CHAPTER VII

SUMMARY AND CONCLUSIONS

Taxation known as 'bali' meaning 'offering', in prevedic period and later 'rajkar', was regarded as one of the important sources of revenue to the state. Our ancient literature is replete with such exhortations made to kings. Taxation was ostensibly for the maintenance of the government. The subjects of the state were taxed according to the benefits they received and therefore taxes were willingly paid. With additional responsibilities entrusted to the state with the passage of time, new sources of revenue were contemplated. A tax on income was one such source added to the system of taxation.

It was William Pitt who introduced personal income taxation in England in 1799, as 'shield money' to finance for the war. It took almost a century for the British government in India to impose a tax on income in the colonial territory. Personal income tax was introduced in India by John Wilson in 1860 to end the budget deficit that followed the uprising of 1857. The first systematic legislation on income tax was enacted only in 1886. The Act was replaced by Income Tax Act of 1922, which was again replaced by a new Income Tax Act of 1961 after independence.
The primary objective of personal income taxation was only to mobilise additional resources to the exchequer. But with the changing political and economic scenario, the spirit of personal income taxation was strengthened with additional objectives of equity, income distribution and social justice. In this context, it is pertinent to record the issues related to the above objectives of personal income taxation in India.

Firstly, personal income taxation in India registered an increase in terms of personal income tax payers, income assessed and income tax payable over the years. The elasticity and buoyancy of tax are effective tools in estimating the mobilisation of such tax revenue. They help to examine to what extent personal income tax collections respond to increase in gross domestic product and how far changes in the personal income tax policy of the government such as tax base and tax rates and concessions affect the mobilisation of tax revenue.

Secondly, as an instrument of equity, social justice and income redistribution, the government is able to use personal income tax by adopting progressive taxation. This is assessed on the basis of burden of tax and its impact on income distribution and also on the determinants of such variables. So, the question is how far personal income
taxation in India is progressive and what the level of impact of personal income taxation is on distribution of income and also what factors influence the impact of personal income taxation on distribution of income.

Thirdly, personal income taxation is generally influenced by socio-economic and political factors such as, gross domestic product, density of population, literacy rate, weaker section of population, primary sectoral contribution, public debt, price index and changes in party in power. Identification of determinants of personal income taxation is immensely useful from the policy point of view to augment the resources to the government. However, studies pertaining to this area considered only a few variables without considering socio-economic, demographic and political variables. So the issue is what the socio-economic, demographic and political variables that influence the personal income taxation in India are.

Fourthly, the role of political factors in influencing the fiscal outcomes receives added attention in recent years. In India, the emergency clamped on the country by Mrs. Indira Gandhi had its own historical, political and economic significance. Therefore, another issue of our study is how far change of political stability into instability influences the determinants of impact of
personal income taxation on distribution of income and
determinants of personal income taxation in India.

Keeping the above issues in mind, the present study
attempted to investigate the following objectives:

1. To sketch the earlier literature pertaining to personal
income taxation and to identify the gaps of the study,

2. To trace the trend and pattern of personal income
taxation in India.

3. To estimate the elasticity and buoyancy of personal
income taxation in different income ranges and to find an
explanation for the difference in such elasticity and
buoyancy, over the years.

4. To examine the burden, progressivity of personal income
taxation and its impact of income distribution in India.

5. To find the determinants of impact of personal income
taxation on income distribution and to verify the influence
of structural disturbances on the determinants of impact of
personal income taxation on income distribution, and

6. To identify the socio-economic, demographic and
political determinants of personal income taxation in India
and to test the stability of such determinants of personal
income taxation.
The following methods are adopted to examine the objectives mentioned above:

Simple ratios and percentages were employed to examine the trend and pattern of personal income taxation. Linear growth rate is computed to identify the growth of personal income tax payers, income assessed and the income tax payable.

We employed 'Z' test statistic to test the null hypothesis that there is no significant difference against the alternative hypothesis that there is significant difference in the growth rates of personal income taxation during 1962-1975 and 1975-1989.

Since different tax rates were applicable to different income ranges and also the surcharge was payable beyond a level of income under the 'slab' system or taxation, the tax payers were grouped according to the income ranges, viz., those with income of Rs. 20,000 and below, those with income from Rs. 20,000 to Rs. 50,000, those with income of Rs. 50,000 to Rs. 1,00,000 and those with income above Rs. 1,00,000, for examining the various issues pertaining to personal income taxation in India.

Consumer price index of 1981-82 was used to adjust the nominal values of income assessed and the tax payable. In
addition, the time span is divided into two phases (1962-1975 and 1975-1989) to identify the influence of change of political stability into instability on personal income tax mobilisation.

Divisia Index approach is employed to estimate the buoyancy and elasticity. The Divisia Index of discretionary revenue growth adjusts the estimated buoyancy of personal income tax revenue in order to obtain elasticity.

