

CHAPTER VII

INFLATION AND THE PERSONAL INCOME

TAXATION IN NEPAL

Introduction :

Inflation has remained like a wild cat in every economic system ever since money as a medium of exchange was introduced to help transactions. It is more so with respect to the tax system. Income tax being a progressive tax is more prone to inflationary effects than any other tax. Because as money income rises (due to inflation) even if real income remains unchanged, the tax payers move upward in tax schedule and are thus subject to higher tax rates. In addition, persons who were not taxed previously because their incomes were below the exemption limit may become liable to taxation as a result of a general rise in money incomes due to inflation.¹ Another

-
1. Jhaveri, N.J., "Erosion of Incomes of Income Tax Payers Through Inflation", Economic and Political Weekly, October 5, 1974, p.1701; Petrei, Amalio Humberto, "Inflation Adjustment Schemes under the personal Income Tax", International Monetary Fund, Staff Papers, July, 1975, p.539; Bagchi, Amareşh, "Inflation and Personal Income Tax", Economic and Political Weekly, May 1, 1982; Frustenberg, George M., "Individual Income Taxation and Inflation", National Tax Journal, March, 1975; Feldstein, Martin, "Taxes, Inflation and Capital Formation", National Tax Journal, September, 1979; Sunley, Emil M., "Indexing the Income Tax for Inflation", National Tax Journal, September, 1979; Tanzi, Vito, "Inflation, Real Tax Revenue and the case for Inflationary finance: Theory with an Application to Argentina", International Monetary Fund, Staff Papers, September, 1978; Hirao, Teruo and Aguirre, Carlos A., "Maintaining the level of Income Tax Collection under Inflationary conditions", International Monetary Fund, Staff Papers, July, 1970.

important effect of inflation is to decrease the real content of the exemptions and deductions which are granted in every tax system.

And the effects of inflation are not the same on the tax payers at different income levels. It varies depending upon the rate of progression of the tax structure. The increase in tax liability resulting from inflation is highest not at income levels where the marginal tax rates are the highest, but rather at incomes where marginal tax rates increase most rapidly.² This is because once the marginal rate of tax reaches its highest level, the rate structure thereafter transforms into a proportional rate structure. The progressiveness of the tax structure ends there and bracket creeping³ due to rise in money income resulting from inflation also ends here. But the income below the highest level crosses the brackets and moves on to higher levels attracting thereby the higher marginal rates. So these are the income levels which are adversely affected by inflation.

As for example, a person having total income of Rs.15,500 in assessment year⁴ (A.Y.) 1975-76 would have been liable to

-
2. Gupta, Ramesh, Inflation and Tax Reforms: A Study in Individual Taxation (Memo-graph) Indian Institute of Management, Ahmedabad (India) June, 1985, p.1.
 3. Bracket-creeping signifies the shifting of the same income in nominal terms from lower to higher level of marginal rate as a result of inflation.
 4. Assessment year is the immediate following year of the year in which the income is earned.

*Deflation will
also create the
real value of
money income
The argument is
in fact a fallacy
inflation leads to
automatic increase
in money income
which, if you have
plus the increase (class
in report 2 all types of
income...)*

pay Rs.617 in tax but at the same level of real income which is equivalent to Rs.30,304 at 1983-84 prices would have had to pay Rs.2927 in tax which is excess of Rs.2310 in nominal terms and Rs.880 in real terms (The price index with 1972-73 = 100 was 137 in 1975-76 and 269.8 for 1983-84). This increase in tax liability has not come from the same bracket as this level of real income used to belong in A.Y.1975-76, but this has crossed two brackets upward and has attracted the rate of 30 per cent as compared to 10 per cent in the original bracket. This would have been the plight of tax payers as a consequence of inflation had there been no corrective measures taken by the government from time to time.

