

Dr.V S KRISHNA GOVT DEGREE & P.G. COLLEGE (A)
NAAC ACCREDITED 'A' GRADE INSTITUTION
NODAL RESOURCE CENTRE
MADDILAPALEM, VISAKHAPATNAM – 530013, ANDHRA PRADESH



**VALUE ADDED COURSE on
INDIAN PUBLIC FINANCE**



**DEPARTMENT OF ECONOMICS
ACADEMIC YEAR 2022-23**

2022-23

Department of Economics started
Add-on course on Indian Public
Finance on 01-02-2023.

Duration of the course: 45 Days.

Start Date: 1-2-2023

End Date: 1-4-2023

No. of students enrolled: 35

Dr. Lalitani
course coordinator

G. V. S. S. S.
PRINCIPAL

Syllabus of Value Added Course on Indian Public Finance

About the Course:

The course was started by the Department of Economics of Dr. V.S. Krishna Govt. Degree College (A) from the Academic Year 2021-22 for the U.G. students to enhance the knowledge regarding various current issues of Indian Public Finance.

Objectives of the Course:

1. To understand the Economics of Government expenditure and taxation.
2. To critically analyse the fiscal policies and its implication in Indian Economy.
3. To understand the various types of Budgets and types of Budget deficits and their significance.
4. To critically analyse the criteria of vertical and horizontal devolution of Finance Commission.
5. To understand the nature of Indian taxation system.

Outcomes of the Course: At the end of the of Course the students are expected to have the following abilities.

Co1: To have conceptual clarity of Public expenditure and revenue.

Co2: To analyse various Government fiscal policies

Co3: To analyse the changing pattern of central state financial relations

Co4. To understand the recent and current issues regarding Indian Public Finance.

Syllabus:

Module 1: Budget – Definition – Types of Budget - Components of Budget – Revenue Receipts and Capital Receipts – Revenue Expenditure and Capital Expenditure – Recent Union Budget.

Module 2: Deficit Financing – Types of Budget Deficit – FRBM act-2003.

Module 3: Taxation – Types of taxes – Proportional Tax – Progressive Tax – Regressive Tax – Direct and Indirect Taxes – Recent Trends in the Direct and Indirect taxes in India.

Module 4: Fiscal Policy in India – Objectives - Expansionary, Contractionary and Neutral Fiscal Policy.

Module 5: Financial Relations under the Constitution – Evaluation of first 14 Finance Commissions – Recommendations of 15th Finance commission.

MODEL CERTIFICATE

 **Dr. V. S. Krishna Govt. Degree College (A)** 
(NAAC ACCREDITED 'A' GRADE INSTITUTION & NODAL RESOURCE CENTRE)
MADDILAPALEM, VISAKHAPATNAM-530013. ANDHRA PRADESH

Value Added Course Certificate

202... to 202...

This is to certify that Mr./Miss.....of
.....has successfully completed the Value Added Course in.....
with Regd No.....Organized by the Department of.....in
collaboration with.....during year 202..... to 202..... He/She has passed the course with
.....grade.

Academic Coordinator **IQAC Coordinator** **Course Coordinator**  **PRINCIPAL**
Dr. V.S. Krishna Govt. Degree College(A)

STUDY MATERIAL

INTRODUCTION

- Public finance is the management of a country's revenue, expenditures, and debt through various Government, quasi-government institutions, policies, and tools.
- Components of public finance: public expenditure + public revenue + financial scrutiny + fiscal policy + financial administration + public borrowing.]

Annual Financial Statement (Budget): Art 112

- The term budget is nowhere used in the Constitution.
- Budget is referred to as Annual Financial Statement in the constitution under 112.
- Rail Budget was separated from the General Budget on the recommendations of the Acworth Committee in 1924.
- However, was merged again in 2017.
- The Budget is a statement of the Government estimated receipts and expenditure in a financial year starting from APRIL 1 and ending on 31 MARCH.
- Those receipts and expenditure that relate to the current financial year only are included in the revenue account (also called revenue budget) and
- Those that concern the assets and liabilities of the government into the capital account (also called capital budget).

Budget

Introduction- Budget is an Annual Financial Statement of yearly estimated receipts and expenditures of the government in respect of every financial year.

Budgeting is the process of estimating the availability of resources and then allocating them to various activities according to a pre-determined priority.

Budgets act as instruments of control and act as a benchmark to evaluate the progress of various departments.

In simple words, "budget is the yearly financial description and the estimate for the expenditure and revenue of coming years".

Prof. Dalton's thought is that." The normal thought of balanced budget is that there is a gain in the income in a time period or it is not less in comparison of expenditure."

In Prof. Taylor's words, " Budget is the most important financial plan of the government. Budget, presents combine the sured income and proposed expenditure's estimate for budget year."

Objectives of Budget:

On the basis of budget, attempts have been made to achieve many targets. Following are the main objectives:

(1) Prepare budget structure for policy. For this, to achieve the targets, the work that will have to be done, takes the decision regarding this. This decision is to be taken that from different competition optional proposals which one is to be choose so that, main national targets can be obtained. It is to be decided that can many targets be achieved combine.

