Unit-III Sources of Government Revenue

• Government Budget:

The govt. budget can be sub divided under two heads viz., (i) Revenue budget and (ii) capital budget.

The revenue budget shows the current reciept and expenditure of the govt. which do not change the asset and liability position of the government. On the other hand capital budget shows those receipt and expenditure which changes the asset and liability position of the government. Let us discuss revenue and capital receipts and then sources in more detailed manner —

(a) Revenue receipts — Revenue receipt of govt. refers to those receipts which neither creates liability nor lead to reduction of assets of the government. Government may recieve such revenue from various sources, viz. —
(i) Taxes (ii) Non-taxes

i. Tax revenue — Revenue receipts are divided into tax and non-tax revenues. Tax revenue consists of the proceeds of taxes and other duties levied by the govt. Taxes are unilateral compulsory payment by the people to the govt. and they do not need to be repaid by the govt. in future. Tax revenue is an important component of revenue receipt and it comprises of direct taxes, which fall directly on individuals (personal income tax) & firm (corporation tax), and indirect taxes (like ~~of~~ GST, excise taxes, custom duties etc.) whose burden can be shifted from one individual to another.

ii. Non-tax revenue — The govt. also enjoys receipts from non-tax sources viz., fees, fines, penalties, gifts, grants, escheates etc.

(b) Capital receipts — Capital receipts are defined as any receipt of the govt. which either creates a liability or leads to reduction of assets. In other words whenever a govt. raises funds either by ~~increasing~~ incurring a liability or by disposing off its assets, it is called a capital receipt. Capital receipts include three items viz. —

(i) Recovery of loan (ii) Other receipts (mainly through disinvestment)
(iii) Borrowing

Among these three items, recovery of loan and disinvestment reduces government assets where as borrowings increases liability of the government. Thus borrowing can be considered as debt creating capital receipts, where as disinvestment and recovery of loans are considered as non debt creating capital receipt.

• Public Revenue:

The income of the govt. through all sources like taxation, borrowing, fees donation etc. is called public revenue.

As public expenditure is necessary for the welfare of the society. so it requires public revenue. Just as production is the means of consumption, public revenue is a mean for public expenditure.

• Sources of Public Revenue:

The sources of public revenue can be classified under two categories —
(i) Tax revenue (ii) Non-tax revenue.

(i) Taxes – Tax is a compulsory payment from a person to the govt. to defray the expenses incurred in the common interest of all without reference to special benefit conferred. The largest part of public revenue is raised through taxes. Taxes may be direct or indirect.

(ii) Fees – The second important source of public revenue is a fee charged for rendering certain services. According to Seligman, "Fee is a payment to defray the ~~of~~ cost of each recurring services undertaken by the govt., ~~primib~~ primarily in the public interest but conferring a measurement special advantage on the fee payer.

(iii) Special assessment – It refers to a compulsory contribution levied in proportion to the special benefit derived. To defray the cost of a specific improvement undertaking in the public interest.

Therefore special accessment is a compulsory payment like tax. Some of the important characteristics of special ~~purpose~~ accessment are —

1) There is element of special purpose in it.
2) The special benefit of the public activity conferred can be

measured.

3) Special accessment are proportional to the cost of benefit receipt. This is not progressive.

4) The aim of levying such accessment is to provide special benefit to the society.

(iv) Fines and penallties — These are the charges imposed on persons as a punishment for ~~in~~/rigment / break of certain law. Fines and penallties are not an important sorce of revenue. These serve as punishment for a crime or infrig--ment of the law and therefore its payment is also compulsory.

(v) Escheates — It refers to the claim of the govt. to a property of a person who dies without having a ~~legal~~ legal heir or without keeping a will.

(vi) Forfeitures — It refers to the penallties imposed by court for the failure of individual who appear in the court to complete contract as stipulated.

(vii) Gifts and grants — Gifts and grants are voluntary contribution from private individual or non-govt. donners to ~~got~~ govt. funds for specific purpose. Such as relief fund, defense fund during a war or emergency.

