Chapter 2

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Taxation as an instrument of fiscal policy is not only important in making available resources to the Government but it also has significant influence on the level and direction of economic activity in both developed and developing countries, with the acceptance of a positive role of fiscal policy specially in the context of economic growth. Taxation as a major source revenue for the large development plans and for regulating the behaviour of private enterprises in a mixed economy has acquired a new dimension than merely being there of distribution of tax burden on the economy equitably. Taxation has an important role to play in securing adjustment in the allocation of resource, adjustments in the distribution of income and wealth and economic stabilisation is the most important economic functions of the government.

Macro-Economic stabilisation requires reduction in fiscal deficit and high tax collections. Higher tax collections, however cannot be achieved by high rates of taxation as it encourages tax evasion. Therefore need is to have a tax system which is simple to administer and has moderate and broad base.

The Government’s thrust towards tax reforms, thus forms a natural corollary to the fiscal policy which it has been successfully pursuing for the last 20 years. Accordingly during the period monumental changes have been brought about in the Indian tax structure.
Over the past 20 years, a number of structural changes covering both direct taxes and indirect taxes were undertaken. Unlike earlier isolated attempts to modify the tax system, these changes were part of medium term programme of tax reform. They were geared to move towards a tax structure which is single, relies on moderate tax rates with a wider base and better enforcement, serves the objectives of equity and provides incentives and signals consistent with developing an internationally competitive and dynamic economy.

An overall tax reform since 1991 has helped in correcting the imbalance in the structure of revenue sources. Direct taxation is the most equitable and efficient form of raising the revenue. Prior to reforms high tax rates in the realm of direct taxation did not yield high collections. It is noteworthy that the share of direct taxes in GDP rose from 3.41 percent in the financial year 2000-2001 to an estimated 5.97 percent in 2009-10. Also the share of direct taxes in the gross tax revenue of the Centre rose from about 23.50 percent in 2000-01 to an estimated 37.32 percent in 2009-2010. This is a healthy trend from the point of view of equity and efficiency in tax administration.

Personal income tax constitutes a very important source of revenue for most of the countries in the world as it covers maximum number of persons and it is levied on a progressively increasing scale with a view to achieving vertical equity among tax payers and ensuring greater amount of revenue with increased in assessed incomes. It is considered the fairest method of taxation and it has been semi scheduler in nature and requires computation of income under specified heads.
Taxation of income of corporate entities also constitutes an important source of revenue for most of the countries across the globe. The methods of taxation and the system of exhibiting the yield from this tax have been somewhat peculiar and basis of corporation tax has been similar to the taxation of individual income. Taxation in India is levied on the total income of the company accrued or deemed to have been received. The Super tax on corporate incomes is levied at a flat rate. This tax has been subject to rebates and was based on two principles of differentiation. The first was tax concessions in favour of smaller companies, and the second was a differentiation between Indian and non Indian companies. The corporation tax in India provides liberal tax concessions to encourage investment in general and in priority industries in particular. The structure of corporate taxation in India is very complex and complicated. Too much of complications and contradictions in the corporate tax laws are amply exploited by the company executives and directors.

The companies are able to evade the legitimate taxes by inflating their expenses. Personal expenses of directors and privileged employees are camouflaged as business expenses. The strange phenomenon in the Indian corporate sector is that many companies continue to exist for a long time, in spite of their growing accumulated losses. A study revealed that the accumulated losses far exceeded their share capital and net worth. These companies are not for earning profit, but to benefit directors, friends and relatives through various means like contracts, advertising, selling agencies etc.

In this context, it becomes essential to study the behavior of both personal and corporation tax collection and the genuineness of various concessions. Using a firm level data in the case of India, and a frontier
approach, it is found that there exists a concave relationship between tax revenue and marginal tax rate. Among the determinants of inefficiency, various concessions and deductions provided to individuals and companies seem to play a significant role.

**Statement of the Problem**

It has been widely acknowledged that over the decades, India’s tax structure system was absurdly complicated, beset with countless anomalies and was impossible to administer properly. The direct tax system was characterised by narrow base, for too many exemptions rules ostensibly encouraging saving of various forms. In the area of indirect taxes, there were too many rates, which often distorted the choice of inputs and lead to inappropriate resource allocation. Nominal rates were very high and evasion became wide spread.

Since the laws relating to taxation in India are highly complex, it is beyond the understanding of the most of the taxpayers and provides enough scope to unscrupulous elements to indulge in tax evasion as well as tax avoidance. This problem has begotten the problem of widespread corruption in the various tax departments and it has at the same time, brought about the problem of tax evasion of unimaginable dimension.

Another problem of the Indian tax structure is that the incidence of taxation in urban areas is much higher than in the rural areas. This is due to the fact that the main occupation of the rural areas is agriculture and income from agriculture has been kept outside the purview of income tax. Development of the Indian tax structure is closely linked with needs and circumstances and it is not based on any scientific lines as some taxes in
India have been imposed under compulsion but subsequently withdrawn under political pressure and purely political consideration.

Another problem is that, income from taxation does not increase automatically in proportion to increase in national income. Hence, the government finds no way out than to increase the taxes every year for maintaining a definite ratio of taxes to income. The Indian tax system also lacks administrative efficiency, overlapping of functions, inefficient manual process, lack of control, lack of sound information, clear cut guidelines, inadequate facilities and representation in legal disputes etc., all these problems have damaged the ideals of tax administration, image of the department and burden of tax is not equitable.

All the above issues indicate that, there is lot of controversies and confusions, problems, complexities and external pressures relating to taxation provisions which are affecting public finance. Frequent changes in rates and procedures had upset the whole system. In order to restructure the taxation policy the Government of India appointed task force committee to suggest ways and means of improving tax system in India. After great deliberation discussions and studies, the committee has offered number of recommendations and suggestions with reference to the various points referred by the government to the committee.

