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UNIT-I

Meaning and Scope of Public Finance

Public finance is a field of economics concerned with how a government raises money, how that money is spent and the effects of these activities on the economy and society. It studies how governments at all levels—national, state and local—provide the public with desired services and how they secure the financial resources to pay for these services.

Public finance deals with the finances of public bodies – national, State or Local – for the performance of their functions. The performance of these functions leads to expenditure. The expenditure is incurred from funds raised through taxes, fees, sale of goods and services and loans. The different sources constitute the revenue of the public authorities. Public finance studies the manner in which revenue is raised; the expenditure is incurred upon different items etc. Thus, public finance deals with the income and expenditure of public authorities and principles, problems and policies relating to these matters. We can analyse some important definitions of public finance given by some leading authorities in public finance.

Economists	Publication	Definition
Charles F. Bastable	Public Finance – 1892	For all States – whether crude or highly developed – some provisions of the kind are necessary and there for supply and application of state resources constitute the subject matter of a study which is best entitled in English as Public Finance
Dalton	Principles of Public Finance-1922	One of those subjects which lies on the border line between Economics and Politics. It is concerned with the income and expenditure of public authorities and with the adjustment of one to the other

Importance of Public Finance

- Provision of public goods: -For providing public goods like roads, military services and street lightsetc. public finance is needed. Business firms will have no incentive to produce such goods, as they get no payment from private individuals.
- Public finance enables governments to tackle or offset undesirable side effects of a market economy. The side effects are called spill overs or externalities. For example, pollution. The governments can introduce recycling programmes to lessen pollution or they can make laws to restrict pollution or impose pollution charges or taxes on activities that bring about pollution.

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- Public finance helps governments to redistribute income. To reduce the inequality in the economy, the governments can impose taxes on the richer people and provide goods and services for the needyones.
- Public finance provides many a programme for moderating the incomes of the rich and the poor. Such programmes include social security, welfare and other social programmes.
- The acceptance of the principle of welfare state, the role of public finance has been increasing. Modern governments are no more police states as the classical economists viewed.
- As the scope of state participation in the economic activity is widening, the scope of public finance has also been increasing. Generation of employment opportunities, control of economic fluctuations like boom and depression, maintaining economic stability etc. are some of the thrust areas of the governments through fiscal operations.

Nature of Public Finance

The Nature And Scope Of Public Finance : Public finance is a science as well as an art. It is a science because we study in it the various principles, problems and policies underlying the spending and raising of funds by the public authorities. It teaches how to collect taxes in the best way and how to maintain them economically and how to spend them properly.

As an art, public finance enables the concerned personnel to adopt the principles and policies in solving the financial problems of the Government in the best possible way to the maximum benefit of the society. The way to be adopted should be logical, suitable and proper according to the time. Application of various principles and policies depends much on the ability of the personnel in the Government how best he can extract from it in the public interest.

Scope of Public Finance

The scope of Public Finance can be broadly classified in to five categories a) Public revenue b) Public expenditure c) Public debt d) Financial administration e) Economic stabilization and f) Federal Finance.

Public Revenue:

The income of the states is referred to as Public Revenue. In this branch, we study the various ways of raising revenue by the public bodies. We also study the principles and effects of taxation and how the burden of taxation is shared among the various classes of society etc.

Public Expenditure

It deals with the principles and problems relating to the allocation of public spending. We study the fundamental principles governing the flow of public funds in to different channels, classification and justification of public expenditure; expenditure policies of governments and the measures adopted for welfare state etc.

Public Debt

The governments borrow when its revenue falls short of its

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expenditure.Public debts is a study of various principles and methods of raising debts and their economic effects. It also deals with the methods of repayments and managements of public debts.

Financial Administration

It deals with the methods of Budget preparation, various types of Budgets, war Finance, Development Finance etc. Thus, financial administration refers to the mechanism by which the financial functions are carried on. In other words, financial administration studies the organizing and disbursing of the finances of the State.

Economic stabilization and Growth

The use of Public revenue and Public expenditure to secure stability in levels of prices by controlling inflationary as well as deflationary pressures is studied. Similarly the income and expenditure policies adopted by the government so as to attain full employment, optimum use of resources, equitable distribution of income etc. are also studied.

Federal Finance

Under federal finance we study the principles and policies governing the distribution of functions and funds among the public authorities in a federal set up. In a federal set up there are different levels of governments-centre, state and local.

Public Finance and Private Finance

The understanding and the study of public finance is facilitated by a comparison of the public or government finance with private or individual finance. Such a comparison will help us to know how the aims and objectives and methods of public Finance operation are similar or differed from the financial operations of the individual.

Similarities

1. Both the State as well as individual aim at the satisfaction of human wants through their financial operations. The individuals spend their income to satisfy their personal wants whereas the state spends for the satisfaction of communal or social wants.
2. Both the States and Individual at times have to depend on borrowing, when their expenditures are greater than incomes
3. Both Public Finance and Private Finance have income and expenditure. The ultimate aim of both is to balance their income and expenditure.
4. For both kinds of finances, the guiding principle is rationality. Rationality is in the sense that maximization of personal benefits and social benefits through corresponding expenditure.
5. Both are concerned with the problem of economic choice, that is, they try to satisfy unlimited ends with scarce resources having alternative uses.

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Dissimilarities

The private individual has to adjust his expenditure to his income. i.e., his expenditure is being determined by his income. But on the other hand the government first determines its expenditure and then the ways and means to raise the necessary revenue to meet the expenditure.

The government has large sources of revenue than private individuals. Thus at the time of financial difficulties the state can raise internal loans from its citizens as well as external loans from foreign countries. In the case of private individual, all borrowings are external in nature.

The state, when hard pressed, can resort to printing of currency, as an additional source of revenue. In fact, during emergencies like war, it meets its increased financial obligations by printing new currency. But an individual cannot raise income by creating money.

The state prepares its budget or estimates its income and expenditure annually. But, there is no such limitation for an individual. It may be for weekly, monthly, or annually.

A surplus budget is always good for a private individual. But surplus budgets may not be good for the government. It implies two things. a) The government is levying more taxes on the people than is necessary and b) the government is not spending as much as the welfare of the people as it should.

The individual and state also differ in their motives regarding expenditure. The individuals hanker after profit. Their business operations are guided by private profit motive. But the states expenditure is guided by the welfare motive.

The private individual spends his income on various items in such a manner as to secure equi-marginal utilities from them. The government on the contrary does not give as much importance to this law as a private individual does. Modern government sometimes incur cretin types of expenditure from which there do not derive any advantage but they do incur this expenditure to satisfy cretin sections of the community.

Individuals always seek quick returns they save only a small amount for future and spend more to satisfy their current needs. Individual tend to think more on the present as they are dead in the long run. Similarly they seldom spend if it does not yield any money income. On the other hand, State has a long term perspective of its expenditure. It does not care only for immediate benefit. State spends on projects having long gestation period. The burden of taxation is borne by the present generation in the interest of long run welfare of the community. Similarly sometimes government may have to spend on schemes which may not yield any money income at all (e.g. Public Health).

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An individual's spending policy has very little impact on the society as a whole. But the state can change the nature of an economy through its fiscal policies.

The pattern of expenditure in the case of private finance is often influence by customs, habits social status etc. The pattern of government expenditures is guided by the general economic policy followed by the government.

Private Finance is always a secret affair. Individual need not reveal their financial transactions to anyone except for filing tax returns. But Public Finance is an open affair. Government budget is widely discussed in the parliament and out sides. Public accountability is an important feature of public finance.

Individuals can plan to postpone their private expenditure. But the state cannot afford to put off vital expenditure like defence, famine relief etc. Findlay Shiraz says that compulsory character is an important future of public finance.

Role of public finance in Developing Economics?

Most developing countries often implement policies that have aggravated rather than corrected the free market failures. So, it is argued that market failures ought to be corrected by the government such as through the provision of goods and services and through taxes and subsidies to caution the vulnerable. Experience has shown that public finance policy reforms in most developing economies have not the corrected the free market failures. In real terms, public finance policies should be designed on the basis of promoting a stable economic growth and development. It can be argued that there is a greater desire among the developing countries to increase their productivity so that the people can attain substantially a better quality of life. Public finance affects developing economies in many different ways. However, also public finance policies do affect key sectors of the economy in many different ways. This is true especially that the economic problems facing the developing countries are extremely difficult to address due to the declining fiscal capacity.

