CHAPTER 5

SUMMARY OF CONCLUSIONS AND SUGGESTIONS

Taxation is considered as the most important source of development finance. The steady increase in the demand for governmental services and economic plans for the rapid growth of a country’s economy has considerably changed the role and scope of taxation. Taxation is treated as an important fiscal instrument in increasing the state revenue and in achieving the economic and social objectives of the country. It is viewed primarily as a means of transfer of resources from private hands to the public exchequer to be utilized for financing developmental expenditure.

The efficiency of tax system in promoting a county’s development depends on the tax structure of a country at a given time and place, which depends on a set of available ‘tax bases’, level of development reached and also on the social and political factors, including the cultural style of the taxing governments.

The feasibility of a particular tax structure depends on factors such as the country’s legal systems; the balance of political and social power within the country; the administrative ability to enforce the tax comprehensively and justly; the effects of different taxes on incentives; and the objective of a proper balance between short term revenue-rising measures for financing urgent development projects and for long run resources which will give steady encouragement to economic development over the longer pull.
The study takes the following as its objectives:

1. To estimate the important changes in the tax structure of Karnataka government.
2. To examine the importance of state taxes in the revenue structure of Karnataka.
3. To estimate buoyancy and elasticity of state taxes to know the responsiveness of tax system to state income.
4. To examine the factors affecting the tax structure of Karnataka government.
5. To estimate the impact of discretionary changes on the tax structure of Karnataka.

The study takes the following as hypotheses:

1. There is no relative change in the importance of individual taxes in the tax structure.
2. There is no improvement in the importance of state taxes in the revenue structure of Karnataka.
3. There is no difference between buoyancy and elasticity coefficients of state taxes.
4. Discretionary changes do not affect the tax revenue in Karnataka.
5. The tax factors did not affect the tax structure for the improvement.

Tax structure indicates the composition of taxes and the relative importance of individual taxes imposed by the government of a country/state. Tax structure, therefore, refers to the mix of taxes levied by the government of a country/state indicating the relative importance of the constituents.

The level of taxation and its rate of growth, however, can be altered only by changing the individual elements that make up the tax structure. This is a complex matter; each element of the tax system has its own rate of growth, its own base and is
related to distinct economic variables. Economic development, thus, depends on a carefully though-out and well organized tax structure.

The principal objective of tax policy of Karnataka State is to augment adequate revenues for financing the state's capital formation. The taxation policy of Karnataka has been geared to mobilize resources to finance the increasing revenue requirement of the successive Five-Year Plans.

Hence, an examination of the tax parameters is of crucial importance for development-oriented tax system, which requires a continuous modification in its tax structure so as to make the system increasingly responsive to the needs of social and economic growth.

The principal taxes imposed, collected and appropriated by the government of Karnataka have been Sales Tax, State Excise Duty, Stamps and Registration Fee, Taxes on Vehicles, Taxes on Goods and Passengers, Taxes and Duties on Electricity, Profession Tax, Entertainment Tax, Land Revenue and Agricultural Income tax. The revenue mobilized from the above taxes is known as State's Own Tax Revenue (SOTR).

The average contribution of state's own tax revenue to the total revenue was increased from 54 per cent in eighties to 64 per cent in nineties in Karnataka State. The State's own tax revenue as ratio of State Domestic Product also shows that there was an improvement from 8.88 per cent in eighties to 9.39 in nineties. These trends indicate that the government of Karnataka performed well in its efforts in the mobilization of revenue through its own taxes during the post-reform period.
The government of Karnataka imposes indirect taxes like Sales Tax, State Excise duty, Taxes on Vehicles, Taxes on Goods and Passengers, Taxes and Duties on Electricity and Entertainment Tax. The government of Karnataka imposes direct taxes like Stamps and Registration Fee, Profession Tax, Land Revenue and Agricultural Income Tax. The changes in the tax structure of Karnataka during the period of study indicate that while the contribution of direct taxes declined from 11.42 per cent in 1980-81 to 9.97 per cent in 1999-2000, the contribution of indirect taxes increased from 88.58 per cent in 1980-81 to 90.81 per cent in 1999-2000.

