

Public Revenue

- Public Revenue is an important concept of Public Finance. It refers to the income of the Government from different sources.
- Dalton in his “Principles of Public Finance” mentioned two kinds of public revenue.
- Public revenue includes income from taxes and goods and services of public enterprises, revenue from administrative activities such as fees, fines etc. and gifts and grants.
- On the other hand public receipts include all the incomes of the government received from formal sources.

- The sources of public revenue have been broadly divided into: (A) Tax Revenue (B) Non-Tax Revenue.
- (A) Tax Revenue Taxes are the first and foremost sources of public revenue. Taxes are compulsory payments to government without expecting direct benefit or return by the tax-payer.
- Taxes collected by Government are used to provide common benefits to all.
- Taxes do not guarantee any direct benefit for person who pays the tax. It is not based on “**quid pro quo principle.**”
- The Tax has been divided into two types such as Direct Taxes and Indirect Taxes.
- (A) Direct Taxes: Direct taxes are those taxes which are paid by the same person on whom it has been imposed. The impact and incidence of tax fall on the same person, because the tax burden cannot be shifted to others.

- Direct taxes include the following taxes.
 - i) Personal Income tax is a tax imposed on the excess income earned by an individual over and above the limit decided by the finance ministry from time to time. It is progressive in nature.
 - ii) Corporate Tax is a tax levied on the profits earned by registered companies.
 - iii) Capital Gains Tax is a tax imposed on the net profits earned through capital investment in stock market , Real estate, Gold and Jewelry etc.
 - iv) Wealth Tax (or) Property Tax is a tax levied upon the property owned by individuals. The property includes Land, Building, shares, Bonds, Fixed Deposits, Gold and Jewelry etc.
 - v) Other taxes :These taxes include taxes like Gift tax and Estate duty.

- (B) Indirect Taxes: Indirect taxes are those taxes which are imposed on one group of people, but the ultimate burden will fall on another group of people.
- The impact of tax and incidence of tax are on different people. In case of Indirect taxes tax burden can be shifted.
- There are middlemen between the Government and the tax payer. The important Indirect Taxes are as follows:
 - i) Excise Duty is a tax imposed on the manufacturers as per the value of goods produced but the ultimate burden will fall on the final consumers.
 - ii) Customs Duty is a tax imposed on import and export of Goods. Customs duty may be specific or advalorem. Advalorem duty is a tax imposed on the basis the value of goods imported while specific duty is imposed as per the number of units imported.

- iii) Value Added Tax (VAT) is a part of a sales tax imposed by the state government.
- iv) Sales Tax revenue goes to the state government when sale or purchase takes place within the state. Sales tax revenue on interstate transactions goes to the central government.
- v) Service Tax is tax imposed on services provided. The impact is on the service provider and the incidence of tax falls on the customers. Service tax is the fastest growing tax in India.
- vi) Octroi is a tax levied on transfer of goods from one state to another or from one region to another.

- **(B) Non-Tax Revenue:** These sources of revenue are classified as administrative revenues, commercial revenues and grants and gifts.
- 1) Grants: Grants are made by a higher public authority to a lower one, for example, from the Central to the State government or from the State to the local government. Grants are given so that a public authority is able to perform certain activities at the local level. There is no repayment obligation in case of grants.
- 2) Gifts: Gifts and donations are voluntarily made by individuals, organizations, foreign governments to the funds of the government, e.g. Prime Minister's Relief Fund. Such gifts are usually made at the time of crisis like war or floods. Gifts cannot be considered a regular source of revenue

- 3) Fees: Fees are an important source of administrative non-tax revenue to the government. The government provides certain services and charges, certain fees for them. For example, fees are charged for issuing of passports, granting licenses to telecom companies, driving licenses etc.
- 4) Fines and Penalties: Another source of administrative non-tax revenue includes fines and penalties. They are imposed as a form of punishment for breaking law or non-fulfillment of certain conditions or for failure to observe some regulations. They are not expected to be a major source of revenue to the government.
- 5) Special Assessment: It is a kind of special charge levied on certain members of the community who are beneficiaries of certain government activities or public projects. For example, due to public park in a locality or due to the construction of a road, people in the locality may experience an appreciation in the value of their property or land.