This is the case of those tax payers who were already within the income tax net in A.Y.1975-76. But inflation entraps even those earners within the tax net in subsequent years whose incomes were far below the exemption limits in A.Y.1975-76. As for example, for A.Y.1975-76 exemption limit was Rs.5500 and deduction was 15 per cent of the total income. According to it, even the persons having total income of Rs.6470 in that year had not to pay any amount in tax. But in A.Y.1984-85 they would have had to pay Rs.375 in tax had their money incomes increased according to price index mentioned above. And all those income earners who had been earning incomes above Rs.3310 in A.Y.1975-76 would have crossed the tax-nil limit of Rs.5500 even after allowing deduction of

Handwritten notes:
 - Tax changes
 - Inflation
 - Government's policy
 - Income tax structure
 - Inflationary effects

15 per cent in A.Y.1984-85. So if the government had not made changes in tax structure from time to time, the income earners of such a low level of income would have paid the tax even without changes in their real incomes.

Taking these facts into consideration, every government changes the tax structure from time to time to offset the adverse effects of inflation. So this chapter makes an attempt to answer the following questions in the context of the effects of inflation upon the income tax structure of Nepal.

- a. What have been the effects of inflation on the income tax payers belonging to different income levels during the last decade (1975-76 to 1984-85) in Nepal?
- b. Whether the measures taken by the government from time to time to offset the inflationary effects have been adequate and equitable for different income levels during the period.

We will consider the followings to find an answers to these questions,

- i. Marginal and average tax rates on nominal and real incomes as they have prevailed from time to time,
- ii. Average tax rate at constant real income assuming that there were no statutory changes in the tax structure, that is, assuming that the tax structure that obtained in the A.Y.1975-76 continued to prevail during all the subsequent years;

- iii. Percentage changes in real disposable income, that is, post-tax income over time, according to the tax structure prevalent in each year,
- iv. Percentage changes in real disposable income, that is, post-tax income according to the A.Y.1975-76 tax structure assumed to be prevalent for the subsequent years.

All this we calculated for different income levels. Ten years period from A.Y.1975-76 to 1984-85 has been taken for this examination and salary earners have been selected as the target group. It may be mentioned that although the salary earners were excluded in earlier chapters for want of the required data, for judging the effects of inflation they are an ideal group. Further it may be stated that what holds true for salary earners, holds true for the non-salary earners because the exemption limits, income slabs and marginal tax rates are the same for them.

Price Index :

National urban consumer's price index has been taken for our purpose here because other indices available in Nepal are either on regional basis or on commodity basis. Also most of the ^{the} tax payers are in urban areas. The index of the last ten years from 1974-75 to 1983-84 fiscal years is given in

Table VII-1. Second column of this Table shows the index of different years and third column displays the increase of price over previous year. Financial year 1972-73 is the base year.

TABLE VII-1

National Urban Consumer's Price Index

(1972-73=100)

Financial Year	General Index	Increase over Previous year (%)
1	2	3
1974-75	138.0	-
1975-76	137.0	-0.7
1976-77	140.7	2.7
1977-78	156.4	11.2
1978-79	161.8	3.5
1979-80	177.6	9.8
1980-81	201.4	13.4
1981-82	222.4	10.4
1982-83	254.0	14.2
1983-84	269.8	6.2

Source : (a) Quarterly Economic Bulletin, Mid October 1983 to January, 1984, Nepal Rastra Bank, Kathmandu, Nepal, p.40.

(b) Economic Survey 1984-85, H.M. Government of Nepal, Ministry of Finance, Kathmandu, Nepal, p.61.

The price index has continuously been going up except in 1975-76 fiscal year. The highest change (14.2 per cent) has taken place during the fiscal year 1982-83. The compounded average rate of increase of price index during the period was 7.5 per cent. Now the issue to examine is what has been the effect of this rate of price rise on the salary earning tax payers during this period and how far the government has neutralized this adverse effect of inflation through the changes in tax structure.

