

CHAPTER-II

THEORETICAL ISSUES CONCERNING LEVY OF DIRECT TAXES

2.1 COMPOSITION OF TAX REVENUE :

Preceding chapter threw light on the trends in the structure of Central Government revenue for a period between 1970-71 till 1992-93. The broad division between various direct taxes such as corporation tax, income tax wealth tax estate duty etc. reveals that there is quantitative increase in the direct tax revenue and the major revenue comes from income tax comprising corporation tax and income tax. The proportion of indirect taxes is also very sizeable amounting to Rs. 59,370 crores in which the major contribution is from excise duty. Thus out of the gross tax revenue of Rs. 76,523 crores major yield comes from indirect taxes.

2.2 NEED FOR SOUND TAX STRUCTURE :

The gross tax revenue constitutes revenue from Non-agricultural sources. The contribution of agricultural sector to the gross domestic product is around 32 percent (1990-91). The States exercise jurisdiction over agricultural taxation and due to political situations and constitutional constraints agricultural sector which is very affluent remains

untaxed. This situation makes the tax system discriminatory and requires ^{us} to examine the sound tax structure to meet requirements of the economy. As stated in the first paragraph, the Indian Tax structure provides a thrust on indirect taxes. It is proved that the percentage of direct tax revenue to the total revenue is on a decline. As although, the aggregate tax revenue is increasing, the direct tax contribution is not that much responsive. This may be due to number of reasons e.g. massive tax evasion, loopholes in the tax legislation, the provision for huge deductions and exemptions, the irrational prevalence of tax rates-tax slabs and initial amount of income not liable to tax. The revenue from direct taxes can be also attributed to discriminatory tax treatments but apart from all these or in addition to all these aspects there may be a reason for adoption of a defective tax base. e.g. under the existing levy tax is imposed on income as a result of which income remains the tax base. The present chapter discusses, therefore, characteristics of sound tax structure before discussing the theoretical aspects of a tax base.

2.3 Characteristics of sound tax structure :

The tax policies make a vital impact on the economic growth of a country. It is often said that, the tax distribution burden among the individuals of the society must be equitable and therefore, the theory of public finance provides operational norms or rules for equity in the distribution of tax burdens. The equity or fairness entails application of the principle of absolute equality. The statistical computation as regards equity would be very simple e.g. total expenditure of the Government would be divided by number of tax paying units, the resultant quotient being the tax liability of each tax paying unit. Therefore, the term equity would mean equality in tax payment. However, such an extreme illustration of equity is farfetched idea because of number of economic and social compulsions. Therefore, absolute equity is a dream and fiscal theoreticians find alternative rules of equity. They are e.g. ability to pay principle and the benefit principle. The ability to pay principle determines equity on an equal sacrifice basis. It suggests that, all tax payers should bear an equal sacrifice in the payment of taxes. Thus the ability to pay constitutes a sacrifice to the tax payers in terms of the alternative uses of the tax moneys that are

forgone. The ability to pay principle further involves the concepts of horizontal equity in taxation, and vertical equity in taxation. The first implies equal sacrifice among tax payers of equal tax paying ability. This means people who are equally well should bear equal tax burden. In vertical equity, individual with unequal tax paying ability should be taxed unequally in order to equalise the sacrifice. Bernard D Herber in Modern Public Finance Fifth Edition at Page 119 observes " :Thus, horizontal equity suggests that, individuals with the same amount of tax paying ability or capacity should bear equal tax burdens, vertical equity in contrast, suggests that persons of differential taxpaying abilities should pay different amounts of tax with the greater absolute amount of tax paid by the taxpayer with the greater ability, though just how much greater an amount of tax should be paid is still another issue."

The observations of Mr. Paul A Samuelson on the horizontal equity at Page 323 in "The Economics, 14th Edition are worth further examination." In addition to these general principles tax systems attempt to incorporate modern views about fairness or equity one important principle is that of horizontal equity, which states that those who are essentially equal should be taxed equally." The notion of equal treatment of equals

has the roots in western culture. If you and I are alike in every way except the color of our eyes, all principles of taxation would hold that we should pay equal taxes. In the case of benefit taxation, if we receive exactly the same services from the highway and parks, the principle of horizontal equity states that we should therefore, pay equal taxes. Or if a tax system followed the ability to pay approach, horizontal equity would dictate that people who have equal incomes should pay the same taxes."

"A more controversial principle concerns vertical equity which concerns the tax treatment of people with different levels of income." Abstract philosophical principles provide little guidance in resolving the issues of fairness here. Imagine that A and B are alike in every respect except that B has 10 times property and income of A. Does that mean that B should pay the same absolute tax dollars as A for Government services such as police protection ? or that B should pay the same percentage of income in taxes ? Or since the police need more time to protect the property of well to do B is it perhaps fair for B to pay a larger fraction of income in taxes ?"

In fact these are highly charged political issues and not narrow economic questions. General and abstract principles of taxation simply cannot decide how different groups should be taxed."

The second principle concerns with the benefit. The different individuals under this principle should be taxed in proportion to the benefit they receive from the Government programmes such as use of collective goods like public roads or parks. BERNARD D. Herber illustrates the benefit principle at page 124 in Modern Public Finance 5th Edition as under :

"The benefit (benefits of received) principle or tax equity rule is the primary alternative to the ability to pay principle used by Western society. This principle has the advantage of directly relating the revenue and expenditure sides of the budget. Basically it involves an approximation of market behaviour in the allocative procedures of the public sector, thus combining both efficiency (allocational) and equity (distributional) considerations. That, is a person voluntarily exchanges purchasing power in the form of taxes for the acquisition of Government economic goods- a quid-pro-que arrangement whereby individual consumers pay directly for economic goods obtained from the public sector, from which goods they derive satisfaction.

The connotation of equity under this approach uses neither a monetary nor a sacrifice benchmark, but instead emphasizes the desirability of the dual facts that : (i) the exchanging of purchasing power for the economic good is voluntary, as it would be in the market sector and (ii) "payments" are made in accordance with the "benefits" received. The benefits may be priced according to either the government cost of providing the service or the value of the service to the purchase, or a combination of these considerations.

The institutional application of the benefit approach is greatly restricted, however, by the inherent nature of joint (collective) consumption. This is public type goods are characterized by the fact that the exclusion principle cannot be effectively applied to all if any of the benefits of the economic goods in question. Unless compulsion exists to require the consumers to pay, they will benefit by free-ride behaviour to avoid payment. They will not pay voluntarily many public sector economic goods, therefore not being subject to a market-type pricing mechanism, cannot be provided under the benefit approach. Hence the benefit principle is not

comprehensive enough in its application to serve as a general benchmark of the distribution of tax burdens, though it does possess merit where it can be utilized through its application of market principles to the public sector. It is generally applicable, of course in cases in which government applies the earmarked tax user-charge means of raising revenues.

The benefit principle implicitly adopts the existing state of income and wealth distribution, which provides the effective demand for the acquisition of various governmentally-supplied economic goods by an individual. The higher-income individual would exert greater effective demand over these economic goods than would a lower-income individual. If the benefit principle were subject to widespread application, or even if it were applied to important economic goods such as public school education, government might well be asked by society to provide a corollary redistributational programme of a tax-transfer nature. This would assure minimum purchasing power which would permit all citizens to acquire the essential goods supplied by the public sector.

In spite of the above discussions Government have generally adopted pragmatic solutions partially based on benefit and ability to pay approaches. Modern tax systems are an uneasy compromise between lofty principles and political pragmatism. A French Finance Minister Colbert observed, " Raising taxes is like plucking a goose: you want to get the maximum number of feathers with the minimum amount of hiss"(quoted by Samuelson in the Economics at P.No.323).

