Chapter 2

REVIEW OF LITERATURE

The theory of taxation has drawn attention of economists for the past 200 years or so, but the empirical work mainly started in the second quarter of the twentieth century. The credit for starting research in the area of taxation in India goes to the Government of India, when it felt the need to mobilize resources through taxation for the purpose of financing the expenditure of Government. Various studies have been conducted on taxation and its various aspects by the individual scholars, research organizations, State Governments and Government of India spanning over a period of nearly six decades. In this chapter an attempt has been made to review some of the available and relevant studies in the area of personal income tax planning, personal income tax reforms and administration and enforcement of direct taxes to provide a theoretical background to the current study.

Ria Sinha (2010)\(^1\) observed that tax systems around the world have undergone significant reforms in the last twenty years due to the varying ideologies and levels of development. In the study ‘An International Comparison of Tax Regimes’, she tries to evaluate the existing tax structure in India in comparison to some of the developed as well as developing countries. The countries which were opted for the study are Malaysia, Mexico, South Korea, Japan, China, USA, UK and Canada. The time period covered in the study was for 2000 - 2008 period. The study revealed that the progressivity of tax structure in India was far below the international levels. The extent of
government expenditure financed by taxes was comparatively low in India as compared to the developed countries of Canada, UK, USA and Japan. It stressed the need to increase significantly the tax - GDP ratio for adequate resource mobilization. It was examined that India had already adopted moderate rates and graduated slabs in personal income tax and corporate tax. It suggested the need to look in to the problem of huge magnitude of tax revenue being foregone every year due to numerous exemptions in the Central Govt. tax system. The study concluded that at present there may be no strong rationale for further reduction in the existing tax rate.

Ankita Gupta (2009)² studied the trends and responsiveness of personal income tax in India after the tax reforms initiated in the liberalisation era. The study analysed the major trends in the taxation of personal income in India during the period 1980 - 2008. It was revealed that tax reforms have a favorable impact on the growth of personal income tax and the major factors responsible for the increase in revenue responsiveness are reduction in top marginal rate of personal income tax; reduction in the number of tax slabs; increasing compliance through wider coverage of tax payers and high GDP growth rate. The study concluded that simplification of tax rate and broadening of the tax base are the important reforms that could be undertaken for reforming the tax structure and increasing its responsiveness.

Anil Kumar Jain and Parul Jain (2007)³ reviewed the tax treatment of savings under the Indian Income Tax Act and examined whether a switch over from EEE to EET is desirable in the present economic scenario. The study revealed that a very serious lacunae in the tax incentive provision in India has been that they have been introduced in an ad hoc manner and have been subject to frequent changes. Such ad hoc changes have created uncertainty in the minds of savers and investors. It was suggested that tax incentives should be well
targeted and relief should be substantial to induce savers and investors. The study concluded that a sudden switch over to EET system will further accentuate the uncertainty.

Rajni Bedi (2007)\textsuperscript{4} studied and evaluated the performance, reforms and incentives of personal income tax system in India. The period opted for the study was AY 1993 - ‘94 to 2002 - ‘03. The study examined the changes in respect of deductions and exemptions available under the various heads of income for the period under study and their impact. It was noticed that most of the deductions, rebates and exemptions were introduced from time to time without adequate examination of the total impact of the different schemes put together. Taken as a whole, the schemes do not seem to satisfy or fit within any definite set of principles. Hence it was suggested that these incentives need to be reviewed and eliminated wherever possible. The study also observed that changes in the tax laws should be made to the minimum extent to reduce complexity in tax laws. It was suggested that the Govt. should give up the practice of introducing changes and concessions in each year’s budget. The study revealed that the share of personal income tax in total tax revenue of the Central Government increased from 12.05 per cent to 17.05 per cent under the period of study. The study concluded that the plethora of exemptions, deductions and rebates available not only eroded the tax base but also complicated the tax laws.

Sindhu.K (2007)\textsuperscript{5} analysed the stock market developments and the changes in the behaviour of retail investors. The study revealed that the first investments made by the young people, generally take the form of bank deposits and life insurance policies which need no prior understanding. People often refrain from investments in stock market since proper learning is necessary for successful stock market investing. It was suggested that suitable
educational programme for investors are essential and such programmes should be conducted during the period of their education so as to attract investors to stock market at an early stage.

Sathyavathi Parol (2006)\(^6\) studied the tax policy and tax administration towards salaried class from colonial period till date, tax compliance of the salaried as against non salaried, computation of salary in comparison with other sources and other factors relevant to progressivity of tax and its impact on salaried. The study revealed that there is no change in the circumstances, which justifies the shift in tax policy towards the salaried class from soft to hard. She opined that the tax structure is unscientific, tax brackets are narrow and the gradation is steep at the bottom level. The salaried are more exposed to marginal impact of gradation and evils of bracket creep due to non-indexation of tax brackets. The study observed that salaried group differently circumstanced in matters of rate compliance, administration and collection. Considering these matters, the study concluded that, salaried group deserves special treatment.

M. Govinda Rao (2005)\(^7\) analyzed the Indian tax system involving its structure as well as operations. It was identified that the reforms in Indian tax system in some aspects are unique. Unlike most developing countries which were guided in their tax reforms by multilateral agencies, Indian tax system have borne the domestic brand largely in response to changes in the development strategy overtime while keeping in tune with the institutional arrangements in the country. It was pointed out that even when the Govt. sought assistance from multilateral financial institutions, the recommendations of these institutions did not directly translate into an agenda for tax reform. The tax reform systems in India were broadly in conformity with international trends.
and advice proffered by the expert groups and was in tune with international best practices.

