

Trends and Patterns of Tax Expenditures on Union Taxes in India

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Abstract

The Union government foregoes revenue on account of various tax exemption/incentive schemes promoted for various purposes. The Constitution of India assigns power of taxation of broad-based taxes to the Union (Federal) government (e.g., Corporate Income Tax, Personal Income Tax, Union Excise Duty, Customs duty). Like the Union government, provincial (or State) governments also provide tax incentives (within the scope and coverage of their taxation power) but revenue impacts (or foregone) of those tax exemption schemes at the state level are not assessed yet. Comprehensive assessment of tax expenditures is important especially after the introduction of Goods and Services Tax (GST). Given the data limitations, the present paper assesses the trends and patterns (structure) of tax expenditures of Union taxes during 2005-06 to 2019-20. Overall tax expenditures of the Union government declined from 8.15 per cent of GVA (Gross Value Added) in 2008-09 to 1.69 per cent in 2019-20. It was possible mainly on account of continuous reduction of tax expenditures on indirect taxes. Tax expenditures on direct taxes (on account of CIT and PIT only) also declined from 32.7 per cent of direct tax (CIT & PIT only) collection in 2008-09 to 22.4 per cent in 2019-20. The tax expenditures related to Union Excise Duty (UED) and Customs Duty (CD) declined from 152 per cent in 2008-09 to 12.6 per cent of tax collection on account of UED and CD in 2019-20. Post Global Financial Crisis (GFC) successive Union budgets raised standard rate of excise duty gradually to pre-GFC level, pruned down the exemption list and consolidated rate structure of excise duty (or CenVAT) to prepare for introduction of GST. This helped the government to contain tax expenditures on indirect taxes.

Key Words: Tax Expenditures, Tax Incentives, Tax Policy, Federal Government, Union Taxes, India.

JEL Codes: H25, H24, H61, H11, D72

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1. Introduction

Tax expenditure (also known as revenue foregone) is a presumptive loss of revenue on account of preferential tax treatments that deviate from the general tax structure (Chen 2015). Tax expenditure arises due to tax exemptions (exclusion from the tax base), tax allowances [amounts deducted from the tax base before applying the tax rate(s)], tax credits (amounts deducted from tax liability), tax rate relief (a reduced tax rate) and tax deferral (a delay in paying the tax liability) (Heady and Mansour 2019). Assessment of tax expenditures on account of preferential tax treatment or provisions of various tax incentives or tax preferences (e.g., special tax rates, exemptions, deductions, rebates, deferrals and credits) has received importance in public finance literature during last two decades (Redonda et al. 2019). However, literature on tax expenditure is still sparse, at least in India. Tax expenditures often considered as pervasive and growing around the world (OECD 2010). If not published (or reported) by the government, tax expenditures often remain invisible (or outside the budgeting exercise) in the public finance management (Burman and Phaup 2012). Often estimates of tax expenditures are not integrated with budget documents, as a result it is considered to be less transparent, prone to encourage corruptions (e.g., preferential tax treatments, discretionary tax practices) and vulnerable to encourage lobbying by politically-active groups (Fuest and Riedel 2009, Burman and Phaup 2012, Hunter and Nelson 1989). Lack of transparency in public finance management (PFM) often curtains fiscal vulnerabilities of the governments. It is widely considered that tax expenditures are allocated based on certain political criteria/ ideology as incumbent political party (or alliance) wants to appease certain section of taxpayers in lieu of their political support (Marjit et al. 2020, Das and Raja 2008). This is often referred in literature as “political clientelism” where political parties or elected legislatures trade benefits to individuals or groups of voters/ citizens in lieu of their political support (Hicken 2011, Das and Raja 2008).

Providing tax incentives/ exemptions is a global practice (Table 1). Over the years larger number of countries has started publishing tax expenditure estimates. There is a sign of rise in world’s average tax expenditures (both as % of GDP and tax revenue)¹ on Corporate Income Tax (CIT) vis-à-vis a fall in tax expenditure on Personal Income Tax (PIT) in between 2005-10 to 2011-19 (Table 1). India’s tax expenditure on CIT (as % of tax revenue) was relatively higher during 2005-10 as compared to other regions of the world. Though the Union government has contained tax expenditure on CIT during 2011-19, it is still higher than other regions in the world, except East Asia & Pacific and North America. According to world’s average, tax expenditure on PIT is higher than CIT. However, in India it is the opposite. During 2011-19, except high income countries all other income groups (or countries) have reduced their average tax expenditure on CIT (as % of tax revenue) vis-à-vis 2005-10. In PIT, except Upper middle income group, all other income groups have reduced tax expenditure (as % of tax revenue) during 2011-19 vis-à-vis 2005-10.

¹ Tax revenue implies overall tax collection, independently of the specific tax base chosen.

Table 1: Average Tax Expenditures on Corporate Income Tax and Personal Income Tax

Region	Corporate Income Tax				Personal Income Tax			
	% of Tax Revenue		% of GDP		% of Tax Revenue		% of GDP	
	2005-10	2011-19	2005-10	2011-19	2005-10	2011-19	2005-10	2011-19
World	3.60	3.77	0.58	0.64	8.85	7.15	1.39	1.22
East Asia & Pacific	3.33	5.55	0.59	0.75	16.27	8.80	1.98	1.36
Europe & Central Asia	2.38	3.54	0.53	0.75	8.23	7.86	1.80	1.62
Latin America & Caribbean	4.68	4.69	0.66	0.70	4.12	3.13	0.58	0.49
Middle East & North Africa	2.94	3.81	0.68	0.75	1.02	3.84	0.29	0.73
North America	6.72	6.88	0.78	0.79	43.29	43.52	4.83	4.96
South Asia	5.06	1.99	0.53	0.22	2.74	1.55	0.29	0.16
Sub-Saharan Africa	2.15	1.61	0.37	0.29	3.79	1.83	0.92	0.44
<i>High Income</i>	<i>3.59</i>	<i>4.42</i>	<i>0.68</i>	<i>0.84</i>	<i>13.10</i>	<i>10.47</i>	<i>2.12</i>	<i>1.82</i>
<i>Upper Middle Income</i>	<i>4.60</i>	<i>4.20</i>	<i>0.59</i>	<i>0.60</i>	<i>3.37</i>	<i>3.58</i>	<i>0.45</i>	<i>0.61</i>
<i>Lower Middle Income</i>	<i>2.46</i>	<i>2.35</i>	<i>0.36</i>	<i>0.36</i>	<i>1.29</i>	<i>1.00</i>	<i>0.15</i>	<i>0.16</i>
<i>Low Income</i>	<i>4.72</i>	<i>1.46</i>	<i>0.41</i>	<i>0.17</i>	<i>N.A.</i>	<i>1.32</i>	<i>N.A.</i>	<i>0.15</i>
India	10.12	5.00	1.06	0.54	4.47	3.12	0.47	0.35

Source: Compiled from Global Tax Expenditures Database (<https://gted.net/>)

Economists' desires of simplicity and uniformity in tax system are often in conflict with political interests, as political system creates numerous specialized benefits for groups or individuals through tax system (Peters 1991). For example, politicians often find it convenient to subsidize middle-class housing by giving tax incentives/ benefits on interest payments on home loans (tax relief on mortgaged payments) than providing direct subsidy (Peters 1991). Tax policy is often perceived as extremely technical by politicians and citizens, and therefore political entrepreneurs often find it easier to create benefits by taxation (read tax incentives/ exemptions) than through public expenditures (Manley 1970, Witte 1985). Tax expenditures often do not go through the rigorous scrutiny or audit process as regular expenditure programmes of the government. Therefore, this lack of transparency may appeal policy makers to offer tax incentives over general public expenditures (Tyson 2014). In this context Burman and Phaup (2012) also argue that politicians favor tax expenditures over potentially more efficient spending alternatives, as explicit spending programmes may attract criticism of favoring high taxes and big government. In general, tax expenditures lower effective tax rates and therefore reduce demands for specific purpose public expenditures. Tyson (2014) argues that tax expenditures are vulnerable to lobbying and special interest groups often find it easier to argue for tax breaks than for explicit spending support.

Alt et al. (210) argue that special interest groups may not be lobbying for tax policy at the first place but they can lobby both for persistence and the extension that allow policy to shift from its original objective. Duade et al. (2014) explain how special interest groups play a major role in shaping the policy framework of a country, and how they create pressure to maintain their control over the administration of tax benefits. Economic elites have a greater ability to influence the management or design of tax incentives, and if successful, they can subsequently become effective lobbyists to maintain status quo (Duade et al. 2014). Lobbying firms are more likely to reap the maximum tax benefits along with the lower effective tax rates as compared to the non-politically active firms (Arayavechkit et al. 2014). Increase in tax expenditures reduces average effective tax rate (ETR) for all firms, however lobbying firms may experience larger decrease in ETR as compared to non-lobbying firms (Arayavechkit et al. 2014). However, one cannot deny the fact that tax expenditures help in providing certain tax incentives to encourage either some specific businesses and/or in some specific locations which otherwise would not have existed (Barrios 2016, Rao et al. 2016).

Tax expenditures (incentives/exemptions) sometimes help economically unviable businesses to become economically viable. Therefore, tax expenditures may also help to increase tax collections in the long run by encouraging certain businesses and/or certain locations (as a result of area/ location based tax incentives) which otherwise would not have existed without tax incentives. Similarly, in PIT if tax incentives for private pension contributions induce investments by additional income generation rather than by switching other savings (investments) and/or cutting expenditures (consumptions), it may increase tax collection (Chan et al. 2022). Sometimes public expenditure programmes may not provide adequate incentives to certain businesses and/or attract economic activities in certain locations to provide employment and economic opportunities (Rao et al. 2016). Also Rao (2013) argues that tax expenditure does not provide exact estimate of potential revenues that the governments would have collected if the incentives cease to exist. Rao (2013) states that “[o]nly a fraction of the entire tax expenditure can actually be referred to as revenue foregone – that which is associated with economic activity which received an incentive in spite of being viable without the incentive regime”. Therefore, it might be the case that tax expenditures in terms of various concessions can actually help in broadening the tax base and improve tax collection in the long run. On the contrary, given the level of tax compliance higher tax benefits may result in higher statutory tax rates to meet the revenue targets and this may result in fall in tax compliance and higher demands for tax expenditures. Perhaps, the existence of vicious cycle of tax incentives and tax compliance cannot be overruled.

Furthermore, it is believed that tax expenditures are motivated by socio-economic objectives based on efficiency and equity arguments. However, existing literature suggests that tax expenditures disproportionately favor higher income groups or large companies who form powerful interest groups to preserve and expand the tax benefits (Branco and Costa 2015, Burman et al. 2008, Howard 1997, Toder et al. 2009). Tax incentives/exemptions are generally given to achieve certain economic objectives (e.g., stimulate economic activity and creations of jobs in specific jurisdiction by attracting investments), however not every businesses or companies could reap the advantage equally. Tax expenditures are often considered as entitlements of middle and upper-income groups (Burman et al. 2008). Tax expenditure is skewed more in favor of relatively well-off individuals as they hold most of the capital and hence more capable of indulgence in lobbying (Arayavechkit et al. 2014). In this

context several studies are conducted in different countries, e.g., U.S. (Slattery and Zidar 2020, Arayavechkit et al. 2014, Hungerford 2006, Burman and Phaup 2012), European countries (Avram 2017), and India (Rao and Mukherjee 2017). Arayavechkit et al. (2014) study the relationship between corporate lobbying and resource misallocation, as well as the effects of corporation tax benefits (also known as corporate tax expenditures) on various enterprises in the United States. The study shows that large capital intensive firms are more capable to enjoy the tax benefits as compared to the small firms (non-lobbying firms). Similarly the study by Avram (2017) within the context of six European countries finds that the tax benefits (tax allowances and tax credits) are able to reach large sections of the population however, their distributional impacts are not equitable i.e. tax expenditures are more advantageous to middle and higher income groups. Furthermore, the study by Rao and Mukherjee (2017) finds that tax incentives in corporate income tax in India are biased in favor of older and larger corporate taxpayers, as they are in better position to reap the benefits of incentives available. Rao and Mukherjee (2017) argue that tax system and incentives are ineffective in stimulating competition in all sectors equally as a result it may not encourage investment and competitions in those sectors where the effective tax rates are high. Burman and Phaup (2012) argue that tax expenditures disproportionately favors higher income groups, which may lead to misallocation of scarce resources away from public expenditure programmes of the governments and therefore enlarge inequality in the society.

However, it is not the case that all tax expenditures are ugly or bad (Hungerford 2006) as it may depend upon nature of tax expenditure and their corresponding objectives. The general division of tax expenditures could be social tax expenditures (that support social policy goals such as promoting retirement savings, health insurance coverage, education, home ownership and providing income support to lower families) and business related tax expenditures which generally aimed at promoting investment and growth, such as accelerated depreciation for capital investment, the research and development tax credit etc. (Toder 1999, 2005). The social and economic implications of tax expenditures may depend upon the nature of tax expenditures, country and the targeted population group (Barrios 2016). For example, tax benefits given to promote pension coverage (or health insurance) mostly benefit the richest income class since the proportion of population with pension coverage (or health insurance coverage) in U.S. increases from poorer to richest income groups. Therefore, richest or upper income families are more likely to get benefits from the exclusion of pension earnings (Hungerford 2006). In the context of U.S. Chetty et al. (2015) argue that high tax expenditures aimed at low-income tax taxpayers have a significant role or impacts on the intergenerational mobility (upward income mobility of low-income families). Barrios (2016) studies the fiscal and equity impacts of social tax expenditures (mainly pension, health, education and house related) among the 27 European countries. The study claims that distributive impacts of tax expenditures can either be progressive or regressive depending on the type of tax expenditures, country and different types of households considered. Therefore, the distributional effects of tax expenditures may depend on the structure or design aspects of tax expenditures and other business and targeted population specific factors.

