Tax-GDP ratio plummets to 9.88%, lowest in 10 years

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The ratio of central taxes to GDP slid further in FY20 to a 10-year low of 9.88 per cent, driven by a decline in collections from custom duties and corporation tax, while excise dutyposted marginal growth. This was despite the fact that only a week was under lock-down in the year. The ratio stood at 10.07 per cent in FY19, and at 11.22 per cent in FY18. It is only estimated to decline further, with revenues falling on account of a slump in economic activity.

While the ratio determines the extent to which the government is able to finance its expenditure from tax collections, it is also an indicator of tax compliance. Developed countries have a higher contribution of tax to their GDP. The Centre's gross tax revenue fell 3.39 per cent in FY20, with a Rs.1.5-trillion shortfall in collections, as against the revised budget target for the year.

It will need growth of 20.5 per cent in FY21 to meet the Budget target for the year. GDP growth for FY20 fell to an 11-year low of 4.2 per cent. 567A higher tax-to-GDP ratio indicates the tax base is increasing along with growth in the GDP. The government has taken a slew of measures to improve compliance, which include the introduction of GST and electronic assessment by tax officers. A lower ratio, however, restricts the government's capital spending, given that puts pressure on the fiscal deficit.

Corporation tax revenue fell 16 per cent in FY20 and Customs revenue declined by 7 per cent, even as excise collections grew 3 per cent. India is way behind OECD members in terms of the tax-GDP ratio — an average of 34 per cent.

In fact, the share of tax revenue in the Centre's revenue receipts fell to 81.3 per cent in FY20, from 83.8 per cent in the previous year and 84.3 per cent in FY18.

The direct tax to GDP ratio fell to its lowest in 14 years, at 5.1 per cent, while the indirect tax to GDP ratio was at a 5-year low in FY20. The share of corporation tax in gross tax fell to 27.2 per cent — at least a 10-year low. Further, the share of customs duties in gross tax fell to 5.43 per cent in FY20, from 5.66 per cent in FY19.

Aditi Nayar, principal economist at ICRA, said the cut in corporation tax rates compounded the impact of the economic slowdown on overall collections, while high gold prices shrunk gold demand and dampened customs duty inflow.

"We estimate a 30 per cent shortfall in Central taxes, relative to the budget estimate for FY21" said Nayar.

The Central Board of Direct Taxes (CBDT) on Sunday clarified that the gross direct tax collection growth in FY20 was actually 8 per cent, at Rs.14 trillion, but tax reforms worth Rs.1.7 trillion led to a 5 per cent contraction in direct tax revenue last year.

The government had, last year, cut the corporation tax rate to 25 per cent to promote private investment. However, some did not avail of the option because they would have had to forego their minimum alternate tax credits. Former finance minister Arun Jaitley had, in a social media post in 2018, emphasised on the need to improve the Central taxes-GDP ratio by another 1.5 percentage points. It had touched a high of 11.3 per cent in FY18.

"Despite higher compliances in the new system, as far as non-oil taxes are concerned, we are still far from being a tax-compliant society. Salaried employees are one category of tax-compliant assesses," he said, adding that most other sections would have to improve their track record.