2.4 Simplicity and cost of Administration and compliance :

A good tax system should be coherent simple and straightforward in addition to being efficient and just and compatible with the country's international position.

The taxing authorities should be accountable to the electorate at large is one of the most important aspects in democratic countries. This can be so only if common man can understand clearly what is the nature of the taxpayer's liability. Tax burdens which are disguised by inflationary movements of prices or by complexities in the devising or the administration of the tax or by uncertainties in its application cannot properly meet this criterion of simplicity. There are

many aspects to this quality which are as follows :

It should be clear in the mind of taxpayer what is and what is not taxable e.g. In the case of an Income Tax there are difficulties in defining precisely what is an income, what is a capital gain, and what is a simple capital receipt, same is the case with other taxes also.

Closely allied to this question of the clear definition of what is to be taxed is the question of certainty as to the amount of tax which should be paid on each taxable object. Problems of valuation are particularly important in this connection e.g. a wealth tax which involve continual valuation of all capital assets the greater part of which are not being continuously bought and sold in a well organised market will involve much less certainty of tax burden than a tax which is levied upon acquisition or disposal of capital assets.

The principle on which the tax base is chosen should itself be simple and easy to perceive.

A tax system cannot be simple and easy to understand unless it makes a coherent whole.

A tax system must be acceptable to the public and simplicity of the system is necessary for acceptability.

Another aspect at the simplicity of a tax system is to be found in the case of its administration. Ease of understanding by the taxpayer and ^{certainty} combined but they are always not to be found together.

While considering case of administration distinction must be drawn between complexity of administration and cost of administration. the following view On "U.S. Tax System" are important in this context.

"The cost of compliance represent still another tax cost borne by the economy : the costs associated with the preparation of tax forms and related reporting requirements by household and business firms and the costs of ensuring compliance with the relevant laws by Government agencies. As tax rates have risen historically and tax forms have become increasingly complex reflecting a vast array of full or partial tax exemptions for different types of income and expenditure, the direct and indirect costs of tax compliance have grown substantially, though it is extremely difficult to obtain reliable estimates.

Such costs are likely to be most important for income taxes, where the opportunities for legally or illegally minimizing taxes are likely to offer sufficiently large financial incentives to compensate

taxpayers for a significant expenditure of their own time and frequently for out-of-pocket payment to outside experts. These imputed and monetary costs of taxpayer compliance are related to such activities as record keeping, making appropriate investment decisions, estimating taxes under alternative permissible practices, keeping up with relevant changes in the tax laws and rule, and on occasion being involved in audit procedures. These compliance costs are in addition to the allocational inefficiencies associated with the uneven tax treatment of different economic activities."

Another important test concerns with the progressivity of taxation., Paul A.Samuelson in "Economics" discussed it as under, "Today advanced countries rely heavily on progressive income taxes. A family with Rs. 50,000 of income is taxed more than one with Rs. 20,000 of income. Not only does the higher income family pay a larger income tax, but it in pays a higher fraction of its income.

This progressive tax is in contrast to a strictly proportional tax, which makes all taxpayers pay exactly the same proportion of income. A regressive tax takes a larger fraction of income in taxes from poor than from rich families..

A tax is called proportional progressive or regressive depending upon whether it takes from high income people the same fraction of income a larger fraction of income or a smaller fraction of income than it takes from low income people.

2.5 Progressive, proportional and regressive taxes

Taxes are progressive if they take a larger fraction of income as income rises : Proportional if taxes are a constant fraction of income; and regressive if they place a larger relative burden on low-income families than on high-income families.

Herber in "Modern Public Finance at Page 123 illustrates these concepts further. He observes, "In a distributional equity context a tax is classified as progressive if the amount of tax paid as a percentage of income increases as income increases. In contrastt, if the amount of tax paid as a percentage of income diminishes as income increases the tax is said to be regressive. If the amount of tax paid remains a constant proportion of increase in income, it is classified as a proportional tax."

Kaldore comments on progressivity :

The rational behind the introduction of expenditure tax appears to be convincing in view of the remarks on Indian Tax Structure by Nicholas Kaldor as under.

"An effective system of progressive direct

taxation is vital to the survival of democratic institutions in India. The need for this arises not merely on financial ground to raise adequate resources for purposes of accelerated economic development but in order to bring about the degree of social cohesion and co-operation that is essential for the successful functioning of a democratic system. In a community where there is such a wide gap between the position of a privileged minority of a well to do and the vast majority who live in dire poverty social cohesion can only be achieved if economic inequality is effectively loosened and the tendency towards increasing concentration of wealth is effectively contained. This can only be done through the instrument of taxation. It is/ ⁱⁿ any case inevitable that heavy burdens should be laid on the broad masses of the population if India is to attain satisfactory role of development in the coming decades. It will not be possible to carry through the programmes successfully with the consent and co-operation of the people : if the privileged minority of the well to do are not made to bear the fair share of this burden. Moreover in matters of taxation, like in administration of law, it is not enough that justice

should be done. It must also be seen to be done. If owing to defects in the tax laws or in their administration, highly progressive taxes of wealth and income have no visible effect on the prevailing economic inequality or in the standards of living of rich, the mere enactment of advanced tax legislation will prove fruitless.

2.6 Built in elasticity :

The developing economy has an insatiable need for resources. The tax structure, therefore, should have an ability to meet such growing needs of the Government. The Built-in elasticity of tax revenue is, therefore, very significant. It means "That the tax structure should yield automatically increasing revenue as the national income increases, without requiring the tax rates, exemptions and coverage being altered every year" Himayya in 'Perspectives on Tax Designs and Tax Reform (Ashish Publishing house P.11).

Therefore, such elasticity is necessary for a sound tax structure.

Dr. Raja Chelliah at P.No.9 and 10 in his interim Report on Tax Reforms submits as under :

This leads us to another desirable characteristic : The acceptability of the tax system. A tax system cannot be satisfactorily implemented unless it is generally acceptable to the target taxpayers i.e., taxpayers towards whom the tax system is targetted. The degree of willingness to comply with the tax law depends firstly on non-economic factors such as the social milieu and the degree of civic consciousness on the part of the population as well as the threat of prosecution in case of breach of law. Given the extent of willingness to comply, the acceptability of a tax. Structure or system will crucially depend on the perception of the population of its fairness in its innerent structure as well as in the system as it operates, the reasonableness of its burden and its simplicity which lowers the cost of compliance. The manner in which the tax proceeds are used by the government also determines the willingness to bear the burden of taxation. The fairer the system is perceived to be, the higher, other things being equal, the burden the population will be willing to bear; similarly if the leaders of the government are perceived to be using the proceeds of the taxes productively and

in the public interest, there would be greater general willingness to pay due taxes. Reasonable rates of taxes are also an important factor in determining the acceptability of the tax system.

Simplicity, certainty and stability are also essential characteristics of a sound tax system. A complicated tax system is difficult to administer, and to comply with at low or reasonable cost. It also spawns disputes and litigation because of differing interpretations of complicated provisions in the tax law. Tax structure and laws in several developing countries had become complicated for two major reasons : The first was the desire on the part of policy makers and their advisers to use the tax system for achieving many objectives besides raising revenue. Great trust was placed in the tax system in this regard in the post-war years until the seventies. This had led to the introduction of a plethora of incentive provisions into the tax laws. Since then there has been general disillusionment with the effectiveness of the provisions and a growing conviction that the provisions have made the tax law too complicated to understand and to enforce without much disputation. Also, with many deductions and exemptions the rates of tax had to be higher in

order to raise a given amount of revenue.

