SYLLABUS

Class – B.Com. V Sem.

Subject – Public Finance

Unit-I	Public finance: Meaning, nature, scope and importance, difference between private and public finance. Principle of maximum social advantage. Role of state in public finance.
Unit-II	Sources of revenue: taxes, loans, grants and aid – meaning and types, canons of taxation, problem of justice in taxes, incidence of taxation, taxable capacity. Impact of taxation & tax evasion characteristics of Indian tax system, defects & steps of reform.
Unit-III	Principle of public expenditure, principle of public depth and its methods of redemption. Effects of public expenditure on production and distribution public debt in India.
Unit-IV	Public finance in India: sources of revenue of central and state govt. concept and types of budget, Fiscal Deficit, Deficit financing and deficit budget, financial relation between central and state.
Unit-V	Constitution and function of finance commission, recommendation of latest finance commission, latest budget of central and MP govt. financial relations between central & state govt., main head of revenue & expenditure of central & state govt.

UNIT-I

Public Finance: Meaning, Nature and importance

Introduction

The State in modern times is called a welfare State. The activities of such a modern welfare State have vastly increased. For a smooth performance of these functions the State nee& finance. Thus public finance means the finances of public bodies—national, State or local—for the performance of their functions. The term 'finance' may also refer to financial management and administration. Public finance thus means the administration of the financial operations of the public authorities. It refers to that branch of Economics which deal with the income and expenditure of public bodies and the principles, problems and policies relating to these matters.

Definition

Carl Plehn defines public finance as. "The science which deals with the activity of statesman in obtaining and applying the material means necessary for fulfilling the proper functions of the State."

Scope of Public Finance

1. **Public Revenues –** In his division we study all those sources from which the government derives its revenues. An extensive study of the principles of taxation is an integral part of this branch. Along with this, we also study in this branch the problem of the incidence of taxation-
2. **Public Expenditure –** Public expenditure is the beginning and end of the collection of revenues by the government. As pointed out by Plehn, "Public expenditure is the end and aim of collection of revenues and of other financial activities of the statesman". Under public expenditure we study its classification, the canons or principles which govern it and its effects on production, employment, income distribution, stability and growth. We also study the reasons for increase in public expenditure and changes in the pattern.
3. **Public Debt –** When public revenue falls short of public expenditure, the government borrows from the public to meet the gap. This is public debt. Under public debt; we study the reasons, methods and sources of public debt, its effects on production, consumption, income distribution and economy, the burden of public debt and the methods of debt redemption
4. **Financial Administration –** The aim of financial administration is to control processes and operations of public revenue, public expenditure and public debt. The scope of financial administration includes the collection, custody and disbursement of public money; the coordination of expenditure according to a well-formulated plan; the management of public debt; and the general control of the financial operations of the state. It also includes the preparation of the budget; its execution and above all auditing the finances of the state.

Nature of Public Finance

1. **It is a Social Science –** Public finance is a social science which is concerned with the problems of raising of funds and their allocation for the collective satisfaction of wants. Its methods of study are based both on the study of the principles and theories or laws of public finance and on a descriptive and statistical study of the actual operations of government finances. Its principles are in the nature of generalizations which state the cause and effect relationships of different variables like public revenue, expenditure, debt and financial administration. These also form the subject matter of public finance.
2. It is an Art – Public finance is also an art. It is concerned with fiscal policies which influence economic policies and economic structure of the country. All governments aim at bringing social justice through an equitable financial system.

Importance of Public Finance

1. Increasing the growth rate of Economy – The role of public expenditure in economic development lies in increasing the growth rate of the economy, providing more employment

opportunities, raising incomes and standard of living, reducing inequalities of income and wealth, encouraging private initiative and enterprise and bringing about regional balance in the economy. All these are achieved by spending on public works, agriculture: industry, transport and communications, power, financial and banking institutions, social services etc. The government is able to increase public expenditure through a budget deficit.

