

CHAPTER 7

TAXES

Fertilizer prices up

expansion of the scheme for distribution of subsidised cereals through ration shops

Higher tax on petrol, diesel

48 new projects planned at a cost of Rs. 40,000 crores

Income tax deductions on housing loans to stay

Customs duty on gold reduced

Service tax extended to several categories

for one year on an experimental basis.

AC, soft drinks to cost less

For the consumers, motor cars, air-conditioners, soft drinks etc. will cost less since the excise duty on these products has been reduced from 32

only.

Pressure cookers, biscuits, boiled sweets and dental chairs will cost less because of lower excise duty while articles such as umbrellas, wood articles, adhesive tapes, imitation 'zari,' walking sticks, bicycle and parts, utensils and kitchen articles, knives, spoons and similar items, and glasses for corrective spectacles will cost much less because the duty on them has been abolished.

Public-private partnerships for infrastructure

60,000 crores is to be spent on new roads, rail projects

The finance minister has made it clear that if the defence ministry makes a case for larger funding it will be granted

Life saving drugs to cost less

Excise on soft drinks, cars, air-conditioners cut

Excise duty on cements up

Take a look at the above newspaper clippings about the budget. One mentions that fertiliser will cost more. Another says that air conditioners and soft drinks will cost less. All this big news was about the budget that the government had announced for the upcoming year.

One part of the budget shows the **revenue** - what the government will earn and where it will get money from. The other part of the budget gives information about the **expenditure** - where the government will be spending money - for example, how much on defence, how much on projects, how much on running the government etc.

The Union Finance Minister presents the Central Government's budget in the Parliament. It is then discussed, debated and modified. Once it has been approved, the budget is implemented.

Similarly, in the states too, the finance minister of each state presents the budget in the Vidhan Sabha. States get money from taxes they levy and they also get a share of the taxes collected by the central government. In this chapter we shall

discuss some of the important taxes levied by the Central and State Governments.

Discuss with your teacher: Why does a government need a budget?

Look at the news items in the illustration on the previous page. Identify the ones which deal with the government's expenditure and the ones which deal with the government's revenue.

Excise Duty

See if you can find a matchbox with a label that says 'Central Excise'. Excise duty is the tax charged on goods that are produced or made in factories. Before the goods manufactured in a factory can be sold, excise duty on the goods produced has to be paid. The owner or manager of the factory pays the money for this tax to the government according to the quantity of production. However, this tax is not imposed on all things that are produced.



The Effect of Excise Duty

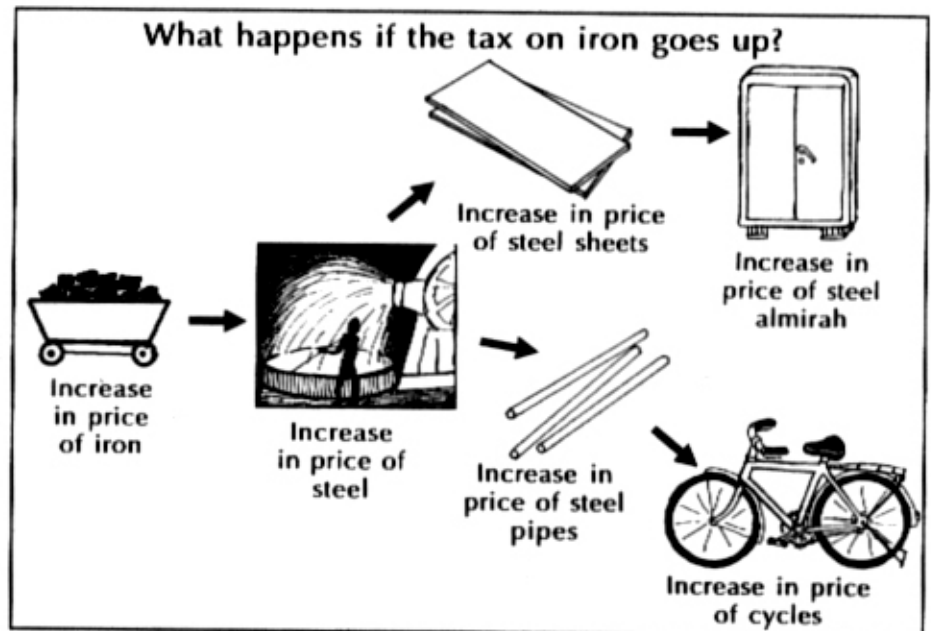
In order to produce one item, often a large number of other things are used. For example, to manufacture bicycles, steel pipes are needed. In order to make steel, the steel factory needs iron and coal.