- 6) Surpluses of Public Enterprises: Most countries have government departments and public sector enterprises involved in commercial activities. The surpluses of these departments and enterprises are an important source of non-tax revenue. These revenues are in the form of profits and interests and are termed as commercial revenues.
- 7) Borrowings: When government revenue is not sufficient to meet the public expenditure government borrows either from internal or external sources. Borrowing is income of the government which creates liability because the government has to repay the borrowings with interest.

Objectives of Taxation

- **1. Economic Development:** One of the important objectives of taxation is economic development. Economic development of any country is largely conditioned by the growth of capital formation.
- But LDCs usually suffer from the shortage of capital. To overcome the scarcity of capital, governments of these countries mobilize resources so that a rapid capital accumulation takes place.
- To step up both public and private investment, government taps tax revenues. Through proper tax planning, the ratio of savings to national income can be raised.

- **2. Full Employment:**

Since the level of employment depends on effective demand, a country desirous of achieving the goal of full employment must cut down the rate of taxes.

Consequently, disposable income will rise and, hence, demand for goods and services will rise. Increased demand will stimulate investment leading to a rise in income and employment through the multiplier mechanism.

- **3. Price Stability:** Thirdly, taxation can be used to ensure price stability—a short run objective of taxation.
- Taxes are regarded as an effective means of controlling inflation. By raising the rate of direct taxes, private spending can be controlled.
- Naturally, the pressure on the commodity market is reduced.
- But indirect taxes imposed on commodities fuel inflationary tendencies. High commodity prices, on the one hand, discourage consumption and, on the other hand, encourage saving.
- Opposite effect will occur when taxes are lowered down during deflation.

4. Control of Cyclical Fluctuations:

Fourthly, control of cyclical fluctuations—periods of boom and depression—is considered to be another objective of taxation. During depression, taxes are lowered down while during boom taxes are increased so that cyclical fluctuations are tamed.

5. Reduction of BOP Difficulties: Fifthly, taxes like custom duties are also used to control imports of certain goods with the objective of reducing the intensity of balance of payments difficulties and encouraging domestic production of import substitutes.

6. Non-Revenue Objective: Finally, another extra-revenue or non-revenue objective of taxation is the reduction of inequalities in income and wealth. This can be done by taxing the rich at higher rate than the poor or by introducing a system of progressive taxation.

Canons of Taxation

- Different objectives of taxation often conflict with each other and a balance has to be struck.
- Therefore, usually economists select some important objectives and work out the corresponding principles on which the tax system should be based.
- The first of such principles were developed by Adam Smith.
- There are known as Canons of Taxation. These canons are still regarded as characteristics of a good tax system.
- According to P.E. Talyer, “Taxes are compulsory payments to government without expectation of direct return or benefits to the tax payer”.

- Characteristics of a Tax:
- i) A tax is a compulsory contribution to the State from the.
- ii) The tax imposes a personal obligation. It means that it is the duty of the tax payer to pay it and he should in no case think to evade it.
- iii) The contribution, received from the tax payer, may not be incurred for their benefit alone, but for the general and common benefit.

Canons of Taxation

- 1) **Canon of Equity:** In the words of Adam Smith, “The subjects of every state ought to contribute towards the support of the Government, as nearly as possible, in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of the state”.
- 2) According to the economists, Adam Smith was an advocate of the system of progressive taxation. It implies that the rich should be taxed more and the poor less.