2. **Emergence of Social Services –** The importance of public finance as also increased due to emergence of social services which can be performed more conveniently, efficiently and also at the minimum cost as against individual. Such services are education, health, social security and protection from certain uncertainties. The need for such social services is increasing day by day and with them is increasing the importance of public finance.
3. **Reduction in Economic Inequalities –** Public finance can play a vital role in reducing economic inequalities which is the source of dissatisfaction, class-struggles, poverty etc. The state can levy heavy taxes on richer sections of the society and thereby spend the income so received on providing food, cheap housing, free medical aid etc. for the poorer sections of the society. Similarly, heavy taxes can be imposed on the use of harmful commodities, such as harmful drugs, wine, opium, hashish etc.
4. **Increases Employment –** Public finance can play vital role in increasing employment which is the burning problem of almost all the countries of the world, The Governments these days establish, give grants, subsidies, grant exemption from excise duty, sales tax etc. to employment-oriented cottage and small-scale industries. Unbalanced budget is also an indispensable measure of increasing volume of employment during depression.
5. **Capital Formation –** The economic development, as is well known, depends upon the rate of capital-formation in the country. Public finance can play a vital role in increasing the rate of capital-formation in the economy. It can be managed in such a manner as to step up the rate of saving and investment in the economy. For example, the tax system can be so managed as to discourage the consumption of non-essential goods and thereby release the resources for being invested in more productive industries. Further, the tax system can be employed to increase the rate of private saving which in turn, can be used as the basis for an increase in public investment.
6. **Industrial Development –** The governments these days give subsidies and grants to different industries to enable them to increase the production of essential goods in the country. These subsidies and grants have special place in the government expenditure of underdeveloped and backward countries .

Differences or Dissimilarities between public and private finance

The following are the main points of differences or dissimilarities between public and private finance:

1. **Adjustment between Income and Expenditure –** An individual determines his expenditure on the basis of his income. He prepares his family budget on his expected income during the month. On the other hand, the government first estimates about its expenditure and then finds out means to raise the necessary income. As pointed out by Bastable, 'The individual says, I can spend so much', the Finance Minister says, 'I have to raise so much'
2. **Elasticity of Finance –** Public Finance is more elastic than private finance. There is not much scope for changes in private finance while drastic changes can be made in government finance. For example, a private individual cannot effect any special increase in his income. As against this the government can increase its income by imposing fresh taxes on the people.
3. **Differences in Objectives –** There are a fundamental difference in the objective of private and public finance. The motive of private expenditure is personal benefit whereas the objective of public expenditure is social benefit. An individual always tries to save and a firm to earn profit. But there are no such considerations on the part of the government, except the public welfare. However, there are some public enterprises which are run on profits that are utilised for public welfare.

4. **Nature of Expenditure –** There are differences in the nature of expenditure between the two". An Individual's expenditure is governed by his habits, customs, fashions etc on the other hand. The government expenditure depends on its economic and social policies, like removing unemployment and poverty, reducing income inequalities, providing' infrastructure facilities, etc
5. **Compulsion –** There is compulsion in public finance. People have to pay taxes. If they do not pay, they are punished by fine and imprisonment. BA an individual or firm cannot force anybody to pay him money. He can file a suit in the court. But even then he may not receive his money back. The same is the case with loans. The government can force the people to lend it during war or emergency. But a individual cannot compel any person to lend him money.
6. **Law of Equi-marginal Utility –** The private individual spends his me on various items in such a manner as to secure equal marginal utilities from them. It is only by equalizing the various marginal utilities that he can secure maximum utility out of his expenditure. The government on the contrary, does not give as much importance to this law as a private individual does. Modern governments sometimes incur certain types of expenditure from which they do not derive any advantage, but they o incur this expenditure to satisfy certain sections of the community
7. **Present Vs Future –** An individual is more concerned with his present needs and tries to satisfy them. Life being uncertain and short, he has his immediate gain or profit in view. On the other hand, government is a permanent organisation. Only the ruling party changes it is concerned not only with the welfare of present generation but also I with future generations. It therefore, undertakes and spends on those activities which also benefit future generations
8. **Nature of the Budget –** A surplus budget is always good for a private individual. Bin a surplus budget may not be good for the government. It implies two things: (i) The government is levying more taxes on the people than is necessary, (ii) The government is not spending as much on the welfare of the public as it should. Keynes supported a deficit budget to meet the situation created by depression. Further, the government budget is passed by the parliament. But the budget of an individual or firm is a private affair without any controlling authority.
9. **Nature of Borrowing –** In the case of an individual, there can no internal borrowing". An individual cannot borrow from himself. He can borrow only from an external agency. The State, however, can borrow both from internal as well as external sources. It borrows not only from its own citizens, but also from foreigners.

