The rationale for the tax proposals

Tax announcements in the Budget can be divided into two parts – proposals to provide incentives for specific sectors and general proposals

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The 2024-25 Budget is not just an account of receipts and expenditures for the financial year; it also sets the stage for several years in terms of expectations. Taking off from the analysis in the Economic Survey, the Budget identifies priority areas for government intervention. Key among these are employability and employment, and productivity and resilience in agriculture and infrastructure. The expenditure side of the Budget addresses many of these priorities. The proposals on taxes play a limited role in addressing these priorities. This article looks at the rationale behind a few of the tax proposals.

Two kinds of tax proposals

Tax announcements in the Budget can be divided into two parts - proposals to provide incentives for specific sectors and general proposals. The former is largely limited to announcements on changes in customs duties. For each of these announcements, the rationale is to protect domestic industry or encourage competition within it. One driver for this approach seems to be to create "national champions". Information on the policy framework for determining sectors and activities for such support could provide a predictable policy environment. The Finance Minister's announcement to undertake a comprehensive review of the rate structure provides comfort in this context.

Regarding the general proposals, two sets pique interest – first, those relating to capital markets and second, those relating to the differences between the old and new tax regimes.

The debate on personal income tax in India has often centred on the number of citizens who file returns and pay taxes. It has been argued that too few people pay taxes in India. Another emerging notion is the impact of growing income inequality on tax collections. A proposal for wealth tax of 2% on billionaires has been offered for discussion in the G20 summit in Brazil. The Economic Survey articulates this concern in terms of differential taxation of capital and labour income. The Budget proposes to address this concern through changes in taxes on capital gains. It proposes increase in both short-term and long-term capital gains. Further, on buyback of shares too, the receipts are now

Illustration of a citizen paying tax. GETTY IMAGES

to be taxed in the hands of the recipient as dividend.

High returns in capital markets, especially in the Futures and Options segments, have been flagged as a source of concern by the Reserve Bank of India and the Economic Survey. Apart from the uncertainty faced by retail investors, high returns are likely to induce a shift away from banking to capital markets. The Budget has proposed an increase in securities transaction tax on derivatives transactions. The revised regime on taxation of capital market transactions with all its components is likely to tone down the irrational exuberance in capital markets in the short term. This might be helpful in stabilising the market as a tool for raising resources for real investments.

Old and new tax regimes

Reform programmes of tax regimes have identified broadening of the tax base and elimination or reduction of tax incentives as primary elements, along with rationalisation of the rate structures. The inter-temporal nature of incentive regimes often renders elimination of tax incentives difficult. To address this concern, the government introduced the option of a simplified regime, where taxpayers do not have access to a range of exemptions and concessions with the advantage of a lower rate of tax. They have been offered a choice between the two regimes. It is hoped that over time, the old regime would become redundant.

In order to nudge taxpayers towards the new regime, the Budget introduces a few changes in tax policy. For individual tax payers, the standard deduction in the new regime has been raised from ₹50,000 to ₹75,000. This provision does not apply to the old regime. Similarly, the slabs associated with different income classes in the new regime have been expanded. In corporate income tax as well, there is a proposal to allow higher deduction of Provident Fund contributions by employers opting for the new regime, provided they adopt the National Pension System too.

The Finance Minister mentioned that 58% of corporate tax and over 66% of the returns in personal income tax came from the new regime. These are impressive numbers. There are two alternative numbers to consider. The share of the old regime in total income reported for corporate income tax increased from 38% in 2021-22 to 43% in 2022-23. Further, in the case of personal income tax, the ratio of revenue foregone to total revenue collected in 2021-22 was 24% and reduced only marginally to 23.33% in 2022-23. These numbers suggest, as one would expect, that taxpayers are choosing the lesser of the two taxes in choosing a regime. While it is benevolent of the government to provide such options, it would appear that the voluntary transition to the new regime could be fiscally costly, if repeated nudges in the form of reduced tax liabilities need to be offered. It is possible to argue that a prospective terminal date could be announced for the old regime, with limited options for grandfathering existing incentives. More so since alternative regimes do not simplify the choice architecture: for taxpayers, it is one more decision to consider.