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Personal Income Tax in India: A Roadmap for Future

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ABSTRACT

No arrangement/ system can be said to be perfect in any circumstances. In the same way it cannot be said that one or other taxation system is perfect for it. But it requires to be looked again and again and make the required improvement/ changes as time and circumstances demands. And that's the way how any economy comes closer and closer to perfection. In India we saw a reform in indirect tax system, but still we are following the same direct tax system from 1961 (nearly 6 decade old). Numbers of things have changed since and also a lot of problems are pointed out. Despite reforms since 1991, much remains to be done to make the tax system broad-based, productive and efficient. The personal income tax continues to be narrow based. This research paper tries to present a **Reformed Personal Income Taxation System (RPITS).** The whole system is based upon the idea of equality.

KEYWORDS: *Taxation System, Economy, Direct and Indirect taxes, Reformed Personal Income Taxation System (RPITS)*

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INTRODUCTION

In any economy tax revenue plays a very significant role which demands an efficient, productive and broad based taxation system. Tax buoyancy and tax elasticity are two very important concepts which shows how efficient a tax system is, at this point both the concepts needs to be clarified.

- **Tax elasticity** refers to changes in tax revenue in response to changes in tax rate.
- **Tax buoyancy** explains this relationship between the changes in government's tax revenue growth and the changes in GDP. It refers to the responsiveness of tax revenue growth to changes in GDP.

At the central level, the income tax was evolved as a principal instrument to bring about redistribution until mid 1970s. Thus, in 1973–1974, the personal income tax had eleven tax slabs with rates monotonically rising from 10 to 85%. When the surcharge of 15% was taken into account, the highest marginal rate for persons above Rs. 200,000 income was 97.5%. Combined with the highest wealth tax rate of 5%, the total tax payable at the highest bracket was more than 100%.

Although there were attempts to simplify and rationalise the tax system in 1976–1977 and 1986–1987, systematic reforms were initiated after 1991–1992, based on the recommendations of the Tax Reform Committee (India, 1991). The tax rates were considerably simplified to have three slabs beginning with a rate of 20%, a middle rate of 30% and the maximum rate of 40% in 1992–1993. The financial assets were excluded from wealth tax and the maximum marginal rate was reduced to 1%. Further reduction came in 1997–1998 when, the three slab rates were brought down further to 10–20–30%. Further changes where inscribed in rates as well as slabs in recent years. The rates were rationalized to 5-20-30% than in budget 2020-21 it government made an optional rates with different slabs (without deductions and exemptions). The very new rates are 5-10-15-20-25-30%.

LITERATURE REVIEW

H L Bhatia (2018) in the book titled **Public Finance (29th Edition)** has commented, A leading drawback of our income tax system is its failure to protest the taxpayer against price rise, and taxing even compensatory receipts like dearness allowance. Even in the proposed Direct Tax Code, the factor of inflation does not find a place. Similarly, removal of rebates and exemptions militates against saving and capital formation.

M. Govinda Rao(2005) in his paper titled **Tax system reform in India: Achievements and challenges ahead** concludes thatThe foregoing analysis shows that there has been some progress in tax reforms in recent years and that has helped to enhance the tax–GDP ratio close to the levels that prevailed prior to reducing customs.The reforms will have to continue not only at the centre, but also at state and local levels. One important objective of sub national reform is to ensure common market in the federation.

ARINDAM DAS-GUPTA, RADHIKA LAHIRI and DILIP MOOKHERJEE (1995) in their paper titled **Income Tax Compliance in India: an Empirical Analysis** analyzed and concluded that the empirical results provide considerable support for income tax reforms that are suggested in most structural adjustment programs. Increased average tax rates and the exemption limit appear to have reduced compliance and revenues in India for the sample period studied. estimates show that both revenues collected and compliance were significantly affected by tax structure (marginal tax rates and exemption limit). In addition, inflation as well as declining assessment intensity had a significant negative effect, while traditional enforcement tools (searches, penalties and prosecution activity) had only a limited effect..

