An Empirical Study on the Journey of Tax Reforms in India

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ABSTRACT
Reforms in the taxation system of a country are an integral part of its development. India has witnessed series of reforms in its taxation system. The tax rates have been rationalized with simplification in the tax laws results in better compliance, ease of tax payment and better enforcement. India has witnessed reforms in both direct tax system and indirect tax system. After every reform, it becomes quite essential to measure its effectiveness. There are various parameters to measure the affects of the reforms and the tax to GDP ratio is considered to be the one. One of the major objectives of tax reform measures has been to increase total tax to GDP ratio as a means of achieving fiscal consolidation and improving resource allocation. Government of India is working to enhance its revenue collection, at the same time ensuring that cumbersome taxes do not bother the investors.

This paper makes an attempt to highlight the journey of tax reforms taken place in India since the post liberalization period. The paper also highlights the tax to GDP ratio over the period of five years of study.

INTRODUCTION
A tax is considered as a “pecuniary burden laid by the government upon individuals or property owners of a country. The assignment of tax powers in the constitution is the framework for the evolution of the tax system in India.

According to the provisions of Indian Constitution, the government has the right to levy taxes on individuals as well as organizations. The tax levied is an enforced contribution imposed by the taxation authority of India and backed by the law passed by the legislature or the parliament. There is a three tier tax system prevailing in India which includes the Central, State Governments and the local government organizations.

Taxes are paid in two basic forms-Direct taxes and Indirect taxes. Direct taxes are the one which are imposed directly on the taxpayer and paid directly to the government. The burden of direct taxes cannot be shifted to another. It includes taxes like income tax, capital gain tax, corporation tax, wealth tax to name a few. On the other hand, Indirect taxes are one that are collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer).custom duty, excise duty, service tax and GST(Goods and Service Taxes) to name a few.

REVIEW OF LITERATURE
Major changes have been witnessed in tax systems of countries with a wide variety of economic systems and levels of development during the last two decades. The reasons for these reforms have varied from one country to another and the thrust of reforms has differed from time to time depending on the strategy of development and philosophy of the times (Rao, 2000).

According to Rao (2009), Fiscal and balance of payments crises of 1991 witnessed systematic reform not only to improve the revenue productivity of the tax system to phase out fiscal imbalance, but also to reorient the tax system to the requirements of a market economy. The tax reforms were an integral part of this larger reform initiative.

Dasgupta, Arindam and Mukerjee (1994), found in their studies that one of the most important reasons assigned for tax reforms in many developing and transitional economies has been to evolve a tax system for meeting the requirements of international competition.

Bird (1993) stated in his study that fiscal crisis has been proven to be the mother of tax reform. Such reforms, however, are often ad hoc and are done to meet immediate exigencies of revenue.
Bagchi and Nayak (1994) highlighted in their research that in the Indian tax system, tax policy was used as an instrument to achieve a variety of diverse goals which included increasing the level of saving and correcting for inequalities arising from an oligopolistic market structure created by a centralized planning regime, including a licensing system, exchange control, and administered prices.

The Tax Reforms Committee (TRC) laid out a framework and a roadmap for the reform of direct and indirect taxes as a part of the structural reform process. The reforms aimed at keeping with the best practice approach of broadening the base, lowering marginal tax rates, reducing rate differentiation, simplifying the tax structure, and adopting measures to make the administration and enforcement more effective (Rao and Rao, 2009).

It was studied by Ascota and Yoo (2012) that total tax revenue as a percentage of GDP indicates the share of a country’s output that is collected by the government through taxes. It is regarded as one of the measures of the degree to which the government controls the economy’s resources. Globally, it has been observed that countries significantly increase the overall level of taxation (as a share of GDP) as they become richer, in line with Wagner’s law, which states that the size of the government—proxied by the tax (and expenditure) share to GDP—rises as the associated country’s income level rises.

The major source of revenue for any Government is ‘Tax Revenue’. The Tax Revenue consists of all compulsory payments made to the Government which include Corporation tax, Personal Tax, Goods and Service Tax, Custom Duty, etc.

