

# **Income Tax Scenario in India**

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Income tax is a tax levied and collected by the government, directly on the income of an individual/ organisation/ business entity for the purpose of financing various operational and planned schemes of the government. The system of progressive income tax is designed in such a manner that it takes a greater percentage of income from high-income persons or corporations than from low-income ones. The system is based on the rationale of ability to pay whereby it ensures more even distribution of wealth in a population and serves as a fiscal stabiliser to cushion the effects of economic cycles.

Income tax is a direct tax which is levied directly on the taxpayer by the government for payment, whereas Indirect Taxes are applied on the manufacture or sale of goods and services. Goods and Services Tax (GST), which has now subsumed all other indirect taxes such as VAT, service tax, excise etc., is an example of indirect taxation in India.

**Income Tax in India:** Everyone (either as resident or a non-resident of India) who earns or gets an income in India is subject to income tax in this country. The Income Tax Department breaks down income under five heads:

- 1) **Income from Salary** covering income from salary and pension.
- 2) **Income from House Property** is mostly rental income (Real or notional).
- 3) **Income from Capital Gains** is income from sale of capital assets like shares/ stocks, mutual funds and immovable properties.
- 4) **Income from Business and Profession** includes Income of businessmen, professionals, contractors and other freelancers/ self employed persons.
- 5) **Income from Other Sources** encompasses any other income that is not covered under the above four heads but is assessed as income from other sources as a residuary head of income.

### **Who pays Income tax in India?**

A miniscule minority in India pays Income tax. According to a data revealed by Central Board of Direct Taxes (CBDT), only 2.06 crore Indians out of total population of India of around 120 crore (roughly 1.7 per cent of the population) paid income tax in the assessment year (AY) 2015-16. Although the number of people filing for income tax rose from Rs. 3.65 crore to Rs. 4.07 crore in the same assessment year, a little over half of them actually paid taxes and the rest claimed their incomes were below taxable level. Further breakdown of the people who paid income tax reveals that 4.63 per cent of total taxpayers paid a whopping 62.34 per cent of taxes collected; next 5.5 per cent paid 13.92 per cent of taxes, while the major chunk of 89.86 per cent paid only 23.73 per cent of total taxes. If little over 10% of taxpayers pay more than 75% of taxes it points to the disproportionate share of income they earn in the society.

### **Why only 1.7% of population pays income tax?**

The answer lies in the facts —

1. That about 95% of rural households and 90% of urban households earn less than 2.5 Lakh a year which is the exemption limit for paying income tax.
2. Categories of income earners like farmers do not have to pay income tax even though they may be earning more than 2.5 Lakh a year because agricultural income has been statutorily exempted from tax.
3. Many non-salaried income earners among the professional/ self employed category like doctors, lawyers, accountants, private tutors etc. conceal their income and pay lower rate of tax or evade paying tax.

Despite the fact that many Indians under-report their income justifying India to be called a ‘tax non-compliant society’, there is also other data that explains why India has such a small income tax base. Data released by the Central Statistics Office (CSO) says that the per capita net national income during 2016-17 was estimated to be just over 1 Lakh Indian Rupees at current prices. This leads one to safely assume that a significant majority of Indians earn less than Rupees 1 lakh per annum. At the same time with the kind of income disparity existing, indicated by 10% of Indians paying 75% of income tax and some 270 million people living below the poverty line, available number of people earning above the exemption threshold of 2.5 lakh per annum can never make

India's tax base sizeable enough. Simply put, it can easily be said that only those who earn 2.5 times of the national average income will be the ones paying income tax in India.

### **Income Tax Return (ITR):**

The provisions of Income Tax Act, 1961 make it mandatory for individuals who earn above the basic exemption limit, even after the tax liability have been reduced to zero post deductions, or their taxes have been paid via tax deduction at source or TDS. Only those who earn up to or less than the basic exemption limit (currently at Rs 2.50 lakh per annum) need not file tax return. Additionally, the income tax laws require ordinary residents under certain circumstances to compulsorily file Income Tax Return e.g. those who own or are beneficiaries of assets situated overseas or have financial interest in any entity located abroad or have signing authority in any account located outside India. Besides the above, individuals who have long-term capital gains from the sale of equity shares of a company, or sale of units of equity-oriented mutual funds, or sale of units of a business trust and/ or have received income derived from property held under trust, wholly or partly for charitable or religious purposes are also required to file ITR. Furthermore, even when a person's income is not taxable, that person can avail certain benefits upon filing ITR, which are as follows:

- 1) **Pride associated being a responsible citizen earning a legal income:** Filing of Income Tax return is a moral responsibility of a citizen as it makes one's income legal comprising of white money. Every person's income is a small constituent of overall national income and tax paid on income, if any, contributes to nation building.
- 2) **Residence Proof:** A tax assessment order obtained after filing of ITR can be used as a proof of residence for applying for other identity documents like Aadhar or passport.
- 3) **Hassle free processing for Bank Loans and Credit Card:** Usually, last three years' income tax returns are insisted upon by banks when someone applies for various types of bank loans for housing, education, business or purchase of vehicle etc. ITR also comes in handy for processing an application for Credit Card.
- 4) **Recording of high-value transactions:** High-value transactions involving purchase of property, buying a car, investing in mutual funds, etc. gets reported to the income tax department. Therefore, by filing income tax returns, these transactions can be corroborated in terms of one's income.