In modern times grants are given from govt. to another for e.g.- in a federal system, the central gives grant in-aid- to the state govt. This may be either conditional or unconditional.

• Difference between Tax and Price:

1) Tax is a compulsory payment to be paid by everyone on whom it is levied on the other hand price is to be paid by the person who purchase goods and services by the govt.

2) A tax doesn't gurantee benefits; while prices are the direct payments for goods and services and the amount paid depends upon quantity of goods and services purchased.

• Tax v/s Fees:

1) A tax is a compulsory contribution but. Fee is optional and the fee payer is ~~fee~~ free to choose whether he would pay or not.

2) A tax payer doesn't receive any specific services on account of paying tax. But a fee is the direct payment for the services render to the payer and the govt. also provide guarntee of the services to the payer who pays the fees.

3) Tax is imposed according to the availability to pay but fees are not based on principle.

• **Tax v/s Special Assessment :**

Similarities –

1) Like a tax, sepecial assessment is a compulsory contribution and hence the element of compulsion is present in both.

2) An element of public purpose is present in both and the income received by way of a tax and special assessment is incurred for the benefit of the community as a whole.

Dissimilarities –

1) Income derived by way of taxes is used for general purpose of govt. while income received by way of special assessment is used for specific local improvement.

2) The basis of assessment of a tax may be many for eg.– income, expenditure, value of property etc. but basis of assess-ment of special assessment is benefit only.

3) Special assessment are mostly levied in order to finance some special developmentall skill. But taxes may be imposed to finance capital development scheme ~~or~~ to defray the running expences of the govt. or both.

• **Taxation :**

Taxes are compulsory payment to govt. without expectation of direct return of benefit to the taxpayer. If a person defies the tax payment he must be punished in the court of low. According to Seligment, " A tax is a compulsory payment to the govt. to defray the expences incurred in the common interest to all without reference to special benefit confurred."

• **Characteristics of Tax :**

1) A tax is a compulsory contribution to the state from the citizens.

2) It is the duty of the taxpayer to pay a tax if he is liable to pay it, and should in no case think to evade it.

3) The contribution received from taxpayers may not be incurred for their benefit alone but for the general and common benefit.

• **Characteristics of a Good Tax System:**

A good tax system means the system with ~~best~~ least shortcomings. The main characteristics of a good tax system are as follows —

1. A good tax system would cause minimum aggregate sacrifice. It should be able to bridge the gap between rich and poor and gain equality.
2. It should ensure maximum social advantage.
3. A good tax must follow most of the cannons of taxation to the most possible extent and such that taxes, should be justiciable, equitable, productive and elastic.
4. In a good tax system, taxes should be acceptable by the public and it should be consistent with the peoples notion of fairplay.
5. In a good tax system, the balance should be maintained by imposing all types of taxes. It should not be a single type of tax oriented system.
6. A good tax system does not hamper the growth of trade and industries, rather it helps the rapid economic development of the country.

Thus it can be concluded that a good tax system should be designed so as to meet the requirement of equity, efficiency and convinience of tax payer and administration.

• **Cannons/Principles of Taxation:**

Economist have suggested various principles regarding taxation but none of them has given the exact cannons of taxation. ~~A time to time bear the testimony of a good~~ A cannon or principles of taxation given from time to time ~~bear~~ the testimony of a good taxation policy.

Adam Smith has given the following four cannons of taxation which are as follows —

1. Cannons of equality — In this principle it is mentioned that the tax must be levied according to the tax paying capacity of the individuals. In other words, this principles states that the burden of taxation should be fair and just. The higher the income, the higher the tax and vise-versa.

2. Cannon of certainity — According to this cannon the tax which each individual is bound to pay should be certain and not arbitrary. The time of payment, manner of payment, amount to be paid, the place of payment, the authority to whom the taxes is to be paid etc. should be clear.

