Post-Demonetisation Indian Economy

What is the issue?

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- The former RBI Governor has recently commented on the ill effects of demonetisation. Click here to know more.
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- It becomes imperative at this point to look at the post-demonetisation Indian economy.
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What are the government claims?

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- Demonetisation has sharply lifted tax buoyancy.
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- It has ushered many new return filers into the income tax net.
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- It has dealt a blow to terrorism, corruption and counterfeiting.
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How is the tax compliance scenario?

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- **Tax Collections** - India managed a second consecutive year of strong growth in its direct tax collections in FY18.
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- Net collections largely fall around Rs. 9.9 lakh crore.
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- This is an increase by around 17% in the just concluded fiscal year.

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- Notably, FY17 saw a 14.6% increase.

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- The figures are better than that of FY15 and FY16, indicating a healthy trend.

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- This is despite the fact that income tax rates had largely stayed put in the last couple of years.

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- There were only minor increases in the surcharge and cess components.

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Is demonetisation a reason?

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- From a historical perspective, a 14% or even 17% annual increase is not that extraordinary for the Indian economy.

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- In FY11, direct tax collections had expanded 18% and in FY14, it rose 14.3%.

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- Clearly, these numbers were achieved without any moves with high-value currency notes.

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- So, the **current trend in tax collections is uncertain to be attributed to demonetisation.**

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Is tax collection the right measure?

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- Not all of the direct taxes come from citizens willingly paying up.

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- Direct tax collections put out by Central Board of Direct Taxes (CBDT) include mandatory deductions by way of TDS.

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- Tax deducted at source (TDS) accounts for a third of the collections each year.

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- So, a better way to measure voluntary tax compliance, and to strip out the impact of TDS, is to look at the Income Tax (IT) returns.
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What do IT returns suggest?

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- IT returns are filed by taxpaying entities such as individuals, small businesses and companies.
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- From FY14, IT returns filings saw a 15% addition over the next two years to FY16.
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- The latest CBDT data (provisional) shows that the number of filings zoomed to around 6.8 crore by the end of FY18.
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- This is an increase of 57% in the last two years, with around 2.4 crore new filings.
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- But notably, IT returns are typically filed for the previous financial year.
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- So, the filings at the end of FY18 would only fully capture the demonetisation impact.
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- Apparently, the **recent boom in IT returns could not wholly be attributed to demonetisation effect**.
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What is tax buoyancy?

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- Direct taxes both for individuals and businesses are levied as a percentage of their annual income.
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- So, it is reasonable to expect tax collections to be in line with GDP growth.
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- And tax buoyancy is a way of measuring this change.
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- It divides the growth in tax collections for each year by the nominal GDP

growth.
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- A higher number indicates better tax compliance and vice versa.
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How is tax buoyancy at present?

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- In the 7 years from FY08 to FY14, direct tax buoyancy hovered between 0.5 and 1.1 times.
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- It thus averaged out at 1 for the entire period.
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- In other words, every additional rupee of nominal GDP growth yielded an equivalent new rupee of direct taxes for the Centre.
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- After hovering at 1.0 until then, in FY15 and FY16, direct tax buoyancy unaccountably slumped to 0.8 times and 0.6 times.
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- But, tax buoyancy has indeed picked up post-demonetisation.
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- Direct tax buoyancy doubled from 0.6 times in FY16 to 1.3 times in FY17.
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- It accelerated further to 1.7 times in FY18.
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- This is favourable, because India’s nominal GDP growth has been below historical levels in the last two years, due to low inflation.
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- If nominal growth picks up and the new-found tax buoyancy sustains, the Centre’s direct tax coffers could fill up even faster.
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How does the future look?

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- The new found improvement in **tax compliance** is appreciable.
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- Better compliance would eventually provide headroom for the Centre to prune down income tax rates.
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- The latest Budget has pegged India's current direct **tax base** at 8.27 crore taxpaying entities.
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- However, the new return filers have mostly joined the bottom of the pyramid where tax rates are nominal or nil.
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- Hopefully, as India's income levels improve over the next few years these can graduate into the higher tax slabs.
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- This should pave the way for the government to relax its anti-evasion measures and lower its sky-high income tax rates.
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Source: The Hindu

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