(2) Budget is a medium to implement a policy. Here standard of work capacity and thriftiness has been implemented, means they try to get policy making regarding decisions on minimum estimate. (3) Budget is a medium of implementation. All decisions regarding budget take a form of act. The reason to pressurise the law control is to stop the misuse of rights and to save public fund from misuses.

(4) Budget documents can be sources of providing information about the coming possibilities, activities of past, present decisions and future possibilities budget process provide offers for legislatives and executives that they can tell us the appropriateness of their decisions and functions.

Components of Government

Budget The budget comprises of the (A)Revenue Budget (B) Capital Budget

(A) Revenue Budget

The Revenue Budget shows the current receipts of the government and the expenditure that can be met from these receipts.

Revenue receipts

Revenue receipts are divided into tax and non-tax revenues.

Tax revenues -Tax revenues consist of the proceeds of taxes and other duties levied by the central government. Tax revenues, an important component of revenue receipts, comprise of Direct taxes – which fall directly on individuals (personal income tax) and firms (corporation tax), Indirect taxes like excise taxes (duties levied on goods produced within the country), customs duties (taxes imposed on goods imported into and exported out of India) and service tax.

Non-tax revenue of the central government mainly consists of Interest receipts (on account of loans by the central government which constitutes the single largest item of non-tax revenue)

- Dividends and profits on investments made by the government

- Fees and other receipts for services rendered by the government.
- Cash grants-in-aid from foreign countries and international organizations are also included

The estimates of revenue receipts take into account the effects of tax proposals made in the Finance Bill. A Finance Bill, presented along with the Annual Financial Statement, provides details of the imposition, abolition, remission, alteration or regulation of taxes proposed in the Budget.

Revenue Expenditure:

Revenue expenditure consists of all those expenditures of the government which do not result in creation of physical or financial assets. It relates to those expenses incurred for the normal functioning of the government departments and various services, interest payments on debt incurred by the government, and grants given to state governments and other parties (even though some of the grants may be meant for creation of assets).

Budget documents classify total revenue expenditure into Plan and Non-plan expenditure

Plan revenue expenditure - Plan revenue expenditure relates to central Plans (the Five-Year Plans) and central assistance for State and Union Territory Plans.

Non-plan expenditure- Non-plan expenditure, the more important component of revenue expenditure, covers a vast range of general, economic and social services of the government. The main items of non-plan expenditure are interest payments, defence services, subsidies, salaries and pensions. Interest payments on market loans, external loans and from various reserve funds constitute the single largest component of non-plan revenue expenditure. They used up 41.5 per cent of revenue receipts in 2004-05. Defence expenditure, the second largest component of non-plan expenditure, is committed expenditure in the sense that given the national security concerns, there exists a little scope for drastic reduction. Subsidies are an important policy instrument which aim at increasing welfare. Apart from providing implicit subsidies through under-pricing of public goods and services like education and health, the government also extends subsidies explicitly on items such as exports, interest on loans, food and fertilizers.

B. The Capital Budget

The Capital Budget is an account of the assets as well as liabilities of the central government, which takes into consideration changes in capital. It consists of capital receipts and capital expenditure of the government. This shows the capital requirements of the government and the pattern of their financing.

capital Receipts

The main items of capital receipts are loans raised by the government from the public which are called market borrowings, borrowing by the government from the Reserve Bank and commercial banks and other financial institutions through the sale of treasury bills, loans received from foreign governments and international organizations, and recoveries of loans granted by the central government.

Other items include

small savings (Post-Office Savings Accounts, National Savings Certificates, etc.),

provident funds and

net receipts obtained from the sale of shares in Public Sector Undertakings (PSUs).

Capital Expenditure

This includes expenditure on the acquisition of land, building, machinery, equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties.

Capital expenditure is also categorized as plan and non-plan in the budget documents.

Plan capital expenditure, - Plan capital expenditure, like its revenue counterpart, relates to central plan and central assistance for state and union territory plans. Non-plan capital expenditure- Non- plan capital expenditure covers various general, social and economic services provided by the government.

- In the Union Budget, the disbursements and receipts of the government comprise the various **types of government funds** in India namely, the Consolidated Fund of India, the Contingency Fund and the Public Account.
- The **Economic Survey of India** will be released ahead of the presentation of the Budget.

The Union Budget 2022-23 seeks to complement macro-economic level growth with a focus on micro-economic level all-inclusive welfare. The budget aims to lay a strong foundation to steer the Indian economy towards Amrit Kaal for the next 25 years, from India at 75 years to India at 100.

Union Budget 2022 focusses on 4 pillars:

1. PM GatiShakti
2. Inclusive Development
3. Productivity Enhancement & Investment, Sunrise Opportunities, Energy Transition, and Climate Action
4. Financing of Investments

Module 2

A budgetary deficit is referred to as the situation in which the spending is more than the income. Although it is mostly used for governments, this can also be broadly applied to individuals and businesses.

