UNIT III

PUBLIC REVENUE

The income of the government through all its sources is called public income or public revenue. It includes income from taxes, prices of goods and services supplied by the public enterprises, revenue from the administrative activities, such as fees, fines etc., and gifta and grants.

SOURCES OR PUBLIC REVENUE

The various sources of public revenues are:

A. Grants and Gifts.
B. Administrative Revenue
   a. Fees.
   b. Licence Fees.
   c. Special Assessment.
   d. Fines.
   e. Forfeitures.
   f. Escheat.
C. Commercial Revenue.

TAX AND NON TAX REVENUE

Tax Revenue

Tax revenues are either from direct taxes or indirect taxes. Direct tax generally means a tax paid directly to the government by the persons on whom it is imposed. Income Tax, Gift Tax, Wealth Tax and Property tax etc. are direct taxes. Indirect tax is a tax collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer). Sales tax, Value Added Tax (VAT), Goods and Services tax (GST) or any other such tax is an indirect tax. Largest chunk of tax revenues of government of India currently comes from Corporation Tax, followed by Income Tax, followed by Union Excise duties, customs and thereafter service tax. The collection of service taxes is increasing over the last years. The amount collected under Direct Taxes (Corporate/ Income/ wealth) is larger than that under Indirect taxes.

Non-Tax Revenue

Non Tax Revenue Receipts are those revenue receipts which are not generated by taxing the public.

a. Money which the Government earns as “Dividends and profits” from its profit making public enterprises (PSUs).
b. Interest which the Government earns on the money lent by it to external or internal borrowers. Thus this revenue receipts may be in foreign currency as well as Indian Rupees.
c. The money which the government receives out of its fiscal services such as stamp printing, currency printing, medal printing etc.
d. Money which the Government earns from its “General Services” such as power distribution, irrigation, banking services, insurance, and community services etc. which make the part of the Government business.

e. Money which the government accrues as fees, fines, penalties etc.

f. Grants the Government of India receives from the external sources. In case of the state Governments, it may be the internal grant from the central Government.

In recent times, spectrum auctions have been one of the major sources of non-tax revenues for the government. We note here, that despite it looks that spectrum amount should be a capital receipt, it is shown as a non-tax revenue receipt in budget documents as one time spectrum charges levied on telecom players.

TAXES

Taxes are compulsory payments to government without expectation of direct return or benefit to the tax payer.

DEFINITION

According to Seligman, “tax as a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all, without reference to special benefits conferred”.

CHARACTERISTICS OF A TAX

a. It is a compulsory contribution to the government from the citizens.
b. It imposed by a government only.
c. It is general and common benefit.
d. The element of sacrifice is involved.
e. Welfare of the community as a whole.
f. It is a legal collection.

CHARACTERISTICS OF GOOD TAX SYSTEM

Some of the most important principles or characteristics of a good tax system are as follows:

a. Productivity or Fiscal Adequacy.
b. Elasticity of Taxation.
c. Diversity.
d. Taxation as in Instrument of Economic Growth.
e. Taxation as an Instrument for Improving Income Distribution.
f. Taxation for Ensuring Economic Stability.

Adam Smith viewed the problem of devising a good tax system chiefly from the viewpoint of devising good tax payers. Taxation system should also be such that it meets the requirements of increasing state activity and achieves the objectives the society has placed before it.

a. Productivity or Fiscal Adequacy:

An important principle of a good tax system for a developing country is that it should yield adequate amount of resources for the Government so that it should be able to perform its increasing welfare and developmental activities. If the tax system fails to yield enough resources, the Government will resort to deficit financing.

An excessive dose of deficit financing is bound to raise prices which are harmful for the society. To make the tax system sufficiently productive it should be broad-based and both direct

and indirect taxes find place in it. Moreover, taxes should be progressive so that the revenue from them rises with the increase in income of the people.

b. Elasticity of Taxation:

Another principle of taxation suitable for the developing countries is the principle of elasticity of taxation. According to the concept of elasticity of the taxation system, as national income increases as a result of economic growth, the Government revenue from taxes should also increase.