The structure of tax incentives is not static and it is changing over time depending on demands for tax incentives as well as changing economic structure of the economy. Digitalization of public finance database and enlarging the domain of third party information capturing and reporting to tax

authorities, has improved transparency in reporting tax expenditures. Lack of information often used to veil tax expenditures corresponding to tax incentives which require large scale data capturing and processing/ analysis to assess the revenue foregone (e.g., tax expenditures on interest earned from savings bank account). Tax expenditures corresponding to tax incentives which were earlier not used to be reported might have now become visible due to introduction of tax deduction at source (TDS) on incomes. Similarly, introduction of mandatory reporting of taxpayer information (e.g., in India Permanent Account Number of tax payer) in various transactions has reduced fraudulent claims of tax credits and therefore tax expenditures. So it may be the case that tax expenditures may not have increased for a country but due to digitalization of public finance database, transparency in reporting tax expenditures has improved. So transparency in public finance database is an important aspect which may help to unearth tax expenditures which are often invisible in budget documents of many countries.

Possibly there exist three prominent relationships between tax expenditures on tax collection. Firstly to generate adequate revenue at a higher level of tax expenditures, statutory tax rate is often increased. Higher statutory tax rate disproportionately increases tax burden on some taxpayers who cannot reap the benefits of tax exemptions / incentive schemes. As a result a group taxpayers ends up paying higher tax. This is especially the case for Indian corporations, as previous studies show that relatively small companies face higher effective CIT rate than large companies (Rao and Mukherjee 2019). Secondly, tax incentives / exemptions schemes make some companies financially viable which otherwise would have running in losses. Therefore, tax expenditures increases financial viability of some companies and therefore tax collection increases (Rao 2013). Tax incentives may sometimes induce people to earn more to invest in specific instruments to avail tax exemptions and therefore income effects (income and labour supply response) of tax incentives may result in increasing the tax base and tax collections (Chan et al. 2022).

Government of India is publishing revenue foregone statement (or tax expenditures) of the Union taxes as part of the budget documents since 2004-05. The present paper assesses the trends and patterns in tax expenditures on four Union taxes, viz., Corporate Income Tax (CIT), Taxes on Income other than Corporation Tax (hereafter Personal Income Tax),² the Union Excise Duty and Customs Duty, for the period 2005-06 to 2019-20. These taxes together contribute on average 86.6 per cent of Gross Tax Revenue (GTR) (including States' share in Union taxes) of the Union government during 2005-20.

Government of India initiated reforms by setting sunset clauses in various tax incentives schemes on Union taxes in the Union Budget 2015-16 and as per our knowledge this is not highlighted in Indian public finance literature yet. Literature on tax expenditure is sparse in India and the present study attempts to fill the gap in literature. Moreover, existing studies highlight only tax expenditures on Corporate Income Tax (CIT) (Rao and Mukherjee 2017, Rao, Tandon and Mukherjee 2016). The

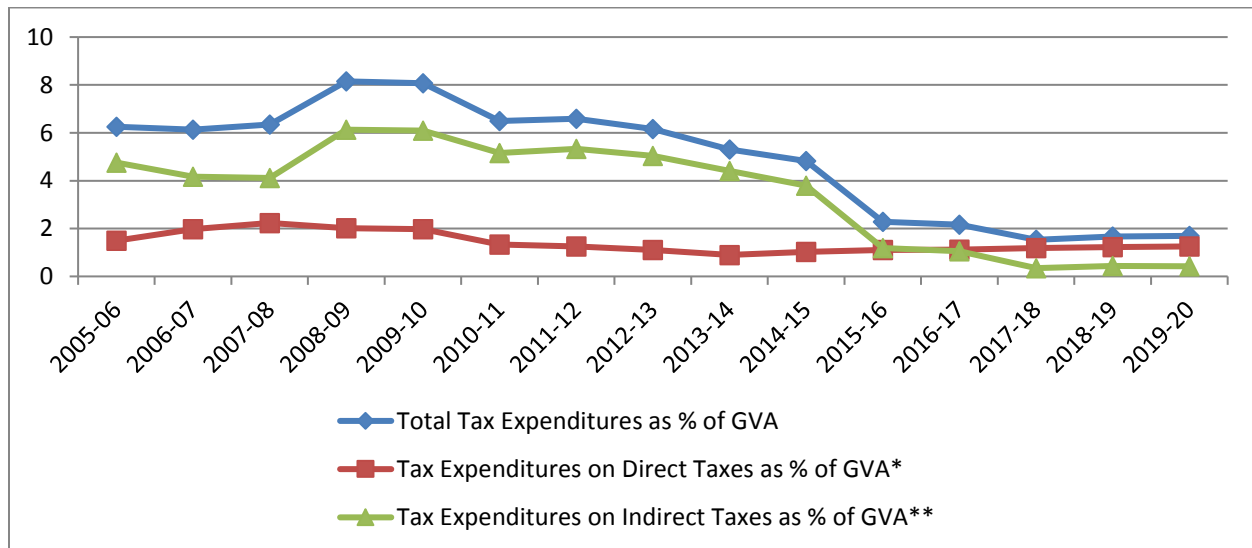
² In this paper Personal Income Tax (PIT) excludes Hotel Receipts Tax (0023), Interest Tax (0024), Fringe Benefit Tax (0026), Other Taxes on Income and Expenditure (0028), Land Revenue (0029), Stamps and Registration fees (0030), Gift Tax (0033), Security Transaction Tax (0034), and Banking Cash Transaction Tax (0036).

present study covers all Union taxes and attempts to understand their dynamics with specific to tax collection as well as Gross Value Added (GVA).

2. Analysis of Tax Expenditures on Union Taxes

Aggregate tax expenditure on Union taxes has gone down from 8.15 per cent of Gross Value Added (GVA) in 2008-09 to 1.69 per cent of GVA in 2019-20.³ This was possible due to continuous reductions of tax expenditures on indirect taxes since 2010-11. Overall tax expenditures remain stable at 1.63 per cent of GVA during 2017-18 to 2019-20. Tax expenditures on Union taxes can be divided into three phases – Phase I (2005-06 to 2007-08), Phase II (2008-09 to 2014-15) and Phase III (2015-16 to 2019-20) (Figure 1). In Phase I average tax expenditure was 6.2 per cent of GVA (Table 2). Rise in tax expenditures on indirect taxes during 2008-09 to 2009-10 is attributed to fiscal stimulus measures adopted by the Union government to tackle Global Financial Crisis (GFC) in terms of reducing tax rates on Union Excise Duty (UED) as well as Customs Duty. In Phase II, average tax expenditure was 6.5 per cent of GVA and post 2009-10 on average each year tax expenditures has declined by 0.65 per cent of GVA. In 2011-12, average tax expenditure increased marginally from 6.49 per cent in 2010-11 to 6.58 per cent. In Phase III, average tax expenditure was 1.9 per cent of GVA and on average tax expenditure in each year has declined by 0.63 per cent of GVA. The largest fall in tax expenditure observed in 2010-11 and 2015-16. An in-depth analysis of tax expenditure on each tax may help to bring out new insights. The experience of Government of India in cutting down tax expenditures may help other countries to reduce tax expenditures.

Figure 1: Overall Tax Expenditure of Union Taxes (as % of GVA)



Notes: *-Direct taxes include CIT and PIT only

**-Indirect Taxes include UED and Customs only

Source: Computed by author based on Union Budget Documents (various years)

³ Gross Value Added (GVA) at basic prices (at current prices, 2011-12 series)

Table 2: Average Annual Tax Expenditure on Union Taxes (% of GVA)

Tax Head	2005-06 to 2007-08	2008-09 to 2014-15	2015-16 to 2019-20
A. Direct Taxes (a+b)	1.9	1.4	1.2
(a) Corporate Income Tax	1.2	0.9	0.6
(b) Personal Income Tax (i+ii)	0.7	0.5	0.6
(i) Firms/AOPs/ BOIs	0.1	0.1	0.0
(ii) Individuals	0.6	0.5	0.5
B. Indirect Taxes (c+d)	4.3	5.1	0.7
(c) Union Excise Duty	2.0	2.4	0.2
(i) Area based exemptions	0.2	0.2	0.1
(ii) General exemptions	1.8	2.2	0.2
(d) Customs Duty (i-ii)	2.4	2.8	0.5
(i) Customs Duty (gross)	3.6	3.4	0.7
(ii) Input tax neutralisation or exemption schemes	1.2	0.6	0.2
C. Total Tax Expenditure - Union Government (A+B)	6.2	6.5	1.9

Source: Computed by author based on Union Budget Documents (various years)

With reduction of tax expenditures on Union taxes, there is no sign of improvement in tax collection (Table 3). Gross Tax Revenue (GTR) (including States' share in Union Taxes) of Union taxes both at the aggregate level as well as for selected taxes does not show any improvement with reductions of tax expenditures. Given the data limitations, it is beyond the scope of the paper to assess the relationship between tax expenditures and tax collections. With availability of data for more years, it will be important to explore the relationship between tax expenditure and tax collection in future research.

Table 3: Average Annual Gross Tax Revenue of Union Taxes (as % of GVA)

Tax Head	2005-06 to 2007-08	2008-09 to 2014-15	2015-16 to 2019-20
I. Gross Tax Revenue (GTR)	12.1	11.1	11.8
A. Corporation Tax	3.7	4.0	3.5
B. Taxes on Income other than Corporation Tax	2.0	2.1	2.6
C. Union Excise Duties	3.0	1.8	1.9
D. Customs	2.2	1.7	1.1
E. GST on Imports (IGST+Cess)			1.5
GTR-Selected (Sum of A to E)	10.8	9.6	9.9

Source: Computed by author based on Union Budget Documents (various years)

During Phase I, on average total tax expenditure was 57.8 per cent of GTR (from selected taxes). It was 67.4 per cent during Phase II and 18.8 per cent during Phase III (Table 4). Major reduction in tax expenditure observed in indirect taxes during Phase III. Introduction of GST from 1 July 2017 helped to contain tax expenditure on account of Union Excise Duty (UED). As a step towards introduction of GST, withdrawal of various tax incentives/ exemptions schemes under UED initiated since 2015-16. Major reduction in tax expenditures on direct taxes observed during Phase II.

Table 4: Average Annual Tax Expenditures on Union Taxes (% of Gross Tax Revenue from Selected Taxes)*

% of GTR-Selected	2005-06 to 2007-08	2008-09 to 2014-15	2015-16 to 2019-20
A. Direct Taxes (a+b)	17.4	14.2	11.9
(a) Corporate Income Tax	11.0	8.8	6.0
(b) Personal Income Tax (i+ii)	6.5	5.4	5.9
(i) Firms/AOPs/ BOIs	0.7	0.7	0.4
(ii) Individuals	5.8	4.7	5.5
B. Indirect Taxes (c+d)	40.4	53.2	6.9
(c) Union Excise Duty	18.2	24.4	2.3
(i) Area based exemptions	1.5	1.8	0.7
(ii) General exemptions	16.7	22.5	1.6
(d) Customs Duty (i-ii)	22.2	28.8	4.6
(i) Customs Duty (gross)	33.3	35.1	7.1
(ii) Input tax neutralisation or exemption schemes	11.2	6.2	2.5
C. Total Tax Expenditure - Union Government (A+B)	57.8	67.4	18.8

Note: *-includes Corporate Incorporate Tax (CIT), Personal Income Tax (PIT, excluding Hotel Receipts Tax, Interest Tax, Fringe Benefit Tax, Other Taxes on Income and Expenditure, Land Revenue, Stamps and Registration fees, Gift Tax, Security Transaction Tax, and Banking Cash Transaction Tax), Union Excise Duty (UED) and Customs Duty (including IGST and GST Compensation Cess from Imports)

Source: Computed by author based on Union Budget Documents (various years)

In addition to reductions in tax expenditures on direct and indirect taxes, there was structural shift in tax expenditure from indirect to direct taxes during Phase III (Table 5). Average share of indirect taxes in total tax expenditure (TTE) went up in Phase II due to reduction of tax expenditure on direct taxes during this phase. In Phase III, the share of direct taxes in TTE went up with reduction of tax expenditures on indirect taxes.