M.Govinda Rao and R. Kavitha Rao (2005) made an analysis of Indian tax system. The study reviewed the evolution of the tax system and its reform over the years and analyzed its efficiency and equity implications. The impact of historical and institutional factors in shaping India’s tax policy was studied. Alternate models of tax system reform were presented with a view to identifying the best practice approach followed in tax systems reforms. The trends in tax revenues were presented and analyzed the reasons for stagnation and deceleration in tax revenues both at Central and State levels. The study revealed that the tax system reform including reform in administration is a continuous exercise for improving the revenue productivity, minimise distortions and improve equity. It was suggested that reforms should be undertaken at Central, State, as well as Local levels. A major objective should be to minimise distortions and compliance cost. The study concluded that broadening the base of both Central and State taxes and keeping the structure simple within the administrative capacity of the Govt. is an important international lesson that has to be taken note of in calibrating further reforms.

Navjot Dhingra (2005) studied the problems and issues relating to direct tax rate structure, deductions, incentives and inflation indexation. The study revealed that income tax rate structure has been changed more frequently and in many cases on year to year basis, which violated the principles of stability and created difficulties in tax administration. It was examined that after eighties, the tax rate structure remained relatively stable. The study of inflation adjustment of personal income tax rate structure showed that there had been ad-hoc and inadequate adjustments of standard deduction and exemption limit. It
was suggested to frame income tax rate structure on scientific and rational basis and then indexing these for inflation.

**H.P. Ranina (2005)** highlighted three important objectives to be borne in mind while levying taxes. They are simplicity, certainty and clarity in tax laws. It was suggested that Govt. must levy only the minimum tax which is necessary for the national good. He recommended that a new tax code with precision and simplicity should be drafted. The study concluded that tax administration needs toning up and tax department should outsource most of its functions, considering the world class ITES available in India. Dispute resolution mechanism should be made effective by speedy disposal of disputes.

**The Standing Committee on Finance (2004-'05), Fourteenth Lok Sabha** studied the need for widening the tax base and to control the evasion of taxes. The Committee viewed that equal emphasis should be placed by the Govt. on the efforts to widen the tax base and to tackle evasion of tax. It was revealed that ineffective steps taken to prevent evasion of taxes leads to creation of huge black money and prevalence of a parallel economy in the country and Govt. losses significant amount of revenue on account of this. It was suggested that a strong will and sincere efforts on the part of the Govt. is necessary to strengthen the anti evasion machinery of the tax Dept. to control the evil effects of tax evasion.

**Chitta Ranjan Sarkar (2004)** identified that the basic purpose of tax incentives in India was to motivate the tax payers to save and invest more, particularly in rural and backward areas of the country. The study described and critically evaluated the policy of liberal income tax exemptions and concessions to accelerate the pace of economic growth in India. It examined various theoretical issues related to the operation of tax incentives. It provided an
overview of the present system of income tax incentives in India. Drawing on the experience of other countries, an attempt had been made to evaluate the tax incentives in India. The countries considered for comparative study are: UK, USA, France, Japan, Singapore, Malaysia and Singapore.

A. Das-Gupta (2004)\(^{13}\) studied the effects on tax compliance of simple reforms in personal policy in the Indian income tax administration. It was pointed out that tax payers voluntarily disclosing higher incomes were currently assigned to special assessment units. To avoid this, high income tax payers have an added incentive to understate their incomes. He explained the spillover effects of enforcement efforts across assessment units. The study tried to incorporate these spillovers in estimating revenue effects of increased support staff. The study concluded that significant compliance gains would accrue from expanded staff employment and changes in assessment procedures for staff and tax payers.

Jain (2004)\(^{14}\) studied and compared the income tax provisions and various other aspects of income tax system in six countries, three developed (U.K., U.S., and Australia) and three developing countries (Malaysia, Pakistan and India). Period opted for the study was 1984 - ‘85 to 1997 - ‘98. The study revealed that in the case of personal income tax a progressive tax rate structure was adopted by all the six 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 applicable in India was very low and the income tax at maximum rate was payable even by individual tax payers 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 has the option to file return jointly. The analysis also revealed that the percentage growth in GDP per capita and income tax per capita in the developing countries
were much higher than the percentage growth in population. This indicated that the base of per capita GDP and income tax per capita was very low in developing countries, especially Pakistan and India and therefore any increase in the GDP and per capita appeared to be substantial in these countries.

Singh and Srinivasan (2004)\textsuperscript{15} studied India’s policy reforms including fiscal policy and opined that promoting growth may require giving up 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 critical areas of reform. Tax reform is an essential step towards increasing Government revenue as well as reducing micro economic distortions.