METHODOLOGY OF RESEARCH

The present research is a basic and exploratory Research which is non hypothesis testing as well. This paper presents a new personal income tax system which is named as Reformed Personal Income Taxation System (RPITS). To complete this research paper a number of budget documents of Government of India, research papers, and some books were studied and referenced. The idea of Reformed Personal Income Taxation System (RPITS) is author's own idea.

OBJECTIVES

- To analyze the present structure and problems of Personal Income Tax.
- To present an alternative method for Personal Income Tax.

PERSONAL INCOME TAX REGIME

As other taxes were undergone many reforms and rationalization of tax rates and tax slabs personal income tax is no exception. But the structural change were always postponed or ignored and mainly the tax rates and tax slabs were rationalized. In the Union Budget 2020-21, a very new tax rates were introduced with new tax slabs. It is actually a parallel tax system (rates and slabs) with the existing system (rates and slabs) which gives an option to tax payers to file tax returns on any of the basis of their choice. The new tax system comes up with no exemptions and deductions.

Present Personal Income Tax Rates

Table 1: Existing tax rates and slabs

If claiming Deductions and Exemptions			
Annual Income	Individuals (below 60 years)	Senior Citizens (60 years to 79 years)	Super Senior Citizens (80 years and above)
Upto ₹ 2,50,000	Nil	Nil	Nil
₹ 2,50,001 to ₹ 3,00,000	5%	Nil	Nil
₹ 3,00,001 to ₹ 5,00,000	5%	5%	Nil
₹ 5,00,001 to ₹ 10,00,000	20%	20%	20%
₹ 10,00,001 and above	30%	30%	30%
Full amount Rebate for those earning upto ₹ 5,00,000 only			

(Source: Union Budget 2019-20, Union Budget 2020-21, www.basunivesh.com)

Table 2: New tax rates and slabs

If NOT claiming Deductions and Exemptions The rates presented in Union Budget 2020-21	
Income Slabs	Tax Rates
Upto ₹ 2,50,000	Nil
₹ 2,50,001 to ₹ 5,00,000	5% or Rebate (under Section 87 A)
₹ 5,00,001 to ₹ 7,50,000	10%
₹ 7,50,001 to ₹ 10,00,000	15%
₹ 10,00,001 to ₹ 12,50,000	20%
₹ 12,50,001 to ₹ 15,00,000	25%
₹ 15,00,001 and above	30%

(Source: Union Budget 2020-21, www.basunivesh.com)

Table 1 & 2 shows two present parallel existing tax rates and slabs. Government provides a rebate for individuals earning money up to ₹ 5,00,000 only. But the very problem of this tax regime are narrow tax base (a very small percentage of working people files income tax return and pays personal income tax), inefficient redistribution of income, regressive tax within progressive tax structure, tax evasion and avoidance.

This paper focus its objective mainly to the idea of equality or efficient redistribution of income which will ensure progressive taxation within progressive tax structure. To counter it a new tax structure has been presented in this paper below.

The Reformed Personal Income Taxation System (RPITS)

To counter the very important problem of equitable distribution of income a new tax structure has been suggested in this section of research paper. This Reformed Personal Income Taxation System (RPITS) is the tax structure where tax will depends upon per capita income. Let's understand the problem of inequality (in taxation) through an example. In a city there are two persons, A and B and both earns ⍰1000000 per year. In the family of person A, there are 6 members dependent on him (a total of 7 member family, 3 Children + 2 senior citizen, tax payer himself and his wife). On the other side, in the family of person B, there are 2 members (a total of 3 members family, tax payer himself, his wife and one child of the couple) dependent on him.

Now both have to pay a tax of ₹ 75,000 per year (under new rates without deductions and exemptions) or ₹ 1,12,500 (with deductions and exemptions).