If the excise duty on iron is increased, the prices of all goods made of iron will go up. It will have an effect on cycles as well.

For instance, iron is used to make steel, so the prices of all things made of steel will also go up. In this way, a tax increase on iron has far reaching effects.

Excise duty is paid to the government by the factory itself, but in reality the burden of the tax falls on those who buy the goods. The factory owners increase the prices of the goods they sell in order to cover the amount they pay in tax.

For example, suppose the cost of manufacturing a TV set is Rs. 4,000. The company wants to make a profit of Rs. 1,000 on each set. It also has to pay an excise duty of Rs. 800 to the government. So it will then sell each TV set for Rs. 5,800 to the dealer.



As shown here, the people who buy cycles and almirahs bear part of the increase in tax on iron.

Look carefully at the illustration on the next page. It shows how many things are made from crude oil - petrol, diesel, kerosene, plastic, synthetic cloth (e.g. terricot and nylon), fertiliser, furnace oil etc. If the tax on crude oil is increased, the prices of all these things would go up.

Petrol and diesel are used to run vehicles. For example, trucks, trains, tractors, buses and jeeps run on diesel. Petrol is used for scooters, motorcars etc. What will happen if the price of diesel goes up? Naturally, it will be more expensive to run trucks, jeeps and such vehicles. But it will also become more expensive to transport goods, so the prices of goods will go up.

Whenever excise duty is increased on any material, it affects the prices of all those things for which the material is used. It sets up a chain reaction and all things which are connected to this thing are affected, in one way or the other.

Sales Tax

This is charged when goods are first sold. The manufacturer or shopkeeper pays this tax and the amount is added to the price of the goods. The consumer therefore has to bear this tax. Suppose we buy a packet of biscuits which says; "Rs. 10 MRP. (All taxes inclusive)". MRP stands for Maximum Retail Price i.e. the maximum price that can be charged to the consumer. This price includes excise duty, sales tax and other taxes. For example, in the above packet of biscuits Rs. 2 was paid as tax.

This system of showing the MRP on products was not very widespread until recently. Fifteen or twenty years ago, shopkeepers used to charge an extra amount over and above the printed price in order to cover the sales tax. The wrappers would show the price with the note saying "local taxes extra" (L.T.E.). You can still see this on some medicine wrappers.

If the tax on iron is increased, give some examples of other things not mentioned here that this will affect.

Make a chart like the one on the previous page to show what might happen if the tax on crude oil increases.