Before the discussion on sound tax structure ends up it may not be out of place to ^{state} one more essential attribute of a good tax structure which concerns with tax evasion, tax avoidance and tax delinquency. A sound tax system is one where there is minimum evasion avoidance and delinquency. Herber in modern Public Finance at P.127 demonstrates his views on these concepts as under :

2.7 Tax evasion, tax avoidance and tax delinquency

It is necessary to distinguish three terms in relationship to the tax ~~forceement~~ tax evasion, tax avoidable and tax delinquency. Tax evasion involves a fraudulent or deceitful efforts by a taxpayer to escape a legal tax obligation. This is a direct violation of tax law. Tax avoidance, in contrast, does not violate the letter of law. It occurs when a taxpayer arranges his/her economic behaviour in such a manner as to maximize his/her posttax economic position, that is, to minimize the amount of tax owed. This may be accomplished in the short run by the advantageous use of existing tax law provisions and in the long run, by influencing tax legislation

through the support of lobbies and pressure groups which represent the special interest of the taxpayer. Tax avoidance is lawful, while tax evasion is not. Tax delinquency refers to failure to pay a tax obligation on the date it is due. Ordinarily, tax delinquency is associated with inability to pay a tax because of inadequate funds, but it does cover the possibility of nonpayment even though funds are available. In any event, tax delinquency may be only a temporary escape from tax payment, since the government unit to which the tax is owed can place liens on the property and future earning of the taxpayer in order to secure payment eventually.

To sum up the tax structure should possess the above qualities advocated by experts. Besides the tax laws should be simple, the tax enforcement machinery must be judicious and efficient, the tax rates should be such as to provide incentive for savings and investments. There should be minimum issues for litigation etc.

2.8 Existing state Tax Reform Report by Dr.Chelliah

In the above background the existing state of tax revenues is summed up by Mr.Raja Chelliah-in his Interim report on Tax Reform under the caption "Tax level and Revenue Growth-

Table-2.1 : Cobined Tax Revenue Recepits of the Centre
States and Union Territories

Financial Year	Gross domestic product at current prices	Combined tax Revenue	Col.3 as % of Col.2
1960-61	15254	1350	8.85
1961-62	16097	1543	9.59
1962-63	17212	1865	10.84
1963-64	19671	2325	11.82
1964-65	22981	2599	11.31
1965-66	24063	2922	12.14
1966-67	27389	3261	11.91
1967-68	32187	3456	10.74
1968-69	33943	3759	11.07
1969-70	37328	4200	11.25
1970-71	39708	4752	11.97
1971-72	42248	5575	13.20
1972-73	46473	6436	13.85
1973-74	56954	7389	12.97
1974-75	67039	9223	13.76
1975-76	71201	11182	15.70
1976-77	76536	12332	16.11
1977-78	87351	13237	15.15
1978-79	93880	15528	16.54
1979-80	102442	17683	17.26
1980-81	122427	19844	16.21
1981-82	143216	24142	16.86
1982-83	159395	27242	17.09

1	2	3	4
1983-84	186723	31525	16.88
1984-85	208577	35813	17.17
1985-86	233476	43267	18.53
1986-87	259055	49539	19.12
1987-88	294266	56976	19.36
1988-89	351724	66925	19.03
1989-90	395143	76762	19.43

Source : Ministry of Finance, Indian Economic Statistics
(Public Finance)

Table 2.2 : Revenue from Taxes as percentage of Gross Domestic Product
(1970-71 to 1989-90)

Financial Year	Corporation income tax CIT	Income tax other than CIT	Wealth tax	Major Direct taxes	Customs duties	Union Excise duties	Total central tax revenue	states' tax revenue
1970-71	0.93	1.19	0.04	2.17	1.32	4.43	8.08	3.85
1971-72	1.12	1.26	0.06	2.45	1.65	4.88	9.17	4.01
1972-73	1.20	1.35	0.08	2.63	1.84	5.00	9.70	4.15
1973-74	1.02	1.30	0.06	2.40	1.75	4.57	8.91	4.05
1974-75	1.06	1.31	0.06	2.43	1.99	4.82	9.43	4.30
1975-76	1.21	1.74	0.08	3.04	1.99	5.40	10.63	4.98
1976-77	1.29	1.58	0.08	2.95	2.03	5.52	10.81	5.27
1977-78	1.40	1.15	0.06	2.61	2.09	5.09	10.14	4.98
1978-79	1.33	1.25	0.06	2.65	2.61	5.69	11.21	5.29
1979-80	1.36	1.31	0.06	2.74	2.85	5.87	11.69	5.53
1980-81	1.13	1.18	0.06	2.37	2.79	5.32	10.76	5.41
1981-82	1.38	1.03	0.05	2.47	3.01	5.19	11.07	5.76
1982-83	1.37	0.98	0.06	2.42	3.21	5.06	11.10	5.95
1983-84	1.34	0.91	0.05	2.31	3.00	5.50	11.14	5.78
1984-85	1.23	0.93	0.05	2.21	3.39	5.36	11.29	5.90
1985-86	1.22	1.07	0.07	2.37	4.07	5.53	12.24	6.21
1986-87	1.21	1.11	0.07	2.39	4.41	5.56	12.66	6.42
1987-88	1.17	1.08	0.03	2.29	4.65	5.58	12.79	6.56
1988-89	1.26	1.22	0.04	2.52	4.53	5.40	12.75	6.42
1989-90	1.20	1.27	0.05	2.51	4.56	5.67	13.07	-

Source : Computed from Table

Note : Shares of Gift Tax and other direct taxes which were also in force during the period are not shown as they were negligible throughout.

Table-2.3 : Growth Rates of Central Taxes and Income
1970 to 1990-91

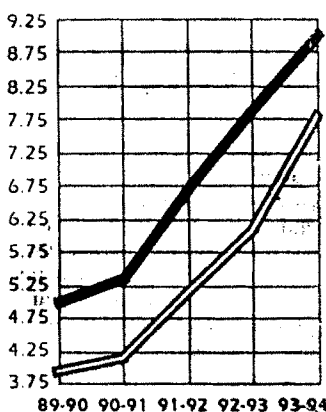
Item	Average Annual Growth Rates		
	1970-71	1980-81	1970-71
	to 1979-80	to 1989-90	to 1989-90
Corporation income tax	14.42	17.15	15.79
Income tax other than corporation income tax	12.76	14.83	13.80
Major direct taxes	13.25	15.61	14.43
Customs duties	20.96	20.03	20.49
Excise duties	14.10	14.31	14.20
Total tax revenue	15.29	16.22	15.75
Gross domestic product (GDP)	12.04	15.58	13.81
Non-agricultural GDP	13.33	15.50	14.92

NATION

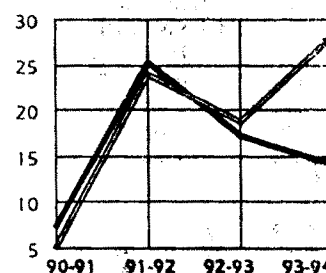
Earnings from Income Tax

States share in income tax collection rose sharply in 1993-94

Revenue Earned in Rs thousand crore



Annual Growth in %



State-wise Share

Distribution in %

Uttar Pradesh	16.787
Bihar	12.418
Andhra Pradesh	8.208
Maharashtra	8.191
Madhya Pradesh	8.185
West Bengal	7.976
Tamil Nadu	7.931
Karnataka	4.928
Rajasthan	4.836
Gujarat	4.550
Orissa	4.326
Kerala	3.729
Assam	2.631
Punjab	1.706
Haryana	1.244
J & K	0.695
Himachal	0.595
Tripura	0.303
Meghalaya	0.208
Manipur	0.171
Goa	0.110
Nagaland	0.096
Arunachal	0.073
Mizoram	0.073

% Share in Total Collection

89-90	90-91	91-92	92-93	93-94
78.38	76.73	75.86	76.82	86.30

— Total Collection — Amount Distributed to States UNI

**Tax level and revenue Growth-The Trends :
Dr.Chelliah's Observations**

By international standards the level of taxation in India is fairly high. The ratio of the tax revenue of government (Centre and the States taken together) to GNP ("The tax ratio" as it is called) currently stands at a little over 19 percent (Table 2.1). For countries with similar per capita income the average tax ratio is around 12-13 per cent. At the time when the country launched its first five year plan, the tax ratio was less than 10 percent. Even in 1970-71 it was less than 12 percent. While the ratio is still way below that of industrial countries, if tax ratios are regressed on per capita GDP, India stands above the "trend" line (chart-3.1). Sustained efforts towards raising resources for the government through taxation in the last two decades have pushed up the ratio of taxation to its present level. However, the growth in tax revenue that underlies this impressive rise in the tax ratio has come about more through changes made in the base and the rates of the taxes from year to year than from an automatic increase in response to changes in incomes and prices. The increase is also accounted for largely by the rise in the level of commodity taxes

consisting principally of the Union excise duties and customs at the Central level and sales taxes at the level of the states.