Table 5: Average Composition of Tax Expenditures on Union Taxes (% Share)

Composition	2005-06 to 2007-08	2008-09 to 2014-15	2015-16 to 2019-20
A. Direct Taxes (a+b)	30.4	20.7	65.1
(a) Corporate Income Tax	19.1	12.8	32.6
(b) Personal Income Tax (i+ii)	11.4	7.9	32.5
(i) Firms/AOPs/ BOIs	1.2	1.1	2.2
(ii) Individuals	10.1	6.9	30.4
B. Indirect Taxes (c+d)	69.6	79.3	34.9
(c) Union Excise Duty	31.4	36.3	10.2
(i) Area based exemptions	2.6	2.8	3.1
(ii) General exemptions	28.8	33.5	7.2
(d) Customs Duty (i-ii)	38.1	43.0	24.7
(i) Customs Duty (gross)	57.5	52.2	37.0
(ii) Input tax neutralisation or exemption schemes	19.4	9.2	12.3
C. Total Tax Expenditure - Union Government (A+B)	100.0	100.0	100.0

Source: Computed by author based on Union Budget Documents (various years)

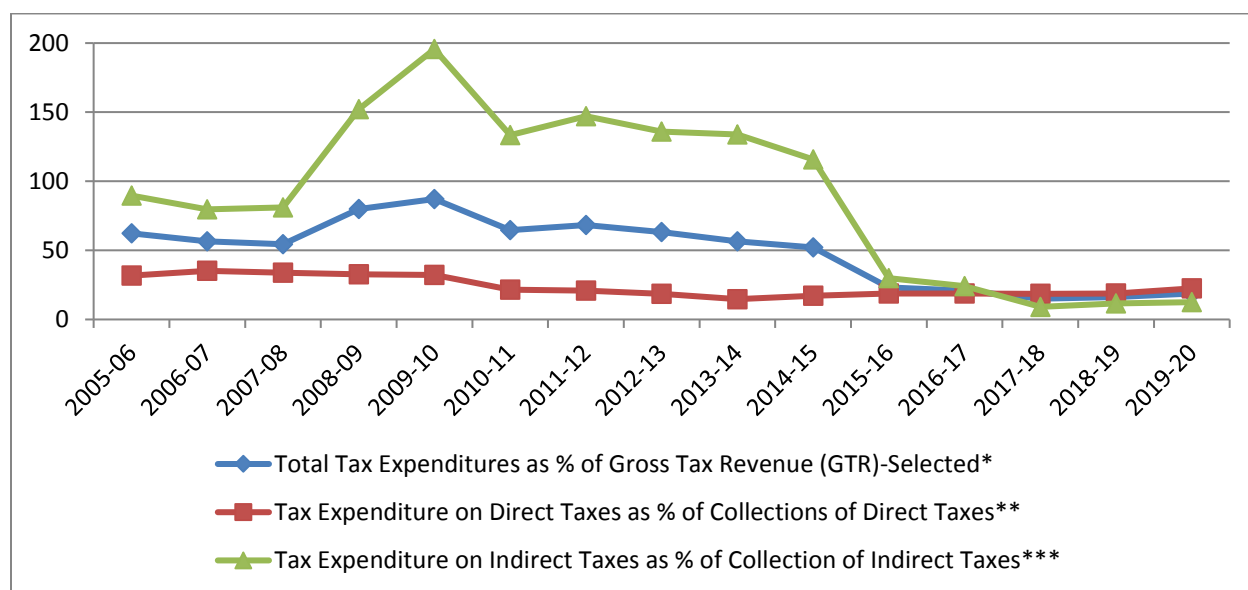
The rise in tax expenditures on indirect taxes during 2008-09 to 2009-10 is attributed to cut in effective Union Excise Duty (UED) rate as a part of fiscal stimulus package announced to counter general economic slowdown due to global financial crisis (GFC). The effective UED rates were reduced by 4 percentage points on 7 December 2008 and later on 24 February 2009 the mean excise duty rate of 10 per cent was further reduced by 2 percentage points (from 10% to 8%). While the standard UED rate was 16 per cent, the effective duty rate on most excisable goods was reduced to 10 per cent and subsequently to 8 per cent in December 2008 and February 2009 respectively. The effective rate of 8 per cent continued throughout 2009-10. This resulted in rise in tax expenditure during 2008-10, as standard UED rate of 16 per cent remained unchanged.

As a part of fiscal stimulus package announced by the Union government, there was also reduction in the effective rates of custom duty in many revenue important items (e.g., crude petroleum, edible oils, steel). In addition, revenue impact of reduction of effective UED rates on customs collections is also observed through countervailing duty (CVD) channel (CVD is levied in lieu of UED or CenVAT on imports). The reductions in UED rates announced in 2008-09 were continued throughout 2009-10, as a result tax expenditures increased during 2008-10. In 2010-11, the difference between the standard UED rate (or tariff rate) and the effective rate decreased from 8 per cent to 6 per cent which helped to contain tax expenditures on account of UED. Further commensurate increase in the effective rates applicable to refined petroleum products also helped to contain tax expenditure on account of UED. Re-imposition of 5 per cent customs duty on crude petroleum (in 2009-10 there was nil customs duty on crude petroleum) with effective from 27 February 2010 and increasing CVD rate

by 2 per cent (and corresponding rise in Special CVD collection) helped to contain tax expenditure on account of customs duty.

As compared to 2007-08, tax expenditures on direct taxes gone down by 1.2 per cent of GTR (selected) in 2008-09 and 1.8 per cent in 2009-10 (Figure 2). There was no reduction of statutory corporate tax rates during 2008-10. Moreover, annual growth rates in CIT and PIT collections went down to 10.6 per cent and 3.3 per cent respectively in 2008-09 from 33.7 per cent and 36.7 per cent in 2007-08. In 2009-10, annual growth rate of CIT and PIT collections improved marginally to 14.7 per cent and 15.5 per cent respectively. Post GFC, annual growth rate in CIT and PIT collections never reached the growth rate that was prevailing prior to GFC.

Figure 2: Overall Tax Expenditure of Union Taxes (as % of Tax Revenue)



Notes: *-Gross Tax Revenue (GTR) of selected taxes, viz., CIT, PIT, UED, Customs Duty (including GST on Imports)

** -Revenue corresponding to CIT and PIT only

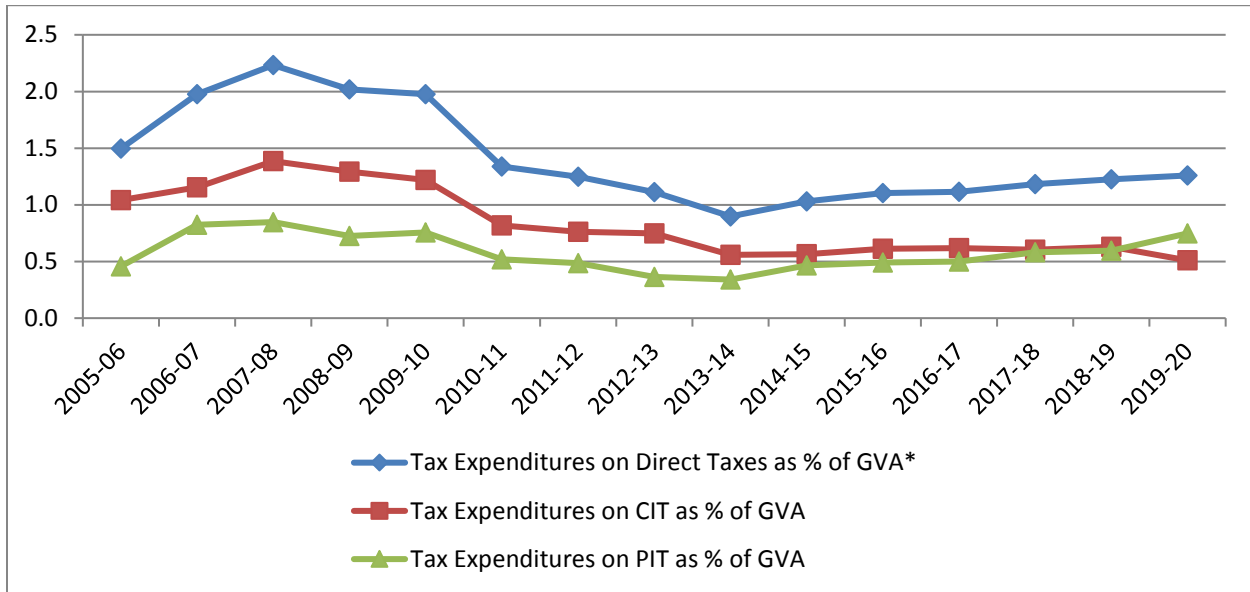
*** -Revenue corresponding to UED, Customs Duty (including GST on imports)

Source: Computed by author based on Union Budget Documents (various years)

2.1 Tax Expenditures on Direct Taxes

Tax expenditure on direct taxes is stable and hovering between 1 to 1.5 per cent of GVA since 2010-11 (Figure 3). The rise in tax expenditure on direct taxes (as % of GVA) observed during 2006-10 and it is attributed to rise in tax expenditures both on CIT as well as PIT. However, there was no reduction in tax rates in either CIT or PIT as a part of fiscal stimulus packages announced by the Union government to counter global financial crisis during the second half of 2008-09 (Figure 3). Therefore, it demands a detail assessment of the reasons for rise in tax expenditures on CIT during 2006-10.

Figure 3: Tax Expenditures on Direct Taxes (% of GVA)



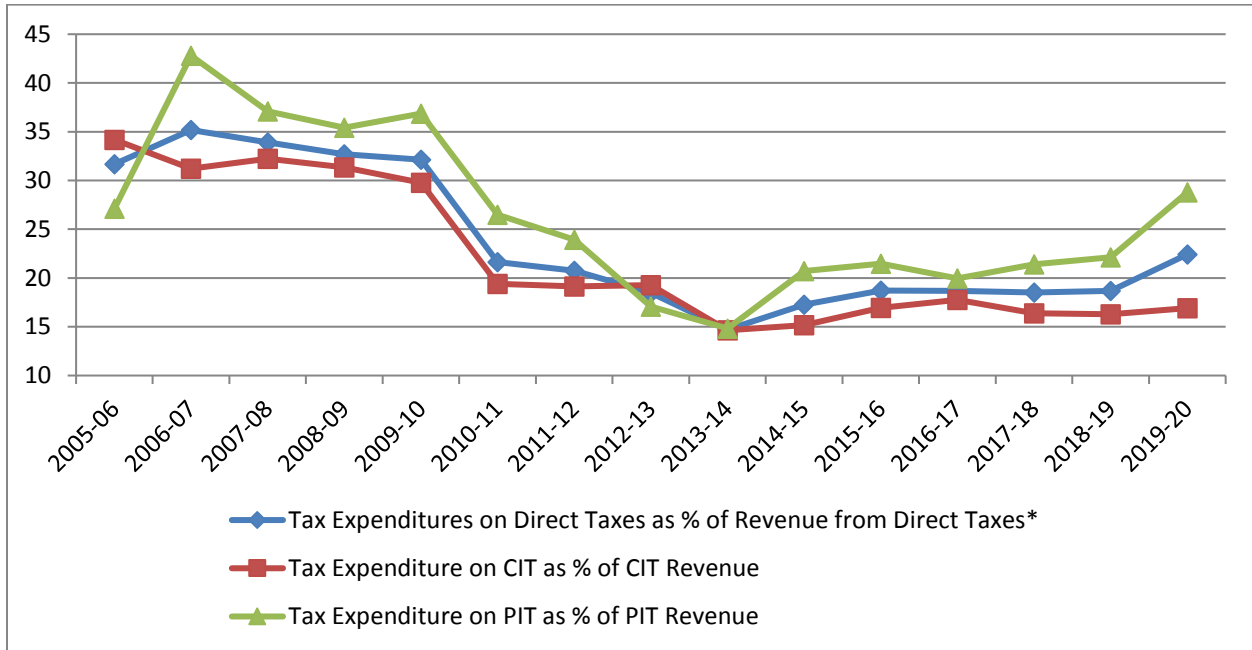
Note: *-Direct taxes include CIT and PIT only

Source: Computed by author based on Union Budget Documents (various years)

Tax expenditure on direct taxes (as percentage of direct tax revenue) has gone down over the years and it is hovering around 19 per cent since 2014-15 (Figure 4). In general, tax expenditure on PIT (as % of PIT collection) is higher than tax expenditures on CIT (as % of CIT collection). In the Union Budget of 2015-16, it was announced to reduce statutory CIT rate from 30 per cent to 25 per cent over four years along with phasing out of some tax exemptions and deductions by 31 March 2017. Setting sunset clauses for various tax exemption schemes, especially those related to profit linked, investment linked and area based, helped the government to contain tax expenditures on CIT as well as PIT.

Figure 4 shows that even during global financial crisis, tax expenditures on direct taxes (as % of tax revenue) did not went up. Out of 15 years (i.e., 2005-20) of our analysis, annual growth rate in tax expenditure on CIT exceeds annual growth rate in CIT collection in 6 years (2007-08, 2012-13, 2014-15 to 2016-17, 2019-20) (Figure 5). In PIT, annual growth rate in tax expenditure on PIT exceeds annual growth rate in PIT collection for 7 years (2006-07, 2009-10, 2014-15 to 2015-16, 2017-18 to 2019-20) (Figure 6). It is to be noted that a rising trend in tax expenditures on PIT is observed since 2014-15. The difference between the growth rate of tax expenditures and tax collection needs to be minimized for consolidation of tax expenditures.

