

INDIAN FEDERAL FINANCE AND TAXES

1.1 INTRODUCTION :

Indian Federal Finance reflects certain peculiar characteristics. The aggregate revenues of the Government of India are composed of tax revenues and non-tax revenues. The major revenues are derived from taxes. The revenue receipts of the Central Government reveal that of late the major thrust is on indirect taxes as compared to direct taxes. Similarly, as compared to the total tax revenue, non tax revenue is rather insignificant.

The following table confirms this statement

Table-11: Trends in Structure of Central Govt. Revenue

Sr.No.	Particular	Rs.in crores				% share in total Revenue		
		70-71	80-81	91-92	92-93	70-71	80-81	92-93
1	2	3	4	5	6	7	8	9
1	Corporation tax	371	1311	7300	8125	6.5	5.4	6.1
2	Income tax	473	1506	6788	7870	8.3	6.2	5.9
3	Wealth tax	15	68	255	300	0.3	0.3	0.2
4	Estate duty	8	16	3	3	0.1	0.1	0.1
5	Others	10	107	654	855	0.2	0.4	0.6
A Direct taxes (1 to 5)		877	3008	15000	17153	15.5	12.4	12.9
6	Customs	524	3409	22895	25212	9.2	14.1	19.0
7	Union Excise duty	1759	6500	27696	32211	31.0	26.9	24.3
8	Others	47	263	1709	1947	0.8	1.1	1.5
B Indirect taxes (6 to 8)		2330	10172	52300	59370	41.0	42.1	44.8

(Contd....Table 1.1)

C Gross tax Revenue(A+B)	3207	13180	67300	76523	56.5	54.5	57.8
D Transfer to state share	755	3792	17199	19992	13.3	15.7	15.1
E Net tax revenue (C-D)	2452	9388	50101	56531	43.2	38.8	42.7
9 Fiscal services	26	143	787	820	6.5	0.6	0.6
10 Interest received	589	1795	11297	13464	10.4	7.4	10.2
11 Dividend and profits	121	292	1049	2622	2.1	1.2	2.0
12 Other Receipts	154	1211	6975	6287	2.7	5.0	4.7
F Revenue Account Receipt(1 to 12)	3342	12829	70209	79724	58.9	53.1	60.2
13 Capital Account	2046	8771	43253	47394	36.1	36.3	35.7
14 Budgetary Deficit financing	285	2577	7032	5389	5.0	10.7	4.1
Total Receipts (1 to 14)	5673	24177	120494	132507	100	100	100

Source : Various RBI Issues and Other Journals.

Since independence the Government is trying to attain the objective of (i) simplification and rationalisation of tax laws (ii) control of tax evasion and black money (iii) better tax assessment and administration (iv) improvement in elasticity of tax revenue. During last three decades the Government has appointed many committees, important among them are

Taxation Enquiry Commission (1953), Bhootlingam Committee on rationalisation and simplification of tax structure (1968), Direct Taxes Enquiry Committee headed by Justice ^{Wanchoo} / Dr. K.N.Roy Committee on taxation of agricultural income and wealth (1971); and Choksi Committee on Direct Taxes (1977). the notable recommendations amongst them are reduction and rationalisation of structure of tax rates and tax limits, incentives and rebates on savings and investment, widening of tax base through levy of tax on capital gains, net wealth and gifts, substitution of expenditure for income as the tax base, rationalisation of Corporate taxes, abolition of surtax, tax on agricultural holdings and agricultural property, integration of agricultural incomes with non-agricultural income, the imposition of agricultural income tax under Central Act by a suitable amendment of the constitution and so on. Even though number of recommendations have been incorporated in the direct tax laws from time to time but tax reform process did not become appropriate and proper with the changing needs of the economy.

Recently, Dr.Raja Chelliah Committee was appointed in August 1991 to study the structure of direct and indirect taxes and make suggestions to make

the tax system more broad based and elastic, make simplification in the existing tax system. These recommendations have been seriously considered by the Government and some of them have been adopted since 1992 budget.

