

Since the mid-1990s, in keeping with the global orthodoxy, India's tax reforms followed a simple mantra: lower tax rates to improve compliance, as opposed to the earlier policies of raising tax rates (to 97% at the margin, during Indira Gandhi's time) which resulted in low compliance. This worked very well, and central tax collections rose from around 8.8% of GDP in 1990-2000 to 11.99 in 2007-08, before they fell in the face of the economic slowdown to 9.53% in 2009-10, and are now projected to rise to 10.38% in 2011-12. In the case of income tax collections, they rose from 1.31% of GDP in 1999-2000 to 2.07% in 2007-08, fell to 1.87% by 2009-10 and are slowly beginning to recover. The trend for most other direct taxes is similar; in the case of indirect taxes, the attempt has been to reduce them while growing direct taxes.

So it does come as a bit of a surprise to hear former finance minister P Chidambaram suggest that the time has come to raise tax rates. "I am the Finance Minister who slashed your tax rates", he told a gathering of industrialists, "... you must be prepared to pay higher tax rates, especially the rich must be prepared to pay higher tax". He then went on to talk of how, newspapers reported, rich people in Europe were getting together to ask that they be taxed more. The most famous example, though not in Europe, is of Warren Buffett saying that he pays taxes at a rate lower than that of his secretary.

Although soak-the-rich seems to be the new orthodoxy, it has to be appreciated that tax codes are vastly different in places like the US where large tax exemptions are provided for the rich. In India, on the other hand, since tax exemptions have been slashed for the better off, this is not the case. The only area where the rich get a big advantage appears to be in the case of dividends where, after a withholding tax of 18% is levied on companies giving out dividends, no tax is charged to the recipients—given this is lower than the marginal tax rates for the rich, this appears a big concession. But any attempts to go back to the pre-withholding tax days will be opposed by the taxman himself since a withholding tax is obviously easier to collect than chasing lakhs of individual investors.

Also keep in mind that while the top 5% of Indians account for a fourth of all incomes according to NCAER data, their tax contributions are a lot higher. According to FE columnist Surjit Bhalla, the tax compliance is the highest for the well-off/rich; the top 0.6% of taxpayers, Bhalla estimates, pay 5% of the total income tax collected; the top 1.5% of taxpayers pay 20% of overall income tax ...

The top 20% of the population accounts for 53% of India's income according to NCAER and according to senior tax officials, they account for 80% of income tax collections. And, yes, let's

## **End of Laffer**

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not forget the seriously rich also make investments that provide jobs for all of us. Soaking the rich makes for good rhetoric but poor policy.