Among the individual taxes, Sales Tax is the most important indirect tax and it has the lion's share in the state's own tax revenue. The revenue from the Sales Tax has been increased continuously from Rs 237 crores in 1980-81 to Rs 4683 crores in 1999-2000. The percentage contribution of revenue from Sales Tax has also been increased continuously from 50 per cent in 1980-81 to 60 per cent in 1999-2000, that is increased by 10 percentage points during the period of study. The contribution of revenue from Sales Tax to the state's own tax revenue increased from 55 per cent in eighties to 59 per cent in nineties in Karnataka state.

The State Excise Duties is the second largest contributor to the state's own tax revenue of Karnataka. The revenue from State Excise Duties increased from 94 crores in 1980-81 to Rs 1215 crores in 1999-2000. The percentage contribution of State Excise Duties to the state's own tax revenue declined from 20 per cent in 1980-81 to 16 per cent in 1999-2000. The contribution of State Excise Duties to the state's own tax
revenue declined from 18 per cent in eighties to 16 per cent in nineties in the Karnataka state.

Another important source of revenue to the government is Stamps and Registration Fee. The revenue from this source has been continuously increased from 29 crores in 1980-81 to 566 crores in 1999-2000. The percentage contribution of Stamps and Registration Fee to the state's own tax revenue has been fluctuated between 6 and 7 during the period of study. The contribution of State Excise Duties to the state's own tax revenue increased from 6 per cent in eighties to 8 per cent in nineties.

Tax on Vehicles is another important source of revenue to the government of Karnataka. The revenue from this source was increased continuously from Rs 47 crores in 1980-81 to Rs 449 crores in 1999-2000. The contribution of Taxes on Vehicles to state's own tax revenue has been declined from 10 per cent in 1980-81 to 6 per cent in 1999-2000. The contribution of Tax on Vehicles to state's own tax revenue declined from 9 per cent in eighties to 7 per cent in nineties.

Sales Tax has been the most important source of state's own tax revenue and it preserved not only its primacy throughout the period of study, but also improved its relative position substantially.

State Excise Duty, though it maintained second rank, its contribution has been decreased considerably.

Stamps and Registration Fee improved its rank from fourth in 1980-81 to third in 1999-2000 but its contribution to state's own tax revenue improved only marginally.
While Taxes on Vehicle decreased from third rank in 1980-81 to fourth rank in 1999-2000 and its contribution also decreased considerably.

Taxes on Goods and Passengers, has not only improved its rank from tenth to fifth but also improved its relative contribution to the state's own tax revenue considerably.

Taxes and Duties on Electricity has improved its rank from seventh to sixth, but it maintained same level of contribution to the state's own tax revenue.

Taxes on Profession has also declined its rank from eight to seventh but its contribution to state's own tax revenue improved very marginally.

Entertainment Tax has fallen from fifth to eighth rank and its relative contribution has been decreased considerably.

Land Revenue, the traditional direct tax, though maintains its rank at ninth, its relative contribution has been declined considerably.

Agricultural Income Tax has fallen from sixth rank to tenth rank and its relative contribution also declined considerably.

The domination of Sales Taxes; the introduction of modern taxes like Taxes and Duties on Electricity; and the declining importance of traditional tax like Land Revenue and Agricultural Income Tax are the basic characteristics of transitional stage of development in tax structure of a government in developing countries. The Karnataka tax structure at present, therefore, suitable for the transitional stage of Hinrichs.
Among the important indirect taxes annual compound growth rates have declined during nineties over eighties. For example, annual compound growth rate of Sales Tax declined from 17.97 per cent in eighties to 15.21 per cent in nineties. Similarly annual compound growth rate of State Excise Duties declined from 13.37 per cent to 11.29 per cent in the same period. In the case of another indirect tax that is Taxes on Vehicles also declined from 16.17 per cent to 10.16 per cent during the same period. On the other hand, annual compound growth rate of important direct taxes (excluding Stamps and Registration Fee) have been increased during nineties over eighties. For example, annual compound growth rate of Land Revenue increased from 11.43 per cent to 14.51 per cent during the same period. Similarly annual compound growth rate of taxes on Profession increased from 9.66 per cent to 13.49 per cent during the same period.