The point to clarify here is that the price index of any fiscal year is applicable to the immediate following year, that is, assessment year, for the tax purpose. As for example, the index of 1983-84 fiscal year which is 269.8 is applicable to 1984-85 assessment year because the income earned in the fiscal year 1983-84 is assessed and taxed as belonging to the assessment year 1984-85. Every adjustment for inflation has been made on this basis.

Here we examine the effects of inflation and effects of the government's measures to offset them only for nine years excluding A.Y. 1976-77. The reason, firstly, is that the effect of inflation is negligible in the next year of the base year which is A.Y. 1975-76 and secondly, price index in 1975-76 fiscal year is negative.

Tax Structure and its Changes :

Rates, brackets, deductions and exemption limits are the ingredients of income tax system. Any change in any of these ingredients results in changes in the tax liability. Government adjusts the tax structure for inflation through changes in any of these aspects of tax structure.

As we look at the income tax structure of Nepal effective before and during this decade we find several changes to have been effected from time to time. As for example, the highest marginal rate was 55 per cent and lowest 7 per cent until A.Y.1974-75. Highest marginal rate was revised upward to 60 per cent for A.Y. 1975-76. while the lowest marginal rate was left unchanged. There were five income brackets until A.Y. 1974-75 and they were increased to seven in A.Y.1975-76. After A.Y.1975-76 also tax structure has seen several changes. Highest marginal rate was reduced to 51 per cent in A.Y. 1976-77 and it was further reduced to 50 per cent in A.Y. 1979-80. It was again increased to 55 per cent in A.Y.1982-83. The lowest marginal rate was reduced to 5 per cent in A.Y. 1976-77, and raised to 10 per cent in A.Y.1983-84. The number of the brackets was seven until A.Y.1981-82, but it was increased to eight in A.Y.1982-83. Although the number of income brackets has not been changed so often, the size of brackets has been re-organised from time to time. For instance, width of brackets was rearranged in A.Y.1977-78,

1978-79 and in 1979-80 and top bracket was added in A.Y. 1982-83 leaving other brackets unchanged.

The increase in exemption limit has been more significant than any other component of tax structure in Nepal. In A.Y.1975-76 it was increased from Rs.4500 to Rs.5500, in A.Y.1976-77 it was raised to Rs.6500, in A.Y.1979-80 it was made Rs.7500, in A.Y.1981-82 it was raised to Rs.10,000 and in A.Y.1983-84 it was further increased to Rs.15,000 for individuals*. The rate of increase of this limit seems to be still more significant. During A.Y.1977-78 and 1979-80, the exemption limit was increased only by Rs.1000, but in A.Y. 1981-82 it was increased by Rs.2500 and in A.Y.1983-84 it was increased by Rs.5000. The relief which these increases in exemption limit might have provided to the tax payers will be seen in the following pages.

The change in deductions has not been as substantial as in other components of the tax structure. For instance, the total deduction was 15 per cent of the total salary in A.Y.1975-76, it was raised to 20 per cent in A.Y.1980-81 and 25 per cent in A.Y.1984-85. The composition of deduction needs to be explained because they have been provided for different purposes in different ways.

Deductions :

The system of the consolidated proportion of deduction like that of Standard deduction in India and elsewhere has not

* Family as a tax paying unit used to be applied to salary earners also till 1979-80 but since 1980-81 in some cases they are treated as individuals. So for the sake of uniformity we have treated them here as individuals.

been introduced in Nepalese income tax structure so far. So the deductions have been provided to the tax payers for different purposes separately, some of which are indiscriminately applicable to all salary earners and some of which are of conditional nature. And, here, we have included only those deductions which are applicable to all salary earners. We enlist both types of deductions here with rationales behind their omission and commission.

