CHAPTER II

REVIEW OF LITERATURE

Ajit Karnik in an article titled "Direct Tax Reform" outlined the necessity of reforming direct tax system so as to achieve equity and efficiency. Task force on Direct Taxes under the chairmanship of Vijay Kelkar has attracted a lot of attention. The major thrust of the recommendations of the Kelkar Committee has been towards simplifying the direct tax system. From the simplicity point of view, the best is a single rate. It involves the same rate for both business income and personal income. The individual tax becomes progressive at lower ends through a standard deduction. Doubts have however been raised regarding equity aspects of the tax as well as its revenue yield.

It concluded that, more inputs are needed before a decision can be made. As with economic reforms, it is best to adopt a gradualist, piecemeal approach if the process of change is to be manageable and credible.

Gurumuthy S. in an article, titled towards an alternative system of tax-sharing in India, analysed the developments in tax-sharing arrangements under the recommendations of the nine finance

commissions and proceed to see whether the system of tax-sharing in its present form should continue or whether an alternative system is possible. As the focus is on the level of vertical transfers, issues connected with horizontal redistribution of devolution among the states were beyond the scope of that analysis.

It concluded that tax devolution is founded on two principles, which have relevance to any federal system, namely,

1. Composition of tax revenues is subject to changes over a period of time and a fixed percentage share of the gross tax revenue could prove more buoyant in the matter of revenue. Sharing revenue between a federal government and the provinces are varying in percentages for selective taxes.

2. The government responsible for levy and collection of a tax should be entitled to a significant share in the yield from the tax for sustaining its interest.

The Indian experience for the last 80 years provides empirical evidence in support of these two principles.

Errol D’Souza did a study on low taxation and high interest rates have adverse consequences for growth. According to him, growth

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is sought to be kept going by leaving resources in the hands of households and the corporate sector through reduced taxation. The hope is that this will either be spent to stimulate demand, or that it will be saved and thus make resources available for investment. In this study a look at the fiscal revenue and expenditure trends since the reforms and then investigate whether policy creates conducive conditions for economic growth.

It concluded that, tax reforms though they did increase the share of direct taxes in the system at the same time cause a deterioration in the income elasticity of the tax system, which resulted in the high interest rate regime not being undermined. Improving the tax/GDP ratio as well as the savings/GDP ratio tend to increase the share of capital expenditures in total government expenditures. Interest rate determination of government debt and helping banks to upgrade the risk assessment and monitoring skills are important issues that needs focus on if economic growth is sought to be promoted.

Govinda Rao, M. 4 made a study on the reforms in tax devolution and evolving a co-ordinated tax system. According to him, the reforms in tax devolution arrangement should achieve better balancing of the revenues and expenditures of the states along with minimizing

distortions in the tax structure in the economy and pave the way for a coordinated development of the tax system in the country.

He concluded that the tax devolution instruments, returning of additional excise duties and assigning the right to levy taxation of services can all be usefully employed as bargaining instruments by the central government to reduce and eventually abolish inter-state sales taxation. The center may have to find a way to deal with stabilising revenues of the states in the short term. But these are issues and should not stand in the way of reforming inter-governmental transfer system along with achieving a harmonised system of internal trade taxes in the country.

Krishnaveni, L. studied the changes in India's Tax structure. The study examined the changes in the tax structure in India at aggregate and disaggregates levels. Direct taxes, whose share has declined mostly falls on people with higher incomes and most of the indirect taxes whose share has increased, burdens poorer sections.

The study concluded that, the Agricultural Income Tax has to be imposed immediately, so that the country can gain more revenue to meet its financial needs from the rural sector. To reform the tax structure it is worth while examining the introduction of expenditure tax as a

replacement of Income tax. To give relief to the common man, Government
should totally exempt the essential commodities from the purview of
indirect taxation. To make the indirect tax structure more effective,
modified value added tax (MODVAT) has to be introduced.

D. Rankoor Coondoo, Amita Majumdar, Robin Mukherjee,
Chiranjib Neogi, made a study on the tax performances of the states in
India. One can often make use of the tax-SDP ratio as the summary
measure of the states tax performance. To judge the relative tax
performance of states, normally one would arrange the states in terms of
their observed tax-SDP ratios and to analyse inter-temporal variations in
relative performance of states. The analysis reveals that the performances
can be classified broadly into four categories.