In developing countries, the share of tax revenue as a proportion of national income is low as compared to the developed countries. This share of tax revenue will rise as national income increases, if the tax system is sufficiently elastic. Progressive taxation of income and wealth provides this elasticity to the tax system. Impositions of higher indirect (axes on luxury goods having a high income elasticity of demand also makes the tax system elastic.

c. Diversity:

A good tax system should follow the principle of diversity. This implies that there should not be a single or a few taxes from which Government seeks to raise large revenue. This is because if a Government tries to get large revenue from a single tax or few taxes, it will have to raise the rates of taxation too high which will not only adversely affect the incentives to work, save and invest but also encourage evasion of taxes.

Therefore, the tax system should be a multiple tax system with a large variety of taxes so that all those who can contribute to the public revenue should be made to do so. This calls for a mix of various direct and indirect taxes. With the diverse tax system, the principles of fiscal adequacy and equity will also be better satisfied.

Commending diversity in the tax system Arthur Young writes, “If I were to define a good system of taxation, it should be that of bearing lightly on an infinite number of points, heavily on none”. Similarly, another expert of public finance writes, “Excessive reliance on any one base may produce adverse economic effects because the rates may become too high. Therefore, a tax system may do less economic damage if it raises moderate amounts from several bases rather than large amounts from one or two.”

d. Taxation as in Instrument of Economic Growth:

In a developing economy such as ours, taxation should serve as an instrument of economic growth. Economic growth is primarily a function of rate of capital formation. If in the development strategy public sector has been assigned an eminent place, then capital formation in the public sector must occur at a relatively higher rate.

This calls for mobilization of resources by the Government so as to finance capital formation in public sector. Therefore, a good tax system for a developing country will be such as will enable the Government to mobilise adequate resources for capital formation or economic growth.

This it can do in the following two ways:

(a). Mobilisation of Economic Surplus:

An important principle for a developing country is that it should mobilise economic surplus found in the economy. Economic surplus is the “surplus of national income over essential consumption”. It is the task of taxation system that it should restrain non-essential or unproductive consumption through appropriate system of progressive direct and indirect taxes and thereby mobilize economic surplus.

In an underdeveloped economy, there are particular economic sectors and classes of people where the economic surplus is generally found and which therefore should receive the special attention of tax authorities in such countries.

(b). Increase in the Incremental Saving Ratio**:**

A good tax system not only tries to mobilise the existing economic surplus but also seeks to raise it with a view to mop up relatively greater amount of increase in national income for the purpose of capital formation. Thus taxation in a developing economy has not only to restrain current unproductive consumption but also to check the large increases in consumption when with the increase in national income, economic surplus goes up.

This will ensure rise in the incremental or marginal saving ratio which is a prime determinant of continuous economic growth. In other words, through the means of taxation consumption should not be allowed to increase in proportion to increase in incomes.

Expansion in economic surplus accruing to the individuals should be mobilised and invested in the public sector for further growth. Progressive income tax and indirect taxes on goods with higher income elasticity will ensure this.

e. Taxation as an Instrument for Improving Income Distribution:

A good tax system for a developing economy should also serve as an instrument for reducing economic inequalities. The purpose of a good tax system for a developing economy is not merely to raise revenue for the Government but also to ensure that burden of taxes falls more on the rich.

This requires that the rates of progressive direct taxes on income, wealth, expenditure, capital gains etc., must be sufficiently high. This objective of reducing income inequalities will be better served if a good part of the tax revenue is used for poverty alleviation programmes.

f. Taxation for Ensuring Economic Stability:

A tax system must also ensure economic stability. Economic fluctuations have been a big problem in the developed countries and for reducing these fluctuations taxation can play a useful role. For this purpose, tax system must have built-in-flexibility. To have built-in-flexibility, the taxation system must be progressive in relation in the changes in national income.

This will ensure that when national income rises, an increasing part of the rise in income should automatically accrue to the Government. On the other hand, when national income falls, as in a recession or depression, the revenue obtained progressive from taxes will fall more rapidly than the decline in national income.

Built-in-flexibility attained through progressive taxation ensures that when incomes are increasing during the period of boom or inflation, the relatively greater amount of tax revenue accruing to Government will moderate the increase in purchasing power with the people and aggregate demand and thus help in keeping prices under check.