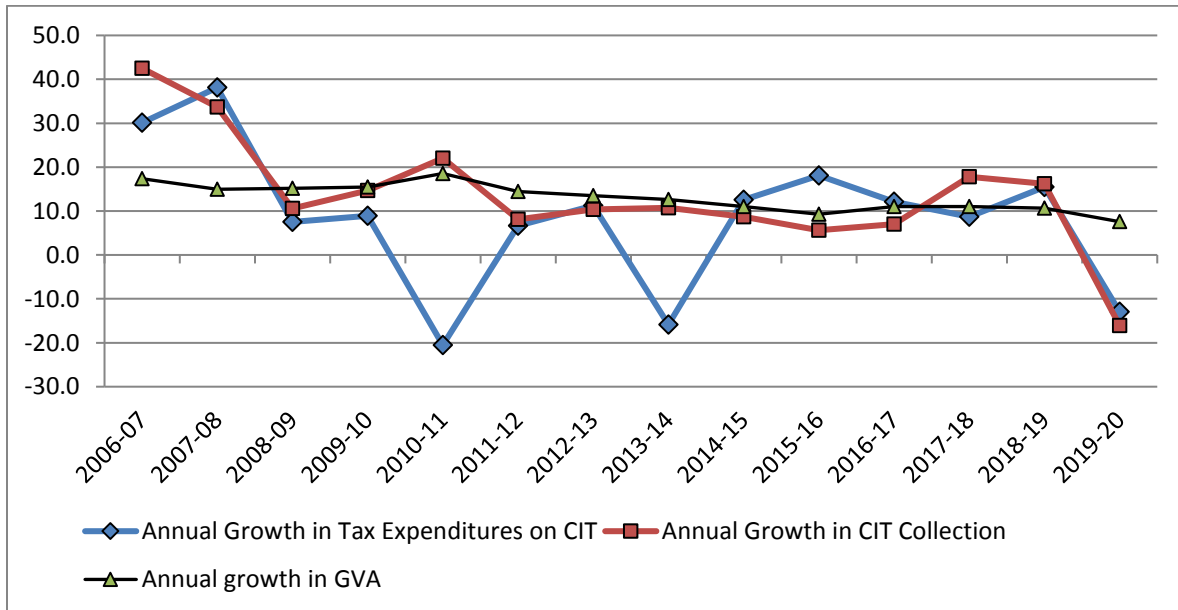
Figure 4: Tax Expenditures on Direct Taxes as Percentage of Direct Tax Revenue*



Note: *-Direct taxes include CIT and PIT only

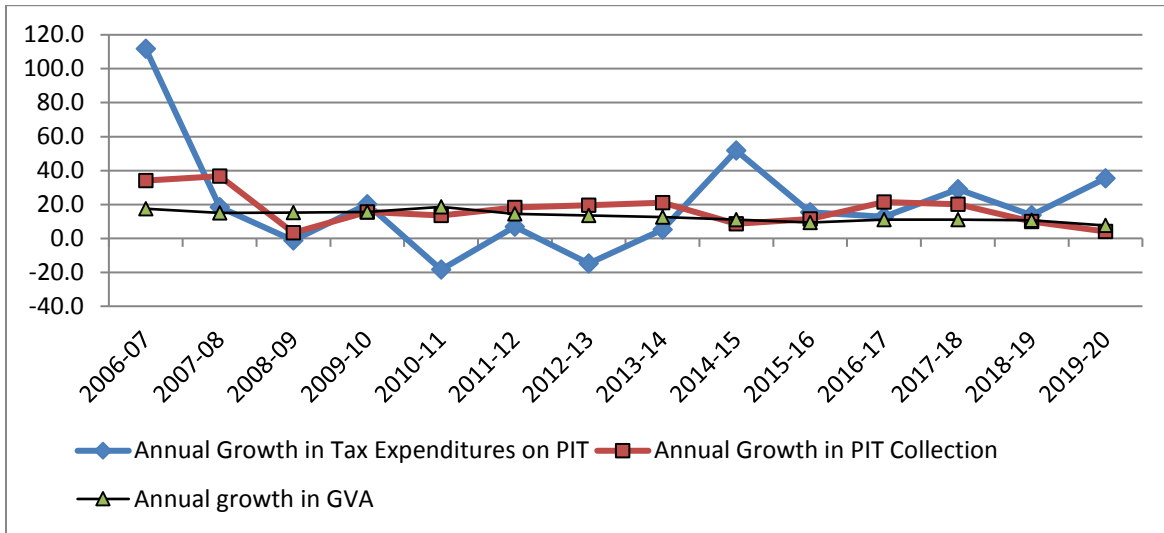
Source: Computed by author based on Union Budget Documents (various years)

Figure 5: Annual Growth Rate in CIT Collection, Tax Expenditure on CIT and GVA (%)



Source: Computed by author based on Union Budget Documents (various years)

Figure 6: Annual Growth Rate in PIT Collection, Tax Expenditure on PIT and GVA (%)



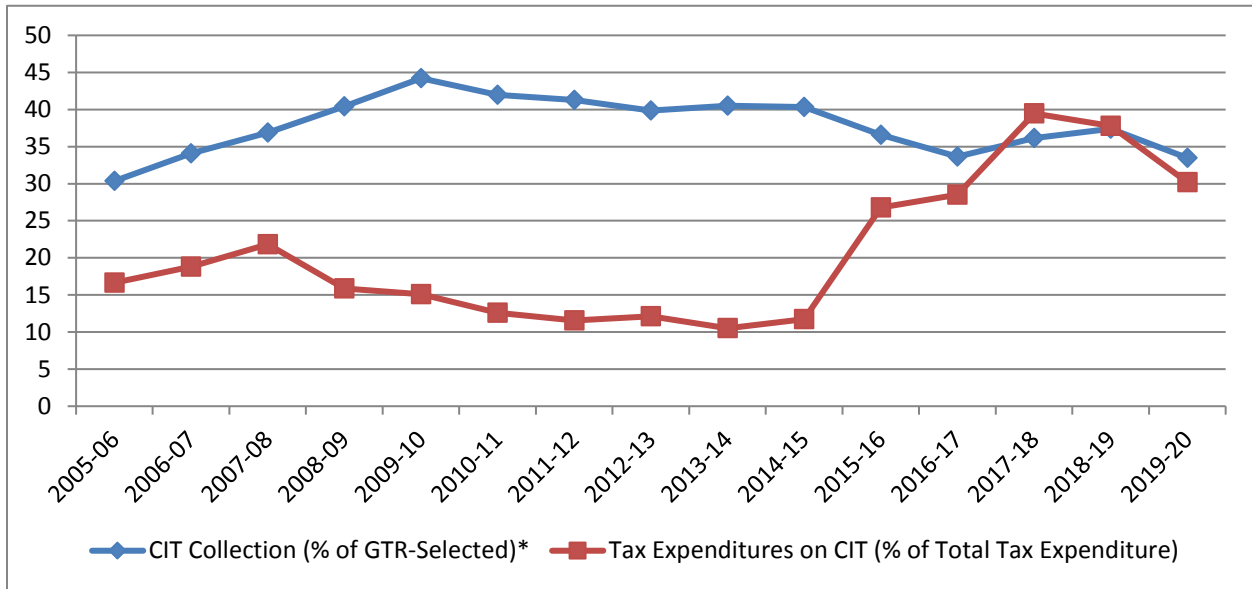
Source: Computed by author based on Union Budget Documents (various years)

2.1.1 Tax Expenditures on Corporate Income Tax

During 2005-07 to 2019-20, on average CIT contributes 32.8 per cent of Gross Tax Revenue (GTR, including states' share). During the period, on average one-fifth (20.6%) of total tax expenditures of the Union government is on CIT. If we consider only GTR of selected Union taxes, average contribution of CIT stands to 37.8 per cent during 2005-07 to 2019-20.⁴ Figure 7 shows that since 2010-11, there is a falling trend in the share of CIT in GTR (selected), except during 2017-19. A falling trend in CIT collection (as % of GVA) is also observed since 2008-09 (Figure A1 in Appendix). The rise in the share of CIT in total tax expenditure is mainly on account of falling share of indirect taxes in the total expenditure. Tax expenditure on CIT shows stable trends since 2013-14 both as percentage of CIT collection and as percentage of GVA (Figure 8).

⁴ Selected GTR includes tax collection on account of CIT, PIT, UED and Customs Duty (including GST on imports). Since there is no information on tax expenditures on UED after introduction of GST (i.e., 1 July 2017), we avoided taking Central GST (CGST) and corresponding IGST (integrated GST) settlement on CGST account in our analysis.

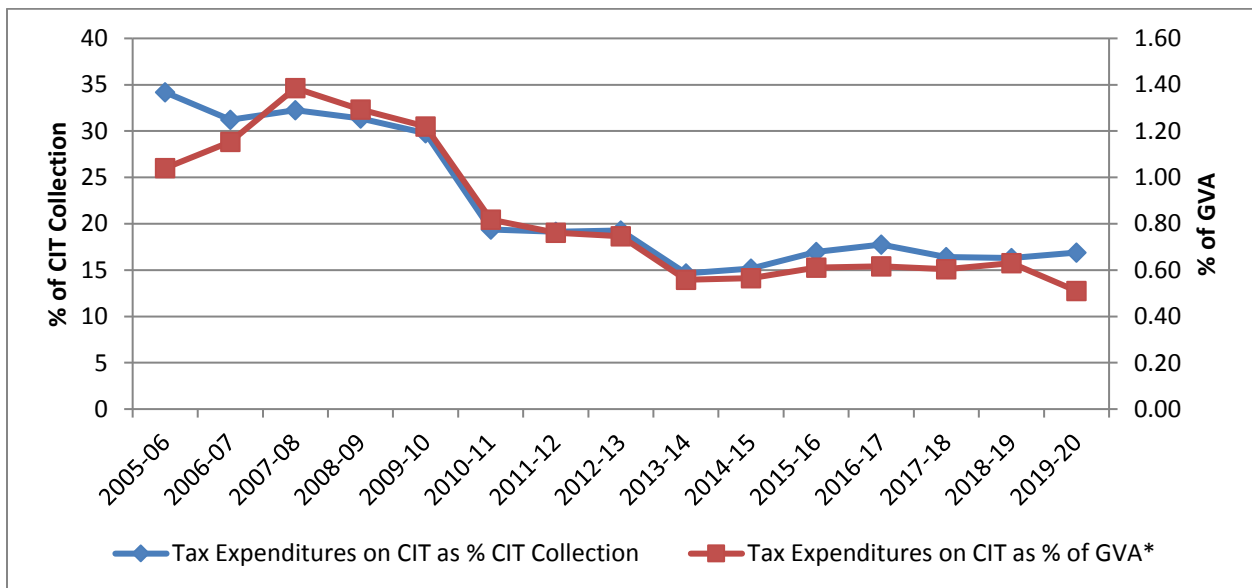
Figure 7: CIT Collection and Tax Expenditures on CIT



Note: *-see footnote 2.

Source: Computed by author based on Union Budget Documents (various years)

Figure 8: Tax Expenditure on CIT

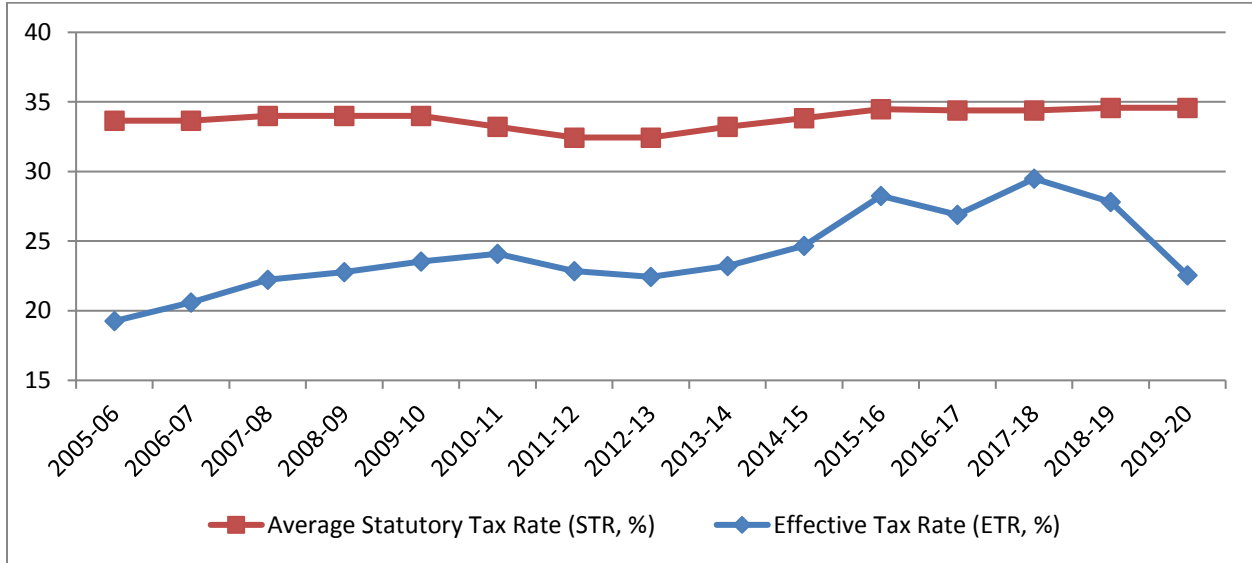


Note: *-see footnote 1.