There is a need to study all these issues to assess the reasons for the inadequate tax structure, failure for implementation of the various recommendations and operations of the taxes in Indian federal system. Particularly in mobilising financial resources /revenues to the state exchequer. Major shortcomings still persisting in the tax system and much remains to be done to simplify and rationalise the tax system.
Concreted efforts are necessary to create proper information automating the tax returns etc. The reforms should be continuous process to keep the economy competitive instead of being sporadic and crisis driven.

It is also necessary to evaluate whether the committee has answered all the questions raised with regard to our complex tax system and also to increase total tax revenue to the government. This study aims at studying all the issues to identify the impact of various income tax provisions on the different components of public finance. Source of the questions raised with reference to the recommendations or whether this committee has made any recommendations to improve the elasticity? ; Is there any recommendations to identify the new areas of tax? ; How for the recommendations benefit the different assesses? ; What are the consequences if the recommendations are implemented? ; Whether recommendations made by the committee are reasonable or unreasonable?.

All these questions need to be answered through a study to know how for they are relevant, practical in nature and their practical applicability. This study aims at evaluating the recommendations of the committee and all related issues including tax compliance, an attempt has also been made to offer suggestions as to how best the tax system can be improved based on the suggestions of the informants.

**Review of Literature**

To have a thorough knowledge of the tax provisions prevailing in the country as well as to understand problems and issues pertaining to fiscal policy, specifically after, the economic reforms, which are introduced in
1991, a detailed survey of related literature has been conducted. It was found fortunately that the literature available on impact of tax reforms on public finance is rather sufficient. Secondly a review of literature on tax reforms with particular reference to Kelkar Committee recommendations evaluation was taken up. Here, it was found that some literature is available although inadequate.

Though the personal and corporation tax revenue constitutes an important source of revenue for the centre, there is limited work done in this field in India. Several studies have been carried out earlier for estimating the buoyancy and trends in Central taxes including Personal Income Tax and corporate tax etc.

However, a review of all available literature revealed that till date no one has studied or not published any work on impact of recent tax provisions on public finance for the specific period of 10 years between 2000-2001 to 2009-2010. In all about eighty articles, majority of them based on empirical studies were studied in detail and abstracts of few literatures are given below:
Ankita Gupta (2009)\(^1\) states that a good tax system is characterised by a high responsiveness of tax revenue to changes in national income; the technique of measuring this response is tax elasticity and tax buoyancy. The total tax revenue is dependent up on three variables viz., tax rate, tax base and national income. Study attempted to find out the responsiveness of personal income taxation with respect to national income and study revealed that there is need for rationalisation of tax rates and increase in revenue productivity was brought about by drastic reduction in the top marginal rates of tax and rationalised to a large extent during the last fifteen years. The top marginal rate has been reduced from 69 percent to 30 percent; the exemption limit has been largely increased from Rs.8000 in 1980-81 to Rs.1.60 lakh in 2009-10 and states that reforms have favourable impact on the growth of personal income tax.

Amresh Bagchi (2000)\(^2\) Studied the need of modern information technology in tax administration and made a cross country comparison of India with countries like Canada, United States, Singapore etc., with respect to information technology in tax administration. The study observed that while the use of computers in tax administration was now almost universal some countries were well on the way to creating a tax regime, in which tax payers gathers efficient information. Study concluded that for a country to succeed in implementing the taxes efficiently and equitably. It was observed that commitment to change at highest levels is must to bring changes in tax system.

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Angela Franchini and Luigi Bernardi (2005)\(^3\) states that Indian GDP showed an impressive rate of growth and general budget is structurally imbalanced and public debts are high. The structure of the tax system is not much beyond the early stage. A complex structure of taxes on goods and services is largely the main headings of the tax system and it is difficulty moving towards a VAT kind structure. Direct taxes still are in an infant stage, both as weight as well as structure, social contributions are entirely lacking. The road to updating and improving the Indian tax system has been entered since the early 1990’s but the reform is still largely to be accomplished.

Boothalingam and K.N. Wanchoo \(^4\) States that Abolishing sur-tax dividend tax, family and parents allowances and also recommended raising the exemption limit in case of personal tax. Maximum marginal rates of personal income tax should be brought down to 75 percent and power to levy and administer agriculture income tax should be assumed by the Central government and also recommended that the tax payers should be given PAN and more in favour of strengthening searches and seizures.

Bhatia.H.L (2004)\(^5\) Describes that the tax system of the country is an integral part of its overall economic system and is expected to contribute to the achievement of Economic and social objectives. Appropriateness of the tax system is judged by looking as its various dimensions, the progressivity incentives and disincentives and the like. There is lot of


\(^4\) Boothalingam “Report on the rationalization and simplification of the tax structure”. Ministry of Finance Government of India. NewDelhi
scope to simplify the tax laws and guarantees that the rate schedules and other important provisions could not change from year to year in an unpredictable manner. The assessment has also to be streamlined.

**Chellaiah Raja** ⁶ Suggested the criteria on which the sound and practicable tax system should be based. He was of the view that to avoid administrative complexity and to preserve horizontal equity, the introduction of various incentive provisions, deductions and concessions should be avoided. He suggested that lowering of tax rates should be accompanied by abolition of most of the tax incentives. He opened that if a concession is really justified, it is better to make that subsidy and its cost transparent through an expenditure provision rather than to introduce a tax concession which results in a tax expenditure whose cost is not readily apparent and is often nor calculated. He also proposed the taxation of agricultural income. The need for achieving horizontal equity in the taxation was also stressed.

**C Choksi** ⁷ Opined that rationalisation and simplification of taxation structure. Integration of the substantive provision of the laws of income tax wealth tax, gift tax, and sur-tax, so as to form a part of single act and enactment of separate act for administration and procedural provision of the four taxes and they are in the opinion of taxation of agriculture income.

