

Revenue foregone under the Central Tax System: Financial Years 2006-07 and 2007-08

Introduction

The main objective of any tax system is to raise revenues to fund Government expenditures. The amount of revenue raised is determined to a large extent by tax bases and tax rates. It is also a function of a range of measures – special tax rates, exemptions, deductions, rebates, deferrals and credits – that affect the level and distribution of tax. These measures are sometimes called “tax preferences”. They have an impact on Government revenue (i.e. they have a cost) and reflect the policy choices of the Government.

Tax preferences may be viewed as subsidy payments to preferred taxpayers. Such implicit payments are referred to as “tax expenditures” and it is often argued that they should appear as expenditure items in the Budget. In this context, the basic issue is not one of tax policy but one of efficiency and transparency – programme planning requires that the policy objectives be faced explicitly; and programme budgeting calls for the inclusion of such outlays under their respective programme headings. Tax expenditures are spending programmes embedded in the tax statute.

A tax expenditure or a revenue foregone statement was laid before Parliament for the first time during Budget 2006-07 by way of annexure-12 of the Receipts Budget. It was well received by all quarters and gave rise to a constructive debate on the entire gamut of issues concerning fiscal policy. It also lent credence to the Government’s intention of bringing about transparency in the matter of tax policy and tax expenditures.

The second edition of this statement was placed before Parliament during Budget 2007-08 by way of annexure-12 of the Receipts Budget and also by way of a separate budget document titled “Statement of Revenue Foregone”

Like in the earlier two years, this Statement seeks to list the revenue impact of tax incentives or tax subsidies that are a part of the tax system of the Central Government. The revenue foregone on account of such tax incentives has been estimated in respect of most items of tax preferences. The estimates are for financial year 2006-07, the most recent year for which data is available. However, an attempt has also been made to estimate the revenue loss during financial year 2007-08 on the basis of the revenue foregone figures of the financial year 2006-07 or the actual figures for 2007-08 (April-September).

The estimates of the tax expenditures have been made on the basis of the following assumptions:-

- (a) The estimates and projections are intended to indicate the potential revenue gain that would be realised by removing exemptions, deductions, weighted deductions and similar measures. The estimates are based on the short-term impact analysis. They are developed assuming that the underlying tax base would not be affected by removal of such measures. To the extent the behaviour of economic agents, overall economic activity or other Government policies could change along with the elimination of the specific tax preference, the revenue implications could be different.
- (b) The cost of each tax concession is determined separately, assuming that all other tax provisions remain unchanged. Many of the tax concessions do, however, interact with each other. Strictly, the interactive compounded impact of tax incentives could turn out to be different from the revenue foregone calculated by adding up the estimates and projections for each provision.

The assumptions and methodology adopted to estimate the revenue foregone on account of different tax incentives are indicated at the relevant places in this Statement.

Direct Taxes

The Income-tax Act, inter alia, provides for tax incentives to promote savings by individuals; exports; balanced regional development; creation of infrastructure facilities; employment; donations for charity and rural development; scientific research and development; and the cooperative sector. Accelerated depreciation is also provided as an incentive for capital investment. Most of these tax benefits can be availed of by both corporate and non-corporate taxpayers. This Statement attempts to estimate some of the major tax expenditures.

A. Corporate Sector

Large business is mainly organised as companies. The Income-tax Department has received 3,28,061 corporate returns electronically up to 31st December, 2007 for the financial year 2006-07 [i.e. assessment year 2007-08]. These returns constitute about 90% of the total corporate returns expected in financial year 2007.08. For the purposes of estimating the tax expenditure, data pertaining to these 3,28,061 companies was culled out from the database for analysis.

The data was analysed and the following facts emerged:-

- The sample companies reported Rs. 5,56,190 crore as profits before taxes (losses were reported by about one-third of the sample) but declared a total income (taxable income)¹ of Rs. 3,41,606 crore only during the financial year 2006-07 **(for filing in financial year 2007-08)**.
- These sample companies paid Rs. 1,14,316 crore as corporate tax [**inclusive of surcharge and education cess**] during the same financial year.
- These companies also paid Rs. 4,251 crore as Fringe Benefit Tax and Rs. 9,674 crore as Dividend Distribution Tax during the year.

Table 1 profiles the sample companies across profit range. **The effective tax rate² of the entire sample was 20.60 per cent** [marginally more than the 19.26 per cent clocked in 2005-06], **which was substantially lower than the statutory tax rate of 33.66 per cent.** Companies with profits before taxes [PBT hereafter] of Rs. 500 crore and above – a total of 150 – accounted for 54.80 per cent of the total PBT and 54.15 per cent of the total corporate income tax payable. However, their effective tax rate was only 20.30 per cent in comparison to an effective tax rate of 25.40 per cent for sample companies having PBT of up to Rs. one crore.

The ratio of total income to PBT is much higher (72.50 per cent) for companies with PBT of up to Rs. one crore than that for the total sample (61.42 per cent). This indicates lesser deviance from PBT in the case of relatively smaller companies as compared to larger companies because of higher tax concessions being availed of by the latter.

**Table 1: Profile of sample companies across range of profits before taxes
(financial year 2006-07) [sample size - 328061]**

Sl. No.	Profit Before Taxes	Number of Companies	Share in Profits Before Taxes (in %)	Share in Total Income (in %)	Share in Total Corporate Income Tax Payable	Ratio of Total Income to Profits Before (in %)	Effective Tax Rate (in %)
1	Less than Zero	103706	0.00	0.33	0.25	-	-
2	Zero	30690	0.00	4.34	1.75	-	-
3	Rs 0-1 Crore	174827	3.31	3.90	4.08	72.50	25.40
4	Rs 1-10 Crore	14900	8.02	7.91	8.12	60.57	20.80
5	Rs 10-50 Crore	2824	10.64	9.60	10.02	55.40	19.40
6	Rs 50-100 Crore	489	6.17	5.44	5.74	54.14	19.10
7	Rs 100-500 Crore	475	17.05	14.75	15.89	53.11	19.20
8	Greater than Rs 500 Crore	150	54.80	53.73	54.15	60.22	20.30
9	All Sample Companies	328061	100.00	100.00	100.00	61.42	20.60

The figures in Table 1 clearly indicate that the companies in the middle of the distribution i.e those having PBT between 10 and 500 crore, are the ones paying the least tax. The effective tax rates of these companies are less than that of the entire sample.

