



## Determinants of Less Direct Tax Revenue Collection in India

### KEYWORDS

Direct Tax, Tax-GDP Ratio, Factor Analysis, Tax

\* Prof. Dinesh Sharma

Mohd Arif

Professor, Department of Commerce, University of Lucknow, Lucknow, \* Corresponding Author

Research Scholar, Department of Commerce, University of Lucknow, Lucknow

**ABSTRACT** Direct taxes constitute the most important source of government revenue in developing countries like India. But when we compare our direct tax revenue collection from the developed and emerging countries, it is quite low. The combined direct tax revenue collection was Rs. 7,48,643 crore only in 2014-15 (combined direct tax-GDP ratio was 5.81%). There may be a several reasons for the same. The present study is an attempt to evaluate the factors which may be responsible for less direct tax revenue collection in India

### Introduction

In today scenario, the Government has assumed several responsibilities. To discharge their duties, they need to perform various activities. These activities required huge public expenditure. To meet this expenditure, huge public revenue is required. Taxes constitute the main source of public revenue. It is a sharp-edged weapon which promotes socio-economic transformation and cohesion in the country. A tax is a financial charge or other levy imposed on an individual or a legal entity by a state or a functional equivalent of a state. In the view of Dalton, taxes have an effect on growth and development by shifting and change of the supply of the resources. It is the backbone of Government functioning.

The taxation power between Union and State is assigned according to the provisions of Constitution. The Article 265 of the Indian Constitution states that no tax shall be levied or collected except by the authority of law. The Article 246 of the Indian Constitution distributes legislative powers between the Central and State Government. Schedule VII of the Constitution describe the detail division of function and resources with the use of three Lists i.e., List I [Union List], List II [State List] and List III [Concurrent List].

The taxes may be classified into direct and indirect taxes. J S Mills has been used the term incidence of taxation to differentiate them. He stated that if the incidence of tax is rest upon the same person who also bear its impact, known as direct tax (Personal Income Tax, Corporation Tax, Security Transaction Tax, Employment Tax etc). On the other hand if the incidence of tax is passed to another person is called indirect tax (Excise Duty, Custom Duty, VAT, Service Tax etc). A tax system is called well structured if the proportion of direct tax should be more than indirect tax. So, it can be said that direct taxes has a significant impact on Government revenue and people. In 2014-15, the direct tax (combined) revenue collection was Rs. 7,48,643 crore while direct tax (gross) was Rs. 7,36,221 crore. The total tax-GDP ratio was 17.38% in 2014-15. The combined direct tax-GDP ratio was 5.81% while the gross direct tax-GDP ratio was 5.67% in 2014-15. As per the Economic Survey 2015-16, the ratio of taxpayers to GDP will have to rise to 23%. Further, the survey reveals that India's tax-GDP ratio is much lower than the emerging market economy average of 21% and OECD average of 34%. According to the Paying Taxes 2016 report published by PwC, India has 157 ranks in Overall Paying Taxes in the world.

### Objective of the Study

The objective of the present study is to evaluate the factors which are responsible for less direct tax revenue collection in India.

### Research Methodology

The present study is analytical in nature and based on primary and secondary data. The primary data was collected by circulating a questionnaire in Lucknow, Kanpur, Allahabad, Bareilly and Ghaziabad Cities of U.P. to 500 respondents. Out of 500 questionnaires, only 478 questionnaires were found valid for further analysis. The factor analysis and one sample statistics has been used to analyze the factors.

### Analysis and Interpretation

Direct taxes are one of the important sources of Government revenue. But when we compare our direct tax revenue collection & tax-GDP ratio from the developed countries, it is quite low. The reason behind this may be a lot. Some people have opinions that direct tax department is not working efficiently while some people claim that there is a high tax evasion and avoidance. Political factors, poor compliance, cumbersome process, mammoth legislations, lack of awareness etc. are also contributed toward less direct tax revenue collection in India. Besides these, the coverage/percentage of tax assessee (approx. 3%) may be a reason for lower direct tax collection. So, there are numerous reasons for less direct tax collection in India. In this study 8 determinants (factors) has been taken which may be responsible for less direct tax revenue collection in India. These factors are Lack of Laws and Rules, Inefficiency of Tax Department, High Tax Evasion and Avoidance, Complicated Procedure, Less Collection Effort, Corruption, Too Many Tax Incentives and Exemption, and Low Tax Base. Respondents are asked to rate all 8 determinants on Likert 5-Scale. Further these determinants are systematically reduces to few by using Exploratory Factor Analysis. Further each determinant is analyzed through one sample t-test with test value 3.

### KMO and Bartlett's Test of Sphericity

Table 1 exemplifies the value of KMO which is 0.874, lies in the range of great category. So we can say that sample is adequate for the application of factor analysis. The Bartlett's test of sphericity has a chi-square value of 4326.9 with significance value of 0.000 which is less than the critical value ( $p < 0.05$ ). It indicates that all the factors are different and normally distributed.

Kaiser-Meyer-Olkin Measure of Sampling Adequacy	0.874	
Bartlett's Test of Sphericity	Approx. Chi-Square	4326.9
	df	28
	Sig.	0.000
<b>Sources:</b> Based on author Calculation		

**Exploratory Factor Analysis**

An exploratory factor analysis is used to identify the small number of factor/s that can be used to represent the inter-relationships among the variables. Basically it reduces the large number of studied variable into meaningful factors on the basis of some common characteristic. An exploratory factor analysis using the Principal Component Analysis (PCA) method with varimax rotation is performed on the reasons for less direct tax revenue collection. The value of communalities and total variance explained are depicted below.