The taxpayer cannot be exploited in any way if the the tax is certain. The cannon of certainity is both in the interest of the payer and the govt.

3. Cannon of convinience — It implies that tax should be imposed in such a manner and at the time which shall be most convinient for the taxpayer. For example, the best time for the collection of land revenue is at the time of harvest. This cannon is important for both taxpayer and the govt. The taxpayer feels convinient in making the payment and the authority also comes to know about the incidence of taxation and the increased income by way of taxes.

4. Cannon of economy — It implies that minimum possible money should be spent in the collection of taxes and a maximum part of the collected money money should be deposited in the govt. treasury. Thus all unnecessary expenses in the collection should be avoided at all cost.

In addition to above four cannon of taxation, there are other cannons which have been added by ~~modern~~ modern economist like Bastable, which are as follows —

5. Cannon of productivity — This cannon ~~suggest~~ suggest that it is better to impose a few productive taxes rather than to go in for a large no. of unproductive taxes. The productivity of a tax may be observed in two ways —

ⓐ On the 1st place a tax should yield a satisfactory amount for the maintainance of a govt.

ⓑ A tax shouldn't discourage production in the short run as well as long run.

6. Cannon of elasticity — This cannon signifies that a tax should be levied in such a way that the amount to be collected can be increased or decreased with least inconvinience.

7. Cannon of diversity — The cannon refers that diversity should exist in the tax system of a country. The burden of paying tax should not centralise on one group of people but it should be diverified in such a way that taxpayer should pay to the administration according to his ability to pay.

8. Cannon of simplicity — It implies that tax should be easily understood by the taxpayer i.e. its nature, its aim, time to payment, method and basis of estimation should all be easily followed by the taxpayer.

• Classification of Taxation:

A) On the basis of form, taxes are classified into two categories —

1. Direct taxes 2. Indirect taxes.

B) On the basis of nature, taxs may be of the following types —

1. Income tax 2. Property tax 3. Tax on Production
4. Tax on Consumption 5. Tax on Capital Goods.

c) On the basis of essence —

1. Ad-valoram 2. Specific tax.

D) On the basis of volume —

1. Single tax 2. Multiple tax.

E) On the basis of method —

1. Proportional tax 2. Progressive tax 3. Regressive tax
4. Degressive tax.

• Direct and Indirect Taxes:

A direct tax is one which is really paid by the person on whom it is legally imposed. In case of direct taxes the impact or the money burden and the incidence fall on the same person on whom the tax is imposed.

Merits of direct tax –

1. Economic – Direct taxes are economical in the sense that the cost of collecting these taxes are relatively low for the govt. as they are usually collected at source.

2. Equity – Direct taxes are considered to be just and equitable, because, they are generally based on the principles of progression.

3. Certainity – The taxpayer is certain as to how much he is expected to pay and similarly the state is certain as to how much it has to receive as income from direct taxes.

4. Direct taxes create civic consciousness among the common masses.

Demerits of direct tax –

1. Inconvenience – The main drawback of the direct tax is inconvenience because it requires numerious accounting and other formulates to be observed.

2. Unpopular – The burden of direct taxes are generally not shifted, therefore they are painful to the taxpayer. Hence, such taxes are unpopular in nature.

3. Obstacle to capital formation – Direct tax adversely affects people's desire and ability to work, save and investment. Therefore it hampers the growth of capital formation.

4. ~~Probability~~ Possibility of tax evasion – It is calculated on the basis of honesty of a taxpayer, so, there is always a possibility of tax evasion.

An indirect tax is one which can be shifted or passed on. Under indirect taxes the impact and incidence falls on different persons. Thus an indirect tax is imposed on one person but is paid by either partly or wholly by another person. E.g. – custom duties, excise duties, GST.

Merits of indirect tax –

1. Convinience – Indirect taxes are quite convinient as they are included in the price of the commodity and the burden is not felt by the consumers.