Table 2 profiles the sample companies across effective tax rates. Companies with average effective rate of less than 20 per cent accounted for 51.42 per cent of total profits before taxes but only 22.59 per cent of total taxable income and 24.38 per cent of total taxes paid. In other words, a large number of companies (1,76,552) contributed a disproportionately lower amount in taxes in relation to their profits. Interestingly, 1,01,447 companies accounting for 16.22 per cent of total profits and 31.65 per cent of the total taxes, had an effective tax rate of greater than the statutory rate. **Therefore, the tax liability across companies is unevenly distributed. This is primarily due to the various tax preferences in the statute.**

**Table 2: Profile of sample companies across range of effective tax rate*
(financial year 2006-07) [sample size - 328061]**

Sl. No.	Effective tax rate (in %)	Number of Companies	Share in Total profits (in %)	Share in Total Income (in %)	Share in Total Tax Payable (in %)
1	Less Than Zero and Zero	120076	4.35	0.71	0.25
2	0-20	56476	47.07	21.88	24.13
3	20-25	9195	10.81	12.52	12.10
4	25-30	11432	7.88	10.97	10.70
5	30-33.66	29435	13.67	20.93	21.17
6	>33.66	70756	16.22	28.64	29.90
7	Indeterminate	30691	0.00	4.34	1.75
8	All Sample Companies	328061	100.00	100.00	100.00

* Effective tax rate is inclusive of surcharge and education cess.

Table 3 compares the effective tax rate of public companies [PSUs only] with that of private companies. While the rate is lower than the statutory rate for both categories, it is evident that the public companies pay a larger proportion of their profits as tax than the private companies. Thus, the private sector entails much larger tax expenditure for the Government.

**Table 3: Effective tax rate* of sample companies in the public and private sectors
(financial year 2006-07) [sample size - 328061]**

Sl.	Sector No.	Number of Companies	Share in total profits (in %) payable (in %)	Share in total tax (in %)	Effective tax rate
1	Public	2158	27.25	30.97	23.35
2	Private	325903	72.75	69.03	19.50
	Total	328061	100.00	100.00	20.60

* Effective tax rate is inclusive of surcharge and education cess.

Table 4 shows a comparison between the effective tax rate of the manufacturing sector and the service sector in respect of the sample companies. Interestingly, while the manufacturing sector has a higher effective tax rate and is paying more tax than the service sector, both the sectors have an effective tax rate that is way below the statutory rate of 33.66 per cent.

**Table 4: Effective tax rate* of sample companies in the manufacturing and service sectors
(financial year 2006-07) [sample size - 328061]**

Sl. No.	Sector	Number of Companies	Share in total profits (in %)	Share in total tax payable (in %)	Effective tax rate (in %)
1	Manufacturing	99280	53.27	56.78	21.91
2	Service	228781	46.73	43.22	19.01
	Total	328061	100.00	100.00	20.60

* Effective tax rate is inclusive of surcharge and education cess.

The industry-wise distribution of effective tax rate of companies is given in the Table in the Appendix. A perusal of the same reveals that while the effective tax rate of almost all the industries is below the statutory level, it is the lowest for the IT Enabled Services Providers & BPO Service Providers and Software Development Agencies at 7.36 per cent and 6.38 per cent respectively. **The two industries contributed 6.18 per cent of the total profits but only 2.08 per cent of the total taxes.**

The tax foregone on each tax concession claimed by the sample companies has been calculated by applying the corporate tax rate of 33.66 per cent on the amount of each deduction. The revenue foregone on account of accelerated depreciation; deduction/weighted deduction for expenditure on scientific research; and deduction for expenditure on eligible projects/schemes for social and economic uplift of the public has been calculated by first determining the difference between the depreciation/deduction debited to the profit and loss accounts by companies and the depreciation/deduction allowable under the Income-tax Act. Thereafter, the corporate tax rate of 33.66 per cent has been applied to this difference to arrive at the revenue foregone figure.

Even though only 90 per cent of all companies are covered by the sample companies, the revenue foregone on account of these sample companies has been taken to be the total revenue foregone in the corporate sector. To this extent the revenue foregone may be an underestimate.

Based on the revenue foregone figures for financial year 2006-07, the revenue foregone during the current financial year, i.e. 2007-08, has been estimated. The estimation for 2007-08 has been done by calculating the ratio of revenue foregone on each tax incentive in 2006-07 to the actual corporate tax collected in the year [Rs. 1,44,318 crore] and then applying the same ratio to the revised estimates of corporate tax collections in 2007-08 [Rs. 1,87,970 crore]. Table 5 depicts the major tax expenditures on corporate taxpayers in terms of revenue foregone during the financial years 2006-07 and 2007-08.

**Table 5: Major tax expenditure on corporate tax payers during
financial years 2006-07 and 2007-08 [sample size - 328061]**

Sl. No.	Nature of incentive	Revenue Foregone (in Rs. Crore) [2006-07]	Revenue Foregone (in Rs. Crore) [2007-08]
1	Deduction of export profits of STPI units (section 10A)	9121	11880
2	Deduction of export profits of EHTP units (section 10A)	89	116
3	Deduction of export profits of units located in SEZs (section 10A and 10AA)	553	720