The said committee has ~~also been~~ criticised on the ground of failure to consider the real and immediate problems of present tax system. It has not thrown the light on the problem of tax evasion and black money¹ and also on the improvement in the quantum of revenue of Central and State Government. It has also not considered the ^{issues of} fixed and middle-class income-tax payers. Apart from criticism there are some good recommendations of the committee such as grievance redressal machinery, development of a tax information system, tax payers educational provision of tax information number, raising the status of Chairman and members of the CBDT etc. adoption of it will help in improving the tax administration.

So many years the Government attitude has been fixed towards safeguarding their political interests and accordingly The Govt. adopted only suitable recommendations. Now time has come for the much debated and long awaited structural reforms in direct

taxes to tackle the resource problems that the country today faces. It needs an earnest and pragmatic attitude and political courage on the part of the Government to tackle such problems. The Government is also considering every opportunity to make the tax system more conducive to the changing needs and conditions of the economy.

It is very important to set out clearly the objectives that, the Government wants to realise from the proposed direct tax reforms before they are adopted. The identification of these objectives will be useful in drawing the format of the reforms stated for inclusion in the existing tax system to obtain desired results. Direct tax reforms- objectives in a nut shell are as follows :

1.2 CERTAIN ISSUES :

1) Widening of Tax Base

The present tax system is intended to achieve the twin objectives of maximising the revenue as well as utilising the tax revenues for achieving socio-economic objectives but as we saw in actual practice, the system has failed to achieve either of these objectives. Since long back the need "for deepening and widening the coverage of the Indian Tax

System was felt. The Taxation Enquiry Commission pointed out this need and also recommended the best kind of tax system.

The population of India is about 850 million but number of tax payers are less than 7 million that is less than 1% of the total population. This is because, nearly 70% population depends on agricultural income which are out of the tax coverage and out of 30% large portion of population who are getting more income are also trying to keep them away from tax coverage. Most of the developed countries collect 25% to 30% of the GNP through taxation but in India in spite of higher rate of taxation the tax revenue does not reflect buoyancy with the increase in national product and income. In this context the Bhootlingam Committee has rightly recommended that "ideally tax system should be built in such a way that, the growth in national income will be automatically reflected in the revenue of the state."

Data given in Table 1.1 throws light on the fact that, There is dire necessity to widen the tax base. It may be seen from the Table that, there has been a considerable decline in the share of net tax revenue

in general and direct taxes in particular. The share of direct taxes in the Centre's revenue, which was 15.5% in 1970-71, declined to 12.4% by 1980-81. Though there has been slight increase in the share of indirect taxes in total revenue, on the whole, after transfer of States share, the share of net tax revenue in the total revenue of the Central Government has shown a decline. A time has come to widen the tax base to improve the share of tax revenues in the overall revenue of the Government.

3 Tax on Agricultural Income and Wealth Tax Base Widening

Among the leading economists, there seems to be general agreement and a consensus on introduction of tax on agricultural incomes. Dr. Kaushik Basu, an economist has rightly said in this context that "Whether a person pays tax or not should depend on how rich he is and not the source of his richness." The former Deputy Chairman of Planning Commission and present commerce minister Mr. Pranav Mukharjee has said that the agricultural sector has made impressive advances and the country was able to attain self sufficiency in food grains production, the revenue collection has dropped to Rs. 2 per Rs. 100. It

creates feeling that agricultural income and wealth should be taxed with a view to widen the tax base. Following table shows the contribution of agricultural sector in Gross Domestic Product and total tax revenues of both Central and State Governments during the past 10 years.