Source: Computed by author based on Union Budget Documents (various years)

Stable statutory CIT rate and gradual reductions of tax expenditure on CIT resulted in rise in effective CIT rate over time (Figure 9). The effective tax rate of CIT has gone up from 19.26 per cent in 2005-06 to 27.81 per cent in 2018-19. Fall in effective CIT rate in 2019-20 to 22.54 per cent is related to concessional CIT rate of 22 per cent offered to existing domestic companies and 15 per cent CIT rate for newly incorporated domestic companies,⁵ provided they satisfy certain conditions including that they do not avail any specified incentive or deductions. Containing tax expenditures on CIT helped to achieve the improvement in ETR apart from maintaining stable statutory CIT rate.

Figure 9: Statutory and Effective tax Rates of CIT (%)



Source: Computed by author based on Union Budget Documents (various years)

2.1.1.2 Structure of Tax Expenditure on CIT

Governments provide tax exemptions/ incentives for various purposes. The structure of tax incentives and associated tax expenditure on CIT has gone through changes over time. For example, shares of ‘accelerated depreciation’ and ‘deduction/weighted deduction for expenditure on scientific research’ have gone up whereas the shares of ‘area based exemptions’ and ‘export promotion’ have gone down (Table 6). Tax exemptions may be guided by economic as well as political interests, in absence of long time series data it is not possible to take up any detailed econometric analysis of political economy aspects of tax exemptions in this paper.

⁵ Which make fresh investment by 31 March 2023 for manufacturing, production, research or distribution of such article or thing manufactured (<https://pib.gov.in/Pressreleashere.aspx?PRID=1585641>, last accessed on 10 March 2022).

Table 6: Average Composition of Tax Expenditures on Corporate Income Tax (CIT) (as % of Total Tax Expenditure on CIT)

Nature of incentive	205-06 to 2007-08	2008-09 to 2014-15	2015-16 to 2019-20
Area Based Exemptions	8.15	7.94	4.89
Accelerated Depreciation	13.03	39.14	44.23
Donations to Charitable Trusts & Institutions, Political Parties, Scientific Research & Rural Development	6.84	0.70	2.37
<i>Export Promotion</i>	<i>29.05</i>	<i>22.08</i>	<i>19.23</i>
Deduction of profits of undertakings engaged in Power Sector	11.28	9.97	11.63
Deduction of profits of undertakings engaged in Telecommunication	11.35	2.87	0.26
Deduction of profits of undertakings engaged in Minerals and Natural Gas Production	9.58	5.13	1.89
Deduction of profits of undertakings engaged in Health Sector, R&D, Environmental Management	0.13	0.12	0.02
Deduction of profits of undertakings engaged in Infrastructure Sector	3.02	3.63	4.98
Deduction of profits of undertakings engaged in Transportation of Foodgrains, processing, preservation and packaging of fruits and vegetables	0.06	0.19	0.23
Deduction of profits of undertakings engaged in Housing Sector	2.12	0.82	0.12
Deduction of profits of undertakings engaged in Economic upliftment, New Employment, Financial Services, SSI Industries, Start-ups and Special Businesses	0.43	1.21	2.98
Deduction/weighted deduction for expenditure on scientific research	4.96	6.19	7.16
Total	100.00	100.00	100.00

Source: Computed by author based on Union Budget Documents (various years)

2.1.2 Tax Expenditures on Taxes on Income other than Corporation Tax

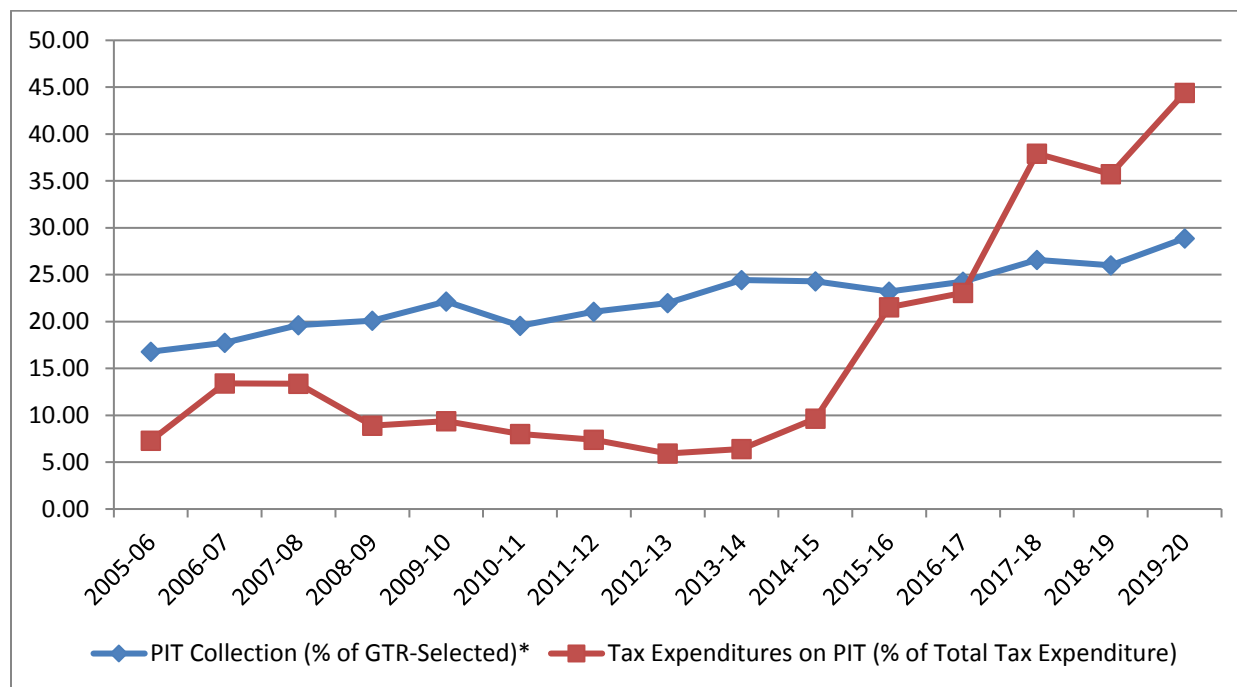
Apart from corporate sector, businesses often organized as partnership firms (hereafter firms), and Association of Persons (AOPs)⁶ or Body of Individuals (BOIs).⁷ Tax collections from firms, AOPs and BOIs are accounted under 'Taxes on Income other than Corporation Tax'. In our analysis we have

⁶ The Indian Income Tax Act, 1961, defines AOP (Association of Persons) as an integration of persons for a mutual benefit or a common purpose. They may be individual or artificial persons such as LLP or a company. For example, two companies may join together and form an AOP for the achievement of a common objective.

⁷ Body of individuals (BOIs) is similar to an AOP and is also an accumulation of individuals who have come together with an objective of earning some income. For example, two individuals may get together and do something together for earning some income.

captured the tax expenditures on these heads under 'Personal Income Tax (PIT)' along with tax expenditures on individuals. Tax expenditure on PIT constitutes on average 16.82 per cent of total tax expenditure of the Union government during 2005-07 to 2019-20 (Figure 10). However, there is an upward trend in the share of tax expenditure on PIT since 2014-15 and a part of this attributed to falling share of indirect taxes on total tax expenditure. Average share of PIT collection in selected GTR was 22.44 per cent during the same period. There is also an upward trend in the share of PIT collection in selected GTR (Figure A1 in Appendix).

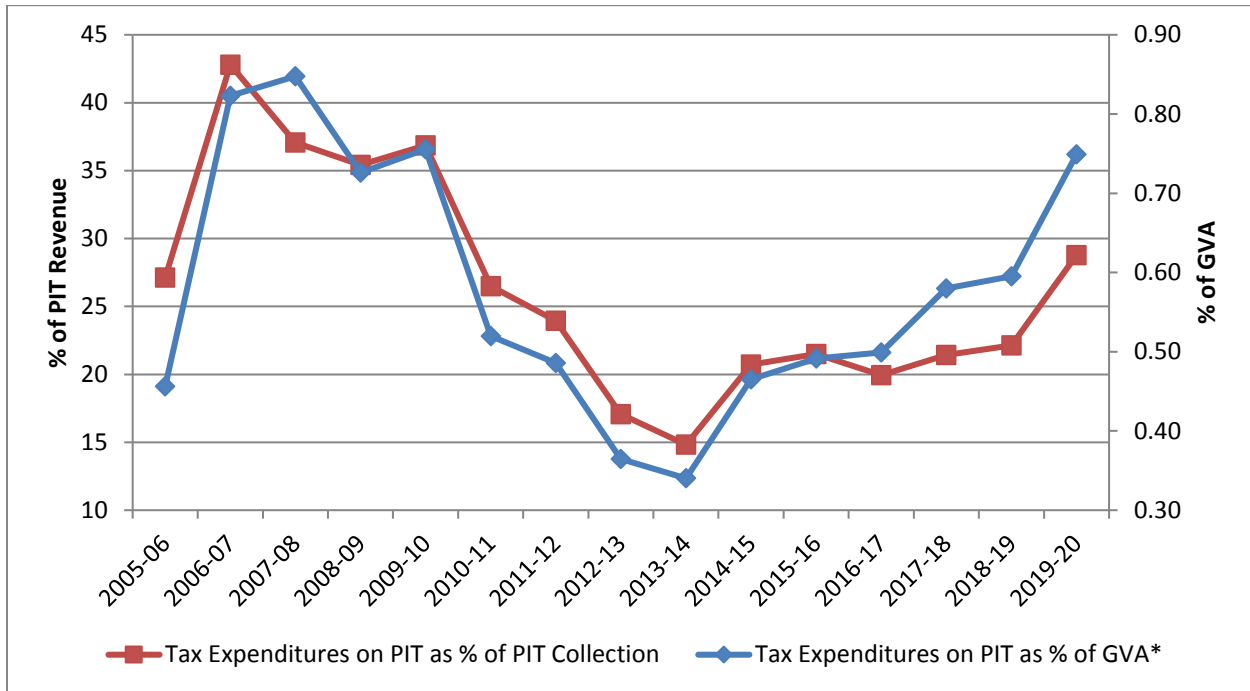
Figure 10: Tax Expenditure on Personal Income Tax (PIT) and PIT Collection



Source: Computed by author based on Union Budget Documents (various years)

Tax expenditure on PIT (both as percentage of PIT collection and GVA) shows similar trend (Figure 11). There was a downward trend in tax expenditure on PIT during 2006-14. Since 2014-15, there is an upward trend in tax expenditure on PIT and a part of this may be related to improvement in capturing information through mandatory reporting of Permanent Account Number (PAN) number for various transactions, extending Tax Deducted at Source (TDS) (withholding of tax) system, digitalization of public finance database and third party reporting of information through Annual Information Return (AIR) submissions.

Figure 11: Tax Expenditure on PIT – as % of PIT Revenue and GVA



Source: Computed by author based on Union Budget Documents (various years)

Tax expenditures on individual taxpayers hold the largest share in the composition of tax expenditure on PIT. On average tax expenditure on firms/ AOPs/ BOIs contributes 1.5 per cent of total tax expenditure of the Union government and 8.7 per cent of tax expenditure on PIT during 2005-20. Structural shift in tax expenditures on firms, AOPs and BOIs is observed as the shares of area based exemptions, deductions of profits related to development of housing projects have gone down over the years whereas the shares of accelerated depreciation and deductions of profits related to cooperative societies have gone up.

2.1.2.1 Tax Expenditures on Individual Taxpayers

On average tax expenditure on individual taxpayers constitutes 15.36 per cent of total tax expenditure of the Union government during 2005-06 to 2019-20. Average share of individuals in total tax expenditure has gone up from 6.52 per cent during 2005-16 to 41.81 percent in 2019-20. Structural composition of tax expenditure on individuals has gone through changes over the period (Table 7).

Table 7: Average Composition of Tax Expenditures on Individual Taxpayers (% share)*

Nature of incentive	2005-06 to 2007-08	2008-09 to 2014-15	2015-16 to 2019-20
Investment in Specific Instruments & Payments	73.16	81.88	72.41
Contribution to Provident Funds and New Pension Scheme	0.39	0.66	3.54
Export Promotion	0.11	0.28	0.09
Area Based Exemptions	1.36	0.83	0.12
Donations to Charitable Trust & Institutions, Political Parties & R&D	0.78	1.34	1.17
Deduction in case of a person with disability	0.18	0.34	0.44
Deduction on account of health insurance premium, expenditure for medical treatment of a dependent disabled person, expenditure for medical treatment of specified diseases	1.50	2.96	4.89
Income Tax Rebate Specific to Income Slab	0.00	0.99	10.53
Deduction of income from certain specific business, industrial activities	2.57	0.66	0.04
House Rent Allowance (HRA)	0.14	0.38	1.25
Interest on Education and Home Loans	0.14	0.71	0.99
Interest Income from Savings Bank Account	0.00	0.77	1.41
Royalty Income	0.02	0.03	0.02
Senior Citizens	11.05	4.97	3.07
Women	8.55	3.18	0.00
Others (Employment Generation, Environmental Management, profits and gains from housing projects, infrastructure projects)	0.05	0.03	0.03
Total	100.00	100.00	100.00

Note: *-Excluding tax expenditures on Firms, AOPs & BOIs.