SI. No.	Nature of incentive	Revenue Foregone (in Rs. Crore) [2006-07]	Revenue Foregone (in Rs. Crore) [2007-08]
4	Deduction of export profits of units located in EPZs (section 10A)	57	74
5	Deduction of export profits of units located in FTZs (section 10A)	22	29
6	Deduction of export profits of Export Oriented Units [EOUs] (section 10B)	3054	3978
7	Deduction of export profits of units manufacturing items of artistic value (section 10BA)	3	4
8	Accelerated Depreciation (section 32)	7396	9633
9	Deduction/weighted deduction for expenditure on scientific research (section 35 (1), (2AA) &(2AB))	1554	2024
10	Deduction for expenditure on eligible projects or schemes for the social and economic uplift of the public (section 35AC)	36	47
11	Deduction on account of donations to charitable trusts and institutions (section 80G)	1530	1993
12	Deduction on account of donations for scientific research or rural development (section 80GGA)	1	1
13	Deduction on account of contributions to political parties (section 80GGB)	1	1
14	Deduction of profits of certain industrial undertakings or a ship or a hotel business (section 80-I)	Nil	Nil
15	Deduction of profits of undertakings engaged in development of infrastructure facilities (section 80-IA)	1247	1624
16	Deduction of profits of undertakings engaged in development of SEZs and Industrial Parks (section 80-IA)	132	172
17	Deduction of profits of undertakings engaged in providing tele communication services (section 80-IA)	5052	6580
18	Deduction of profits of undertakings engaged in generation, transmission and distribution of power (section 80-IA)	4613	6008
19	Deduction of profits of undertaking engaged in revival of power plant (section 80-IA)	273	356
20	Deduction of profits of undertakings engaged in development of SEZs in pursuance to SEZ Act, 2005 (section 80-IAB)	139	181
21	Deduction of profits of industrial undertakings operating in the small-scale sector (section 80-IB)	240	313
22	Deduction of profits of industrial undertakings located in Jammu & Kashmir (section 80-IB)	136	177
23	Deduction of profits of industrial undertakings located in industrially backward States other than Jammu & Kashmir (section 80-IB)	715	931
24	Deduction of profits of industrial undertakings located in backward districts (section 80-IB)	519	676
25	Deduction of profits of industrial undertakings derived from multiplex theatre and convention centre (section 80-IB)	10	13
26	Deduction of profits of industrial undertakings derived from development of scientific research (section 80-IB)	31	40
27	Deduction of profits of industrial undertakings derived from production of mineral oil (section 80-IB)	5248	6835

Sl. No.	Nature of incentive	Revenue Foregone (in Rs. Crore) [2006-07]	Revenue Foregone (in Rs. Crore) [2007-08]
28	Deduction of profits of industrial undertakings derived from housing projects (section 80-IB)	839	1093
29	Deduction of profits of industrial undertakings derived from operating a cold chain facility (section 80-IB)	5	7
30	Deduction of profits of industrial undertakings derived from integrated business of handling, storage and transportation of food grains (section 80-IB)	19	25
31	Deduction of profits of industrial undertakings derived from processing, preservation and packaging of fruits and vegetables (section 80-IB)	10	13
32	Deduction of profits of industrial undertakings derived from hospital in rural area (section 80-IB)	1	1
33	Deduction of profits of undertakings set-up in North Eastern States (section 80-IC)	760	990
34	Deduction of profits of undertakings set-up in Sikkim (section 80-IC)	9	12
35	Deduction of profits of undertakings set-up in Uttaranchal (section 80-IC)	517	673
36	Deduction of profits of undertakings set-up in Himachal Pradesh (section 80-IC)	1055	1374
37	Deduction of profits from business of collecting and processing of bio-degradable waste (section 80JJA)	7	9
38	Deduction in respect of employment of new workmen (section 80JJAA)	20	26
39	Deduction in respect of certain incomes of Offshore Banking Units [OBUs] and International Financial Services Centre [IFSC] (section 80LA)	20	26
	TOTAL	45034	58655

While the revenue foregone figure for 2006-07 was estimated last year to be Rs. 50,075 crore, it has now been estimated at Rs. 45,034 crore, which is 10 per cent lower. A notable feature of Table 6 is the increase in the revenue foregone on account of accelerated depreciation from Rs. 641 crore only in 2005-06 to Rs. 7,396 crore in 2006-07. This sharp increase is probably an indicator of higher new investment made by companies during the year.

B. Non-Corporate [Firms/AOPs/BOIs] Sector

Apart from the corporate sector, large business is also organised as partnership firms; and Association of Persons [AOPs] or Body of Individuals [BOIs]. The tax expenditure on these is not as large as that in case of companies. For the purposes of estimating the tax expenditure, data pertaining to 3,32,246 firms/AOPs/BOIs was culled out from the database of the Income-tax Department. Till 31st December, 2007, 3,32,246 firms/AOPs/BOIs had filed their returns electronically. They account for about 90 per cent of the tax paid by the universe of firms/AOPs/BOIs in financial year 2006-07.

The data was analysed and the following facts emerged:-

- The sample firms/AOPs/BOIs reported Rs. 38,363 crore as profits before taxes (losses were reported by about one-third of the sample) but declared a total income (taxable income) of Rs. 27,809 crore only during the financial year 2006-07 (**for filing in financial year 2007-08**).
- These sample firms/AOPs/BOIs paid Rs. 8,819 crore as income tax [**inclusive of surcharge and education cess**] during the same financial year. The effective tax rate³ in their case works out to 22.99 per cent.
- These firms/AOPs/BOIs also paid Rs. 473 crore as Fringe Benefit Tax during the same financial year.

The tax foregone on each tax concession claimed by the sample firms/AOPs/BOIs has been calculated by applying the income tax rate of 33.66 per cent on the amount of each deduction. The revenue foregone on account of accelerated depreciation; deduction/

weighted deduction for expenditure on scientific research; and deduction for expenditure on eligible projects/schemes for social and economic uplift of the public has been calculated by first determining the difference between the depreciation/deduction debited to the profit and loss accounts by firms/AOPs/BOIs and the depreciation/deduction allowable under the Income-tax Act. Thereafter, the income tax rate of 33.66 per cent has been applied to this difference to arrive at the revenue foregone figure.

Even though the sample firms/AOPs/BOIs account for only 90 per cent of all such entities in terms of taxes paid, the revenue foregone on account of these sample firms/AOPs/BOIs has been taken to be the total revenue foregone in this sector. To this extent the revenue foregone may be an underestimate.

Based on the revenue foregone figures for financial year 2006-07, the revenue foregone during the current financial year, i.e. 2007-08, has been estimated. The estimation for 2007-08 has been done by calculating the ratio of revenue foregone on each tax incentive in 2006-07 to the actual income tax collected in the year from firms/AOPs/BOIs [Rs. 9,499 crore] and then applying the same ratio to the revised estimates of income tax collections in 2007-08 [Rs. 12,781 crore]. Table 6 depicts the major tax expenditures on non-corporate taxpayers in terms of revenue foregone during the financial years 2006-07 and 2007-08. As can be seen, the highest tax expenditure is on account of deduction under section 80-IB of the Income-tax Act.