Budgetary activities of the government results in transfer of purchasing power from some individuals to others. Taxation causes transfer of purchasing power from tax payers to the public authorities, while public expenditure results in transfer back from the public authorities to some individuals, therefore financial operations of the government cause ‘Sacrifice or Disutility’ on one hand and ‘Benefits or Utility’ on the other.
This results in changes in pattern of production, consumption & distribution of income and wealth. So it is important to know whether those changes are socially advantageous or not.
If they are socially advantageous, then the financial operations are justified otherwise not.
According to Hugh Dalton, “The best system of public finance is that which secures the maximum social advantages from the operations which it conducts.”

Principle Maximum Social Advantage (MSA)
The Principle of Maximum Social Advantage (MSA)’ is the fundamental principle of Public Finance.

The Principle of Maximum Social Advantages states that public finance leads to economic welfare when public expenditure & taxation are carried out up to that point where the benefits derived from the MU (Marginal Utility) of expenditure is equal to (=) the Marginal Disutility or the sacrifice imposed by taxation.

Hugh Dalton explains the principle of maximum social advantages with reference to –
1. marginal Social Sacrifice
2. Marginal Social Benefits

This principle is however based on the following assumptions –
- All taxes result in sacrifice and all public expenditure lead to benefits.
- Public revenue consists of only taxes and no other sources of income to the government.
- The government has no surplus or deficit budget but only balanced budget.

Public expenditure is subject to diminishing marginal social benefit and taxes are subject to increasing marginal social sacrifice.

Marginal Social Sacrifice (MSS)
Marginal Social Sacrifice (MSS) refers to that amount of social sacrifice undergone by public due to the imposition of an additional unit of tax.
Every unit of tax imposed by the government taxes result in loss of utility. Dalton says that the additional burden (marginal sacrifice) resulting from additional units of taxation goes on increasing i.e. the total social sacrifice increases at an increasing rate. This is because, when taxes are imposed, the stock of money with the community diminishes. As a result of diminishing stock of money, the marginal utility of money goes on increasing. Eventually every additional unit of taxation creates greater amount of impact and greater amount of sacrifice on the society. That is why the marginal social sacrifice goes on increasing.

Marginal Social Benefit (MSB)
While imposition to tax puts burden on the people, public expenditure confers benefits. The benefit conferred on the society, by an additional unit of public expenditure is known as Marginal social Benefit (MSB).

Limitations of Social Advantage
The principle of Maximum Social Advantage suffers from a number of shortcomings. Importance ones are –
1. There is no effect means of quantifying utility and disutility.
2. Equating of marginal utility and disutility is spoken of for the society as a whole", not for "individual members" of the society so there is the possibility that for some individuals marginal utility of public expenditure may be higher or lower than the marginal disutility, of taxation. This raises the question of distributional equity. How the marginal utilities and disutilities should be divided among individual members of the society.
3. The basic weakness of this principle ox that it gives neither a concrete standard by which the efficiency of various expenditure programmes can be.
4. The utility of public expenditure is a macro issue, while the disutility of taxation id a micro one. To treat the two as the two sides of the same coin is methodologically wrong.
5. In a situation of large scale involuntary unemployment, government spending may need to be increased enormously with or without the sanction of the principle. Here the principle breaks down.

Tests of Social Advantage
Dalton has provided the following tests of social advantage –
1. The first is the need to preserve the community from internal disorder and external attacks. Here it is assumed that the society is worth pressuring. it is not a strictly economic test of social advantage, yet it is true that no society can progress without peace.
2. The second test is strictly economic and relates to increasing the economic welfare of the community. Two conditions are necessary for this. They are improvement in production and improvement in the distribution of what is produced.