Governments of developing economies through its public finance policies should be able to increase rate of investment and also alter the pattern of investment. It follows to emphasize the fact that the main role of public finance policy in developing countries is to expand productive capacity by raising the level of real capital including skills as well as plants and equipment and to check the demand generating effect of expanding investment. In developed countries its role is to expand both production capacity as well as the level of aggregate monetary demand in relation to their economic growth. In practice, public finance policies through its different measures such as taxation policy, budgetary policy, public debt policy and a co-ordination with monetary policy can direct the economic destiny of a nation. For example, fiscal policy can be used to mitigate the effects of trade cycles such as inflation and depression in an economy.

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UNIT - II
Public Expenditure

Public Expenditure:
Meaning and Importance

The expenses incurred by the governments for its own maintenance, preservation and welfare of the economy as a whole is referred to as public expenditure. In other words, it refers to the expenses of public authorities-central, state and local governments in a federation-for the satisfaction of collective needs of the citizens or for promotion of economic and social welfare. The development functions include education, public health, social security, irrigation, canal, drainage, roads, buildings, etc. The major cause of increase in the public expenditure is nothing but, these developmental functions. Hence, the study of public expenditure has become very significant in the study of public finance.
The two major reasons for the same are: a) the economic activities of the state has increased manifold and b) nature and volume of public expenditure have greatly affected the economic life of the country in a different manner. i.e., it has affected production and distribution and general level of economic activities.

Prof. RA Musgrave, the twentieth century economist, advocated public expenditure since a government is forced to do many activities such as 1) activities to secure a reallocation of resources 2) redistribution activities, 3) stabilizing activities and 4) commercial activities.

Causes for the Increase in Public Expenditure:
OR Need for Public Expenditure

One of the most important features of the present century is the phenomenal growth of public expenditure. Some of the important reasons for the growth of public expenditure are the following.

Welfare state:

Modern states are no more police states. They have to look in to the welfare of the masses for which the state has to perform a number of functions. They have to create and undertake employment opportunities, social security measures and other welfare activities. All these require enormous expenditure.

Defence expenditure:

Modern warfare is very expensive. Wars and possibilities of wars have forced the nation to be always equipped with arms. This causes great amount of public expenditure.

Growth of democracy:

The form of democratic government is highly expensive. Theconduct of elections, maintenance of democratic institutions like legislatures etc. cause

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great expenditure.

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Growth of population:

Tremendous growth of population necessitates enormous spending on the part of the modern governments. For meeting the needs of the growing population more educational institutions, food materials, hospitals, roads and other amenities of life are to be provided.

Rise in price level:

Rises in prices have considerably enhanced public expenditure in recent years. Higher prices mean higher spending on the part of the govt. on items like payment of salaries, purchase of goods and services and so on.

Expansion public sector:

Counties aiming at socialistic pattern of society have to give more importance to public sector. Consequent development of public sector enhances public expenditure.

Development expenditure:

For implementing developmental programs like Five Year Plans, Modern governments are incurring huge expenditure.

Public debt:

Along with debt rises the problem like payment of interest and repayment of the principal amount. This results in an increase in public expenditure.

Grants and loans to state governments and UTs:

It is an important feature of public expenditure of the central government of India. The government provides assistance in the forms of grants-in-aid and loans to the states and to the UTs.

Poverty alleviation programs:

As poverty ratio is high, huge amount of expenditure is required for implementing alleviation programmes.

Canons of Public Expenditure
Or Principles of Public Expenditure

The canons or principles of public expenditure are the fundamental rules which govern the public expenditure policy of the governments. The method and direction in which the public expenditure utilized is of paramount importance

Professor Alfred G.Buchler made some guidelines for the utilization of expenditure by the public authorities. They are as follows: -

a) Public expenditure should promote the welfare of the society.
b) Careful judgement should be exercised by the public authority and the electorate to ensure that the advantages of the public expenditure should exceed the costs and that the fund utilized by the governments will be more conducive to social welfare than

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the same funds would, if privately utilized.

c) Public expenditure should be utilized in the order of priority of welfare. That is, the services which will bring about maximum welfare should be undertaken first.

Prof. Findlay Shirras has explained four canons of public expenditure. They are canon of benefit, canon of sanction, canon of economy and canon of surplus.

Canon of Benefit

The ideal of this is maximum social advantage. That is, public expenditure should be planned so as to yield maximum social advantage and social welfare of the community as a whole and not of a particular group. Public expenditure must be spent in those directions which will maximise utility. It is possible only when the marginal utility from different uses is equal. The public authorities should distribute resources so as to increase production, reduce inequalities of income distribution, preserve social life of the people, and improve the quality of social life etc

Canon of Economy

This implies that the state should be economical in spending money.It should not spend more than the necessary amount on items of expenditure. The sole aim is to avoid extravagance and corruption. Social benefit can be maximised when resources are not wasted. While incurring public expenditure social costs are to be minimised. To satisfy this canon Project Appraisal and Cost Benefit Analysis are to be adopted. "Economy means protecting the interests of the tax payers not merely in effecting economies in expenditure, but in developing revenue."—Shirras**.**

Canon of Sanction

According to this canon, no expenditure should be incurred without the proper approval of the sanctioning authority. It also implies that the spending authorities should spend the amount for which it has been sanctioned and to see that the sanctioned amount is properly utilized. Public accounts are to be audited at the end of financial year. This canon acts as check on arbitrary, unwise and reckless spending of public funds.

Canon of Surplus

This canon believes in the avoidance of deficit in public expenditure. According to Findlay Shirras,**"**Public authorities must earn their living and pay their way like ordinary citizens. Balanced budget must, as in the private expenditure; the order of the day. Annual expenditure must be balanced without the creation of fresh credits unrepresented by the new assets." Modern governments does not consider balanced budget a virtue always. In an inflationary condition a surplus budget is desirable as it reduces purchasing power of the individuals. Similarly, in the time of depression a deficit budget is recommended in order to enhance the purchasing power of the people.The canon of surplus is not relevant in modern public finance.

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Other Canons of Public Expenditure Canon of Productivity

Public expenditure should promote production and increase the working efficiency of the people. Major part of public expenditure should be incurred on developmental activities. The aim of public expenditure should be maximum production, employment and income.

Canon of Elasticity

There should be flexibility in government expenditure. That is, the government may be able to change its public expenditure policy with changing conditions. It means that public expenditure should increase during periods of emergency and reduce during normalcy.

Canon of Equality

This implies that public expenditure should be incurred in such a way that inequality in the distribution of income should be reduced. For achieving this canon the benefit of public expenditure should conferred more on the poorer section of the society.

Canon of Neutrality

Public expenditure should not worsen the production-distribution-exchange relationship instead of improving it. Public expenditure should result in increased production and productivity, reduced inequality of income and wealth and increased economic activity and exchange relationship.

Canon of Certainty

The public authorities should clearly know the purposes and extent of public expenditure to be incurred. This anon explains the preparation of public budgets.

Effects of Public Expenditure

The traditional economists held the view that the state should least interfere in economic activities and the government is merely an agent for the people to keep political organization intact. During the time of Adam Smith the government that interfered least in the economic activities of the state was considered the bestgovernment. Till the beginning of the 20th century, state performed only limited functions-the maintenance of law and order and protection of the country from the external attack. Therefore, the state had to collect only small revenue andspend little. Recently, in almost all countries of the world there has been a phenomenal increase in the magnitude and the variety of governmental activities. The acceptance the principle of welfare state, the necessity of maintaining full employment and economic development etc. the significant role of the government has been increased. All these show the need for an ever increasing public expenditure. In the following few paragraphs we can explain the important effects of public expenditure.

Effects of Public Expenditure on Production

"Just as taxation, other things being equal, should reduce production as little as possible so the public expenditure should increase it as much as possible."---Prof.Dalton. The effects of public expenditure on production can be evaluated by examining its effects on the following.

a) Effects upon ability to work, save and invest.
b) Effects upon willingness to work, save and invest.
c) Effects upon diversion of economic resources as between different uses and localities.