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7. CC Choksi “Taxation and Economic Development in India”. Published by Vikas Publication Pvt Ltd, New Delhi page no 25-28
Das-Gupta 8 attempted to measure the income tax compliance cost of corporations in India for 2000-01. The objective of the study was to measure the cost of compliance with the income tax of Indian corporations and to ascertain how these costs compare internationally.

The estimates were based on a postal survey of 45 companies throughout India, with a very low response rate of 1.15 percent. The compliance cost included internal (personnel and other) costs, payments to advisors and bribe cost. Gross compliance cost was estimated to be between 5.6 percent and 14.5 percent of corporation tax revenues.

Corporate tax revenue has been modeled as a function of statutory tax rate, corporate profitability and other variables for Organization for Economic Co-operation and Development (OECD) countries, by Kimberly (2007). Using a panel data set up, the empirical results indicated a parabolic relationship between tax rate and corporate tax revenue.

G.K. Govinda Rao 9 studied the evolution of Indian Tax system and trends in the tax revenue of the Central and State government for the period 1970-71 to 2008-2009. Study revealed that share of personal income tax in total tax revenue increased from 10 percent to 12.6 percent. It was observed that as regards the personal income taxes, the most drastic and visible changes were the reduction in income tax rates and raising of exemption limit which gets further enhanced when combined with standard deduction.

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Helene Poirson (2006) 10 opines that the effect of India’s tax system on growth, through the level and productivity of private investment, comparison of India’s indicators of effective tax rates and tax revenue productivity with other countries shows that the India tax system is characterised by high dependence of indirect taxes, low average effective tax rates and tax productivity and high marginal effective tax rates and large tax induced distortions on investment and financial decisions. He also states that recent tax reforms improved the tax productivity and lowered the marginal tax burden and tax induced distortions.

Jha and Economic reforms Commission 11 States that employers may be permitted to deduct from the salary payable tax on the employees incomes from sources like house property, interest on deposits etc., if the employees make a specific request to the employer in this behalf and furnish necessary particulars. It is also recommended that a suitable system should be devised under which the work of monitoring and checking of deduction of tax at source should be centralised and computerised and for this purpose, an appropriate identification code for tax payers liable to deduct tax at source should be developed.

Kaldor (1956) 12 States that a progressive tax on personal expenditure with a relatively high exemption limit should be imposed and also recommended the broadening of the tax base through the introduction of an annual tax on wealth, taxation of capital gains, general gift tax and personal expenditure tax. For reducing the scope of tax evasion, he


suggested the introduction of the institution of a comprehensive tax return for all direct taxes and the introduction of a comprehensive reporting system on all properties transferred. He also recommended breaking up vicious circle of charging more and more on less and less. He suggested that maximum rate of Income tax should not be more than 45 percent and to make the concept of income sufficiently comprehensive to embrace all beneficial receipts which increase the tax payers spending power.

**Kumar, Vinay** (1988)\(^{13}\) attempted to examine the role of income tax in India’s Tax System in regard to its coverage, contribution to tax revenue and its administration. Administrative problems relating to evasion and avoidance of tax, arrears of tax and tendency of assessment were also covered in the study. Suggestions for making the tax system more effective and revenue elastic were given at different appropriate places. The period from 1950-51 to 1984-85 was opted for the purpose of study. An appraisal of the enforcement of income tax measures in India revealed that income tax in India has not been able to achieve the objective of redistributive justice as it was inequitable not only on account of its improper coverage, but also due to inefficient administration.

Large scale evasion and avoidance of tax and the failure of the department in tackling this problem had further demoralised the honest tax payers. He made some suggestions for extending the coverage of Income Tax, making it revenue elastic and administratively effective, such as bringing agricultural income within the purview of central taxation, making family as the basic unit of assessment instead of

\(^{12}\) Kaldor Nicholas “Indian Tax reform report of a survey”. Ministry of Finance & Govt. of India, NewDelhi.

\(^{13}\) Kumar, Vinay. “Tax system in India and role of income tax”. Published by Deep and Deep Publications New Delhi. 21st Edition. page no:25-32
‘individual’, extending the scope of deduction of tax at source, increasing the number of assessment officers and strict enforcement of tax recovery proceedings by Central Board of Direct Taxes (CBDT), launching search and seizure proceedings effectively, withdrawing the exemptions, deductions and allowances, which go to make the tax law complicated and so on.

**Nitin Kumar (2008)**

Says that taxation of income of corporate entities constitutes an important source of revenue for most of the countries across the globe. However, associated with the task of tax collections are various incentives provided for development of specific industries and other regional considerations and explained that there exists a concave relationship between tax revenue and marginal tax rate. Among the determinants of inefficiency various concessions and deductions provided to companies seem to play a significant role.

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studied the economic implications and impact of the direct taxes on individuals and business income with focused stress on budget of the financial years 1982-83. The study of average tax rates for assesses in different income brackets for various years 1974-75 to 1978-79 revealed that the average tax rates progressively increased with the income bracket but were always substantially lower than the marginal income tax rate applicable to that income bracket. It was suggested that there was no economic justification for giving preferential tax treatment for assesses with the lowest income bracket on the ground of administrative expediency and human considerations study also showed that a difference were the composition of salary income and discriminatory treatment through Section 10(13(A) related to house rent allowance.

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Jain and Garg (1993)\textsuperscript{16} studied the role of direct taxes in India with regard to its coverage, contribution to tax revenue and its administration. Period opted for the study was from 1950-51 to 1990-91. Administrative problems relating to evasion and avoidance of tax, arrears of tax and pendency of assessment were also covered in the study. Study showed that personal income tax collection as percentage of direct taxes decreased from 75 percent in 1950-51 to 46.08 percent in 2000-01.

