaited Value Added Tax (VAT) has been introduced in Indian Taxation System from April 1, 2005. Now India is a part of other 123 countries following VAT which was leaded first time by the UK in 1973. It is said that four years is a very short period in introducing VAT in the country as compared to ten years on an average by other countries.

VAT is imposed on goods only and not services and it has replaced sales tax. Other indirect taxes such as excise duty, service tax etc., are not replaced by VAT. VAT is implemented at the state level by state governments. VAT is applied on each stage of sale with a mechanism of credit for the input VAT paid. There are four slabs of VAT:

- 0 per cent for essential commodities.
- 1 per cent on bullion and precious stones.
- 4 per cent on industrial inputs and capital goods and items of mass consumption.
- All other items 12.5 per cent, and
- Petroleum products, tobacco, liquor etc., attract higher VAT rates that vary from state to state.

A Central Sales Tax at the rate of 4 per cent is also levied on inter-state sales and would be eliminated gradually.

Municipal/Local Taxes

- Octroi/entry tax - Some municipal jurisdictions levy octroi/entry tax on entry of goods.

Excise Duty:

Manufacture of goods in India attracts Excise Duty under the Central Excise Act 1944 and the Central Excise Tariff Act 1985. Herein, the term Manufacture means bringing into existence a new article having a distinct name, character, use and marketability and includes packing, labelling etc.

Most of the products attract excise duties at the rate of 16 per cent. Some products also attract special excise duty and an additional duty of excise at the rate of 8 per cent above the 16 per cent excise duty. 2 per cent education cess is also applicable on the aggregate of the duties of excise. Excise duty is levied on *ad valorem* basis or based on the maximum retail price in some cases.

Developments in Excise Duty

1. The government has increased excise duty from 4 to 8 per cent on the following items:
   a. food items, and
   b. drugs, pharmaceuticals and medical equipments.
2. Bio-diesel, obtained from vegetable oils and used for blending with petro-diesel, is currently from excise duty.
3. Excise duty on the software which involves transfer of the right to use after the levy of service tax on IT software has been exempt.
4. Petrol driven trucks provide a useful means of transport within cities and across short distances. These were chargeable to 20 per cent has been reduced to 8 per cent.

Customs Duty:

The levy and the rate of customs duty in India are governed by the Customs Act 1962 and the Customs Tariff Act 1975. Imported goods in India attract basic customs duty, additional customs duty and education cess. The rates of basic customs duty are specified under the Tariff Act. The peak rate of basic customs duty has been reduced to 15 per cent for industrial goods. Additional customs duty is equivalent to the excise duty payable on similar goods manufactured in India. Education cess at 2 per cent is leviable on the aggregate of customs duty on imported goods. Customs duty is calculated on the transaction value of the goods.

Rates of customs duty for goods imported from countries with whom India has entered into free trade agreements such as Thailand, Sri Lanka, BIMSTEC, South Asian countries and MERCOSUR countries are provided on the website of CBEC.

Customs duties in India are administrated by Central Board of Excise and Customs under Ministry of Finance.

Developments in Customs Duty

1. Set Top Boxes are subject to impose a nominal basic custom duty of 5 per cent, prior to financial year 2008-09, Set Top Boxes were fully exempt from the custom duty.
2. The electronic hardware industry has a strong potential for creating employment especially in the SME sector. The customs duty on the LCD has been reduced from 10 to 5 per cent to support indigenous production of LCD televisions.
3. Customs duty on permanent magnet – a critical component for Wind Operated Electricity Generators, has been reduced from 7.5 to 5 per cent.
4. Customs duty has also been reduced from 10 to 5 per cent on influenza vaccine and nine specified life saving drugs used for the treatment of breast cancer, hepatitis-B, rheumatic arthritis etc.
5. Customs duty has also been reduced on two specified life savings devices used in treatment of heart conditions, from 7.5 to 5 per cent.
6. In order to encourage the use of environment friendly fuel and augment its availability in the country, customs duty has been reduced from 7.5 to 2.5 per cent on Bio-diesel and petro-diesel.

Service Tax

Service tax is levied at the rate of 10 per cent (plus 2% education cess and 1% higher secondary education cess) on certain identified taxable services provided in India by specified service providers. Service tax on taxable services rendered in India are exempt, if payment for such services is received in convertible foreign exchange in India and the same is not repatriated outside India. The Cenvat Credit Rules allow a service provider to avail and utilize the credit of additional duty of customs/ excise duty for payment of service tax. Credit is also provided on payment of service tax on input services for the discharge of output service tax liability.

Developments in Service Tax

1. Services received by exporters from goods transport agents and commission agents, where the liability to pay service tax is *ab initio* on the exporter now exempt.

2. In order to provide a level playing field in the goods transport sector, service tax will be levied on the goods carried by Indian railways or costal cargo of through inland waterways.
3. Except the individual, service tax will be levied on the advice, consultancy or technical assistance provided in the field of law.
4. Transportation of passengers undertaken by private enterprises in vehicles having "Contract Carriage Permits" has now been exempt.