Mitra and Stern (2003)\textsuperscript{16} analyzed the evolution and reforms of tax systems of Central and South-Eastern Europe and the Baltic (CSB) and Commonwealth of Independent States (CIS). It was found that the ratio of tax - revenue to GDP decreased largely due to fall in revenue from the corporate income tax, notwithstanding a rise in the share of individual income tax. Social security contributions together with payroll taxes became less important in the Commonwealth of Independent Nations and domestic indirect taxes gained more importance in overall tax revenues. The authors observed that there has been increased role of personal income taxation and these developments went in a direction opposite to those observed in poor countries as they get richer. To improve tax administration, it was suggested that tax payer should be made aware of general concepts of taxation, assistance should be made available only to large tax payers and to those who wish to comply voluntarily, and the compliance cost should be reduced.
Navjot and Om Prakash (2003)\textsuperscript{17} studied various aspects of income taxation in India from 1950 - '51 to 2003 - '04. Regarding personal income tax, study revealed that the income tax rate structure was changed very 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. Study also revealed that a number of incentive provisions in the form of deductions and allowances have been incorporated in to personal income tax rate structure, which reduced the rigour of taxation. Authors observed that these incentives, to some extent provide tax benefit to higher income taxpayers, but reduce the progressivity of tax rate structure at the same time. It was suggested that when tax rates have been reduced, there is need to limit these benefits to bare minimum for the sake of simplicity and providing equal treatment to equals.

Das-Gupta, S.Chattopadhyaya and D.Bhatanagar (2002)\textsuperscript{18} conducted a study on the economic theory of tax compliance with special reference to tax compliance cost. It was pointed out that a clear understanding of the impact of different types of taxes on individual behaviour is necessary if taxes are to be designed to minimise their negative impact on efficiency and equity. The study revealed that this is a major motivator of optional tax theory in economics. The intended and actual impact of taxes will differ if the tax administration is not able to counteract attempts by tax payers to minimise the taxes they pay given administratively complex taxes. One important dimension of individual responses to taxes is the extent to which they willingly comply with tax laws. Tax evasion and avoidance are major causes of deviation between the actual and intended impact of taxes. It was concluded that identifying administratively simple taxes which provide limited opportunity for tax evasion and avoidance is therefore also an important part of the agenda for tax research in economics.
Saumen Chattopadhyay and Arindam Das Gupta (2002)\textsuperscript{19} made a study on the influence of compliance costs on compliance behavior of individual tax payers in India and to examine the extent to which non compliance is due to high compliance costs. It was identified that there appears to be a relationship between some components of compliance costs, including bribes, and compliance which exerts a negative effect on the tax revenue. The measures to reduce compliance costs, particularly components contributing to decreased revenue, are likely to have revenue benefits. Third party compliance costs, borne by those charged with deducting tax at source, have revenue benefits that possibly exceed third party costs. The main empirical finding is a qualitative difference between time and (legal) money compliance costs, with the latter adversely affecting compliance and the overwhelming negative effect of bribe costs on tax compliance. Time compliance costs may, on the other hand, positively affect compliance. Besides bribes, the use of tax advisors may adversely affect compliance, while the opposite is true for third party costs via TDS. The estimated compliance effect of compliance costs suggested that compliance costs led to a decrease of between 51 per cent and 88 per cent of personal income tax collections in 2000 - ‘01.

Khatri and Kochhar (2002)\textsuperscript{20} made international comparison with respect to revenue performance of tax between countries like Argentina, Brazil, Bulgaria, Chile, China, Columbia, India, Indonesia, Malaysia, Pakistan, Romania, Russia, South Africa, Thailand, Turkey and Vietnam for the period 1990 to 2001. The study revealed that the tax revenue of India was significantly below the un weighted average of all countries taken for study. The average Central Government tax to GDP ratio for around 30 Asia-Pacific countries was just over 14.5 per cent during 1990s. In contrast, Central Government tax revenue of India (before transfers to the States) averaged 9.75 per cent in the
first half of 1990s had declined to 9 per cent in the second half of 1990s. The study observed that there was significant scope for broadening the direct tax base, since agriculture and services which constitute three-fourth of the economy, remain untapped. Using the average of Central Government tax revenue to GDP in Asian countries as a benchmark, there was the potential to increase tax revenue by around 3 to 5 per cent of GDP. The study concluded that improved tax administration could help in the effort to broaden the tax base and to raise tax revenue.

**Muneer (2002)**\(^{21}\) studied the awareness of college and university department teachers on tax planning measures and the investment pattern followed by them for availing tax benefits under the Income Tax Act. The study included the tax planning measures adopted by the respondents for the AY 2001 - ‘02. It was observed that there was a general level of awareness among the respondents on the various tax planning measures available under the Income Tax Act. However, there was variation in the extent of awareness among the respondents regarding certain tax planning measures.

**Sarma and Gupta (2002)**\(^{22}\) studied the fiscal reforms in India during the nineties. The study revealed that Union Government’s tax reforms did not help to improve its revenue - GDP ratio. The only area that showed a marked improvement was the performance of personal income tax and corporate tax. This could be seen in terms of improved growth and buoyancy in the post-reform period. Performance of personal income tax from 1991 - 2001 was compared with the performance during the period 1981 - ‘82 to 2000 - ‘01. Rate of growth of personal income tax increased from 13 per cent in eighties to 25.3 per cent in nineties. The buoyancy coefficient for the same period increased from 1 per cent to 1.6 per cent.
Upendar (2002)\textsuperscript{23} conducted an empirical study to determine the validity of 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 substantial reductions in maximum marginal tax rates. The period of study selected was from 1960 - '61 to 2000 - '01. The results showed the year to year movements in the negative elasticity 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 unity, which was indeed not apparent in most of the financial years after 1991 raising a little doubt about the success of tax reforms.