Pawan. K. Agarwal (1991)\textsuperscript{17} is an attempted to estimate the responsiveness of personal income tax as a result of a change in inequality in the distribution of income. The study also develops the methodology for estimating the elasticity of taxation given a change in the distribution of personal income. Interestingly, the study reveals that an increase in tax inequality in the distribution of income among the taxpayers increases yield of personal income tax in India. The study empirically finds that during 1966-67 to 1983-84, when the inequality in taxable income had a declining trend the elasticity of tax also decelerated. The estimated elasticity 1.17 will vary with the rise and fall of inequality during the reference period.

Prasad (1999)\textsuperscript{18} examined the issue whether income tax could be replaced by expenditure tax in our country. It was observed that an expenditure tax tried in 1957 in India was in a limited way as it was made applicable to individual and HUF only. It was failure because revenue was insignificant and collection charges were much more. Also it caused hardship to the assesses. After considering the pros and cons, it was


\textsuperscript{17} Pawan, K. Agarwal- Income inequality and elasticity of personal income tax. Economic and Political weekly. Vol. XXVI No 29 July 20, pp.1741-1747
observed that no good case could be made out for such replacement particularly when the evidence for the main expectation that expenditure tax would increase the level of savings with the resultant benefits in capital formation were inadequate. It was observed that no good case could be made out for such replacement particularly when the evidence for the main expectation that expenditure tax would increase the level of savings with the resultant benefits in capital formation were inadequate.

Rajni (2009) reports that the major reforms in the era of individual income taxation have resulted in restructuring tax rates, increase in exemption limit and rationalisation of tax incentives for investments and introduction of some new taxes. The study concluded that main objective of individual income tax reforms is to broaden the tax base, rationalise the tax incentives, curb tax evasion in, provide greater flexibility to tax payers and simplify the tax laws and expressed concern to rationalise the individual income tax system in India to raise revenue for the government in a fair and efficient manner and achieve redistribution.

Sandhu 20 Studied tax structure in Indian economy and examined revenue importance and the rate structure of personal Income Tax in India and stated that personal income tax constituted 63.3 percent of the direct tax revenue. The study also revealed that the proportion of national income mobilised through personal income tax tended to fall during the period under study but the percentage of national income mobilised through the corporate tax tended to rise rapidly during the same period.

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Study revealed that, the rates of personal income tax did not seem to have adversely affected saving’s as there were large number of exemptions allowed to promote savings and investments.

**Dr. Vijay Kelkar** 21 Task force on direct taxes constituted under the chairmanship of Kelkar by Ministry of Finance, Government of India. The Task Force was asked to suggest measures to rationalise and simplify the direct taxes, improvement in taxpayers service and redesign procedures for strengthening enforcement so as to improve the compliance of direct tax laws.

The task force recommended the raising of exemption limit. The rate Structure as recommended by task force up to Rs. 1,00,000. Further task force recommended elimination of surcharge eliminate of standard deductions. Task force suggested to broaden the base of personal income tax by way of elimination of some tax incentives and rationalisation of other incentives considered necessary on social grounds. Task force was of the view that revenue loss caused by raising of exemption limit would be made up by way broadening the tax rate through rationalisation of tax incentives.

It was also suggested to increase expenditure on tax payers service. The need of computerisation of the income tax administration was also emphasised by the task force. It was suggested that Central Government

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should be empowered to impose tax on agricultural income. The recommendation must be seen as a package and piecemeal implementation must be avoided at all cost.

**Tax Reforms Committee (1991)**\(^{22}\) was constituted by the Government of India under the chairmanship of Raja J. Chelliah to study the direct and indirect tax system soon after the economic reforms were introduced in 1991. The study was desired because in spite of the reviews and recommendations of various committees the volume of resources mobilised by Central Government had not improved remarkably corresponding to the requirement of the Government.

The Committee studied different aspects of the tax system in India and in its report gave elaborate recommendations for enforcement. The committee submitted a comprehensive interim report in December 1991 covering almost all taxation issues, except details regarding corporate taxation, and matters related to tax enforcement and administration. The Final Report Part – I submitted in August 1992 contain the reform of both direct and indirect taxes. The final report Part – II discussed the proposed restructuring of the tariff structure.

The committee observed in its interim reports that multiplicity of the provisions, with all kinds of conditions and stipulation to guard against misuse, make both administration and compliance burdensome. Furthermore, the deductions often tend to confer unduly large tax benefit on

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\(^{22}\) Tax Reforms Committee. “Interim and Final reports of Tax reforms committee”. Department of Revenue, Ministry of Finance, Government of India New Delhi
tax payers with higher incomes who are more resourceful and who can It take full advantage of the tax concessions. It was also pointed out in the interim report that one of the motivating factors underlying the sweeping reform that took place in the 1980s in many countries of the world was the disenchantment with tax incentives as an instrument of promoting social and economic objectives. Apart from the fact that they invariably research findings casting strong doubt on their efficacy in achieving the objectives underlying them.

The committee recommended for reducing the tax rates and broadening the tax base though elimination of most of the tax incentives except for cost of earning. The committee also suggested to introduce method of indexation for computing long-term capital gains. The committee also stressed on the need to simplify the tax system, modernise the tax department through computerisation and improve the tax enforcement. This study was very important in the history of taxation in India because the tax reforms in nineties in India followed the recommendations of the Tax Reforms Committee.

**Mookherjee and Das Gupta** (1995) 23 traced the causes of the poor and declining revenue performance of the income tax in India and suggested measures for improvement based on a review of international experience. The study started by reviewing evidence that the performance of the income tax in India was poor compared with other countries with similar per capita GDP. Furthermore, the performance had a negative secular trend. It was then argued that this was due to low or falling compliance rather than other handicaps.

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This can, in turn be traced to ineffective administration due to a reliance on enforcement tools with limited potential; inappropriate organisational structures, lack of computerisation and inefficient allocation of limited manpower resources coupled with a growing taxpayer population. International experience in administrative reform was reviewed paying particular attention to Mexico, the Philippines, Singapore and Spain and the process of computerisation that had taken place in many countries.

