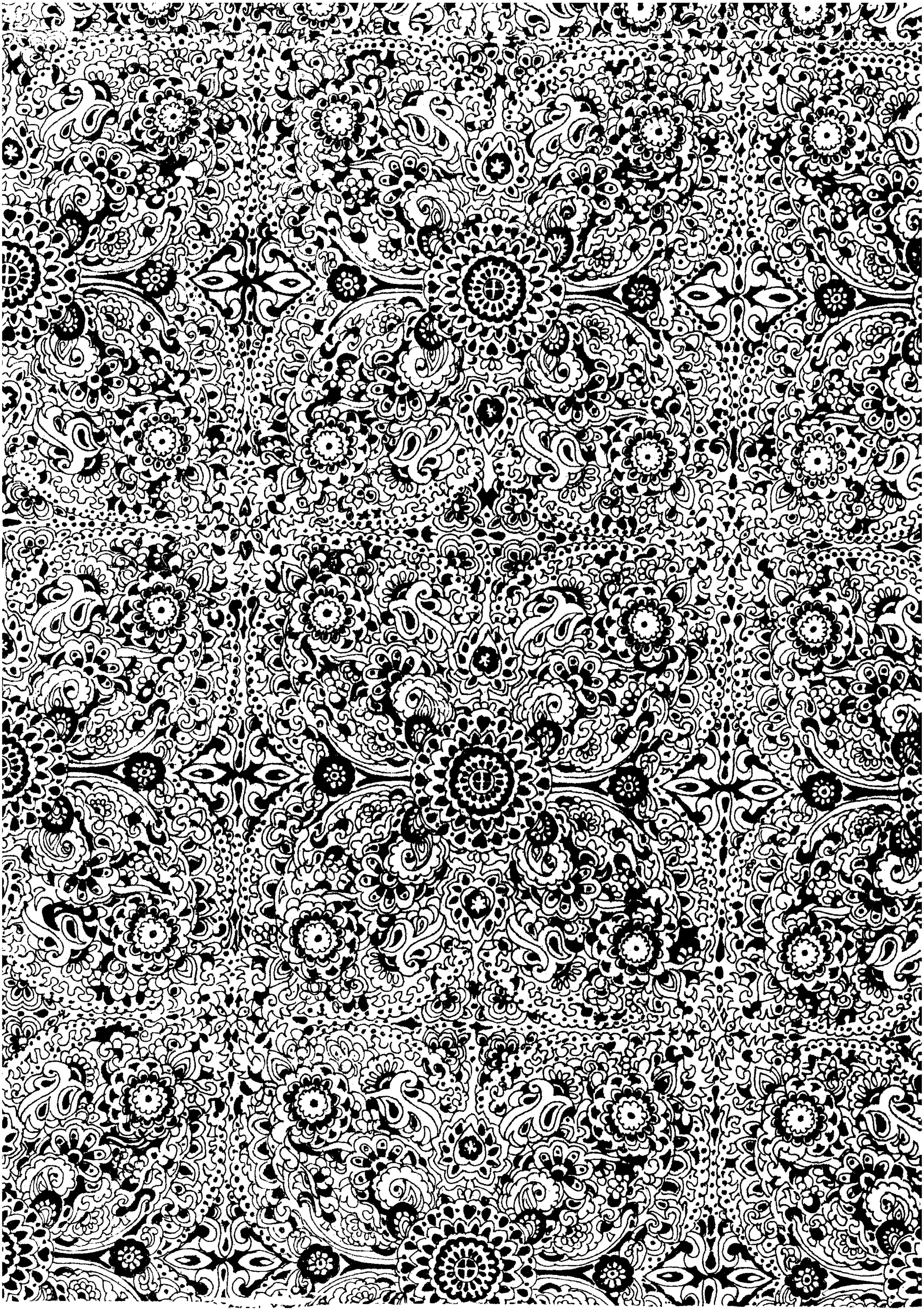

CHAPTER ONE / INTRODUCTION AND METHODOLOGY

1.1 HISTORICAL BACKGROUND

1.1.1 Conceptual Basis of 'Budget':

In medieaval England, the word 'budget' was used for identifying an altogether different object, namely, a leather wallet or pouch to be carried on one's back. Down through the centuries, however, it came to be used more and more for referring to the contents than the outer covering; and with the advent of modern economic theories, it entrenched itself into English language more as a fiscal term.

