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# Review Of Research



## TREND IN PERSONAL INCOME TAX IN INDIA (1997-98 TO 2015-16)



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### ABSTRACT

Seventh Pay Commission is about to be implemented very soon for central government employees which will increase their incomes substantially. The benefits of this commission will be given from January 1, 2016. With the pay commission people were also expecting some relief in income tax but unfortunately there was no change in income tax structure. With this fact the benefits will not remain same as were expected from recommendations for Seventh Pay Commission and this makes it an important topic for discussion. In this paper I am trying to look at the trend of Personal Income Tax in India in recent years from the lens of progressivity and I also try to look whether individuals with same purchasing power are subjected to higher tax burden or not as tax payment is dependent on nominal incomes and not real incomes.

**KEYWORDS** :Personal Income Tax , nominal incomes and not real incomes.

### 1. INTRODUCTION

Independent India since beginning had a progressive personal income tax regime. The personal income tax rates were extraordinarily high during the decades of 1950-80. In 1973-74 the highest tax rate applicable to an individual could have gone up to an astronomical level of 97.50 per cent. In 1974-75 the recommendation of The Direct Tax Enquiry Committee, 1971 was implemented and reduced the highest effective marginal tax to 77 per cent. This trend of reduction in highest marginal tax continued till 1997-98 where it was pegged at 30 per cent with only three taxable income brackets, since then

there has been no change in either number of taxable income brackets or marginal tax rates in those. But there have been continuous changes in scope of these taxable income brackets by shifting the limits upwards and thereby decreasing the tax burden. These changes (reduction in tax burden) were not unwarranted as India had been facing considerable inflation. Inflation reduces purchasing power and to compensate individuals for the same these changes in taxable income brackets were desirable. But it remains a question that whether the raise in limits was more (or less) than the raise required to compensate for the inflation. Here I try to answer this particular question in following sections.

One other aspect of personal income tax structure is progressivity. If we look at the history of income tax in India, income tax has become substantially less progressive than it was in 1970s. Here I try to analyze the direction of progressivity of Indian Personal Income Tax for the period 1997-98 to 2015-16.

## 2. DATA

I have utilized the data for taxable income brackets from financial year 1997-98 to 2015-16, which later were adjusted for inflation taking 1997-98 as base year (Table 1 shows these data). I have considered only this period of 18 years because during this period tax structure has remained fairly stable except changing the limits of taxable income brackets and this fact ensures less complexity in the analysis. Then I have tried to analyze the trend of lower limits of all three taxable income brackets to answer whether the income tax in India has gone more progressive over time or it has lessened and whether the relief granted (against decreasing purchasing power of money over time) in form of increasing limits was sufficient or not.

Incomes below taxable income bracket-1 are exempted of tax whereas incomes are taxed at rates of 10%, 20%, 30% within taxable income bracket1, bracket2, bracket3 respectively.

In the analysis I have used terms lower limit, middle limit and upper limit in place of lower limits of taxable income bracket 1, 2 and 3 respectively.

## 3. PROGRESSIVITY

An Income Tax structure is progressive if richer people pay higher average tax than poorer people. A progressive income tax reduces inequality in the society and seen as an instrument for inclusive growth. But as nothing is ideal in this world, neither is progressive tax scheme as more progressivity means more deadweight loss. Hence government faces a trade-off between equality and inefficiency and needs to arrive at an optimum level of progressivity in Income Tax structure.

If we see the history of income tax in India since independence, then it is very much clear that Income tax structure has become less progressive in nature (peak rate 97.5% in 1973-74 to just 30% at present). Though, the tax structure was highly progressive during early periods but that high a progressivity was undesirable as it provided great incentives for tax evasions which were rampant at the time. In this paper my focus is on the above mentioned period during which tax structure had been fairly stable.

For progressivity whether we analyze nominal limits or inflation adjusted limits, it will not make any difference as we are comparing values across brackets and all three limits are discounted by same discounting factors. Hence I opt for nominal taxable income brackets as it is simpler to analyze.

During the early nine years of the period considered (1997-98 to 2005-06), limits had been almost same, clearly showing there had been no change on the degree of progressivity. There had been only one change in the exemption limit, which was increased after one year, clearly showing progressivity had a slight upward turn.

Period after 2005-06 is interesting to analyze as there had been many changes in the limits during this period. First significant change was made in 2006-07 when the exemption limit was doubled, upper limit of bracket 1 was more than doubled and lower limit for highest tax rate bracket was increased to 1.66 times clearly showing that for lower middle income groups the progressivity decreased while for upper middle income groups progressivity in fact increased. This makes overall direction of degree of progressivity ambiguous. Again in 2012-13, the overall direction of progressivity is ambiguous as lower limit and upper limit were both increased but middle limit was kept constant.

Next significant change was made in 2008-09 when both the upper limits were doubled while there was not very significant increase in exemption limit clearly showing that tax structure became less progressive. While in 2010-11, there was again a significant change in limits where lower limit was not changed but remaining were changed significantly. Percentage change in middle limit was higher than in upper limit which means that tax structure became slightly more progressive in nature.

In 1998-99, 2007-08, 2009-10, 2011-12 and 2014-15 only lower limit was increased keeping other two same making tax structure more progressive.