Table 6 : Major tax expenditure on sample firms/AOPs/BOIs during financial years 2006-07 and 2007-08 [sample size - 332246]

SI. No.	Nature of incentive	Revenue Foregone (in Rs. Crore) [2006-07]	Revenue Foregone (in Rs. Crore) [2007-08]
1	Deduction of export profits of STPI units (section 10A)	45	61
2	Deduction of export profits of EHTP units (section 10A)	Nil	Nil
3	Deduction of export profits of units located in SEZs (section 10A and 10AA)	150	202
4	Deduction of export profits of units located in EPZs (section 10A)	11	15
5	Deduction of export profits of units located in FTZs (section 10A)	6	8
6	Deduction of export profits of Export Oriented Units [EOUs] (section 10B)	300	404
7	Deduction of export profits of units manufacturing items of artistic value (section 10BA)	20	27
8	Accelerated Depreciation (section 32)	434	584
9	Deduction/weighted deduction for expenditure on scientific research (section 35 (1), (2AA) &(2AB))	1	1
10	Deduction for expenditure on eligible projects or schemes for the social and economic uplift of the public (section 35AC)	8	11
11	Deduction on account of donations to charitable trusts and institutions (section 80G)	87	117
12	Deduction on account of donations for scientific research or rural development (section 80GGA)	Nil	Nil
13	Deduction on account of contributions to political parties (section 80GGC)	Nil	Nil
14	Deduction of profits of certain industrial undertakings or a ship or a hotel business (section 80-I)	Nil	Nil
15	Deduction of profits of undertakings engaged in development of infrastructure facilities (section 80-IA)	66	89
16	Deduction of profits of undertakings engaged in development of SEZs and Industrial Parks (section 80-IA)	11	15
17	Deduction of profits of undertakings engaged in providing telecommunication services (section 80-IA)	2	3
18	Deduction of profits of undertakings engaged in generation, transmission and distribution of power (section 80-IA)	2	3

Sl. No.	Nature of incentive	Revenue Foregone (in Rs. Crore) [2006-07]	Revenue Foregone (in Rs. Crore) [2007-08]
19	Deduction of profits of undertaking engaged in revival of power plant (section 80-IA)	Nil	Nil
20	Deduction of profits of undertakings engaged in development of SEZs in pursuance to SEZ Act, 2005 (section 80-IAB)	2	3
21	Deduction of profits of industrial undertakings operating in the small-scale sector (section 80-IB)	72	97
22	Deduction of profits of industrial undertakings located in Jammu & Kashmir (section 80-IB)	239	322
23	Deduction of profits of industrial undertakings located in industrially backward States other than Jammu & Kashmir (section 80-IB)	151	203
24	Deduction of profits of industrial undertakings located in backward districts (section 80-IB)	67	90
25	Deduction of profits of industrial undertakings derived from multiplex theatre and convention centre (section 80-IB)	3	4
26	Deduction of profits of industrial undertakings derived from development of scientific research (section 80-IB)	Nil	Nil
27	Deduction of profits of industrial undertakings derived from production of mineral oil (section 80-IB)	3	4
28	Deduction of profits of industrial undertakings derived from housing projects (section 80-IB)	681	916
29	Deduction of profits of industrial undertakings derived from operating a cold chain facility (section 80-IB)	1	1
30	Deduction of profits of industrial undertakings derived from integrated business of handling, storage and transportation of food grains (section 80-IB)	1	1
31	Deduction of profits of industrial undertakings derived from processing, preservation and packaging of fruits and vegetables (section 80-IB)	13	17
32	Deduction of profits of industrial undertakings derived from hospital in rural area (section 80-IB)	1	1
33	Deduction of profits of undertakings set-up in North Eastern States (section 80-IC)	78	105
34	Deduction of profits of undertakings set-up in Sikkim (section 80-IC)	1	1
35	Deduction of profits of undertakings set-up in Uttaranchal (section 80-IC)	65	87
36	Deduction of profits of undertakings set-up in Himachal Pradesh (section 80-IC)	225	303
37	Deduction of profits from business of collecting and processing of bio-degradable waste (section 80JJA)	1	1
38	Deduction in respect of certain incomes of Offshore Banking Units [OBUs] and International Financial Services Centre [IFSC] (section 80LA)	Nil	Nil
39	Deduction of profits of cooperative societies (section 80P)	266	358
	TOTAL	3013	4054

C. Individual Taxpayers

Chapter VI A of the Income-tax Act primarily provides for deduction on certain payments; and deduction on certain incomes. Individual taxpayers are eligible to claim these deductions and have a wide range of tax preferences available to them. However, since 50 per cent of the individual taxpayers derive their income primarily from salaries, the profit-linked deductions [i.e. deduction on

certain business incomes] are not claimed by them. On the other hand, the group of non-salaried individuals claims both types of deductions.

The revenue foregone under various sections of chapter VI A of the Income-tax Act has been estimated on the basis of various claims for tax preferences in the 6,27,182 returns filed electronically by individuals with the Income-tax Department till 31st December, 2007. The revenue foregone on account of the various tax benefits granted to individual taxpayers is presented in Table 7.

Based on the revenue foregone figures for financial year 2006-07, the revenue foregone during the current financial year, i.e. 2007-08 has been estimated. This estimation has been done by calculating the ratio of revenue foregone on each tax incentive in 2006-07 to the actual income tax collected in the year from individual taxpayers [Rs. 65,593 crore] and then applying the same ratio to the estimated income tax collections from individuals in 2007-08 [Rs. 87,858 crore].

Apart from chapter VI A, the other major tax expenditure on individual taxpayers in the financial year 2006-07 was the higher basic exemption limits for senior citizens (individuals aged 65 years or more) and women (other than senior citizens).

The revenue foregone on account of higher basic exemption limits, as aforesaid, has been calculated by multiplying the revenue foregone per senior citizen and woman with their respective numbers. Their respective numbers have been estimated by calculating the percentage of sample returns filed by them. Thereafter, this percentage has been applied to the total number of returns filed by individuals for financial year 2006-07. The total sample returns filed electronically with the Income-tax Department till 31st December, 2007 is 6,27,182.

As per data collected from the field formation of the Income-tax Department, the total number of returns filed by individuals for financial year 2005-06 was 2,42,14,698. This was an increase of only 0.15 per cent over the returns filed for financial year 2004-05. Applying the same nominal growth rate, the total number of returns for financial year 2006-07 was calculated to be 2,42,87,841.

