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Tax Revenue Surge: Temporary Spike Or Lasting Feature?

M Govinda Rao | 03:41 PM IST, 02 May 2022

India's low tax-to-gross domestic product ratio, as compared to the countries with a comparable level of development, has been a matter of policy concern. Despite several reforms over the years, the ratio has been stubbornly constant at 16-17% of GDP in the aggregate and 10-11.5% at the central level. Furthermore, the fluctuations in the ratio mainly reflect the centre's ratio. The inability to generate adequate revenues has starved allocations to much-needed sectors on physical and human capital formation.

There are a number of reasons for the low tax ratio, of which poor compliance has been an important one. Not surprisingly, the central tax ratio declined to less than 10% in FY20 due to the economic slowdown and remained at about 10.3% in FY21, following a significant decline in GDP due to Covid-19, before increasing sharply to 11.7% in FY22. The surge in revenue for FY22 was 34%, and this comes as a pleasant surprise with the revenue from direct taxes growing by 49% and indirect taxes revenue increasing by 20% over the previous year.

The important question is whether this is just a blip or a structural change.

Past Changes

How do we explain the spectacular growth of 34% in tax revenue collections even as the contact-intensive sectors were yet to open up fully due to Covid-19 restrictions in FY22? Of course, the progressive relaxation of many sectors has revived economic activity considerably over the previous year, registering nominal GDP growth of 17.5%. However, this cannot explain the growth of tax revenue by 34%, and a significant part of the revenue increase has to be attributed to improved compliance with the tax regime. If this improvement is structural and not due to some random factor, the trend is likely to stay and buoyancy in revenues will continue in the medium term. Examination of this issue requires a detailed analysis, but some crystal gazing shows that increase in compliance is likely to continue as this has come about due to improvements in administration, particularly the application of technology.

> **It may be recalled that between FY04 and FY08, the tax-GDP ratio of the Centre showed a spectacular increase of 3.5 percentage points from 8.4% to 11.9% due to two main factors.**

First was the application of technology, the Tax Information Network or TIN increasing the direct tax-GDP ratio from 1.1% of GDP to 2.8% of GDP. Second, progressive expansion in the base of service tax, increasing the revenue from indirect taxes from 1.1% to 3.1%.

The introduction of TIN was started in December 2003, and it provided checks against evasion, facilitated taxpayer assistance, improved administrative efficiency, and expanded the information on taxpayers to induce better compliance. It had three major components – tax accounting, assessees specific information (based on information returns on high-value transactions), and assessment-related information. To begin with, the TIN devised a system to confirm the tax deduction-at-source claimed by the deductor with the electronically received information on payments by the banks to ensure that the tax was actually deposited in the government account. This led to significant improvement in compliance and an increase in the tax-to-GDP ratio was sustained in the future years.

What's Different Now?

Although it is too early to say without a doubt that the present surge in tax revenue will continue, there are indications to suggest that it will be the case. The only credible explanation for the turnaround in the tax-to-GDP ratio from FY20 seems to be an improvement in the compliance, with both direct and indirect taxes.

In the case of indirect taxes, at last, the technology platform of the Goods and Services Tax administration seems to have become more operational. Thus, even as the economy has not fully opened up and supply disruptions in semiconductors have significantly constrained to production and sale of industries like automobiles, mobile phones, and other electronic goods, the indirect taxes have registered a 20% increase in revenues in FY22.

That trend appears to have continued with GST collections in April 2022 reaching a record high of Rs 1.68 lakh crore, a 20% increase over the monthly collection a year ago and Rs 25,000 crore more than the previous month's collections. The generation of e-way bills has led to significant improvement in compliance. Stricter enforcement of the tax against errant taxpayers identified through artificial intelligence and by comparing the income tax returns with the GST returns to closely monitor wrong claiming of input tax credit and to detect fake invoicing are some measures to increase the probability of detection ad inducing voluntary compliance with the tax.

In the case of direct taxes, the gross corporate tax showed a record increase from Rs. 6.5 lakh crore in FY21 to Rs. 8.6 lakh crore in FY22, which, in part, reflects the success of broadening the base by phasing out concessions and lowering the rate. There were a lot of apprehensions about whether the strategy of removing concessions and lowering rates would work at all. The other initiatives taken by the government including the Faceless Assessment System, the e-filing portal, and the new Annual Information System for earlier filing of tax returns have been important. Improved administration with a better information system has not only enabled speeding up assessment and enabling refunds expeditiously but also helped to identify cases of evasion. In addition, matching the income tax returns with GST returns and the use of artificial intelligence to detect doubtful cases for detailed scrutiny will help in enhancing the compliance of the tax.

While the attempt to improve the technology application and matching of the information collected from GST and income tax returns have been talked about in the last four years, the recent improvements to stabilise the technology platform for GST and income tax administration have provided a considerable amount of information which will further induce voluntary compliance in the years to come.

Surely, this bodes well for raising tax revenues and truly confirms what Milka Casanegra of the International Monetary Fund said: "….in developing countries, tax administration is tax policy".

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