Ability to work, save and invest

Public expenditure may tend to influence the ability of the people to work, save and invest. This is described as 'efficiency effect'. Public expenditure designed to increase the efficiency of the people will certainly improve their ability to work. When a person's ability to work is increased, his earnings will also increase. As a consequence his ability to save also improves. For example, expenditure on education, health services, and cheap housing facilities, subsidised food, free education means of transportation, communication etc. will increase the efficiency of the people to work. Similarly, public expenditure incurred for maintaining law and order build up the confidence in the minds of the people which will in turn encourages them to invest in production activities. Public expenditure may have adverse effects also. If public expenditure is spent on wasteful social functions or on the production of intoxicants and drugs which are detrimental to health, the ability to work, save and invest of the people may adversely be affected. Hence, public expenditure should be incurred in such a way that it is most beneficial to entire society

Willingness to Work Save and Invest

Public expenditure may tend to affect the willingness of the people to work, save and invest which is described as 'incentive effect'.As far as the will to, save and invest is concerned, it depends to great extent on the character of public expenditure and public policy of the governments. For example, old age pension, provident fund benefit, insurance against sickness and unemployment allowances etc., have an adverse effect on the willingness of the people to work, save and invest. This is because people will have a feeling that the governments will look after them, when they are unable to earn an income. Therefore, public expenditure should be incurred in such a way that it may not adversely affect the incentive to work of the people. If, however, the benefit increases with the increase in work and the volume of savings, the willingness to work, save and invest will increase and vice-versa. Similarly, the willingness to work can be increased by making the benefits conditional, i.e., the people may be required to contribute something in order to avail the benefits of social security measures. In brief, public expenditure should be incurred systematically and in a planned manner in order to provide social security measures to the maximum extent. Public expenditure should also provide opportunities under which savings and investments are properly rewarded and do not enlarge inequalities.

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Diversion of Resources between Different Uses and Areas

Public expenditure can significantly influence the level and pattern of production through the diversion of economic resources between different uses and areas. Therefore, the government has to incur public expenditure in those areas and regions which would secure maximum national production and maximum social advantage.

For example, the public expenditure on projects like roads, railways, irrigation energy etc. helps in accelerating the tempo of economic development. Creation of such essential projects through diversion of economic resources from private use to public use is very essential in developing countries. Similarly, concessions and subsidies by governmentsmay help many industries and agricultural activities. According to Dalton the role of public expenditure in the diversion of economic resources from private use to government use and as among different regions is important only when the area of economic activities of the government is limited i.e. in a capitalistic economy.

The forms of public expenditure which increase the productive power and are socially very much desirable for the transfer of resources are generally of the following nature. a) Debt redemption b) Developmental projects like irrigation, power and transport, roads, railways etc. c) Promotion of education, research, inventions training etc. d) Provision of public health and e) Social security etc.

Public expenditure also results in the diversion of resources among different regions. This will reduce the regional inequality- one of the important objectives of Indian economic panning. In order to bring about regional balanced growth the government has to provide special expenditure programmes to economically backward regions. Such diversion of resources among regions is made possible by setting up a federal system of government. Grants-in-aid from Central government to state governments and from state governments to local governments are examples of diversion of resources.

In short, the public expenditure does have many favourable effects on production. To conclude the effect of public expenditure on production we can quote Dalton once again."Whereas taxation, taken alone, may check production, public expenditure, taken alone, should almost certainly increase it.

Effects of Public Expenditure on Distribution

One of the important modern state policies, especially in developing countries and socialistic countries, is reduction of inequalities in the distribution of income and wealth. Public expenditure plays vital role in realising this objective. According to Dalton, "The system of public expenditure is the best, which has the strongest tendency to reduce inequality of income." Public expenditure which is in the form of money grants, supply of social goods and services, social security measures, subsidies etc. certainly affects the distribution of income in a country in socially desirable way. Expenditures carried out for benefiting the poor people such as those on

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social services like free medical treatment, free education, unemployment benefit etc. will enhance the benefit of the poor section than the rich. This will help in reducing the gulf between the rich and the poor in the distribution of income and wealth, thus bringing about justice in the economy.

Public Expenditure and Stability

Economic stability refers to a fairly stable level of national income, employment, prices, savings and investments in the economy. The economy may face cyclical fluctuations on account of imperfections in the market (Depression and Inflation). Public expenditure can be used to check the fluctuations. According to Lord J.M.Keynes economic instability implies departure from full employment at stable price level. It is the deficiency of the effective demand caused by a low marginal propensity to consume coupled with low marginal efficiency of investment in developed countries. ("The General Theory of Employment, Interest and Money-1936")

During depression the effective demand falls short of what is required. Deficiency in effective demand leads tounemployment which in turn reduces consumption and finally to fall in production.In order to solve the situation public expenditure is to be enhanced to compensate the deficiency in effective demand. The increased public expenditure during the time of depression is described as compensatory public expenditure. In a period of depression the suitable public expenditure policy will be Deficit Budgeting. (i.e., Current expenditure should be inexcess of current revenue.)

Similarly, during the time of inflation-rising prices- the public expenditure has an entirely different role to play. The government has to adopt Surplus Budgeting policy. That is, the government should spend less than its revenue.During inflation that part of the public expenditure which reduces the funds going to the people with higher propensity to consume is reduces. After full employment, public expenditure is likely to add to inflationary pressure, for public expenditure will further increase the purchasing power of the people without any corresponding increase inproduction.

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UNIT - III
Public Revenue

Public Revenue

In the last module we have seen that in recent time, public expenditure has been increased enormously. The main reason is that the functions of governments have been increased manifold. The modern states are no more police states but welfare states. Adolph Wagner, a German economist presented his famous 'Law of Increase of State Activities.' He states that 'comprehensive comparison of different countries and different times show that among progressive people with which alone we are concerned, an increase regularly takes place in the activity of both central and local governments.' This increase is both intensive and extensive.

Professor R.A Musgrave, the twentieth century economist, advocated public expenditure since a government is forced to do many activities such as 1) activities to secure a reallocation of resources 2) redistribution activities, 3) stabilizing activities and 4) commercial activities.

Public Revenue

This is one of the branches of public finance. It deals with the various sources from which the state might derive its income. These sources include incomes from taxes, commercial revenues in the form of prices of goods and services supplied by public enterprises, administrative revenues in the form of fees, fines etc. and gifts and grants.

The income of government through all sources is known as public revenue or public income. Prof. Dalton defined public revenue in two senses – Narrow sense and broader sense.

Narrow sense:

In the narrow sense, it includes income from taxes, prices of goods and services supplied by public sector under takings, revenue from administrative activities, such as fees, finesetc.

Wider sense:

It includes all the incomes of the governments during a given period of time, including public borrowing from individuals and banks and income from public enterprise it is known as public receipts.

Sources of Public Revenue

The sources of public revenue can be broadly classified in to two – Tax - source and non- tax source.

Taxes:

Taxes are imposed by the government on the people and it is

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compulsory on the part of the citizens to pay taxes, without expecting a return.

Some definitions

Economists	Definitions
Professor Seligman	Tax is compulsory contribution from a person to the government to defray the expenses incurred in the common interests of all without reference to special benefits conferred
Professor Taylor	Taxes are compulsory payments to the governments without expectation of direct return to or benefit to the tax payer

The revenue from taxes came from three main sources. viz; a) **Taxes on income** b) **Taxes on wealth and property** and c) **Taxes on commodities.**

What is Public Revenue?

The study of public finance is the deep study of all finance operations, related to the state which is therefore concerned with complete income and expenditure of public authorities and administrative structures, that are adjusted with one another.

Public finance is a concept that includes Public expenditure, public debt and public revenue and income.

Public revenue is exactly income generated from sources of government in order to meet requirements of expenses of public.

Meaning of Public Revenue

Public revenue generally refers to government revenue. Some important sources or concepts that are included in public revenue consist of taxes, fees, sale of public goods and services, fines, donations, etc.

The main sources of public revenue are: Tax and Non-tax revenue
Sources of Public Revenue
A) Tax Revenue:

The chief source of public revenue is Tax. To define tax, it is said that tax is a mandatory imposition of duty on public authority by government organizations to meet requirements of general public as a whole.

Therefore, with the above defined term, some points are highlighted as below:

I. A Tax is a compulsory duty levied by the government. If any individual refuses to comply with tax payments, he can be punished or penalized
II. Tax basically involves some understanding and sacrifice on the basis of a tax payer
III. Tax is a duty and not a penalty
IV. Most part of revenue income is generated from tax by the central government.

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Broad classification of taxes is: Direct and Indirect Taxes

Direct taxes:

Direct taxes are levied on wealth and income of individuals or organizations. These taxes are personal income tax, corporate tax, and gift or wealth tax. The impact of direct taxes is on the same person.

Direct taxes are developing in nature and the tax rate increases along with the tax base. Progressive direct taxes are involved in falling income discrimination especially in rising countries.

Following major direct taxes are stated:

Personal Income Tax:

Personal income tax is duty imposed on an individual or group of individuals after specific permissible deductions. Personal income taxes are planned as stated below:

Income (rs)	Rate
0-1, 60,000	0%
1, 60,000 – 5, 00,000	10%
5, 00,000 – 8, 00,000	20%
8, 00,000 and above	30%

Senior citizens are exempted from payment of tax on income up to Rs: 2,40,000.
Females are exempted from payment of tax on income up to Rs: 1, 90,000

Corporate Tax:

Corporate tax is a duty that has to be paid on the profits registered corporate firms.
Corporate tax is direct tax because the company is given legal entity.

