



# ROLE OF TAXATION IN EQUAL DISTRIBUTION OF THE ECONOMIC RESOURCES

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## ABSTRACT

Tax being the major source of revenue for the government is the compulsory contribution that is paid by the citizens of India. More equitable revenue and asset distribution are made possible by direct taxes. Indirect taxes can occasionally help with equitable division by being levied on luxuries and exempted from being applied to necessities. Taxes play a major role in development of different sectors like health, education, infrastructure etc. as well as the economic development of the nation. India experienced a greater growth rate and a lower tax to GDP ratio than other countries indicating that the economy's tax return is strong. The Taxation laws in India has been an ongoing area of research, discussion, and study among economic experts and financial experts. Due to the consistently evolving tax laws in the country that subsequent governments have introduced and implemented, the taxpaying community has also been coping with and adjusting to the ever-evolving Indian tax system. Even though the Indian Tax Regime has periodically experienced alterations, it is still far from being a perfect tax system

## OBJECTIVE OF THE PAPER

The object of this paper is to analyse and review the role of taxation in equal distribution of economic resources in India. This paper also clarifies the role of direct and indirect taxes in development of Indian economy while describing the situation of Indian tax system during the period of pandemic

## RESEARCH QUESTIONS

The following are some of the research questions that this paper seeks to address with reference to the relevant laws and facts -

- What is the role of direct and indirect taxes in development of Indian economy?
- What role does taxes play in the equal distribution of economic resources in India?
- How was the Indian tax structure affected during the period of Covid-19 pandemic?

## RESEARCH METHODOLOGY

The research conducted for this paper is secondary. This research paper aims to explore the different aspects of the notion of tax laws in India. A qualitative approach was used for all the data collection. All the data was collected through various online sources like websites, scholarly articles, research papers, blogs etc. The legal provisions and case laws are investigated from different sources such as Manupatra and SCC Online.

## CHAPTERIZATION

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## INTRODUCTION

The compulsory contribution or charge levied by any government upon an individual or an organization to collect revenue for public welfare is known as tax. Article 265 states that only government has the authority to levy taxes. In India, taxes are mainly divided into two categories which are – Direct Taxes and Indirect Taxes

One of the main factors promoting economic growth in our country is generation of tax revenue. A good tax system ought to be capable to recognize economic surpluses and regulate them in a manner that does not harm the production of goods and services and development of a country. Nowadays, treating the nation's taxpayers fairly, justly, and equitably is the nation's true challenge.

For tax collectors or the administration who is responsible for collecting taxes in developing nations, collecting taxes is extremely challenging. The nation's biggest tax payers do not want to pay taxes unless they are compelled by the law to do so and because of this, there is a dire need for a mechanism to be implemented so

that paying taxes is no longer a matter of morality and autonomous choice for individuals. In India, the Income Tax Act 1961 governs the tax laws of the country and in order to prevent tax fraud, penalties are imposed accordingly. These penalties in the law should be designed in such a way that it makes tax evasion difficult so that tax evasion is reduced and should be used in addition to the continuous collection of taxes. Nowadays, tax avoidance which is considered as a risk-free lawful method of not paying taxes, is practiced by more intellectual and sophisticated taxpayers to prevent the penalties of tax evasion under law.

Consequently, tax evasion results in a much smaller income loss for the government than does tax avoidance. Hence, it becomes important for the laws to be framed in a manner that makes tax evasion challenging.

## **Chapter I – Tax Structure in India**

Tax is defined as a compulsory contribution or charge levied by any government upon an individual or an organization to collect revenue for public welfare. The funds collected are then further used for different public welfare programs. According to Article 265 of the Indian Constitution<sup>1</sup>, taxes are not to be levied or collected by anyone other than the authority of law. It is a compulsory contribution that is ought to be paid from the income of the taxpayer. The absence of payment of tax would lead to serious legal implications and penalties.

The taxes are categorized into two broad forms, and those are Direct Taxes and Indirect Taxes. Direct Taxes are those taxes that are paid directly to the government by any individual or organization. It is directly related to the wealth and income of the taxpayer. The most common examples of direct taxes are Income tax, wealth tax, etc. Indirect taxes are however consumption-based taxes that apply to only those goods and services that are brought and sold. It is an indirect payment to the government made by the seller or provider of the goods and services. The most common examples of indirect taxes are Goods and Services Tax, customs duty, etc.

