Chapter No: 1
Introduction and Methodology

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1.1-Introduction

Taxation plays an important and pivotal role for the development and growth in all countries. Taxation policy has always been an important instrument for augmenting revenue, especially in developing countries, where it is the major source of domestic revenue. It is also an important instrument for attaining a proper pattern of resource allocation, income tax distribution, and economic stability, in order that the benefits of economic development are evenly distributed. Increased revenue are desired for many other purposes including expending socially desired governments current expenditures, or even on pragmatic grounds. Taxation levels impact on the economic behaviour of individuals and companies and there is a substantial theoretical body of literature relating to this area. Workers and firms react to changes in taxation levels. Workers may increase or decrease the hours of labour supplied depending on the change in their post-tax pay. Similarly, firms may increase (or substitute) labour for other inputs in production following changes in the aggregate cost of labour. Taxation levels also impact on investment decision by firms.

The behavioral response of individuals and firms depend to some extent on the final incidence of the tax, i.e. who actually pays the tax. There are some general principles regarding incidence that apply whatever the tax is. For example, although an individual or a company is legally liable for a tax, the economic burden may fall elsewhere. An increase in corporation tax, which is a tax on corporate income, can reduce dividend payments to shareholders, reduce wages for employees or lead to higher prices for consumers.

The final impact of changes in tax depends on the sensitivity of various supplies and demands to changes in price. For example, labour supply and demand within the sector, workers bargaining strength and the degree of market power the firm has in relation to the price of their output are all factors, which may influence any tax.
Traditional analyses of the economics of payroll taxes have suggested that it makes no difference in the long run if the tax is imposed on the firm or the worker- the incidence is the same. Individuals through changes in wage rates absorb the impact of changes in payroll taxes and what matters to the firm is not the split between the two types of contributions but total labour costs. There is however less clear empirical work relating to the impact of specific taxes on the economic behaviour of firms.

In comparing taxes, ideally we would want to consider the incidence and impact of different taxes on employment and output levels. However this is not possible, particularly for comparison with other countries due to the data requirements and complexity of individual tax systems. The key point regarding 'incidence' is comparing taxes or groups of taxes in isolation can be very misleading. Ultimately if the final incidence of tax falls on individuals, what is important is the aggregate or total tax environment, not specific taxes.

After the Independence, India has adopted the socialist pattern of mixed economy, where public sectors and private sectors work hand in hand. Republic of Yemen has adopted nearly the same. Taxation in those countries has played a significant role, where the fiscal policies are used, as a tool for the development and growth of economic and societies, but Income Tax is very important because of its effects on economics and society. It plays a great role in achieving the welfare of the people. Income tax also affects flourishing trade, company’s profitability and investment volume. The effect of income tax in both the Republic of Yemen and India is very important, as both of them are developing countries. This study focuses on income tax at the individual level and corporation in both countries, from the year 1998 to 2002.

1.2- Literature Studies

Some studies in the literature discussed the income tax in some countries, as shown below:

1 – Study of Sunil U. Pathak . 1993,

The study was made in India, with the following objectives:-
- To find out from different segments the reactions of the assesses about the provisions of depreciation.
- To find out the general awareness amongst the assesses about the provisions of depreciation.
- To know the controversies which have cropped up regarding the provisions and depreciation.
- To highlight the major controversies which either affects a large number of assesses or which involve a large amount of tax effect or both.


The study was made in India, with the following objectives:-
- To study the corporate tax structure in India since 1970-1971.
- To review the rate structure of corporate tax and tax collections for the period 1970-1971.
- To compare India’s tax structure with some selected countries in the world.
- To study the impact of corporate tax before and after the new economic policy 1991, on growth of corporation in India, and
- To suggest suitable remediable measures aiming at promoting wherever necessary. Study titled “Corporate Tax in India and Corporate Growth”.


The study was made in the Republic of Yemen, the main objective of that study is to reveal the weakness and shortcoming in the tax control instrument and then, to find the appropriate solutions in order to avoid the evasion of taxes. The study disclosed the black of information of taxpayers, weakness of control instruments, weakness of relationship between taxpayers, tax administration, unemployed of financial and accounting instruments. Study titled “TAX CONTROL INSTRUMENTS ON THE INCOME TAX IN THE REPUBLIC OF YEMEN – ANALYTICAL STUDY”.
4- Study of Stephen Bond and Lucy Channels, 2000.

The study discussed the developments of Corporate Income Tax in the USA, Japan and 5 European countries Germany, France, UK, Netherlands and Denmark.

Over the last twenty years, the study estimated the effects of corporate income taxes on the cost of capital and effective average tax rate for a range of domestic and international investments. Also the study discussed reform of taxes in some countries.

The impact of the proposed reform would be to reduce costs of capital for investments financed by retained profits and effective average rate for those types. Study titled “Corporate Income Taxes and Investment: A Comparative study”.