- **2) Canon of Certainty:** According to Adam Smith, the tax which an individual has to pay should be certain, not arbitrary.
- The tax-payer should know in advance how much tax he has to pay, at what time he has to pay the tax, and in which form the tax is to be paid to the government.
- In other words, every tax should satisfy the canon of certainty.
- **3) Canon of Convenience:** According to Canon, every tax should be levied in such a manner and at such a time that it affords the maximum convenience to the tax-payer.
- The reason is that the taxpayer makes a sacrifice at the time of payment of the tax. Hence, the government should see to it that the tax-payer suffers no inconvenience on account of the payment of the tax.

- **4) Canon of Economy:** According to this Canon, the tax should be such as to bring the maximum part of the collected revenue into the government treasury.
- In other words, the cost of tax-collection should be the minimum. If a major portion of the tax proceeds is spent on the collection of the tax itself then such a tax cannot be considered as a good tax.
- **5) Canon of Elasticity:** According to this Canon, every tax imposed by the government should be elastic in nature. In other words, the income from the tax should be capable of increasing or decreasing according to the requirements of the country.
- For example, if the government needs more income at a time of crisis, the tax should be capable of yielding more income through an increase in its rate.

- **6) Canon of Productivity:** According to this Canon, the tax should be of such a nature as to yield sufficient income to the government. If a tax yields poor income, it cannot be considered as a productive tax.
- According to this Canon, it is better to go in for a few productive taxes rather than to impose a large number of unproductive taxes on the people.
- A large number of unproductive taxes create difficulties not only for the people but also for the government because it gets no special increase in income from them.
- **7) Canon of Variety:** According to modern economists , the tax system should contain a large variety of taxes on persons as well as commodities.
- The reason is that if the government levies a single tax, it will become easier for the tax-payers to evade it. But if the government imposes a large variety of taxes, it will be difficult for the people to evade or to avoid them.

- **8) Canon of Simplicity:** According to this Canon, every tax should be simple so that the tax-payer can understand its implications without the help of experts.
- If the tax is complex and complicated, the tax payers will have to seek the assistance of tax experts to understand its implication. Besides a complicated tax also increases the chances of corruption in the country.

- **The tax base** is the total amount of income, property, assets, consumption, transactions, or other economic activity subject to taxation by a tax authority.
- A narrow tax base is inefficient.
- A broad tax base reduces tax administration costs and allows more revenue to be raised at lower rates.

Types of Taxes

- **Proportional Taxes:**

- Taxes in which the rate of tax remains constant, though the tax base changes, are called proportional taxes.
- Here, the tax base may be income, money value of property, wealth, or goods etc. Income is, however, regarded as the main tax base, because it is the determinant of taxable capacity of a person.
- In a proportional tax system, thus, taxes vary in direct proportion to the change in income. If income is doubled, the tax amount is also doubled. This has been illustrated in the schedule below (see Table 1).
- Thus, a proportional tax extracts a constant proportion of rising income.

Table 1
Schedule of Proportional and Progressive Tax Rates

<i>Tax Base (Y)</i> <i>(Rs.)</i>	<i>Proportional</i>		<i>Progressive</i>	
	<i>Tax Rate (R)</i> <i>(Per cent)</i>	<i>Amount of Tax</i> <i>(T) (Rs.)</i>	<i>Tax Rate</i> <i>(R)</i> <i>(Per cent)</i>	<i>Amount of</i> <i>Tax (T)</i> <i>(Rs.)</i>
1,000	10	100	10	100
2,000	10	200	15	300
3,000	10	300	25	750

- **Progressive Taxes:**

- Taxes in which the rate of tax increases are called progressive taxes.
- Thus, in a progressive tax, the amount of tax paid will increase at a higher rate than the increase in tax base or income, for the taxation amount is the product of multiplying the base by the rate and both these increase in a progressive tax.
- Thus, a progressive tax extracts an increasing proportion of rising income.