According to the law, ten per cent of the salary is deducted from salary of the employees and is deposited in the Employee's Provident Fund. This deposit is allowed to be deducted while computing the assessed income. This is the most consistent and unconditional item of deduction for the salary earners. So this has been included in our calculation. Deduction equivalent to 5 per cent of the salary or Rs.50 per month whichever is less in lieu of expenses incurred on periodicals has also been granted to the salary earners from the beginning which is another consistent and unconditional item of deduction which has also been included in our calculation. But for the sake of simplicity, calculation has been done only on the basis of 5 per cent of the salary. Besides these two, there are other deductions also provided to the salary earners which are of conditional nature. One of these is the transport expense under which five per cent of the salary is allowed to be deducted from the salary in lieu of

the transport cost. But the condition is that the employees concerned should not be provided either with the official conveyance facility or the official residence. And the reason for not including this deduction in our calculation is that majority of the top officials enjoying high scale of salary have been posted in the capital city and other cities where they have been provided with transport facility. And high ranking officials having been posted in rural districts have not, necessarily, been provided with the transport facility but have been residing in the office-cum-residence buildings. So they are also not entitled to claim this provision of deduction. It, therefore, seems that the number of the employees who are legally entitled to claim this deduction might be negligible during the whole period.

There is another provision of deduction in the law according to which seven per cent of the total sum insured if it does not exceed Rs.50,000 and five per cent of the total sum insured if it exceeds Rs.50,000 is allowed to be deducted in lieu of premium paid on life insurance. This also has not been included in our calculation on the ground that, firstly, due to having a very short history, very few people may be aware of the insurance business in Nepal. Secondly, this being an optional case the salary earners who are comparatively lowly paid in the face of rising cost of living can hardly afford to go for long term saving like life insurance.

There is yet another provision of deduction in the law according to which the amount expended or donated by the tax payers for religious or philanthropic purpose not exceeding Rs 10,000 or 5 per cent of assessed income whichever is less is deducted. This provision seems to have no practical significance for the salary earners.

So the deduction for the provident fund and that for journals have remained the only unconditional deductions applicable to every salary earner during the period from A.Y.1975-76 to 1979-80. Both the deductions combined constitute 15 per cent of the total salary.

The education allowance was introduced for the salary earners through the Third Amendment of the Income Tax Act in 1980 according to which two and half per cent of the salary in lieu of the expenses incurred for the education of each of the two minor children was allowed to be deducted. Here it has been assumed that all the employees have at least two children and hence have been entitled to claim this allowance fully. So since A.Y.1980-81 total deductible allowances including this, have reached 20 per cent of the salary. And the education allowance was raised to 10 per cent in total through the Fourth Amendment of the Act in 1984. Thus the total allowance has gone up to 25 per cent of the salary since A.Y.1984-85.

We have incorporated the total salary levels ranging from Rs.8000 to Rs.900,000 per annum in terms of 1974-75 price which becomes Rs.15,641 and Rs.17,59,565 respectively in A.Y.1984-85 at 1983-84 prices. The total number of slabs which were 7 since A.Y.1975-76 and 8 from A.Y.1982-83 onwards have been broken into 18 in total so as to give a comparable picture for all the slabs of the effect of inflation and statutory changes in tax structure on the tax payers of different income levels. It may seem that the analysis of the very high income levels is more hypothetical than real because salary earners are by no means likely to receive such a large amount in salary. It is true. But it has been done so only in order to incorporate all slabs and corresponding marginal tax rates as contained in the tax law in our study. By implication, this would help us to form judgement about the effects of inflations on non-salary income earners.

Analysis of the Result :

We have prepared three sets of data for our analysis: first, in nominal terms according to the statutory tax structure as it existed in each assessment year; Second, in real terms according to the statutory tax structure prevalent during each year; and third, in real terms as per the statutory tax structure of 1975-76 assessment year carried over to all the subsequent years.

The first set of data tells us about how the tax payers have been faring under different statutory tax changes over the period under review in nominal terms without standardising for inflation.

The second set of data will throw light on how tax payers would have fared if inflation was adjusted for. This part of analysis, specifically, will give us the picture of whether inflationary effects have been adequately and equitably offset by the statutory tax changes or not.