The study used comparative Approaches to Central and Eastern European Tax Reform. The study focused on present operations within local and regional tax offices. It highlighted problems such as efficiency, customer orientation, corruption, the need to introduce modern financial and managerial principles and practices etc., the main goals of the research were to study and analyze the actual state of affairs in local and regional tax administrations in five Central and Eastern European countries. Then to make an international comparison between them by using the experiences of Western European Tax Administrations, different countries study, theoretical models, and extensive empirical research. Study titled “Local and Regional Tax Administration in Transition Countries reformer of taxes system, the study discussed in the transition countries, Czech Republic, Estonia, Hungary Romania, Ukraine and introduction to taxes & Tax administration in Sweden”.


The study was made in the Republic of Yemen, the study made for the purpose of evolution of the tax computation ways of Yemeni Income Tax and suggesting new framework for tax computation,


The study disclosed the following: -

1. Shortage of some manners, ways of evolution and cost historical approach for elements of the financial statements and determines of taxable income;
2. Using of principle of the historical cost by tax administration in Yemen, although, the economy of Yemen suffers of high inflation ratio;

1.3- Problem under the Study

Income taxes have always been an important instrument for augmenting revenue, especially in both developed and developing countries, where it is the major source of domestic revenue. It is also an important instrument for attaining a proper pattern of resource allocation, income distribution, and economic stability. Increased revenues are desired for many other purposes including expanding socially desired and government current expenditures.

Today, many developing countries still face difficulty in raising incomes taxes revenue to the level required for promotion of economic growth. A poor income tax performance, in terms of raising revenue can mean either deficiencies in income tax structure or an inadequate effort to collect, on the part of the government, both of which are influenced by various factors.

The study aims at investigating the important role of income tax in both Yemen and India. Thus, the study will spell out the impact of income tax types, income tax rate, income tax revenue, its proportion of public budget, rates of national income, effect of economic development, influence on business activity, influence on personal income, etc.
1.4 - Research Hypotheses

The study will verify the following hypotheses:
1- Income tax system has achieved the canon of tax equity in the allocation of general expenditures in both countries.
2- The main source of the government revenues is income tax in both countries.
3- The International Accounting Standards are applied in both countries, wherever there is a need to compute taxable income.
4- There is a high percentage of income tax evasion in both countries.

1.5 - Importance of the Study

The important aim of the economic policy is to achieve economic growth of the nation, equitable distribution of the wealth and reduction of poverty. Taking this aspect into consideration, public finance is mainly related to the methods by which the funds are raised to meet public expenditures. In spite of several revenues of government, Taxation plays an important and pivotal role in the development of economic, business, investment and social life in any country. It also has an impact on living standards. In other words, income tax forms the main source of public budget in Yemen and India. However income tax influences individual companies' income, firms' income, government revenue and expenditures volume of undertaking etc.

1.6 - Objectives of the Study

The objective of this study is to examine income tax system, with particular reference to the income tax system in Yemen and India. The study draws on published statistics for comparing tax regimes across countries, which considers tax revenues for individuals and groups of taxes related to income in both countries,

1. To verify application of the IASs by computation of taxes on income in both countries.
2. To investigate and compare the income tax system in the two countries.
6. To determine the impact of tax policy and procedures adopted on income tax.
7. To determine the factors, which affect the tax policy and income tax rate.
8. To study the techniques which will help to prevent the taxation evasion.
9. To study the optimum pattern; this may help in the increase of income tax collection.
10. To determine the impact of the revenue of income tax in an economic development in both countries.
11. To verify whether income tax is acceptable to the general public and guilt fair to all the members of the society.
12. To verify the application of the canons of taxation in the societies.

1.7- Limitations of the Study

The study has the following limitations:-
1. The study will be restricted to investigate the income tax system in Yemen as well as in India in terms of finance, accounting, procedures and techniques.
2. The study period will be confined to five financial years in the two countries, i.e. 1998, 1999, 2000, 2001 and 2002.
3. Sample of the study is confined to Sana’a city in Yemen and Pune city in India.

1.8- Methodology of Research

Comparing income tax systems in both countries is not straightforward due to the complexity of tax regimes. Ideally, the researcher would like to compare the impact of income tax systems on individual and business in both countries. The methodology used in this study is of three types’ viz., comparative study; a
questionnaire survey; group discussions; and interviews with both tax officers and taxpayers for study and evaluation of income tax system in Yemen and India. The analysis uses panel data in both countries over the period 1998-2002. The study uses ration to GDP, total tax revenue and other data. The questionnaires also allowed respondents to make free text comments.