In other words, a budgetary deficit is said to have taken place when the individual, government, or business budgets have more spending than the income that they can generate as revenue.

Types of Budget Deficits

There are three types of budget deficit. They are explained follows:

1. Fiscal deficit
2. Revenue deficit
3. Primary deficit

Fiscal Deficit

Fiscal deficit is defined as the excess of total expenditures over the total receipts, excluding the borrowings in a year. In other words, this can be defined as the amount that the government needs to borrow in order to meet all expenses.

The more the fiscal deficit, the more will be the amount borrowed. Fiscal deficit helps in understanding the shortfall that the government faces while paying for the expenditures in the absence of lack of funds.

The formula for calculating fiscal deficit is as follows:

Fiscal deficit = Total expenditures – Total receipts excluding borrowings

Impact of Fiscal Deficit

The following impacts of fiscal deficit should be kept in mind.

1. Unnecessary expenditure: A high fiscal deficit leads to unnecessary expenditure done by the government that leads to potential inflationary pressure on the economy.
2. Printing more currency by RBI for meeting the deficit, also known as deficit financing, leads to the availability of more money in the market, leading to inflation.
3. Borrowing more will hinder the future growth of the economy, as most of the revenue will be utilised towards meeting debt payments.

Remedial Measures for Fiscal Deficit

Fiscal deficit can be reduced by the following ways:

1. Reduced public expenditure
2. Reduction in bonus, leave encashments, and subsidies
3. Increase tax to generate revenue
4. Disinvestment of public sector units

Revenue Deficit

Revenue expenditure is defined as the excess of total revenue expenditure over the total revenue receipts. In other words, the shortfall of revenue receipts as compared to that of the revenue expenditure is known as revenue deficit.

Revenue deficit signals to the economists that the revenue earned by the government is insufficient to meet the requirements of the expenditures required for the essential government functions.

The formula for revenue deficit can be expressed as follows:

Revenue deficit = Total revenue expenditure – Total revenue receipts

Impact of Revenue Deficit

Revenue deficit has the following impacts on the economy.

1. Reduction in assets: For meeting the shortfall in the form of revenue deficit, the government has to sell some assets.
2. It leads to the conditions of inflation in the economy.
3. A large amount of borrowing leads to a greater debt burden on the economy.

Remedial Measures for Revenue Deficit

The following remedial measures can be taken by the government in reducing the revenue deficit.

1. By reducing unnecessary spending
2. By raising the rate of taxes and applying new taxes wherever possible

Primary Deficit

Primary deficit is said to be the fiscal deficit of the current year subtracted by the interest payments that are pending on previous borrowings. In other words, the primary deficit is the requirement of borrowing without the interest payment.

Primary deficit, therefore, shows the expenses that government borrowings are going to fulfil while not paying for the income interest payment.

A zero deficit shows that there is a requirement for availing credit or borrowing for clearing the interest payments pending.

The formula for the primary deficit is expressed as follows:

Primary deficit = Fiscal deficit – Interest payments

Measures to reduce the primary deficit can be similar to the steps taken to reduce the fiscal deficit as the primary deficit is any borrowings that are above the existing deficit or borrowings.

FRBM Act – Guidelines, Targets, and Escape Clause

The FRBM Act was passed by the Parliament of India in 2003 to reduce Fiscal Deficit.

Every time when the Union Budget of India is presented, the term FRBM is seen in the news.

You may see headlines like 'FRBM targets are missed' or 'FRBM targets are met'. What exactly is FRBM? What is the significance of FRBM with respect to Indian economy?

The FRBM Act is a law enacted by the Government of India in 2003 to ensure fiscal discipline – by setting targets including reduction of fiscal deficits and elimination of revenue deficit.

It is considered as one of the major legal steps taken in the direction of fiscal consolidation in India.

What is the full form of FRBM?

The full form of FRBM is Fiscal Responsibility and Budget Management.

Why was the FRBM Act enacted?

In India, the borrowing levels were very high in the 1990s and 2000s. [Indian Economy](#) was weak as it had high Fiscal Deficit, high Revenue Deficit, and high Debt-to-GDP ratio.

By 2003, the continuous government borrowing and the resultant debt had severely impacted the health of the Indian economy. Much of the borrowing was utilized for interest payments of previous borrowings, but not for productive-purposes. This resulted in interest payments becoming the largest expenditure item of the government.

Many economists then warned the government that this condition is not sustainable. They advised legal steps to prevent India to fall into a debt-trap.

Parliamentarians of India too felt that there should be control on the government of India not to resort to a high level of borrowing to fund its expenditure. Hence in 2000, they introduced a bill to bring responsibility and discipline in matters of expenditure and debt. This bill was passed by the [Indian Parliament](#) in 2003 and came to be known as the Fiscal Responsibility and Budget Management Act.

The Fiscal Responsibility and Budget Management (FRBM) Act, 2003

The Fiscal Responsibility and Budget Management Bill (FRBM Bill) was introduced in India by the then Finance Minister of India, Mr. Yashwant Sinha in December 2000. The provisions provided in the initial versions of the bill were too drastic. After much discussions, a watered-down version of the bill was passed in 2003 to become the FRBM Act. The FRBM Rules came into force from July 5, 2004.

