

India's Taxation Needs Structural Reform Beyond Rhetoric on Inheritance Tax

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It's election season and knives are being drawn out in the nature of debates, promises, and accusations by leaders of the BJP and the Congress.

While PM Modi at a rally in Rajasthan called out the Congress party on its “plan to redistribute wealth amongst the minorities,” Congress' senior leader P Chidambaram attacked the PM for his “outrageous remarks” filled with “absolute falsehood, brazen mendacity.”

At the same time, another issue that has picked national attention, particularly in newsroom discussions, is ‘inheritance tax’. It started with comments from Sam Pitroda, Chairman of the Indian Overseas Congress, advocating an American-style inheritance tax policy in India.

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Citing the US inheritance tax policy, Pitroda said, “Probably 45 per cent of a US citizen's wealth can be transferred to his children, 55 per cent is grabbed by the government. That's an interesting law.” Reacting to Pitroda's remarks, Prime Minister Narendra Modi charged head-first, alleging that Congress would impose such a tax if voted to power.

Pitroda's suggestions were vehemently dismissed by his party, i.e., by Congress President Mallikarjun Kharge, followed by General Secretary Jairam Ramesh who clarified, "I would like to categorically state that Congress has no plan on the inheritance tax."

On this issue, it is difficult to ascertain what the fuss here is really about. Both parties have argued for imposing it at different periods of time. From the BJP's end, Arun Jaitley, ex-Finance Minister, and leaders like Jayant Sinha have spoken of it in the recent past too.

More importantly, there isn't a lot of tax revenue promised by the imposition of such a tax even if it is imposed. The rich hardly let their wealth be accrued in 'inheritance' incidence forms.

As recently argued, "As against the government's estimate of Rs 4 crore collections during the first year of its (inheritance tax) rollout in 1954-55, revised collections stood at an unspeakable Rs 1.26 crore. And by the time it was scrapped in 1985 (under Rajiv Gandhi), estate duty collections turned in just Rs 20 crore, which critics will conclude as crumbs from the rich man's table".

On the contrary, there are a lot more structural issues at hand which need the government's attention (irrespective of which party is in power).

Modi's Demeanour Reveals His Mounting Disquiet

Average Income Tax Paid by Individuals is Decreasing

On closer observation, if we look at the tax data over the last few years, the average personal income tax collected has seen a declining trend, even as the overall tax base has continued to widen with the government's quest to formalise India's economy. A few years ago, back in October 2018, the e-filing of tax returns increased up to 70 per cent, while the average income tax paid by individuals came down by 32 per cent (to Rs 27,083).

In the two years before that, the e-return filing growth (year-on-year) went up by 24 per cent and 29 per cent respectively, and the average income tax paid was Rs 44,000 and Rs 40,200 respectively. One reason for this could be that the government, in its effort to get more people under the taxable base, is gradually increasing some individual (and corporate) tax exemptions, which allows more people to report their incomes and file e-returns, but subsequently end up paying less tax annually. This inversely affects the fiscal base, in terms of tax revenue, for the government.

With shrinking collections from direct tax revenues, higher dependence on the more regressive indirect tax revenue, and the repeated corporate tax cuts announced by the BJP government over the last ten years have seen the incumbent government make strategic cuts to its welfare expenditure plans (or worse, delay disbursements to ministries), in order to keep its fiscal deficit mark 'low'. This has widened both income and access inequality and not reduced it, nor helped redistribute wealth from the top to those in need.

This should make one wonder, to what extent will the measures that the government is currently undertaking, actually address the 'structural' inequities driving the economic slowdown?

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Wealth Creation Hasn't Disappeared

A few years ago, Credit Suisse reported how the richest 10 per cent of Indians own 56 per cent of the nation's wealth, where the richest one per cent owns 51.5 per cent of the wealth, while the bottom 60 per cent owns less than 5 per cent.

It is remarkable how in a democracy (ideally giving equal agency to each voter), the richest one per cent have been able to consistently maintain their share of wealth year-on-year, while the majority remains meekly destitute, given the real wage growth patterns across the middle and lower income groups.

Corporate tax cuts, as undertaken by the BJP repeatedly over the last ten years, have provided a sugar rush to the economy.

With tax cuts, big Indian businesses and other multinational foreign corporations might increase their scale of investment for greater profit. As a result, the nature of 'tech-based/capital-anchored investment models' substituting labour-intensive forms of industrial production may hardly change the existing scale (and rate) of labour productivity or generate higher-wage paying opportunities for India's workforce.

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What About Consumption Tax ?

The idea in favour of imposing a consumption tax, especially in countries where consumer sentiment is strong and wealth inequities are higher, has been debated by economists for some time now. Kenneth Rogoff, in a recent article, presented a case for imposing such a tax in the United States too, where wealth inequalities across income classes have increased since the late 1970s.

In practice, consumption is much easier to measure than income, and the dynamic efficiency gained from encouraging savings and investment could be large. In India, we have already been seeing a gradual erosion of household savings, and a consumption-based tax structure can help encourage the value of savings for further (domestic) investments and financial credit creation. The transitional difficulties, often associated with implementing such a system, are more likely in nations where consumption-based data and its sources are weak.

In India, a relatively more robust consumption-based household data set allows any such transitional costs to be minimised. For a start, in a graduated implementation cycle, at least one can consider imposing a marginal consumption tax or spending tax side-by-side with existing income taxes, which can then be phased out over time.

Another advantage of a consumption-based tax system is that it may allow certain natural resources (like water) to be used in a fixated quantum. A higher carbon-consumption tax may over time channelise resources towards 'renewable' or eco-sensitive modes of production, which will take the policy discourse away from providing any 'subsidies' on renewables but to encourage them through a consumption-based tax system.

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With high unemployment levels amongst the educated youth, real wages diverging in rural and urban areas (due to poor farm incomes), and the broader real-wage growth trend flattening across sectors, Adam Smith's constitutive elements of 'wealth' – seen in the relative importance of labour as against any other factor of production – can be progressively realised through a fairly imposed consumption-based tax system.

As one of the measures, this can allow the state to accrue income from higher consumers (i.e. those with a higher willingness to pay) and allow for greater fiscal incentivisation of worker-productive sectors of occupation and production, which in India would relate to agro-based industries and those part of a farm-to-factory manufacturing supply chain.

In any case, discussing empty promises on 'wealth redistribution' may ultimately require those in power to address the stark inequality of wealth creation and distribution, affecting the lives and livelihoods of citizens across diverse social and economic groups. Bold measures, structural reform (in balancing the weight between direct-indirect taxes), and the imposition of a 'consumption-based tax' (as discussed here), may be ideas worth considering rather than indulging in petty, partisan politics.

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