Table-1.2: Agricultural Sector in Gross Domestic Product (At Current Prices) (Rs.in Crores)

Year	GDP at Factor cost		Percentage share in total
	Agricultural Sector	Total	
1950-51	5,009	8,979	55.8
1960-61	6,990	15,254	45.8
1970-71	17,937	39,708	45.2
1980-81	46,649	1,22,427	38.1
1981-82	52,685	1,43,216	36.8
1982-83	56,151	1,59,395	35.2
1983-84	67,498	1,86,723	36.1
1984-85	71,950	2,08,533	34.5
1985-86	77,224	2,33,799	33.0
1986-87	82,413	2,60,030	31.7
1987-88	92,379	2,94,765	31.3
1988-89	1,13,998	3,50,899	32.5
1989-90	1,27,201	4,01,569	31.7
1990-91	1,53,119	4,72,599	32.4

Source : Basic Statistics Relating to the Indian Economy, Centre for Monitoring Indian Economy, Vol.1, August, 1992.

Table-13: Taxation of Agriculture
(Rs.in Crores)

Year	Tax on Agriculture		Total tax	Col.3 as	Col.4
	Land Revenue	Agriculture Income tax	revenue of Central & State Govt.	% of	
1951-52	48	4	52	741	7.0
1961-62	95	9	104	1,543	6.7
1971-72	101	13	114	5,575	2.0
1981-82	205	38	243	24,169	1.0
1982-83	189	30	219	27,242	0.8
1983-84	213	44	257	31,525	0.8
1984-85	282	84	366	35,814	1.0
1985-86	353	127	480	43,266	1.1
1986-87	382	104	486	49,540	1.0
1987-88	447	63	510	56,976	0.9
1988-89	594	64	658	66,872	1.0
1989-90	657	93	750	77,257	1.0
1990-91	586	176	762	89,177	0.9
1991-92	766	204	970	1,03,137	0.9

Source : Basic Statistics Relating to the Indian Economy, Centre for Monitoring of Indian Economy Vol.1 August, 1992.

It may be noted from Table 2 that, the share of agriculture sector in GDP(at current prices), which was 55.8 per cent in 1950-51 declined to 45.8 per cent by 1960-61, 45.2 per cent by 1970-71, and to 38.1 per cent in 1980-81. During 1980s it varied between 31 and 37 per cent. It can also be observed that, the agricultural sector has been contributing nearly 1/3rd of GDP for last one decade, and it is disheartening to note that, the agricultural sector is hardly contributing one per cent of the total tax revenue of the Central and State Government.

Table-1.3 shows that, the revenue contribution from the agricultural sector, in the form of land revenue and agricultural income tax levied by State Government together has gradually declined over the time.

These facts clearly suggest that, immediate steps are needed for better transfer and utilisation of resources. It needs to contribute more to the revenue of the Government. Various committees such as, Dr.K.N.Raj Committee, Chokshi Committee, the latest Raja Chelliah Committee had made serious efforts to tap this most important economic sector.

But there is a constitutional hurdle on imposition of tax on agricultural income as agriculture being a State subject it needs the consent of the State Government. It has already been clarified by the Courts that the State Governments would be bound by the definition of agricultural income as contained in the Act, which is final as far as States are concerned.

Despite political problems and constitutional impediments it is time the Centre and the States agree to experiment with taxing rich agriculturists. Taxing rural rich will besides bringing revenue to the Government bring "equity" in the system as there is no justification in ^{sparing} those in the agricultural sector who have a capacity to pay taxes.

3 Restoration of Equity and Balance in Fiscal System

While considering total revenue direct taxes contribution is meagre as compared to indirect taxes which is always on higher side. Stress is always given on improvement in direct taxes. As a percentage of total tax revenues when we considered revenue from direct taxes has shown a steady decline over the time and as a proportion of GNP it remained stagnant thus impairing the equity and balance in the fiscal

Table-1.4: Direct, Indirect and Total Taxes
(Centre, States and Local Bodies)