Average and marginal burdens of personal income tax are computed to examine the burden of personal income taxation. Besides, tax level and tax progressivity are considered to identify the progression of personal income taxation. The tax level is represented by the weighted average of statutory marginal tax rate and it is computed as follows:

\[ TL = \frac{1}{k} \sum_{i=1}^{k} w_i m_i \]

Where,

- **TL** = Tax level,
- **m** = Marginal tax rate \((\Delta T/\Delta Y)\)
- **w** = Weight attached to the respective marginal tax rate i.e., proportion of tax payers to total tax payers in each income range.

Tax Progressivity is computed by using Kakwani's measure of tax progressivity and it is defined as:
\[ TP = \frac{(1-t)}{t}(G_1 - G_2) \]

Where,

- \( TP \) = Tax progressivity,
- \( t \) = Average tax rate \((T/Y)\)
- \( G_1 \) = Gini coefficient ratio of income distribution before tax and
- \( G_2 \) = Gini coefficient ratio of income distribution after tax.

Gini coefficient ratios of pre-tax and post-tax income distribution are computed for examining the redistributive impact of personal income taxation on income distribution and it is presented below:

\[
\begin{align*}
\text{Gini Coefficient ratio} &= \frac{\sum_{i=1}^{n-1} X_i Y_i - \sum_{i=1}^{n-1} Y_i X_i}{10,000}
\end{align*}
\]

Where,

- \( X_i \) = Cumulative percentage of number of tax payers and
- \( Y_i \) = Cumulative percentage of income.

For identifying the determinants of redistributive impact of personal income tax on income distribution, the log linear multiple regression equation was employed. Besides, multiple linear regression equation is employed to identify the influence of socio-economic, demographic and
political factors on personal income taxation. Further, step-wise regression analysis was adopted in the above determinant analysis to overcome the problem of multicollinearity and necessary equation for the analysis was selected on the basis of higher $R^2$ value and large number of significant explanatory variables.

The Chow test was employed to test the influence of change of political stability to instability on the stability of impact of personal income taxation on income distribution and influence of socio-economic, demographic and political factors on personal income taxation.

Major Findings

The main findings of the present study are:

The review of literature pertaining to the study was classified into (i) studies pertaining to elasticity and buoyancy of tax revenue, (ii) literature related to burden and distribution of tax and (ii) works associated with determinants of tax revenue. Though exhaustively applied both at the global and at the national levels, these studies suffer from the following gaps:

Studies related to elasticity and buoyancy traced back to 1948, when the term 'built-in-flexibility' was used in the place of elasticity. It was Sahota who introduced the
concept of buoyancy of taxes first in 1961. Though the earliest work on 'built-in-flexibility' was related to personal income tax, there were works available on the income elasticity of other taxes as well. Following Sahota, several attempts were made in India to study the elasticity and buoyancy of personal income tax in the country. However, these studies did not employ the most reliable Divisia index method to estimate the elasticity and buoyancy of personal income taxation in India and they did not take into account the influence of structural changes in the political economy of the country on elasticity and buoyancy of personal income tax.

Literature related to burden and distribution of tax is available since 4th century B.C. Kautilya's Arthashastra is a monumental work on public finance. In modern days, several seminal attempts have been made in the area of measuring the burden of income distribution of personal income taxation. However, these works confined themselves to analysis of the burden and income distribution in respect of total personal income tax payable over the years. They did not satisfactorily explain average and marginal tax burdens across different income ranges, the study of which is quite relevant and academically rewarding in the modern context. Similarly, no attempt was made in the earlier works to bring the impact of structural and political
factors in relation to burden of personal income taxation. Besides, attempts pertaining to the determinants of impact of personal income taxation on distribution of income were not also made. They are immensely useful from the policy point of view.

The works associated with determinants of tax revenue are mostly general and very few studies are available in the area of personal income taxation and their determinants. Besides, multiple explanatory variables that include socio-economic, demographic and political factors, were not reasonably linked with the study of the determinants of personal income tax revenue.

In the light of the above gaps in the study of personal income taxation, the present study meticulously prepared the ground for a satisfactory and relatively more fruitful analysis of the personal income taxation in India. In the study, a sincere attempt was made to present the above mentioned unexposed dimensions of personal income taxation in India by employing more appropriate and reliable tools available.

The analysis of the trend and pattern of personal income taxation in India reveals that both the tax base and tax rates underwent drastic changes during the period of study. The total number of tax payers showed an increasing
trend from 9,61,841 in 1962-63 to 30,83,306 in 1988-89. However, there were certain jerks in the trend. For instance, the increasing trend upto 20,51,635 in 1975-76 dipped to 8,33,759 in 1983-84 due to competitive policy of liberalisation on taxation. The increase thereafter might be due to natural growth of tax payers and accelerated economic activities.