## **Chapter II - Role of Direct and Indirect Taxes in the Development of the Indian Economy**

The consumers of goods and services must pay indirect taxes regardless of their financial capacity. However, because direct taxes are assessed on income or profits rather than on goods or services, they are less burdensome for the general public than indirect taxes. Because the amount of taxes increases in proportion to the decline in demand for goods and services, the indirect tax is also known as a regressive tax. The gap between the wealthy and the poor grows as a result of excessive reliance on indirect taxes. More equitable revenue and asset distribution are made possible by direct taxes. Indirect taxes can occasionally help with equitable division by being levied on luxuries and exempted from being applied to necessities. Alternative strategies for accomplishing any specific redistribution of income and wealth include both direct and indirect taxes.

The points listed below are how different types of taxes contribute to the development of the Indian economy –

### **1. Mobilization of resources**

Tax allows the government to generate revenue by imposing it on the general public which is further utilized for public welfare.

<sup>1</sup> The Constitution of India, Article 265

## 2. Decrease in income inequalities

The concept of equity is followed to lowering income tax inequalities. Direct taxation is inherently progressive. Additionally, some indirect taxes, such as those imposed on high-end goods, are also progressive. This means that taxes have a higher incidence for the wealthy class, whereas commodities used by the general public are either exempt from taxation (direct taxes) or subject to a lower rate of duty (indirect taxes) for those with lower incomes. Thus, taxation aids in reducing revenue and wealth disparities.

## 3. Social Welfare

For products, such as alcohol, tobacco, etc., high taxes are imposed on such products which limits their consumption and promotes social welfare. To enhance social welfare and order in society, a portion of tax revenue is used for social development initiatives like health, education, and family welfare.

## 4. Foreign exchange

Taxes promotes exports while limiting imports. Neither, developed nor developing nations tax goods that are exported. Exports, for instance, are free from excise duty, VAT, customs duty, and other duties in India. On imported products, there is a customs duty, though. Consequently, taxes aid in the promotion of foreign currency.

## 5. Regional Development

Tax incentives establish industries in underdeveloped regions and encourage business firms to do so. Tax money collected by the government is also used to build infrastructure in underdeveloped areas, which plays a significant role in regional development.

## 6. Inflation

Taxes also control inflation. The government may reduce indirect taxes or try to cut down demand accordingly.

## Chapter III - Role of Taxes in Different Sectors

### 3.1 Health Sector in India

The Indian tax laws have had immense benefits on health and have contributed to its development in a significant manner. For instance, the government collects taxes and generates revenue which is further utilized for the establishment of a health system that ensures that every citizen is provided with equal and equitable access to healthcare facilities and services irrespective of their social and economic standards. Taxes can also be used as a tool to limit the production of harmful goods which can further enhance the health sector of the country.

Several shreds of evidence have suggested that taxes imposed on harmful substances such as alcohol, tobacco, etc., thus increasing their prices has resulted in the decreased consumption rate of such products or goods with the overall consumption rates of such products falling to 4% for developed nations and 8% to developing nations.

When compared to citizens of other nations, Indians have some of the highest healthcare expenses as a percentage of their income. According to the Economic Survey 2021, 4% of India's population must endure such high levels of expenditure, compared to the global average of 3% of the population who spend more than

25% of their income on healthcare.<sup>2</sup> Therefore, government spending on the healthcare sector can increase access to timely, high-quality care for a larger portion of the people while also improving the overall health infrastructure in the country.

Hence it can be concluded that the government would be unable to develop the health industry without taxes paid by the general public from their income. The financing of health services, such as social healthcare, medical and scientific research, development costs, etc., is provided by taxes collected from the citizens of the country.

### 3.2 Education Sector in India

Education is considered one of the most important aspects of any economy. Education standards provided to the younger generation are what determine whether the economy of a country flourishes or not. Education fosters knowledge, insight, ingenuity, and productivity in people, which aids in a nation's progress. In India, both the state and private sectors offer educational services. Providing everyone in India with access to affordable education is one of the top concerns of the government and therefore the education sector enjoys several tax-related exemptions from the government. Hence, educational services are no longer taxable up to the higher secondary school level. Governments invest a lot of time and energy into the advancement of their nation in the areas of human resources and education. The public education system is financed, provided for, and maintained using tax revenue.

