

Book Review

# Income Elasticity of Indian Taxes

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**Indian Tax Structure and Economic Development** by G S Sahota, Asia Publishing House, Bombay, 1961. Pp 88, Price RS 9.00.

THE main preoccupation of the author has been to study the buoyancy of our tax structure, i e, the Capacity of our tax structure to increase the flow of revenue to the exchequer year after year. In a developing economy, the author rightly expects the policy of the Government to be such that a large portion of the increment in national income is automatically taxed away.

He makes a distinction between the buoyancy of a tax system on the one hand and the elasticity of a tax system on the other. While elasticity measures the change in tax receipts due *purely* to the change in national income (and possibly income-distribution and population, though Shri Sahota does not explicitly say so), buoyancy relates the change in tax receipts due to all factors, including the increase or decrease of national income, to the change in national income,

Shri Sahota defines elasticity as "the percentage rate of change in tax consequent upon one per cent change in the income". Elasticity is normally defined as "proportionate change in the dependent variable consequent upon proportionate change in the independent variable . The difference between the two definitions is apparently not great. But one begins to doubt whether the author is clear in his mind about the application of the concept of elasticity. The footnote on page 63 reads as follows:

"Earlier the elasticity coefficients 'b' were for 1% increase in National Income and since an annual rate of growth of 6% is assumed for the III Five Year Plan, the annual coefficient is calculated by multiplying the coefficient in Table III by figure 6".

On this basis, the author has obtained the projections of yields of various taxes and buoyancies for the Third Five Year Plan.

### Measurement of Elasticity

But it is with respect to his methodology, that the present reviewer would like to join issue with Shri Sahota. For calculating the elasticity of various taxes, he has taken great pains indeed to work out first the index numbers of "net" yields for each tax. In order to eliminate the influence of "legislative changes of tax rates and coverage", he has relied on estimates available in the Finance Ministers' Budget Estimates etc. If instead, Sahota had followed a simpler procedure of calculating tax receipts at two points of time, say 1949-50 and 1958-59, with rates of tax assumed to stay unchanged, the exogenous influence of the above type would have been eliminated and still the impact of change between these two years in incomes as well as in income distribution would have been accounted for.

Shri Sahota's method is not only cumbersome but also faulty in that he has relied on "mere" estimates of the effects of exogenous influences without realising that budget estimates of any changes in tax rates or in tax coverage usually tend to be understated. This is a well known fact. Instead, we have calculated the yield of income tax on non-corporate assesseees in 1949-50 and 1958-59, at the rates prevailing in 1958-59 and find that, as per table below, income tax receipts in 1958-59 should be more than twice those in 1949-50.

	Income tax receipts at 1958-59 rates	Index number for income tax based on our calculations	Sahota's index number of income tax.
		(Rs crores)	
In 1949-50	56	100	100
In 1958-59	117	209	115

The assumption implied in our calculation is that the rates of income tax applying in 1949-50 and in 1958-59 are the same. But changes in income as well as the numbers of assesseees in each income-group are accounted for in our estimates. Sahota's index number indicates an increase of only 15 per cent. This is a very large disparity indeed. We are not surprised at it because the very basis of his calculations are so very unreliable. While Sahota's elasticity of non-corporate income tax works out to 0.4, ours works out to 2.7. Since our calculations are confined to two years the result obtained should not be taken to indicate the trend. But they should serve the limited purpose of demonstrating how far off the mark Sahota's estimate of elasticity has gone. Our suspicion is that the same is true with respect to other tax receipts.

### Tax Evasion

Another interesting point made in this study is that with regard to tax evasion. Shri Sahota estimates evasion of income tax to be Rs 61.31 crores in 1957-58 but this, as he himself indicates in parenthesis, is "in addition to whatever evasion existed before 1951-52." In other words, his is an estimate of increase in evasion rather than of the total evasion in income tax. Moreover, this estimate appears to relate only to non-corporate assesseees. The corporate sector's evasion is not covered by Sahota's estimate, though one may readily grant that the increase in evasion in the corporate sector may have been not that large.

If evasion increased between 1951-52 and 1957-58 by about Rs 60 crores while the rates were somewhat lowered, there is every reason to believe that the evasion

in 1951-52 was quite substantial and certainly larger in amount than Rs 60 crores. Thus total evasion of income tax by non-corporate assesseees must have been over Rs 120 crores in 1957-58 (i.e. Rs 60 crores tax evasion in 1951-52 plus Rs 60 crores estimated by Sahota to be the addition to evasion between 1951-52 and 1957-58). In the introduction to the book, Sahota's estimate of evasion is referred to as "the first systematic estimate to be published on the subject". The editor refers with satisfaction to the fact that Sahota's "figure (of evasion) compares well with the estimate of the Taxation Inquiry Commission who placed the income tax evaded at Rs 50 crores." But does it really? We do "not want to press further the point made earlier about the basic plan in Sahota's methodology. But his calculation of tax evasion is subject to the same limitation. This, of course, may imply tax evasion, may be lower than what has been suggested above.

While making a study of rural-urban disparity with respect to taxes, the author finds that the rate of increase in indirect taxes is higher in rural areas than in urban areas. But this result has to be related to the fact that the base-rate of indirect tax-burden is comparatively lower in rural area. The author has himself taken great pains in highlighting the well-known point that the taxes paid by the rural sector as percentage of income arising in rural sector are very much lower than the taxes paid by urban sector as percentage of income arising in urban sector.

The tax liability in our country begins at a comparatively higher level of income but this according to Sahota, should not be considered as a serious defect in our tax structure because, (1) it is not economically feasible to lower the minimum taxable income and (2) higher minimum taxable income should make our tax structure look highly progressive. The second point would be an argument in favour of raising the level of exemption limit still further. But one wonders if the type of progressiveness the author has in mind can at all be claimed as a virtue.



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