Findings and Results

Table-1 Tax Revenue

(in percentage of GDP)

Year	*GDP*
2002-03	6.5
2003-04	6.8
2004-05	7.1
2005-06	7.5
2006-07	8.5
2007-08	9.3
2008-09 (BE)	9.5
2008-09 (RE)	8.8

Source: *Economic Survey 2008-09*, Note: RE- Revised Estimates, BE- Budgeted Estimates

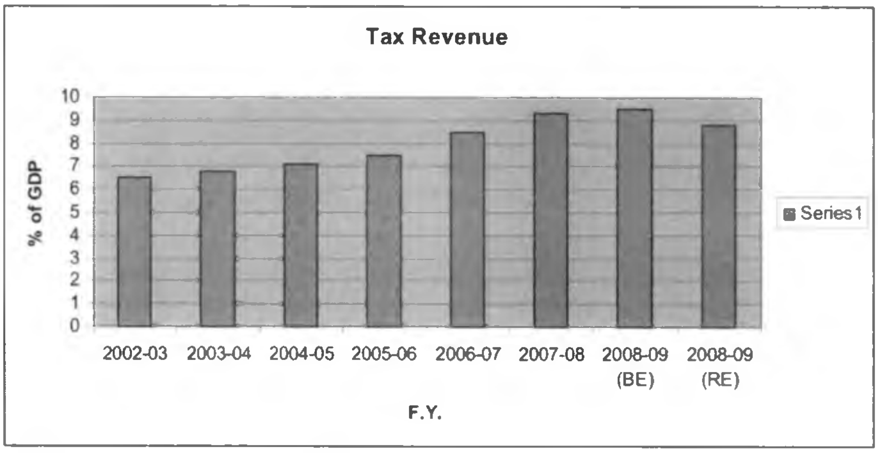


Figure: 1.1

The center's tax GDP per cent has increased 46 per cent in financial year 2008-09 (BE) from a low of 6.5 per cent in the financial year 2002-03. In fiscal 2008-09, expenditure has gone up sharply while growth in revenue of the government has slowed. During April-December, 2008, gross tax revenue grew by a lower rate of 9.6 per cent as against an impressive 27 per cent increase in the same period a year ago. The decline in revenue from corporation tax reflects lower profits of the corporate sector.[1]

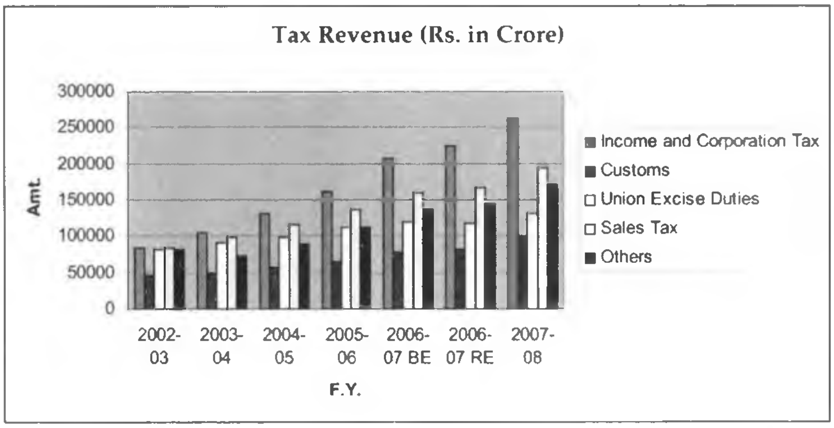
Table- 2 Tax Revenue

From Financial Year 2002-03 to 2007-08

(Rs. in crore)

Year	*Income and Corporation Tax*	*Customs*	*Union Excise Duties*	*Sales Tax*	*Others*	*Total*
2002-03	83038	44852	82310	83768	81251	375219
2003-04	104949	48629	90774	98001	71732	414085
2004-05	131948	57611	99125	116234	89452	494370
2005-06	162034	65067	111226	136500	112861	587688
2006-07 BE	206420	77066	119000	159444	137205	699135
2006-07 RE	224708	81800	117266	166547	145152	735473
2007-08	262031	98770	130220	192812	170980	854813]

Source: *Economic Survey 2008-09,* Note: RE- Revised Estimates, BE- Budgeted Estimates



The healthy growth in tax revenues over last five years is essentially attributable to growth in direct taxes, since income tax and corporation tax contribute a large in Indian taxation revenue; government is more concern on direct taxes provisions. In total tax revenue has increased 3.16 times in 2007-08 from 2002-03. We found that direct tax and indirect tax both have registered continuous growth from the tax revenue collection point of view.

Conclusion

GDP for BE 2009-10 has been projected at Rs. 58,56,569 crore assuming 10.05 per cent growth over the revised estimates of 2008-09 (Rs. 53,21,753 crore).[2]

It may be concluded that despite several amendments and developments in both direct and indirect taxes, impact is positive on the India's GDP and tax revenue collection. The government has been or is committed for the reform from time to time.

Upto September, 2009 net direct tax collections during first six months of the present fiscal (upto September 2009) stood at Rs.1,52,625 crore, up from Rs.1,47,197 crore in the same period last fiscal, registering a growth of 3.69 per cent. Growth in Corporate Taxes was 5.55 per cent (Rs.1,00,572 crore as against Rs.95,283 crore), while Personal Income Tax (including STT, and residual FBT and BCTT) grew at 0.38 per cent (Rs.51,897 crore as against Rs.51,700 crore). Lower growth in net collection was mainly on account of higher tax refund outgo of 51.1 per cent at Rs.28,281 crore as against Rs.18,717 crore last fiscal.[3]

Note

[1] Monthly Review of the Indian Economy, Centre for Monitoring Indian Economy, CMIE, *Gross tax revenue declined sharply in December-2008*, Feb. 09, p. 37

[2] Budget at a Glance, *Finance India*, Journal of Indian Institute of Finance, p.430

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