### 3.3 Governance Sector

Poor governance would have an enormous impact on economic development and have a far-reaching effect on every nation. The government, therefore, needs to make sure that the taxes are paid and the revenue collected is utilized for the welfare of the people of the nation. People working in different fields such as medicine, the army, government employees, police, and other entities receive direct funding from these taxes. Hence it becomes essential to ensure that good governance is established so that people can receive the benefits of the taxes.

### 3.4 Infrastructure, Transport, Housing and Other Sectors

Government utilizes the revenue generated by collecting taxes to fund other major sectors that promote and work towards the development of the nation such security of the nation, scientific research, and development etc. Taxes help promote economic development, which in turn raises the standard of living in society and boosts a nation's gross domestic product value. Taxes also increase employment opportunities which benefits young and unemployed people in the country.

<sup>2</sup> <https://economictimes.indiatimes.com/wealth/personal-finance-news/if-govt-spends-your-tax-on-better-healthcare-you-would-have-to-spend-less-survey/articleshow/80584717.cms> [Accessed on 03rd Mar 2023]

## Chapter IV - TAX to GDP Ratio

The tax to GDP ratio shows how much money is collected in taxes as a proportion of GDP and how much money the government receives in taxes overall. India, despite experiencing greater growth rates and a lower tax to GDP ratio than other countries, has a higher ratio, indicating that the economy's tax return is strong. This further compels the government to spend money for development of the infrastructure sector and pressures the government to adhere to its fiscal deficit goals.

Governments spend on the development of the infrastructure, and when they receive tax revenue, they invest it in expanding the infrastructure sector, which in turn stimulates economic activity across the nation. Every small, medium, or large company is required to pay attention to the tax amount since governments can reinvest this money in the economy in the form of loans and perhaps other measures of financing.

As of 2018–19, India's tax to GDP ratio was at around 10.9% which was alarmingly low when compared to the average of OECD member states, which hovers around 34%. A high tax to GDP ratio indicates the government can successfully control spending without resorting to excessive borrowing. The high ratios are typically linked to developed countries. India's numbers were relatively low because of several factors, including high GDP growth, extensive income tax evasion among big companies and the upper classes, and decreased service tax collection.

The greatest tax-to-GDP ratio was 11.7% in 2021–22, with direct taxes accounting for 6.1% and indirect taxes for 5.6% of GDP. According to the report of Ministry of Finance of the Government of India, the tax buoyancy, an indicator of the increase in tax revenues relative to GDP growth, is at a very healthy 1.9, with direct taxes accounting for 2.8 and indirect taxes for 1.1. The direct tax to indirect tax percentage increased from 0.9 in 2020–21 to 1.1 in 2021–22.

## Chapter V - Indian Tax System and its Drawbacks

The Taxation laws in India has been an ongoing area of research, discussion, and study among economic experts and financial experts. The complexity of being the most populated country in the world, as well as the type and size of the businesses chosen to be included in the taxation system, are to blame for this. Due to the consistently evolving tax laws in the country that subsequent governments have introduced and implemented, the taxpaying community has also been coping with and adjusting to the ever-evolving Indian tax system.

Even though the Indian Tax Regime has periodically experienced alterations, it is still far from being a perfect tax system. Tax evasion is one of many issues the administration of India is dealing with in modern times.

Tax evasion is defined as an illegal activity where the tax payer evades his tax liabilities on purpose. Tax evasion is therefore a white-collar crime where in order to decrease their tax liability, the tax payer willfully conceals the annual income or falsely represent their income to the authorities. In India, evading taxes is illegal and a punishable offence under the law.

The Income Tax Act, 1961, Chapter XXII, encompasses provisions relating to the prosecution of such offences, including late filing of returns, providing false information, knowingly attempting to avoid payment of taxes,

fabricating numbers, etc. In these situations, the onus of proof rests with the accused. If the amount of tax evaded surpasses Rs. 25 lakhs, the offender faces a fine in addition to a minimum of six months' rigorous imprisonment and a maximum of seven years' imprisonment. According to section 271(C) of the Income Tax Act of 1961, the fine for failing to provide accurate information or hiding income tax will range from 100% to 300% of the tax that was avoided. If the tax is not paid when due, a penalty is assessed, but it cannot be greater than the sum owed.<sup>3</sup>

In the case of *Balaji v Income Tax Officer*<sup>4</sup>, when determining the petitioner's total income for the purpose of assessment, the petitioner and his wife established a partnership and included their three minor boys in it. Under Sections 16(3)(a)(i) and (ii) of the Indian Income Tax Act, 1922, the income-tax officer included the wife's and the three boys' portions of the family's income.

