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# The Curious Case of Tax Inequality

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A developing country is a country with a less developed industrial base and a low Human Development Index (HDI) relative to other countries. The term low and middle-income country (LMIC) is often used interchangeably but refers only to the economy of the countries. Developing country needs more support from the government than the developed one. The needs and the demography of both the countries are different.

Based on the market and economic growth, the countries are bifurcated into developed countries/market and developing countries/market. By the nature of its name, developing countries term imply inferiority of such countries as compared to developed one. Such differentiation asks for difference in treatment when it comes to financial aid, economic reforms, and incentive in taxation regime. The world bank classifies the world economies into four different groups and these group is based on the gross per capita national income. These groups are:

## India, an emerging economy, and emerging inequality:

India falls into the category of developing countries. Post covid recovery is stunning as the economy is already aiming expansion of GDP to the tune of 9%, as estimated by International Monetary Fund (IMF)[1]. Stock market also zoomed and registered biggest ever gain in a single financial year. Goods and Service Tax (GST) collection constantly soaring high and crossing the mark of Rs. 1 trillion every month. Income Tax recovery is also inspiring, and which is giving enough breather to government to recover the unprecedented fiscal deficit this year. Barring few months, the output of the core sector is also showing revival signs.

Where everything seems colorful and wonderful, various report doing the rounds which indicates the rising inequality of India. India being a developing country, cannot afford rising inequality because it has direct impact on:

- The income of individual
- Consumption

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- Reduced demand
- Less indirect tax collection (being regressive in nature)
- Burden on the government finance

According to reports by Oxfam, the number of Indian billionaires grew during 20-21 from 102 to 142, almost many listed companies reported unprecedented profits, thanks to lower tax regime and pent-up demands. On the contrary to this, the said reports claimed that 84% of Indian household saw an income decline amid the pandemic. It is a hard truth that the pandemic has brought us here at the juncture of inequality. Unequal access to incomes and opportunities does more than create unjust, unhealthy, and unhappy societies.[2]

According to this reports, top 100 wealthy Indian families have 98% of the wealth generated by all Indian households. **Wealth of the richest 98 same as bottom 552 million** . This suggests the rising inequalities. Every pandemic follows this suit I.e., rising inequality. The reason being the wealthy can whether the shock better and with the readily available capital they can bounce back easily. The same pandemic which makes rich richer, makes poor poorer because they do not have enough corpus to cope up with the life living.

The origin country of covid, China has already put in the various measures to tackle the case of rising inequality. Such measures include non-profit organization for education, increased pay for the low skill workers at the cost of the profit of the company, mandating banks to maintain profit in a single digit to foster the credit culture. China being an autocratic country, can take such measures as they don't need to pass laws and regulations which makes it decision making process easy and early.

However, India cannot follow this blindly as we are a democratic country and cannot rule the decision-making process of the companies and individual. However, the country can pay heed to the taxation regime based on what United States is about to apply I.e., taxing the top richest in the country.

The report of Oxfam claims that 4 per cent tax on the wealth of 98 billionaires can fund the mid-day meal programme for 17 years. A 1 per cent wealth tax would be enough to take care of the total expenditure for school education and literacy or fund the government health insurance scheme Ayushman Bharat for more than seven years.

**Warren Buffet taxed at lower rate than his employees:**

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This veteran investor back in 2011 had pointed out this inequality. This is because he mostly earns from the stocks, and which is taxed at around 17.4 % and his employees who earns salary income is on an average taxed 36%. The rate difference is almost double which is startling. The money he made is from the prudent investments he has made and only gains are taxed and not otherwise. Capital gain is often taxed at less rate than any other source of income.

Recently, Joe Biden proposed plan to tax these gains at higher tax. The plan, intend to tax such money earned from the sale of assets such as stocks or property -- at 25%, up from 20% under current law Including a 3.8% Medicare surtax on high earners, the top capital gains rate would be 28.8%. Also, this plan target to tax those who earned more than 1 billion dollars.

Tax rate of 28.8% is still lower than the highest tax rate of 43.4% in the country.

**India is not the exception to this rule:**

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India along with the other countries follows the same suit of lower tax for capital gain. Generally, the assets on which such capital gains are paid includes shares, gold, silver, real estate and mutual funds. In India, long term capital gains of shares taxed at 10% and short-term capital gains are taxed at 15%. So, taxes on shares are more generous and the same needs reconsideration.