The authors emphasised that continuation with current administrative and enforcement practices cannot lead to dramatic improvements in the performance of the income tax in India. Consequently, reform of income tax administration must be more thoroughgoing to increase the contribution of income tax to revenue significantly. Study pointed out the improvement in information system and organisational restructuring as main areas of reform. It was also suggested to close-off loopholes exploited by large-scale tax evaders regarding appeals, penalties and prosecution activities.

**Virmani (1997)** 24 recommended elimination of as many exemptions as possible, compulsory filing of simplified return of income and reduction of rates prevalent at that time. He also recommended that a comprehensive approach to bringing potential taxpayers into the tax net is needed. It was pointed out that a computerised database using declared and authenticated expenditure data such as on electricity bill(s) etc., need to be built. This could be supplemented by data on foreign air travel and domestic tourism (travel and hotel). The tax staff would also have to be

re-oriented from existing taxpayers to expanding the number of taxpayers. Author suggested that a management consultant should be engaged to build a comprehensive Management Information System and Human Resource Development plan for this purpose. Various measures to check tax evasion were also suggested in the study.

**Das Gupta and Mookherjee (1998)** 25 studied the tax enforcement in India and compared it with countries like Mexico, Spain, Singapore, Philippines and Indonesia. The study concluded that the compliance with the personal income tax during the period under study (1965-66 to 1994-95) had steadily worsened. This was the principal cause of the decline in revenue raised by personal income tax in relation to the GDP, rather than changes in the tax rates, exemptions, and non-taxation of agriculture or reported temporary tax amnesties. The two principal tools of enforcement in India, search and seizure activity and prosecution of tax offenders, were found to be ineffective in influencing levels of tax evasion. The decline in compliance was explained primarily by higher effective tax rates, exemption limits, inflation and the declining frequency and quality of audits. Revenues were however found relatively insensitive to tax rate changes, so the declining revenue performance was explained largely in terms of declining audit standards and weakened penal standards for tax offenders besides inflation.

It was pointed out in the study that thorough reform of income tax administration is necessary to bring performance up to international standards. Study observed that in many other countries, most successful

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reforms were associated with strong political support from highest levels. Such support was necessary to overcome inertia within the administration, resistance from adversely affected taxpayers and to make available necessary finances and leadership. Such political will resulted from the need for elected governments to successfully resolve ongoing fiscal crisis to ensure continuation of their mandates.

Haughton (1998) 26 studied the various methods to calculate tax buoyancy. He opined that most elegant approach was to calculate tax buoyancy by regressing the log of the tax revenue on the log of the base, i.e., Gross Domestic Product (GDP). He also suggested that use of this approach should be used only if data for every year is available. He also pointed out various other methods to calculate tax buoyancy.

Jha (2000) 27 examined the reasons for tax evasion and implications of offering amnesties to evaders in India. Study outlined the various tax measures and amnesties undertaken by the Government of India in the recent past, especially the voluntary disclosure of income scheme (VDIS 97) of 1997. It was reported that besides tax evasion, black income was generated from illegal activities like smuggling, trafficking in illegal tricks and gambling etc. The different methods of making black income white were also discussed. On the basis of various guesstimates, unaccounted income in India was reported to be in range of Rs. 350-700 thousand crore comprising more than 50 percent of GDP. Author opined


that sensible tax policies should include reduction in marginal income tax rates for individuals, firms and corporations, which could help widen the tax base. Amnesty scheme might lead to continued tax evasion with the hope of continuation of such schemes in future. Elimination of such schemes would make the tax administration more deterrent and creditable.

**Raikhy and Om Prakash (2000)**

studied the structure of direct and indirect taxes in the pre and post – liberalisation period as well as the effect of liberalization on tax – GDP ratio. Buoyancy of various types of taxes was also calculated. Period opted for the study was from 1950-51 to 1999-2000. It was found that share of personal income tax in total tax revenue of the Central Government, which was 32.76 percent in 1950-51, declined to 9.34 percent in 1990-91 and further increased to 15.70 percent in 1999-2000. Also the growth rate of personal income tax which was 1.9751 percent during the period 1950-51 to 1959-60, increased to 18.7295 percent during 1990-91 to 2000-01. Overall growth rate of personal income tax during the period under study was 11.76 per cent which was less than all other types of direct and indirect taxes of the Central Government.

The buoyancy of different types of taxes during the period 1950-51 to 1999-2000 and sub-periods consist of different decades was estimated. Results showed that during nineties personal income tax showed a high degree of responsiveness. Buoyancy coefficient of personal income tax

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that was 0.4814 percent during 1950-51 to 1959-60 increased to 1.587 during 1990-91 to 1999-2000. Buoyancy coefficient of personal income tax for the period 1990-91 to 1999-2000 was more than all other taxes of the Central Government except corporate tax.

Study concluded that tax structure in India, which was being increasingly biased towards indirect taxes, underwent a change after the adoption of liberalisation policies in 1991. The share of direct taxes including personal income tax in total tax revenue continuously increased during nineties. The growth rate and buoyancy coefficient of direct taxes including personal income tax was also higher than the indirect taxes. This can be termed as a welcome change under the new policy regime. It was suggested that the tax rate structure has to be made more scientific; loopholes have to be plugged by withdrawing necessary deductions and allowances and widening the tax net further. Need was also felt by the author to strengthen tax administration machinery and introduction of more stringent laws to tackle tax evaders.

Pandey (2000) 29 Compared the tax relief provisions as applicable in India with that of United States. Study observed that India has unique distinction of having the largest number of tax incentives, exemptions and deductions provisions and the situation was improving each year. Compared to this, the Internal Revenue Code of U.S.A. contain very few provisions of this nature. Study concluded that tax relief’s under the U.S. laws were more pragmatic in nature and were limited only to the extent of need and were not open-ended.