Lady U.K. Hicks has also developed two criteria for judging whether the operation of public finance would add to net social benefit or not. They are production optimum and utility optimum. An optimum in production is attained when production of one commodity cannot be increased through reallocation of given productive resources without reducing the output of some other commodity. A utility optimum is achieved when a reallocation of national product cannot increase the total satisfaction of the commodity.

Unit – II

Sources of Revenue: Taxes, Loans, grant & Aids

Meaning and significance Source of Revenue

As public expenditure is necessary for the government to perform its various functions for the welfare of the society, so it requires public revenue. Public revenue holds the same position in study of public finance, which production holds in the study of economics. Just as production is the means of consumption, public revenue is the means for public expenditure.

The income of government through all sources is called public income or public revenue. However, Dalton has defined 'Public income" in a broad and a narrow sense, i.e., in terms of Public receipts and 'Public revenue". Public revenue includes income from taxes, prices of goods and services supplied by public enterprises, revenue from administrative activities, such as fees, fines, etc., and gifts and grants; while Public receipts include all the incomes of the government which it may have during a given period of time, i.e.. Public receipts = Public revenue + Income from all other sources, such as public borrowing from individuals banks and income from public enterprises.

Various Classifications of Revenues

1. Adam Smith's Classification – Adam Smith classified public revenue into two categories –
   a. Revenue from the people
   b. Revenue from the Sate Property

   Revenue from the people includes tax revenue and revenue from State property includes revenue obtained from public enterprises as well as that revenue which are derived from the property in possession of the state.
2. Bastable's Classification – Like Adam Smith, Bastable has also divided public into the following two categories –
   a. That income which the state receives from its various functions just like a private individual.
   b. Those income which the State derives in the own capacity as "State".

   The first category includes all the income which the State derives in the form of fees and prices, while the second category includes taxes and Levis. This classification is also limited and narrow like that of Adam Smith. This classification does not appear to be compressive from one other angle also,, that is, fee, gifts, fines and special assessments are difficult to be classified into separate groups.
3. **Prof. Adam's Classification –** Prof Adam has divided the public revenue into three categories–
   a. **Direct Revenue –** This includes income form (a) public domains, (b) public industries, (c) Gratuities, etc., (d) confiscations and indemnities. These categories includes all the income which the State derives from public land public enterprise like rail, roads, highways, post and telegraph and other incomes which the state derives due to the ownership of productive enterprises.
   b. **Derivative Revenue –** This includes taxes, fees, assessments, fines and penalties, i.e., the income derives from the people is grouped under this head.
   c. **Anticipatory Revenue –** This includes income from the sale of bond or other forms of commercial credit. It also includes income from the treasury notes. This group deals mainly with the revenue derived from the public credit.

Administrative Revenue

Administrative revenues refer to the receipts from fees, licences fines, forfeitures and escheats and special assessment, etc. The revenue from these sources is collectively termed as administrative activities of the government. According to Taylor, administrative revenues arise as a by-product of the administration.

Fees – A fee is a compulsory contribution made for a specific series which primarily has a public purpose: A fee has been defined by Prof. Seligman as “a payment to defray the cost of each recurring services undertaken by the government. Primarily in the public interest, but conferring measureable special advantages on the fee payer.”

Commercial Revenue

The characteristics which distinguishes commercial revenue from the categories of revenue is the direct receipt of a commodity or services in return for payment and a rough adjustment of the amount of payment to cost. Commercial revenues may arise from two principal sources. They may either arise from public properties or from public enterprises.

a. **Revenue from Public properties –** The government everywhere owns some real properties, like lands, buildings, forests, mines, fisheries, etc. The government can obtain revenue either by selling or leasing these properties. Thus, for example, the Government of Orissa gets large revenue by selling timber, tends leaves, bamboos and other forest products. So also the government can obtain huge royalties by leasing out mines or fisheries, etc. Revenue from public enterprises is also known as revenue from public domain.
b. Revenue from public enterprises – In modern times the role of the public sector in the various countries is fast expanding. The State for various reasons takes Up the production and sale of a number of essential commodities and services. The State may also enter the economic arena, in insurance of the policy of planning and socialism.