Vijay.L.Kelkar, Chairman of the Task Force on Direct Taxes (2002)\textsuperscript{24} stressed the need and importance of providing education and quality services to tax-payers in improving tax compliance. A cross country survey of tax-payer service done by the Task Force indicated that the relatively more successful tax administration provides relatively high levels of tax-payer service. It was observed that there has been much more emphasis and spending up on providing tax-payer education and tax-payer service in many countries of the world – both developed and developing as compared to India. It was found that tax-payer service in India suffer due to inadequate budgetary support and lack of sufficient policy initiative. The report concluded that Department should expand the present scope of tax-payer service to a wide range of programmes taking into account the best international practice in the area of tax-payer service.

Chelliah and Rao (2001)\textsuperscript{25} analyzed the trends in tax revenue for the period 1980-'81 to 1999-2000 and suggested ways to improve tax revenue. The
study laid emphasis on computerization of income tax administration. The study revealed that computerization of tax administration and strong and deterrent action against tax evaders and corrupt tax officials are the two important steps to be taken to increase revenues in the existing situation. In India, tax administration was based on traditional, manual based methods which had fallen far behind the tax administration in advanced countries in terms of revenue efficiency, tax payer service and standards of integrity. The authors pointed out that the measures needed to increase tax revenue and at the same time to reduce distortion and improve horizontal equity, was to eliminate a large number of exemptions granted.

**Joint Economic Committee** (2001)\(^\text{26}\) constituted by the United States Congress under the chairmanship of Jim Saxton studied the economic benefits of personal income tax rate deduction. Period opted for the study was from 1980 to 1999. The Committee studied the changes in the top personal income tax rate for the G-7 industrial economies and for 30 other important economies, including India. The average top tax rate for the G-7 countries fell 18 percentage points since 1980. The other economies including India fell by 22 percentage point by the same period. The OECD figures showed that the average top personal income tax rate for OECD member countries fell by 17 percentage points between 1975 and 1995. The Committee concluded that the high marginal tax rates distort work and savings decisions and promote unproductive tax avoidance and evasion activities.

**Jha** (2000)\(^\text{27}\) examined that whether the broad trends in tax changes in India were consistent with the principles of tax reform. The study observed that as an economy develops, reliance on indirect taxes as a source of revenue should fall and that on direct taxes increase. Within direct taxes reliance has to be shifted from corporate tax to income tax because corporate profits paid out
are taxed as individual incomes anyway. Within the category of income taxation, the rate exemption structures have to be rationalized. Since the tax reforms began in 1991, regarding personal income tax, there have been some changes in the form of cut in the marginal income tax rates and reduction in the number of slabs. The share of personal income tax in total tax revenue decreased from 21.37 per cent in 1950 - ‘51 to 8.1 per cent in 1995 - ‘96.

Pandey (2000)\textsuperscript{28} analysed and compared the tax relief provisions as applicable in India with that of United States. Study reported that India has unique distinction of having the largest number of tax incentives, exemptions and deduction provisions. The Internal Revenue Code of U.S.A. contains very few provisions of this nature, compared to India. Study concluded that tax reliefs under the US laws were more pragmatic in nature and were limited only to the extent of need and were not open ended.

Raikhy and Om Prakash (2000)\textsuperscript{29} studied the structure of direct and indirect taxes in the pre and post-liberalization 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 the share of personal income tax in the total tax revenue of the Central Government was declined from 32.76 per cent in 1950 - ‘51 to 9.34 per cent in 1990-1991 and further increased to 15.70 per cent in 1999 - 2000. Also the growth rate of personal income tax which was 1.97 per cent during the period 1950 - ‘51 to 1959 - ‘60 increased to 18.73 per cent during 1990 - ‘91-2000 period. 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. It was reported that during nineties personal income tax showed a high degree of responsiveness. Buoyancy coefficient of personal income tax was increased from 0.4814 per cent during
1950 - ‘60 to 1.1587 per cent during 1990 - 2000. Study concluded that tax structure in India, which was being increasingly biased towards indirect taxes, underwent a change after the adoption of liberalization policies in 1991. The share of direct taxes including personal income tax in total tax revenue continuously increased during nineties. It was suggested that the tax rate structure has to be made more scientific; loopholes have to be plugged by withdrawing unnecessary deductions and allowances and widening the tax net further.

Rao (2000)\textsuperscript{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 to 12.6 per cent during the period under study. It was observed that as regards 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.

Shome (2000)\textsuperscript{31} suggested that in the case of personal income tax, tax incentives for savings should be given in the form of tax credit. Incentives under Section 80L should be removed and those under Section10 should be streamlined. The investment ceiling for the tax credit under Section 88 should be appropriately raised.

Srekantaradhya (2000)\textsuperscript{32} 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 analyzed and the changes that had taken place in post 1991 period were evaluated.
study revealed the major deficiencies of the personal income tax system in India.

Jha Shikha (1999) examined the reasons for tax evasion and implications of offering amnesties to tax 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. It was suggested 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 schemes 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.

Das-Gupta and Mookherjee (1998) studied the tax enforcement in India and compared it with countries like Spain, Mexico, Singapore, Philippines and Indonesia. The study revealed that the compliance with the personal income tax during the period under study (1965 - '66 to 1994 - '95) had steadily declined. 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 decline in compliance was explained primarily by higher effective tax rates, exemption limits, inflation and the declining frequency and quality of audits. 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. It was revealed in the study that thorough reform of income tax administration is necessary to bring performance up to
international standards. The study concluded that strong political support from higher levels was necessary to overcome inertia within the administration, resistance from adversely affected tax payers and to make available necessary finance and leadership.