According to the sample returns, 6 per cent of the total returns were filed by senior citizens and 25 per cent of the balance returns were filed by women. Thus, the number of senior citizens availing the higher exemption limit of Rs. 1,85,000 is 14,57,270. Similarly, the number of women [who are not senior citizens] availing the higher exemption limit of Rs. 1,35,000 is 57,07,643. The revenue foregone per senior citizen is Rs. 12,240 as the tax liability (including education cess) on an income of Rs. 1,85,000 is Rs. 12,240. Similarly, the revenue foregone per woman (who is not a senior citizen) is Rs. 3,570 as that is the tax liability on an income of Rs. 1,35,000.

The estimates for 2007-08 have been done by assuming a 5 per cent growth in number of returns filed by senior citizens and women for financial year 2007-08 over what was filed for financial year 2006-07. Further, the revenue foregone on account of each senior citizen and woman [who is not a senior citizen] has been calculated by taking into account the higher basic exemption limits [Rs. 1,95,000 and Rs. 1,45,000, respectively] and the additional levy of one per cent of secondary and higher education cess. The resultant figures are Rs. 13,390 and Rs. 3,605 respectively. Thereafter, the revenue foregone on account of each such taxpayer has been multiplied with their numbers.

Table 7 depicts the major tax expenditures on individual taxpayers in terms of revenue foregone during the financial years 2006-07 and 2007-08.

Table 7: Major tax expenditure on individual taxpayers during the financial years 2006-07 and 2007-08

Sl. No.	Nature of incentive/deduction	Revenue Foregone (in Rs. Crore) [2006-07]	Revenue Foregone (in Rs. Crore) [2007-08]
1	Deduction on account of certain investments and payments (section 80C)	22134	29647
2	Deduction on account of contribution to certain pension funds (section 80CCC)	178	238
3	Deduction on account of contribution to the New Pension Scheme (section 80CCD)	18	24

SI. No.	Nature of incentive/deduction	Revenue Foregone (in Rs. Crore) [2006-07]	Revenue Foregone (in Rs. Crore) [2007-08]
4	Deduction on account of health insurance premium (section 80D)	496	664
5	Deduction on account of expenditure for medical treatment of a dependent who is disabled (section 80DD)	127	170
6	Deduction on account of expenditure for medical treatment of specified diseases (section 80DDB)	21	28
7	Deduction on account of interest on loan taken for higher education (section 80E)	38	51
8	Deduction on account of donations to charitable trusts and institutions (section 80G)	326	437
9	Deduction on account of rent paid for housing accommodation (section 80GG)	59	79
10	Deduction on account of donations for scientific research or rural development (section 80GGA)	4	5
11	Deduction on account of contributions given to political parties (section 80GGC)	2	3
12	Deduction of profits of undertakings engaged in development of infrastructure facilities, SEZs and Industrial Parks, generation of power, and providing telecommunication services (section 80-IA)	43	58
13	Deduction of profits of undertakings engaged in development of SEZs in pursuance to SEZ Act, 2005 (section 80-IAB)	2	3
14	Deduction of profits of industrial undertakings derived from housing projects, production of mineral oil, development of scientific research, integrated business of handling, storage and transportation of food grains and of industrial undertakings located in Jammu & Kashmir and in other backward areas (section 80-IB)	1167	1563
15	Deduction of profits of undertakings set-up in North Eastern States, Sikkim, Uttaranchal and Himachal Pradesh (section 80-IC)	612	820
16	Deduction of profits from business of collecting and processing of bio-degradable waste (section 80JJA)	2	3
17	Deduction of professional income of authors of text books in Indian languages (section 80QQA)	Nil	Nil
18	Deduction of royalty income of authors of certain books other than text books (section 80QQB)	10	13
19	Deduction of royalty income on patents (section 80RRB)	Nil	Nil
20	Deduction in case of a person with disability (section 80U)	69	92
21	Higher exemption limit for senior citizens	1784	2049
22	Higher exemption limit for women	2038	2160
	TOTAL	29130	38107

It is evident from the table that the tax expenditure on account of investments in various savings instruments; repayment of housing loan and payment of tuition fees for children [section 80C of the Income-tax Act] is the single largest tax expenditure in case of individual taxpayers. As regards profit-linked deductions, the highest tax expenditure is on account of section 80-IB of the Income-tax Act. Further, the revenue foregone on account of higher basic exemption limits for senior citizens and women are also significant.

Indirect Taxes**A. Excise duties**

Excise duty is levied as per the rates specified in the First and Second Schedules to the Central Excise Tariff Act, 1985. There are some other duties such as Additional Excise duty, National Calamity Contingency duty and Education Cess that are also levied as duties of excise. In many cases, the various Finance Acts specify the rates at which these duties should be levied. The rates specified in various enactments are known as the "tariff" rates of excise duty. Government has been delegated powers under Section 5A(1) of the Central Excise Act, 1944 to issue notifications in public interest to exempt any goods from excise duty either wholly or partially. This implies that the Central Government may prescribe duty rates lower than what are prescribed in the Schedules. These rates prescribed by notifications are known as the "effective" rates.

Accordingly, the revenue foregone is the difference between duty that would have been payable but for the issue of the notification, and the actual duty paid in terms of the relevant notification. Therefore:

$$\text{Revenue foregone} = \text{Value} \times (\text{Tariff rate of duty} - \text{Effective rate of duty})$$

In case of goods subjected to specific rates of duties, the revenue foregone figures are obtained by substituting the value by quantity. Duty foregone is, thus, zero if tariff rate is equal to the effective rate.

A beginning was made in the 2006-07 budget to estimate the revenue foregone for 2004-05 and 2005-06. Estimates were based on information relating to the value of clearances obtained from periodic returns filed by duty paying units, as also the SERMON database - the system that captures data on the basis of entries made by field formations in 23 different zones of Central Excise. However, the data was not comprehensive due to some limitations. Firstly, units which make only exempted goods, are not registered and are not required to file any returns with the department. As such, no data was available in respect of clearances by such units. Secondly, in the absence of comprehensive computerization, it was found difficult to estimate the revenue foregone with a great degree of accuracy.