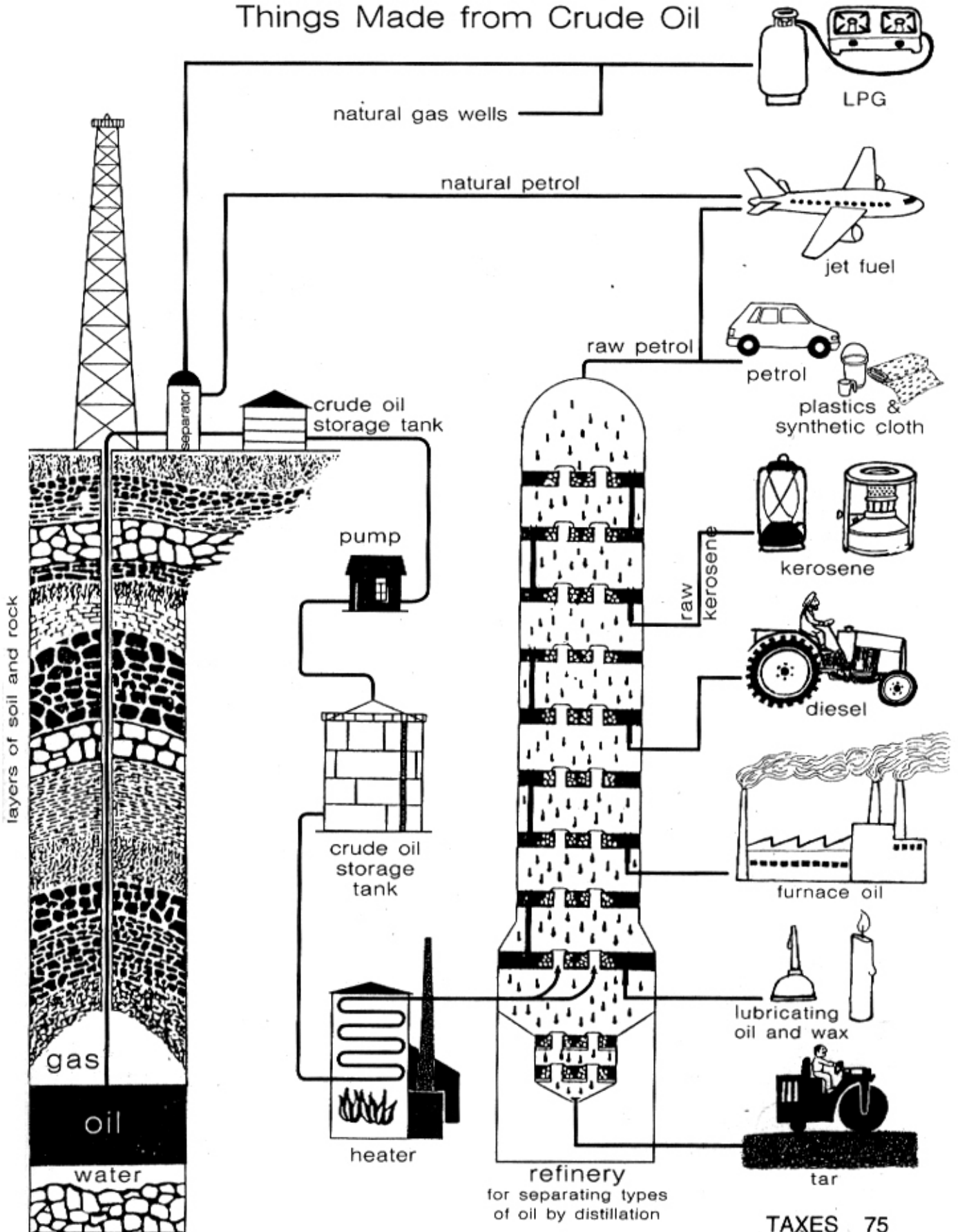
What do you think is the advantage of showing the MRP on goods?

What is the difference between sales tax and excise duty?

Find the maximum retail prices printed on five different packets.

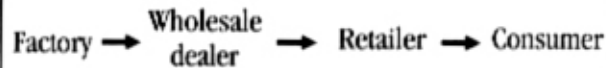


Simplified Schematic Diagram Things Made from Crude Oil



The Tax System

Most items reach the consumer from the manufacturer through a chain of buying and selling by 'middle-men' (wholesale dealers and retailers).



There are various taxes, such as excise duty and sales tax, which are paid and then included in the price of the goods. At every stage there are some costs and some profits made by the sellers. For example, here is a breakdown of all the charges (in rupees) for the TV set mentioned earlier.

Cost of manufacture, transport, storage ...	5,000
Profit of the manufacturer	1,000
Profit of the wholesale dealer	400
Profit of the retail trader	600
All taxes paid (excise duty + sales tax)	2,000
Cost to the consumer (MRP)	9,000

This is only an example. The percentage earned as profits and the taxes paid would vary from item to item. For some items, such as computers, medicines etc the profit margins are much higher.

What percentage of the cost of the TV set did the consumer pay as tax?

Collect the labelled wrappers or boxes of some items and note the MRP. Discuss in class the probable taxes paid.

If there are two people manufacturing the same kind of thing and one of them evades paying taxes, what advantages could he have over the other?