1.8.1- Collection of Primary Data:-

Both time series and cross sectional data are collected. This study involved a preliminary data, a questionnaire survey, group discussions and interviews with both tax officers and taxpayers. Primary data have been collected from two different cities (i.e. Pune city and Sana’a city), and three groups. The target respondents of the different surveys can be broadly classified into three groups in both countries:

First, the officers and staff of Tax Authority & Department of Income Tax and its constituent departments were interviewed.

The second group comprised taxpayers. An attempt was made to capture representations of key economic sectors in order to identify any differential responses across sectors.

The third group consisted of opinion leaders of key segments of the Chartered Accountants, i.e., media, professionals, religious leaders, and academics.

The nature of the subject, the type and the extent of information required precluded cold calls to randomly selected respondents. In order to reach these target groups three sets of questionnaires and interviewing strategies were used.

The questionnaire was designed to address more general questions, such as beliefs, attitudes and opinions about tax computation, tax evasion and achievement of fairness in different taxpayers. It was assumed that the general public would not be able to respond to more detailed questions about tax computation, as they do not interact very extensively with the Tax Authority. Data collection of the general public was also sub-contracted to respondents in both countries, which used its standardised procedures to obtain a random sample of the general public. From the sampling frame of Sana’a and Pune cities were divided into three strata, i.e., Tax Authorities, Taxpayers and Chartered Accountants. Second, cities were randomly drawn from each stratum. Third,
households were randomly selected from each city/town. Data provided in the text is weighted data and is identified in the text as "general public survey." A brief description of the sample obtained is provided in Table 1.1 below and the weights assigned to different cells are shown in Table 1.2.

Taxpayer respondents were primarily chief executives of their organisations or senior people well versed with the tax related issues in the company. A similar methodology was used to sample civil society representatives. Well-known personalities were approached and interviewed. Respondents for all in-depth interviews were selected from Sana'a city in Yemen and Pune city in India.

To collect the required primary data, the following techniques of data collection were used.

1) Questionnaire.
2) Interviews.

Two sets of questionnaires were prepared to collect detailed information for the research work.

I) Questionnaires:-

The first set was prepared for Tax Authority, Taxpayers and Chartered Accountants in both countries to collect the data regarding the working of Income Tax Officers, Taxpayers and Chartered Accountants. These questionnaires were personally handed over to M.D./Manager or inspector of the Tax Authority, Taxpayers and Chartered Accountants.

The primary objective of the questionnaires was to collect basic data on tax accounting in various departments as perceived by the general public. The target population was defined as urban males only.

Total household of all sample Income Tax Officers, Taxpayers and Chartered Accountants as in table (1.1). The second set of Questionnaires was supplied to (190 members in Sana’a City) Yemen and (350 members in Pune City) India as and when they were available. These questionnaires were submitted to respondents the personally handed.

II) Interviews:-

Personal interviews 20-25 offices of Income Tax Authorities in both countries were visited to conduct the survey and 540 questionnaires are circulated of which
540 respondents were received. Personal interviews were conducted with 30 executives and officers to understand their Income Tax strategy in taxable income, tax planning and policy and. To collect information from the Chief Commissioners and General Managers or Officers of Income Tax Authorities in both countries, and some businessmen in Yemen.

**1.8.2- Collection of Secondary Data:**

This study used all available data on income tax system in both countries. The secondary data was collected from offices of Tax Authority in Yemen and Income Tax Department in India in-depth information of the societies; their annual reports and office records used. Published materials such as government annual Bulletins, Professional Journals, Magazines. Official statistics published by the Bureau of Statistics and newspapers wherever event has been used for study in both countries. Also in-depth information of the Internet, work papers on taxation.

To collect secondary data the researcher used the following library facilities available at Jaikar library of University of Pune, library of National Institute of Bank Management of Pune, library of Institute of Economics (Pune) and B.M college of Commerce library, Central library in University of Sana’a, library of Commerce Faculty at University of Sana’a, library of Central Organization for Control & Auditing of Republic of Yemen.

**1.8.3 - Questionnaire Design, Pre-Survey, Sample Selection:**

This section summarises relevant information from primary sources (2004) on the nature of sample based income tax data. Questionnaires were prepared and piloted with taxpayers and tax officers. Following detailed negotiations it was agreed that the questionnaires should cover identical issues. Each questionnaire invited respondents to indicate the extent to which they agreed or disagreed with a series of statements and enquiries.