Present corporate tax rates are:

1. For Indian Organization – 30% + 7.5% surcharge.
2. For Foreign organization – 40% + 2.5% surcharge.

In the year 2009-2010, Corporate Tax added to 40% of the Total Tax Revenue

Other Direct Taxes

1. List of other direct taxes include, Wealth tax, Interest tax, gift tax, Expenditure tax, etc
2. The share of these taxes is unimportant.
3. Indirect taxes
4. Indirect taxes are imposed on goods & commodities.
5. These taxes include sales tax, excise duty, service tax, customs duty, VAT, etc.
6. The impact of indirect taxes may be implied on different people.
7. In direct taxes are not progressive but regressive in nature. Here, the burden to pay duties is indirectly or directly bearded by the consumer irrespective of their income level.
8. Indirect taxes are of utmost importance for countries that are developing and face low income levels.

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Major Indirect Taxes:

a) Excise Duty :

These taxes are levied on manufactured goods and consumable goods in India Excise duty is the chief and single largest source to generate revenue income Rates of excise duty faces a declining trend

b) Customs Duty:

This duty is imposed on exports of selective range and imports With revenue point of view, Custom duty has less importance Peak rate of custom levy is 10%

c) Service Tax:

This tax is imposed by specific category of firms, agencies or persons Rate of service taxes have been increased progressively

d) Goods and Service Tax

1. Goods and service tax includes range of all taxes like excise duty, service tax, goods tax, VAT, etc
2. It covers goods and service charges in mostly all sectors
3. It generally simplifies the complexity of charges on good and services Non tax revenues
4. Non Tax Revenue comprises all revenues apart from taxes accumulated to the Government.
5. Non tax revenues are funds that are generated from internal sources

The sources of revenue are:

- Administrative revenues
- Commercial revenues
- Grants and gifts

Important sources of Non tax revenues include

a) Special Assessment:

- This can be called as betterment charge
- This tax is imposed to a certain category of members of a community who are generally benefited from governmental activities or public functions like constructions of road, railways, parks, etc
- Therefore, government imposes special charges on such properties

b) Surplus of Public Enterprises

The government has arranged public sector enterprises that are concerned in commercial activities.

The surpluses generated of these enterprises are a significant source of non-tax revenue.

These incomes are in the form of profits that are known as commercial revenues.

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c) Fees:

- A fee is a significant source of managerial non-tax revenue charged by Government authorities for depiction services to the members of the public.
- There is no compulsion to pay fees. All those utilize services may pay fees.
- Fees may be charged for getting licenses, passports or registrations, filing of court cases, etc.

d) Fine and Penalties

- These are general sources of administrative non tax revenues.
- These may be applied on public for non compliance with certain rules and regulations.
- These are not considered as the major source of revenue for the government

e) Grants and Gifts

- Grants are financial support
- These are provided to public authority to perform certain social activities
- These are generated by higher public authority to lower ones e.g. World bank gives grants to State bank
- There is no repayment compulsion
- Gifts and donations are voluntarily made by individuals, organizations or foreign governments to the Central Government.
- These gifts are made by natural feeling in case of disasters or natural calamities
- Gifts are not considered as a source of income
- Therefore, tax plays an important part in generating government revenue. Non tax is important in developing revenue.

Changing trends in Tax and Non tax revenue in India

The Government elevates economics to meet its expenses from tax and non-tax revenue sources.

As a matter of fact, Government expenditure goes beyond government revenue, consequential in Government discrepancy.

Changing trends

a) Tax revenue

Tax structure is developed and divided as follows:

Central Government:

It levy taxes on income excluding agricultural income customs duty, central excise duty and service tax.

State Government:

It levies taxes on state excise duty, agricultural income, Stamp Duty, Value Added Tax (VAT), land revenue tax and professional tax.

Local Government Bodies:

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They levy Octroi, property tax, and tax for utilities like water supply, Sanitation etc. Since Indian tax structure and system have faced certain reforms. These reforms include decrease in rate of all major tax that simplifies laws and rules & procedure, modernization of administration and enforcement machineries.

Main land tax revenue is:

- Trends in tax revenue
- Collection of tax rate has risen with reduction of tax rate, simple procedures and high growth rate GDP.
- The share of Gross tax revenue of the Central Government as 1% of GDP has which lies constant 9% to 10%.
- This is a low rate compared to developing or developed nations

Year	Tax Revenue	Rate
1990-1991	57,576	10%
2002-2003	216266	8.8%
2009-2010	641979	10.4%

Trends in direct and indirect taxes

Before liberalization revenue taxes were more than 70% income Since 1990-91 (post-liberalization), this trend got overturned due to economic development. The direct taxes donated significantly due to raise in corporate tax and personal income tax.

Year	Direct taxes	Indirect taxes
1990-1991	19.1	80.9
2004-2005	43.3	56.1
2009-2010	57.7	42.0

Trends in Direct taxes

Share of direct taxes is raised. The Direct Tax Code will replace the Income and Wealth Tax Laws and will be affective from April 1, 2011.

Main direct taxes:

Corporate Income Tax

This is the most important direct tax in order to collect revenues and contribution to total tax revenue.

Contribution of direct tax has been increased after liberalization:

Year	% Of Total Tax Revenue	Rs. Crores
1990-1991	9.3	5335
2004-2005	27.1	82680
2009-2010	40.0	256725

Personal Income Tax:

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From 1990-1991, Collection of direct income tax has increased rapidly. Contribution of personal income tax has also increased.

Year	% Of Total Tax Revenue	Rs. Crores
1990-1991	9.3	5371
2004-2005	16.2	49268
2009-2010	17.6	112850

Trends in Direct taxes

Total share of indirect taxes related to central government has fallen

There are 3 main indirect tax generating revenues

Excise duty

YEAR	Rs. CRORES	% OF TOTAL TAX REVENUE
1990-1991	24,514	42.6
2004-2005	99,125	32.5
2009-2010	1,06,477	16.6

Customs Duty:

YEAR	Rs. CRORES	% OF TOTAL TAX REVENUE
1990-1991	20,644	35.9
2004-2005	57,611	18.9
2009-2010	98,000	15.3

Service tax (introduced in 1994-95)

YEAR	Rs. CRORES	% OF TOTAL TAX REVENUE
1990-1991	862	0.8
2004-2005	14,200	4.7
2009-2010	65,000	10.1

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Characteristics of a Tax

It is compulsory payments to the government from the citizen. Each individual irrespective of caste, colour or creed, of age or sex has to pay it. Refusal to pay it or delay in payment brings punishment.

It is imposes a personal obligation. It means that it is duty of tax payer to pay it and he should in no case think to evade it.

Absence of direct benefit or quid pro quo between the State and people. The tax payer do get many advantages from the public authorities but no tax payer can claim direct benefit as a matter of right on the ground that he is paying a tax.

It is payments for meeting the expenses in the common interest of all citizens. The governments have to provide public utility goods. For this the governments have to incur huge amounts of expenditure. Therefore, taxes are

imposed on all citizens so that all may share a common burden.

Certain taxes are imposed on specific objectives for example, tax on petrol to reduce consumption and tax on luxuries so as to divert resources for the production of essential commodities.

There is no tax without representation. This means that proposals regarding taxes are to be sanctioned in respective assembly of elected representatives.

<u>Non - Tax Revenue</u>

a) Commercial Revenue. (Income from public property and enterprises)
b) Administrative Revenue (Fee, Fine, Special assessment)
c) Gifts and grants and
d) Others

Commercial Revenue:

Income earned by public enterprises by selling their goods and services. For example, Payments for postage, tolls, interest on borrowed funds etc. They are also known as prices because they come in the form of prices and goods and services provided by government.

Administrative Revenue

The receipts of incomes accrued on account of performing administrative functions by the government are called administrative revenue. The important items of administrative revenue are listed below.

Fees:

"Fee is a payment to defray the cost of each recurring service under taken by the government in the public interest" – Prof.Seligman. Fees are payments imposed by the government. For Example, Court Fee, License Fee, Passport, Fee etc.

Fines and Penalties:

Fines penalties are imposed on persons as a punishment for infringement of laws. They are imposed to prevent crime. Fines and penalties are arbitrarily determined.

Special assessments:

According to Prof. Seligman "A special assessment is a compulsory contribution levied in proportion to the special benefit derived to defray the cost of specific improvement to property under taken in the public interest". For example, when the government constructs a highway, the prices of plots on either side of it will naturally go up. There for, the land owners may be required to bear a part of expenses incurred by the government. Such charges are called as special assessments.