- 5) **Claiming refund of Tax Deducted at Source (TDS):** To claim refund of TDS deducted at various points from one's income, filing of income tax return is the only way forward.
- 6) **To carry forward losses:** A long-term capital loss in one year can be carried forward for set off against long term capital gains, for eight consecutive years immediately succeeding the year in which the loss is incurred.
- 7) **Visa processing:** An applicant of Visa for travelling abroad on business or leisure need to submit ITR as one of the documents for processing of Visa application because it strengthens the case of a visa applicant as someone who will not leave the country for good but will return.
- 8) **Quick registration of immovable properties:** In some of cities of India, furnishing a copy of the ITR facilitates speedier registration of properties.
- 9) **As a tax saving tool:** By submitting ITR a tax assessee can claim additional deductions which are not considered by his employer while deducting TDS. Many people are unaware that tuition fees paid for two children are available u/s 80C of Income Tax Act 1961 as an allowable deduction for calculating tax liability and claiming tax refund through ITR.
- 10) **Buying a high life cover:** These days, buying high life cover has become commonplace. Nonetheless, these covers are available against furnishing of ITR to verify annual income of the life assurance buyer.
- 11) **Government tender:** Suppliers and Contractors while submitting government tender papers usually need to submit ITR for last 5 years to support their credentials for executing an order.
- 12) **Avoiding penalties and additional interest rates:** Penalties ranging from Rupees 1000 to 10000 are liable to be charged for late filing and non-filing of returns depending on the income of the assessee and date of filing the return. Additional interest on balance of tax payable is also chargeable for late payment of tax.

To encourage more people to participate in the annual exercise of filing ITR the Income tax department has been taking steps to make the process of filing return simpler. Some of the measures it has already taken in this direction include devising simplified tax return forms, allowing paperless filing of returns, providing pre-filled tax return forms etc. The one-page ITR Form-1 (Sahaj) is a simplified form meant for individuals with income up to Rs 50 lakh and owning one house property. Similarly there are forms like ITR-2, ITR-3 and ITR-4 (Sugam) for people with higher income and

income under other heads like capital gains, income from Business or Profession etc. A tax payer may e-file his own return if there is a working internet connection available or may employ a tax consultant for doing it on behalf.

Every taxation system has costs to the society. According to Adam Smith, the great Scottish economist philosopher, a taxation system should be so designed that the Administrative and Enforcement costs in the form of salaries of a great number of officers of the tax levying machinery should not eat up greater part of the produce of the tax. Modern day tax machinery significantly inflicts all these costs on the society including what Adam Smith calls evasion and compliance costs. In other words cost benefit justifiability of the tax system ought to be ensured.

### **Income Tax vs Banking Transaction Tax:**

After demonetisation on 8 November, 2016 there was speculation around that the government would abolish all kinds of direct and indirect taxes except import duty and substitute these taxes with one single tax in the form of Banking Transaction Tax (BTT). The speculation was rife for the fact that the Pune based think-tank *Arthakranti* is said to have mooted the idea of demonetisation of high value currency notes which the NDA government accepted and implemented, also recommended implementing BTT across the nation. The proposal gathered more credence as demonetisation was preceded by widespread implementation of Pradhan Mantri Jan Dhan Yojana (PMJDY), India's National Mission for Financial Inclusion, whereby 30 crore bank accounts were opened for people who never had a bank account. *Arthakranti* proposed a taxation rate of 2 per cent on all forms of banking transactions both credit and debit. The revenue distribution between Centre, State, Local Bodies and Banks would be 0.7%, 0.6%, 0.35% and 0.35% respectively.

### **The merits of the proposal could be:**

1. Since the proposal envisaged scrapping of all currencies above denomination of Rs. 50 the scope of hoarding wealth in the form of cash and evading taxes through the loopholes in Income Tax would be eliminated and people will shift to electronic methods of transaction.
2. BTT will ensure a broader tax base in the country by bringing more people into the tax net.
3. BTT at a rate of 2% would leave 98 per cent of the salary to remain as disposable income.
4. Shifting towards electronic and cheque modes of transactions would encourage a cashless economy.

## **Demerits of BTT:**

1. Rural economy which primarily deals in cash will be seriously affected. With poor penetration of banking services in rural India, BTT will be a non-starter there.
2. Progressive taxation is fair system being a leveller to remove inequities in income. BTT will not be so.
3. States with less penetration of the banking sector will lose on revenue earning.

Though the government declared in Parliament that it has no proposal “at present” to replace Income Tax with Banking Transaction Tax or BTT, there are many protagonists within the ruling party for this scheme of taxation. One reason that may be deterring the government from seriously considering the proposal could be that the experimentation with the scheme of taxation did not previously work in Australia, Argentina & Brazil.

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Mr. Prapanna Lahiri is from Kolkata, West Bengal. He was involved with the Indian banking industry as an employee and has almost thirty years of experience as a banker. He also had associations with the vocational training industry as an administrator. At present, Mr. Lahiri is associated with IDC International Journal.

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