CHAPTER I
INTRODUCTION

Market mechanism in a highly developed financial economy does not always bring high employment, price stability and the socially desired rate of growth. So, the limitations of market mechanism call for corrective or compensating measures of public policy. For an efficient implementation of the public policies, governments need resources. These resources can be realized by means of taxes, charges and borrowings. Among these three, taxes, according to Justice Holmes are the prices of civilization and also the largest source of revenue.

A tax system aims at transfer of resources from private hands to public exchequer. Hence, the imposition of a tax reduces the resources available for private use. Adjustments in income, consumption and savings of individuals and institutions due to taxation are called as tax burden. Since, commodity taxes are the main source of revenue to the states in Indian federal set up; they are also the most burdensome taxes.

Tamil Nadu state which accounts for 4 per cent of the land area and nearly 7 per cent of the population in India is the first state in the country to introduce a general sales tax in its present form way back in 1939. For all the states in Indian federation, commodity taxes in general and sales tax in particular are the main sources of revenue. The revenue significance of sales tax can be realised through its aggregate share which was 30.64 per cent of
state’s own tax revenue in 1957-58 and 67.14 per cent in 2004-05. Fiscal importance of this tax can also be understood by means of its growth rate which was between 15 and 20 per cent over the years.

This phenomenal upsurge of revenue through sales tax in Tamil Nadu resulted in the corresponding reduction in the resources available for private use. In the absence of an evaluation of burden of a tax system, annual budgetary proposals may assume indiscriminate dimensions which add to the hardship of the tax payers. Budgeting for additional tax potential to a very large extent depends upon the pattern of distribution of burden of the existing taxes. Therefore, a study on the pattern of distribution of burden of taxation will help the tax authorities to plan for the mobilisation of additional resources. Moreover, the question of how should the burden of additional taxes be distributed cannot be answered independent of the burden distribution of existing taxes. Hence, need arises to investigate the manner in which the burden of individual taxes and the tax system as a whole is distributed over the tax paying community by economic classes and regions. It is with this intention; the present study tries to verify scientifically the structure and distribution of burden of taxes in Tamil Nadu in general and sales tax in particular.

STATEMENT OF THE PROBLEM

Modern governments bear enhanced social, political and economic responsibilities. So revenue mobilization is essential to fulfill the various
obligations of the state. Revenue mobilization by means of indiscriminate taxes normally leads to the sacrifice of equity. If the priority of the fiscal authorities goes in favour of improving equity, paucity of resource will be the end result. Therefore, how best the fiscal authorities strike a balance between increased revenue needs with a fair distribution of burden among the masses become the crux of fiscal issues today. The present study is an attempt on the distribution of burden of taxation in Tamil Nadu in general and sales tax in particular.

There is no doubt that taxes are the surest means of mobilizing additional resources to undertake developmental activities, by governments. But, while mobilizing additional resources, equity should not be sacrificed. Equity requires the allocation of tax burden among different economic units in different regions in such a way as to minimize the aggregate burden. If the tax system is equitable (i.e.) the burden of taxes are so distributed to minimize aggregate burden, then higher revenue will accrue to the government than the budgeted ones. Therefore, economic development heavily depends on resources which are mobilized in sufficient quantities without sacrificing equity.

The question of how should the additional taxes be distributed over the tax paying community cannot be answered without examining the distribution of burden of existing taxes and tax system. Therefore, it is necessary to investigate the pattern in which the burden of individual taxes
and the tax system as a whole is distributed over the tax paying community by economic classes and regions. The present study is a positive step in this direction with respect to Tamil Nadu state, for which such an examination is absent.

Moreover, such examinations are considered to be the first step to assess the broader effects of taxation. In the absence of such periodical evaluation, budget proposals may assume indiscriminate distribution of burden of taxation which impose heavy burden on the tax paying community than it was actually intended.

Therefore, the research questions are:

1. Whether the tax system is equitable?
2. How the burden of sales tax is distributed between regions?
3. How sales tax burden is distributed among various expenditure classes?
4. Whether the tax burden is more on urban households? or on rural households?
5. Whether burden is more on the households of developed districts or on backward districts?
6. What is the extent of higher and lower tax burden?
7. Whether the distribution of tax burden has affected revenue mobilization?
8. Are there any variations in the tax burden before and after the introduction of economic reforms?

9. Whether the tax burden has increased over a period of time or not?

Answers to these questions can be obtained, only by examining the distribution of burden of existing taxes, as per economic capacities. Therefore, the distribution of burden of taxes in Tamil Nadu over the different expenditure classes and regions assumes significance.

**SCOPE OF THE STUDY**

This study intends to analyse the growth and distribution of burden of taxation in Tamil Nadu in general and sales taxation in particular. Since, sales taxes are the significant sources of revenue to the state exchequer, contributing nearly 60 per cent of the state’s own tax revenue; sales tax has come to occupy the centre stage of the fisc in Tamil Nadu. Though this study attempts to probe the growth and distribution of burden of sales tax in Tamil Nadu, other taxes such as state excise on liquor, electricity duty, entertainment tax, motor vehicle tax, tax on passengers and goods and services are also examined for the purpose of comparison. Estimation of burden of these taxes and their inclusion in this study is justified as it helps to determine the relative position of sales tax in terms of revenue significance and the corresponding distribution of burden.