Sales tax charged by the state government is a major source of revenue for the state. Different states have different tax rates. So we find people going to particular cities for purchasing goods like motorcycles, garments etc. because the tax rates are lower there. The state governments are now thinking of changing the way this tax is charged.

Customs Duty

Apart from sales tax and excise duty, another kind of tax is levied on certain things. This is known as customs duty. It is charged on those things which we bring from other countries. For example, a person returning from a foreign trip brings a computer with her. At the airport in our country she will have to pay a customs duty. Many factories need machines or raw material to be brought from foreign countries. Customs duty has to be paid on these things too.

Among the news items in the beginning of the chapter, can you locate one which deals with customs duty? In what ways would this decision affect the traders and consumers of this commodity?

Why can't the government charge excise duty on those goods for which it charges customs duty?

Income Tax

Besides taxes on goods such as excise, custom and sales tax, there is also **income tax**. Income tax is levied on the **income** of individuals or on the **profits** earned by companies and businesses.

As we have seen, the prices that we pay when we buy some things in the market include whatever taxes have been levied on them. Hence, in effect, we pay these taxes when we **spend money**. Tax may also be charged when we **earn money**, i.e. we may pay tax on our income.

Tax should be collected fairly.
Let's read about some possible ways of doing this.

What is a fair way of collecting income tax?



- 1.** Fixed Amount: You may think it is fair for everyone to pay the same amount of tax. Would it really be fair if each of the following three people has to pay the same amount?

Person	Work	Earning (per month)	Tax as fixed amount (per month)
Jyoti	Daily wage labourer	1000	50
Asif	School teacher	6000	50
Jatinder	Business person	20,000	50

If Jyoti cannot even afford to feed her children properly, is it fair for her to pay Rs 50 as tax?

- 2.** Fixed Proportion: You may think it is more fair to ask each person to pay a certain percentage of what he or she earns. Supposing everyone paid 10% in taxes. Calculate how much each of the following persons would pay.

Person	Earning (per month)	Tax as a fixed proportion (per month)
Jyoti	1000	
Asif	6000	
Jatinder	20,000	

Would this be fair? Jyoti may still not have enough money to live on. Asif may not have enough to repair his house. But Jatinder may have plenty of money for all the basic necessities even after paying 10% in taxes.

- 3.** Variable proportion: To make taxes more fair you may then say that only people earning more than a certain amount, say Rs 4000 per month, have to pay taxes. You may also say that the richest people should pay a greater proportion of their earnings.

For example:

If you earn	You will pay as tax
Less than 4000	0%
4000 to 5000	10%
5000 to 15000	20%
More than 15000	30%

Use the above Table to calculate how much each person would then pay.

Person	Earning (per month)	Tax as a variable proportion (per month)
Jyoti	1000	
Asif	6000	
Jatinder	20,000	

Would this be fair?



Many people think it is not right that a few people earn lakhs of rupees while others don't have enough to eat. They feel that the government should collect more taxes from the rich than from the poor. Besides, there is also a need to improve the income of the

poor by providing better job opportunities and living conditions.

Suppose Kanti has an income of Rs. 100,000 per year and pays an income tax of Rs. 3000, and Kamlesh has an income of Rs. 200,000/year and pays Rs. 26,000.

- a) Who pays more income tax?
- b) Who has to pay a larger part of the income as tax - the one who earns more or the one who earns less?



The tax system in India today is similar to the third example on the previous page: the amount of income tax that each person is supposed to pay is **proportional** to how much they earn. Income tax is charged only from those who earn above a certain

amount. Those who earn a higher income have to pay a greater proportion of their income as tax. According to these rules a person who earns Rs. 1,50,000 per year pays 9% and another who earns Rs. 3,00,000 pays 19% of their income as tax. However, because there are also rules that allow for a large number of deductions, most people pay only a small portion of their income as tax. Even those who have high incomes hardly ever pay more than 6% of their income as tax.

According to the income tax rules those with higher incomes have to pay _____ (greater/smaller/equal) part as tax.

Corporate Tax

Apart from personal income taxes, companies that run factories or businesses also have to pay taxes. Companies or businesses receive money from the sale of their products or services. After subtracting all expenses (on raw materials, salaries etc.) from their earnings, the portion that remains is known as the profit of that company or factory. On this profit, corporate tax has to be paid according to rules.