2. No evasion – Indirect taxes are difficult to evaded as they are included in the price of the commodity. A person evade an indirect tax only when, he decides not to purchase the commodity.

3. Wide coverage – Through indirect taxes every member of the community can be taxed. Hence the tax system can be made broad based.

4. Social welfare – Heavy indirect taxation on article (like ~~alcho~~ alcohol) serve a great social purpose by curtailing the consumption of such harmful commodities.

Demerits of indirect tax –

1. Regressive in nature – Indirect taxes are generally regressive in nature because they fall on the all person indiscriminately irrespective of their ability to pay.

2. No civic consciousness – As indirect taxes are levied on commodities, the consumer doesn't feel the burden of such taxes which makes him less conscious.

3. The administrative cost of collecting such taxes is generally high because they have to be collected from millions of individuals in small amounts.

• Difference betw direct & indirect tax

• Importance of Incidence of Taxation:

1. It helps to find out the effect and burden of a particular tax.

2. It guides for achieving a fair distribution of the burden and for understanding the general economic consequences of taxation.

3. It guides which type of taxes should be prefixed i.e direct and indirect.

• **Impact of Tax:**

The impact of a tax falls upon the person who pays it in the 1st instance. In other words the person who bears the 1st burden of a tax is supposed to bear its impact too. For instance, if the govt. imposed an excise duty of 20% on the prod.n of fertilizers, its impact will fall on the producer of fertilizer. It is so because the responsibility of paying the excise duty lies upon the manufacturer of fertilizers.

Meaning of public expenditure: Public expenditure refers to the expenses incurred by the government for the maintainance of the government and to preserve the welfare of the society as a whole.

28. Public expenditure vs Private expenditure.

(i) Public expenditure is not motivated by profit whereas private expenditure is strictly based on the motto of maximum profit.

(ii) Public expenditure is dependent directly on the state revenues and the private expenditure is directly dependent on individual's income.

(iii) Public expenditure is more elastic than private expenditure

(iv) Public expenditure is made for social benefit like education, relief to the poor, public health etc, while private expenditure is limited to person level.

(v) Public expenditure is influenced by various politically motivated and social aspects while there is no such consideration on private expenditure

29. Aims and objectives of public expenditure

The aim of public expenditure is –

(i) To maximise economic and social welfare.
(ii) To control the depressionary tendency in the market economy.
(iii) To optimise the level of investment to maintain full employment with growth.

(iv) To accelerate the tempo of economic development by making infrastructures and increasing capital formation for further augmenting.

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Classification of public expenditure.

It implies the systematic arrangement of various kinds of state outlays on some scientific and economic basis so that we may be able to know the effects and nature of each kind of expenditure with other. Hence, the classification of public expenditure is important for clear understanding the nature and effects of various kinds of public expenditure.

Various classification of public expenditure

(A) Classification on the basis of benefit

On the basis of benefit, public expenditure was classified by Cohn and Plehn into four parts as –

(i) Public expenditure which confers special benefits to certain people. Eg – public expenditure of justice, public expenditure on police protection.

(ii) Public expenditure which benefits equally to all. eg – transport, defence.

(iii) Public expenditure benefiting people and entire community as well. Eg – unemployment relief, old age pension

(iv) Public expenditure that specially benefit some individuals. eg – subsidies given to particular industry.

(B) Classification on the basis of function.

Adam Smith classified public expenditure according to the functions of the government as

(i) Protective expenditure: It includes expenditure on the purchase of arms and ammunations, defence, police, administration of justice and jails.

(ii) Commercial expenditure: It consists of expenditure incurred on the commercial activities, rail, roads, highways etc.

... consist of expenditure made on providing education, health, public utility facilities to the community etc.

Criticism/Limitations.

It is not possible to say that a certain expenditure is protective but not developmental, another commercial and not developmental.

(C) Classification on the basis of revenue

On the basis of revenue Nicholoson has divided public expenditure into three heads :-

(i) Expenditure without direct return of revenue. eg - poor relief.