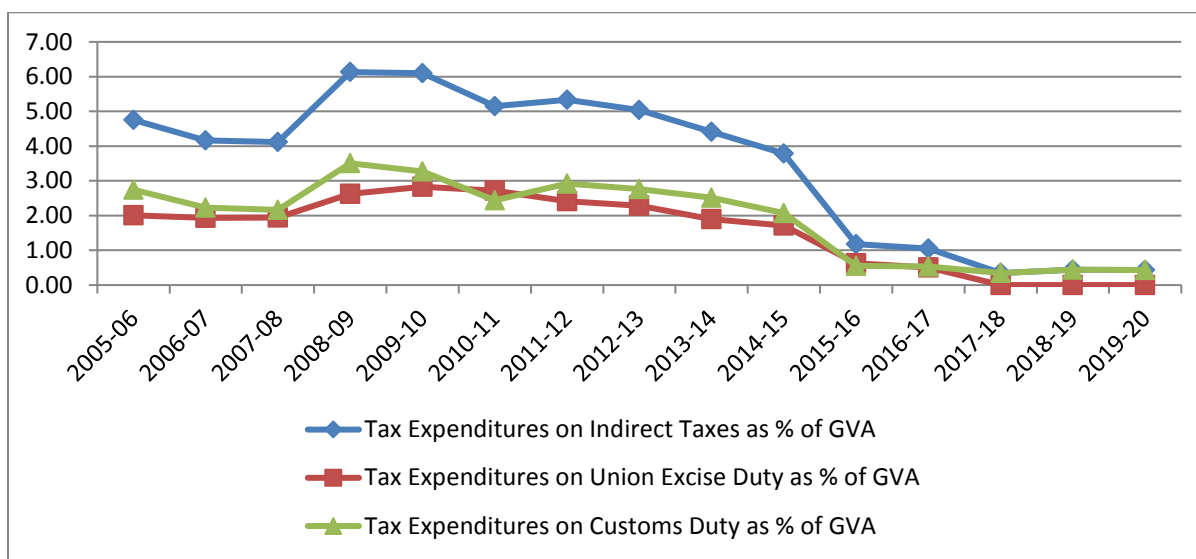
Source: Computed by author based on Union Budget Documents (various years)

2.2 Tax Expenditure on Indirect Taxes

The success of India in containing tax expenditures on indirect taxes is a remarkable achievement. However, it is to be noted that tax expenditures in the GST regime is yet to be assessed. As mentioned earlier, major reduction in tax expenditure on indirect taxes happened since 2015-16. This was possible, as India was preparing to roll out harmonized tax system on goods and services under the GST (Mukherjee 2021). Tax expenditure on indirect taxes (as % of GVA) has gone up from average of 4.3 per cent during Phase I (2005-06 to 2007-08) to 5.1 per cent in Phase II (2008-09 to 2014-15) and then fall to 0.7 per cent in Phase III (2015-16 to 2019-20) (Table 8). As discussed earlier the reductions of effective rates of UED and customs as a part of fiscal stimulus package to moderate the impacts of global financial crisis had impacts on rising tax expenditures on indirect taxes of the Union government during 2008-10 (Figure 12). Post Global Financial Crisis (GFC) successive Union budgets

raised standard rate of excise duty gradually to pre-GFC level,⁸ pruned down the exemption list and consolidated rate structure of excise duty (or CenVAT) to prepare for introduction of GST. This helped the government to contain tax expenditures on indirect taxes. However, containing tax expenditure on indirect taxes was slow during Phase II as compared to Phase III.

Figure 12: Tax Expenditures on Indirect Taxes (as % of GVA)



Notes: *-Indirect taxes include UED and Customs duty (including IGST and GST Compensation Cess on imports) only

**-Revenue from Customs Duty includes IGST and GST Compensation Cess on imports

Source: Computed by author based on Union Budget Documents (various years)

Tax expenditure on indirect taxes went up from average of 83.3 per cent of indirect tax collection (on account of UED and customs duty) during 2005-08 to average of 144.8 percent during 2008-15 (Table 8). The rise in tax expenditure during 2008-15 is the result of reductions in UED and customs duty rates as a part of fiscal stimulus measures adopted by the Union government to tackle GFC (Figure 13). Post GFC, the containing tax expenditure (as % of indirect tax revenue) was slow and as a result on average tax expenditure (as % of revenue from indirect taxes) was 144.8 per cent during Phase II. During 2015-20, average tax expenditure on indirect taxes fell to 17.5 per cent.

⁸ Please refer Para 177 of Budget Speech of the Union Budget 2012-13.

Table 8: Tax Expenditures on Indirect Taxes (% of GVA and Indirect Tax Revenue)

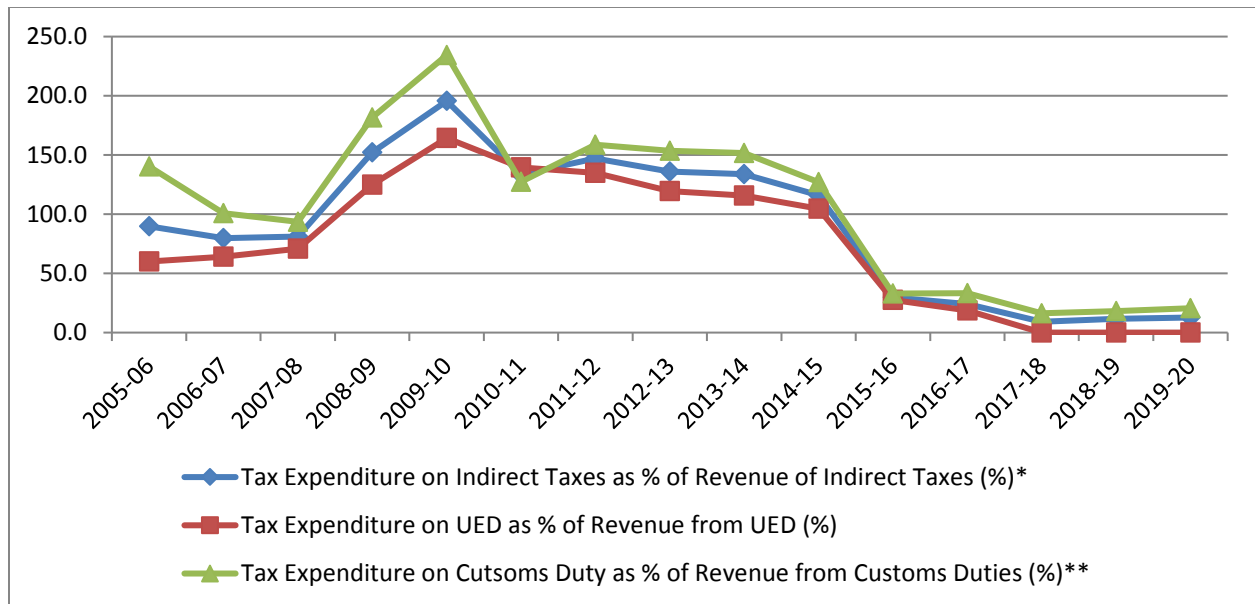
	2005-06 to 2007-08	2008-09 to 2014-15	2015-16 to 2019-20
Tax Expenditures on Indirect Taxes as % of GVA	4.3	5.1	0.7
<i>Tax Expenditures on Union Excise Duties (UED) as % of GVA</i>	2	2.4	0.2
<i>Tax Expenditures on Customs Duties as % of GVA</i>	2.4	2.8	0.5
Tax Expenditure on Indirect Taxes as % of Revenue of Indirect Taxes (%)*	83.3	144.8	17.5
<i>Tax Expenditure on UED as % of Revenue from UED (%)</i>	65	129.1	9.2
<i>Tax Expenditure on Customs Duty as % of Revenue from Customs Duty (%)**</i>	111	162	24.2
GTR-Selected as % of GVA	10.8	9.6	9.9

Note: *-Indirect Taxes include UED and Customs Duty (including IGST and GST Compensation Cess on Imports)

**.-Customs Duty includes IGST and GST Compensation Cess on Imports

Source: Computed by author based on Union Budget Documents (various years)

Figure 13: Tax Expenditures on Indirect Taxes (as % of Revenue from Indirect Taxes)



Notes: *-Indirect taxes include UED and Customs duty only

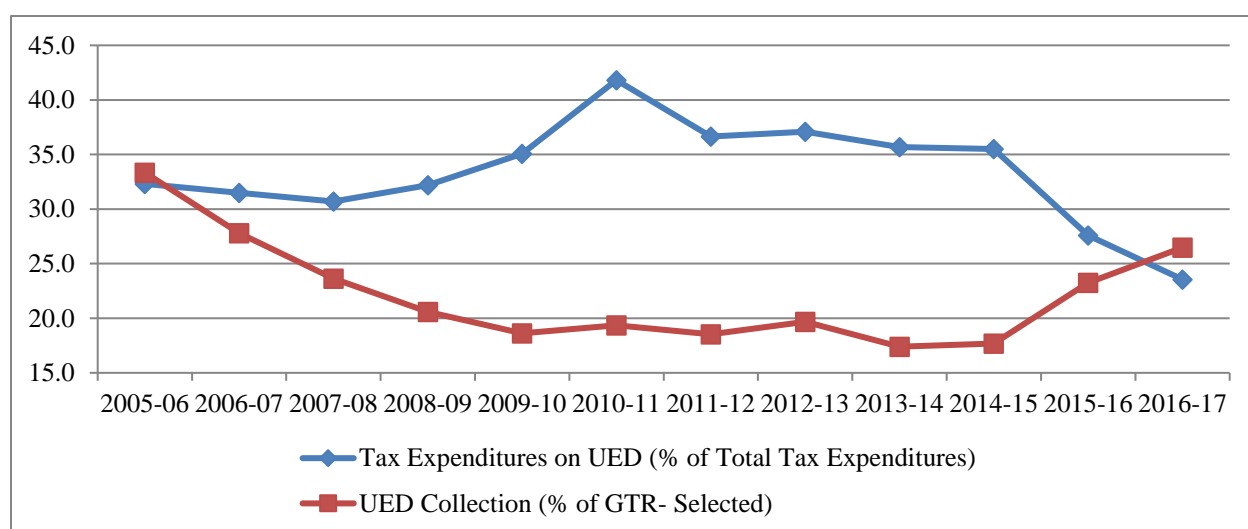
**.-Revenue from Customs duties includes GST on Imports

Source: Computed by author based on Union Budget Documents (various years)

2.2.1 Tax Expenditures on Union Excise Duty

On average UED contributes 22.2 per cent of GTR (selected taxes) during 2005-06 to 2016-17. The share of UED in GTR (selected) has gone up from average 18.8 per cent during Phase II (2008-15) to 24.9 per cent during 2015-17. Average share of tax expenditure on UED in total tax expenditure was 36.3 per cent during Phase II and it went down to 25.6 per cent during 2015-17 (Figure 14). After introduction of GST, UED is only applicable on three refined petroleum products (petrol, diesel, and aviation turbine fuel), compressed natural gas (CNG), and tobacco products. Broadly UED is subsumed into GST and since there is no comprehensive estimate of tax expenditure in the GST regime available yet, overall tax expenditure of the Union government is incomplete beyond 2016-17.

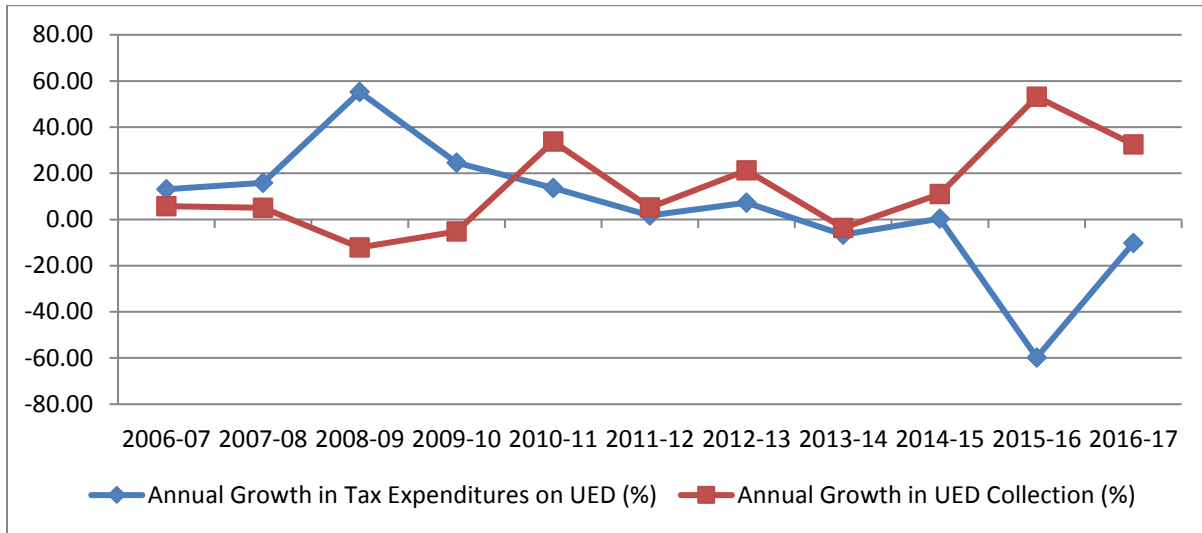
Figure 14: Tax Expenditure on UED and UED Collection



Source: Computed by author based on Union Budget Documents (various years)

During 2010-11 to 2014-15 annual growth rates in tax expenditure on UED and UED collection show similar movements which resulted in stability in tax expenditure on UED as percentage of UED collection (Figure 15). In 2015-16, growth rate in UED collection improved whereas growth rate in tax expenditure on UED has fallen, as a result we observe substantial fall in tax expenditure on UED. The rise in tax expenditure on UED in 2008-09 is related to reductions of effective tax rates of UED as part of fiscal stimulus measures adopted to moderate the impact of GFC on the economy. Higher tax expenditure coupled with negative growth in UED collection during 2008-10 resulted in rising tax expenditure on UED as percentage of UED collection.