Year	Tax Revenue (Rs. crores)			% share in total Tax Revenue		Tax Revenue as % of GNP		
	Direct	Indirect	Total	Direct	Indirect	Direct	Indirect	Total
1950-51	231	428	659	35	65	2.5	4.6	7.1
1960-61	420	1,040	1,460	29	71	2.6	6.4	9.1
1970-71	1,091	3,864	4,955	22	78	2.5	9.0	11.6
1980-81	3,575	16,746	20,321	18	82	2.6	12.3	14.9
1981-82	4,461	20,089	24,550	18	82	2.8	12.6	15.4
1982-83	4,835	22,985	27,820	17	83	2.7	12.9	15.7
1983-84	5,355	26,471	31,826	17	83	2.6	12.8	15.4
1984-85	5,806	30,640	36,446	16	84	2.5	13.3	15.8
1985-86	6,574	36,987	43,561	15	85	2.5	14.2	16.7
1986-87	7,328	42,714	50,042	15	85	2.5	14.7	17.2
1987-88	8,001	49,847	57,848	14	86	2.4	15.1	17.5
1988-89	10,396	57,430	67,826	15	85	2.7	14.7	17.3
1989-90	11,351	66,875	78,226	14	86	2.5	15.0	17.5
1990-91	14,378	75,025	90,303	14	86	2.7	14.5	17.2

system. This trend is clearly shown from the following Table-14. It is clear from the table that the share of the revenue from direct taxes in total tax revenue has steadily declined over a period of time and it accounts for 14% of total tax revenue today as against 86% of indirect taxes. As we see the table we find that, the proportion of indirect taxes in GNP has shown a steady increase while proportion of direct taxes in GNP has almost remained stagnant during the same period. If the equity and balance is to be restored in our fiscal system then the above trend will have to be reversed.

4 Improvement in Elasticity of Tax Revenue :

In India one of the important canons of tax system is the canon of income elasticity of tax revenue. The share of tax revenue in total revenue rises as income rises. At present all Governmental revenue in India taken together with ^{is} tax revenue/only around 17% of Gross National Product, while it is around 25% to 30% in developed countries. Thus there is an immediate need for improvement in elasticity of tax revenue.

5 **Control of Tax Evasion and Black Money : TAX EROSION**

It is very difficult to have an estimate of the black money in circulation. According to the report of the Direct Taxes Enquiry Committee in 1961-62 the income which escaped tax stood at Rs. 811 crores and tax evaded income for 1965-66 was Rs. 1,216 crores. The report of the committee confirms about black money that "not only is black money running parallel economy in this country, but it is growing faster than national income. It is said that "economy would be collapsed if the growth of black money is not checked in time. The report of the National Institute of Public Finance and Policy (NPFPP) on black money, published in 1985, said that the black money in circulation at an estimate Ground Rs. 50,000 crores per annum.

But the latest committee on tax reforms headed by Mr.Chelliah did not consider seriously and not suggested immediate remedy to check tax evasion and black money which is assuming alarming proportions day-by-day. To improve the elasticity of tax revenue and increase its share in the central revenue the committee should have considered the issue of tax evasion and black money seriously. Without controlling tax evasion and black money direct reforms would not be complete.

6) **Presumptive Tax System AN EXPERIMENT FOR TAX WIDENING**

There is necessity to find out potential tax payers. There is a need to cover the self employed, professionals and traders who are liable to pay taxes but are not paying under tax net. Less than 1% of the total population is only paying of the direct taxes which has resulted in a very sharp decline in the share of direct tax revenue in the total tax revenue of the Government. Following Table shows the figures of the revenue from direct taxes and its share in the total tax revenue of the Government.