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Gifts and grants:

In general gifts and grants are the payments made by one government to another for some specific functions for example, central grant to state government. Gifts are voluntary contribution made by the people to the government for some special purposes.

Other sources of Revenue:

Other sources of revenue are Forfeitures, Escheat, Issuing of currency and Borrowings

Forfeitures:

It is penalty imposed by the court for failure of individual to appear in the court to complete certain contract as stipulated.

Escheat:

Properties having no legal heirs or without will, that go to government are called Escheats.

Issue of Currency:

The printing of paper money yields income to the government. It is mean to create extra resources by the printing of paper money. It is normally avoided because if once this method of financing is started it becomes difficult to stop it. This further leads to inflation.

Borrowings:

This is another source of public revenue. That is through borrowings from the public in the shape of deposits bonds etc. It also includes external borrowings.

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UNIT - IV
Taxation

Classification Taxation

Taxes are classified on different bases. Different bases adopted by the economists to classify taxes are the forms, nature, aims and methods of taxation. The various taxes may be classified under following major heads.

Classification of Taxes

Direct Taxes and Indirect Taxes

According to Dalton ' A direct Tax is really paid by a person on whom it is legally imposed, while an indirect tax is imposed on one person, but paid partially or wholly by another, owing to consequential change in the terms of some contract or bargaining between them.'

According to J.S. Mill, 'A direct tax is one, demanded from the very person who is intended or desired should pay it. Indirect taxes are those which are demanded from the one person in the expectation and intention that we shall identify him at the expenses of another'.

According to Prest, "The distinction between direct and indirect taxes is more commonly drawn by reference to the basis of assessment rather than the point of assessment."

Professor Antonio defines direct taxes as, "Direct taxes strikes a citizen's income at the moment of its production."

In the words of Gladstone, "The direct and indirect taxes are like two attractive sisters between whom an exchequer should be perfectly impartial."

According to P.E. Taylor, an authority on public finance, distinguished direct taxes and indirect taxes as follows," The terms direct and indirect taxes are finally distinguishable in meaning only in terms of shiftability. Direct taxes are not shifted while indirect taxes are."

From the above we can reach in a conclusion that direct taxes are those which are paid by persons on whom these are imposed and the real burden is also borne by them. The burden of such taxes cannot be transferred or shifted to some other persons. That is, in the case of direct taxes both impact and incidence fall upon the same person.

Indirect taxes are imposed on one person but, are paid either partly or wholly by another. The person who pays the tax in the first instance, transfers its burden on the shoulders of another person. In other words, an in the case of indirect tax, the impact and incidence of the tax fall on different persons.

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Examples of direct taxes are income tax, wealth tax, corporation tax, gift tax etc. And examples of Indirect taxes are Sales tax, excise duty, VAT etc.

Merits of Direct Taxes:

Following are the main merits of direct taxes.

Equity:

Direct taxes such as income taxes, taxes on property, capital gain taxes etc. are progressive in their nature. That is, higher incomes are taxed heavily and lower incomes are taxed lightly. Hence, direct taxes are based on ability to pay of the tax payer and they ensure the canon of equity.

Economy:

The administrative cost of collecting the direct taxes is low. The tax payers directly pay the tax to the state. So there is not much waste of resources and time. That is, direct taxes satisfy the canon of economy.

Certainty:

Another merit of direct tax is that it is certain. The tax payers know how much tax is to be paid, on what basis tax is paid to the government etc.
Thus, the tax payer is able to make adequate provision the payment of tax in advance. The government can also plan development activities since they can estimate the amount of revenue they receives in the form of taxes.

Elasticity and revenue generation:

The yield from direct taxes increases as the country economically advances. The government gets more revenue through direct taxes automatically at higher rates.

Distributive justice:

Since direct taxes are progressive in rates, tax rate increases as the income of individuals rises. The tax burden will heavily be on the richer sections of the society. The increased revenue through taxes is allocated for providing subsidized food, clothing and housing to the poor and needy people. This will bring about distributive justice in the country.

Civic consciousness:

Direct taxes create civic consciousness among the tax payers. The tax payers will be vigilant in the utilization of the tax revenue and will see whether the resources are efficiently used and wastage is avoided.

Absence of leakages:

Since there is direct payment of taxes by tax payers to the government, there is no room for any wastage. The whole amount of direct taxes such as income taxes, property taxes, and taxes on capital gains etc., reaches the treasury without any middlemen.

Demerits of Direct Taxes

The important demerits of the direct taxes are explained below.

Uncertainty:

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The precise degree on needed progression cannot be estimated on account of the difficulties of measuring the ability to pay and the subjective nature of the marginal utility of income.

Unpopularity:

The direct taxes are directly imposed on individuals. They have to bear both the impact and incidence of these taxes. Thus they experience their pinch directly. Consequently, direct taxes are not as popular as indirect taxes.

Violation of the principle of equity:

The burden of direct taxes falls almost exclusively on the richer sections of the society while the poorer section are totally exempted from these taxes. This is unjustified and improper because the burden of state expenditure should be borne by individuals at all levels of society according to their ability to pay.

Large scale evasion:

Direct tax is based on honesty. The tax is not evaded only when the tax payer is honest. It is a fact that the people in the higher income groups do not reveal their full income. It is remarked that "direct taxes are a premium on honesty."

Merits of Indirect Taxes

The following are the important merits of indirect taxes.

Convenience:

Indirect taxes are more convenient to pay. It is paid at the time of purchase of a commodity. Hence, the tax payer does not feel the burden of tax. The tax is hidden in the price of the commodity bought. It is paid in small amount. The government can also collect it conveniently.

Indirect taxes lead to social welfare:

Indirect taxes on narcotics and intoxicants reduce the consumption of them which are harmful to health. Reduction in the consumption of such goods will indirectly increase the welfare of the people.

Indirect taxes are justified:

Indirect taxes are justifiable and equitable. They are paid by all the individuals and when they purchase goods and services.

Indirect taxes help production and investment:

Another advantage of indirect taxes is that they perform as powerful tool in moulding the production and investment activities of the economy.

No evasion:

Indirect taxes are generally difficult to be evaded as they are included in the price of the commodity. A person can evade an indirect tax only when he decides not to purchase the taxed commodity.

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Highly revenue yielding in developing countries:

Direct taxes do not yield much income in developing countries, as the income of the people is very less. Since indirect taxes cover a large number of essential commodities to be consumed by both the rich and the poor in the country, large revenue could be collected.

Demerits of Indirect Taxes

Indirect taxes promote inequality:

Indirect taxes are generally imposed on the consumption goods. The poor people have to pay as much by way of indirect taxes on commodities as the rich people. This is unjust and equitable. They are regressive in nature which will promote economic inequality in society by imposing larger burden of taxes on the poor people.

Uneconomical:

Indirect taxes involve high costs of collecting them. To raise desired levels of public revenue, taxes should be collected from millions of people.

Element of uncertainty:

Indirect taxes are extremely uncertain. The revenue accrued to the government from indirect taxes cannot be estimated accurately. As soon as the tax is imposed, the price of the commodity is raised. This will in turn reduce the demand for the commodity. It cannot be estimated with certainty as to what extent the demand falls.

Lack of civic consciousness:

Indirect taxes do not create civic consciousness as the tax payers in most cases do not feel the burden of the tax they pay.

Indirect taxes promote inflation:

Another demerit of indirect taxes is that it promotes inflationary tendency in the economy, as they would increase the prices of the taxed goods.

Discourage saving:

Indirect taxes discourage savings because they are included in the prices of commodities. Therefore, people have to spend more on the purchase of commodities. This will reduces the disposable income of the people and hence the savings.

Progressive, Proportional, Regressive and Degressive Taxes

A tax may be progressive, proportional, regressive or degressive according to the relationship between tax rate structure and tax revenue.

Progressive Tax:

A progressive tax is that in which the rate of the tax depends on change in income. That is, the rate of tax increases with the increase in the income. The higher the level of income, the higher the tax will be and vice- versa.

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(Table-1)

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Table1. Progressive Tax Rates

Taxable income	Tax Rate%	Amount of tax
3000	10	300
4000	15	600
5000	20	1000
6000	25	1500

Proportional Taxes

A proportional tax is one in which the rate of tax remains the same irrespective of the level of income. Here, the same percentage of tax is levied on all income groups. The tax amount is simply calculated by multiplying the tax base with the tax rate. This is illustrated in Table 2.

