

## **Budget 2017 and income tax rates: Why Arun Jaitley should cut rates instead of hiking tax exemptions**

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Given the need to assuage demonetisation pains and the need to collect more taxes, finance minister Arun Jaitley is expected to cut tax rates on February 1, but he has to refrain from populism while doing so. Keep in mind, as the Economic Survey pointed out this year, India's tax-to-GDP is 5.4 ppt below comparable countries and just 15% of national income is reported to the tax authorities. In this context, while hiking tax-exempt income to, say, Rs 3 lakh—or bringing back standard deduction as appears to have been recommended by the Easwar panel—will be popular, this will remove 15-20 lakh taxfilers out of the 130 lakh there are today. The Survey points out that, had the limits not been raised from FY09, there would have been 1.65 crore more returns and tax-GDP levels would have risen 0.32 ppt due to this alone.

Apart from greater efficiency in bringing in lucrative sectors like real estate into the tax net, the big challenge is the low compliance of those earning between Rs 10-15 lakh—tax compliance here is a mere 10% versus 20-25% in all other tax brackets, based on a comparison of the tax data with a theoretical income distribution of the country for that year. Since this is likely due to the fact that the top 30% tax bracket kicks in at a fairly modest level of income, the solution is to, say, create another bracket of Rs 10-20 lakh and tax that at, maybe, 20%. While this segment brings in around Rs 50,000 crore of taxes—based on data for AY 2014-15—the cut in rates will probably be more than made up by the impact of the increased compliance. This will necessitate cuts in rates in the lower slabs—in AY 2014-15, the Rs 2.5-5 lakh income group brought in around a tenth of personal income tax collections, so the loss in doing so may not be much while the move will be widely welcomed. Since the government loses around Rs 55,000 crore on various tax exemptions like those on insurance, it will be important to phase them out—while this will hurt those in the upper-middle income brackets, perhaps removing surcharges may neutralise the impact.

Though the tax-exemption limit has been overtaken by time, much of this was a recommendation of the Direct Taxes Code in 2009 anyway—that recommended doing away with all tax deductions and taxing incomes of Rs 1.6-10 lakh at 10%, Rs 10-25 lakh at 20% and above that at 30%. The finance minister would do well to revisit that document.

*(Financial Express)*