Thus, the State derives revenues from its public enterprises by selling the produced goods and services. Under revenue, from public enterprises, we include the receipts from the railways, post offices, State transport and from public sector industrial undertakings, etc. The government charges a price for the provision of these goods and services. In India, however, till the recent past, the performance of the public sector enterprises has not been very encouraging. Thus, the railway finance has not been very sound. The contribution of Posts and Telegraphs Department to the total non-tax revenue has been modest. Similarly, till now most of the other public undertakings have been running in the red avoid the payment of a price by avoiding the purchase of a commodity or service produced by the government. Price is a contractual payment. Thirdly, a price paid for the enjoyment of a good or service by an individual. It is paid for individual satisfaction. But a tax is paid for furthering common good.

Gifts and Grants

Gifts are given by private agencies, individuals and institutions. Gifts are purely voluntary in nature. In a country there are many patriotic and public spirited individuals and organizations who make voluntary contributions for some specific purposes. These gifts are usually made for helping some particular causes, like providing aid to the flood-affected people or drought affected or quake hit people. Gifts may be given in the form of contributions to the National Defence Fund, etc. Gifts may also be given by foreign nations or foreign organizations. The Red Cross sands gifts to the people in distress in any country of the world. “Gifts are, however, not a very important source of public revenue.

Public Revenue

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

Characteristics of Tax

A tax possesses three characteristics. **First, a tax is a compulsory** contribution to the State from the citizens or even from aliens subject to the jurisdiction for reasons of residence or property and this contribution is for general or common use, As it is a compulsory contribution, so no one can refuse to pay a tax on any ground; for instance, as he does not drive any benefit from certain State services or as he has no right of franchise, so he is not liable to pay a tax. Therefore, everyone has to pay a tax upon whom it is levied by the State; it is immaterial whether he is an adult or a minor, or a citizen or an alien.

Moreover, the refusal to pay a tax is subject to punishment. However, there are certain qualifications to it.

The second characteristic is that a tax imposes a personal obligation on the tax payer. It means that it is the duties of the taxpayer to pay the tax if he is liable to pay it and should in no case think to evade it. Suppose a tax is imposed on the incomes of the individuals, the sources of income may be many and the public authority may not be in the know of all those sources. Here it is the duty of the tax payer to show all of his income and take into account his total income while paying the tax.

The third characteristic is that the contribution received from the tax payers, may not be incurred for their benefit alone, but for the general and common benefit. As an individual finds himself helpless to meet all this needs especially those which involve heavy expenditure, i.e., the construction of a hospital, the State renders such services for the benefit of all people. Hence, taxes are imposed upon all those people, who are able to pay them, to share the common burden.

Meaning of Tax

It is, of course, very necessary to define tax before going into further details about taxation. The following are the various definitions of tax given by different economists –
Adams- "A tax is a contribution from citizens for the support of the State.

Objects or Aims of Taxation

What are the aims behind the imposition and collection of taxes? Generally we may say that the imposition of taxes has the following aims –

1. **Raising Public Revenue –** The first and foremost aim of taxes is to raise Public Revenue to meet the ever-increasing public expenditure. This aim has its special significance particularly in the undeveloped economies where the Government has taken over the task of securing at minimum level of living to the public and has assumed the responsibility of active participation in the task of economic growth. This aim also receives even greater importance due to the fact that the public sector has been constantly increasing in these economies.
2. **Reduction in the Inequality of Wealth-** Another important object of taxation is to reduce the inequality of wealth. One of the chief characteristics of under-developed countries is said to be that there is vast gap between the income of persons in the highest income group and of those- in the lowest income group. That is why one of the -important aims of the growth programmes in these countries is to bring about a reduction in the inequalities in the distribution of incomes and wealth. One of the aims of the taxation comes to be redistribution of wealth and income in such a way so as to ensure more equitable distribution and by taxing rich people heavily and to confer benefit on the poor.
3. **The Aim of Tax Collection is Public Good-** It is for the benefit of the general public and for the maximum welfare of the whole society that the taxes are imposed and collected. The use of taxes in the welfare of vested individual interests or for the development of a particular section in a way not agreeable to the general public is not permissible. Tax-revenue is spent keeping in view the aggregate welfare of the whole nation and not of a particular section.
4. **Restriction on production and use of harmful goods -** The government not only raises revenue through taxation but it also imposes restriction on the use of certain goods and services in a way desirable and respectable for a healthy State of society. Taxes on intoxicant tobacco etc., raise public revenue on less than other taxes but their main aim is prevent the deterioration of health of general public.
5. **Regulation of Import and Export-** On the other hand there is import and export duties which also raise revenue but their specific aims are some others. Import taxes are levied in order to restrict imports of those goods which may harm the "infant" industries producing those goods in the country. Similarly luxury goods may be taxed heavily while being imported so as to divert the national funds in some other forms of production inside the country. In the same way