**1.8.4- Selection of Sample and Response Rate:**

Study team members, with the help of hired canvassers, canvassed two different versions of the questionnaires followed by second pre-test using revised questionnaires for Tax Authority and Taxpayers or Chartered Accountants. Two final questionnaires were then designed, one for tax authority and one for taxpayers &chartered accountants. Arabic versions of these questionnaires were
also made. Keeping in view the possibility of a low response rate, two versions of the questionnaires were also prepared. All Questionnaires were anonymous, but the respondents were given the option of providing their names and contact information. Most questionnaires were hand delivered in both countries. The list of taxpayers for addressing was obtained from Taxpayer Large Administration in Yemen, while in India, Department of Income Tax (Pune). The respondents' rate to the survey was disappointing at around percent so that, including pre-survey questionnaires, the sample size for this study is 190 respondents in Yemen, while the sample size for this study in India is 350 respondents. Table 1.1 shows the total number of members as shows below:

Table 1.1 Society and size of the sample member’s household

<table>
<thead>
<tr>
<th>Categories</th>
<th>Yemen</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Sample</td>
</tr>
<tr>
<td></td>
<td>members</td>
<td>selected</td>
</tr>
<tr>
<td>Tax Authority/Income Tax Dept.</td>
<td>210</td>
<td>57</td>
</tr>
<tr>
<td>Taxpayers</td>
<td>830</td>
<td>83</td>
</tr>
<tr>
<td>Chartered Accountants</td>
<td>220</td>
<td>50</td>
</tr>
<tr>
<td>Total</td>
<td>1260</td>
<td>190</td>
</tr>
</tbody>
</table>

1.8.5- Areas covered in questionnaires:

Questionnaires contained areas covered in the questionnaire relevant for this study include:

1. Taxes revenue and tax administration: Covering tax payments, tax collection, administration procedures, tax audit.

2. Fairness of taxation: Covering self-assessed knowledge of the income tax, willingness to pay for tax simplification, clarity and stability, and assessment of benefits from government services and whether income taxes were felt to be high, about right or too low.

4. Tax evasion: including perceptions of tax evasion by similar persons or taxpayers and perceived probability of non-compliance being detected and penalized.
5. Background information: Including education, age, experience, job, professional and general information.

<table>
<thead>
<tr>
<th>Categories</th>
<th>Yemen</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Desire Responses</td>
<td>%</td>
</tr>
<tr>
<td>Tax Authority/Income Tax Department</td>
<td>57</td>
<td>40</td>
</tr>
<tr>
<td>Tax-Payers</td>
<td>83</td>
<td>49</td>
</tr>
<tr>
<td>Chartered Accountants</td>
<td>50</td>
<td>29</td>
</tr>
<tr>
<td>Total</td>
<td>190</td>
<td>118</td>
</tr>
</tbody>
</table>

The age average of many respondents is between 35-45 years in both countries, we can see that in chart 1.1 below.

Graph 1.1 Distribution of respondents according to Ages

The educational level of respondents is high in India, while in Yemen is more than India in B.Com. Also we found that 49.2 per cent from respondents in India have Master of commerce while Ph.D is 10.3 and 5.9 percent in both countries respondents see that in chart 1.2 as below.
The experience of respondents is high in both countries. 35.9% in India and 31.4% in Yemen are higher ratio that has experience between 10-20 years, also 19.5% in Yemen and 13.9% in India from respondents are experience more than 20 years see that, chart 1.3 as below.

We observed that the respondents of specialized journals were high in Yemen (between 1and 2), while in India are higher ratio (between 3 and 4). We can see that in chart 1.4 below.
We observed that high ratio of respondents is subscribers of specialized journals but the respondents were equity in both countries, we can see that in chart 1.5 below.

Graph 1.5 Distribution of respondents according to Subscription in specialized Journals

We observed that 50.9% respondents in Yemen the update knowledge on taxes by Tax Periodical. But in India 13.3%, 41.5% and 30.9% from received answers through ICAI, subscription of journal and conference on tax respectively. We can see that in chart 1.6 below.

Graph 1.6 Distribution of respondents according to update of their knowledge.

We observed that 47.5% in Yemen and 41.0% in India of respondents have chartered accountants. We can see that in chart 1.7 below.
We observed that high ratio of respondents have got training on tax in both countries. We can see that in chart 1.8 below.

1.8.6 – Period of Study:
The study covers a period of five years of the functioning of Tax Authority in both countries. Accordingly, the period of study is from 1998- to 2002, the year 1998 being the year of introduction of the scheme.

1.9 Some Tools and Techniques of the Research
After the collection of the research data, . An analysis of the data is to be made with reference to the objectives of the study and its possible bearing on scientific discovery. An analysis is made with reference to the research problem at hand and with reference to the hypothesis to be tested. For analysis and interpretation of data the researcher has used the following statistical methods.

- SPSS and Excel for windows
• Tabulation.
• Classification.
• Charts.
• Simple average.

For analysis and interpretation of data the researcher has also used the following management accounting techniques wherever necessary.

1. Comparative analysis.
2. Ration analysis.
3. Figure analysis;
4. Growth rate analysis;

This analysis is primarily based on behavioral pattern of various parameters rather than on any rigorous statistical methodology. Essentially, heuristic analysis has been carried out.