In the 2007-08 budget, as a result of improved data validation by the SERMON software, the revenue foregone figure for 2006-07 was estimated with greater accuracy, compared to the previous years. The estimates were arrived at based on actuals for April-September, when SERMON captured about 81 percent of the revenue collection. The estimates for the full year were arrived at assuming that the same pattern of coverage also applies to the remaining 19 per cent and for the full year. The revised duty foregone for 2006-07, however, is different from the estimates. This is on account of two factors. Firstly, the completeness of the SERMON figures for the full year has improved to 93%. Secondly, since the revenue foregone is the difference between tariff rate and effective rate, the revenue foregone estimates were higher than the actual figure, on account of the high revenue foregone figures for television sets (which was estimated on an annualized basis to be Rs 31252 crore). This is because the tariff rate for TV sets then was 'Rs 34,000 per set or 16%, whichever is higher', whereas the effective rate was 16%. In budget 2007-08, the tariff rate for television sets has been reduced to 16%, as a result of which the duty foregone on television sets now is nil.

For the estimates of revenue foregone during 2007-08, again SERMON data has been relied upon. For the first six months of the year, SERMON captured about 84 percent of the revenue collection. The estimates for the full year have been arrived at assuming that the same pattern of coverage also applies to the remaining 16 per cent and for the full year. The revenue foregone figures captured by SERMON do not include the revenue foregone under area based exemption schemes. Figures for this have been separately obtained and are given in the Table 8 below:

Table 8: Tax expenditure under Excise duty regime

Sl. No.	Details of Exemption	Revenue foregone (in Rs crore)		
		2006-07 Estimates	2007-08 Revised (provisional)	2007-08 Estimates*
1.	Area based exemptions applicable in the North Easternstates, Uttarakhand, Himachal Pradesh, Jammu & Kashmir and Kutch district of Gujarat	7000	7000	8550
2.	Others	92690	68475	79442
	Total	99690	75475	87992

[* - Based on actuals for 2007-08 (April-September, 2007)]

The estimates of revenue foregone presented do not include revenue foregone on account of ad hoc exemption orders issued under Section 5A(2) of the Central Excise Act, 1944, which relate to circumstances of an exceptional nature.

B. Customs duties

Customs duty is levied as per the rates specified in the Schedule to the Customs Tariff Act, 1975. The Customs Tariff Act, 1975 also provides for levy of additional duty of customs (commonly referred to as countervailing duty or CV duty), which is levied at a rate equal to the duties of excise leviable on such goods if they were manufactured in India. As already indicated these duties of excise are levied either under The Central Excise Act, 1944 or under various Finance Acts, which specify the rates at which these duties should be levied. Similarly, a special CVD is also levied at 4% under the Customs Tariff Act to compensate for State VAT levied on domestic goods. The rates specified in various enactments are known as the tariff rates. The Central Government has been delegated powers under Section 25(1) of the Customs Act, 1962 to issue notifications in public interest to exempt any goods from duties of customs. Thus, these notifications prescribe duty rates lower than what are prescribed in the Schedule. These rates prescribed by notifications are known as the "effective rates". In the context of customs duty, the revenue foregone is thus defined to be the difference between duty that would have been payable but for the issue of the notification and the actual duty paid in terms of the relevant notification. In sum:

Revenue foregone= Value X (Tariff rate of duty – Effective rate of duty)

Duty foregone is, thus, zero if tariff rate is equal to the effective rate

The estimate of revenue foregone for 2006-07 on account of issue of various exemption notifications is based on the data generated from Bills of Entry filed in the Indian Customs Electronic Data Interchange System (ICES) at various Electronic Data Interchange (EDI) locations. The EDI data, however, are not complete, as certain ports are outside EDI. Besides, the EDI data does not capture Bills of Entry in respect of imports by EOUs, Warehouse Bills of Entry and where manual Bills of Entry are filed in EDI locations.

The revenue foregone data takes into account the exemptions from basic customs duty, CV duty and also exemption notifications issued under Central Excise Act, 1944 which are relevant for levy of CV duty. It also takes into account exemptions from special CVD of 4%.

For 2006-07 gross customs revenue captured by EDI data is Rs.73770 crore as against actual gross revenue collection of Rs.88570 crore. EDI data thus represents about 83% of actual reported gross revenue collection for 2006-07. Therefore, the revenue foregone estimates are based on a fairly large sample.

EDI data has been extrapolated to work out the estimated revenue foregone for the year 2006-07, with appropriate adjustments wherever required. It has been seen that EDI data coverage is particularly low for edible oils, petroleum products, crude petroleum and some other items. Data on actual revenue realized from these items was collected separately. When the actual revenue from these two commodities is added to EDI data, the coverage goes up to Rs.83280 crore or about 94% of the total revenue. This still leaves a shortfall of about 6% from the actual revenue. In the absence of any other data, it has been assumed that composition of import of goods giving the balance revenue was unchanged and was the same as per the EDI data. After suitable inflation of the data base, the duty foregone for 2006-07 on account of all exemption notification is estimated at Rs. 1,37,105 crore.

For 2007-08, a similar methodology has been adopted to the revenue data which is available so far only for the period April-September, 2007. Apart from extrapolating to achieve full coverage, this data has been annualized to work out the estimated revenue figures for 2007-08. The estimated revenue foregone for 2007-08 on this basis works out to be Rs. 1,48,252 crore, showing a growth of about 8% over the previous year.

The revenue foregone data for each of the chapters of Customs Tariff Act is given in Table 9 as under:

Table 9: Estimates of major tax expenditure under the Customs duty regime

(in Rs. crore)

Chapter	Brief Description of Goods	2006-07 (Provisional)	2007-08 (Estimated)
1	Live animals	1	1
2	Meat and edible meat offal	0	1
3	Fish and crustaceans, other aquatic invertebrates	5	19
4	Dairy Products	15	23
5	Other products of animal origin	17	26