The third set of data will provide us idea about how much the tax burden would have been as a result of inflation, had there been no statutory changes in tax structure.

In Table VII-2, we present the marginal tax rates on nominal total income. Careful attention is invited to the note below the table.

The A.Y.1975-76 is chosen as the starting point as the new Income Tax Act came into full operation in that year.

The Table VII-2 read along with footnote tells us the changes in (i) personal allowances; (ii) exemption limits; (iii) income slabs; (iv) marginal tax rates all of which would have provided in adjustment of tax burden against inflation.

TABLE VII-2

Marginal Tax Rates on Nominal Total Income

(Without Inflation Adjustment)

(In Percentage)

Total Income (Rs.)	A.Y. 1975-76	A.Y. 1977-78	A.Y. 1978-79	A.Y. 1979-80	A.Y. 1980-81	A.Y. 1981-82	A.Y. 1982-83	A.Y. 1983-84	A.Y. 1984-85	Total Income (Rs.)
1	2	3	4	5	6	7	8	9	10	11
8,000	8.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0	0.0	8,000
10,500				5.0	5.0	0.0	0.0	0.0	0.0	10,500
13,000	10.0					5.0	5.0	0.0	0.0	13,000
15,500			10.0	10.0				0.0	0.0	15,500
20,500	20.0	10.0	15.0		10.0	10.0	10.0	10.0	10.0	20,500
25,500				15.0	15.0	15.0	15.0	15.0		25,500
30,500	30.0								15.0	30,500
35,500		20.0	25.0	20.0	20.0			20.0	20.0	35,500
45,500	40.0	30.0				20.0	20.0	25.0		45,500
60,000	55.0	40.0	35.0	30.0	30.0				25.0	60,000
80,000				40.0		30.0	30.0	30.0	30.0	80,000
1,00,000					40.0	40.0	40.0	40.0	40.0	1,00,000
2,00,000				50.0	50.0	50.0	50.0	50.0	50.0	2,00,000
3,00,000		45.0	45.0							3,00,000
4,00,000			51.0					55.0	55.0	4,00,000
5,00,000							55.0			5,00,000
7,00,000	60.0									7,00,000
9,00,000		51.0								9,00,000

Note : (a)

Assessment Year 1976-77 is dropped as the prices fell in 1975-76

(b)

The marginal tax rates presented under each assessment year are the statutory marginal rates effective during the respective years applicable to the nominal total income level given in column 1 or 11. The marginal rates are to be applied first by deducting the personal allowances which have been discussed in the text. Then we have to take into account the tax nil slab which is not separately shown.

(i) Personal allowances permitted for deduction were 15 per cent of the total income during 1975-76 to 1979-80; and 20 per cent during 1980-81 to 1983-84; and 25 per cent in 1984-85.

(ii) The tax-nil slab was Rs.5500 in 1975-76; Rs.6500 in 1977-78 and 1978-79; Rs.7500 in 1979-80 and 1980-81; Rs.10,000 in 1981-82 and 1982-83; and Rs.15000 in 1983-84 and 1984-85.

The table is to be read as follows:

A marginal tax rate shown in Columns 2 to 10 applies in each year to total incomes up to a level, when a new marginal rate is shown in the table. Thus for a total income of Rs.10,500 in A.Y.1975-76, the marginal rate of taxation of 7 per cent is applicable in the following manner. Deduct from Rs.10,500, an amount of Rs.1575 as personal allowances permitted to be deducted at 15 per cent of the total income. That makes Rs.8925 as the assessed income. Rs.5500 is the tax nil limit. On the remaining Rs.3425, at 7 per cent marginal rate, the tax liability comes out to Rs.240. In this way for each year for each total income level, the calculations of the tax liability can be made.

For example, the tax nil limit has been raised gradually from Rs5500 to Rs.15000. The marginal tax rates on Rs.20500 nominal income have come down from 20 per cent to 10 per cent from the beginning of period to the end.