1. The best performing states are the south-western states viz., Goa,
   Gujarat, Karnataka, Kerala, Rajasthan and Tamil Nadu.
2. The worst performing states are the eastern states of Assam, Orissa
   and West Bengal.
3. The medium level performance throughout the sample period are
   the states of Bihar, Haryana, Madhya Pradesh and Uttar Pradesh.

6. Dipankor Coondoo, Amita Majumder, Robin Mukherjee, Chiranjib Neogi
   "Relative Tax Performances Analysis for Selected States in India," Economic
4. The final category of states which short out at the medium / top level in terms of performance and show a declining trend in performance over the sample period are the states of Andhra Pradesh, Maharashtra and Punjab.

This may be due to a number of reasons viz., relatively larger taxable capacity of these states, relatively greater tax effort made by these states or some deep-rooted political economic characteristics that these states may share.

Jose Sebastian⁷ in an article listed out several factors responsible for revenue potentialities are efficiency of administration and enforcement. Administrative efficiency of any tax system depends upon a variety of factors including work culture in a society, level of independence and autonomy in decision-making, intensity of training given to staff, existence of information system and simplicity of law and procedure. On the basis of the above-cited attributes, the administrative efficiency of sales tax system in Southern States were verified. Through the data and methodology as to which administrative efficiency is incomparable, the study revealed the following conclusion, i.e., sales tax administration in Andhra Pradesh, Karnataka and Tamil Nadu is more efficient than in Kerala.

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A.K. Agarwal in an article titled "Sales tax Need for uniformity" is of immense importance to the states revenues. It is evident from the fact that the contribution of sales tax to the states tax revenue has gone up from 26 per cent in 1950-1951 to 56 per cent in 1980-1981. Sales tax is a relatively new source of revenue. The main objective is to avoid double taxation of the same transaction especially on goods entering into inter-state trade. The article discussed about, the rate structure of different commodities for which the data are available and comparable in sixteen different states. It will also not be possible to study the rate structure of all the taxable items. Therefore certain selected items have been taken in to account for this study.

It is clear that the existing sales tax structure is heterogeneous. Therefore it is essential to adopt uniformity. It does not mean that all the states should follow similar tax structure in respect of general sales tax, because in a federal structure, every state is free to levy tax keeping in view the need for financial resources, structure of state economy, size of state per capita income, level of development and size of population below poverty line etc.

Mahesh C. Purohit\textsuperscript{9} studied the sales tax policy of states. The sales tax system of states should be able to raise enough resources for the development of the state. According to him, it should aim at having a tax structure that could be more income-elastic.

The sales tax structure should fulfill the criteria of both the horizontal and vertical equity. It should thus be causing proportionately larger burdens on the better-off sections of the population and should not be taking more contribution from the poorer sections of the society.

The incidence of the tax should be calculated by taking into account of the effective rates of tax and not simply looking in to the statutory rates.

As the sales taxes are having a significant role in the fiscal structure of the states, it is of paramount importance that the sales taxes are reformed on the above lines so that the structure is economically rational and administratively expedient too.

S. Gurumurthi\textsuperscript{10} studied the Tax Reforms Committee (TRC) headed by Raja J. Chelliah. In its interim report (1991), it pointed out that the need for reforming basic indirect tax at the central level. The committee

\textsuperscript{9} Mahesh C. Purohit, "Structure of Sales Taxes in India", \textit{Economic and Political Weekly}, Vol. XVII, No. 34, August 21, 1982.

has made certain recommendations, both in its interim and final reports. To simplify the excise-cum-MODVAT system, expansion of base, increase in income and price elasticity to prepare the ground for a full-fledged VAT system at the central level. The reaction of trade and industry to these recommendations has been quite positive, because adoption of VAT could help eliminate the cascading effects of excise and sales tax regimes.

It concluded that a single-point sales tax system could argue that largely takes care of the problems, which are supposed to be solved by VAT. It has been the general experience that the single-point sales tax proves efficiency at relatively low rates but it becomes increasingly difficult to administer the same with the progressive rates. Therefore a country like India, which experiences the phenomenon of a large fiscal deficit might stand to gain by opting for VAT in the not too distant future.