The income assessed in different income ranges revealed that the groups of tax payers with income of Rs. 20,000 to Rs. 1,00,000 constituted only 27.4 per cent of the total income assessed in 1962-63 but their share increased to 74.31 per cent in 1988-89. This is due to effective tax compliance and compensatory taxation on this group to make the loss right by giving concessions to the lower income group and reduction of maximum rate from 97.7 per cent to 52.5 per cent including surcharge applicable to highest income group of tax payers.

With regard to tax liability, though the trend showed persistent increase from Rs. 11,835 lakh to Rs. 2,45,603 lakh during the study period, the increase was not uniformly distributed among the different income ranges of tax payers. Raising the exemption limits and reduction of marginal tax rates benefitted the lower income groups. The third and fourth income groups of tax payers were imposed 72.94 per
cent of total taxes in 1988-89 as against 48.3 per cent in 1962-63. Personal income tax has lost its significance in the total revenue of the centre, but its share in the total direct taxes showed considerable improvement over the years.

The per capita personal income tax in nominal terms increased but it showed a decline in real terms. Further, in relation to other macro economic variables such as, gross domestic product, public expenditure etc., the personal income taxation has been losing its importance over time.

Income range wise discussions revealed that the lower income bracket of tax payers were benefitted by competitive raising of exemption limits and other groups were also soft treated by reduced tax rates, concessions and incentives.

The analysis of elasticity and buoyancy revealed that for the whole period of 27 years and for the divided two phases, the responsiveness of the tax payers and the tax yield had been significantly different. For the whole period, the first group of tax payers behaved differently from the other groups. The buoyancy of the group was negative while the elasticity was positive. The difference indicates that the discretionary measures had reasonable influence on the mobilisation of personal income tax.
Conversely, all the other groups had positive elasticity and buoyancy during the period.

The elasticity and buoyancy estimated in respect of the first phase showed that the tax liability of the first two groups increased greater than unity. But the impact of the discretionary changes was negative on the two groups.

However, during the second phase the results showed that the sensitivity of the tax payers both in terms of buoyancy and elasticity were either greater than unity or very close to unity. During this period the exemption limit was hiked by leaps and bound and the tax rates were sliced down. Besides, several incentives and concessions were also extended. These discretionary changes resulted in the negative reaction of the lower income bracket among tax payers.

The results also convey that the tax compliance and the yield have been better during the second phase compared to the first phase, though the national income has been increasing consistently both at current and at constant prices. This proved that the discretionary changes in exemption limit, tax base, tax rates and other incentives had a strong impact both positively and negatively on the mobilisation of personal income tax revenues across different income ranges of the tax payers.
Successive Tax Reforms committees appointed from time to time in the country recommended raising of exemption limits to adjust with ever rising price situation and also suggested gradual reduction of tax rates. Although their recommendations were not accepted in toto, a test dose of these discretionary changes proved to be fruitful. While a rise in the exemption limit, allows many erstwhile tax payers to fall out of the tax net, a reduction in the tax rates and permissible rebates came to the rescue of the middle income tax payers to slice down their tax liability. The lose of revenue from one set of tax payers has been meticulously neutralised by the other, thereby keeping the buoyancy and elasticity always close to unity in respect of total tax payers. The study also proved that the discretionary measure and tax policy changes have a sure impact on the tax mobilisation.

The discretionary tax benefits extended to a large number of tax payers have more political significance and therefore they have been competitively followed by successive governments as safety measures under democracy. Since a tax payer is also voter, tax policies are designed in such a way that the benefit goes to larger size of population and the resultant loss of revenue has been duly compensated by a small number of higher income group of tax
payers, who are relatively less complaining and whose role in democratic process is very insignificant.

The analysis of burden, progressivity and impact of personal income taxation on income distribution revealed that personal income taxation has an important role to play in capitalist and democratic systems, since in such set up legislative and direct methods of promoting equity and social justice are rarely present or are ineffective. Fiscal policies under such circumstances at least would support the other measures.

The results of the study established that in terms of average burden, there was a continuous increase from 0.1282 in 1962-63 to 0.1848 in 1988-89, with some minor jinks. However, income wise results showed a differential situation. Relatively the average burden of the higher income groups of tax payers is higher than that of lower income groups, both at the opening years and at the closing year of the study.

The marginal burden explains the degrees of additional burden as they move from lower income range to higher income range. The study showed that in 1962-63, as the tax payer moves from low income group to higher income groups, his marginal tax burden increases from 0.0401 to 0.7791, while in 1988-89 this move resulted an increase in marginal burden.
only from 0.0206 to 0.4610. This brings to light the drastic cut in the tax rate over the years.