export taxed may be levied within for the purpose of restricting export of those goods which are required 'within the country, and their export may hamper national production or consumption. Thus an important objective of taxation is to regulate the economy in accordance with the needs of the country.

Introduction

Taxation imposes burden or sacrifice on the tax-payers. Tax moreover, have far-reaching economic effects. The tax system, therefore, should be so organised as to impose the smallest possible sacrifice on the community. For that purpose, the tax system should be based on certain well-defined rules and principles. Otherwise, the very objective of taxation and the aspect of social justice, both may be hampered. For example, a tax which widens the gulf between the rich and the poor may be highly productive, but as it goes against the canon of social justice, it should not be supported. So also, if a tax adversely affects the productive system of a country, it should be avoided.

Thus, to devise a sound and efficient tax system, economists and public men, from time to time, have laid down certain principles to; which the tax structure should confirm. In this direction, the contribution of Adam Smith is very great. He laid down certain canons or maxims of taxation for the guidance of taxing authority, which are still famous for their clarity, simplicity and reasonableness. Later on, other economists laid down more canons of taxation to supplement the canons of Dr. Smith.

1. **The Canon of Ability of Equity –** The canon of ability is the most important canon of taxation to Adam Smith, 'The subjects of every State ought to contribute towards the support of the government as nearly as possible its proportion to their respective abilities, that is in proportion to the revenue which they respectively enjoy under the protection of the State." This principle emphasizes that the tax burden should be imposed needing to the respective abilities of the tax-payer so as to achieve equality of sacrifice. Here equality of sacrifice does not mean that all should pay at equal rates. Equality in taxation signifies that the rich afraid contribute at a higher rate and the poor at a lower rate. Sometimes the canon of ability has been interpreted to mean proportional taxation. But actually this canon stands for progressive taxation and hence this principle is just and equitable.
2. **The canon of Certainty –** The canon of certainty is important from the point of view of the tax-payers as well as the government. The tax-payers must be certain about the rate of tax, method and time of collection, etc. There should be no element of arbitrariness in taxation. Otherwise it will lead to all kinds of malpractices, such as corruption and bribery, etc. The taxpayers will be subjected to unnecessary harassment. Similarly, the government also will fail to prepare accurate budgets unless it is certain about the amount of revenue likely to be raised by taxes and can make an estimate. So Adam Smith had laid down, "the tax which every individual is bound to pay ought to be certain and not arbitrary. The time of payment, the quantity to be paid ought to be clear and plain to the contributor and to every other person." Ari old tax imposes the least inconvenience and confusion as people are already fully accustomed o and familiar with it. So it is popularly said:"An old tax is no tax.
3. **The Canon of Convenience –** The canon of convenience follows from the canon of certainty. Not only should the time and method of payment be certain, but they should be minted as to cause least inconvenience. Thus, Adam Smith pointed out, "Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it.
4. **The Canon of Economy –** Adam Smith laid down the canon of economy in the following way: "Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible, over and above what it , brings into the public treasury of the State.

Characteristics of a Good Tax System

A Good tax system should have the following characteristics –

1. **Equity –** The burden of a tax in a good taxation system should be the minimum. Along with that, it should be distributed amongst the different sections of the community in a just and equitable manner. The heaviest burden should be borne by the broadest shoulders. There should be a

proper blending of direct and indirect taxes in the taxation system to achieve this objective. From the point of view of equity, the Indian tax system leaves much to be desired. The predominance of indirect taxes in the Indian tax system reflects the inequitable nature of this system.