- **Regressive Taxes:**

- When the rate of tax decreases as the tax base increases, the taxes are called regressive taxes. This has been illustrated in the schedule below

Schedule of Regressive and Digressive Tax Rates

Tax Base (Y) (Rs.)	Regressive		Digressive	
	Tax Rate (R) (Per cent)	Amount of Tax (T) (Rs.)	Tax Rate (R) (Per cent)	Amount of Tax (T) (Rs.)
1,000	10	100	5	50
2,000	8	160	6	120
3,000	6	180	1	210
4,000	5	200	7	280

- It must be noted that in regressive taxation, though the total amount of tax increases on a higher income in the absolute sense, in the relative sense, the tax rate declines on a higher income.
- As such, relatively a heavier burden (sacrifice involved) falls upon the poor than on the rich.
- Generally, taxes on necessities are regressive as they take away a greater percentage of lower incomes as compared to higher incomes.
- **Digressive Taxes:**
 - Taxes which are mildly progressive, hence not very steep, so that high income earners do not make a due sacrifice on the basis of equity, are called digressive. In digressive taxation, a tax may be progressive up to a certain limit; after that it may be charged at a flat rate.
 - In digressive taxation, thus, the tax payable increases only at a diminishing rate.

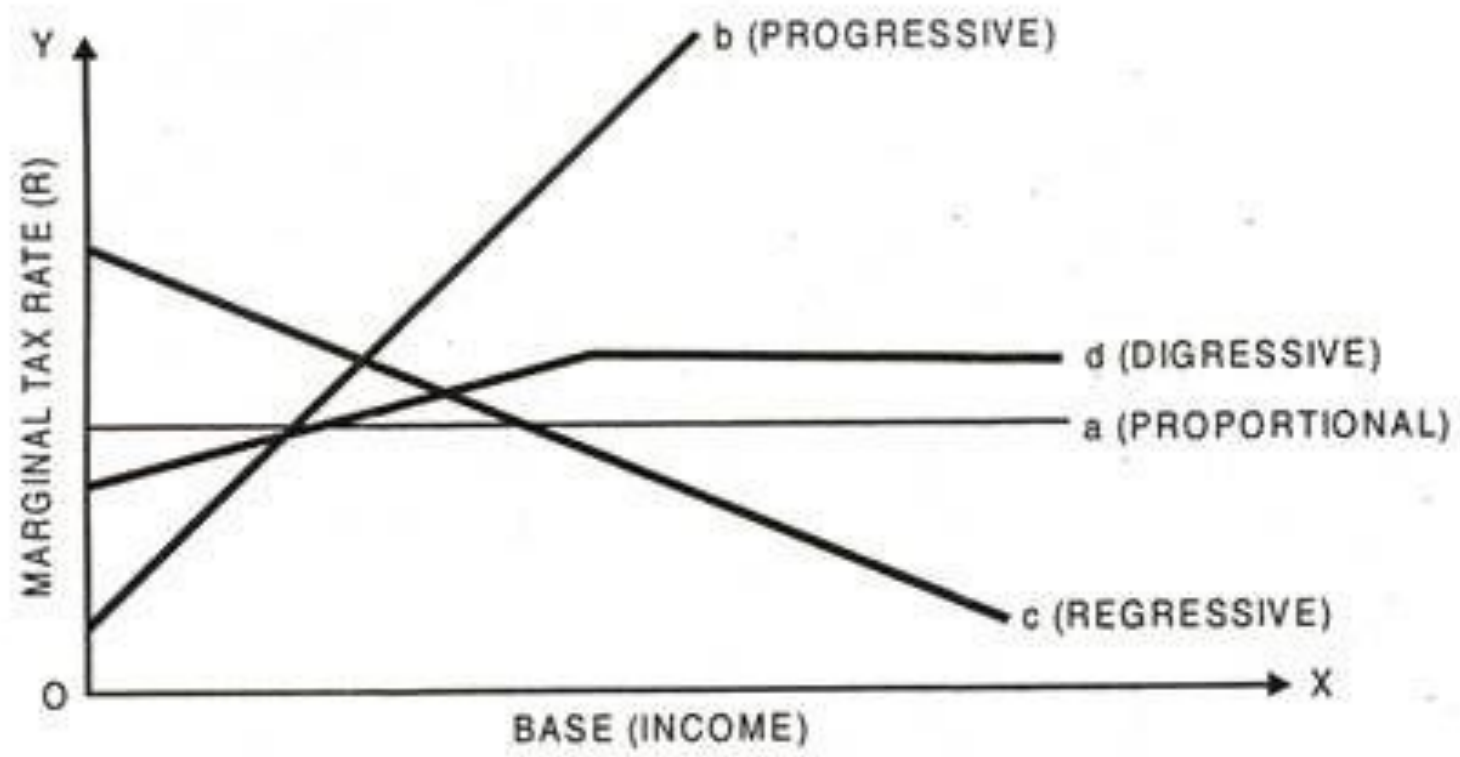


Fig. 1. Different Tax Rates.

Taxable Capacity

- Taxable Capacity refers to the maximum capacity of the people of a country to bear the burden of taxation without much hardship.
- It is nothing but the maximum limit that a government can tax the people.
- If the government exceeds this red signal, namely the maximum limit, it will result in over-taxation.

- **Taxable capacity has two interpretations:**
 - (i) Absolute taxable capacity; and
 - (ii) Relative taxable capacity.

- **The absolute taxable capacity** refers to the maximum tax paying capacity of the economy or country as a whole, or a region, or an industry, or a group of individuals.
- **Relative taxable capacity** refers to the comparison between the absolute taxable capacity of different tax payers, or industries or groups of tax-payers. Here, the concept of ability to pay comes into the picture.
- E.g. Section A may have double the ability to pay than Section B, then A's relative taxable capacity is twice that of the absolute taxable capacity of B.