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Rao M. Govinda (2000) \(^{30}\) studied the evolution of the Indian Tax System and trends in the tax revenue of the Central and State Government for the period 1970-71 to 1997-98. Study revealed that share of personal income tax in total tax revenue increased from 10 per cent in 1970-71 to 12.6 percent in 1997-98. It was observed that as regards the personal income taxes, the most drastic and visible changes were the reduction in Income Tax rates and raising of exemption limit which gets further enhanced when combined with standard deduction.

Sreekantaradhya (2000) \(^{31}\) Studied the structure and reform of taxation in India. He presented the broad picture of the reforms that were implemented in respect of taxation as a part of economic reforms during the period 1990-91 to 1998-99. For the purpose of study, tax structure prior to 1991 was analysed and also the changes that had taken place in post 1991 period were described. He outlined the major deficiencies of the personal income taxation system in India. Study revealed that share of the personal income tax in total tax revenue of the Central Government in 1999-2000 was marginally higher than in 1970-71. Also the coverage of personal income tax revenue was extremely limited due to the exclusion of agricultural sector and predominance of hard-to-tax groups. Study also revealed that personal income taxation suffered from the limitation of poor compliance. Evasion and avoidance was rampant. High marginal rates which prevailed in the past for a very long time and cumbersome rules and procedures provided incentives to evade taxes and adversely affected the revenue yield. Various reform measures attempted since


1991 in respect of broadening the tax base, lowering of tax rates and rationalisation of incentives were also studied.

**Advisory Group on Tax Administration for the Tenth Plan (2001)**

was constituted under the chairmanship of Partha Sarathi Shome by the Planning Commission, Government of India, in July 2000, to study tax policy and tax administration issues and make appropriate recommendations at different levels of Government with the purpose of generating adequate resources for the Tenth Five Year Plan (2002-03 to 2006-07). Group submitted its report in May 2001. The group observed that for Central Taxes, the potential of corporation and personal income taxes that have demonstrated the highest revenue buoyancy has to be tapped further. Measures include improvements in the tax structure as well as in tax administration. The group opined that the former issue has to focus on minimising exemptions and incentives and improving the base of the minimum alternate tax (MAT) whereas the latter issue should include increasing the number of assesses while reducing tax payer burden to improve compliance, and introducing comprehensive and meaningful computerisation of major functional areas of administration. The group of improved over time, many deficiencies remain that, when corrected, would have a negative revenue impact in the short to medium term. The group took the option of analysing such aspects and recommending corrective action despite their potential negative impact. This implied that major complementary revenue yielding measures are needed to improve the overall revenue productivity of the tax system,

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comprising both tax policy and tax administration and including all levels of Government – Central, state and local.

Chellaiah and Rao (2001) 33 analysed the trends in tax revenue for the period 1980-81 to 1999-2000 and suggested ways to increase tax revenue. Regarding direct taxes, it recommended to remove many exemptions, improve the tax administration and introduction of adequate extent of computerisation so as to fastly expand the actual tax base and tax collection. The study laid emphasis on computerisation of the income tax administration. The authors revealed that the computerisation and strong deterrent action against tax evaders and corrupt tax men were the two most important steps to be taken to increase revenues in the existing situation.

In India, by and large, no serious effort was made to modernise tax administration, although some important were effected, the tax administration of all the taxes was based largely on traditional methods was largely manual based and fallen for behind the tax administration in advanced countries in terms of efficiency, helpful approach to the tax payers and standards of integrity. The authors also pointed out that another important measure needed to raise revenues (and at the same time, reduce distortion and improve horizontal equity) was to eliminate a large number of exemptions granted.

Khatri and Kochhar (2002) 34 made international comparison with respect to revenue performance of tax between countries like Argentina,


34. Khatri,Yogesh and Kalpana kochhar . “India’s Fiscal Situation in International Perspective”. IMF Staff Seminar Paper. Asia and Pacific Department India.
Brazil, Bulgaria, Chile, China, Colombia, India, Indonesia, Malaysia, Pakistan, Romania, Russia, South Africa, Thailand, Turkey and Vietnam for the period 1990 to 2001. The results showed that the tax revenue of India was significantly below the unweighted average of all countries taken for study. The average Central Government tax to GDP ratio for around 30 Asia – Pacific countries was just over 14 ½ percent during the 1990s. In contrast, India’s Central Government tax revenue (before transfers to the states) averaged 9 ¾ percent in the first half of 1990’s, but declined to just over 9 percent in the second half of the decade. The study revealed that there was significant scope for broadening the direct tax base given agriculture and services (¾ of the economy) remain largely untaxed.

Using the average of Central Government revenue to GDP in Asian countries as a benchmark, there was the potential to increase tax revenue by around 3 to 5 percent of GDP. Improved administration could help in the effort to raise revenue and broaden the tax base – the size of the middle classes in India was thought to be over 150 million, compared to the total registered tax payers of around a 24 million. In this context, large taxpayers units were found to be effective in improving administration and increasing revenue in a broad range of developing, emerging and industrialised countries.

**Sarma and Gupta** (2002) 35 studied the fiscal reforms in India during nineties. Study pointed out that Union Government’s tax reforms did not

35. Sarma, Atil and Manish Gupta “A Decade of Fiscal Reforms in India.” Georgia State University working Paper 02-04
led to rise in revenue as proportion of GDP. The only area that showed a marked improvement was the performance of personal income tax and corporate tax. This could be said in terms of improved growth and buoyancy in the post-reform period. Performance of personal income to rise in its revenue as proportion of GDP. The only area that showed a marked improvement was the performance of personal income tax and tax from 1991 to 2001 was compared with the performance during the period 1981-82 to 2000-01. Rate of growth of personal income tax increased from 13.0 percent in eighties to 25.3 percent in nineties. Also the buoyancy coefficient for the same period increased from 1.0 to 1.6.