	Communalities		Component
	Initial	Extraction	
Lack of Laws and Rules	1	0.810	0.900
Inefficiency of Tax Department	1	0.873	0.934
High Tax Evasion and Avoidance	1	0.252	0.502
Complicated Procedure	1	0.882	0.939
Less Collection Effort	1	0.866	0.931
Corruption	1	0.760	0.872
Too Many Tax Incentives and Exemption	1	0.702	0.838
Low Tax Base	1	0.777	0.882
Extraction Method: PCA			
a. 1 components extracted			
<b>Sources:</b> Based on author Calculation			

Table 2 exemplifies the value of communalities before and after extraction. Before extraction, the value of communalities for all factors is 1 because of PCA method assumption. After extraction, the values of communalities reflect the proportion of variance caused by that factor. In our case, all the reasons have high value of communalities except High Tax Evasion and Avoidance (0.252). The reason Complicated Procedure shared 88.20% variance followed by 87.30% variance by Inefficiency of Tax Department.

Table 3 exemplifies the Eigenvalue of the factors before extraction and after extraction. A factor/s that has an Eigenvalue less than 1 should be eliminated from the further analysis. In this case, before extraction 74.02% of total variance is explained by one factor. After extraction and rotation, we found that only one factor has an Eigenvalue greater than 1 [5.922]. This factor is accounted for 74.02% of total variance. So this factor is retained for further analysis and other variables are eliminated.

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
	Lack of Laws and Rules	5.922	74.029	74.029	5.922	74.029
Inefficiency of Tax Department	0.975	12.185	86.214			
High Tax Evasion and Avoidance	0.332	4.146	90.36			
Complicated Procedure	0.244	3.044	93.404			
Less Collection Effort	0.207	2.582	95.987			
Corruption	0.139	1.735	97.722			
Too Many Tax Incentives and Exemption	0.107	1.343	99.065			
Low Tax Base	0.075	0.935	100			

Extraction Method: PCA.

**Sources:** Based on author Calculation

The component matrix (table 2) exemplifies the factor loading for each variable onto each factor using PCA method. The rotated component matrix shows the loading of 8 variables on one extracted factor. The extracted factor comprises all 8 variables i.e., Lack of Laws and Rules (0.900), Inefficiency of Tax Department (0.934), High Tax Evasion and Avoidance (0.502), Complicated Procedure (0.939), Less Collection Effort (0.931), Corruption (0.872), Too Many Tax Incentives and Exemption (0.838) and Low Tax Base (0.882). After analyzing the nature of all these reasons, it can be grouped under the term **Complex and Inefficient Direct Tax System**. This is also supported by the various studies that present income tax laws and rules have many loopholes which provide opportunities for tax evader and avoider to reduce their tax liabilities. So the main reason for less direct tax collection is Complex and Inefficient Direct Tax System.

Table 4 exemplifies that all the factors taken under this study except Too Many Tax Incentives and Exemption (2.47) have a mean value greater than 3. This indicates that respondents have an opinion that all the factors taken under this study except Too Many Tax Incentives and Exemption are the reasons for lower direct tax collection in India.

Reasons	N	Mean	Rank	S.D	Std. Error Mean	t	Sig. (2-tailed)
Lack of Laws and Rules	478	3.53	3	0.89	0.041	13.05	0.000

Inefficiency of Tax Department	478	3.35	5	1.11	0.051	6.81	0.000
High Tax Evasion and Avoidance	478	4.33	1	1.01	0.046	28.86	0.000
Complicated Procedure	478	3.48	4	1.10	0.050	9.49	0.000
Less Collection Effort	478	3.28	6	1.08	0.049	5.62	0.000
Corruption	478	4.27	2	1.16	0.053	23.93	0.000
Too Many Tax Incentives and Exemption	478	2.47	8	1.04	0.048	-11.16	0.000
Low Tax Base	478	3.12	7	1.21	0.055	2.20	0.028
<b>Source:</b> Primary Data							

Further the data reveals that High Tax Evasion & Avoidance (4.33) is the most important reason for less direct tax collection followed by Corruption (4.27). The factor Lack of Laws and Rules (3.53) got the third rank while Complicated Procedure (3.48) got fourth rank as the reason for lower direct tax collection. The least contributing factor is Too Many Tax Incentives and Exemption (2.47) which got last rank in the list. The respondents have an opinion that providing Too Many Tax Incentives and Exemption is not a reason of lower direct tax collection. The standard deviations of the factors are close to 1 which indicates that data are normally distributed. The significant value of t-test is less than 0.05 for all factors taken under this study. It means what we have stated above is true and significant. These factors are responsible for lower direct tax collection in India.

### Conclusion

In developing countries like India, the Direct taxes are the key driver of economic development. The various studies reveal that the direct tax revenue collection in India is comparatively less as compared to developed and emerging market. The present study concludes that the main reason for less direct tax revenue collection is Complex and Inefficient Direct Tax System. Further the mean analysis and t-test reveals that the factors taken under this study except Too Many Tax Incentives and Exemption are the reasons for less direct tax revenue collection in India. So, the Government should restrict, remove or mitigate the impact of above factors especially High Tax Evasion & Avoidance and Corruption to improve the direct tax collection.

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