The study of tax level and tax progressivity proved that they have significant role to play in the distributive impact in respect of personal income taxation in India. However, the values indicated that the tax progressivity lost its vigour, while the tax level acquired added importance in bringing about redistribution of income, over the years.

The ratios of Gini coefficient before and after personal income taxation provide a clear picture of the changing effectiveness of income tax as redistributive measure. Since 1962-63, personal income tax proved to be very effective in bringing about the redistribution of income in India.

The examination of the determinants of impact of personal income taxation on income distribution showed fruitful results. One per cent increase each in tax progressivity and income inequality lead to an additional impact of 0.6169 per cent and 2.5117 per cent respectively in the reduction of inequality of income distribution. However, between the two divided phases the results were different. The degree of influence of tax progressivity on
income distribution was 0.3376 and 0.7734 during the first and second phase respectively. This is because of higher tax progressivity in the first phase that carried along with it the element of evasion. The degree of influence of income inequality on income distribution was 2.6565 and 1.5408 during the two phases. This is due to higher pre-tax inequality of income during the first phase than the second. Similarly, the influence of tax level coefficient was insignificant during the first phase and significant during the second phase. This is due to the fact that tax level was substantially higher during the second phase than the first phase (0.058 to 0.092). This shift is due to populist policies of the successive governments with a tilt towards political motives rather than economic.

The Chow test results of the determinants of impact of personal income taxation on income distribution equation also showed that the 'F' value was 3.32 and it was significant at five per cent level. Hence, we concluded that the estimated determinants of impact of personal income taxation on income distribution equation were not stable during the two phases. The possible reasons for it are the shift from socialistic to liberalised policies and from economic to populist principles and also from political stability to instability of the government during the two phases.
The results of determinants of personal income taxation revealed that per capita gross domestic product, literacy rate, per capita public expenditure are positively associated, while percentage of urban population and Scheduled caste and Scheduled tribe population are negatively associated with the per capita personal income taxation in India.

Further, when we moved from political stability period (1962-1975) to political non-stability period (1975-1989), there was an increase of 0.75 per cent of per capita personal income tax in India. Besides, the determinants of per capita personal income tax equation was not stable during political stability and non-stability period. This is due to structural changes in the government policies and programmes as aforesaid.

Implications of the study

The main implications of the present study are:

i) Personal income taxation occupies a prominent place in the direct taxes of the centre and therefore, a permanent standing policy is essential for its operational efficiency. Besides, even a test dose of erudite recommendations of expert committees pertaining to exemption limits and gradual reduction of tax rates proved to be realistic and rewarding.
Hence, a consistent policy in this direction is imperative.

ii) Only a small fraction of population is brought under the purview of personal income taxation. Therefore, there is a need for widening the tax base to promote tax participation, thereby converting personal income tax a 'mass tax' rather than a 'class tax'.

iii) Since the results of elasticity and buoyancy of personal income tax reveal more productive in terms of tax collection during the period of tax reduction and concessions, we recommend to slice down the opening marginal tax rates to 10 per cent and maximum tax rates may also be further slashed to accommodate the reasonable demands of the higher income bracket earners, to promote voluntary and honest tax compliance.

iv) Tax cuts and rebates should be followed by strict enforcement of tax laws and defaulters punished deterrently.

v) There is a need for reduction of average and marginal burden of personal income tax. It promotes tax honesty and will result in greater mobilisation of tax revenue, which will be income elastic and therefore yielding.

vi) The policy makers and the tax administrators should effectively design the tax level of personal income tax to
attain the objective of reduction of inequality of distribution of income.

**Limitation of the Study**

It is honestly admitted that the present study is subject to the following limitations:

i) The present study is limited to the extent of data on personal income tax in respect of individuals, Hindu undivided families and other associations of persons. However, personal income tax collected from sources other than individuals is very small and therefore it does not bear any impediment to the study.

ii) Personal income does not include agricultural income which is exempt as per Section 10(i) of the Income Tax Act 1961.

iii) The study used the data related to "tax payable" for the assessment year and not the "actual tax paid". There is bound to be a difference between the tax payable and the tax paid, due to excess payment of tax made in the year or the outstanding arrears carried over to the following years.

iv) The study grouped the income tax payers into four income brackets for clarity, simplicity and comparability.
This classification of personal income tax payers on the basis of income over a long period may create money illusion. Hence, the study is restricted to the extent of existence of such money illusion over the years.

v) The Divisia index method employed to identify the elasticity and buoyancy of personal income tax is limited to the requirement of conditions of homogeneity and structure neutral discretionary change similar to Hicks-neutral technical change.

vi) The present study is also limited to the extent of simultaneous relationship between the exogenous variables in the determinants of personal income taxation.

vii) The Chow Test employed in the study is limited to the extent of requirement of continuous non-increasing or non-decreasing functional relations.