**Upender (2002)**\(^{36}\) conducted an empirical study to determine the validity of income tax Laffer curve (a bell shaped curve that shows the relationship between tax rates and tax revenue) in the Indian tax system in view of the reductions in maximum marginal tax rates. For this purpose regression equation was fitted to the data points covering the period from 1960-61 to 2000-01. The results showed the year to year movements in the negative elasticities of Income tax revenue with respect to maximum marginal tax rates. This confirmed that the Indian income tax system was operating in the prohibitive range of Laffer curve. The Laffer curve works efficiently only if the size of negative elasticity of income tax revenue with respect to maximum marginal tax rate exceeds units, which was indeed not apparent in most of the financial years after 1991 raising a little doubt about the success of tax reform’s.

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36. Upender.M, “The effectiveness of income tax Laffer curve in India”. The Indian Economic Journal Vol. 49 No.4 April-June pp74-84
Navjot and Om Parkash (2003) studied various aspects of Union Government’s taxation in India. Period opted for the study was from the year 1950-51 to 2003-04 regarding personal income tax. Study revealed that the income tax rate structure was changed more frequently in recent years and in many cases on year to year basis which violated the principle of stability and created difficulties in tax administration. However, after eighties, the tax rate structure remained strictly stable.

Study also revealed that a number of incentive provisions in the form of “deduction and allowances” have been incorporated into personal income tax rate structure, which reduced the rigour of taxation. Different allowances and deductions were allowed on salaries, interest on securities, income from house property, profits and gains from business or profession, capital gains and income from other sources. Tax deductions were allowed on investment in specified channels. Authors observed that these incentives, to some extent, provide tax benefit to higher income taxpayers as also these deductions and allowances reduce the progressivity of tax rate structure to some extent. It was suggested that when the tax rates have been reduced, there is a need to limit these tax benefits to bare minimum for the sake of simplicity and providing equal treatment to equals. Various suggestions were also made to make the tax administration more effective and responsive.

Singh and Srinivasan (2004) while discussing the India’s policy reforms including fiscal policy opined that promoting growth may require


giving up of some indirect taxes and raising revenue from other existing taxes or imposition of new taxes. Study revealed that improved tax administration and enforcement remains one of the most critical areas for Government reform. Tax reform is an essential step towards increasing Government revenue as well as reducing microeconomic distortions.

Jain, Indu (2004) compared the income tax provisions and various other aspects of income tax system in six countries, three developed – the UK the US, and Australia, and three developing ones, namely Malaysia, Pakistan and India. Period of the study opted was 1984-85 to 1997-98. Study revealed that while the progressive tax rate structure in the case of individual taxpayer was adopted in all these countries, the tax rates in developed countries were found to be higher than that of developing countries. The level of income at which the maximum marginal rate was applicable in India was very low and the income tax at maximum rate was payable even by individual taxpayers whose income was not very high.

The basic unit of assessment was individual in all the countries selected for study except U.S. where the married person had the option to file return jointly. Author opined that levying tax on agricultural income in India may not result in higher tax revenue; rather it may increase the administrative cost. The system of personal exemptions was found to be more rational in U.S and U.K. U.S. had a system of phasing out exemptions and tax credits as the gross income exceed a certain level, and of withdrawing completely the exemption if such income reached another fixed higher level.

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Research Gap:
The literature survey made indicates that though there are many research articles on impact of tax reforms on various issues, there is no specific literature as well as no specific research work conducted and reported on economic implications of recent tax provisions in India. Hence, an “Analytical study on the impact of recent tax provisions on public finance” is considered to be the gap. The gap relates to rates of taxes, exemptions, incentives and various other provisions which contribute for the overall tax revenue to the government.

The gap is also relates to impact of various measures suggested by various tax reform committees to maintain Indian tax structure with the international standards and budget proposals. All these impact on the total tax revenue to the government. Therefore, it was felt that there is need to study the impact of recent tax provisions on public finance. Hence this study.

Relevance of the Study
Taxation as an instrument of fiscal policy is not only important in making available resources to the government but it is also has significant influence on the level and direction of economic activity. There have been major changes in the tax systems of a country in the recent years to enhance the revenues of the government to meet fiscal crisis and to meet the requirements of international competition. The changes brought in the income tax provisions affects the sources of tax revenue of the Government. Under these circumstances, it was felt necessary to study an impact of recent tax provisions on public finance.
This analytical study is based on the considered Opinions of Chartered accountants, advocates, Tax Consultants, income tax authorities and Corporate Assesses. It is useful as to know how for the recent changes in the income tax provisions as per the recommendations of the Kelkar Committee after amendments in taxation are relevant, practical in nature and its practical applicability.

**Objectives of the Study**

The broad objectives of the study covers the recent changes in the Indian income tax provisions and to highlight its impact on public finance and also to suggest measures for achieving the higher efficiency in this respect.

The following specific objectives have been set for the study.

1. To examine the tax system prevailing in developed and developing Countries.
2. To examine the Dr.vijay kelkar committee recommendations relating changes in Income Tax Acts and its impact vis-à-vis government’s view
3. To evaluate the cases of tax evasion and methods of avoiding the same.
4. To analyse the implications of changes in taxation provisions on the State Exchequer/Public Finance.
5. To study areas which requires simplification of procedures as well as introducing transparency.
6. To examine the penal provisions and its impact on tax collection.
Hypothesis
Based on literature survey, in order to have a outlook of the study the following hypothesis has been formulated: “A simple and transparent tax system will generate more revenue to the Government.” Since the study is based on analytical method and the null hypothesis (one variable) is qualitative and alternative hypothesis (other variable) is quantitative testing of hypothesis has not been made.

