

11. The Government Budget and Taxation

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1. Question

Why does the government need a budget? Why does the budget talks of taxes?

Answer

Budget is a future estimation of all the revenues and expenditure over a specific period of time. It is used to allocate the scarce resources in the best designed economic use. The budget is used as the tool of decision making by the government. Most of the economic decisions are being dependent on the budget. The economic decision includes the investment spending and allocation of resources.

One of the main components of the budget is the tax. Tax includes the major part of the revenue. In India, the tax is collected in the unified tax system known as Goods Service Tax (GST). This tax is collected by both the state governments and central governments with a single rate. Thus it constitutes a major part of the revenue for the government.

2. Question

What is the difference between income tax and excise duty?

Answer

Basis	Income tax	Excise duty
Meaning	These are the tax at a fixed rate which is levied on the individual income or wages earned.	It is levied on the goods that are produced within the domestic territory.
Form	It is the form of direct tax	It is the form of indirect tax
Burden	The tax burden is borne by the person itself, and he pays the tax amount.	The tax burden is transferred to those who buy the commodity by adding the duty to the price of the commodity.

3. Question

Match the following:

i. Excise duty	a. Levied on the yearly income of individuals.
ii. Sales tax	b. Levied on the yearly profit of companies and business establishments.
iii. Customs duty	c. Levied on the production or manufacture of goods
iv. Income tax	d. Levied when goods are sold.
v. Corporation tax	e. Levied on goods brought from abroad

Answer

i. Excise duty	c. Levied on the production or manufacture of goods
ii. Sales tax	d. Levied when goods are sold.
iii. Customs duty	e. Levied on goods brought from abroad
iv. Income tax	a. Levied on the yearly income of individuals.
v. Corporation tax	b. Levied on the yearly profit of companies and business establishments.

Explanation

i. Excise duty is the tax levied on the goods that are produced within the domestic territory. Excise taxes are those paid on the purchase of goods or services and are often reflected in total purchase prices.

ii. Sales tax is the consumption tax imposed by the government on the sale of goods and services. It is levied when the goods are being sold to the consumer. Therefore the ultimate payer of this tax will be the consumer.

iii. Customs duty is a tax levied on the imports (and sometimes in exports) of the country to raise the state revenue is known as customs duty. It is generally based on the value of the goods being imported.

iv. Income tax is the direct tax which is collected by the government from the individual by fixing a fixed rate is known as income tax. It is collected on a yearly basis, and the tax rate differs as the income of the individual differs.

v. Corporation tax is the tax imposed on the net income of the company. Income of the company will be profit. Therefore it will be levied on the profit with a fixed rate on a yearly basis.

4. Question

You are expected to tax on steel, matches, clocks, cloth, iron; a tax increase on which of these would affect the prices of other commodities the most, and why?

Answer

When the tax is imposed on commodities such as steel, matches, clocks, and iron, there will be changes in the price level of the other commodities. There will be less effect on the imposition of tax on the finished goods such as matches, clock, and cloth. Since these goods are final consumption goods and being directly used by the consumer, it will result less towards the increase in the price of other commodities. Whereas when there is an increase in the tax rate on intermediate goods such as iron and steel, it will affect the prices of the other commodities. These goods will increase the price of the other commodities because they are intermediate goods, which are used for further consumption. Therefore the increase in the tax rate will increase the price of the commodities and the commodities will become costly. When these commodities are used for the production of the other goods, then the price of those final goods rises.

Example: when there is an increase in the tax rate on the commodities on the products of iron and steel, it will increase the price of iron and steel. These iron and steel is used for further production activities such as car manufacturing, construction works, and other heavy industries. Ultimately when there is an increase in the price of iron and steel, it will result in an increase in the price of the final goods such as cars, houses, bikes, etc.,

5. Question

Ordinary food items, such as grain, pulses, oil are used by all. Then why is it said that imposing a tax on them will have a greater effect on the poor?

Answer

Poor are the people who are cannot afford the essential requirements of their life due to lack of income. When there is an imposition of tax on the ordinary food items, it will make the food item very costly. When the price the items are being increased it makes very difficult for the poor people to afford those things with their minimal income. The price rise will be affordable for the middle income and richer people because their income will be higher compared to the poor people income. This increase will adversely affect the lives of poor people.

6. Question

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.

a. How could this be shared among them?

b. We also know that two of them earned Rs.3000 per month and the other two Rs.7000 per month. Is there some other way of sharing the cost so that each one of them feels the same pinch?

c. Which way of sharing would you prefer and why?