Of the tax revenues of the government (centre and the states combined), roughly two-thirds (67 percent) are collected at the central level. The proportion seems to have remained steady over the years. The ratio of Central Tax Revenue to GDP has gone up from 8 percent in 1970-71 to nearly 13 percent to 19 percent during 1989-90 as the aggregate tax ratio has moved up from 13 percent to 19 percent during the same period (Table 2.2) over the 20 years, 1971-90, Central Tax Revenues (gross) grew at the rate of 15.8 percent per annum as against a growth rate of 13.8 percent in GDP and 14.9 percent in non-agricultural GDP. The growth has been faster during the 1980s than in the 1970s (16.2 percent as against 15.3 percent vide Table 2.3). However, the buoyancy of the Central Taxes with respect to GDP registered a decline, though slight, during the 1980s compared to the 1970s (1.2 as against 1.3 vide Table 2.3). Direct taxes consisting mainly of income tax personal and corporate had a slower growth than that of non-agricultural GDP. During the entire period of

1970-71 to 1989-90, major direct taxes registered a growth rate of 14.4 percent per annum while non agricultural GDP grew at the rate of 14.9 percent (Table 2.3). The gap between the growth in direct taxes and that of non-agricultural GDP has widened during the 1980s(15.6 percent as against 16.5 percent).

Government of India earlier had appointed a Tax Reforms Committee headed by Prof.Nicholas Kaldore a British Economist. He was to suggest an efficient and equitable tax system to meet the needs of a growing economy. He felt that the existing tax structure doesnot exhibit natural buoyancy that is automatic rise in yields with the increasing in national production and income. Indian tax structure has been heavily criticised as it lacks required elasticity as well s buoyancy. It has further been argued that the Income Tax structure suffers from lack of equity because the certain incomes such as agriculture income are still not subjected to tax. There are innumerable exemptions and deductions. For the purpose of illustration it would not be irrelevant if the exemptions under sec 10 are perused. There are nearly 32 exemptions following singularly

under this section. The list of exemptions is stretched further under section 10A which exempts income of newly established industrial undertakings in free tax zones, Sec.10B. exempts income of 100% export oriented undertakings, section 11, exempts income from property held for charitable or religious purposes, Sec.12 exempts income of trust or institutions from contributions and finally Sec.13A exempts incomes of political parties. There are also innumerable deductions under the head income from business or professions as under :

2.10 Value Of Deductions Under Business Income :

Sr.No.	Section	Particulars
1	2	3
1	30	Rent, Rates, taxes, repairs and insurance for buildings.
2	31	Repairs and insurance of machinery, plant and furniture.
3	32	Depreciation
4	32A	Investment allowance
5	32AB	Investment deposit account
6	33	Development allowance
7	33A	Development allowance

1	2	3
<hr/>		
8	33AB	Tea development account
9	33AC	Reserves for shipping business
10	33B	Rehabilitation allowance
11	34	Conditions for depreciation allowance and development rebate
12	34A	Restriction on unabsorbed depreciation and unabsorbed investment allowance for limited period in case of certain domestic companies.
13	35	Expenditure on scientific research
14	35A	Expenditure on acquisition of patent rights or copyrights
15	35AB	Expenditure on know-how
16	35AC	Expenditure on eligible projects or schemes
17	35CCA	Expenditure by way of payment to associations and institutions for carrying out rural rural development programmes
18	35CCB	Expenditure by way of payment of association and institutions for carrying out programmes of conservation of natural resources.

1	2	3
19	35D	amortisation of certain preliminary expenses
20	35E	Deduction for expenditure on prospecting etc. for certain minerals
21	36	Other deduction
22	37	General
23	38	Building, etc; partly used for business etc; or not exclusively so used
24	40	Amount not deductible
25	40A	Expenses or payments not deductible in certain circumstances
26	41	Profit chargeable to tax
27	42	Special provision for deduction in the case of business for prospecting, etc. for mineral oil
28	43	Definitions of certain terms relevant to income from profits and gains of business or profession
29	43A	Special provisions consequential to changes in rate of exchange of currency
30	43B	Certain deductions to be only on actual payment
31	43C	Special provision for computation of cost of acquisition of certain assets

1	2	3
32	43D	Special provision in case of income of public financial institutions etc.
33	44	Insurance business. In addition there are further deduction in computing to total income chapter vi-a of income Tax Act. Deduction in respect of investment permanent disability.
34	80CC	Deduction in respect of investment in certain new shares
35	80CCA	Deduction in respect of deposits under National ¹ saving scheme or payment to a deferred annuity plan
36	80CCB	Deduction in respect of investment made under equity linked saving scheme
37	80D	Deduction in respect of medical insurance premia
38	80DD	Deduction in respect of medical treatment etc; of handicapped dependents
39	80G	Deduction in respect of donations to certain funds, charitable institutions etc

1	2	3
40	80GG	Deduction in respect of rents paid
41	80GGA	Deduction in respect of certain donations for scientific research or rural development C. Deduction in respect of certain incomes.
42	80HH	Deduction in respect of profit and gains from newly established industrial undertakings or hotel business in backward area
43	80HHA	Deduction in respect of profit and gains from newly established small scale industrial undertakings in certain areas.
44	80HHB	Deduction in respect of profits and gains from projects outside India
45	80HHC	Deduction in respect of profit retained for export business.
46	80HHD	Deduction in respect of earnings in convertible foreign exchange
47	80HHE	Deduction in respect of profit from export of computer software, etc.
48	80-I	Deduction in respect of profit and gains from industrial undertakings after a certain date etc.

1	2	3
49	80-IA	Deduction in respect of profits and gains from industrial undertakings, etc in certain cases
50	80J	Deduction in respect of profit and gains from newly established industrial undertakings or ship or hotel business in certain cases
51	80JJ	Deduction in respect of profits and gains from business of poultry farming
52	80L	Deduction in respect of interest on certain securities, dividends etc.
53	80M	Deduction in respect of certain inter corporate dividends
54	80-O	Deduction in respect of royalties etc from certain foreign enterprises
55	80P	Deduction in respect of income of co-operative societies
56	80Q	Deduction in respect of profit and gains from the business of publication of books
57	80QQA	Deduction in respect of professional income of authors of text books in Indian languages

1	2	3
58	80R	Deduction in respect of remuneration from certain foreign sources in the case of professors ,teachers etc.
59	80RR	Deduction in respect of professional income from foreign sources in certain cases
60	80RRA	Deduction in respect of remuneration received for services rendered outside India. D-other deductions
61	80U	Deduction in the case of permanent physical disability (including blindness)

2.11 INCOME AS TAX BASE : DEFINITION :

Under the existing tax design tax is levied on income and the term income itself is subjected to huge ambiguities and vast litigations. The tax is on income which is defined under Sec.2. inclusively Sec.2 runs as under :

"Income" includes-(i) profits and gains (ii) dividend; (iia) voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes [or by an association or institution referred to in clause (21) or clause (23) or by fund or trust or institution referred to in sub-clause (iv) or sub clause (v) of (23C) of section 10).