Along with the implementation of the tax policy, its time to time assessment is equally important. Tax to GDP Ratio is considered as one of the important benchmarks to measure the financial health of any country (Mittal, 2018).

Rao (2015) highlighted in his study that the tax to GDP ratio in India has stagnated in the last 25 years. This implies that there has been no effective additional resource mobilization (ARM) from the tax side during the period.

While the Goods and Services Tax (GST) is to widen the base of indirect taxes, complete administrative and legal reforms are necessary to control huge avoidance of direct taxes in India as studied by Singh (2016).

Subrahmanyan and Urmi (2015) made a study on the various components of GDP with a special emphasis on direct and indirect taxes. It was found in their study that in the short run customs duty had appositive impact on economic growth and excise duty has negative impact. Among the components of direct taxes, personal income tax had no impact on economic growth while corporate income tax had a positive statistically significant impact on economic growth in the long run.

OBJECTIVES OF THE STUDY

The present study is conducted to achieve the following objectives:

1. To highlight the tax reforms in India during the post liberalization period.
2. To analyze the effectiveness of tax reforms with the help of tax to GDP ratio.
3. To study the impact of direct and indirect taxes on the GDP of the country.
4. To offer certain suggestions or recommendations, if any.

RESEARCH METHODOLOGY

The present study is based on secondary data collected from sources like journals, articles, newspapers and magazines and internet sites. The study focuses to analyze the tax reforms in India during post liberalization period for the period of five years, i.e. 2013-18. Statistical tools like percentage and techniques like multiple regression analysis, t-test have been used to measure the significance of both direct and indirect taxes on the GDP of India. The level of significance is measured at 95% level of confidence.

THE REFORM ODYSSEY

The evolution of tax policy within the framework of planned development strategy had important implications. The government is required to fulfill various responsibilities. The tax policy aims at provision of public goods and services, building physical and social infrastructure; investing in education of the population; alleviating poverty, etc from the revenue so collected through tax system. The government needs to mobilize adequate financial resources in order to fulfill its above commitments. The government mobilizes financial resources for funding
its different activities mainly through taxes, user fees/service charges and borrowings.

The fiscal reforms in India were launched following the crisis in the early 1990s. The basic objectives of such reforms were at improving efficiency, production, and competitiveness of Indian industries and imparting dynamism to the overall growth process of the nation. The reforms aimed at reduction of fiscal deficits to sustainable levels by expenditure management and resource mobilization through rationalization of taxes and duties, widening of tax base, modernization of tax administration and improvement of Centre-States fiscal relations.

Indirect Tax reforms

Tax reforms committee was set up in 1991 under the chairmanship of Raja J. Chelliah to examine the tax structure of the country during that time and to suggest appropriate changes therein. A report was submitted to the Government in January 1993 by suggesting several recommendations for reforming tax structure in India. The recommendations suggested by the committee are:

- Lower rate and narrow spread: Reduction of tax rate is essential to make the direct tax system more effective. Lowering of tax rates would lead to less tax evasion and avoidance. There is also the need to narrow the spread between the lowest rate and maximum marginal rate (the rate of the highest slab).
- Avoiding double taxation system: Avoidance of double taxation system like corporation tax and personal tax should be one of the objectives of the taxation system. This will lead to more corporate capital formation.
- Reduction of corporate tax rate: To encourage the flow of foreign capital, reduction of tax rates of foreign companies is essential.
- Rationalization of capital gains tax: The Committee was of the view that the system of long term capital gains lacked rationality. However, it was recommended to introduce some sort of indexation.
- Tariff reduction: The Committee made several important recommendations like reduction in the general level of tariffs, reduction in the dispersion of the tariff rates and rationalization of the system with the abolition of the numerous end-use exemptions and concessions.

Government has taken several measures since 1991-92 to reform the indirect tax structure by reducing the number of rates, re-moving exemptions, and by switching over to ad valorem rates. One of the major reforms in indirect tax was initiated in 2005 with the introduction of Value Added Tax (VAT) in the taxation system. The objectives of VAT are to replace the existing general sales tax laws with VAT Act 2005 and associated VAT rules.