- Indeed, it is very difficult to measure absolute taxable capacity. There is no specific standard to measure it.

Factors Influencing Taxable Capacity

- **1. Psychology of tax payers**

- If the people are prepared to make greater sacrifices, then taxable capacity is said to have increased. In times of war, the people are made to pay more taxes. People are generally optimistic during the period of prosperity and they are prepared to pay more taxes.

- **2. Distribution of Wealth**

- It is distributed equally, the taxable capacity becomes limited. If it is concentrated with few people, then they can be made to shoulder heavy burden of paying taxes.

- **3. Nature of taxation**

- If the tax system is scientifically framed, the taxable capacity increases. If the tax system produces adverse effects on the productive capacity of the people, this will reduce the taxable capacity.

- **4. Purpose of taxation**

- If the purpose of taxation is to raise resources to bring about economic development [in agricultural, industrial and infrastructural development], people of the country are willing to pay taxes. In contrast, if it spends huge money for stock piling and ammunition and war overheads, this will inevitably reduce the taxable capacity of the people.

- **5. Level of economic development**

- The taxable capacity of the people is determined by level of economic development of the country. Highly developed countries have greater taxable capacity than the poor countries.

- **6. Political conditions**

- It depends on political stability and internal prosperity. If there is peace inside and outside country, there will be encouraging atmosphere for expanded economic activity, which will in turn increase the taxable capacity.

- **7. Population**

- It depends on the size and rate of growth of population. If population increases at a faster rate than the national income rate, the taxable capacity becomes poorer.

- **8. Size of National Income**

- The taxable capacity of any community will depend upon the size of national income which itself will depend upon such factors as the volume of natural and other resources, the degree of utilization of resources, the state of technology, and so on. The richer a community, the higher is its capacity to pay taxes.