Haughton (1998)\textsuperscript{35} studied the various methods to calculate tax buoyancy. He advocated that the most elegant approach to calculate tax buoyancy was by regressing the log of the tax revenue on the log of the tax base, i.e. Gross Domestic Product (GDP). He suggested that this method should be used only if data for every year is available.

Kantawala (1998)\textsuperscript{36} conducted a study to identify the major aspects influencing individual taxation in India for a period from 1964 - '65 to 1995 - '96. They include adequacy of exemption limit to cope up with inflation, the burden of tax in real terms at selected level of income over a period of time, the average rate of tax in percentage terms for selected years, changes in average rate of tax in percentage terms over selected period, increase in tax liability in percentage terms over preceding selected level of income, the progressiveness of tax rates in percentage terms, burden of tax at selected level of income at current prices over a period under consideration and level of government collection of income tax from individual taxation. The comparison of notified exemption limit with the inflation adjusted exemption limit revealed that for almost all years notified exemption limit fell short of inflation adjusted exemption limit. The study revealed that the increase in average rate of tax for real income level for the low income group was highest where as the high income group showed a declining average rate of tax indicating that progression of income tax had declined over the period under study. The number of assessees also increased, resulting in an increase in the revenue of the Government.
Sunnykutty Thomas (1998) studied the tax planning practices among the salaried people of Kerala, in general to judge the extent of awareness and compliance of tax planning schemes among the salaried people. The study revealed that there is a positive relation between tax planning awareness and assessment age. It was found that neither the tax administration nor the employer had framed any regular methodology so far to impart training to the salaried people in effective tax planning. The study also revealed that there was a significant variation among the employees of different employment sector as regards the number of tax planning schemes selected by them. The study concluded that even though employees were aware of certain tax planning schemes, they were not implementing the decision of tax planning in their actual life.

Indian Tax Institute (1997) studied the distortions in income tax system caused by the inflation. Corrective measures to mitigate such distortions were suggested. The study pointed out that inflation impairs the progressivity of the tax structure. Real income tax rates increase during the inflation although the formal tax structure remains the same. Moreover, changes in the real tax rates, induced by inflation, are of permanent nature. The study suggested the introduction of inflation indexing schemes. The report stressed the need to take corrective measures to offset the adverse inflationary effects particularly when inflation persists for longer periods.

Joy.K.J. (1997) identified that a wise tax plan with thorough knowledge of the exemptions of the existing tax system could reduce much of the tax burden. The study revealed that majority of the Govt. employees were facing a number of problems like inadequacy of income, rising cost of living, lack of sufficient savings and investments, growing debts and uncertainty about the future financial position. Their income increased over the years but cost of
living increased much faster than income. Most of the Govt. employees were struggling hard to make both ends meet.

Viramani (1997)\textsuperscript{40} identified the need for eliminating as many exemptions as possible, compulsory filing of simplified tax returns and reduction of rates prevalent at that time. He recommended that a comprehensive approach to bring potential tax payers into the tax net is needed. It was pointed out that a computerized database using declared and authenticated expenditure data on electricity bills, rentals, telephone bills, automobile purchase, property ownership etc., needs to be built. The tax officials would have to be reoriented from existing tax payers to expanding the number of tax payers. Various measures to check tax evasion were also suggested in the study.

Mookherjee and Das-Gupta (1995)\textsuperscript{41} 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 revealed that the performance of the income tax in India was poor compared with other countries with similar per capita GDP. Furthermore the performances had a negative secular trend. It was argued that the reason was due to low or falling compliance rather than other handicaps. This was due to ineffective administration, reliance on enforcement tools with limited potential, inappropriate organizational structure, lack of computerization and inefficient allocation of limited manpower resources coupled with a growing tax payer population. The study concluded that the continuation of current administrative and enforcement practices cannot lead to dramatic improvements in the performance of the income tax in India. The reform of income tax administration must be more thorough going to increase the contribution of income tax to revenue significantly.
J. Ram Pillarisetti (1995) made a comparative study of India and Latin American Countries to analyze the role of tax reforms in privatizing economies. He argued that direct tax reforms in India should include elimination of income tax and capital gains taxes. He presented an analysis of how the high direct tax rates over several years coupled with several types of controls, drastically distorted the price and incentive system. The study revealed that in comparison with other developing countries, India is a high taxed economy. The institutionalized corruption resulting from direct taxes cannot be reduced without elimination of these taxes. Measures such as broadening of direct tax base, higher penalties etc. are counter productive. It was concluded that the success of liberalization programmes, environmental conservation and general socio economic development requires the elimination of these taxes.

Harvey S. Rosen (1995) identified that the income tax affects incentives for myriad decisions - everything from the purchase of medical service to the amount of charitable donations. Personal income tax affects many economic decisions, savings, residential housing, consumption and portfolio choice.

Alice Mani (1994) argued that the savings incentives available to the tax payers in effect help the higher income groups only, even though the income tax deductions claimed by them form a lower percentage of total deductions compared to their income share.

Chelliah (1994) suggested the criteria on which the sound and practical tax system should be based. He was of the view that to avoid administrative complexity and to preserve horizontal equity, the introduction of various incentives, 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 pointed out that if a concession or subsidy 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, the cost of which is not readily apparent and is not often calculated. He stressed the need for achieving horizontal equity.

