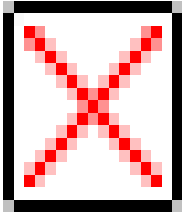


Personal Income Tax Liability Threshold Vs Per Capita Income: The India Story

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Income Tax (PIT) liability and how many met that compliance is generally reflected in the Income Tax Return (ITR) filings by taxpayers through ITR-1, ITR-2, ITR-3 and ITR-4, ITRs designed for individual taxpayers who have a PIT liability. Taken together, these 4 ITRs do the heavy lifting, as far as ITRs numbers go, for the Income Tax Department. Last FY, out of a total of 71.4 million ITRs, these 4 categories accounted for 68.4 million or 95.8% of the gross number of ITRs. For FY 2018-19, 19-20 and 20-21, the proportion stood at 95.6%, 95.8% and 93.44% respectively. The filing numbers have traditionally raised few questions principally whether the numbers reasonably match or correspond to the size of the country's population. One is generally persuaded to believe that either singly or in association with other elements, factors such as (a) constitutional bar on the central government and statutory exemption from imposing tax on agricultural income, a line of activity which engages more than half of the population (b) lack of research and attention to the tax challenges of a massive informal sector (c) general lack of awareness about legislation, regulation and tax administration, are germane to the low ITR filing. Persuasive as these reasons are, the asymmetry between the per capita income and threshold PIT liability has also emerged as one of the key determinants in any discussion on ITR filing.

Of course per capita income is not the lone factor driving the gross tax revenue or ITR filing behaviour, since other macro-economic factors such as adequacy of employment opportunities, scale and nature of industry sector where employment opportunities are opening up, education, inflation, corruption, trade and investment openness, structural strength and weakness of the tax administration and finally the tax rate do count in the eventual algorithm. However, among all the listed factors, per capita income has strong, natural and significant causal connection with tax revenue growth or retardation. Lotz and Mors (1967), Shin (1969), Purohit (2006) and Bahl (1971) in their researches have all confirmed to this strong causal correlation between per capita income and tax revenue. There is now a general consensus without exception that increase in per capita income provides the individual a stronger motivation and necessary wherewithal to file his ITR, pay taxes and get engaged in the taxation process.

Seen in this context, India's per capita income (globally ranked at 149th position among all countries) as per World Bank report of 2021 went up from USD 1,358 in 2010 to USD 2,277 in 2021 or from Rs 61,137 to Rs 1,66,676. In the same period, threshold levels of PIT liability rose from Rs 1,60,000 in FY 2010-11 to Rs 2,50,000 in FY 2020-21. If we factor in rebate of Rs 12,500 under section 87A for determining PIT liability for total income not exceeding Rs 5,00,000 vide Finance Act 2020, there is zero PIT liability for a total income not in excess of INR 5,00,000. Measured as paired co-factors, PIT liability threshold which stood at 2.60 times of per capita income in 2010 is close to 3 times (300%) of per capita income in 2021.

Contrast India's position with few random selection of advanced economies and emerging economies and how their PIT liability stack up against their per capita income:

Country	Per Capita Income In USD- 2021	Threshold PIT in USD- 2021	Threshold PIT as a % of per capita income
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Singapore	64,010	14,400	22
Australia	56,760	12,558	22
Israel	49,560	22,446	45
China	11,890	5,400	45
Japan	42,620	14,040	33
Cambodia	4,683	3,744	74
Bangladesh	2,620	3,300	126

It is undeniable that there are serious policy implications in devising PIT liability thresholds in the manner these are crafted, and more so in the context of socio-political needs and economic compulsions of developing and lower middle income countries, and in the manner the burden ratios of individual PIT liability while incrementally pushing the tax revenue growth are worked out in a manner that they do not adversely impact the minimum livelihood requirements or exceed the tolerance range of taxpayers. This is the underlying ratio behind configuring PIT thresholds across all economies. High and upper middle income economies and developed economies generally have a threshold PIT sufficiently below their per capita income range, while emerging economies including lower middle and low income jurisdictions have an altogether different matrix of constructing the threshold PIT liability. Size of the population, any perceived porosity in its institutional frameworks, largeness of its informal sectors and above all, basic economic compulsions would have contributed, as in India's case in devising a typical threshold PIT much higher than the country's per capita income. Furthermore, capacity of the tax administration to ensure that tax legislations on PIT are enforced with due rigour including factoring in costs on monitoring compliance behaviour, automation of processes and setting up institutional arrangements for a very large size pool of individuals is a critical design driver in fixing threshold levels of PIT liability.

Summing up, PIT liability threshold allows for rudimentary levels of consumption and frees low income individuals from PIT. On average, in low income developing countries, an individual needs to earn 1.3 times of its GDP per capita to be liable for PIT contrary to 0.8 times for emerging economies and 0.2 times for developed economies. Though an outlier to the general rules for decoding the relationship between PIT threshold and per capita income, India did have its special socio-economic reasons and a typical dispensation for devising a PIT threshold level almost 3 times its per capita income. While this, apart from other compelling factors, explains the present lower volume of ITR filing, international experience tells us that as India's economy gets bolstered and per capita income rises, tax base on which PIT is levied also expands with corresponding refinements in institutional arrangements and technological enablement by the tax administrators and higher quality policy design for integrating a larger mass of taxpayers to the taxation process. Till such time, the per capita income must be allowed to creep closer to the existing PIT liability threshold before we start off on a fresh review of the threshold.