Answer

a. Since they are a group of four friends and the total rent comes to about 2000, they can divide the total rent in such a way that each person equally contributes to the whole amount, i.e. $2000/4 = 500$ each. This division will make sure that the burden of the rent is shared equally by everyone.

b. Since two among the four are earning more, they have the capability to contribute more amount for the rent. Thus the whole rent amount can be divided in such a way that the ratio between the marginal cost of paying rent and their income is equal for everyone, i.e. $\text{cost of paying rent by A/income} = \text{cost of paying rent by B/income} = \text{cost of paying rent by C/income} = \text{cost of paying rent by D/income}$.

c. I would prefer the second method of rent bifurcation. The first method though leads to each person paying the same amount of rent is less efficient compared to the second where each person pays according to their ability to pay. Thus this would be the preferred strategy for the division of rent.

7. Question

Tax on income or tax on commodities. Which of the two affects the rich more and which affects the poor more? Explain with reasons.

Answer

Tax on income affects the rich more. Income tax is levied on people who have income above a particular threshold. They will be more affected by income tax as higher income results in the levy and collection of higher taxes from them. The consumption of these sections remains relatively unresponsive to changes in income. Thus they are not affected by the tax on commodities. Rather, a higher rate of income taxes can have an effect on them.

Tax on commodities affected the poorer sections of society. If the commodities they consume are taxed more, they would be compelled to pay a higher price for the commodities and services. This affects their cost of living and standard of living. Thus the poorer sections are affected by commodity taxes more than income taxes.

8. Question

How would VAT reduce the evasion of taxes on goods?

Answer

A VAT is the Value Added Tax in which the tax is levied on every production process of a commodity. Any increase in the value in each stage of production it will be imposed by VAT. When the tax is levied in every stage of production, it becomes very difficult to evade the tax. Tax evasion is the illegal evasion of the tax by the individuals. When the tax is included in all the stages of the production, it will reduce the evasion of the tax by the individuals. But tax

avoidance can be done in VAT by transferring the tax burden to another individual by increasing the price of the product which the consumer buys.

9. Question

What is the difference between the Excise duty and Customs duty?

Answer

Basis	Excise duty	Customs duty
Meaning	Excise duty is the tax levied on the goods that are produced within the domestic territory.	This duty is imposed on the imported and exported goods in the country.
Goods imposed	Imposed on the goods which are being domestically produced.	Imposed on the good which is produced in outside the domestic territory.
Valued	Excise duty is valued ad-valorem, which means that the duty is calculated taking into relation the number of goods.	The customs duty of any goods is valued by its quantifiable value.
Paid by	The excise duty should be by the manufacturer within the country.	The customs duty is to be paid by the manufacturer of the foreign goods.

10. Question

Is there any hike in the bus fares recently? If so, try to know the reasons for it.

Answer

Hike in the bus fare is the problem faced nationally in and around India. There is a continuous rise in the bus fares in the economy. Most of the state governments are increasing their bus fare by a huge percent. The main reasons for the hike in the bus fare are:

- A rise in the price of Petrol and diesel

This increase in the price of petrol and diesel will increase the price of tickets in the buses. This is because petrol and diesel are the main components used to run the bus. The petrol prices were 60Rs in 2014 whereas it crossed 80Rs in 2018. This makes the ride very costly and increases in the bus fare.

- Increase in vehicles

Everyone has their own vehicle in most of the cities. This makes them travel in their vehicle rather than in buses and other common vehicles. When there is a lack of passengers in buses, then the bus fare will automatically be increased to maintain the busses and pay the salary to drivers and conductors.

11. Question

Read the paragraph under the heading 'Direct Taxes' and answer the following: Why do high-income earners pay more tax?

Answer

High-income earners have to pay more of direct taxes- income tax and corporation taxes. Direct taxes are those types of taxes which cannot be transferred to others and has to be paid by the individual directly. It can be an income tax or corporation tax. Corporation tax is the tax incurred on profits made by a business organisation excluding its expenses. This increases as the rate of profit increases. Higher income earners would be required to pay more taxes. Same is the case of income tax which is charged against the income of a person. People with higher income would be required to pay more taxes. Since they are incurring more income, they have the ability to pay more taxes. Thus the rich are taxed more and the poor taxed less.

12. Question

What is the effect of black money on our economy?

Answer

The unaccounted money that circulates in the market is referred to as black money.

The effect of black money are:

- a. Black money means a substantial loss in revenue for the government.

- b. shortage created by black money is resorting by raising more indirect taxes, that increases the burden on middle and poor class people.
- c. Black money results in the transfer of funds from India to foreign countries.
- d. Black money has also corrupted our political system.