What is the FRBM Act all about?

FRBM Act is all about maintaining a balance between Government revenue and government expenditure.

The intention of the Fiscal Responsibility and Budget Management Act was to bring –

- fiscal discipline.
- efficient management of expenditure, revenue and debt.
- macroeconomic stability.
- better coordination between fiscal and [monetary policy](#).
- transparency in the fiscal operation of the Government.
- achieving a balanced budget.

Objectives of the FRBM Act

The main objectives of the act were:

1. to introduce transparent fiscal management systems in the country.
2. to introduce a more equitable and manageable distribution of the country's debts over the years.
3. to aim for fiscal stability for India in the long run

Additionally, the act was expected to give the necessary flexibility to Reserve Bank of India (RBI) for managing inflation in India.

Provisions of the Fiscal Responsibility and Budget Management Act

The FRBM rules mandate four fiscal indicators to be projected in the medium-term fiscal policy statement. These are:

1. revenue deficit as a percentage of GDP
2. fiscal deficit as a percentage of GDP.
3. tax revenue as a percentage of GDP.
4. total outstanding liabilities as a percentage of GDP.

The FRBM Act set targets for fiscal deficit and revenue deficit.

The FRBM act also provided for certain documents to be tabled in the Parliament of India, along with Budget, annually with regards to the country's fiscal policy. This included the *Medium-term Fiscal Policy Statement, Fiscal Policy Strategy Statement, Macro-economic Framework Statement, and Medium-term Expenditure Framework Statement*. For details check the details of the [budget documents](#).

Initial FRBM Targets (to be met by 2008-09)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2009. The minimum annual reduction target was 0.5% of GDP.
2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2009. The minimum annual reduction target was 0.3% of GDP.
3. Contingent Liabilities – The Central Government shall not give incremental guarantees aggregating an amount exceeding 0.5 per cent of GDP in any financial year beginning 2004-05.
4. Additional Liabilities – Additional liabilities (including external debt at current exchange rate) should be reduced to 9% of the GDP by 2004-05. The minimum annual reduction target in each subsequent year to be 1% of GDP.
5. RBI purchase of government bonds – to cease from 1 April 2006. This indicates the government not to borrow directly from the RBI.

Did the government meet the FRBM targets by March 2009?

No. Implementing the act, the government had managed to cut the fiscal deficit to 2.7% of GDP and revenue deficit to 1.1% of GDP in 2007–08. However, the targets were not met.

The global financial crisis (2007-08) led the government to infuse resources in the economy as the fiscal stimulus in 2008. Therefore, fiscal targets had to be postponed temporarily in view of the global crisis.

Amendments in the FRBM Act

In 2012 and 2015, notable amendments were made, resulting in relaxation of target realisation year.

A new concept called Effective Revenue Deficit (E.R.D) was also introduced.

The requirement of 'Medium Term Expenditure Framework Statement' was also added via amendment in FRBMA.

FRBM Targets after Amendment to FRBM Act in 2012 (to be achieved by 2015)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2015. The minimum annual reduction target was 0.5% of GDP.

2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2015. The minimum annual reduction target was 0.3% of GDP.

FRBM Targets after Amendment to FRBM Act in 2015 (to be achieved by 2018)

1. Revenue Deficit Target – revenue deficit should be completely eliminated by March 31, 2018. The minimum annual reduction target was 0.5% of GDP.
2. Fiscal Deficit Target – fiscal deficit should be reduced to 3% of GDP by March 31, 2018. The minimum annual reduction target was 0.3% of GDP.

FRBM Review Committee headed by NK Singh: Recommendations

The government believed the targets were too rigid.

In May 2016, the government set up a [committee under NK Singh](#) to review the FRBM Act. The committee recommended that the government should target a fiscal deficit of 3 per cent of the GDP in years up to March 31, 2020, cut it to 2.8 per cent in 2020-21 and to 2.5 per cent by 2023.

The Committee suggested using debt as the primary target for fiscal policy. This ratio was 70% in 2017.

These are the targets set by NK Singh:

1. Debt to GDP ratio: The review committee advocated for a Debt to GDP ratio of 60% to be targeted with a 40% limit for the centre and 20% limit for the states.
2. Revenue Deficit Target – revenue deficit should be reduced to 0.8% of GDP by March 31, 2023. The minimum annual reduction target was 0.5% of GDP.
3. Fiscal Deficit Target – fiscal deficit should be reduced to 2.5% of GDP by March 31, 2023. The minimum annual reduction target was 0.3% of GDP.

Latest FRBM Targets

The latest provisions of the FRBM act requires the government to limit the fiscal deficit to 3% of the GDP by March 31, 2021, and the debt of the central government to 40% of the GDP by 2024-25, among others.

The Act provides room for deviation from the annual fiscal deficit target under certain conditions.

Escape Clause in the FRBM Act

Escape clause refers to the situation under which the central government can flexibly follow fiscal deficit target during special circumstances. This terminology was innovated by the NK Singh Committee on FRBM.