Table 2 Proportional Tax Rate

Tax Base	Tax Rate %	Amount of tax
1000	10	100
2000	10	200
3000	10	300

Regressive Taxes

In regressive taxation, the higher the income of the tax payer, the smaller is the proportion of income he contributes to the government in the form of taxes. That is, in the regressive taxation, the tax rate declines as income increases. This type of taxation is against the objective of welfare state in modern time. (Table 3)

Table 3.Regressive Tax Rates

Tax Base in Rs.	Tax Rate %	Amount of tax in Rs.
1000	10	100
2000	8	160
3000	6	180

Degressive Taxes

Under this tax system, the tax is mildly progressive up to a certain limit. After that the tax may be charged at a flat rate. In other words, degressive tax system is a mixture of proportional as well as progressive tax system. In this, the higher income group people have to make little sacrifice in comparison

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with lower income group. (Table 4)

Table 4Degressive Tax Rates

Tax Base in Rs.	Tax Rate %	Amount of Tax in Rs.
1000	10	100
2000	12	240
3000	13	390
4000	13	520

Single and Multiple Taxation

Single tax refers to a system in which the taxes are levied only on one item or head of tax. It is only one kind of tax. It implies a tax on one thing. That is, one class of things or one class of people. This type of tax was advocated by economists from 17th to 19th century. Such a tax is collected at regular intervals, may be monthly or annually or any other shorter or longer duration. A single tax may be progressive, proportional or regressive.

First of all, thephysiocrats during the 17th and 18th century strongly advocated a single tax on land, for according to them agriculture was the only productive sector yielding surplus. Issac Sherman proposed a single tax on all real estates—on land— because it was convenient in administration and payments. Henry George also advocated a single tax on land mainly because he thought that it was not possible to shift the tax.

Merits of Single tax System

1) It is a very simple tax as it simplifies the work of the government.
2) It is less costly as lesser amount is spent to collect the revenue.
3) It is based social justice.
4) It does not discriminate against any particular work or industry.

Demerits

1) It Cannot bring adequate revenue to meet the needs of the modern governments.
2) Single tax system violates the principle of ability to pay.
3) The burden of taxation is not equally distributed.
4) The tax system is not effective during the period of emergency or crisis.
5) Tax evasion is much possible.
6) It lacks elasticity.

Multiple Taxation

The multiple taxes imply that there should be all types of taxes so that every citizen can contribute to the state revenue. Similarly, modern economy has to fulfil many objectives like those of economic growth, equitable distribution of income and wealth, economic stability, full employment and so

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on. Since no single tax can realise all these objectives simultaneously, a multiple tax system is preferred. But at the same time, too many taxes will yield only a small amount of revenue. The cost of collection will be very high. According to Dalton, "It is better to rely on few substantial taxes for the bulk of revenue." Thus, the burden of taxation should be widely distributed. Multiple tax system is a mixture of proportional, progressive, direct and indirect taxes.

Merits

1) It leads to equitable distribution of tax burden as it includes proportional, progressive, direct, and indirect taxes.
2) Tax evasion is very difficult under this system.
3) It is more flexible than single tax system.
4) It is based on the principle of equity.
5) It enhances the income of thegovernments.

Demerits

1) It is more complicated than single tax system.
2) Too much multiplicity leads to inconvenience to both the taxing authority and the tax payer.
3) It is not based on the principle of ability to pay.
4) It checks the productive process of the economy.

Specific and Ad Valorem Taxes

According to the assessment, taxes on commodities can be divided in to two types—Specific tax and Ad Valorem tax.

Specific Tax

Taxes which are based on specific qualities or attributes of goods are called Specific tax. This tax is imposed on commodities according to their weights, size or volume. It is a per unit tax on commodity. For example, specific excise duty may be levied on the cloth in the length units and tax on sugar is based according to the units of weight.

Advantages

1) It is quite easy to calculate and administer.
2) The collection of the tax is very convenient.
3) It does not add to inflation, since it is fixed in amount.
4) It confirms to the canon of certainty.
5) It is difficult to evade as the tax is imposed on the basis of weight, size or measure.

Disadvantages

1) It is regressive in nature. It falls heavily on the cheaper varieties of products which the lower income groups consume.
2) It is less equitable as compared to the ad valorem tax.
3) They are less productive and less elastic.
4) They are also less economical during the period of inflation.

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AD VALOREM TAX

When a tax is imposed on a commodity on the basis of its value, it is called ad valorem tax. This type of tax is levied after assessing the value of the taxable possession of a person. For example, several imported articles are taxed in terms of value and they have nothing to do with the weight, length, and size of the commodity.

Advantages

1) It imposes greater burden on the rich section of the society.
2) It is more equitable as it is imposed on the value of goods and thus the canon of ability to pay is fulfilled.
3) It is highly productive and elastic.
4) It is economical.

Disadvantages

1) It is quite difficult to administer as it is difficult to assess the value of commodities.
2) It increases inflationary pressures when there is rise in price level
3) There is wide scope for tax evasion as people may show smaller value of a particular commodity only for the sake of saving the tax amount.

Canons of taxation

Canons of taxation refer to the administrative aspect of the tax. They relate to the rate, amount method of levy, and collection of a tax. In other words, the qualities or attributes of a good tax are called canons of taxation. It was none other than Adam Smith who gave first a detailed and comprehensive statement of the principles of taxation. According to Findlay Shirras, "No genius, however, has succeeded in condensing the principles into such clear and simple canons as has Adam Smith."

Adam Smith has given the following four canons of taxation.

- Canon of Equality
- Canon of Economy
- Canon of Certainty
- Canon of Convenience. (2 Es & 2Cs).

Canon of Equality

Canon of equity or equality is the most important and basic Canon of taxation. It is based on the principle of social justice and ability to pay. Tax burden should be equally distributed among the tax payers according to their ability to pay. That is, the rich people should bear a heavy burden and the poor a less burden. Hence, the tax system should be progressive. According to Adam Smith, **"The** subject of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of the state."

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Canon of Economy

Canon of economy explains that taxes should be collected at minimum cost. The tax laws and procedures should be simple. The administrative machinery should not be elaborate and costly. According to Adam Smith, "Every tax ought to be so contrived as little to take out and to keep out of the pockets of the people as possible over and above what it brings in to public treasury of the state."

Adam Smith argued that lack of economy would result when:

- Tax administration is costly on account of complicated taxes.
- Taxes are unduly heavy which would discourage investment, so that the income level reduces, hence the relative taxyields.
- Taxes are having elaborate and complicated administrative supervision and
- Taxes are unproductive in yielding sufficient revenue.

Canon of Certainty

Taxation must have an element of certainty. That is, there must be certainty about the tax which an individual has to pay. Things like the time of payment, the manner of payment, and the quantity to be paid etc. should be plain and clear to the tax payer. It should not be arbitrary. According to Adam Smith, "The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought to be clear and plain to the contributor and to every other person."

Canon of Convenience

It explains that a tax should be levied in such manneror in such a time that it is convenient for the tax payer to pay it. In the words of Adam Smith, "Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it."

Other Canons of Taxation

Besides the four canons put forward by Adam Smith, there are some other canons given by writers like Charles F.Bastable. They are canon of productivity, canon of elasticity or flexibility, canon of simplicity, canon of diversity, canon of co- ordination etc.

Canon of Productivity

Tax should be productive of large revenue. According to this canon it is desirable to have a few taxes yielding large revenue rather than having a large number of taxes yielding small revenue. It also implies that instead of imposing large number of unproductive taxes, it is advisable to have a few productive taxes.

Canon of Elasticity

It means that taxation should be flexible or elastic. That is, it should be

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capable of increasing or decreasing the tax revenue depending on the need of the government. In other words, the tax revenue may increase automatically whenever needed by an upward revision of tax rates or by extension of its coverage.

Canon of Diversity

This implies that there should be a number of different taxes in the country. This will make every citizen of a country to pay something to the national exchequer. As the number of taxes increases it will increase the administrative costs, reducing the revenue. Hence, too many taxes are to be avoided.

Canon of Simplicity

This canon implies that the tax should be simple to understand even to a layman. It should be free from all ambiguities and provisions to avoid differences in interpretation and legal disputes.

Canon of Co-ordination

There should be co-ordination among different layers of governments in imposing taxes. Especially, in a federal country like India there should be co-ordination among the central, state and local governments regarding taxes, since each of these is having legal right to impose taxes.

Impact, Incidence, and Shifting of Taxation

In modern time there is large number of taxes. In order to understand the various social and economic effects of taxes it is very essential to discuss terms like impact, incidence and shifting.