Collection and Evasion of Taxes

We read about some of the major taxes collected by the government. Through which kind of tax is the government able to collect more money? Let's see . . .

The government gets revenue from many different kinds of taxes. It has to decide how much money to collect through each kind of tax. For this it has to consider: how many people would have to pay; whether this tax can be collected easily and how would it affect the rich and the poor. A related question is whether people will pay their taxes or evade paying taxes.

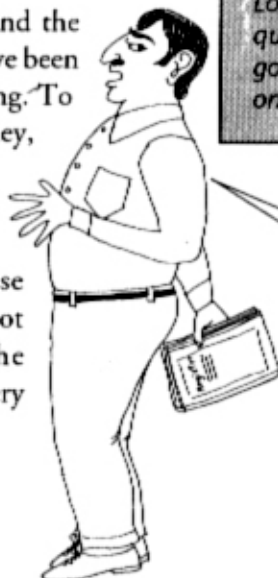
You know that a large number of people in our country depend on agriculture. Most of them are small and medium farmers. There are also some big farmers earning high incomes. However, all agriculture income is exempted from tax. Similarly, a large section of people in the country earn very low incomes from trade, running small shops, or providing labour. The income of these people is below the limit for income tax. On the other hand there are a number of people who should be paying tax but evade it. Thus the percentage of people in the entire country who pay income tax is very small (less than 2%).

However, since the total population is more than 100 crore, even this small percentage of people is sizeable. For example, in 1997 the incomes of 114 lakh individuals were assessed for income tax. They were living in different places in the country. Thus, collecting income tax is not easy.

Many people do not disclose their entire income or they show it to be less than what it actually is. This income, which is kept hidden, is known as **black money**.

Many factory owners, rich moneylenders, traders, and those doing private business can easily evade the law and show a low income. Because there is no tax on income from agriculture many wrongly show their income as income from land and therefore evade paying tax. It is easy to calculate the income of those who are paid monthly salaries. Tax on their income is directly deducted at the source from where they get their salaries. But many salaried persons also have other sources of income which they keep hidden.

Thus there are many 'tax evaders' and the black money on which tax should have been paid but wasn't, goes on accumulating. To get hold of this hoard of black money, the income tax department raids many people's places. It has also tried to make the procedures for paying tax more convenient. Despite these efforts a large number of people do not pay any income tax. Hence the government is unable to collect a very large sum of money from this tax.



What are the reasons why income tax is not able to yield much money to the government?

On the other hand taxes on goods can be collected more easily since there are fewer places from where they have to be collected. Excise duty is collected from factories, customs duty from international airports and seaports and sales tax from traders and shopkeepers. As compared with income tax to be paid by individuals the government finds it easier to keep a track of these factory records or shops.

Even here, there are those who try to escape taxes by showing lower production than has actually taken place. Sales tax is evaded on a wide scale. Some people, by not issuing proper bills or recording it in their official registers show much lower sales than actually occurred.

Taxes collected by the government

<u>Taxes on goods</u>	<u>Percentage of total tax</u>
Excise duty	26%
Sales tax	23%
Customs duty	18%
Other taxes on goods	14%
Total tax on goods	81%
<u>Taxes on income</u>	<u>Percentage of total tax</u>
Income tax	9%
Corporate tax	9%
Other taxes on income	1%
Total tax on income	19%

Total taxes on goods and income 100%

Look at the above table and answer the following questions: From which type of tax does the government earn more – taxes on income or taxes on commodities? What is the reason for this?

QUICK! HIDE THIS REGISTER! SHOW THE OTHER ACCOUNT REGISTERS TO THE TAX PEOPLE...

One problem that is often encountered and that has serious consequences is evasion of taxes. For example, in a certain town a large number of residents do not pay the required property tax. Discuss how this might affect the life of the people in that town.

In the history chapters you have seen that agriculture has usually been taxed. However, in this chapter you read that agricultural income is not taxed at all. Why do you think this is so?

other things. You can guess how many industries, factories and businesses use these things. People do not buy them directly. To get more income, the government levies high taxes on those things which are very widely sold but which are not directly used by people.