In Budget 2017, Finance Minister Arun Jaitley deferred the fiscal deficit target of 3% of the GDP and chose a target of 3.2%, citing the NK Singh committee report.

However, the Comptroller and Auditor General of India (CAG) pulled up the government for deferring the targets which it said should have been done through amending the Act.

In 2018, the FRBM Act was further amended. Specific details were updated in sub-section (2) of Section 4. The clause allows the govt to relax the fiscal deficit target for up to 50 basis points or 0.5 per cent. Under FRBM, if the escape clause is triggered to allow for a breach of fiscal deficit target, the RBI is then allowed to participate directly in the primary auction of government bonds, thus formalising deficit financing.

The Escape Clauses can be invoked:

- by the Government after formal consultations and advice of the Fiscal Council.
- with a clear commitment to return to the original fiscal target in the coming fiscal year.

In 2020, Finance Minister, Nirmala Sitharaman used the escape clause provided under the FRBM Act to allow the relaxation of the target. Finance Minister revised the fiscal deficit for FY20 to 3.8 per cent and pegged the target for FY21 to 3.5 per cent.

Note: The Act exempts the government from following the FRBM guidelines in case of war or calamity.

What if there is no Fiscal Discipline?

If there is no fiscal discipline, the government (executive) may spend as it wishes.

A country is just like a house; if the expenditure is too much and if there is no revenue to balance the high expenditure, the country will eventually fall into a debt trap, which may finally result in its collapse.

Conclusion

The FRBM Act seeks to achieve long-term macroeconomic stability, while generating budget surpluses, prudential debt management, limiting borrowings to cut down deficits and debt, greater transparency, removal of fiscal impediments and providing a medium-term framework for budgetary implementation.

As seen in the above analysis, different governments have failed to achieve the FRBM targets set to be achieved in 2008 even by 2020.

Though the Act aims to achieve deficit reductions prima facie, an important objective is to achieve inter-generational equity in fiscal management. This is because when there are high borrowings today, it should be repaid by the future generation. But the benefit from high expenditure and debt today goes to the present generation.

Achieving FRBM targets thus ensures inter-generation equity by reducing the debt burden of the future generation.

Fiscal Deficit 2022

The country's fiscal deficit is projected to be higher at 6.9 per cent this fiscal year as against 6.8 per cent estimated earlier, with Finance Minister Nirmala Sitharaman emphasising the need for stronger and sustainable growth through public investment. The marginal rise in fiscal deficit for the current fiscal is against the expectations of the market and experts who expected a slight decline in the numbers on the back rising tax collections.

MODULE 3

A proportional tax is a type of income tax in which everyone pays the same percentage tax, regardless of their income. Low, middle, and high-income taxpayers all pay the same percentage of tax. Flat taxes are another name for proportional taxes. GST is an example of proportional tax where everyone pays the same tax irrespective of the income group.

Proportional Tax

What is Proportional Tax?

- A proportional tax is one in which the tax rate stays proportional regardless of the taxpayer's income level.
- In this case, the individual's tax liability is not proportional to his income.
- Examples of progressive, regressive, and proportional taxes in the table

Taxable income (Rs)	Progressive tax (rate)	Regressive tax (rate)	Proportional tax (rate)
10000	10%	30%	20%
30000	20%	20%	20%
50000	30%	10%	20%
Example	Income Tax	Sales Tax	GST

- People are taxed at the same percentage of their annual income when they pay a proportional tax.
- Supporters of a proportional tax system argue that it encourages taxpayers to earn more by not penalizing them with a higher tax bracket.
- Flat tax systems also make filing simpler. Flat tax critics contend that the system unfairly burdens low-wage earners in exchange for reduced tax rates for the wealthy.

- However, critics argue that a progressive tax system is more equitable than a flat tax structure.

Example of Proportional Tax

- All taxpayers under a proportional tax system must pay the same percentage of their income in taxes. If the rate is set at 20%, a taxpayer earning Rs.100,000 will pay Rs.2,000, while a taxpayer making Rs.50,000 will pay Rs.10,000. Similarly, a millionaire would pay Rs.200,000 in taxes.
- In India, GST is an example of proportional tax. Everyone having food in an A/C restaurant pays a GST of 5% irrespective of the income levels or the bill amount.

Advantages

Advantages of Proportional Tax

- The first and most important advantage of proportional tax is that because everyone pays the same rate of tax, there is no ambiguity about the rate of taxation, which leads to clarity in the minds of both taxpayers and tax collectors.
- When it comes to taxes, the majority of people do not understand the tax rates because there are many slabs and exemptions associated with those slabs, so having clarity about the rate of taxation makes life easier for taxpayers.
- Another advantage of proportional tax is that it reduces tax evasion by the wealthy because when tax rates are high for the wealthy and low for the middle and poor, the wealthy will try every trick in the book to avoid paying taxes, and thus proportional tax results in less tax leakage from the system.
- Another advantage of proportional tax is that it is simple to understand for both tax authorities and tax payers, resulting in improved implementation by tax authorities and acceptance by taxpayers.