When government imposes taxes, the amount should be paid by someone. In all the cases the tax burden should not be borne by the same persons on whom the taxes are imposed. To understand this in a better way we have to know two things—a) who pays the tax initially and b) who actually bears the tax burden. In short, a tax may be imposed on one person; the burden of the same may be transferred to a second person or transferred to others who ultimately bear the burden. This is explained in the theory of incidence. In order to understand the theory of incidence, it is very much essential to distinguish between impact, shifting and incidence.

Impact

According to Professor Seligman, "Impact is the initial phenomenon, shifting is the intermediate process and incidence is the result." Impact is otherwise called statutory tax incidence. It implies the burden of a tax borne by the person on whom it is imposed. (De jure tax payer- De Viti). In other words, impact refers to the immediate burden of a tax or the person who first bears the legal obligation of a tax.

Shifting

The process of transferring the burden of a tax from one person to another is called shifting. The producer may shift the tax burden to the

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wholesaler, the wholesaler to the retailers, and the retailers to the consumers etc. This is done through the changes in prices. This is a case of forward shifting. Forward shifting may be multi point or single point. The case explained above is an example of multi point shifting. When the tax burden is shifted by a producer to consumers directly it is a case of single point shifting. Shifting may also be backward. Backward shifting refers to shifting of tax burden to sellers by buyers. **Tax capitalization** is a particular case of backward shifting.

Incidence

The final or ultimate money burden of a tax is called incidence. It is the money burden of a tax which is borne by the last person. That is, the incidence of a tax is the final resting place of it (De Facto tax payer- Di viti).

Distinction between Impact and Incidence

- Impact refers to the initial burden of the tax, while the incidence is the ultimate burden of the tax.
- Impact is at the point of imposition, while incidence is at the point of settlement.
- The impact of a tax falls upon the person from whom the tax is collected and the incidence rests on the person who pays it eventually.
- The impact may be shifted but the incidence cannot be shifted.

Effects and Incidence of Taxation

In economic analysis, incidence and effects are used to denote different connotations. As we have already discussed, incidence is the final money burden of a tax whereas effects of tax refer to the economic consequences of a tax on production, consumption, distribution, and exchange. The study of effects is broader than the study of incidence as taxes affect production, consumption, savings, investments, growth, regional balance, distribution of income and wealth and so on.

GST:

GST is an Indirect Tax which has replaced many Indirect Taxes in India. The Goods and Service Tax Act was passed in the Parliament on 29th March 2017. The Act came into effect on 1st July 2017; Goods & Services Tax Law in India is a **comprehensive,** multi-stage, destination-based tax that is levied on every value addition.

In simple words, Goods and Service Tax (GST) is an indirect tax levied on the supply of goods and services. This law has replaced many indirect tax laws that previously existed in India.

GST is **one indirect tax** for the **entire country.**

So, before Goods and Service Tax, the pattern of tax levy was as follows:

Under the GST regime, the tax is levied at every point of sale. In the case of intra-state sales, Central GST and State GST are charged. Inter-state sales are chargeable to Integrated GST.

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Now let us try to understand the definition of Goods and Service Tax – "GST is a comprehensive, multi-stage, destination-based tax that is levied on every value addition."

Multi-stage

There are multiple change-of-hands an item goes through along its supply chain: from manufacture to final sale to the consumer.

Let us consider the following case:

- Purchase of raw materials
- Production or manufacture
- Warehousing of finished goods
- Sale to wholesaler
- Sale of the product to the retailer
- Sale to the end consumer Goods and Services Tax is levied on each of these stages which makes it a multi-stage tax.

Value Addition

The manufacturer who makes biscuits buys flour, sugar and other material. The value of the inputs increases when the sugar and flour are mixed and baked into biscuits.
The manufacturer then sells the biscuits to the warehousing agent who packs large quantities of biscuits and labels it. That is another addition of value after which the warehouse sells it to the retailer.
The retailer packages the biscuits in smaller quantities and invests in the marketing of the biscuits thus increasing its value.
GST is levied on these value additions i.e. the monetary value added at each stage to achieve the final sale to the end customer.

Destination-Based

Consider goods manufactured in Maharashtra and are sold to the final consumer in Karnataka. Since Goods & Service Tax is levied at the point of consumption. So, the entire tax revenue will go to Karnataka and not Maharashtra.
Journey of GST in India

The GST journey began in the year 2000 when a committee was set up to draft law. It took 17 years from then for the Law to evolve. In 2017 the GST Bill was passed in the Lok Sabha and Rajya Sabha. On 1st July 2017 the GST Law came into force.

Advantages Of GST

GST has mainly removed the Cascading effect on the sale of goods and services. Removal of cascading effect has impacted the cost of goods. Since the GST regime eliminates the tax on tax, the cost of goods decreases. GST is also mainly technologically driven. All activities like registration, return filing, application for refund and response to notice needs to be done online on the GST Portal; this accelerates the processes.

What are the components of GST?
There are 3 taxes applicable under this system: <u>CGST, SGST & IGST</u>.
CGST:
Collected by the Central Government on an intra-state sale (Eg: transaction happening within Maharashtra)

SGST:
Collected by the State Government on an intra-state sale (Eg: transaction happening within Maharashtra)

IGST:
Collected by the Central Government for inter-state sale (Eg: Maharashtra to Tamil Nadu)

In most cases, the tax structure under the new regime will be as follows:

Transaction	New Regime	Old Regime	
Sale within the State	CGST + SGST	VAT + Central Excise / Service tax	Revenue will be shared equally between the Centre and the State
Sale to another State	IGST	Central Sales Tax + Excise / Service Tax	There will only be one type of tax (central) in case of inter-state sales. The Centre will then share the IGST revenue based on the destination of goods.

Illustration:
Let us assume that a dealer in Gujarat had sold the goods to a dealer in Punjab worth Rs. 50,000. The tax rate is 18% comprising of only IGST.
In such case, the dealer has to charge Rs. 9,000 as IGST. This revenue will go to the Central Government.
The same dealer sells goods to a consumer in Gujarat worth Rs. 50,000. The GST rate on the good is 12%. This rate comprises of CGST at 6% and SGST at 6%.
The dealer has to collect Rs. 6,000 as Goods and Service Tax. Rs. 3,000 will go to the Central Government and Rs. 3,000 will go to the Gujarat government as the sale is within the state.

Tax Laws before GST
In the earlier indirect tax regime, there were many indirect taxes levied by both state and centre. States mainly collected taxes in the form of Value Added Tax (VAT). Every state had a different set of rules and regulations. Interstate sale of goods was taxed by the Centre. CST (Central State Tax) was applicable in case of interstate sale of goods. Other than above there were many indirect taxes like entertainment tax, octroi and local tax that was levied by state and centre. This led to a lot of overlapping of taxes levied by both state and centre. For example, when goods were manufactured and sold, excise duty was charged by the centre. Over and above Excise Duty, VAT was also charged by the State. This lead to a tax on tax also known as the cascading effect of taxes.

The following is the list of indirect taxes in the pre-GST regime:

- Central Excise Duty
- Duties of Excise
- Additional Duties of Excise

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- Additional Duties of Customs
- Special Additional Duty of Customs
- Cess
- State VAT
- Central Sales Tax
- Purchase Tax
- Luxury Tax
- Entertainment Tax
- Entry Tax
- Taxes on advertisements
- Taxes on lotteries, betting, and gambling

CGST, SGST, and IGST has replaced all the above taxes. However, the chargeability of CST for Inter-state purchase at a concessional rate of 2%, by issue and utilisation of c-Form is still prevalent for certain Non-GST goods such as:

I. Petroleum crude;
II. High-speed diesel;
III. Motor spirit (commonly known as petrol);
IV. Natural gas;
V. Aviation turbine fuel;
VI. Alcoholic liquor for human consumption. in respect of following transactions only:
   - Resale
   - Use in manufacturing or processing
   - Use in the telecommunication network or in mining or in the generation or distribution of electricity or any other power

What changes has GST brought in?

In the pre-GST regime, every purchaser including the final consumer paid tax on tax. This tax on tax is called Cascading Effect of Taxes.

GST has removed this cascading effect as the tax is calculated only on the value-addition at each stage of the transfer of ownership. Understand what the cascading effect is and how GST helps by watching this simple video:

This indirect tax system under GST has improved the collection of taxes as well as boosted the development of Indian economy by removing the indirect tax barriers between states and integrating the country through a uniform tax rate.

Illustration:

Based on the above example of biscuit manufacturer along with some numbers, let's see what happens to the cost of goods and the taxes in the earlier and GST regimes.