Bagchi (1993) argued the need for modern information technology in tax administration and made a cross-country comparison of India with countries like Canada, United States, Singapore, New Zealand, Spain, Mexico, Indonesia, Chile and Kenya with respect to computerization in tax administration. The study observed that while the countries opted for the study were in varying stages of sophistication in computerizing their tax procedures and organization, Canada and Singapore seemed to be ahead of others in using modern technology to operate the tax system and provide a myriad of services to their citizens through the network set-up for the purpose. It was pointed out that the most important single factor that weakened the efficacy of tax administration in India in implementing the tax laws was the absence of an efficient information system. Cross country experience showed that modern information technology provide a cost-effective answer for the problems of managing information which was not available earlier. Modern information technology also provides better quality tax payer assistance and introduced new services which could not be contemplated earlier. Need of organizational change, training of human resources, standardization and supportive legal frame work was also realized to fully utilize the benefits of modern information technology.

Jain and Garg (1993) studied the role of direct taxes in India with regard to its coverage, contribution to tax revenue and its administration. The period opted for the study was from 1950 - '51 to 1990 - '91.
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 per cent in 1950 - ‘51 to 46.08 per cent in 2000 - ‘01.

A.N.Shambhag (1993)\textsuperscript{48} provided information about various investment plans and the existing tax structure in India. He made an attempt to give the reader a capacity to make his own calculations and form an independent judgment. According to him, safety is the prime concern for all investors, but liquidity preferences vary, and investors generally try to get the maximum return consistent with reasonable safety and their liquidity preferences.

Richard.M.Bird (1992)\textsuperscript{49} studied the impact of tax Policy in the economic development of developing nations and stated that in order to stimulate economic development and to improve the social conditions of their citizens, developing countries cannot rely on investments and aid from abroad, but must secure their own financial resources through taxes. He evaluated the unique conditions that applies to these developing nations and examines their impact on the kinds of taxes that can be raised and on the effective administration of tax policy.

Das-Gupta (1990)\textsuperscript{50} studied rate of return of Government and private sector financial instruments after personal taxation. A sample of about thirty assets was considered. For the purpose of study the rate of return before tax, rate of return after tax and rate of return after tax under the assumption that no tax concessions were present, were computed for each income bracket separately. It was found that the ranking of assets after income tax differ across tax bracket, which implies a distortionary tax system. Furthermore, tax deductions favour upper bracket tax payers the most. It was also found that
among the financial instruments relatively greater favour was accorded to Government Bonds as compared to private sector assets.

Raj (1990)\(^1\) studied the role of tax structure in the Indian economy, growth rate and rate structure of personal income tax. The study also examined the tax administration. The period opted for the study was 1951-‘52 to 1988 - ‘89. The study concluded that rationalization of tax structure is must to promote the objectives of economic growth, equity and built in revenue raising capacity of personal taxation and other direct taxes. It was observed that the cost of administration will go up if the tax net is enlarged by including large number of taxpayers with small income group. It was also suggested to make tax law simpler so that it will be easier to understand for tax payers and less difficult to administrators.

Kumar (1988)\(^2\) examined the role of income tax in India’s tax system with regard to its coverage, contribution to tax revenue and its administration. Administrative problems relating to evasion and avoidance of tax, arrears of tax and pendency of assessment were also covered in the study. Suggestions for making the tax system more effective and revenue elastic were given. The period opted for the study was 1950 - ‘51 to 1984 - ’85. An appraisal of the enforcement of income tax measures in India revealed that income tax in India had 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 demoralized the honest tax payers. Bringing agricultural income within the purview of Central taxation , making ‘family’ as the basic unit of assessment instead of ‘individual’, extending the scope of deduction of tax at source, increasing the number of assessment officers, strict enforcement of tax recovery proceedings
by CBDT, launching search and seizure proceedings effectively, withdrawing the exemptions, deductions and allowances etc., are some suggestions made by him for extending the coverage of income tax, making it revenue elastic and administratively effective.

Kwatra (1988)\textsuperscript{53} made a comparative study of taxation of capital gains in indifferent countries. It was observed that the effective legal definition of capital gains varies in different countries and, therefore, treated differently. It was observed that on the whole the system of capital gains tax in India fulfill the principle of equity and ability to pay. It was fairly efficient, flexible but not simple as frequent changes were made. The role of capital gains tax in Government revenue was very little because of valuation and administrative problems.

Sandhu (1987)\textsuperscript{54} studied the tax structure in Indian economy and examined the revenue importance and rate structure of personal income tax in India. The period opted for the study was 1951 - ‘52 to 1985 - ‘86. The study revealed that in 1951 - ‘52, personal income tax constituted 63.3 per cent of the direct tax revenue. During the period under study, percentage of personal income tax to total direct tax revenue, total tax revenue and national income declined from 63.3 per cent, 19.33 per cent and 1.5 per cent to 33.1 per cent, 4.5 per cent and 1.0 per cent respectively. The study also revealed that the proportion of national income mobilized through personal income tax tended to fall during the period under study but the percentage of national income mobilized through corporate tax tended to rise rapidly during the same period. The study revealed that, the rates of personal income tax did not seem to have adversely affected savings as there were large number of exemptions allowed to promote savings and investments.


Organisation for Economic Co-operation and Development (OECD, 1986)\textsuperscript{55} in the report made by the Committee on Fiscal Affairs of OECD stated that tax reforms had become a major issue of public debate in many OECD countries because of widespread concern about high unemployment, slow economic growth and low investment. The chances for radical income tax reforms were greater in those periods than for some years. The Report analyzed developments in personal income tax in OECD member countries over the past decade and examined the policy choices facing governments.