(ii) Expenditure without direct return of revenue but with indirect return to revenue.

eg - expenditure on education.

(iii) Expenditure with full return or even profit

eg - postal service, gas service etc.

Limitations : The classification is however onesided. The main purpose is not to yield revenue but to confer benefits to the community. The theory cannot be regarded as sound and perfect classification.

(D) Mill's classification.

J.S. Mill classified public expenditure into two classes -

(i) Obligatory expenditure : It refers to those expenditures which the state must incur. eg - defence expenditure.

(ii) Optional expenditure : It refers to those which state may or may not spend. They are expenditures on education, agriculture, industries etc.

E) Classification on the basis of importance.

F. Shirras divided public expenditure into primary expenditure and secondary expenditure. Primary expenditure includes all expenditures of government which the government are obliged to undertake. Eg- defence, law and order, the payments of debts. All other expenditure after achieving this level would be secondary expenditure.

Limitations :- This classification was severely criticised because the terms primary and secondary have no scientifically fixed meaning.

F) Dalton's classifications.

On the basis of whether or not the government gets on service in return of the expenditure, Hugh Dalton classified public expenditure into two categories - grants and purchase price.

When the state spends money and gets in return some services on communities called purchase price.

Eg- salaries on government employees, price paid on purchasing furniture.

On the other hand, when the government spends money and doesnot get any commodity or service in return, the expenditure is known as grants

Dalton also distinguishes between direct and indirect grants. According to him direct grants are those, the whole benefit of which accrues to the person to whom the grants are made.

Eg- old age pension.

On the other hand indirect grants are those where the whole are part of its benefit passed on to others.

Sacrifice of
Income of

Rosher classifies public expenditure into three categories.
(i) Necessary (ii) Useful and (iii) Superflouous.

Necessary expenditure is that which the state has to incur and which cannot be postponed. eg-defence exp.

Useful expenditure is that which is desirable but can be postponed. eg-welfare exp..

Superflouous expenditure is that which the state may or may not incur. eg- unemployment allowance.

Limitation : The expenditures incurred by the state are changing with the change in activities and responsibilities of the state. The expenditure which once was regarded as superflouous may now be regarded as necessary and useful for the state

The expenditure which is necessary is also useful and the expenditure which is not useful is also not necessary

** (H) PIGOU'S CLASSIFICATION

Pigou has classified public expenditure into transferable expenditure and non-transferable expenditure

Transferable expenditure : Transferable public expenditure implied to purchase current national resource service. For eg- expenditure made on the payment of interest on government debt, pensions, sickness, benefit etc. It doesnot give rise to any income or output.

Non-transferable expenditure : An expenditure is said to be non-transferable public expenditure when it takes the form of money payment made to people either greatuitously or for the purchase of existing property rights. It always implies the actual using of commodities or services. For eg- expenditure incurred on maintainance and building of the armed, naval and air forces, civil services educational services, post office etc.

~~Limitation~~ Pigou's classification is suffered from vagueness as there is no clear cut distinction between transferable and non-transferable public expenditure

I) MEHTA'S CLASSIFICATION.

Mehta classified public expenditure into two categories - (i) Constant expenditure and (ii) Variable expenditure.

Constant expenditure is that ~~the~~ the amount of which doesnot depend upon the extent of the use by the people in who interest it is incurred. For eg - defence expenditure. As this expenditures are incurred irrespective of the number of people using the services

On the other hand, variable expenditure is that which increases with every increase in the use of public services by the people for whose benefit it is incurred. For eg - Postal service.

Limitation: In Mehta's classification, the basis of classification is cost and not benefit. This classification has been criticised by saying that it is defective as it assumes that state can incur unproductive expenditure also.

(J) ECONOMIC classification.

According to this classification public expenditure is divided into revenue expenditure and capital expenditure

Revenue expenditure includes all current expenditure on administration, defence and public-commercial undertakings like railways, post and telegraphs, grants-in-aid etc.