2. **Productivity –** The term 'productivity' is interpreted in two senses. Firstly, the tax system should be such as to provide adequate name to the government to meet its expenditure. Secondly, the taxation system should be such as to produce no adverse effect on the productive capacity of the country. From the point of view of productivity, the Indian tax system leaves much to be desired. The' Indian income-tax system for example, produces adverse reaction on the incentive to worn of the citizens.
3. **Elasticity –** The tax system should provide to the government increased income with the increase in the national income of the country. The tax system should also yield more income when the government expenditure goes up at a time of emergency or crisis. It should be possible then to obtain more income with slight increases in the rates or the taxes. Two things are essential to bring about elasticity in the tax system. Firstly, there should be a proper blending of direct and indirect taxes. Secondly, certain sources of income should be exclusively reserved ire emergencies, such as, war etc. The Indian tax system satisfies the canon of elasticity in a sufficient measure insofar as the income of the government keeps on increasing in accordance with its requirements.
4. **Convenience** – The government should also keep in mind the convenience of the tax payer while devising the tax system of the country. Since the taxpayers make sacrifices-when they pay the taxes, it is essential for the government to see that they are not put to any avoidable inconvenience. Besides, the tax system should be simple so as to be within the understanding of the ordinary taxpayer. The Indian tax system, no doubt satisfies the canon of convenience, but it does not satisfy at all the canon of simplicity. It is a highly complex and complicated tax system, much beyond the understanding of the average taxpayer.
5. **Absence of Tax Evasion –** The tax system of the country should be s devised as to leave no scope for tax evasion on the part of the taxpayers. To achieve this objective, there should be a proper blending of all sorts of commodity and personal taxes. This will reduce the scope for tax evasion to the minimum. From this point of view, the Indian tax system leaves much to be desired. There is at present a large-scale evasion of the income-tax going on in the country, especially by the business classes
6. **Maximum Social Advantage –** According to Dalton, that system of taxation is the best which is based on the principle of „maximum social advantage. The objective of every tax system should be to promote the greatest good of the greatest number. It is also essential that the tax system produces no adverse reactions on the productive capacity of the country. It is doubtful if the Indian tax system satisfies this canon of maximum social advantage.
7. **Economical –** A good tax system should be economical to the government in the sense that the cost of collection of taxes should be small in proportion to the revenue from them.
8. **Multiple Taxes –** A good tax system should have multiple taxes rather than a single tax. According to Dalton, It is best to rely on a few substantial taxes for the bulk of the tax revenue
9. **Income-Elastic –** It should be income-elastic. As national income increases, the share of taxation in national income should rise more than proportionately.

Problem of justice in taxation

1. **The Physiocratic Theory –** This is the earliest theory regarding taxation and this is based o the view that land is capable of producing a net surplus. The Physiocratic School of Economic Thought had its origin in France. And the Physiocrates maintained that agriculture alone could yield a net return and could add to the wealth of the country and hence recommended that revenue of the State should be derived from a single direct tax levied upon land.. Henry George of San Fransisco also advocated a single tax on the appropriation of unearned increment, by the state.

2. **Financial Theory –** There are various theories with regard to the distribution burden of taxation among the people One of them is often called financial theory, which is embodied in the principle attributed to colb pluck the goose with as little squealing as possible
3. **The Principle of Equity –** Horizontal and Vertical Theory: Modem writers have laid a great emphasis on justice and advocated to follow the principle of equity the distribution of burden of taxation. Equity generally means fairness or justice in the distribution of burden of taxation. Equity involves two aspects: the treatment of people in like and unlike circumstances. The like circumstances imply that those; who are equally well off from the economic point of view, should pay equal amount as taxes. It is also called horizontal equity. The unlike circumstances imply that the people in dissimilar circumstances should be subjected to dissimilar treatment i.e., the persons who are -'better off" should pay more as taxes that others: This is called vertical equity'
4. **Cost of Service Theory –** This is one of the oldest principles advocated for the distribution of the tax burden. According to this theory, the basis of taxation should be the cost incurred by government on different services for the benefit of the individual tax-payers. Each tax-payer has to pay the tax equal to the cost of service to him. It means, the higher the cost, the higher should be the tax rate and vice versa. The government acts like a producer of a commodity, who charges the price from his customers equal to the amount of cost of production of the commodity.
5. Benefit Theory of Taxation – This theory explains that every citizen should be called upon to taxes in proportion to the benefits derived by him from services provided. Therefore, contribute to the cost value of other facilities in proportion to benefits received by them. The more the benefit a citizen derives, the more taxes he should bear, is the main assumption of the theory. The principle justifies the payment of taxes. It also measure s benefits received by the individuals in the case of certain special taxes such as petrol tax, betterment tax etc.