Disadvantages

Disadvantages of Proportional Tax

- The most significant disadvantage of proportional taxation is that a large segment of society, namely the middle and lower classes, feel cheated because they believe that those who have more money should pay more tax and those who have less money should pay less tax, but because this system keeps tax rates the same for everyone, there is frustration and anger among the majority of people in the country, as middle- and lower-class people make up 99 percent of the population.
- Another disadvantage of proportional taxation is that because rich and poor people are taxed at the same rate, it creates a huge disparity between them, which can lead to resentment, frustration, and, in the worst-case scenario, a revolt by the middle and lower classes against the country's affluent people and government.
- Another disadvantage of proportional tax is that the government obtains less income than under other tax systems because the tax rate must be kept low to please the poor and middle class, which leads to a lower tax rate for the wealthy, resulting in a loss of revenue for the country's government.

Conclusion

The goal of proportional taxation is to achieve more parity between marginal and average tax rates. Because there is no tax penalty for earning more, proponents of proportional taxes think they stimulate the economy by encouraging people to spend more and work more.

Progressive tax

Progressive tax is the one where the tax rate increases with the taxpayer's income. The correct interpretation is that the tax liability for a taxpayer increases with his income in terms of proportion of income and in absolute amount.

Progressive and regressive tax

A *progressive tax* is a tax where the tax rate increases with increase in the taxpayer's income. Here, individual who get high income pay higher proportion of there income as tax. On the other hand, in the case of regressive tax, tax rate decreases with increase in income.

Tax burden of the taxpayer also goes up when the tax is progressive.

An example for progressive taxation is: 10% tax rate for income of Rs 2 lakh, 20% for Rs 5 lakh and 30% for Rs 10 lakh. Here, the tax liability or the absolute amount as well as the proportion of income to be paid as tax increases with income of the taxpayer.

Example for progressive tax

Income Slab	Tax rate
Rs 2.5 lakh to Rs 5 lakh	5%
Rs 5 lakh to Rs 10 lakh	20%
Above Rs 10 lakh	30%

Ideally, the tax system should be progressive, and it should not be regressive.

Regressive tax

In the case of regressive tax, the tax rate decreases with increase in income. Here, the tax liability of the taxpayer decreases with increase in his income. Or in other

words, the proportion of his income to be paid as tax decreases with increase in income.

For example, suppose, there is 30% tax for Rs 2 lakh, 20% for Rs 5 lakh and 10% for Rs 10 lakh. Here, the tax liability or the amount of the income to be paid as tax decreases with increase in income.

Example for regressive tax	
Income Slab	Tax rate
Rs 2.5 lakh to Rs 5 lakh	30%
Rs 5 lakh to Rs 10 lakh	20%
Above Rs 10 lakh	10%

The above examples are just general and easy to understand demonstrations. Sometimes, progressiveness and regressiveness are measured in a much complex way as well by estimating the relative tax burden.

The tax rates may be proportional as well. Here, tax rate is same for all slabs of income.

Progressive and regressive tax are interpreted in a much broader angle as well. For example, when the tax system gets sizable revenue from low income people, we can say that the tax system is collectively regressive. Ideally, tax revenue should come from the rich people to ensure progressiveness. A progressive tax system is beneficial for the poor people.

Classification of Taxes

Broadly taxes are divided into two categories:

1. Direct Taxes
2. Indirect Taxes

This is an important topic for [IAS Exam](#). In this article, relevant details related to taxation in India have been provided.

Direct Taxes

A direct tax can be defined as a tax that is paid directly by an individual or organization to the imposing entity (generally government). A direct tax cannot be shifted to another individual or entity. The individual or organization upon which the tax is levied is responsible for the fulfillment of the tax payment.

The [Central Board of Direct Taxes](#) deals with matters related to levying and collecting Direct Taxes and formulation of various policies related to direct taxes.

A taxpayer pays a direct tax to a government for different purposes, including real property tax, personal property tax, income tax or taxes on assets, FBT, Gift Tax, Capital Gains Tax, etc.

Indirect Taxes

The term indirect tax has more than one meaning. In the colloquial sense, an indirect tax such as sales tax, a specific tax, [value-added tax](#) (VAT), or goods and services tax (GST) 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).

The intermediary later files a tax return and forwards the tax proceeds to the government with the return. In this sense, the term indirect tax is contrasted with a direct tax which is collected directly by the government from the persons (legal or natural) on which it is imposed.

COMMON TYPES OF DIRECT TAXES IN INDIA

Some of the most common types of **direct tax** implemented in India are as follows-

1. Income Tax

The most common type of direct tax in India is income tax. It is imposed on the income you earn in a financial year based on the [income tax slabs](#) of the IT department. The tax is paid by individuals as well as businesses directly to the IT department. For individual taxpayers, there are also several tax deductions available under various sections of the IT Act.