But the implementation of the VAT paved the way for cascading effects of tax (tax on tax). To deal with such an issue, Goods and Services Tax (GST) emerged as the biggest reform in the Indian history. GST has replaced many indirect laws existed in India and is levied on supply of goods and services. It has emerged as one indirect tax for the entire country and is charged at every point of sale by the Centre and State Governments. With the introduction of GST, India had switchover to new indirect Tax regime which is administered with the help of new age Information technology. With the introduction of GST, The states gave up sales tax (VAT) and the Centre gave up excise and service tax. The central sales tax imposed on inter-state commerce is abolished along with other entry taxes at state boundaries. This creates a truly un-fragmented and unified common economic market across India.

Direct Tax reforms:

The journey of direct tax reforms in India commenced with the recommendations of the Task Force on Direct & Indirect Taxes under the chairmanship of Vijay Kelkar in 2002. The main recommendations of this task force related to the direct taxes giving emphasis to increase the income tax exemption limit, rationalization of exemptions, abolition of long term capital gains tax, abolition of wealth tax etc. The recommendations suggested by the task force are as follows:

- Administration of Direct Tax: The taxpayer services should be extended both in quality and quantity and taxpayers should get easy access through internet and email. PAN (Permanent Account Number) should be expanded so as to cover all citizens of the country. All returns and issue of refunds should be completed in the period of four month.
- Personal income tax: Increase in exemption limit for the general categories of taxpayers to Rs.1 lakh and further exemption for senior citizens and widows to be introduced. Increase in deduction under Section 80CCC for contribution to pension funds.
- Corporation Tax: Reduction in the corporate tax to 30% for domestic companies and 35% for foreign companies. Exemption for the listed companies from tax on dividends and capital gains. Increase in rate of depreciation for plant and machinery.
Table 1: Table showing the Tax Revenue, GDP and Tax to GDP Ratio from 2013-2018

| YEAR      | TAX REVENUE (Amount in 100 crores) | GDP (Amount in 100 crores) | TAX TO GDP RATIO (In %) |
|-----------|-----------------------------------|---------------------------|------------------------|
| 2013-14   | 11,387                            | 112,366                   | 10.20                  |
| 2014-15   | 12,449                            | 124,337                   | 9.90                   |
| 2015-16   | 14,556                            | 136,753                   | 10.80                  |
| 2016-17   | 17,032                            | 152,510                   | 11.30                  |
| 2017-18   | 19,116                            | 162,423                   | 12.10                  |

Source: Union Budget documents

MEASUREMENT OF EFFECTIVENESS OF THE REFORMS

After the introduction of the reforms, it becomes quite essential to measure the effectiveness of the reforms. There are various parameters to measure the affects of the reforms and the tax to GDP ratio is considered to be the one. Tax-to-GDP ratio is a ratio of tax revenue collected by the Government and the GDP of the country. Policymakers use this ratio to compare tax receipts from year to year. Ideally, this ratio should stay relatively consistent.

Interpretation: The table depicts that there is an increase in the amount of tax revenue from Rs.11,387 (100 crores) i.e. 10.20% in 2013-14 to Rs.14,556 (100 crores) i.e. 10.80% in 2015-16. The tax revenue has further increased to Rs.19,116 (100 crores) in 2017-18 i.e. about 12.10%. The tax collected this year due to the demonetization can be considered as one of the major reasons for such an increase. However, the GDP has also shown a rising trend over the period of study.

CONCLUSION

The Indian tax reform experience can provide useful lessons for many countries due to the largeness of the country with multilevel fiscal framework, uniqueness of the reform experience and difficulties in calibrating reforms due to institutional constraints, introduction of new concepts of taxes to name a few. The full impact of tax reform and attendant benefits are possible only when both direct and indirect tax reforms are implemented with more effectiveness. The performance of India in global platform has to be improved.