Table-4.5: Revenue From Direct Taxes of the Central Govt. (Before Transfer of States Share)

Year	Income tax	Corporate tax	Others	Total	% of Share total tax receipts
1	2	3	4	5	6
1950-51	134 (33.1)	39 (9.6)	04 (1.0)	177	43.7
1960-61	169 (18.9)	110 (12.3)	10 (1.1)	289	32.3
1970-71	473 (14.7)	371 (11.6)	26 (0.8)	870	27.1
1980-81	1440 (11.0)	1311 (10.0)	149 (1.1)	2900	22.1
1981-82	1476 (9.3)	1970 (12.4)	341 (2.2)	3787	23.9
1982-83	1570 (8.9)	2185 (12.3)	384 (2.2)	4139	23.4

(Contd....Table-1.5)

1	2	3	4	5	6
1983-84	1699 (8.2)	2493 (12.0)	307 (1.5)	4499	21.7
1984-85	1928 (8.8)	2556 (10.9)	314 (1.3)	4798	20.4
1985-86	2511 (8.8)	2865 (10.0)	246 (0.9)	5622	19.6
1986-87	2879 (8.8)	3160 (9.6)	198 (0.6)	6237	19.0
1987-88	3192 (8.5)	3433 (9.1)	133 (0.4)	6758	17.9
1988-89	4241 (9.5)	4407 (9.9)	139 (0.3)	8757	19.8
1989-90	5010 (9.7)	4729 (9.2)	270 (0.5)	10009	19.4
1990-91	5371 (9.3)	5335 (9.3)	318 (0.6)	11024	19.1
1991-92	6788 (10.1)	7300 (10.8)	912 (1.4)	15000	22.3
1992-93	7870 (10.3)	8125 (10.6)	1158 (1.5)	17153	22.4

It is seen from the table that, the share of direct taxes in the total tax receipts sharply declined from 43.7% in 1950-51 to 32.3% by 1960-61 and 27.1% by 1970-71. During 1980s it is moving around 20%. These declining trends clearly suggest that, efforts are, required to be made to identify and bring on record the non-tax payers through introduction of presumptive

tax system in India.

The case for presumptive taxes needs attention from three angles. Identification; income estimation and provision of an effective deterrence for delinquents in the system. The most difficult task is identification of persons evading the tax.

A study conducted by the National Institute of Public Finance and Policy to find out non-tax payers in an industrial town is useful in this context. Four criteria were used for picking up samples for the study. viz. ownership of a flat/house recently constructed, motor vehicle for personal use, annual electricity consumption exceeding Rs. 1200, and residential telephone connection. On verifying different data sets, 7238 households with tax paying capacity, only 798 were filing tax returns. On a very conservative basis 6440 persons out of 7238 i.e. around 90% of potential tax payers were found to be non-tax payers.

In advanced countries like France, Italy signs of wealth such as tax payers main and secondary residences, number of domestic servants, automobiles, private planes etc. are being considered for working

out taxable income. In a country like Columbia which is considered to have most comprehensive presumptive method for finding out tax payers. All tax payers are presumed to have income of at least 8% of their net wealth and this presumption can be reduced by the Government in case abnormal conditions are found in any region of the country. Most of the developing countries have already resorted to presumptive tax to widen their tax net. Many countries are using the net wealth as a base for presumption of income. India may adopt the same criteria as adopted by NIPFP in their study and the other developing countries.

In the budget 1992 a modest beginning has already been made with introduction of presumptive tax in respect of shop keepers and other retail traders with an annual turnover of Rs. 5 lakhs. It is necessary to further broaden the area by using different criteria on the lines of NIPFP as discussed before.

It is obvious that the success of the presumptive tax system depends on the efficiency of tax administration. To support the working of the presumptive tax system, other measures like legal prescription of compulsory maintenance of books of accounts, effective tax information system, creation

of a separate research wing of experienced professionals from public finance and other related fields to recommend proper guidelines from time to time would be very essential.

The Government can adopt proper changes in the present system like tax concessions for inflation, rationalisation of tax rate structure, a firm policy on tax deduction at source, constitution of a permanent tax Commission, broad based policy on tax personnel to support the aforesaid structural reforms in direct tax laws, to make the existing tax system more effective and responsive to the changing needs of economy. Some of the steps as discussed above have been taken by the Indian Government. The following table, the data of which has been taken from Annual Report of the Ministry of Finance, 1988-89 shows the growth of Income-Tax Payers as a result of these steps adopted by the Government in the reform process.