Likewise, under progressive taxation at times of depression or recession, tax revenue will fall faster than the income so that purchasing power of the people does not fall as fast as their pre-tax income. This will serve to check decline in economic activity.

However, in developing countries, the problem is more of restraining inflation so as to achieve price stability. By discouraging or restraining consumption, especially of non-essential or unproductive type, taxation can pay a useful role in controlling inflation in the developing countries.

Conclusion:

From the foregoing analysis, we conclude that in the world today taxation is called upon to achieve several socio-economic objectives. It is not just a means of raising revenue for the

limited functions of the State. Neutrality principle of taxation, that is, leave them as you find them, no longer finds favour with the modern economists. Tax system today has to play a more positive role. It is intended to bring about rapid economic growth, reduce inequalities of incomes, and promote stability and to achieve other socio-economic objectives.

CLASSIFICATION OF TAXES

Taxes can be classified on the basis of form, nature, aim and methods of taxation. Following classifications are commonly found in the modern tax system.

a. Direct and Indirect Taxes.
b. Specific and Ad Valorem Duties.
c. Progressive, Proportional, Regressive and Degressive Taxes.

A. Direct and Indirect Taxes

Direct tax is really paid by a person on whom it is legally imposed.

Merits of Direct Taxes

a. Ability to pay.
b. Economy.
c. Certainty.
d. Equity.
e. Flexibility.
f. Reduce inequalities.
g. Social consciousness.

Demerits of Direct Taxes

a. Unpopular.
b. Inconvenience.
c. Possibility of Injustice.
d. More expenditure.
e. Possibility of Evasion.
f. Exemption of low income group.

Indirect Taxes

Indirect tax is imposed on one person, but paid partly or wholly by another.

Merits of Indirect Taxes

a. Convenient.
b. Elastic.
c. No Evasion.
d. Control of Consumption.
e. Can be progressive (Luxuries goods).
f. Flexibility.
g. Productive.
h. Wide Coverage.

Demerits of Indirect Taxes

a. Administrative Cost.
b. Discourage Savings.
c. Inflation.
d. No Social Consciousness.
e. Uncertainty.
f. Heavy burden of poor people.

B. Specific and Ad Valorem

Specific tax is levied on the weight of the commodity or on some external measures, it is known as Specific Tax. Specific duties are duties expressed as definite sum to be paid for a definite measure or weight of the commodity.

Ad Valorem

If a tax is levied on the value of property, it is known as ad Valorem. It is duty expressed as percentage of the value of the commodity. Salt, kerosene oil etc.

C. Progressive, Proportional, Regressive and Degressive Taxes.

Progressive tax rate is one which the rate of taxation increases as the tax base increases. i.e., if income increases the tax rate also increased. (Sloping upward).

Proportional tax rates in one which the rates of taxation remains constant as the tax base changes. i.e., if whatever the level of income, the tax rate remains constant. (Horizontal).

Regressive tax rates is one which the rate of taxation decreases as the tax base increases. i.e., if income increases the tax rate is decreased. (Sloping downward)

Degressive tax may be slowly progressive up to a certain limit, after that it may be charged at a flat rate. i.e., if income increases slowly tax rate also increased certain limit, after that it may be flatted. (Sloping up after certain point it horizontal).

Commented [WU1]:

CANON OF TAXATION (ADAM SMINTH'S)

The Adam Smith's canon of taxation as follows:

a. Canon of Equity.
b. Canon of Certainty.
c. Canon of Convenience.
d. Canon of Economy.
e. Canon of Flexibility.
f. Canon of Elasticity.
g. Canon of Productivity.
h. Canon of Simplicity.
i. Canon of Diversity.
j. Canon of Fiscal Adequacy.
k. Canon of Stability.
l. Canon of Co-ordination.

THEORIES OF TAXATION

A. BENEFIT THEORY OF TAXATION

According to the benefit theory, the burden of taxation should be divided among the people in proportion to the benefits received from the state. It is otherwise known as Quid

Proquo Theory. It was accepted widely among the political theoreticians of seventeenth century. Benefit remained the basis of organised society, and protection appeared as a major objective of contract.

SPECIAL FEATURES

a. Reason for levy taxes.
b. Combination of tax and expenditure.
c. Benefits are measured.
d. Importance to the feelings of public.