The value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of section 17 :

Any special allowance or benefit, other than perquisite included under sub-clause(iii) specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.

Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.

The value of any benefit or prerequisite, where convertible into money or not, obtained from a company either by a Director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

The value of any benefit or prerequisite, whether convertible into money or not, obtained by any representative assessee mentioned in clause (iii) or clause (iv) of sub section (1) of section 160 or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee (such person being hereafter in this sub clause referred to as the beneficiary) and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary;

Any sum chargeable to income tax under clauses (ii) and (iii) of section 28 or section 41 or section 59.

Any sum of chargeable to income tax under clause (iiia) of section 28.

Any sum chargeable to income tax under clause (iiib) of section 28;

Any sum chargeable to income tax under clause (iiic) of section 28;

The value of any benefit or prerequisite taxable under clause (iv) of section 28;

Any sum chargeable to income tax under clause (v) of section 29;

Any capital gains chargeable under section 45;

The profits and gains of any business of Insurance carried on by a mutual insurance company or by a cooperative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First schedule;

Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever;

Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 (34 of 1948), or any other fund for the welfare of such employees;

The income itself is classified under Sec.14 as under :

Heads of Income : Classifications :

Save as otherwise provided by this Act, all income shall, for the purposes of charge of income-tax and computation of total income, be classified under the following heads of income :

- A Salaries
- C Income from house property
- D Profits and gains of business or profession
- E Capital gains
- F Income from other sources.

The tax is levied on income the scope of which depends upon Sec.5 which runs as :

1) Subject to the provisions of this Act, the total income of any previous year of person who is a resident includes all income from whatever source derived which :

- a) is received or is deemed to be received in India in such year by or on behalf of such person; or
- b) accrues or arises or is deemed to accrue or arise to him in India during such year; or
- c) accrues or arises to him outside India during such year;

Provided that, in the case of a person not ordinarily resident in Indiaa within the meaning of sub-section (6)* of section 6, the income which accrues or arises to him outside India shakll not be so included unless it is derived from a business controlled in or a profession set up in India.

Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived with-

- a) is received or is deemed to be received in India in such year by or on behalf of such person; or
- b) accrues or arises or is deemed to accrue or arise to him in India during such year.

The income is further dependant upon the resident of an assessee for which test has been laid down as under Section 6 :

Residence in India : Another Limiting Factor U/S of The Act :

An individual is said to be in India in any previous year, if he-

- a) is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more; or

b) 42[**] ;

c) having within the four years preceding that year been in India for a period or periods amounting all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to sixty days or more in that year.

Explanation : In the case of an individual :

- a) being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958), or for the purposes of employment outside India, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted;
- b) being a citizen of India, or a person of India origin within the meaning of Explanation to clause (e) of section 115C, who, being outside India, comes on a visit to India in any previous year, the provisions of sub-clause (c) shall apply in relation to that year as if for the words, "sixty days" occurring therein, the words "one hundred and fifty days" had been substituted.

A Hindu undivided family, firm or other association of persons is said to be resident in India in any previous year in every case except where during the year control and management of its affairs is situated wholly outside India.

A company is said to be resident in India in any previous year, if-

- i) It is an Indian company; or
- ii) during that year, the control and management of its affairs is situated wholly in India.

Every other person is said to be resident in India in any previous year in every case, except where during that year the control and management of his affairs is situated wholly outside India.

If a person is resident in India in a previous year relevant to an assessment year in respect of any source of income, he shall be deemed to be resident in India in the previous year relevant to the assessment year in respect of each of his other sources of income.

A person is said to be "not ordinarily resident" in India in any previous year if such person is-

- a) An individual who has not been resident in India in nine out of the ten previous years preceding

that year, or has not during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and thirty days or more; or

A Hindu undivided family whose manager has not been resident in India in nine out of the ten previous years preceding that year or has not during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and thirty days or more.

The charging provisions that subject income to the levy of tax is clarified in Sec 4 as under :

Charge of Income Tax : Statutory Provision. U/S

1) Where any Central Act enacts that income tax shall be charged for any assessment year at any rate or rates, income tax at that rate or those rates shall be charged for that year in accordance with, and [subject to the provisions (including provisions for the levy of additional income tax) of, this Act] in respect of the total income of the previous year[**] of every person; Provided that where by virtue of any provision of this Act income tax is to be charged in respect of the income of a period other than the previous year, income tax shall be charged accordingly.

2) In respect of income chargeable under sub section (1), income tax shall be deducted at the source or paid in advance , where it is so deductible or payable under any provision of this Act.

The term person determines the various taxable entities subjected to tax as under :

"Person" includes- U.S (2/31)

- i) an individual,
- ii) a Hindu undivided family
- iii) a company
- iv) a firm
- v) an association of persons or a body of individuals, whether incorporated or not
- vi) a local authority, and
- vii) every artificial juridical person, not falling within any of the preceding sub-clauses;

Here it can be seen that in case of companies there were again number of sub-entities such as Trading Companies, Industrial Companies, Indian Companies, Foreign Companies, Companies in which public are substantially interested, Domestic Companies etc.

2.12 TAX EVASION :

The main issue and the cause for concern regarding the taxation of income is that the existing legislation has failed in counteracting tax evasion. Which in a country like India assume extra significance. Right from the British legislation the tax evaders have through out indulged in the loopholes of the Tax legislation. The distinction between tax evasion and tax avoidance is very thin and the persons take advantage by manipulating the tax planning device. Various committees and commissions have been appointed by the Government and their recommendations have been partially followed. However, the disease is so deep that it has posed a problem for fiscal experts and apparently it looks that it is incurable. The tax evasion influences the tax legislation in an adverse manner. First the honest tax payers are always at a disadvantage and the dishonest crooks rob the national exchequer. The basic cannon of taxation of bridging the gap between the rich and the poor frustrates and contrary to this objective the rich becomes richer on the corrupt administrative setup. The main issue therefore before the concerned authorities of fiscal legislation is as regards minimisation of tax evasion.

The volume of tax evasion, causes of and remedial measures have been discussed by H.L.Bhatia in Public Finance as under :

"The problem of tax evasion and avoidance is one of the most serious ones of our tax system."

Estimates of tax evasion have varied quite widely. the taxation Enquiry Commission estimated the evasion of income tax at Rs. 500 crores. Kaldor estimated that between Rs. 200-300 crores were being evaded, while the Direct Taxes Administration Enquiry Committee put the figure at barely Rs. 20-30 crores. Rangnekar estimated that black income grew at rate of 13.3% p.a. against that of national income(in money trms)at 10.8% p.a. and against inflation rate of 6.9%p.a. between 1961-62 to 1969-70 in absolute terms from Rs. 1,150 crores in 1961-62 to Rs. 3,080 crores in 1969-70 S.N.Prasad in his "Estimates of Black Income in India" (Economic Times, Jan.21 1983) estimated an increase from Rs. 701 crores in 1953-54 to Rs. 12,611 crores in 1979-80. There are still other estimates which are at great variance with the ones mentioned here. Recently, quite a few more studies have tried to use different approaches for measuring the extent of unaccounted income. In June 1990, the Union Finance

Minister put the figure at Rs. 80,000 crores. All these estimates show that the extent of tax evasion is anybody's guess. This is because these are only subjective estimates and have no authentic basis. And it has become impossible to estimate its cumulative figure and the forms of wealth in which it is being held, more particularly by the burgeoning class of middle level entrepreneurs. But one thing is certain. With the passage of time, the growth of economy, complexity and variety of taxes, tax evasion has certainly increased to a very large extent. And evasion of tax is not confined to only direct taxes. Indirect taxes are also being evaded very extensively whereby both the consumers and the Government lose. It may be argued by some that to some extent the growing complexity of our tax laws is inevitable due to certain inherent tendencies connected with an expanding tax system. But defective policies pursued by the Government have fed these tendencies. There have been many number of committees and study groups. Unfortunately, the recommendations made by such committees are mostly formulated for short term and contradictory objectives. They led to greater of tax machinery, more records, more inspections, and more complicated procedures. Consequently, their recommendations remain not only deficient but also add to the existing drawbacks.