If we take ₹ 75,000 as the tax amount than in the family of person A, the amount of money left per capita will be ₹ 10,00,000 – ₹ 75,000 = ₹ 9,25,000 / 7 (members) = ₹ **1,32,143.**

In the family of person B, the amount of money left per capita will be ₹ 10,00,000 – ₹ 75,000 = ₹ 9,25,000 / 3 (members) = ₹ **3,08,333.**

Who will be the family members:
- A child of 2 years (requires birth certificate) or more till age of 24 years.
- Senior Citizens (mother and father or grandmother and grandfather) if they are not getting pension of □8,000 or more per month individually.
- Any other person can be counted as member if above 60 years or below 24 years having blood relation and do not have someone else to care.
- Widow will be counted as member till not get married and lives with that family.
- Adopted child will be counted if he /she getting education.
- Every family will have a family card which will be updated every year, 3 months prior to filing income tax return.

Table 3: Per Capita Income basis of Reformed Personal Income Taxation System (RPITS)

For those who are eligible for "per capita income basis" of Reformed Personal Income Taxation System (RPITS)	
Per Capita Annual Income	**Tax Rates (per capita)**
₹ 1,00,000 to ₹ 2,00,000	7%
₹ 2,00,001 to ₹ 3,50,000	15%
₹ 3,50,001 to ₹ 5,00,000	25%
Addition of 3% Education and Health Cess	

(Source: Author's own idea)

For example, if a family's income is ₹ 10,00,000 and there are 5 members in the family, than per capita income will be ₹ 10,00,000/5 = ₹ 2,00,000. Then according to tax rate of 7% + 3%(cess) or 10%, amount of tax will be ₹ 20,000 multiplied by 5 (number of family members) = ₹ 1,00,000.

Second example, if with the same family income, number of members are 2, than per capita income will be ₹ 10,00,000/2 = ₹ 5,00,000. Then according to tax rate of 25% + 3%(cess) or 28%, amount of tax will be ₹ 1,40,000 multiplied by 2 (number of members) = ₹ 2,80,000.

The above two examples shows how the same income has been taxed on the basis of two different tax rates, and different amounts are taxed.

Who are not eligible for paying tax under per capita income basis of Reformed Personal Income Taxation System (RPITS):
- A family of more than 5 members (if no senior citizen included) or 7 members (if senior citizens are included).
- If per capita income exceeds ₹ 5,00,000 or family income exceeds ₹ 20,00,000 (which one is lower).
- Even a person /family with more than 5/7 members will be allowed to pay personal income tax of per capita basis till 2025 or till 5 years from the date of implementation (whichever is later).

Table 4: Non Per Capita Income basis of Reformed Personal Income Taxation System (RPITS)

For those who are NOT eligible for "per capita income basis" of Reformed Personal Income Taxation System (RPITS)	
Yearly Individual Income	Tax Rates
Upto ₹ 7,00,000	15% or rebate
₹ 7,00,000 to ₹ 12,00,000	24%
More than ₹ 12,00,001	28%
More than ₹ 50,00,000	Additional surcharge of 25%
Addition of 4% Education and Health Cess	

(Source: Author's own idea)

Table 3 and 4 shows **Reformed Personal Income Taxation System (RPITS)** both on the basis of per capita income basis as well as on the basis of non per capita income basis. The main objective behind this arrangement is to ensure more equitable distribution of income among rich and poor ones.

The amount of tax revenue collected from education and health cess should be put in separate account (created by an act of parliament) and should only used for that purposes only.

CONCLUSION

This paper presents a new Personal Income Taxation System named **Reformed Personal Income Taxation System (RPITS)** on both per capita income and non per capita income basis. It defines the conditions that a person have to fulfill if he wants to take the benefit of paying tax under per capita income basis. The whole concept is based upon equitable redistribution of income among masses. It tries to cover larger number of people who require to get benefitted. Even a large family of more than prescribed members are also allowed to take the benefit of new system but only till 5 years of implementation.

The above examples explain how the same income attracts different tax amounts. This system of taxation can give a great results in future after implementation. But as every system takes time to perform it will also take time. Although it cannot be guaranteed how much effective it would be from the existing system, it needs to be looked again and again and many more research and work is required to make it more better.

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