Chapter	Brief Description of Goods	2006-07 (Provisional)	2007-08 (Estimated)
6	Live trees and other plants	3	3
7	Edible vegetables, certain roots and tubers	2041	2781
8	Edible fruit and nuts	1013	970
9	Coffee, tea, mate and spices	303	445
10	Cereals	1295	255
11	Products of the milling industry	13	8
12	Oilseeds, grains, seeds, fruits	92	96
13	Lac, gums and resins	88	150
14	Vegetable plaiting materials	1	1
15	Animal of vegetable fats	4155	7901
16	Preparations of meat or fish	0	6
17	Sugar	33	67
18	Cocoa	19	10
19	Preparations of cereals	40	26
20	Preparation of vegetables	12	16
21	Miscellaneous edible preparations	106	133
22	Beverages and spirits	154	55
23	Residues and waste from food industry	64	112
24	Tobacco	4	4
25	Salt, sulphur earths and stone	243	301
26	Ores	1557	1466
27	Mineral fruits and mineral oils	24895	22007
28	Inorganic chemicals	2173	2241
29	Organic chemicals	5268	6278
30	Pharmaceutical products	1467	1452
31	Fertilizers	3399	4830
32	Tanning and dyeing extracts, pigments	265	293
33	Essential oils	123	131
34	Soap and washing preparations	82	82
35	Albuminoidal substances	54	58
36	Explosives, matches	17	8
37	Photography goods	73	35
38	Miscellaneous chemical products	1087	1121
39	Plastics	1773	2094
40	Rubber	657	871
41	Hide and skins and leather	268	279
42	Articles of leather	17	19
43	Fur skins	8	6
44	Wood	915	1128
45	Cork	1	0
46	Manufactures of straw	0	0
47	Wood Pulp	268	301
48	Paper	895	888
49	Printed books, newspapers	487	463
50	Silk	258	331
51	Wool	284	364
52	Cotton	3057	3320

Chapter	Brief Description of Goods	2006-07 (Provisional)	2007-08 (Estimated)
53	Other vegetable fibres	63	39
54	Manmade filaments	2734	2977
55	Man made staple fibres	483	392
56	Wadding and non wovens	38	28
57	Carpets	20	17
58	Special woven fabrics	2047	475
59	Coated textile fabrics	289	376
60	Knitted fabrics	130	156
61	Knitted readymade garments	10	11
62	Woven garments	20	30
63	Made ups	44	39
64	Footwear	114	154
65	Head gear	1	1
66	Umbrellas	6	10
67	Feathers/artificial flowers	2	2
68	Articles of stone, plaster	72	70
69	Ceramic Products	188	176
70	Glass and glass ware	161	155
71	Precious stones, jewellery	25672	35182
72	Iron and steel	7650	6145
73	Articles of iron and steel	2855	2424
74	Copper and articles thereof	564	465
75	Nickel and articles thereof	422	318
76	Aluminum and articles thereof	1000	842
78	Lead and articles thereof	139	41
79	Zinc and articles thereof	545	220
80	Tin and articles thereof	49	38
81	Other base metals	104	67
82	Tools and implements	250	248
83	Miscellaneous articles of base metals	95	107
84	Machinery	15081	13630
85	Electrical machinery	9113	9622
86	Railways or tramways locomotives, rolling stocks etc.	120	83
87	Motor vehicles	1830	2644
88	Aircrafts	698	2097
89	Ships, boats and floating structures	965	1173
90	Optical/photographic instruments	2642	2719
91	Clocks and watches	12	17
92	Musical instruments	2	1
93	Arms and ammunitions	222	109
94	Furniture	198	223
95	Toys and games	93	100
96	Miscellaneous manufactured articles	168	171
97	Work of art, antiques	5	102
98	Project imports, baggage	1127	876
	Total	137105	148252

The above figures include revenue forgone owing to various export-promotion schemes barring drawback. The split up for various export promotion schemes is given below separately. Of these, only the DFCE, Target Plus, VKGUY & Served from India are incentives schemes. The rest are either input tax neutralization or exemption schemes. These largely represent input tax credit that has to be allowed in order to offer a level playing field to our exporters in international markets. In this sense, the revenue foregone from customs duties should be scaled down to the extent of revenue foregone for various export promotions schemes falling in the latter category. Accordingly the amounts shown at sl. no. 14 in the table below would be reduced from the gross revenue foregone on account of customs duty.

Table 10 Revenue Foregone on account of Export Promotion Concessions

(in Rs. crore)

S.No.	Name of the Scheme	2006-07 (Provisional)	2007-08 (Estimated)
1	Advance License Scheme	17928	16604
2	EOU/EHTP/STP	14386	23806
3	EPCG	9152	8592
4	DEPB Scheme	4842	4643
5	SEZ	2194	2962
6	DFRC	845	595
7	Duty Free Import Authorization Scheme	699	1214
8	DFCE Scheme	1416	561
9	Target Plus Scheme	2619	1087
10	Vishesh Krishi and Gram Udyog Yojana (VKGUY)	548	403
11	Served from India Scheme	444	579
12	Total	55072	61046
13	Less Revenue Foregone on account of incentive schemes mentioned at sl. nos. 8 to 11	5027	2630
14	Revenue Foregone on account of input tax neutralization or exemption schemes to be reduced from Gross Revenue Foregone on account of Customs Duty	50045	58416

The above does not include revenue foregone on account of exemption notifications issued under Section 25(2) of the Customs Act, 1962. The revenue foregone figures for financial years 2006-07 and 2007-08, in respect of both direct and indirect taxes, is presented in Table 11

Table 11: Revenue Foregone in financial years 2006-07 and 2007-08 (in Rs. Crore)

	Revenue Foregone in 2006-07	Revenue Foregone as a per cent of Aggregate Tax Collection in 2006-07	Revenue Foregone in 2007-08	Revenue Foregone as a per cent of Aggregate Tax Collection in 2007-08
Corporate Income Tax	45034	9.56	58655	10.09
Personal Income-tax	32143	6.82	42161	7.25
Excise Duty	75475	16.02	87992	15.14
Customs Duty	137105	29.11	148252	22.51
Total	289757	61.51	337060	58.00
Less Export credit related [Sl. No.14 of Table 10]	50045	10.62	58416	10.05
Grand Total	239712	50.89	278644	47.94

Notes: (1) Aggregate Tax Collection refers to the aggregate of net direct and indirect tax collected by the Central Government.

(2) The figure of Aggregate Tax Collection for 2006-07 is based on actuals while that for 2007-08 is based on revised estimates.

To conclude, the amount of revenue foregone continues to increase year after year. As a percentage of aggregate tax collection, revenue foregone remains high even though a declining trend is noticeable. This trend reflects the success of the tax reforms undertaken by the Government during the last four years. Moderate tax rates and base expansion are the two essential elements of such tax reforms.