The Causes

The reasons for tax evasion are many and interdependent. In some circles it is believed that in India high rates of direct taxation are basically responsible for large scale tax evasion. This is only partly true. High rates only make the tax evasion more tempting. As Wanchoo Committee asserts the tax evaders are ready to take greater risks if they find that in the event of success the reward is high. This was one of the arguments given by Kaldor and repeated by Wanchoo Committee for reducing the tax rates in the upper slabs. But high rates by themselves do not explain all the tax evasion. There have to be opportunities also to this end. Given the scope, taxes will be evaded even at lower rates, since in general nobody likes to pay taxes. Thus even in the case of indirect taxes like sales tax, excise duties etc. Where the incidence can be mostly shifted to the purchasers, the sellers resort to tax evasion if they can. This practice helps them in increasing their own incomes by cheating the Government of its legitimate revenue. Thus, we may conclude that large scale tax evasion is basically the result of opportunities to evade tax though high tax rates strengthen the desire

for this malpractice. However, there are certain built-in-factors which prompt the tax payers to resort to evasion. Both L.K.Jha and Wanchoo Committees claim that financing of elections is major black income generating force in our country. Inflationary price rise not only leads to a generation of abnormal profit income but also eats into real purchasing power of fixed income groups.

Opportunities for tax evasion emanate from many sources. Our economy is yet an underdeveloped one and there are information gaps at all levels. Appropriate accounts are not maintained by most individuals and even by most farmers and small businessmen etc.

This enables many tax payers in concealing or twisting of factual information and thus evading taxes. Actually quite a number of potential tax payers just do not come to the notice of the tax collecting authorities. Such concealing or misrepresentation of facts is not limited to the field of direct taxes only.

Another opportunity for tax evasion comes to the way of tax dodgers in the form of complicated tax laws. Our tax laws are highly complicated and coupled with insufficient information on the working of the

taxpaying economic units, a state of confusion arises. Similarly, indirect taxes are subject to thousands of changing tax provisions, rebates and other details.

Investment in real property (movable and immovable), concealing their true ownership and benefit including price appreciation, and capital gains constitute another set of devices for tax evasion. This happens more so through benami holdings (which were banned in 1989, but still continue to exist), bearer bonds and blank transfers of shares. Absence of a comprehensive reporting system on income, wealth transactions and benefits of a tax-payer provide a source of misrepresentation of facts and cheating the authorities. To this may be added the imperfect tax administration.

Wanchoo Committee points out that a system of shortages, controls and licences also breeds tax evasion and black money. The Committee also lists donations to political parties as another factor in the same process.

It goes without saying that the evil of tax evasion should be eradicated from the country. Amongst various advantages, it will enable the authorities to raise additional resources without corresponding

increasing in tax rates by spreading the tax net. It may even be possible for the authorities to lower certain tax rates. If tax evasion is there, the tax system is always likely to lack adequacy and buoyancy which are two of the basic features of a good tax system. Furthermore, tax evasion breeds black money which creates its own parallel economy.

Artificial scarcities are added to the genuine ones and inflationary pressures are strengthened and effectiveness of Government's fiscal and monetary measures is either lost or reduced. The productive resources of the economy are diverted into less desirable and sometimes even undesirable channels. It causes a considerable amount of leakage of foreign exchange through shady foreign trade deals, and also through wrong invoicing, secret cuts and commissions on joint ventures and collaboration agreements involving Indian and foreign parties. Moreover, as tax evasion increases, the tax burden on those who are paying the taxes has to move up in order to provide as much revenue to the Government as told, the effects of tax evasion and black money can only be termed disastrous.

Remedial Measures

Various proposals have been put forth from time to time for checking the evil of tax evasion. Their main drawback, however, has been that they have been advocating only stricter enforcing of tax laws and making the laws themselves less complicated. Hardly any attention was paid to the innerent defects in the organisational structure of our economy (that is relying on controls and regulations than on market forces) which generates black money and wealth. One such important set of proposals is found in the Indian Tax Reforms-Report of a Survey by Nicholas Kaldor in 1956.

Kaldor emphasised the need to have appropriate conceptual definitions of income, etc. This would ensure simplicity and certainty and thereby reduce the scope for tax evasion. Furthermore, he wanted a two pronged attack on the problem, viz. reducing the incentives for tax evasion and providing greater obstacles in its way. Kaldor believed that a high marginal income tax rate meant a correspondingly big reward for concealing income. This view was also substantiated by most of the economists, professors, departmental officers and others who testified before

the Wanchoo Committee. When the marginal rate of taxation is as high as 97.75 percent, the net profit on concealment can be as high as 4,300 percent, of the after tax income. The implication of 97.75 percent income tax is that it is more profitable at a certain level of income to evade tax on Rs. 30 that earn honestly Rs. 1000. We will not be surprised that placed in such a situation it would be difficult for a person to resist the temptation of evade taxes. In other words, if tax rates are reduced, people will be less ready to incur expenditure and take risk of tax evasion because the corresponding reward in the event of success will be smaller.

Kaldor's set of proposals to put hurdles in the way of tax evasion included the supplementing of income tax with four more taxes, viz. capital gains tax, annual tax on wealth, personal expenditure tax, and gift tax. Such a composite tax system was designed to ensure that a tax-payer was not able to evade tax liability by camouflaging or concealing his economic activities or the result thereof. Furthermore, he wanted a comprehensive return concerning the personal accounts of each tax payer and the introduction of a reporting system of all capital transaction by means

of tax vouchers. For the latter purpose a national register was to be maintained. He believed that a comprehensive return along with a multiplicity of direct taxes and the national register would reduce the scope for tax evasion through falsification of accounts. An effort to save some tax liability in one direction would result in an enhanced tax liability in the other, or the tax liability of some other taxpayer would have to increase (in which case the other taxpayer would not permit such falsification by the first one).

All these steps, however, could not ensure a complete plugging of tax evasion. First, the proposals covered only direct taxes, and secondly because all individuals are not tax-payers. Kaldor, therefore, recommended some additional steps to help the tax authorities in toning up the tax machinery. Kaldor suggested that the tax-payers whose incomes exceeded a certain limit must be made to have their accounts compulsorily audited with the statutory obligation on the chartered accountants to examine whether the accounts presented were drawn up in an appropriate manner so as to show the true chargeable income for tax purposes. He recommended that each taxpayer should be supplied with a code number and it should

be obligatory in the case of all property transfers to disclose the code number of the transferor and the transferee. And all these steps were to be supplemented by a system of deterrent punishment in the case of detection of tax evasion.

The Government introduced the taxes as recommended by Kaldor, but did not accept most other recommendations. Code numbers to tax-payers were not allotted, the system of a comprehensive single return was not adopted. A national register for recording the property and capital transactions was not introduced and the marginal rates of taxation were not reduced. The recommendation regarding the compulsory auditing remained on paper. And in the absence of these additional measures, the introduction of additional taxes did not reduce the evil of tax evasion.