CRITICISMS

a. Price not tax.
b. Not measureable.
c. No relation with welfare activities.
d. Benefits are not separated.
e. No relation in income and benefit.
f. Government decision.
g. Relation with other objectives of taxation.

B. ABILITY TO PAY THEORY

It is most generally accepted theory. According to this theory each person should contribute to the state in proportion to his ability to pay.

APPROACHES OF THE THEORY

The two approaches of the theory are:

a. Objective - property revenue and expenditure.
b. Subjective – sacrifice of tax payer.

JUSTIFICATION TO ABILITY THEORY

There are three justifications are:

a. Psychological.
b. Law of Diminishing Marginal Utility.
c. Faculty interpretation.

MEASUREMENT OR INDEX OF ABILITY TO PAY

The measurement of ability to pay are as follows:

a. Property.
b. Income.
c. Expenditure.
d. Size of the family.

CRITICISMS:

a. Regressive tax rate.
b. No uniformity.
c. No common measurement for property value.

d. Cheating.

IMPACT AND INCIDENCE OF TAXATION

OBJECTIVS OF TAXATION

a. Revenue Objective.
b. Social and political objective.
c. Redistribution in income and wealth.
d. Reduction in inequalities.
e. Removing depression or deficit.
f. Removing of inflation.
g. Motivational objective.
h. Functional finance.
i. Regional development.

TAX OBJECTIVES IN INDIA

The three important tax objectives in India are:

a. Promotion of Economic Growth.
b. Redistribution of Income.
c. Economic Stability.

IMPACT OF TAXATION

The impact of a tax is on the person who pays the money in the first instance. In other words the man who pays the tax to the government in first instance bears its impact. Therefore, it refer to the immediate burden of the tax and not to the ultimate burden of the tax.

SHIFTING OF TAXATION

It refers to the process by which the money burden of tax is transferred from one person to another.

It may be forward shifting and backward Shifting. If shifting is forward, from sellers to buyers. Or backward from buyers to sellers.

INCIDENCE OF TAXATION

It refers to the money burden of tax on the person who ultimately bears it. In other words, when the money burden of a tax finally settles or comes to rest on the ultimate taxpayer is called the incidence of a tax.

THEORIES OF INCIDENCE OF TAXATION

A. Concentration Theory. – Tax on particular goods. Agriculture.
B. Diffusion Theory. - Opposite to concentration theory.
C. Modern Theory. - Tax is depends on elasticity of demand and supply.

FACTORS AFFECTING INCIDENCE OF TAXATION

a. Nature of Taxation.
b. Level of taxation.
c. Elasticity of demand and supply of goods.
d. Production expenditure.
e. Nature of Tax Payer.

f. Time.
g. General Business Conditions.
h. Price.

EFFECTS OF TAXATION

Dalton discussed the economic effects under the following three heads:

A. Effects of taxation on production.

a. Effects on the ability to work, save and invest.

b. Effects on the desire to work, save and invest.
   1. Nature of Taxes.
   2. Psychological reaction of the tax payer.
   3. Effects of taxation in boom and depression.
   4. Times of war.
   5. Types of Industries.
   6. Corporate Enterprises.

c. Effects on composition and pattern of production.
   1. Beneficial Diversion.
   2. Harmful Diversion.
   3. Diversion of resources from present to future uses.
   4. Diversion of resources from one state to another.
   5. Diversion of resources from one country to another country.
   6. Protection and Diversion of resources.

   Taxes Causing No Diversion
   a. Monopoly.
   b. Non-differential taxes.
   c. Taxes on wind-falls.
   d. Taxes on land values.

B. Effects of taxation on Distribution.
   a. Nature of Taxation or Tax rates.
      1. Progressive taxation.
      2. Proportional taxation.
      3. Regressive taxation.
   b. Kinds of taxes.
      1. Direct tax and distribution.
      2. Indirect tax and distribution.

C. Other Effects of taxation.
   1. Effects of taxation on employment.
   2. Effects of taxation on economic development.
   3. Effects of taxation on inflation.
   4. Effects of taxation on depression.
   5. Regulatory effects on consumption and production.