Tax calculations in earlier regime:

Action	**Cost**	**10% Tax**	**Total**
Manufacturer	1,000	100	1,100
Warehouse adds a label and repacks @ 300	1,400	140	1,540
Retailer advertises @ 500	2,040	204	2,244
Total	1,800	444	2,244

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Along the way, the tax liability was passed on at every stage of the transaction and the final liability comes to rest with the customer. This is called the **Cascading Effect of Taxes** where a tax is paid on tax and the value of the item keeps increasing every time this happens.

Tax calculations in current regime:

Action	**Cost**	**10% Tax**	**Actual Liability**	**Total**
Manufacturer	1,000	100	100	1,100
Warehouse adds label and repacks @ 300	1,300	130	30	1,430
Retailer advertises @ 500	1,800	180	50	1,980
Total	1,800		180	1,980

In the case of Goods and Services Tax, there is a way to claim credit for tax paid in acquiring input. What happens in this case is, the individual who has paid a tax already can claim credit for this tax when he submits his taxes. In the end, every time an individual is able to claim the input tax credit, the sale price is reduced and the cost price for the buyer is reduced because of lower tax liability. The final value of the biscuits is therefore reduced from Rs. 2,244 to Rs. 1,980, thus reducing the tax burden on the final customer. GST regime also brought a centralised system of waybills by the introduction of "E-way bills". This system was launched on 1st April 2018 for Inter-state movement of goods and on 15th April 2018 for intra-state movement of goods in a staggered manner. Under the e-way bill system, manufacturers, traders & transporters are now able to generate e-way bills for the goods transported from the place of its origin to its destination on a common portal with ease. Tax authorities are also benefitted as this system has reduced time at check -posts and help reduce tax evasion.

For further reading and understanding, check out our articles:

- Know about gst.gov.in
- GST Council
- EWay Bill Guide for rules
- Guide on How to login to GSTN
- GST registration
- Best GST Software in India
- GST Return

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UNIT - V
Public debt

Public Debt and Budget

Among the non-tax sources, the major source of revenue of the government is public debt. That is, borrowing. It may either be internal or external debts. When the government raises revenue by borrowing from within the country, it is called internal debt. Similarly, if the government is borrowing from the rest of the world, it is a case of external debt. According to Philip E. Taylor, "The debt is the form of promises by the treasury to pay to the holders of these promises a principal sum and in most instances interest on the principal. Borrowing is resorted to provide funds for financing a current deficit."

Causes for Public Debt

Till the beginning of the 20th century, state performed onlyvery limited functions- maintenance of law and order, protection of the country from external attack etc. Therefore, the state had to collect only small revenue and little debt. Recently, in almost all countries of the world there has been a great increase in the magnitude and variety of governmental activities. The acceptance of the principle of the welfare state increases the role of state participation in economic activity. This has necessitated the need to find out additional sources of finance. Hence, modern governments have come to rely on public borrowings.

Objectives of public debt:

The objectives of public debt are the following. To bridge the budget deficit (Deficit Financing)

- To fight against depression.
- To check inflation.
- To finance economic development.
- To meet unforeseencontingencies.

An alternate source of income when taxable capacity isreached

- To finance wars.
- To finance public enterprises.
- To carry out welfare programmes.
- To create infrastructure.
- For creation of productive assets.
- For creation of essential non-income yielding assets (provision of public goods) etc.

Important Sources of Public Debt

Every government has two major sources of borrowing—internal and external. Internally the government can borrow from individuals, financial institutions, commercial banks and from the central bank. Externally, the

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governments borrow from individuals and banks, international institutions like IMF, IBRD, ADB etc. and from foreign governments.

They can be briefly summarized as follows.

- Borrowing from individuals.
- Borrowing from Non-Banking Financial Institutions (Insurance companies, investment trusts, mutual funds etc.)
- Borrowing from commercial banks.
- Borrowing from central banks.
- Borrowing from External sources (IMF, IBRD, ADB, Foreign Governments or countries)

Classification of Public Debt

Voluntary and compulsory (On the basis of legal enhancement):

Voluntary debt is the debt which is paid any legal enforcement. Whereas compulsory debt is legally forced in nature. Here people have no option but repay the debt.

Funded and unfunded debt (Provision for repayment):

Funded debt is long term or 'definite period' debt. A proper agreement and terms and conditions of repayment with the percentage of interest payable are declared. They are used for creation of permanent assets. Unfunded debt is for a short term and for indefinite period. It is paid through the income received from other sources. These are used for meeting current needs.

Internal and external debt:

When the government raises revenue by borrowing from within the country, it is call internal debt. Whereas if the government is borrowing from the rest of the world, itis case of external debt.

Productive and Unproductive(Purpose of loans):

Loans on Projects yielding income (Construction of plants, railways, power schemes etc.) are called productive debt. Loans on loan non income yielding projects are called unproductive loans (war, famine relief etc.)

Redeemable and Irredeemable loans (Promise to repay):

Redeemable debts refer to the loan which the government promises to pay off at some future date. (principal plus interest) Irredeemable debts are those, principal amount of which are never returned by the government but pays interest regularly.

Short / Medium / Long term loans (Time duration):

Short term loans are usually incurred for a period varying from three months to one year. Usually governments get such loans from the central bank by using treasury bills. These loans are calls **'ways and means advances.'**

Medium Term loans are those which are obtain for more than one year but less than ten years. Long term loans are those which are obtain for more

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than ten years. These are used to finance developmental activities.

Redemption of Public Debt

Redemption of public debt means repayment of a loan and it is an important responsibility of the government. All government loans should be repaid promptly. It is, therefore, necessary that the provision of repayment should be inherent in the scheme itself.

Advantages of debt redemption

- It saves the government from going into bankruptcy.
- It checks extravagance on the part of the governments.
- It preserves the confidence of the lenders.
- It makes easy for the government to float future loans.
- It reduces the cost of management of public debt.
- It saves the future generations from the pressure of public debt.
- The resources obtained after redemption of the debt would be diverted towards private investments and therefore a favorable climate for investment could be created.
- Redemption of debt may act as a useful tool to curb deflation.

Methods of Repayment of Debt

Repudiation:

It means refusal to pay a debt by governments. This method was followed by the USA after the civil war and by the USSR after the 1917 Revolution. This method is undesirable and has not been used recently anywhere in the world. Repudiation shakes the confidence of the people in public debt and many provoke retaliation from creditor countries.

Refunding:

Refunding is the process of replacing maturing securities with new securities. In some cases the bonds may be redeemed before the maturing date when the government intends to rearrange the maturity of outstanding debts or when current rate of interest is low. Generally, short-term borrowings are made in anticipation of tax collections for meeting current expenditure. However, excessive burden of new expenditure does not permit the retirement of the debt by means of revenue newly raised or by means of long term borrowing. Thus, there is necessity of refunding the loans by old lenders and renewing the loans at lower rate of interest for future period. The drawback of this method is that government is tempted to postpone its obligation of debt redemption. This leads to a continuous increase in the burden of public debt in future.

Conversion of Loans:

It is a special type of refunding. Conversion of existing securities into new securities before maturity It is generally resorted to reduce the burden of debt by converting high interest loans into low interest loans. According to Professor Dalton, the conversion does not reduce the burden of public debt on the state; because a reduction in interest rates reduces the ability of the

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creditors to pay taxes which may mean a loss of income to the governments there by reducing its capacity to repay loans.

Sinking Fund:

Sinking fund is a special fund created for the repayment of public debt. There is a theoretical justification for creating this fund because it imposes a requirement on the government to pay the old debts regularly. According to this method, the government sets aside a certain amount out of the budget every year for this fund. The balances in the funds are also invested and the interest accruing on them is also credited in the fund.

Sinking fundis of twotypes:

certain sinking fund - here, the governments credit a fixed sum of money annually.

Uncertain sinking fund - the amount is credited when government secures a surplus in the budget.The one danger of this method is that the government may not wait till the end of the period of maturity and utilize the fund for some other purpose than the one for which the fund was created originally.

The practice of sinking fund inspires confidence among the lenders and the enhancement of the creditworthiness of governments.

Capital levy:

Capital levy is a special type of **"once for all"** tax on capital imposed to repay war debts. All capital goods are taxed above a minimum level of assets possessed by residents of the country. Simply, capital levy refers to a very heavy tax on property and wealth. This tax was levied immediately after the First World War. This method has been advocated by economists like David Ricardo, Pigou and Dalton.Professor Dalton has suggested that capital levy as a method of debt redemption with least real burden on the society. It is useful on account of its deflationary character.

Surplus budget:

Quite often, surplus budget may be used to clear public debt. But in recent times due to the ever increasing public expenditure, surplus budget is a rare phenomenon.

Buying up of Loans:

Governments redeem debt through buying up loans from the market.

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