Table-16: Growth of Income-Tax Payers

Year	Number in Million	Growth over preceding year
1975-76	3.8	-
1980-81	4.6	-
1981-82	4.7	2.2
1982-83	4.8	2.1
1983-84	4.9	2.1
1984-85	4.9	0.0
1985-86	5.5	12.2
1986-87	6.3	14.5
1987-88	7.8	23.8

"In most of the times the economic solutions are political questions" rightly said the Joan Robinson. So if the present Government possesses the necessary political will and courage then the reforms will be effected in the tax system of the country. Let us hope that the Government will adopt the pragmatic view in the area of direct tax reforms.

1.3 OBJECTIVES OF THE STUDY :

In the background of the above facts the topic 'Expenditure As a Tax Base-A conceptual evaluation' has been selected with the following objectives.

- 1) whether taxation of income as is now prevalent is useful for resources mobilisation ?
- 2) whether the existing tax base is adequate to respond to the needs of sound tax structure ?
- 3) whether any alternative tax base is possible.

On the basis of these objectives the researcher undertakes to examine the overall issues pertaining to direct taxes in the present research.

1.4 SCOPE OF THE STUDY :

The research concerning the topic "Expenditure As a Tax Base- a conceptual evaluation" is primarily based on an investigation into the existing direct tax

framework in India. The theoretical discussions relating to characteristic of good tax structure, tax base clarification of certain concepts, the rationale behind the taxation on the basis of income etc. has been studied in the present exercise. The study thus, revolves around the theoretical issues, factual data published by various authentic agencies.

1.5 SIGNIFICANCE OF THE STUDY :

It has been recently advocated by various experts in Public Finance that in a country like India the tax base is very important. Because of the fact that, the tax base on income has very narrow coverage as even a population of less than 1% is currently in the tax net. It has also been argued that, in spite of various recommendations of committees appointed by Government of India, the tax laws have remained complicated and there is massive tax evasion.

It/ ^{is} also criticised that, the contribution of direct taxes to the national exchequer is on a decline. In view of these arguments and concentration the researcher desires to examine the existing/ ^{income based} direct tax framework and study the tax base in an appropriate manner.

1.6 LIMITATIONS OF THE STUDY :

The fiscal experts often support the view that, it is impossible to adopt a fullproof framework for taxation. The researcher, therefore, is compelled to confine his exercise on the basis of the tax laws, the reports of various committees and commissions and the authoritative publications of experts. The researcher limits his study to conceptual tax base in general, and more particularly desires to examine the weaknesses of taxation on income base. Therefore, the study examines issues related to tax base and at the same time the tax enactments concerning income and expenditure.

1.7 METHODOLOGY :

The researcher has undertaken this exercise on the basis ^{of} /secondary data pertaining to the issues involved in the study. More particularly the reference is made to Income Tax Act, 1961, Expenditure Tax Act 1987, Publication in the issues of Income tax Reports, Magazines, such as Chartered Accountants and Foreign Journals. Besides the researcher has utilised the masterly authoritative contributions by Palkhiwala and other renowned contributors in Public Finance.

1.8 BRIEF CHAPTER SCHEME :

Chapter-One : Deals with the Introduction, significance, objectives of the study, scope, limitations and methodology used.

Chapter-Two : Concerns with theoretical issues concerning taxation including characteristics of sound tax system.

Chapter-Three : Concern; with the examination of tax base proper.

Chapter-Four : Deals with overall evaluation.

Chapter-Five : Deals with conclusions and suggestions.

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- 1 T.N.Pandey, " Chelliah Committee" An Incomplete
Job-I" Economic Times, 4th Sept.1992.
- 2 Ibid. P.