APPENDIX to Annex-12

**Effective tax rate, inclusive of surcharge and education cess, of sample companies across industry
(financial year 2006-07) [sample size - 328061]**

Sl. No	Sector	Industry	Number of Companies	Profit before tax (in Rs. crore)	Total tax payable (in Rs. crore)	Effective tax rate (in %)
1	Manufacturing	Agro-based Industries	10691	9562.6	2147.8	2.46
2	Manufacturing	Automobile and Auto parts	3521	20412	5313.8	26.03
3	Manufacturing	Cement	539	6149.2	1055.5	17.16
4	Manufacturing	Diamond Cutting	361	698.3	122.1	17.48
5	Manufacturing	Drugs and Pharmaceuticals	4180	14040.5	1952.4	13.91
6	Manufacturing	Electronics, including Computer Hardware	2376	4433.7	755.7	17.04
7	Manufacturing	Engineering goods	7916	13052.1	3330.7	25.52
8	Manufacturing	Fertilizers, Chemicals and Paints	3423	9349.5	2072.7	22.17
9	Manufacturing	Flour and Rice Mills	1082	205.2	52	25.32
10	Manufacturing	Food Processing Units	1968	2007.8	465.6	23.19
11	Manufacturing	Marble and Granite	1561	400.2	71.5	17.87
12	Manufacturing	Paper	1250	1859.9	347.6	18.69
13	Manufacturing	Petroleum and Petrochemicals	573	26931.8	5184.8	19.25
14	Manufacturing	Power and Energy	1709	52719.7	11090.9	21.04
15	Manufacturing	Printing and Publishing	2054	2945.1	824.7	28.00
16	Manufacturing	Rubber	894	492.5	107.7	21.88
17	Manufacturing	Steel	3855	18988.5	4414.1	23.25
18	Manufacturing	Sugar	214	1033.7	128	12.38
19	Manufacturing	Tea and Coffee	834	811.6	97.9	12.06
20	Manufacturing	Textiles, Handlooms and Powerlooms	8522	6451.2	956.7	14.83
21	Manufacturing	Tobacco	303	4362.3	1334.6	30.59
22	Manufacturing	Tyre	147	1107.3	124.3	11.22
23	Manufacturing	Vanaspati and Edible Oils	617	628.8	89.6	14.25
24	Manufacturing	Others	40690	97645.1	22866.3	23.42
25	Trading	Chain Stores	679	159.8	39.8	24.87
26	Trading	Retailers	7598	1617.7	382.1	23.62
27	Trading	Wholesalers	13362	2789.6	704.1	25.24
28	Trading	Others	46117	13729.7	3026	22.04
29	Commission Agents	General Commission Agents	3213	768.6	226.9	29.52
30	Builders	Builders	8710	2949.3	615.3	20.86
31	Builders	Estate Agents	1907	253.3	62.7	24.77
32	Builders	Property Developers	13577	11382.6	2385.1	20.95
33	Builders	Others	8982	1646.7	339.4	20.61
34	Contractors	Civil Contractors	5118	5087.7	1321.6	25.98
35	Contractors	Excise Contractors	17	13.7	3.6	26.38
36	Contractors	Forest Contractors	9	0.1	0.04	39.33
37	Contractors	Mining Contractors	332	747.1	177	23.69
38	Contractors	Others	5020	3352	757.4	22.60
39	Professionals	Chartered Accountants, Auditors, etc.	71	8.3	1.7	20.33

Sl. No	Sector	Industry	Number of Companies	Profit before tax (in Rs. crore)	Total tax payable (in Rs. crore)	Effective tax rate (in %)
40	Professionals	Fashion Designers	49	7.2	2.2	30.07
41	Professionals	Legal Professionals	176	28.4	4.7	16.42
42	Professionals	Medical professionals	782	85.7	24	28.05
43	Professionals	Nursing Homes	787	91.3	24.3	27.28
44	Professionals	Speciality Hospitals	576	215.8	47.4	21.97
45	Professionals	Others	2864	465.5	127.9	27.47
46	Service	Advertisement Agencies	1709	711.1	225.8	31.75
47	Service	Beauty Parlours	134	30.1	7.9	26.24
48	Service	Consultancy Services	8118	6933.5	1152.2	16.62
49	Service	Courier Agencies	402	201.5	75.8	37.64
50	Service	Computer Training, Educational and Coaching Institutes	1804	361.9	88.1	24.33
51	Service	Forex Dealers	420	34.5	8.6	24.83
52	Service	Hospitality Services	1841	2017.7	479.6	23.77
53	Service	Hotels	4462	3376.1	834.7	24.72
54	Service	IT Enabled Services, BPO Service Providers	5525	18391.3	1352.9	7.36
55	Service	Security Agencies	787	111.2	42	37.80
56	Service	Software Development Agencies	7511	16006.2	1021.1	6.38
57	Service	Transporters	2772	2371.1	457.8	19.31
58	Service	Travel Agents and Tour Operators	2565	509.2	135	26.52
59	Service	Others	33291	56632	9362.6	16.53
60	Financial Service	Banking Companies	303	41510.9	11201.3	26.98
61	Financial Service	Chit Funds	2092	197.9	62.9	31.78
62	Financial Service	Financial Institutions	249	4989.1	1024.5	20.53
63	Financial Service	Financial Service Providers	2410	2912.6	677	23.24
64	Financial Service	Leasing Companies	719	891	130.8	14.68
65	Financial Service	Money Lenders	404	60.1	11.3	18.84
66	Financial Service	Non-Banking Financial Companies	7900	16492.5	2978.1	18.06
67	Financial Service	Share Brokers, Sub-brokers, etc.	3355	4329.5	1048.2	24.21
68	Financial Service	Others	15548	30761.7	5394	17.53
69	Entertainment Industry	Cable T.V Productions	183	287.1	76.8	26.75
70	Entertainment Industry	Film Distribution	246	165.2	31.1	18.84
71	Entertainment Industry	Film Laboratories	35	17.1	4.2	24.49
72	Entertainment Industry	Motion Picture Producers	277	324.7	91	28.02
73	Entertainment Industry	Television Channels	167	788.9	286.9	36.37
74	Entertainment Industry	Others	3606	3085.8	872.8	23.71
		Total	328061	556190	114316	20.60