2. Securities Transaction Tax

If you are involved in stock trading, each of your trade also has a small constituent known as the securities transaction tax. Irrespective of whether you made money on the trade or not, you will have to pay this tax. The broker collects this tax from you and passes on to the securities exchange, which then pays it to the government.

3. Capital Gains Tax

Every time you make capital gains, you will be required to pay capital gains tax. This capital gain could come from the sale of a property or from investments. Based on the capital gains and the duration for which you held the investment, you will be required to pay either LTCG (Long-Term Capital Gains) tax or STCG (Short-Term Capital Gains) tax.

BENEFITS OF DIRECT TAXES

There are some key benefits of direct taxes such as-

- **Curbs Inflation-** In case if there is monetary inflation, the government can increase **direct tax** rates so that the goods and services demand can be reduced. As the demand falls, it helps in condensing inflation.
- **Equitable-** Direct taxes are also known to be equitable as the progression principle is at its foundation. People with lower income pay lower taxes, and people with higher income pay higher taxes.
- **Reduces Inequalities-** The higher taxes collected from the rich are used by the government to launch newer initiatives for the poor. The initiatives provide income sources to people with lower income, helping them improve their living standards.

DISADVANTAGES OF DIRECT TAXES

Direct taxes also have some drawbacks such as

- **Considered a Burden-** As taxpayers are required to pay direct taxes like income tax in a single lump sum every year, they are considered a burden. Moreover, even the documentation process is generally complex and time-consuming.
- **Evasion is Possible-** While the government has made tax evasion very difficult now, there are still many fraudulent practices through which individuals and businesses can avoid or pay lower taxes than they should.
- **Restrains Investments-** Due to the imposition of direct taxes like securities transaction tax and capital gains tax, a lot of people avoid investing. So, in a way, direct taxes restrain investments.

WHAT IS INDIRECT TAX?

While direct taxes are imposed on income and profits, indirect taxes are levied on goods and services. A major **difference between direct and indirect tax** is the fact that while direct tax

is directly paid to the government, there is generally an intermediary for collecting indirect taxes from the end-consumer. It is then the responsibility of the intermediary to pass on the received tax to the government.

Unlike a direct tax, indirect taxes do not depend on the income of an individual. The tax rate is the same for everyone. The CBIC (Central Board of Indirect Taxes and Customs) is mostly responsible for handling indirect taxes in India. Just like CBDT, CBIC also works under the Department of Revenue.

COMMON TYPES OF INDIRECT TAXES IN INDIA

Some of the most important types of **indirect tax** in India are as follows-

1. Goods and Services Tax (GST)

GST subsumed as many as 17 different indirect taxes in India like Service Tax, Central Excise, State VAT, and more. It is a single, comprehensive, indirect tax which is imposed on all the goods and services as per the tax slabs laid by the GST council. One of the biggest benefits of GST is that it mostly eliminated the cascading or tax-on-tax effect of the previous tax regime.

2. Customs Duty

When you purchase something that needs to be imported from a foreign country, you are required to pay customs duty on it. Irrespective of whether the product has come to India by air, land, or sea, you will have to pay the customs duty on it. The goal of imposing this indirect tax is to make sure that every product entering India is taxed.

3. Value Added Tax (VAT)

A VAT is a type of consumption tax imposed on products whenever its value increases throughout the supply chain. It is imposed by the state government, which also decides the VAT percentage on different goods. While GST has mostly eliminated VAT, it is still imposed on some products such as items that contain alcohol.

BENEFITS OF INDIRECT TAX

Some significant benefits of indirect taxes are listed below-

- **Poor Contributes Too-** It is essential for the country that every individual contributes towards its development. As the poor are often exempt from paying direct taxes, the indirect taxes ensure that even poor contribute towards nation-building.
- **Convenience-** Unlike direct taxes which are generally paid in a lump-sum, indirect taxes like GST are paid in small amounts. When you purchase a product or service, a small amount of GST is already included in the price, and this makes its payment more convenient for the taxpayers.
- **The collection is Easy-** If you want to know **what is the difference between direct and indirect tax**, one of the biggest of them is how they are paid. Unlike direct taxes, there are no documents or complex procedures involved in paying indirect taxes. You are required to pay the tax right when you purchase a product or service.

Read also : [Know The Basics Of Goods and Services Tax - GST](#)

DISADVANTAGES OF INDIRECT TAXES

A few cons of indirect taxes are as follows-

- **Regressive-** Indirect taxes are widely known to be regressive in nature. While they make sure that everyone pays taxes irrespective of their income, they are not equitable. People from every income group are required to pay indirect taxes at the same rate.
- **Makes Products and Services More Expensive-** As **indirect tax** is added to the price of goods and services, it makes them more expensive. For instance, products like cigarettes, high-end bikes, premium cars, etc. are included in the 28% tax slab of GST.
- **Lacks Civic-Consciousness-** As indirect tax is added to the price of the product or service, the consumers are generally unaware of the tax they are paying. This is opposite to direct taxes where the taxpayer clearly knows the taxes he/she is paying.