- **The impact of a tax:** It is on the person on whom it is imposed first. Thus, the person who is liable to pay the tax to the government bears its impact.
- **The incidence of taxation** refers to the location of the ultimate or the direct money burden of the tax as such.
- It signifies the settlement of the tax burden on the ultimate tax payer.
- Incidence emerges when the tax finally settles or comes to rest on the person who bears it.
- It, in fact, is the ultimate result of shifting.
- Hence, the incidence of a tax is upon that person who cannot shift the burden any further, so he has to himself bear the direct money burden of the tax.

Thus,

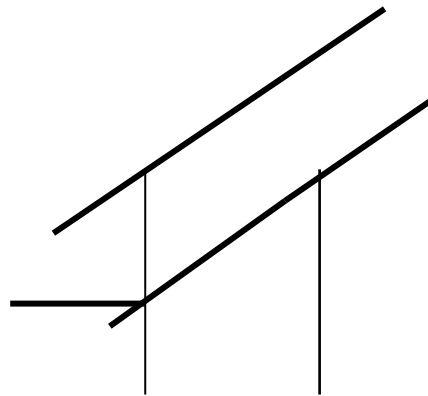
1. Impact refers to the initial burden of the tax, while incidence refers to the ultimate burden of the tax.
2. Impact is at the point of imposition, incidence occurs at the point of settlement.
3. The impact of a tax falls upon the person from whom the tax is collected and the incidence rests on the person who pays it eventually.
4. Impact may be shifted but incidence cannot. For, incidence is the end of the shifting process. Sometimes, however, when no shifting is possible, as in the case of income tax or such other direct taxes, the impact coincides with incidence on the same person.

Shifting of Tax Burden

- It refers to passing on the money burden of taxation to some other person.
- The shifting is possible through the process of exchange, i.e. through the act of buying and selling.
- It is of two kind:
 1. Forward shifting: Burden is shifted from producer to consumer in the form of rise in price of the commodity. E.g. Excise duty
 2. Backward shifting: Here, burden is shifted to the owners of factors of production. E.g. Labour is forced to accept lower wages.
 3. Combination of both
 4. Single point and multi-point shifting

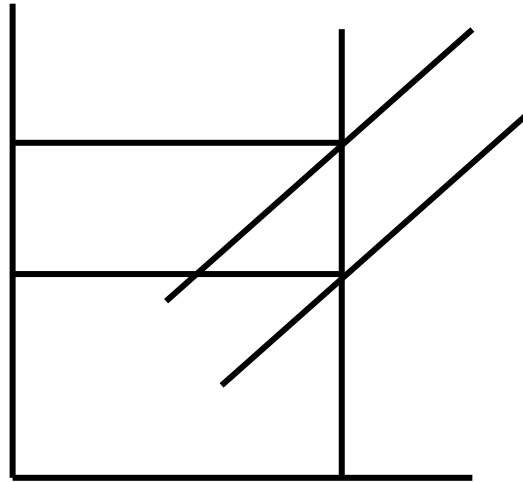
Factors influencing Incidence of Taxation

- 1. Elasticity of Demand:
- Perfectly elastic demand:



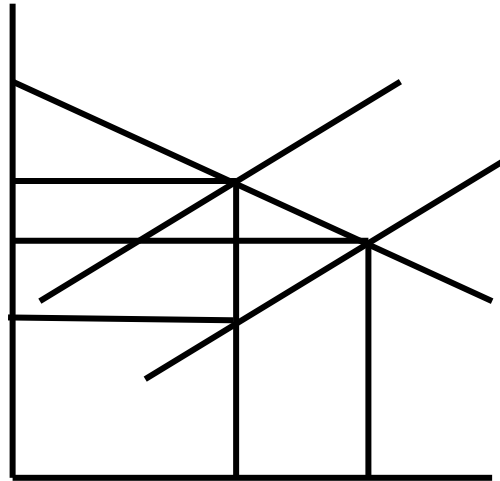
Here, tax rate = TE1
Entire tax burden is borne
by the seller.