This study attempts to quantify the direct money burden of state taxes including sales tax in terms of expenditure of the consumers. Estimation
of excess burden and psychological burden does not come under the purview of this study. Excess burden is related to the distortions of choices due to taxes, whereas, psychological burden is related to the form in which the tax is levied viz. commodity taxes are believed to be burdensome.

This study confines itself to the revenue side of the budget policy. Therefore, budget incidence arising from the expenditure side of the budget policy is excluded from this study. The changes in the positions of households due to the combined effects of tax and expenditure changes are considered as Budget incidence.¹

For the determination of incidence of sales tax, central sales tax does not form part of analysis. The reason is, being a tax on inter-state trade, the incidence of central sales tax falls on the subjects of one state and revenue goes to the other state.

The estimation of burden of taxation in Tamil Nadu confines to the partial equilibrium setting and not to general equilibrium analysis. The response of buyers and sellers in a particular market in which the tax is imposed is the partial equilibrium view of the principle of tax incidence.²

**OBJECTIVES OF THE STUDY**

As per traditional tax incidence theories it is extremely difficult to assess the burden as government policies interact with the tax policies. But formulation of tax policy to a larger extent depends upon the estimation of tax burden. Therefore, estimation of tax burden becomes the integral part of the
tax analysis. It provides a quantitative basis to examine equity in taxation and helps in determining on whom the direct money burden of a tax ultimately falls.

The general objective of this study is to assess the distribution of burden of taxes in Tamil Nadu. The specific objectives are:

1. To assess the revenue significance of various taxes in Tamil Nadu.
2. To evaluate the inter-temporal distribution of burden of different taxes.
3. To assess and compare the tax burden during the pre-reform and post-reform period.
4. To measure and analyse the sales tax incidence on the rural and urban sectors and among different expenditure groups in the two sectors in Tamil Nadu.
5. To assess the progressivity and regressivity of sales taxation in the rural and urban sectors.
6. To assess and compare the inter-regional distribution of sales tax burden in Tamil Nadu.

HYPOTHESES

This study intends to verify the following hypotheses, which were framed on the basis of the literature studied and the preliminary analysis of the data.

1. Indirect taxes are more burdensome than the direct taxes.
2. Tax burden during post-reform period is higher than that of the pre-reform period.

3. The tax burden is more on the low expenditure classes than on the higher expenditure classes.

REFERENCE PERIOD

This study covers a period of 25 years from 1980-81 to 2004-05. For a better understanding of the distribution of burden of taxes, a comparison is necessary. A decade before and after the introduction of economic reforms is more appropriate to assess and compare the burden of taxation in Tamil Nadu. Therefore, for measuring the burden of taxation in Tamil Nadu, the analysis covers the period between 1980-81 and 2004-05.

For estimating the burden of sales tax and its sectoral distribution in Tamil Nadu, the study is confined to the year 2004-05 only. It is because; the latest NSSO data on monthly household consumer expenditure is available for 2004-05 only (NSSO 61st Round Survey). Therefore, the cross-section analysis of burden of sales tax confines to the year 2004-05 only.

NATURE AND SOURCES OF DATA

Data pertaining to this study were extracted mainly from published sources. So, they are secondary in nature. The data on revenue from various taxes of Tamil Nadu, including sales tax, were collected from the Reserve Bank of India publications.
Data on state income were collected from the National Accounts Statistics of Central Statistical Organisation (CSO).

Another important data required for this study is household consumer expenditure on different commodities. The National Sample Survey Organisation (NSSO) conducts a comprehensive household consumer expenditure survey once in five years (quinquennial survey). The latest such survey is 61st Round Survey (2004-2005). Data pertaining to household consumer expenditures needed for estimating the burden of sales tax were obtained from the NSSO 61st Round Survey.

Data on population and its projections were collected from the publications of Registrar General, Census operations, Government of India.

OUTLINE OF THE CHAPTERS

This study consists of seven chapters.

Chapter I is Introductory. It includes introduction, statement of the problem, scope of the study, objectives of the study, hypotheses, reference period, nature and sources of data and chapter scheme.

Chapter II describes the Evolution of Tax System in India.

Chapter III contains the review of literature. It gives an account of the studies on taxation at international, national and regional levels.

Chapter IV deals with conceptual and methodological issues.
Chapter V analyses the economic significance of taxes in Tamil Nadu.

Chapter VI presents the incidence of taxes in Tamil Nadu.

Chapter VII explains the distribution of burden of sales tax in Tamil Nadu. It covers sectoral distribution of burden of sales tax. Moreover, it explains the inter-regional (district-wise) distribution of burden of sales tax.

Chapter VIII provides the summary of findings and conclusions.
REFERENCES