The concept of 'Government Budgeting' is related to the system of representative government, one of the basic tenet of which is that 'the representatives of a nation must vote the public revenues and expenditures'. This, in other words, means that the representatives of the people alone can determine the quantum of State expenditure; while the levy of tax is based on the idea of sovereignty since only in a sovereign State, the people have the right to entrust their representatives with public revenue and expenditure. In fact, 'budget prerogative' is a term used for expressing the right of the legislature to wield control over public purse and incorporates the attribute of the legal right of ulmate control or sovereignty.

William E.Gladstone (d.1898), the British Chancellor of Exchequer and later Prime Minister had opined that:

Budgets are not merely affairs of arithmetic, but in thousand ways, go to the root of prosperity of individuals, the relations of classes and strength of Kingdoms.[1]

Samuelson and Nordhaus define government budgets in plain and simple terms, bringing out all the important aspects, when they state:

Governments use budgets to control and record their fiscal affairs; a budget shows, for a given year, the planned expenditures and receipts that government spending and programmes would yield. The budget typically will contain a list of specific programmes (education, welfare, defence, etc.) as well as tax sources (personal income-tax, sales-tax, etc.[2]

A detailed discussions about the Budget, its content and their implication has been offered in Chapter-II.

1.1.2 Conceptual Basis of 'Direct Taxes':

In the year 1776, Adam Smith, founder of the Science of Economics, first propounded his now famous maxims of taxation, which could be summarized as under:

1. The subjects of State ought to contribute towards the support of the Government;
2. The tax levied on individuals should be certain and not arbitrary;
3. It should be convenient for the contributor to pay the tax levied.[3]

Two decades later, in 1798, income-tax was imposed for the first time in England, in order to raise the funds needed by the Government to meet the financial difficulties caused by the war with France. It gave equal treatment to all the taxpayers in the sense that the rate was uniformly applied to each corner of income, but the incidence was proportional.[4]

However, direct taxation is not a novelty in India introduced by the British as too commonly supposed but a most ancient and well-known institution. The British Government, which had gradually abandoned the older Indian system of direct taxation, was obliged by the financial necessities to revert to direct taxation in 1860, to meet the exigencies caused by the events of 1857. But instead of an indigenous model, softened and adopted to local circumstances, the Government imposed the income-tax as was in force in England.[5] With one object or another, twentythree Acts on the subject were passed between 1860 and 1886, the Act of 1886 remaining in force for next three decades. In 1916, the First World War necessitated increased taxation and tightening up of the assessment machinery, which brought into force the Income-tax Act of 1918. This Act, however, was shortlived and was replaced by a more comprehensive Act of 1922,[6] which was passed on to the independent India in 1947.

The economic planners of the newly-independent nation were acutely aware of the flaws and lacunae in the Income-tax Act of 1922; particularly of the fact that the tax structure lacked buoyancy, i.e. the automatic rise in yields with the increase in national production and income, which is a common feature of the tax systems in Western countries. Accordingly, the Government entrusted Prof.Nicholas Kaldor of England to recommend suitable tax reforms. Prof.Kaldor submitted his Report to the Government in 1956, which aimed at:

> *...broadening the tax base through the introduction of an* ***annual tax on wealth****; ... (and) a general* ***gift tax,*** *(which also aimed at the) elimination of ... tax evasion through the institution of a ... comprehensive reporting system on all property transfers and other transactions of a capital nature.*[7]

After due consideration of Prof.Kaldor's report, the Goverrnment enacted first **the Wealth-tax Act, 1957** (27 of 1957) and subsequently, **the Gift-tax Act, 1958** (18 of 1958).

Meanwhile, despite extensive amendments made to it in 1948, 1951, 1955, 1956 and 1957, the Indian Income-tax Act of 1922 had failed to check the extensive tax evasion. Hence, in 1961, the Act was completely recast, partly to give effect to the recommendations of the Income-tax Investigation Committee which had examined the administrative processes and partly to carry out the recommendations of the Law Commission appointed for the purpose. Thus, came into being **the Income-tax Act, 1961.**

The express purpose of the commission entrusted to Prof.Nicholas Kaldor was to explore the avenues for generating increased revenue for developmental purposes. In

Prof.Kaldor's words:

> *The Second Five Year Plan envisages additional tax revenue (by the Centre and the States) of Rs.450 crores for five year period, a deficit expenditure of Rs.1,200 crores and a 'gap' of further Rs.400 crores. ... the amount of deficit expenditure which the economy can absorb is not likely to exceed Rs.150 crores a year, or, say Rs.800 crores in the five year period. Hence, if the targets of the Second Five Year Plan are to be fulfilled, the additional taxation required is more of the order of Rs.1,250 crores for the five years (or Rs.250 crores a year) than of Rs.450 crores.*[8]

Prof.Kaldor had only visualized the Union and the State Budgets during the Second Plan Period and discerned the quantum of the additional revenue required to be generated; and proposed suitable taxation measures to tide over the situation.