Satya Narayan Mittal (1986)\textsuperscript{56} attempted to evaluate, assess and discuss the history of income tax laws from 1951 onwards. Various tax provisions had been cross examined and concrete suggestions given to rationalize the tax structure and to make it more conducive to economic growth.

C.P.Srivastava (1986)\textsuperscript{57} conducted a study on tax administration in India and stated that the success of any tax system depends not only on its structure, rates, exemptions, etc., but it also depends to a large extent, upon how the tax system is administered so that the system may, on the one hand, yield adequate revenue to the exchequer and on the other, causes least possible inconvenience to the public. The study revealed that a sound tax administration should possess four essential characteristics viz., no arrears of assessment and collection; no pendency in appeal; quick disposal of refunds and claims; and least chances of evasion and avoidance.

Srinivas Madhur (1984)\textsuperscript{58} conducted an empirical study on taxation and household savings in India and revealed that Income taxation has significant effects on household savings. The study also observed that a reduction in the tax on interest income can lead to substantial increase in household savings.
Dr. G. Thimmaiah (1984) provided a theoretical background to the principles of tax design and tax reform. The defects in the existing taxes in India were discussed against such theoretical background and outlined the need and scope for tax reforms in Indian tax structure. The study covered most of the direct taxes of the Central Govt. and also gave attention to important indirect taxes levied by the central and state governments.

Ronald C. Gable (1983) conducted a study on investments and financial planning of individuals and it was observed that each individual must be responsible for his or her financial decision making. Only knowledgeable active decision makers will achieve financial security. The study observed that all planning is purposeful and financial planning can be done only by those who sets goals and actively strive to implement those goals.

Lall (1982) studied the economic implications and impact of the direct taxes on individuals and business income with focused stress on budget of the financial year 1982 - '83. The study of average tax rates for assessees with different income brackets for the 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 assessees with the lowest income bracket on the ground of administrative expediency and humane considerations. The study also showed that a difference in the average tax rates for the employees of Central Govt., State Govt. and private sector employees. The reasons given for such difference were the composition of salary income and discriminatory treatment through Section 10(13) (A).

A Study on Tax Planning Measures Adopted By the Salaried Class in Kerala
Kapadia.M.B. (1981) member of Institute of Chartered Accountants of India conducted a study on Tax Planning through public provident fund. He discussed the various tax provisions in the Income Tax Act and explained the way in which an investor could avail maximum tax benefits through proper planning.

N.J. Yasaswy (1979) discussed objectively the pros and cons of various investment opportunities in the light of tax implications as an integral part of the total investment planning. He discussed the impact of inflation on investments and the need for protecting the purchasing power of the investments. The book emphasized the need to provide necessary information and insights to build a diversified investment portfolio.

Chitale (1978) examined the personal income tax system in India and suggested the reshaping of personal income taxation in India with a focus on encouraging savings. It was found that in India, the quantum of tax benefit depends not so much on the amount saved as on the level of one’s income, thus the cost benefit principle gets ignored in this method of rewarding savings. It was suggested in the study that just like progressive income tax rates, the rate of tax benefit or tax credit also be made progressive.

Vaish and Panadiker (1978) opined that excessive taxation increased the level of national consumption at the cost of national saving. The study revealed that the higher the rate of taxation, the greater the temptation to evade taxes. It was argued that with 69 percentage marginal rate of taxation including surcharge, the premium on undisclosed income was 323 per cent. It was recommended that at the level of ₹ 3 lakhs, the tax rate should be 44.44 per cent as compared to the then existing rate of 61.03 per cent. It was also suggested
that the tax base of the country should be widened so that the sacrifice is equally distributed.

**Anupam Gupta and Pawan.K.Agwal** (1975) estimated the elasticity of personal income tax with respect to the tax base and income and analysed it in terms of the progressivity of the tax structure and the distribution of income. The impact of the personal income tax on the distribution of income among the tax payers was examined on the basis of the comparisons of pre-tax and post-tax distributions. The re-distributive impact of the tax was observed in terms of the progressivity of the tax structure and effective rates of tax. The study estimated the adverse effect of inflation on the progressivity of the tax structure and the distribution of the real burden of tax.

**Suman** (1974) observed that direct taxes as a percentage of total tax revenue occupied relatively greater importance in tax structure of developed countries, but in developing countries like India their importance has been declining and these proved to be less elastic source of revenue during the plan period. For the year 1962 - '63, the direct tax revenue as a percentage of total tax revenue in USA was 60.8, where as in India it was 29.6. In India personal income tax and corporation tax contributed 96 percentage of the total direct tax revenue in 1968 - '69. The study highlighted that although the rates of these taxes seemed to be high but these did not adversely affect personal and corporate savings and investment. The study revealed that inadequate taxation of agricultural sector, political considerations, gradual raising of the exemption limit, existence of non-monetary sector, inefficiency of tax administration, a large degree of tax evasion and avoidance were the important factors which come in the way of effective use of direct taxation in India. It had been noticed that tax evasion was mainly concentrated in upper income brackets. It was suggested that tax laws should be made simple and frequent changes in income
tax laws should be avoided. Steps should be taken for speedy realization of income tax arrears and to avoid over assessment on the part of income tax authorities.

V.V. Borkar (1971) examined critically the structure of income tax in India and discussed the basic problem of formulation of the income tax base. The Indian tax laws have been assessed in the light of the basic principles and practices in some of the leading developed foreign countries. He offered many constructive and concrete suggestions to frame the fiscal policies to suit the national goal of democratic socialism.