Summing the Biggest Differences between Direct and Indirect Tax

Here is a table pointing out the biggest **direct vs. indirect tax** differences-

Context	Direct Tax	Indirect Tax
1. Imposed on	Income and profits	All the goods and services
2. Who pays	Individuals and businesses	End-consumers
3. How much	Depends on income and profits	Same for everyone
4. Transferability	Not transferable	Transferable
5. Tax Evasion	Possible	Not possible
6. Nature	Progressive	Regressive
7. Collections	Complex	Convenient
8. Common examples	Income tax and securities transaction tax	GST, excise duty, and VAT

PAYING TAXES IS YOUR RESPONSIBILITY

As you can see, direct as well as indirect taxes have their pros and cons, but both are abundantly important for the economy. While taxes are generally considered to be an unnecessary burden, it is from the taxes you pay that the government builds the nation, invests in defence, healthcare, infrastructure, launches welfare initiatives, and prospers. Our dream of seeing our country become a global superpower can only be achieved if the citizens continue to pay taxes with complete honesty.

Now that you've understood the different **types of direct and indirect taxes in India**, fulfil your responsibility of paying taxes and being a responsible citizen of the country. Make use of the available tax deductions as much as possible but do pay the remaining tax liabilities on time every year as this will ultimately help the citizens and make the country more prosperous.



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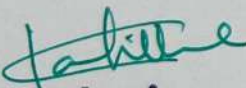
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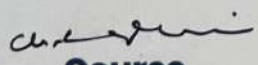
Value Added Course Certificate

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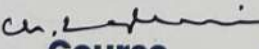
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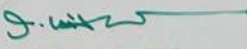
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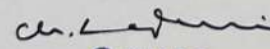
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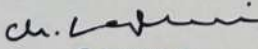
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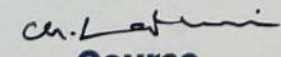
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BA (HEP) has successfully completed the Value Added Course in Indian public finance
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collaboration with - during year 2022 to 2023. He/She has passed the course with
A grade.


**Academic
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**IQAC
Coordinator**


**Course
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MADDILAPALEM, VISAKHAPATNAM-530013. ANDHRA PRADESH




Value Added Course Certificate

2022 to 2023

This is to certify that Mr./Miss Dusevra Charanya of
BA (HEP) has successfully completed the Value Added Course in Indian public finance
with Regd No. 21415016 Organized by the Department of Economics in
collaboration with - during year 2022 to 2023. He/She has passed the course with
A grade.


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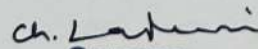
Value Added Course Certificate

2022 to 2023

This is to certify that Mr./Miss Gopu Madhu of
BA (HEP) has successfully completed the Value Added Course in Indian public finance
with Regd No. 21415021 Organized by the Department of Economics in
collaboration with - during year 2022 to 2023. He/She has passed the course with
A grade.


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Coordinator**


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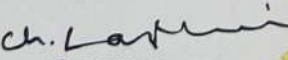
Value Added Course Certificate

2022 to 2023.

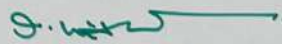
This is to certify that Mr./Miss Grumpa Durga of
BA (HEP) has successfully completed the Value Added Course in Indian public finance
with Regd No. 21415022 Organized by the Department of Economics in
collaboration with — during year 2022 to 2023 He/She has passed the course with
A grade.


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Value Added Course Certificate

2022 to 2023

This is to certify that Mr./Miss Jogineta Bhascan of
BA HEDB has successfully completed the Value Added Course in Indian public finance
with Regd No. 21415028 Organized by the Department of Economics in
collaboration with - during year 2022 to 2023 He/She has passed the course with
A grade.


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**Course
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Value Added Course Certificate

202~~2~~ to 202~~3~~

This is to certify that Mr./Miss Mosuri Sai of
BA (Eco) has successfully completed the Value Added Course in Indian public finance
with Regd No. 21417019 Organized by the Department of Economics in
collaboration with - during year 202~~2~~ to 202~~3~~. He/She has passed the course with
A grade.


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Value Added Course Certificate

2022. to 2023.

This is to certify that Mr./Miss Divya Sri of
BA (Eco) has successfully completed the Value Added Course in Indian public finance
with Regd No. 21417014 Organized by the Department of Economics in
collaboration with - during year 2022. to 2023. He/She has passed the course with
A grade.


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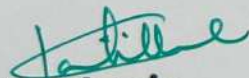
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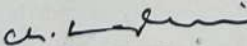
Value Added Course Certificate

2022 to 2023

This is to certify that Mr./Miss Pinninti Bharathi of
BA (Eco) has successfully completed the Value Added Course in Indian public finance
with Regd No. 21417023 Organized by the Department of Economics in
collaboration with - during year 2022 to 2023. He/She has passed the course with
A grade.


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Value Added Course Certificate

2022 to 2023

This is to certify that Mr./Miss Bantu. Chiranjeevi of
BA (Eco) has successfully completed the Value Added Course in Indian public finance
with Regd No. 21417002 Organized by the Department of Economics in
collaboration with - during year 2022 to 2023. He/She has passed the course with
A grade.


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