- Perfectly inelastic demand:



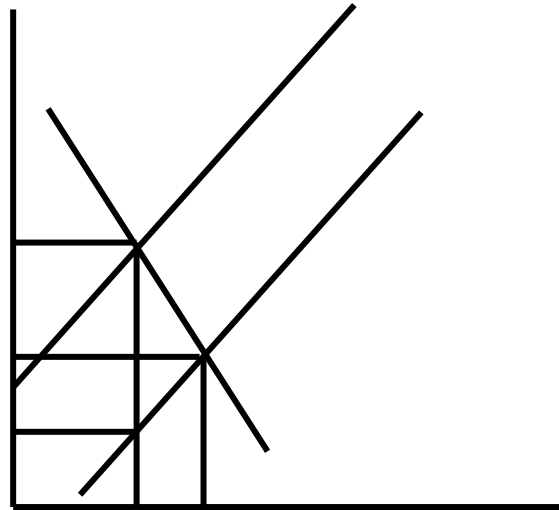
- Here, Tax rate = EE1. Entire burden of tax is borne by the consumer.

- Relatively elastic demand:



More burden is borne by the seller and lesser is borne by the buyer.

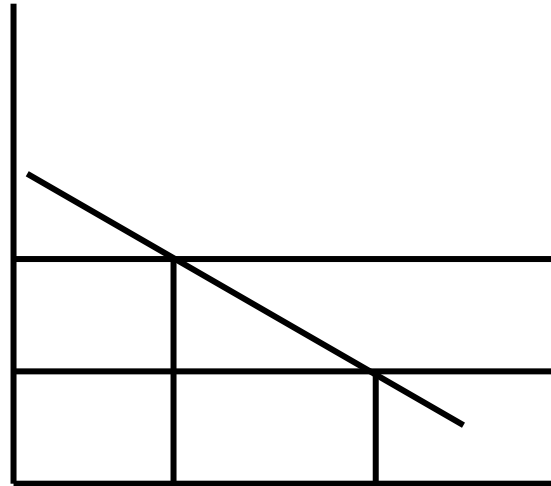
- Relatively inelastic demand:



When tax is imposed, more burden falls on the buyer than the seller.

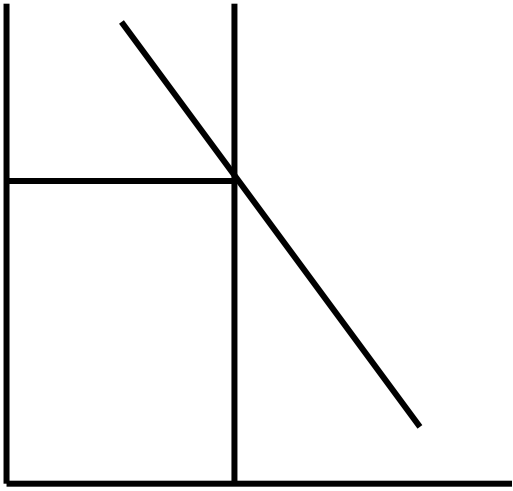
- Elasticity of Supply:

1. Perfectly elastic supply:

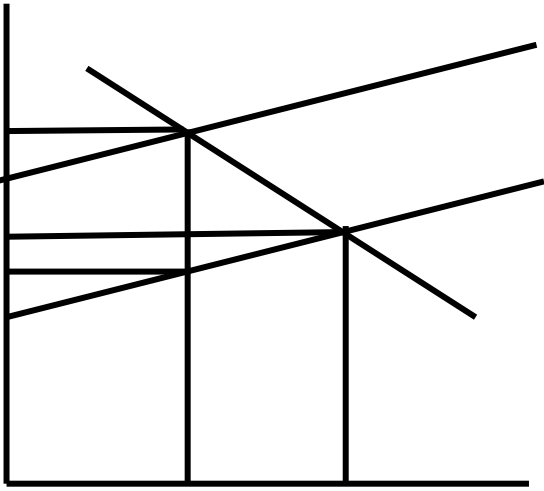


Entire burden falls on the buyer.