India is under a rein of tax reforms with a proposal to repeal the Income Tax Act and to introduce the Direct Tax Code (DTC). Several proposals to restructure and rationalize the tax system are in the pipeline. Discussion Papers and Policy Documents have been introduced. It is the salaried class with a stable income who are the most anxious on the impact of such reforms on their savings and investment. Hence it is appropriate to make a brief discussion on the DTC which is expected to come in to force by April 2012.

Discussion Paper on the Direct Taxes Code

The Income Tax Act 1961 has been subjected to numerous amendments since its passage fifty years ago. It has been considerably revised not less than thirty four times by amendment acts besides the amendments carried out through the fifty annual Finance Acts since the introduction of the Act. As a result of all these amendments, the basic structure of the Income Tax Act has been overburdened and its language has become complex and difficult to understand by the average tax payers. The Wealth Tax Act, 1957 has also witnessed amendments. The Government, therefore decided to revise, consolidate and simplify the language and structure of the direct tax laws. A
draft Direct Taxes Code along with a Discussion Paper was released in August, 2009 for public comments. It proposed to replace the Income Tax Act 1961 and the Wealth Tax Act, 1957 by a single Act namely the Direct Taxes Code. Public and stakeholder feedback on the proposals outlined in these documents was analysed and suggestions for amendments received from the public, business associations and other bodies were taken in to account. There after a Revised Discussion Paper addressing the major issues was released in June, 2010. The Direct Taxes Code Bill was introduced in Lok Sabha on 30th of August 2010. The salient features of DTC are the following:

- Single code for direct taxes.
- Complex structure is simplified.
- Use of simple language.
- Reduction in scope for litigation.
- Flexibility.
- Consolidation of provisions.
- Elimination of regulatory functions.
- Providing stability.

All rates of taxes are proposed to be prescribed in a Schedule to the Code, thereby obviating the need for legislation through Finance Act every year, if no change in the tax rate is prescribed. Table 2.1 presents individual income tax rates proposed by the DTC.
Table 2.1 Tax Rate Schedule for Individuals proposed by Direct Tax Code

<table>
<thead>
<tr>
<th>Income Slab (₹)</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 2 lakh</td>
<td>Nil</td>
</tr>
<tr>
<td>2 lakh to 5 lakh</td>
<td>10%</td>
</tr>
<tr>
<td>5 lakh to 10 lakh</td>
<td>20%</td>
</tr>
<tr>
<td>Above 10 lakh</td>
<td>30%</td>
</tr>
</tbody>
</table>


The Researcher had also reviewed the following Committee Reports on direct tax reforms and presented the findings in Chapter four, which makes a study on direct tax reforms in India.

2. Nicholas Kaldor Committee (1956).
3. Direct Taxes Administration Enquiry Committee (1959)
5. Direct Taxes Enquiry Committee (1971).

Current Status of Direct Taxes

Various studies examined the performance efficiency of direct taxes in India in the light of administrative and enforcement practices prevailing in the state. The current status of direct taxes in terms of compliance level, revenue
growth, arrears of collection, cost of collection, tax – GDP ratio and tax-buoyancy for the period covering 2008 – 2010 is presented in Table 2.2.

Table 2.2 Current Status of Direct Taxes

<table>
<thead>
<tr>
<th>Variables</th>
<th>2007 - ‘08</th>
<th>2008 - ‘09</th>
<th>2009 - ‘10</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Assessees (in lakh)</td>
<td>336.60</td>
<td>326.50</td>
<td>340.90</td>
</tr>
<tr>
<td>Revenue Collection (₹ in crore)</td>
<td>312,213</td>
<td>333,828</td>
<td>377,982</td>
</tr>
<tr>
<td>Arrears of Collection (₹ in crore)</td>
<td>124,274</td>
<td>201,276</td>
<td>229,032</td>
</tr>
<tr>
<td>Cost of Collection (₹ in crore)</td>
<td>1,551</td>
<td>2,286</td>
<td>2,774</td>
</tr>
<tr>
<td>Tax-GDP Ratio</td>
<td>6.31</td>
<td>5.99</td>
<td>6.07</td>
</tr>
<tr>
<td>Tax Buoyancy</td>
<td>2.48</td>
<td>0.55</td>
<td>1.25</td>
</tr>
</tbody>
</table>

2. Ministry of Finance, Govt. of India, Annual Report 2010-’11

There had been numerous studies on tax planning measures in the back drop of taxation reforms and administrative issues. However studies pertaining to personal income tax in terms of tax planning measures related to income are few. The present study examines the status of tax planning measures adopted by the salaried tax payers under different income groups and their perception on the reforms adopted so far and the procedures planned. The impact of reforms on tax planning considering income and nature of employment is attempted in this study.

The foregoing review of literature provided a theoretical background to the principles of direct tax system and tax reforms in India. The defects in the existing tax system were discussed and outlined the need for further reforms in Indian tax structure. Various studies reviewed the performance of personal income tax in India and examined the changes in respect of deductions and exemptions available to individual tax payers under the Income Tax Act and its impact on them. The awareness level of assessees on tax reforms and resulting
tax planning measures need to be assessed for a better understanding of the effectiveness of such reforms. Similarly the pattern of savings, pattern of investments and income status have a bearing on tax planning measures adopted. A comprehensive study on the above issues pertaining to the salaried class was thus found essential. Hence the following chapters will discuss these issues in detail.
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