IN June 1958, the Government appointed the Direct Taxes Administration Enquiry Committee under the chairmanship of Shri. Manavir Tyagi with the specific objective of implementing the integrated scheme of direct taxation with due regard to the need for eliminating tax evasion and avoiding inconvenience to the assesseees. Strangely enough, a number of

suggestions made by Kaldor for plugging the tax evasion did not find favour with this Committee. For example, the Committee did not favour the idea of a comprehensive single tax return. Instead it suggested a few changes in the administrative procedure and wanted the authorities to enlist public cooperation in tax evasion. The evil of tax evasion, obviously, continued unabated.

The main loop-hole of the direct tax structure in India is tax evasion on massive scale. This was attempted to be contracted by introducing various voluntary disclosure schemes. The substance of the schemes has been heavily criticised by H.L.Bhatia in public finance as under :

Amongst various measures to check the evil of black money is the voluntary disclosure of black income and wealth by the tax dodgers. Since Independence, number of such schemes have come into force, though none has been able to unearth all the black money and wealth or prevent their further generation. As argued by the Wanchoo Committee, such schemes help the fraudulent people at the cost of the

honest and law abiding tax payers and this has demoralising effect for them. In a number of cases the same set of people took advantage of tax concessions under all the schemes indicating that such schemes do not reform the law breakers. These schemes do not tackle the problem of generation of black money or the intention to conceal the ill-gotten income and wealth. We may add that these schemes are also highly inequitable as between different tax payers. Resorting too frequently to such a measure of voluntary disclosure shakes the confidence of the honest tax payers and encourage the unscrupulous tax evaders. The tax enforcement machinery also loses respect in the eyes of the tax payers. The Wanchoo Committee contested the claim that voluntary disclosures broaden the base of investment and accelerate economic growth since the concealed amount happens to be, by a large already invested in a surreptitious manner. However, such an investment by tax evaders is mostly in economically and socially low priority or even undesirable lines of investment. The schemes have the advantage of shifting the same to areas of accepted priorities.

A voluntary disclosure scheme was announced in 1951 in which the penal provisions of the tax laws were relaxed to persuade the tax evaders to come forth and disclose their unaccounted incomes. The second was brought into being under Section 68 of the Finance Act of 1965. Thus scheme was popularly known as the 60-40 scheme since the tax evaders were to pay 60% of the disclosed income by way of tax and the remaining 40% could be brought into books of account (that is could be converted into white money). This was followed by another scheme in the same year under Section 24 of the Finance (No.2) Act, 1965. This scheme was known as the 'Block Scheme', because according to its provisions the tax payable was determined according to the block of income disclosed and not at flat rate of 60%. The total disclosure under the three schemes amounted to only 267 crores, which in the view of the Wanchoo Committee was only a small fraction of the concealed income during 15 years from 1951 to 1965. the grand total of the tax yield of the three schemes was only Rs.61.23 crores.

The next scheme was announced on 8th Oct.1975 which enabled persons and firms with black income and wealth to take advantage of this scheme. It provided that all black income would be clubbed together

irrespective of the years over which this was earned and treated as a block separately from other taxable income for the purposes of income tax liability. It provided for a concessional rate of (25% to 60%) tax on income disclosed under this scheme. The declarant was to invest 5% of the disclosed income and 25% of the disclosed wealth in notified Government securities.

The total disclosures of income and wealth under this scheme turned out to be more than Rs. 1500 crores leading to an income tax realisation of over Rs. 250 crores and a corresponding investment of about Rs. 40 crores in government approved securities. But irrespective of the actual amount of black money declared under this scheme, we can safely say that it was still a small proportion of the total hidden amount. It only enabled the tax evaders to come clean in so far as their past deeds were concerned. As discussed earlier, in itself, the scheme did not and could not provide for plugging the loopholes in the working of the economy and the legal structure through consumption. the probability of a person getting caught is more if he conceals his income from the authorities by putting it in some form of taxable assets. But if he consumes it away, he is less likely to be caught.

In early 1981, the Government again introduced a scheme of bringing black money out of the parallel economy. Under this scheme, Special Bearer Bonds were offered to the public to be redeemed after ten years (in 1991) and carrying a simple interest rate of 2% p.a. The Bonds were marketable and the holders did not have to explain their origin. The mere fact of their possession did not make any person liable to tax, or prosecution under direct tax laws, making the scheme independent of the tax system. Commercial banks could grant advances against bonds as collateral security, but they were not permitted to purchase them. On their redemption, the holders were able to bring them into their books. The value of the bonds and interest thereon were exempt from income taxation and wealth taxation till their redemption. The bonds yielded Rs. 88.66 crores to the Government in 1980-81 and Rs. 875.26 crores in 1980-81. Their redemption began in October 1990.

Over the last few years, a number of voluntary disclosure schemes have been introduced with a variety of coverage and contents and with a varying degree of success. The latest in the series were launched in 1991 in pursuance of the indication given in the Budget for 1991-92 namely, the following :

1 Under the first scheme, any tax payer could deposit any amount with the National Housing Bank(during a prescribed period) of the deposited amount 40% was to be deducted as a special levy (to be used for housing schemes for the poor) and the remaining 60% could be withdrawn by the depositor in one or more instalments any time after the deposit was made. The depositor enjoyed all varieties of immunity from tax laws and related economic offences.

2 The second scheme enabled any person in India to receive foreign exchange from abroad without disclosing the name of the person/agency etc. who actually took it out illegally. the money could be received by any mode and only the mode amount and date of remittance alongwith the names of the recipients and authorized dealer were to be disclosed. The recipients were extended full immunity from investigation and for having committed any economic offence under any provision or Act.

3 The third scheme took the form of India Development Bonds floated by State Bank of India. the first series of such bonds had been floated in 1988 and the second in 1990 and fetched 591 million and 5261 million respectively. The series under consideration was made extremely attractive. Both the

principal and the interest of the interest of the Bonds were denominated in US dollars and pound sterling. They had a maturity of five years and carried a high rate of 9.5% p.a. Moreover, the bondholders enjoyed complete immunity from any kind of investigation into the nature and sources of funds under any tax law and Foreign Contributions (Regulation) Act.

It was expected that these schemes would enable the country in bringing in a large amount of foreign exchange and bring into open unaccounted income and wealth. By 10th of Feb. 1992, actual inflow of foreign exchange through the schemes equalled \$ 52144 million.

The tax evasion prevailing today the causes thereof, the remedial measures adopted by the Government have failed. It appears that there is something inherently wrong with the fundamental issues going deep to the tax structure.

The taxation of income at a reasonable rate encourages the economic activity, spurs savings and thus contributes to the economic growth through investments. The high rates of taxes has a disincentive effect and encourages tax evasion. There is a global trend in tax reforms by structural reduction in the tax rates, tax slabs etc. The following table extracted from British Tax System Fifth edition, by J.A.KAY and M.A.King at P.2.23 throws light on this aspect.

Table-2.4 : Changes in income tax schedule 1975-89

Name	No.of brackets		Maximum rate	
	1975	1989	1975	1989
Australia	07	04	65	49
Belgium (a)	11	07	60	55
Canada (a)	13	03	47	29
France	13	13	60	57
Germany	Verg large (b)		56	56
Ireland	06	03	72	58
Italy	32	07	72	60
Japan (a)	19	05	75	50
Netherland	10	08(1990)	71	60
Newzealand	22	02	57	33
Sweden (a)	111	03	56	42
UK	10	02	83	40
US(a)	25	02	70	33

Source : Chossen and Messere(1989)

Note : a indicate - local income taxes payable in addition.

b indicate Has polynominal formula tax schedule

c indicate comparable because integrated with social security

The following observations, however, go to the root of the issue that "high marginal tax rates on big incomes may seem fair. But they waste economic resources and may not even raise much money".

The observations at P.No.72 in the Economist dated April 1994 are very important.