Methodology
This study is based on analytical as well as survey method. The relevant data has been obtained from concerned authorities through schedules and analysed making use of simple statistical tools. The behavioral data regarding taxpayer’s opinions, preferences, suggestions etc., were collected through structured questionnaires. In addition, available literature on the subject, journals and newspapers, reports of various committees and materials available in the web sites has been used.

Sources of Data
This study is based both on primary and secondary data. Primary data has been collected through structured questionnaires and information has been collected from the informant’s majority of whom are chartered accountants, Income Tax authorities, Tax Consultants, individuals, corporate assesses, academicians, Ministry of Finance and other persons.

The secondary data has been collected from published and unpublished reports by the government and government agencies and other agencies regarding the formation of committees, its recommendations and the
other relevant information’s and various other institutions which are directly or indirectly deal with tax matters.

Scope of the study
In this study, included all the major provisions of income tax Act which are affecting the public finance. The study also involves an evaluation of Kelkar Committee recommendations and aims to bring to light its relevance, and its practical applicability.

An in depth analysis of the Kelkar committees recommendations on direct taxes is made. Particularly emphasis has been laid on the individual and corporate assesses. More specifically on income tax aspects. The study aimed at analysing the impact of the recommendations on various assesses, administrative reforms, and various incentives to individuals, corporation and other assessed companies in recent years is covered in the form of individual case studies in addition to general impact thereof and measures initiated by the government of India in recent years. Further an attempt is also made to understand various measures suggested by the committee to improve the tax system.

Techniques of Data Collection
This study is purely analytical and based on non-probability sampling technique where in convenience and judgment sampling methods are adopted.

Judgment sampling method is followed because the intricate questions raised which requires some amount of knowledge in taxation matters as such chartered accountants, advocates and tax consultants income tax authorities are intentionally selected.
In case of companies under convenience sampling method, 100 companies with higher book profit and payment of higher corporate taxes have been included. In the case of other informant’s, 100, tax Practitioners, academicians and other experts were selected from different areas and locations based on stratified sampling method.

While gathering information from the officials of income tax department very specifically nothing could be said about sample size since the study is basically analytical and based on secondary data.

**Tools of Analysis**

After collecting both primary and secondary data, the data has been edited and organised and presented in number of tables based on specific parameters or attributes. The analysis comprises qualitative information and as such tables have been prepared to assess the different opinions regarding the recommendations and analysis of qualitative nature. They have been analysed through simple Statistical tools. After the analysis the conclusions have been drawn.

**Limitations of the study**

This study covers the assessment of an impact of recent changes in income tax provisions on the public finance and other related aspects of tax reforms. Even though it was planned to make a detailed study of recommendations both on direct and indirect taxes due to non availability of time, the study is restricted to the direct taxes.

As the income tax is a central government subject and taxpayers are scattered all over the country/world it is not possible to study each and every assessee. Therefore, due to constraints in financial, human
resources and limited availability of time, questionnaire has been administered, responses have been obtained from companies, institutions and general public located/residing in Bangalore city.

**Chapter Scheme**

After the analysis, the research report has been presented in eight chapters as under.

**Chapter 1: Recent Changes in Income Tax provisions - An overview**

In this chapter the details pertaining to the tax provisions introduced by the government of India from time to time, background of direct and indirect taxes, Constitutional provisions pertaining to taxes in India, sharing of taxes, tax structure etc., have been covered.

**Chapter 2: Design of the Study**

This chapter covers the statement of the problem, Research Gap, Hypothesis, objectives of the study, the methodology, scope of the study, Limitations of the study, research instruments, sampling plan and plan of analysis etc.,

**Chapter 3: Income Tax Act and its provisions— An overview**

This chapter covers various acts introduced by the Govt. of India before Tax reforms in 1991 and post reforms provisions and also major recommendations made by certain important committees like Dr. Raja Chellaiah and Dr. Kelkar committees has been included. The study also deals with the in-depth study regarding the recommendations of Dr. Vijay
Kelkar committee and its implementations by Government at different levels.

Chapter 4: Tax Evasion and Role of Tax Administration

In this chapter, the Key problems / factors of tax evasion has been identified. This chapter also covers the details of the various provisions recommended by the various committees constituted by various governments to avoid the tax evasion. The role of tax administration in controlling tax evasion, Penal provisions, problems of tax administration etc has been analysed with the help of statistical tools.

Chapter 5: Analysis of Kelkar Committee Recommendations and Government view

This chapter includes the in-depth study of the terms of reference of the task force committee headed by Dr. Kelkar, lapses of the previous Committees and recommendations made by the committee towards the long term sustainable solutions to enhance transparency, reduce transaction costs, improve the tax compliance and to increase the tax to GDP ratio through world class fiscal regime, simplification and rationalisation of tax laws and to impart a greater transparency in tax administration etc. and the extent of governments implementation at different levels with modifications.

Chapter 6: Corporate Tax compliance

In this chapter the recommendations of kelkar committee on corporate taxation has been analysed based on the 50 selected (both public and private sector) companies by comparing the profit before tax earned by the companies and tax paid ratio for a ten year’s period. The analysis also
covered the tax revenue forgone by the government due to various tax deductions and exemptions prevailing in the tax system, coefficient of variation between statutory rates of tax and actual tax paid and its effect on tax revenue by using Laffer curve method.

**Chapter 7: Impact of tax reforms on Public Finance**

In this chapter details of various tax reforms introduced since 1991, more specifically kelkar committee recommendations, the motivations and the context of undertaking tax reforms, the relationship between national income (GDP) and revenue collection, broad goals and their impacts on the revenue collection of the union government has been analysed.

**Chapter 8: Summary of findings and Suggestions**

In this chapter the summary of the research findings are presented. This is done with the back ground of objectives set for the research work. Based on the research findings conclusions has been drawn and suitable suggestions are given after the conclusion.