1.1.3 Relationship between 'Budget' and 'Direct Taxes':

The Constitution of India divides the tax revenues into three Lists, namely, (1) Union, (2) States, and (3) Concurrent; and also places the levying, collection and administration of direct taxes within the exclusive powers of the Union Government. The Constitution, vide Article 285, further empowers the Union Government to enact such laws as may be necessary in this behalf. The Union Government has retained the British Treasury Control System in the matters of financial administration, which includes the function of compilation of an annual budget (Annual Financial Statement). Article 112 of the Constitution lays down that:

> *(The President of India) shall in respect of every financial year cause to be laid before both the Houses of Parliament a statement of the estimated receipts and expenditure of the Government of India for that year ... referred to as the 'annual financial statement'.*[9]

Since the revenues generated through direct taxes constitute a part of the Union revenues, successive Governments have come to look upon them as an important component for balancing the receipts and expenditure columns of the 'annual financial statement', that is, the Budget.

1.2 STATEMENT OF THE PROBLEM

Evidently, Budget is a document which brings together all the fiscal operations of the Government and presents them in the form of a single comprehensive statement. In sum, it reflects the fiscal policy of the Government, wherein taxation is an important instrument. Taxation, therefore, has to be utilized properly keeping in view the principles of equity and social justice. The statement of the problem, therefore, could be accurately expressed as: **A Critical Study of Union Budgets for the Period from 1984-85 to 1988-89 with Special Reference to Direct Taxes.**

1.3 OBJECTIVES OF THE STUDY

The following have been set out as the objectives of the present study:

1. To study the major changes in the provisions of the direct taxes in relation to the annual Union Budgets;
2. To understand and critically appreciate the rationale behind these changes;
3. To examine whether these changes in direct taxes were required, from the point of view of resource mobilization and social justice.

1.4 METHODOLOGY OF THE STUDY

The very nature of the topic under investigation has compelled the researcher to limit his data-base to the **secondary data** only, which consists of the annual financial statements (i.e. budgets) of the Union Government and the proclamations of amendments issued consequent thereto to the direct tax statutes. The study, therefore, lays its thrust on the comparative analysis and interpretation of the Union Government's activity as it relates to the enhancement of resource mobilization and social justice in the direct tax structure on year-to-year basis through the Union budgets during the study period. In order to further help such analysis and interpretation, the research has also resorted to other published sources as authoritative books and articles on the subject.

1.5 SCOPE OF THE STUDY

Chronologically, the study is limited to a period of five financial years, i.e. 1984-85, 1985-86, 1986-87, 1987-88 and 1988-89. It is also limited to appreciating the implications of the amendments incorporated in the direct tax statutes consequent to the announcements made in the Union Budgets for the aforesaid financial years.

1.6 LIMITATIONS OF THE STUDY

The following are the limitations of the present Study:

1. The study is limited to merely last five financial years, whereas the system of preparing the "Annual Budgets of the Government of India" is in vogue since "1921 onwards".[10]
2. The study takes into account the contribution of taxes to the total revenue through the mechanism of Budget and analyses the quantitative contribution thereof to the aggregate revenue.
3. The details pertaining to the data are exclusively extracted from the published sources. Therefore, the entire exercise is confined to the secondary data only.

1.7 CHAPTER SCHEME

The Dissertation is divided into four Chapters. **Chapter One** deals with the conceptual basis of Union Budget and Direct Taxes and the framework aspects like statement of problem, objectives, methodology, scope and limitations. **Chapter Two** deals with the theoretical background of the Union Budgets and Direct Taxes. **Chapter Three** pertains to the analysis and interpretation of the Budgets and the consequent revisions and modifications in the direct tax statutes during the study period with special emphasis on the provisions pertaining to the resource mobilization. **Chapter Four** presents the conclusions arrived at and offers certain suggestions for using the direct taxes as an effective means for greater resource mobilization with the object of attaining social justice. A detailed **Bibliography** concludes the Dissertation.

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