Interpretation: The above table shows that there is a relationship between the direct taxes and indirect taxes on the GDP of the India. However the test of significance reveals the result that the direct taxes are not significant to the growth of GDP (p value of .968 > 0.05) and Indirect Taxes are also not significant to the GDP growth (p value .085> 0.05). But, of the two, the direct taxes are highly insignificant to the GDP. This forces us to give a thought to the very fact that the taxation system being an important indicator of economic growth is not having a recognizable impact on the GDP of the country.

SUGGESTION

India needs more reforms in the taxation system.

Table 2: Table showing the Total Direct and Indirect Taxes collected by Central and State Government and the GDP from 2013-2018

| YEAR      | DIRECT TAXES (Amount in 100 crores) | INDIRECT TAXES (Amount in 100 crores) | TOTAL TAXES (Amount in 100 crores) | GDP (Amount in 100 crores) |
|-----------|-----------------------------------|--------------------------------------|-----------------------------------|---------------------------|
| 2013-14   | 7267.73                           | 11197.72                             | 18465.45                          | 112,366                   |
| 2014-15   | 8034.40                           | 12172.89                             | 20207.28                          | 124,337                   |
| 2015-16   | 8301.21                           | 14669.81                             | 22971.01                          | 136,753                   |
| 2016-17   | 9525.09                           | 16696.38                             | 26221.47                          | 152,510                   |
| 2017-18   | 11288.26                          | 18843.97                             | 30132.23                          | 162,423                   |

Source: Budget documents of the Government of India and the State Governments
### Correlations

|                | GDP   | DIRECT TAXES | INDIRECT TAXES |
|----------------|-------|--------------|----------------|
| GDP            | 1.000 | .954         | .993           |
| Pearson Correlation | Direct Taxes | Direct Taxes | Indirect Taxes |
| Direct Taxes   | .954  | 1.000        | .962           |
| Indirect Taxes | .993  | .962         | 1.000          |
| GDP            | .006  | .000         | .000           |

Sig. (1-tailed)

|                | GDP   | DIRECT TAXES | INDIRECT TAXES |
|----------------|-------|--------------|----------------|
| Direct Taxes   | .006  | .004         | .004           |
| Indirect Taxes | .000  | .004         | .000           |
| GDP            | 5     | 5            | 5              |
| Direct Taxes   | 5     | 5            | 5              |
| Indirect Taxes | 5     | 5            | 5              |

### Model Summary

| Model | R    | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | R Square Change | F Change | df1 | df2 | Sig. F Change |
|-------|------|----------|-------------------|----------------------------|-------------------|----------------|----------|-----|-----|--------------|
| 1     | .993 | .985     | .971              | 3482.27454                 |                   | .985          | 67.110   | 2   | 2   | .015          |

a. Predictors: (Constant), Indirect Taxes, Direct Taxes

### ANOVA

| Model | Sum of Squares | df | Mean Square | F       | Sig. |
|-------|----------------|----|-------------|---------|------|
| Regression | 1627586026.876  | 2  | 813793013.438 | 67.110 | .015 |
| Residual  | 24252471.924  | 2  | 12126235.962 |         |      |
| Total    | 1651838498.800 | 4  |              |         |      |

a. Dependent Variable: GDP, b. Predictors: (Constant), Indirect taxes, Direct taxes

### Coefficients

| Model | Unstandardized Coefficients | Standardized Coefficients | t     | Sig. | 95.0% Confidence Interval for B |
|-------|-----------------------------|---------------------------|-------|------|--------------------------------|
|       | B                           | Std. Error | Beta |      | Lower Bound | Upper Bound |
| (Constant) | 43924.134 | 11144.171   | 3.941 | .059 | -4025.362 | 91873.631 |
| DIRECT TAXES | -186 | 4.071  | -.014 | .046 | -17.703 | 17.331 |
| INDIRECT TAXES | 6.483 | 2.027  | 1.006 | .085 | -2.236 | 15.203 |

a. Dependent Variable: GDP
global presence of India has to be improved by paying more attention to increase the Tax to GDP ratio in the years to come. India has to gear up to increase its revenue and GDP so that it can be exemplified in the global arena in terms of growth, welfare and development. Efforts must be made to increase the tax to GDP ratio of the country.

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