The 1980s fashion for cutting income-tax rates now seems to be in reverse. In 1980 America's top federal tax rate was 70% by 1988, after the 1986 tax reform act, it was down to 28% but was later raised to 31%. It was now 41%. Adding in local income taxes, top earning now face a total marginal tax rate of almost 50%.

Britain, another tax-cutting pioneer, slashed its highest marginal rate of tax on earned income from 83% (and a staggering 98% on unearned income) to 40% between 1979 and 1988. In recent years, however, tax bands and allowances have not been raised in line with inflation, so more taxpayers have been dragged up from the 25% to the 40% bracket.

The economic case for trimming marginal income tax rates was and still is sound. The simplest version of it focuses on work incentives. High tax rates, the story goes, make people work-shy : they are less

inclined to put in another hour or seek promotion, because a big slice of their extra earning will go to the taxman.

The snag is that this tale is incomplete. True, a higher marginal tax rate makes an extra hour's toil less rewarding, but higher taxes also mean that workers have to work longer hours to take home the same amount of cash. Economic theory cannot predict which effect will dominate.

Most empirical studies of male employment suggest that the pro-and antiwork effects cancel each other out. This is good news for governments that want to raise cash, even at the risk of distorting marginal work incentives. If increased taxes do not affect how long people work, they will have little effect on earnings, and other things being equal, will therefore haul in plenty of revenue.

But Martin Feldstein, head of America's National Bureau of Economic Research and Chairman of the Council of Economic Advisers between 1982 and 1984, reckons that America's latest tax increases will raise far less cash than Bill Clinton's administration hopes.

In India the tax rates fluctuate very often and various authorities confirmed the fact that the high rates of taxation are the main reasons for tax evasion. Now the tax base in India is also narrow and the revenue requirements, are much more. IN this background the high tax rates affect very few pockets leaving untaxed bulk of the society. The taxation of income at present stage has proved ineffective in widening the tax base and therefore, unless there is fundamental change in the tax structure, there is no scope for reducing the tax rates and consequently encouraging the economic growth.

The taxation of income therefore, appears a weak device in a country like India where a majority of a society remains outside the tax net. The reduction of tax rates decreases the tax revenue and increase in the tax rates provides disincentives. Therefore, a tax structure should be such that with the reasonable tax level higher revenues should be fetched.

Govt. of India on the basis of recommendation of Chellian Committee introduced pre-emptive taxation scheme recently. Under this scheme small assesseees were allowed to pay a fixed tax of Rs. 1400 and get

rid-off submission of return and enquiries etc. The scheme was available for small traders hawkers, retailers. In the budget speech for 1994-95 the Finance Minister further modified and widened the said scheme for broadening the tax net Dr.Manmohan Singh in his budget speech dated March 1,1994 at Paragraph 114 and 115 observes.

We have been implementing a simple presumptive scheme of taxation for the assesseees in the unorganised sector for the past two years. The scheme was to have ended with this year. I propose to continue with the scheme. My hope is that more people will avail of this very simple scheme and come forward readily to contribute their mite to the national tax effort without any fear or inhibition.

In addition, I am introducing a new estimated income scheme for contractors with a turnover of upto Rs. 40 lakhs and for truck-owners who own upto ten trucks. In the case of contractors, the net profit will be estimated at 8 percent of the gross receipts. In the case of truck owners, the income will be estimated at Rs. 24,000 per truck per year for Light Commercial Vehicles and Medium Motor Vehicles and

Rs. 30,000 per truck per year for Heavy Transport Motor Vehicles. IN both these cases, no further deduction on account of depreciation or interest or other expenses will be allowed. In both cases, the scheme is optional. This scheme is based on the recommendation of the Chellian Committee on Tax Reforms. The scheme will be simple and free of irritants, and I expect an enthusiastic response.

However, the results of the presumptive Taxation are not encouraging and it has not significantly contributed to the objectives desired.

The tax offenders and evaders have practically made the Tax structure a mockery as in spite of these schemes" less than 3% of Rs. 80,00,000 cross gross national product was collected by of direct taxation. (Financial Express 18th May 1994).

An addition of 1% to GNP provides Rs. 8000 crores to the national ex-chequers.

The aforesaid facts and circumstances necessiated a new alternative feasible tax structure which should be responsive to the growing needs of a developing ^{economy} / The alternative tax structure should have wider tax base minimise tax evasion provide vary

Moderate rate structure and give no scope for discretion and discrimination in legislative constitutional or administrative grounds.

Table-2.5 : Actual Collections

	1993-94		Revised budget estimates		
	1992-93	Amount	% Change	1992-93	1993-94
Direct tax revenues	11200+	11412+	1.9	17500	20000
Indirect tax revenues	54608	53651	-1.8	57423	54250
Excise	30832	31592	2.5	32211	31750
Customs + corporate tax and income tax	23776	22059	-7.2	25212	22500
*April-December					

Source : Economic Times

While dealing with the income based tax policies a country like India poised for economic growth a resource raising ability is also an important factor in adopting a rationalised tax structure. The observations from financial express March 13, 1994 are relevant from this point of view.

"The basic issue sometimes starts with the fact whether a tax policy should necessarily be different for developing and developed countries. In a book titled "Tax Policy and Planning in Developing Country". Edited by Ameresh Bagchi and Necholes Stern, it is observed that, "While it must be acknowledged that the economically advanced countries rely more on direct taxes and the poor nations on indirect or commodity taxes, the compulsions of revenue mobilisation are not, by any means, less in respect of Government in market economy countries and more as regards those where the State has a substantial role in development activity. We must do well to remember that in countries where the market forces are generally allowed a free play the Government assumes a lot of responsibility for social security and even more so for defence. In fact, the gun and butter debate is as old as fiscal policy. The size of the US federal deficit and the transformation of the United States from the biggest debtor reflect the growing pressure on the public exchequer and, to that extent, on the tax collector, as Colbert would have said."

In developing countries also, the conflict between guns and butter is very strong. Indeed, the complaint of the World Bank is that they are spending more on defence preparedness than justified by their development needs and wants a cut in defence spending as a pre-condition for the development aid. For its part, the IMF insists on subsidies and public expenditure generally going cut, though not so much to reduce the role of the state as to prevent a large deficit. Though the developed countries do not need access to IMF-though Britain under Mrs. Margaret Thatcher needed such access and privatisation was part of the Fund-inspired reform that her Government pursued-generally one must say that the pressures on the public exchequer and the tax collector are greater.

There is an interesting chapter on the role of IMF in tax reform. This particular comment demands more than a passing look, "even if one is concerned only with 'Pro-poor' rather than 'anti-rich' policies, both the level of taxes required to finance pro-poor expenditure (which are often the marginal expenditures in political terms-i.e. , the first to go when expenditure are cut, if only because the voice of the poor is seldom very loud in the Cabinet room)

and the structure of taxes(e.g., the generally greater regressivity of a uniform VAT compared to the more differentiated commodity taxes now in place in most countries) need close attention. I am as aware of the administrative advantages of relatively uniform taxes as anyone else but it seems to me that, all too often, the Fund's tax recommendation in recent years have displayed a considerably lower degree of 'aversion to inequality' than I feel comfortable with or than is currently manifest in the tax systems of the countries concerned."

It is practically impossible to aspire for a full proof tax structure even in an advanced and highly industrialised economy like United States. The tax lever fluctuates during regims of two presidents as it has happened in the ~~regims~~ regims of President Reagan who reduced tax rates and Bill Clinton who increased tax rates. However, in a country like India the tax collection remains at far of distance from the budget estimates.

In this background also a fresh look in devising a proper tax base is necessary. The researcher observes that the existing income based taxation has number of loopholes. In recent years many economists and lawyers have taken renewed interest in proposals for taxing expenditure as an alternative to taxing income.