Pinaki Chakraborty in an article titled, "Tax Reductions and their Revenue Implications", argued the rationale behind Laffer Curve. High tax rate adversely affects the growth of income and the fall in income would result in more than proportionate fall in tax revenue. Therefore, reduction in tax rate is essential for higher growth of income and tax revenue. This again raises the question of time lag. If, in the short period,

the Laffer Curve phenomenon has to operate, there should be negative functional relationship between the tax rate and the tax base.

Studies on direct taxes in India showed that lowering of tax rate did not result in higher tax mobilisation in the part. This is an attempt to examine whether in recent years the lowering of tax rates has actually resulted in higher tax mobilisation.

It concluded that, the analysis of the movement of tax rates and income elasticities of various taxes showed that generally reduction in tax rate cannot make a tax more buoyant instantly. There is a time lag involved. Since there is a time lag, expectation that the Laffer Curve phenomenon, accepting that it has validity for some taxes for some time, though not in its purest form, will start operating, instantaneously with a reduction in tax rate may well prove far too optimistic.

Indra Rajaraman, Nilabja Ghosh did a study on revenue estimates for a crop-specific agricultural tax. The study covered possible revenue yield from a crop-specific levy on eight major field crops, levied in a spatially dispersed manner at the Panchayat level of government.

The need for a region specific taxable surplus parameter for each crop, that can be applied each year to per hectare revenue to generate

the levy per hectare. In the absence of field surveys, the only available source from which the taxable surplus parameter can be estimated is the Commission on Agricultural Costs and Prices (CACP) which episodically Publishes Cost of Cultivation (COC) data for some selected crops.

It concluded that, the crop specific tax levies proposed to adjust for actual yield below another yields, but carry no exemption threshold yield. There is a crop insurance scheme now on offer in India. This scheme protects against area yield failure, at thresholds stipulated for each of several regions within a state. Panchayats will be free to exempt farmers facing idiosyncratic yield failure, using the same announced thresholds as under the crop insurance scheme.

K.C. Sharma 13 made a study on "Dividend Taxation and Harmonisation of Depreciation rates - Some policy suggestions". Tax on distributed profits or dividends disbursed by a company has been levied at the modest rate of 10 per cent which would increase the tax incidence marginally by only 2 per cent as the companies distribute, on an average, only 15 to 20 per cent of their profits.

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Abolition of tax on dividend income in the hands of shareholders is unnecessary and, if implemented, may highly constrain the administration from its reintroduction in future without severely affecting adversely the stock markets.

It concluded that, depreciation rates admissible to the corporates should go hand in hand with the overall tax structure in which they have to operate. The tax structure in itself should conform to the principles of equity and justice and should not unduly favour one section of the society as against others. In this context, the new dividend tax policy introduced in 1997-1998 budgets is lopsided and inequitable and should be made a balanced one.

M. Govinda Rao made a study on issues in taxation of services with a view to improve the revenue productivity of the tax system, to ensure a measure of neutrality in taxation between goods and services and eventually help to evolve an efficient system of domestic trade taxes at central and state levels. A rational consumption tax system it is important to levy a general tax on services rather than continuing with the selective taxation prevailing at present. However, there should be a small but well-defined exemption list and a negative list to avoid taxing services arising from the sovereign functions of the state and services of a meritorious nature. There should also be a threshold to exclude small

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service providers. At the central level it is also suggested that by 2004-2005, service tax should be merged with the MODVAT to evolve a manufacturing stage value added tax. In the case of states, it is argued that to evolve a destination based retail stage value added tax, it is necessary to give concurrent powers to tax all services subject to certain safeguards to ensure orderly development of the consumption tax system.

G. Venkatachalam and D. Dakshinamurthy made the pattern of tax provision dividends and profits retained in an aggregate manner in respect of medium and large public limited companies in the private sector in India to point out the impact of tax provision on profits retained. To analyse the inter-industry differences in the pattern of profit allocation as well as to examine the impact of tax provision in Industry-wise profit retentions. The study of impact of tax provision on corporate profit retentions has revealed that the tax provision is the major component and dividends are the minor component of profits before tax. The industry-wise analysis highlights that except in the cement industry, the profit retentions were significantly higher in capital-intensive industries than in the agro-based industries. Between chemicals and engineering the profit retentions were higher in chemicals.