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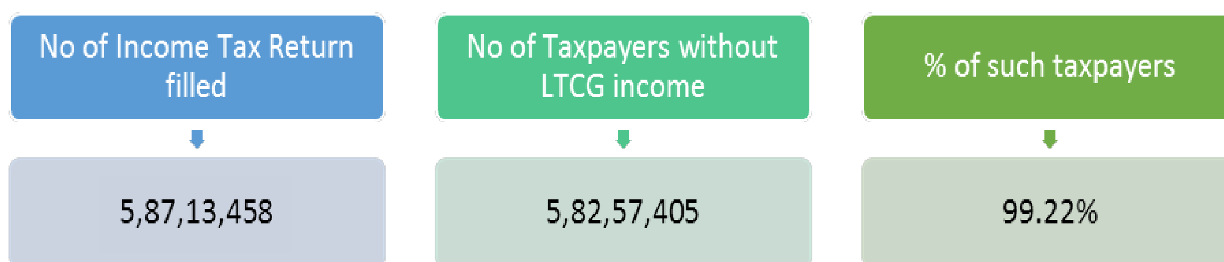
**Let us look at the source wise income distribution:**

| Head of Income | Income | % To total income |
|---|---|---|
| Salary Income | 20,04,070 | 37.54% |
| House Property Income | 62,765 | 1.18% |
| Business Income | 24,36,953 | 45.65% |
| Long Term Capital Gains | 1,42,033 | 2.66% |
| Short Term Capital Gains | 89,456 | 1.68% |
| Other Sources Income | 6,03,307 | 11.30% |
| **Total Income** | **53,38,584** | |

So, around 2.66% of the taxpayers are having long term capital gain income which is taxed at generous rate of 10%, with indexation benefit. Higher tax rate on the super-rich will even have less percentage if we consider the income earners with income exceeding Rs. 100 Crore. The discussion which we have considered here will be mostly affect the very minority portion of Indian household. Majority income earners are from salary and business income which has higher average rate of taxation.

**Let us look at the data declared by the Income Tax department for AY 18-19, with reference to long term capital gain income**[3]:

"About 99.22% Indian household does not have income from long term capital gain source."




If you break the data in detail to analyze as to what is the range of income offered in this income head and what is the tax collected, we get another surprise!

| Range of Income offered | No of Returns | Sum of LTCG (In INR Crore) | % To total income declared |
|---|---|---|---|
| **Till 1 Crore** | 443,988 | 31,521 | 22.19% |
| **From 1 Crore to 10 Crore** | 10,834 | 27,654 | 19.47% |
| **From 10 Crore to 100 Crore** | 1,114 | 28,536 | 20.09% |
| **From 100 Crore to 500 Crore** | 98 | 19,829 | 13.96% |
| **From 500 Crore** | 19 | 34,493 | 24.29% |
| **Total** | **456,053** | **142,033** | |

Out of the long-term capital gain income of Rs. 142,033 crores, about 38% of such income comes from high net worth individual i.e., who earns more than 100 Crore a year. This scenario is not different when we consider the short-term capital gain income. Remarkably, this data is of the AY 2018-19 i.e., pre pandemic scenario.

So, various reports doing the rounds about raising inequality believes to be true, then this scenario would have been even worse off in post pandemic scenario. Also, with GST collection soaring all time high,

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which is a regressive tax i.e., burden fall on to the consumer rather than the producer, there is no doubt that rich become richer and poor become poorer.

Many countries have higher capital gains tax rate for individual. Report of PwC shows the applicable capital gain tax rate as follows[4]:

| **Country** | **Tax Rate** |
|---|---|
| Brazil | 22.5% |
| Canada | 50% of capital gain is taxed at applicable tax rate |
| China | 20% |
| Finland and France | 34% |
| Israel | 25% |
| United States | 20% |

**Conclusion:**

So, considering the rising inequality, India can consider the suggestions to increase the tax rate on the long-term capital gains on the super-rich individuals i.e., say earners with income greater than Rs. 100 crore or other way like capital gain income of more than Rs. 10 crores can be taxed at higher rate in the form of surcharge. Such surcharge can be used to address the question of inequality. Companies are anyway enjoying the lower taxation regime ever but such low tax rate on the company can be justified as they generate employment, make capital investment, and hence keep the heart of economy beating.

This curious case of unequal taxation may not bring home the folly of following western concepts in India blindly. This upcoming budget is such opportunity for India to address the question of inequality with the help of taxing the super-rich. If one believes that increase rate of long term capital gain will be turn off for the investors, then prudent investors never scrap the good investment for minor tax impact.

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[1] IMF cuts India’s economy growth forecast to 9% in FY22 (msn.com)

[2] Inequality kills | Oxfam International

[3] IT-Return-Statistics-Assessment-Year-2018-19.pdf (incometaxindia.gov.in)

[4] Capital gains tax (CGT) rates (pwc.com)