In the tax structure of Karnataka the annual compound growth rate of direct taxes improved in general, while that of indirect taxes have declined. Therefore it can be concluded that the importance of direct taxes gained momentum during the nineties over eighties, while that of indirect taxes has declined.

The trends in the tax structure of Karnataka explained above indicate the non-availability of new tax handles or bases and limited options open to the Government to change the mix of taxes. It is, thus, obvious that the luxury of tax structure flexibility has not been available to the Government of Karnataka for economic and political reasons.
The responsiveness of tax revenue to state income implies a functional relationship between the two, with tax revenue as dependent variable and state income as an independent variable. A quantitative measure of responsiveness of tax revenue is useful for having a better understanding of the tax structure and its behavior. Two concepts—tax elasticity and tax buoyancy—are used in the measurement of the responsiveness of the revenue to changes in state income.

Tax elasticity is the built-in-income elasticity of a tax. It measures the automatic response of the tax revenue to changes in state income i.e. revenue increase excluding the effects of discretionary changes. In estimating built-in-income elasticity of a tax, a time-series of tax revenue is adjusted to eliminate the effects of discretionary measures on tax revenue. A high tax elasticity allows growth in expenditure to be financed without resorting to the raising of the tax rates and introduction of new taxes.

Tax buoyancy measures the total response of the tax revenue to changes in state income. In other words, it includes both natural growth through tax elasticity as well as the growth due to the raising of tax rates and introduction of new taxes.

The buoyancy coefficient is derived simply by regressing the series of actual tax revenue on the state income series. On the other hand, the elasticity coefficient is derived by regressing the series of adjusted tax revenue (after 'cleansing' the effect of discretionary measures) on the state income series.
The responsiveness of changes in tax revenue to the changes in state Domestic Product of Karnataka is measured with the help of two coefficients, namely buoyancy and elasticity.

By observing the co-efficients of buoyancy and elasticity it can be inferred that the Sales Tax revenue in Karnataka has responded more effectively during the pre-reform period than during post reform period to the SDP of Karnataka. The difference between the buoyancy and elasticity coefficients indicate the impact of discretionary changes in the structure of sale tax on its revenue. If this difference is positive, it can be said that there is a positive impact on the responsiveness and vice versa. Since the difference between buoyancy and elasticity coefficients of sale tax is negative in pre-from period and positive in post-re-from period it can be inferred that the discretionary changes in sales tax system have made negative impact in pre-reform period and positive impact in post-reform period.

By observing the coefficient of buoyancy and elasticity it can be inferred that the State Excise Duty in Karnataka has responded more effectively during the pre-reform period than during post-reform period to the SDP of Karnataka. Since the difference between buoyancy and elasticity coefficients of State Excise Duty is positive both in pre-from period and post-reform period it can be inferred that the discretionary changes in State Excise Duty have made positive impact in pre-reform period as well as in post-reform period.

By observing the coefficients of buoyancy and elasticity it can be inferred that Taxes on Vehicle in Karnataka has responded more effectively during the period of
pre-reforms that during post-reforms to the SDP of Karnataka. Since the difference between buoyancy and elasticity coefficients of Taxes on vehicle is positive both in pre-from period and post-reform period, it can be inferred that the discretionary changes in Taxes on vehicle have made positive impact in both pre-reform period and post-reform period.

The government of Karnataka has made changes in the rate and base structure of Indirect Taxes eight times during the period of 1980-81 to 1989-90. All these eight times, except in 1989-90, the discretionary measures have yield positive revenue to the government.