The petitioner filed a case in the Supreme Court of India pursuant to Article 32 of the Constitution challenging the constitutionality of the provision contending that they were in violation of Entry 54 of the Federal Legislative List of the Government of India Act 1935 and violation of fundamental rights enshrined in Articles 14 and 19 (1) (f) and (g) of the Constitution of India.

The court in this case contended that it was improper to generalize tax evasion cases in India where the circumstances were completely distinct from the tax evasion cases of those in the United States. It would not be appropriate for the court to assert based on the analogy of American decisions that there was no need for such legislation given that the legislature, aware of the widespread tax evasion in this country, passed the law for its prevention.

Both direct and indirect taxes place a disproportionate amount of burden on the business sector which further leads major business groups to often transfer the financial burden to shareholders and customers, who may make up a very small group. This does not go well with concept of fair economy in the country. Additionally, there is a possibility that companies will engage in widespread tax evasion, which could lead to a loss of tax revenue.

Another challenge faced by the Indian tax system or the Indian tax structure is lack of tax on agricultural income. Despite being the largest sector of the Indian economy, agriculture does not have a tax on its income. It is almost impossible to propose any agricultural tax scheme because state governments oversee handling taxes on agricultural goods and products. Taxpayers who falsely claim exemption under the heading of agricultural revenue present another issue. Nobody wants to upend the status quo because farmers are an important and a major source of votes for every political parties.

It can therefore we concluded that the Indian Tax structure is not perfect and even after the existence of the lengthy Income Tax Act 1961 and other statues, the administration faces several drawbacks in generating the tax revenue.

<sup>3</sup> The Income Tax Act, 1961

<sup>4</sup> (1962) AIR 123

## Chapter VI - Effect of Covid-19 on Indian Tax System

Too many countries were severely impacted by the COVID-19 outbreak, particularly due to the widespread lockdowns that have halted economic and social activity. The UN issued a warning, predicting that the coronavirus will have a major negative impact on the world economy. Due to COVID-19, there was another impact on the financial markets, international oil markets, where it was predicted that money would flow to Western Capital Markets because of rate cuts, a decline in stock values globally, and historically low demand for oil, which led to declining crude oil prices.

The outbreak of COVID-19 affected India's indirect tax income. In comparison to February's revenue generated by the government of Rs 1.05 lakh crore, the Goods and Services Tax collections for March 2020 decreased to Rs 97,597 crore. Even before the pandemic started, India was experiencing a decline in the revenue from indirect taxes.

In the third quarter of 2019–20, India's GDP increased by 4.7%, according to data published by the government of India in February. The prior quarter's GDP growth had been revised upward to 5.1%.

The Indian government, among other things, moved swiftly to provide taxpayers with relief under direct tax laws in India in order to maintain their standard of living and stabilize economic growth. That after the lockdown, additional steps were made to address the taxpayers' sincere fears and burdens. The guidance provided by foreign organizations, economic research, some revenue officers' suggestions for handling the situation, and the direct tax administration's policy decisions were also taken into consideration.

### CONCLUSION

The central government of India has implemented a plethora of policies to assist people in reducing their income taxes, even though the value of taxes to the nation's economy cannot be overstated. To increase revenue generation in the nation, the Indian government needs to expand the types of investments allowed under income tax laws or policies. For the general public to better understand tax law and processes, the income tax department should plan taxpayer awareness campaigns which would in turn help citizens to understand the importance of paying taxes and how taxes contributed to the equal distribution of resources while promoting the overall development of economic standards of the country.

The massive burden of revenue collection presents a variety of issues and difficulties for developing nations like India. Hence the laws should be formulated in such a manner that in cases where either of party that makes baseless and unfounded claims, should be compensated for the costs of the legal action.

The tax structure should be expanded by the government in order to successfully tax the middle and lower economics classes. To lessen the income inequality difference, more indirect taxes should be levied on the wealthier members of society while the poor should attempt to be exempted from paying indirect taxes.



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