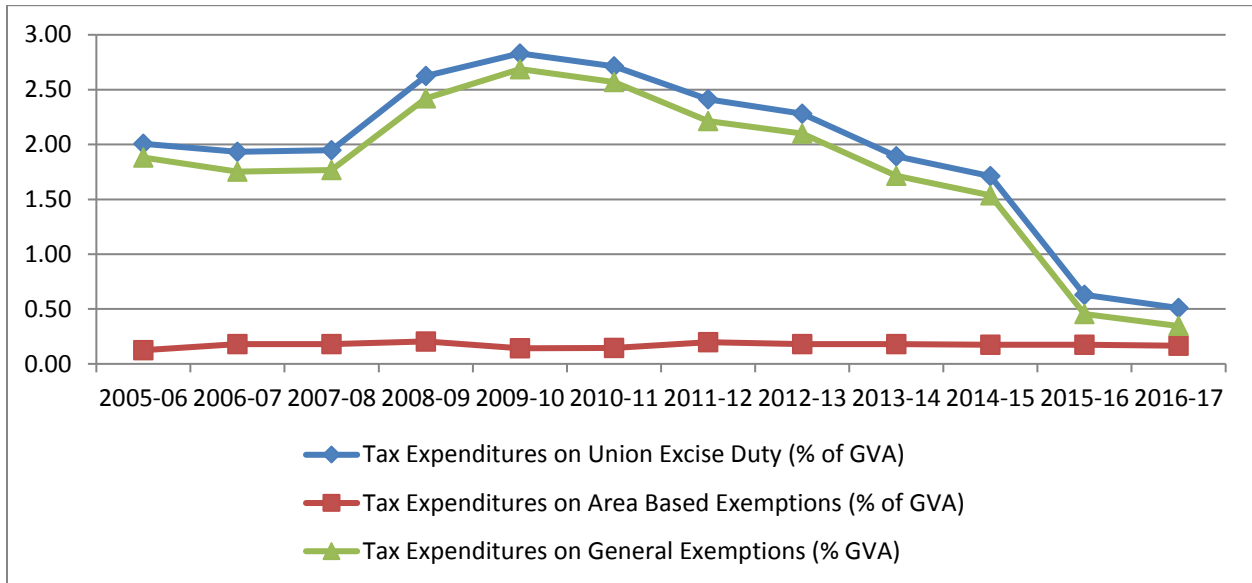
Figure 15: Annual Growth Rate in Tax Expenditure on UED and UED Collection



Source: Computed by author based on Union Budget Documents (various years)

Tax expenditures on Union Excise Duty (UED) consist of two components – general UED exemptions and area-based exemptions. General exemption has gone down from 2.69 per cent of GVA in 2009-10 to 1.54 per cent in 2014-15 and further to 0.35 per cent of GVA in 2016-17 (Figure 16). Average share of area based exemptions in total tax expenditure on UED remains stable at 7.87 per cent during 2005-15. However, it has gone up to average 30 per cent during 2015-17. The rise in the share of area based exemptions during 2015-17 is attributed falling share of general exemptions. In the GST regime, if the decision on any tax exemption/ incentive scheme is not taken by the GST council, the corresponding revenue impact is to be borne by the concerned government (the Union or state) offering tax incentive/ exemption scheme. To avoid the complication in determining tax liabilities and input tax credit adjustments, instead of upfront tax exemptions, tax refunds are provided where the refunds are adjusted with the respective share of the government responsible to offer the tax incentive/ exemption (Mehta and Mukherjee 2021).

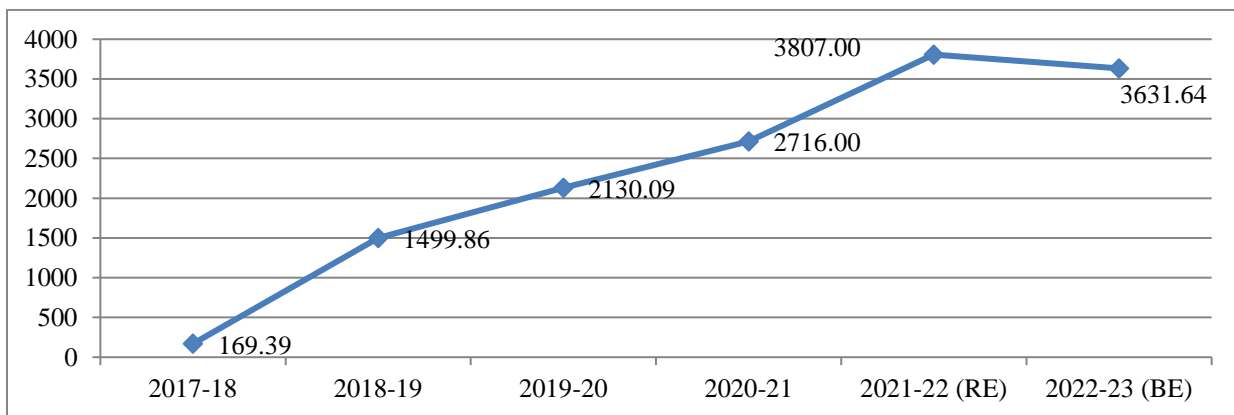
Figure 16: Tax Expenditure on UED (% of GVA)



Source: Computed by author based on Union Budget Documents (various years)

In the budget documents, the Union Government publishes the amount of refund issued against Central GST (CGST) and Integrated GST (IGST) (CGST portion) to industrial units located in North Eastern Region and Himalayan States. Figure 17 shows that tax expenditure on this account has gone up from Rs. 169.4 crore in 2017-18 to Rs. 3807 crore in 2021-22 (RE). During 2014-15 to 2016-17, average annual tax expenditure on area based UED exemption was Rs. 21,639 crore. Therefore, it is to be noted that there is substantial fall in tax expenditure on area based exemptions in the GST regime. Revenue foregone due to general tax exemptions in the GST regime is yet to be assessed.

Figure 17: Refund of Central GST (CGST) and Integrated GST (IGST) to industrial units located in North Eastern Region and Himalayan States (Rs. Crore).

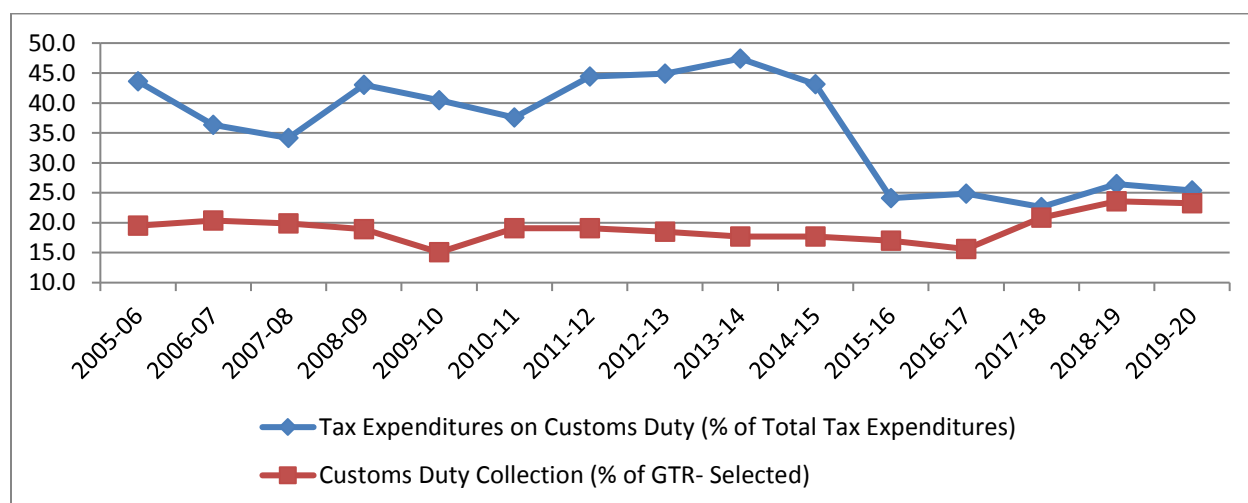


Source: Computed by author based on Union Budget Documents (various years)

2.2.2 Tax Expenditures on Customs Duty

On average customs duty contributes 19 per cent of GTR (selected taxes) during 2005-06 to 2019-20. Since Countervailing Duty (CVD, in lieu of equivalent UED on domestic production of goods) and Special Additional Duty on customs (SAD, in lieu of State taxes on domestic production of goods) have been subsumed into GST, we include GST collection on imports (Integrated GST or IGST and GST Compensation Cess) along with Basic Custom Duty (BCD) collection to make the series comparable. The share of tax expenditure on customs duty in total tax expenditure has gone down from average 43 per cent during Phase II to average 24.7 per cent during Phase III (Figure 18). Improvement in the share of customs collection (as % of GTR- selected) is observed in the GST regime.

Figure 18: Tax Expenditure on Customs Duty and Customs Duty Collection



Source: Computed by author based on Union Budget Documents (various years)

Tax expenditures on Customs Duty consist of two components – gross tax expenditures on customs duty and input tax neutralization or exemption schemes. To avoid exportation of taxes to destination countries, zero rating exports is a common practice across the world. Prior to introduction of GST in India, due to overlapping jurisdiction of indirect taxes between the Union and state governments, it was difficult to assess the burden of input taxes on exported goods and services (Mukherjee 2021). As a result various schemes were prevalent to provide access to duty free imports of inputs as well as capital goods to exporters, e.g., Advanced License Scheme, tax exemptions of inputs used for exports in Export Oriented Units (EOU), Electronic Hardware Technology Park (EHTP), Software Technology Park (STP), Special Economic Zone (SEZ), Export Promotion Capital Goods (EPCG) Scheme (duty free imports of capital goods), Duty Free Import Authorization Scheme, Duty Free Replenishment Certificate (DFRC), Duty Entitlement Pass-Book (DEPB) Scheme. In the GST regime, the following schemes are available for exporters to avoid exportation of taxes to destination countries:

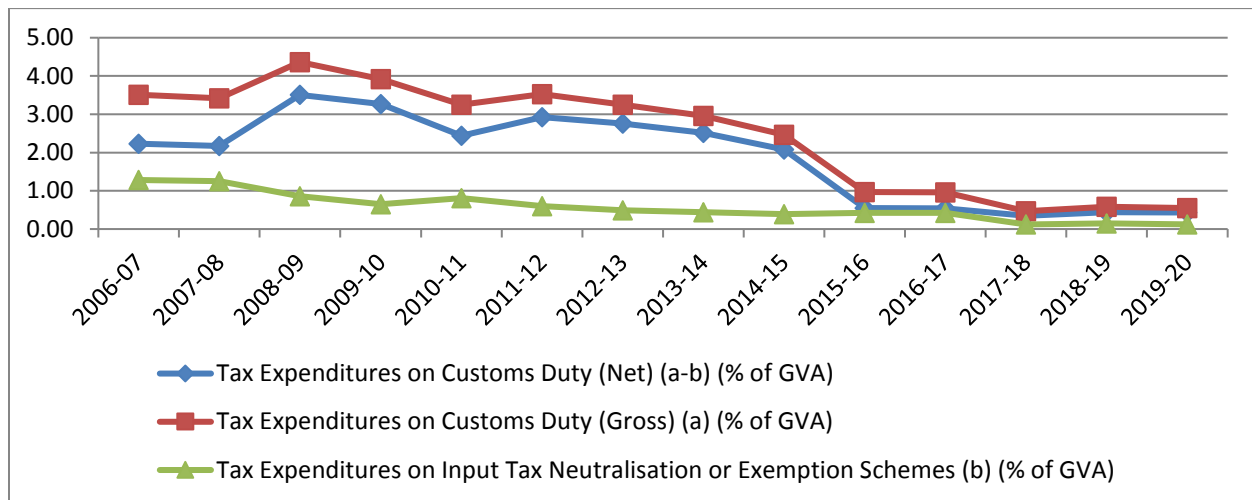
- LUT Bond Scheme – Exporters can export goods without paying any GST by obtaining a ‘Letter of Undertaking (LUT)’ bond.