During the post-reform period the government of Karnataka revised the rate and base structure of indirect taxes nine times, of which, except in 1996-97, the discretionary measure given positive revenue to the government of Karnataka.

The buoyancy coefficient of indirect taxes is 1.2149 during pre-reform period and it declined to 0.9266 during the post-reform period. The elasticity coefficient of indirect tax is 1.1180 during the pre-reform period and it is also declined to 0.8553 during the post-reform period.

By observing the coefficients of buoyancy and elasticity it can be inferred that the indirect taxes in Karnataka have responded more effectively during the pre-reform period than during the post-reform period to the SDP of Karnataka. Since the difference between buoyancy and elasticity of indirect tax is negative in pre-reform period and positive in post-reform period, it can be conclude that the discretionary
changes in indirect taxes have made negative impact in pre-reform period and positive impact in post-reform period.

The government of Karnataka has made changes in the rate and base structure of Direct Taxes six times during the period of 1980-81 to 1989-90. All these six times the discretionary measures have yielded positive revenue to the government.

During the post-reform period the government of Karnataka revised the rate and base structure of Direct Taxes in eight times. All these eight times, discretionary measures have given positive revenue to the government of Karnataka.

The buoyancy coefficient of Direct Taxes is 1.0840 during pre-reform period and it increased to 1.1272 during the post-reform period. The elasticity coefficient of Direct Taxes is 0.9457 during the pre-reform period, but it is declined marginally to 0.9078 during the post-reform period.

By observing the coefficients of buoyancy it can be inferred that the Direct Taxes in Karnataka have responded more effectively during the post-reform period than during the pre-reform period to the SDP of Karnataka. By observing the coefficient of elasticity it can be inferred that the Direct Taxes in Karnataka have responded more effectively during the pre-reform period than during the post-reform period of the SDP of Karnataka. Since the difference between buoyancy and elasticity of Direct Taxes is negative both in pre-reform period and in post-reform period, it can be concluded that the discretionary changes in direct taxes have made negative impact both in pre-reform period and in post-reform period.
State's Own Tax Revenue is the sum of revenue from indirect taxes and direct taxes levied by the government of Karnataka. The buoyancy coefficient of SOTR is 1.2019 during pre-reform period and it declined to 0.9449 during the post-reform period. The elasticity coefficient of SOTR is 1.1070 during the pre-reform period and it is also declined to 0.8571 during the post-reform period.

By observing the coefficients of buoyancy and elasticity it can be inferred that the SOTR in Karnataka has responded more effectively during the pre-reform period than during the post-reform period to the SDP of Karnataka. Since the difference between buoyancy and elasticity of SOTR is positive both in pre-reform period and in post-reform period, it can be conclude that the discretionary changes in SOTR have made positive impact in both pre-reform period and post-reform period.

The present study used per capita NSDP and the ratio of tertiary sector income to NSDP as independent variables, which determine the level of revenue from taxation in Karnataka. The regression equations have been estimated for two-time periods’ i.e. pre-reform period (1980 to 1990) and post-reform period (1990 to 2000). The regression estimates are calculated for ten individual taxes and three aggregates of individual taxes, namely indirect taxes, direct taxes and state's own tax revenue.

The results of the regression equations for each and every tax and their aggregates have been discussed above. The following are the main findings from the regression analysis.
1. Per capita NSDP and ratio of tertiary sector income to NSDP together contributed more than 75 per cent in the variations of all major taxes except agricultural income tax, profession tax and land revenue during the pre-reform period and except entertainment tax and electricity duty during the post-reform period. Therefore, the two selected variables have been treated as effective determinants of the tax structure of Karnataka government.