One year the government heavily taxed luxury items such as refrigerators and air conditioners. This yielded Rs. 183 crores. In the same year the government got Rs. 2941 crores from a tax on crude oil. Compare and explain the difference in income.

The Effect of Taxes on Goods

While imposing a tax, the government keeps in mind whether it is more likely to affect the rich or the poor. While levying taxes on goods, however, it becomes a little more difficult to distinguish between the poor and the rich. Whether rich or poor, everyone has to pay the same amount of tax when buying something.

However, there is a way by which a distinction can be made between some goods. For example, grains, vegetables, cloth, kerosene, cooking oil - all these things are essential and, rich or poor, everyone buys them. However, the poor spend most of their income on these things. There are other things which only the rich can purchase: refrigerators, cars, motorcycles, VCRs.... It is difficult for the poor to afford these 'luxuries'. Hence one way to distinguish between rich and poor is not to tax essential things but to tax luxury items.

The problem is that since not many people can afford to buy these luxury items, taxing **only** such things cannot bring much income to the government.

On the other hand there are also many things which are not directly used by people, such as diesel, steel, aluminium, machines, trucks, truck tyres etc. Such things are used to make or transport

Can we say that imposing taxes on things such as crude oil, iron, steel etc does not have any effect on the poor? We saw that when the tax is increased on such things, the increase gets added to the cost of those things which are made from them or transported with their help. Thus, even the poor who buy grain or cloth have to pay some part of the tax on diesel or steel. When the tax on such things is increased, the price of many other things goes up. To take an example of this, read a news item that appeared a week after the annual budget.

"The increase in the price of petrol and diesel alone has led to an all-round increase in prices. Fruits, vegetables, dals and other food items, for example, have become more expensive."

I'M SURE WE'LL END UP PAYING...
THE THINGS WE NEED TO BUY
WILL COST MORE!



Who will be affected more if the tax on kerosene is increased? And who will be affected more if the tax on computers is increased?

Which tax increase will yield more money -- a tax on crude oil or on cars? Why?

Which tax increase will affect the prices of other goods more -- on crude oil or on kerosene? Why?

We saw that the government earns a greater income through taxes on goods. Among goods, too, it receives more tax from those things which

are used in the manufacture or transport of other goods. When the tax is increased on such things it has an all-round effect on prices.

For this reason the question that troubles everyone each year is: which taxes are going to be increased? We saw that much more money can be collected by a tax on goods, but this also affects the poor more. The burden of income tax falls more heavily on the rich, but the government is able to collect very little money through it. That is why the announcement of the budget is so important for everyone.

Exercises

- Taxes charged and collected have always had a strong impact on people's lives. You have seen some examples. Can you recall some of them from the following:
 - What is mandi tax? What is it used for?
 - In the chapter on municipalities, why were people reluctant to pay the water tax?
- Why does the government need a budget? Why does the budget talk of taxes?
- Match the following:

Excise duty	levied on the yearly income of individuals
Sales tax	levied when goods are sold
Customs duty	levied on the production or manufacture of goods
Income tax	levied on the yearly profit of companies and businesses
Corporate tax	levied on goods brought from abroad
- In the history chapter 'Villages in the Mughal Period' you will read about a system of land taxes.
 - What portion of their produce did the farmers have to pay as tax? What problems did they face?
 - How were the rules of land tax during that period different from today's income tax rules?
- Steel, matches, clocks, cloth, iron - a tax increase on which of these would affect the prices of other commodities the most, and why?
- Ordinary food item, such as grain, dals and oil are used by all. Then why is it said that imposing a tax on them will have a greater effect on the poor?
- A group of four friends decided to stay together by contributing money towards the rent of a house. The rent was Rs 2000 per month.
 - How could this be shared among them?
 - We also know that two of them earned Rs 3000 per month and the other two Rs 7000 per month. Is there some way of sharing the cost so that each one feels the pinch equally?
 - Which way of sharing would you prefer and why?
- Tax on income or tax on commodities - which of the two affects the rich more and which affects the poor more? Explain with reasons.