- IGST Refund – Exporters can export goods on payments of ‘Integrated GST (IGST)’ and later, claim the refund for the same from the Customs Department.
- 0.1% GST Benefit for Merchant Exporters – Merchants can procure the export goods from domestic suppliers at 0.1% concessional GST rate.

In addition, Remission of Duties and Taxes on Export Products (RoDTEP) scheme is also rolled out since 1 January 2021 to ensure that the exporters receive the refunds on the embedded taxes and duties which are non-recoverable even in the GST regime (e.g., Mandi tax, State VAT, Coal cess, Central Excise duty on fuel, electricity duty etc.).⁹

Average tax expenditure on customs duty was around 2.7 per cent of GVA during 2005-15 (Figure 19). During 2015-20, average tax expenditure on customs duty has gone down to 0.5 percent of GVA (Table 8). This shows that gradually tax expenditure on customs duty has been reduced in India. Possibility of further reduction of tax expenditure on customs duty must be explored especially on items which are not covered under any free or preferential trade agreements / treaty (either bilateral or multilateral).

Figure 19: Tax Expenditures on Customs Duty (% of GVA)

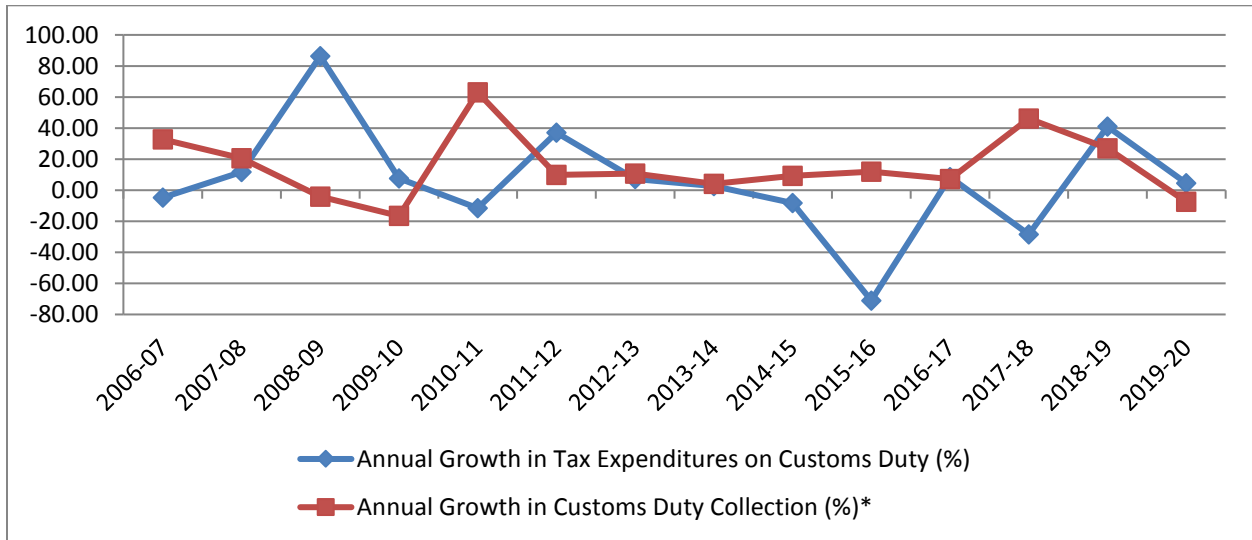


Source: Computed by author based on Union Budget Documents (various years)

During 2006-20, annual growth in customs duty collection falls below the annual growth in tax expenditure on customs duty for six years (2008-10, 2011-12, 2016-17, and 2018-20 (Figure 20). The impact of GFC was not only restricted to fall in tax collections but also rise in tax expenditures during 2008-10.

⁹ In addition there is Rebate of State & Central Taxes and Levies (RoSCTL) Scheme to exporters of readymade garments and made-ups. It is an export incentive scheme in the form of transferable and sellable duty credit scrips offered on the basis of the FOB value of the export. The Ministry of Textiles notified the introduction of RoSCTL in March 2019. It was followed by the release of the RoSCTL rate list and a CBIC notification on the scheme.

Figure 20: Annual Growth in Tax Expenditure and Tax Collection – Customs Duty

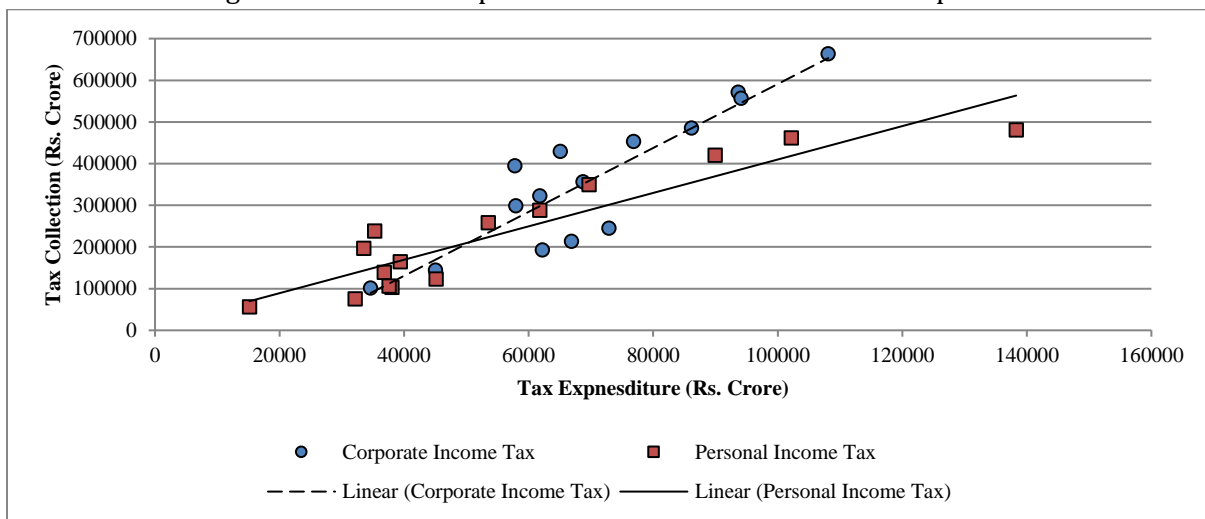


Note: *-includes GST on imports

Source: Computed by author based on Union Budget Documents (various years)

The relationship between tax expenditure and tax collection is yet to be explored in literature. Given the limited data points available for tax expenditure, we observe a positive relationship between tax collection and tax expenditure for CIT and PIT in India. This implies that tax incentives / exemptions may not necessarily reduce tax collection. Tax incentives/ exemptions may induce larger income generation, savings and investments which could help to increase tax base and therefore tax collection.

Figure 21: Relationship between Tax Collection and Tax Expenditure



Source: Computed by author based on Union Budget Documents (various years)

3. Conclusions

Providing tax incentives/ exemptions is global practice and India is not an exception. World's average tax expenditure on Personal Income Tax (both as % of tax revenue and GDP) is higher than tax expenditure on Corporate Income Tax (CIT). However, in India it is the opposite. Aggregate tax expenditure on Union taxes in India has gone down from 8.15 per cent of Gross Value Added (GVA) in 2008-09 to 1.69 per cent of GVA in 2019-20. Average annual tax expenditure was 6.43 per cent of GVA during 2006-15 and it has gone down to 1.76 per cent of GVA during 2015-20. Though tax expenditures in the GST regime is to be assessed, the fall in tax expenditure is observed both in direct as well as indirect taxes. The success of India in containing tax expenditure is a significant achievement which is not yet highlighted in Indian public finance literature.

Tax expenditure often viewed as a potential loss of tax revenue which otherwise would have been collected by the government. However, with fall in tax expenditures in India, we have not observed any improvement in tax collection (as % of GVA) in Union taxes during 2006-07 to 2019-20. Our preliminary finding shows that with larger tax expenditure on direct taxes (CIT and PIT), tax collections improve. Given the limitations of data, as we have only 15 data points, we cannot confirm statistical strength of the relationship between tax expenditure and tax collection. However, it will be important to explore the relationship between tax expenditure and tax collection in future research with larger availability of data, preferably from cross-country perspectives.

We observed significant rise in tax expenditures on indirect taxes during 2008-10 and it is attributed to cut in tax rates of Union Excise Duty (UED) and Customs Duty as part of fiscal stimulus measures adopted by the Union government to cope up with the global financial crisis (GFC). Therefore, any measure to provide fiscal stimulus by cutting effective tax rates may have revenue impact in terms of lower tax collection as well as rising expectations of taxpayers for tax incentives/ exemptions. With recovery of the economy, timely withdrawal tax exemptions/ incentives is important to achieve macroeconomic stability. However, often withdrawals of tax incentives take longer time and face resistance from taxpayers. Impact assessments of tax incentive/ exemption schemes are lacking in India and it would be important to initiate such assessments.

Reduction in tax expenditures on indirect taxes was slow post-GFC (during 2010-15). However, the introduction of Goods and Services Tax (GST) in India since 1 July 2017 helped the Union government to eliminate tax exemptions on UED. As a step towards introduction of GST, the Union government reduced tax expenditures on indirect taxes starting from 2015-16. Average annual tax expenditure on indirect taxes reduced from 4.7 per cent of GVA during 2010-15 to 0.7 percent during 2015-20. Though, comprehensive assessment of tax expenditures in the GST regime is awaited, available data shows that area based tax expenditures in the GST regime is much lower than pre-GST regime.

Prior to introduction of GST in India, due to overlapping jurisdiction of indirect taxes between the Union and state governments, it was difficult to assess the burden of input taxes on exported goods and services. As a result various schemes were mooted to provide access to duty free imports of inputs as well as capital goods to exporters. Consolidation of tax base of indirect taxes in the GST regime has facilitated zero rating of Indian exports. This has also helped to contain tax expenditures on customs duty.

In addition to overall reduction in tax expenditures, structural composition of tax expenditure has also undergone changes over the period of our analysis. This shows that priorities of the government change over time and tax incentives is one way to assess the priority of the government. Significant reduction in tax expenditures on direct taxes observed during 2010-15 whereas in indirect taxes it was during 2015-20. Average annual tax expenditure on Union taxes (as % of Gross Tax Revenue of selected taxes) has fallen from average of 70 per cent during 2006-10 to 61 per cent during 2010-15 and further to 18.4 per cent during 2015-20.

Cut in tax expenditure on Corporate Income Tax (CIT) helped to reduce the difference/ gap between statutory and effective CIT rate. However, tax expenditure on PIT (both as % of GVA and % of PIT revenue) shows a rising trend since 2014-15.

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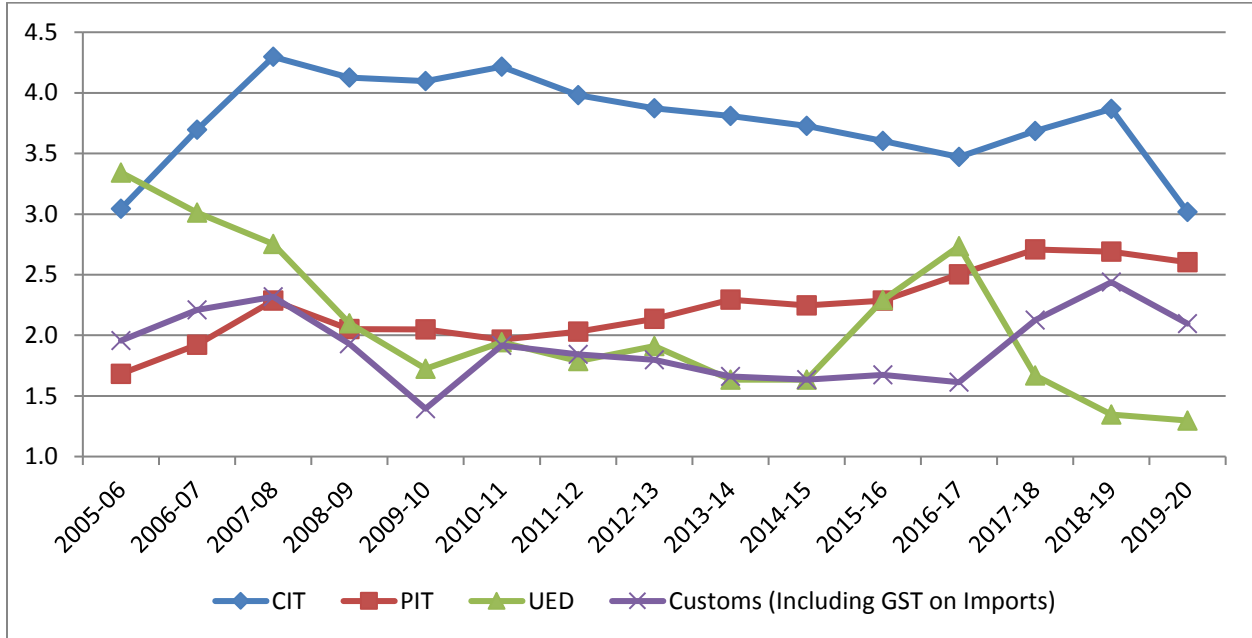
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Appendix

Figure A1: Trends in Tax Collections (% of GVA)



Source: Computed by author based on Union Budget Documents (various years)

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