Features of Indian tax system

In India the authorities have been of the view that tax policy is a powerful tool by which the economy can be effectively regulated and by economic incentives and disincentives can be created. As a result our tax system has come to acquire the following salient features –

1. The system has become extremely complicated with rapidly changing provisions and rates. Frequently, these provisions have been contradictory to each other and self-defeating in nature.
2. The system is laced with a excess of exemptions, rebates, concessions, penalties and other provisions. In addition, there are notifications, clarifications, procedural details and the like. All this has made the system a highly complex one, and according to one opinion, counterproductive.
3. The authorities have always recognized the need to simplify the tax system but steps taken to this effect have only added to its complexities.
4. The tax-base of our country is a narrow one. Taxpayers are practicing large-scale tax evasion and avoidance. They are helped in this task by highly complicated tax provisions and procedures, as also by the vast discretionary powers enjoyed by the tax officials
5. Frequent voluntary disclosure schemes under which tax evaders are provided an opportunity to pay, tax (often on concessional basis) on concealed income and wealth, etc. have also contributed to the phenomenon of tax evasion.
6. Indirect taxes comprise a major portion of our tax revenue. Compared with direct taxes, they feed inflationary forces. They are more burdensome and cause widespread distortions in the allocation of resources. They are known to be highly regressive in their nature. Selective exemption of items from indirect taxes has not been able to reduce their regressive nature because of widespread evasion.
7. The authorities have used, on a systematic and selective basis, tax holidays and other concessions; for promoting certain industries considered essential for the overall balanced growth of the economy; for promoting and helping small-scale industries and self-employment

activities so as to reduce unemployment and encourage labor-intensive techniques; for encouraging investment in backward areas with the objective of reducing inter-regional economic disparities.

8. Critics claim that the tax provisions relating to depreciation are based upon the cost of acquiring assets and not the cost of their replacement. This, therefore, discourages capital formation.
9. Authorities have tried to encourage exports by levying customs duties on imports; providing income tax and other forms of relief on income from exports.
10. Over the years, the government has made a systematic effort to reform indirect taxes by converting the base of excise duties from specific to value added, and by replacing excise duties with VAT.

Characteristics of a Good Tax System

A Good tax system should-have the following characteristics:

1. **Equity –** The burden of a tax in a good taxation system should be the minimum. Along with that, it should be distributed amongst the different sections of the community in a just and equitable manner. The heaviest burden should be borne by the broadest shoulders. There should be a proper blending of direct and indirect taxes in the taxation system to achieve this objective. From the point of view of equity, the Indian tax system leaves much to be desired. The predominance of indirect taxes in the Indian tax system reflects the inequitable nature of this system.
2. **Productivity –** The term 'productivity' is-interpreted in two senses. Firstly, the tax system should be such as to provide adequate income to the government to meet its expenditure. Secondly, the taxation system should be such as to produce no adverse effect on the productive capacity of the country. From the point of view of productivity, the Indian tax system leaves much to be desired. The' Indian income-tax system for example, produces adverse reaction on the incentive to worn of the citizens.
3. **Elasticity –**The tax system should provide to the government increased income with the increase in the national income of the country.
4. **Convenience –** The government should also keep in mind the convenience of the tax payer while devising the tax system of the country. Since the taxpayers make sacrifices when they pay the taxes, it is essential for the government to see that they are not put to any avoidable inconvenience.
5. **Absence of Tax Evasion –** The tax system of the country should be so devised as to leave no scope for tax evasion on the part of the taxpayers. To achieve this objective, there should be a proper blending of all sorts of commodity and personal taxes. This will reduce the scope for tax evasion to the minimum.