2. Perfectly inelastic supply:
Here, entire burden falls on the seller.

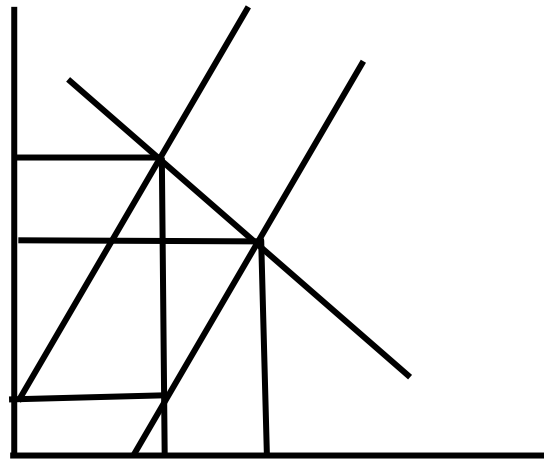


3. Relatively elastic supply:



Here, more burden falls on the buyer.

- 3. Relatively inelastic supply:

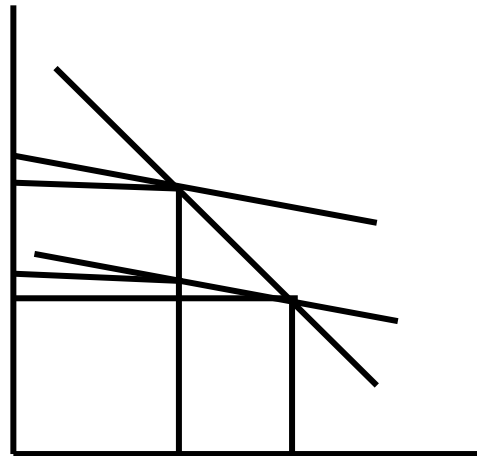


- Here, more burden falls on the seller.
- **In case of unit elastic demand and supply, equal (50%-50%) burden will be shared by the producer and the consumer.**

- Cost conditions:

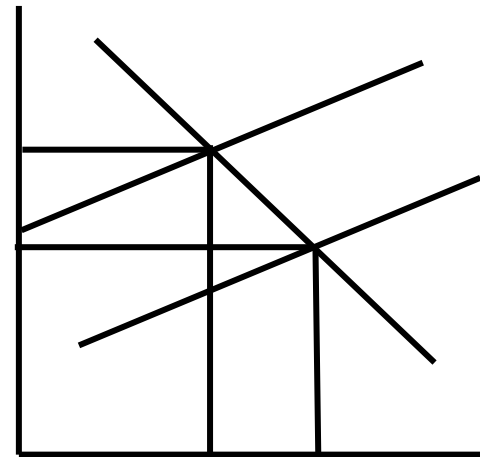
1. Decreasing cost:

More burden on buyer, than on seller.



2. Constant cost: Entire burden falls on the consumers.

3. Increasing cost: More burden on seller.



Effects of Taxation

- Effects on income and wealth:
 - Progressive tax: reduces income inequality
 - Regressive tax: increases inequalities
- Effect on Consumption:
 - Income effect of taxation: Fall in purchasing power or real income of the consumers
 - Substitution or price effect of taxation: consumers are forced to consumed un-taxed commodities or reduce quantity of consumption, which leads to fall in welfare. This is excess burden of taxation.
 - Effects during inflation and deflation
 - Regulatory effects on consumption of sin goods.

- Effects on savings, investment and production
 - Effect on **ability** to work, save an invest
 - Effect on **willingness** to work, save an invest – Money burden and psychological burden of tax
- Effect on resource allocation: production of necessary goods can be encouraged and harmful goods can be discouraged.
- Redistributive effects
- Anti-inflationary nature of taxation