If we look at the change in progressivity during the whole period then the change is negative making tax structure less progressive since middle and upper limits increased more significantly than lower limit, increase in lower limit is 525% as compared to 733% in middle and 566% in upper limit.

Though the tax structure has become less progressive it does not mean that it was undesirable. This loss in progressivity is not a result of making poor worse off. Exemption limit in real terms, in fact got doubled. This was the result of making middle income people better off, which might have benefited the economy through increased incentives to work more as their marginal net income was increased. So where the net effect of these changes (cost of less progressivity through inequality and benefits resulting from increased incentives to work) goes in which direction is a topic for further analysis and is not under the scope of this paper.

#### **4. INCREASE IN LIMITS AS COMPENSATION FOR DECREASING PURCHASING POWER DUE TO INFLATION**

If we look at the inflation adjusted limits then during the whole period the increments in limits were more than sufficient so as to tackle inflation, as the adjusted limits were at least got doubled during the considered period.

But if we divide our analysis into different sub-periods then we see that the changes in taxable income brackets were not sufficient for all the sub periods. For 2003-04 and 2004-05 all the limits were decreased in real terms as compared to the base limits (1997-98). Till 2005-06, the exemption limit did not go down for every period but middle and higher limits were significantly reduced during entire period, clearly indicating that the tax burden increased on individuals even if they had same purchasing power as before.

Though the limits (in real terms) have been doubled during the entire period indicating that the increments were more than sufficient to accommodate inflation but if we look more closely, the picture is little different. Even though overall change was sufficient but these changes were irregular and were not sufficient if we look at the sub-periods. These irregular changes pose a serious problem of inequality e.g. consider two similar individuals with one year age difference, one is retiring in the year just before the year in which changes in limits were made and another after changes were made. Though the individuals should have had same net income in the last year of their service but these changes made first individual relatively worse off than second individual, in a way these irregular changes were rewarding depending on when you born and hence causing "inequality within equals".

To avoid such problems the limits should be updated every year keeping in mind the inflation. One way is to overcome this serious issue is to index the taxable income brackets with inflation.

## 5. CONCLUSION:

Though the tax structure has become less progressive it does not mean that it was undesirable. This loss in progressivity is not a result of making poor worse off. Exemption limit in real terms, in fact got doubled. This was the result of making middle income people better off, which may benefit economy through increased incentives to work more as their marginal net income was increased. So where the net effect of these changes (cost of less progressivity through inequality and benefits resulting from increased incentives to work) goes in which direction is a topic for further analysis and not under the scope of this paper.

Lower limits of taxable income brackets (in real terms) have been doubled during the entire period indicating that the increments were more than sufficient to accommodate inflation but if we look more closely, the picture is little different. Even though overall change was sufficient but these changes were irregular and were not sufficient if we look at the sub-periods. These irregular changes cause a serious problem of inequality. To overcome this serious problem government should update these limits regularly and should index these limits to inflation.

## 6. REFERENCES:

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**Table-1 Lower limits of three income brackets for the purpose of calculating Income Tax in India over years.**

Fiscal year	Lower Limits			Inflation (%)	Discount factor	Inflation adjusted Lower Limits		
	Taxable Income Bracket-1	Taxable Income Bracket-2	Taxable Income Bracket-3			Taxable Income Bracket-1	Taxable Income Bracket-2	Taxable Income Bracket-3
1997-98	40,000	60,000	150,000	13.17	1	40000	60000	150000
1998-99	50,000	60,000	150,000	4.84	1.0484	47691.7	57230.06	143075.2
1999-00	50,000	60,000	150,000	4.02	1.0905457	45848.6	55018.33	137545.8
2000-01	50,000	60,000	150,000	3.77	1.1316593	44182.9	53019.49	132548.7
2001-02	50,000	60,000	150,000	4.31	1.1804338	42357.3	50828.77	127071.9
2002-03	50,000	60,000	150,000	3.81	1.2254083	40802.7	48963.27	122408.2
2003-04	50,000	60,000	150,000	3.77	1.2716062	39320.3	47184.42	117961
2004-05	50,000	60,000	150,000	4.25	1.3256494	37717.4	45260.83	113152.1
2005-06	50,000	60,000	150,000	5.79	1.4024046	35653.1	42783.66	106959.2
2006-07	100,000	150,000	250,000	6.39	1.4920182	67023.3	100535	167558.3
2007-08	110,000	150,000	250,000	8.32	1.6161541	68062.8	92812.93	154688.2
2008-09	150,000	300,000	500,000	10.83	1.7911836	83743.5	167487	279145
2009-10	160,000	300,000	500,000	12.11	2.0080959	79677.5	149395.3	248992.1
2010-11	160,000	500,000	800,000	8.87	2.1862141	73185.9	228705.9	365929.4
2011-12	180,000	500,000	800,000	9.3	2.389532	75328.6	209246	334793.6
2012-13	200,000	500,000	1,000,000	10.92	2.6504688	75458.3	188645.9	377291.7
2013-14	200,000	500,000	1,000,000	6.37	2.8193037	70939.5	177348.8	354697.5
2014-15	250,000	500,000	1,000,000	5.88	2.9850788	83749.9	167499.8	334999.5
2015-16	250,000	500,000	1,000,000	5.91	3.1614969	79076.5	158152.9	316305.9



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