2. The regression coefficients of per capita NSDP shows that it has a positive influence on the revenue from all tax components during the pre-reform period and all tax components, except entertainment tax, during post-reform period. Further, the regression coefficients indicate that one per cent improvement in per capita NSDP leads to more than one per cent increase in majority of the taxes (six taxes out of ten taxes) in the pre-reform period but only four taxes out of ten taxes in the post-reform period. Therefore, it is indicated that per capita NSDP influenced the changes in the revenue of many taxes in the pre-reform period and its influence is limited to only four taxes (which have low revenue contribution to the SOTR) in post-reform period. Hence, it can be concluded that the influence of per capita NSDP has been lower in the post-reform period than in the pre-reform period. However, the regression coefficients of per capita NSDP on state's own tax revenue presented an opposite view that is its influence is more (0.937) in the post-reform period than in the pre-reform period (0.871).
3. The ratio of tertiary sector income to NSDP has positive influence on revenue from six individual taxes out of ten taxes in the pre-reform period but only five individual taxes out of ten taxes in the post-reform period. A one per cent increase in this ratio leads to less than one per cent increase in all individual taxes except taxes on goods and passengers during pre-reform period and except electricity duty, stamps and registration fee and profession tax during the post-reform period. Therefore, it is clear that the influence of ratio of tertiary sector income to NSDP is lower than that of per capita NSDP.

The above analysis of the study shows that the tax structure of Karnataka State became less buoyant and inelastic during the post-reform period than during the pre-reform period. For a variety of reasons like leakage in tax administration and evasion of tax, the revenue collection from different taxes in Karnataka has not been effective. Therefore, there is a need for tax reform and for this the following suggestions have been made through this study to make the tax structure of Karnataka more buoyant and elastic in future.

Suggestions

1. Since sales tax has been the single largest revenue contributor to the state's own tax revenue, reform of sales tax needs urgent attention. To improve the revenue from sales tax in Karnataka, there is a need to rationalize the sales tax rates based on the theory of Laffer curve, which explains high tax rates after a certain level will generate lower tax revenue.
2. To achieve the objective of simplicity in sales tax system, exemption based on the forms or uses of commodities or nature of purchasers will have to be eliminated. Tax administration methods should be modernized and assessment procedure simplified to encourage better compliance.

3. There is a clear rationale for separately levying both excise duty and sales tax on alcoholic beverages. It is important to levy sales tax as part of the broad based value added tax. Excise duty should be levied to regulate the consumption of alcoholic beverages, demerit goods.

4. There is a need to carefully calibrate measures needed to strengthen the administration, enforcement machinery and information system and consider introduction of e-governance for administering the sales tax in the state.

5. VAT (Value Added Tax) should be introduced by rationalizing the tax structure to minimize exemptions and to reduce the number of tax rates. State should come to an agreement regarding new floor rates, in case state introduces VAT before other states to avoid tax competition.

6. Since alcohol is a demerit good, it is appropriate to impose an additional levy in the form of excise duty, which should also fully compensate for reduction in sales tax revenue from alcohol.

7. To make the revenue form taxes on vehicles more buoyant and elastic, the “lifetime Tax” rates on private motor cars and two-wheelers may be increased.

8. The base of the profession tax has to be widened. For this, there is a need to identify more sources of information about potential taxpayers. The income tax database could be accessed for this purpose.
9. All forms of entertainment will be covered under taxation to widen the base of entertainment tax. In preparation for this, it is suggested that the tax should be extended to newer forms of amusement like theme parks, consumer exhibitions, bowling alleys, browsing centers etc.

10. Since agriculture sector is an area of under taxation in Karnataka, the extension of Agricultural income tax to the commercial crops like eucalyptus plants, coconut trees, arecanut trees and mango trees, which have been extensively growing in agricultural field is called for to increase tax revenue.

11. To control tax evasion in all types of state taxes, penalty should not be limited by a ceiling; it should be linked to the value of tax evaded and multiples of it.

12. Finally, it is suggested that for a continuous evolution of tax statutes and monitoring of compliance and collection efficacy and methods, a committee should be set up under finance ministry, government of Karnataka, in which all taxation departments are represented.

If the government of Karnataka rationalizes its tax structure by adopting the above suggestions, there is a possibility for the improvement in the tax revenue from its own taxes and the tax system would become elastic.