In Table VII-3 we have presented the marginal tax rates on constant real incomes in terms of 1974-75 price level. Thus for example as seen in Table VII-3, columns 1 and 11, Rs.8000 of A.Y.1975-76 are equal to Rs.15,641 in A.Y.1984-85. Rs.10,500 are equal to Rs.20,528 and so on. Thus the figures in column 11 are in nominal Rupees in A.Y.1984-85 which are equal to the corresponding respective figures in column 1, at 1974-75 prices. Just as column 11 shows the correspondence between the 1975-76 money incomes at 1974-75 prices and its equivalent in A.Y.1984-85 at 1983-84 prices, it is possible to calculate for each of the intervening assessment years, 1977-78 to 1983-84 such equivalence with each income mentioned in column 1. These calculations have been made by us. But for reasons of economy of space the table is not cluttered with such figures. 1984-85 figures in column 11 fully illustrate what we have done. Broadly we can say from Table VIII-3 that the tax structure in each

TABLE VII-2

Marginal Tax Rates on Constant Real Income
(Adjusted for Inflation)

Total Income (Rs.) *	(In Percentage)											Total Income (Rs.) **
	A.Y. 1975-76	A.Y. 1977-78	A.Y. 1978-79	A.Y. 1979-80	A.Y. 1980-81	A.Y. 1981-82	A.Y. 1982-83	A.Y. 1983-84	A.Y. 1984-85	A.Y. 1985-86	A.Y. 1986-87	
1	2	3	4	5	6	7	8	9	10	11	12	
8,000	7.0	5.0	5.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0	15.641	
10,500						5.0		10.0	10.0		20.528	
13,000	10.0		10.0	10.0	10.0	10.0	10.0				25.416	
15,500								15.0	15.0		30.304	
20,500	20.0	10.0	15.0	15.0	15.0	15.0	15.0	20.0	20.0		40.079	
25,500							20.0	25.0	25.0		49.854	
30,500	30.0		25.0	20.0	20.0	20.0					59.630	
35,500		20.0						30.0	30.0		69.405	
45,500	40.0	30.0				30.0	30.0	40.0	40.0		88.956	
60,000	55.0	40.0	35.0	30.0	30.0	40.0	40.0				1,17,304	
80,000				40.0	40.0		50.0	50.0	50.0		1,56,406	
1,00,000				50.0	50.0	50.0					1,95,507	
2,00,000		45.0	45.0								3,91,016	
3,00,000		45.0	51.0					55.0	55.0		5,06,522	
4,00,000							55.0				7,82,029	
5,00,000											9,77,536	
7,00,000	60.0										13,68,551	
9,00,000		51.0									17,59,565	

* Total income is in A.Y.1975-76 rupees.

** Total income is in A.Y.1984-85 rupees.

Notes : (a) Total incomes during the intervening assessment years which are equal to the real total income of A.Y.1975-76 are not separately shown as explained in the text.

(b) The marginal tax rates presented under each assessment year indicate the statutory marginal rates which would have been applicable to the real total income levels of the A.Y.1975-76 during each year at tax structure prevailing in each assessment year respectively.

assessment year has been broadly revised to neutralize the bracket creep due to inflation. Though of course, in each case it is neither uniform nor exactly equal.

To judge the real burden of tax, we need the average tax rate (that is tax liability as a percentage of total income) for each income slab for each assessment year. Table VII-4 shows the average tax rates on nominal total incomes without adjusting for inflation. These average rates reflect every statutory change made in tax structure during the period. It is because of this fact that the average rates are not same for any income bracket in any year. Marginal rates have been reorganised, deductions have been added or increased and exemption limit has been raised year after year in order to neutralize the effects of inflation in correspondance of which average tax rates have been different in different years.

In Table VII-5, average tax rates on different levels of real income are presented. These average tax rates reflect the combined effects of the inflation and the statutory tax changes undertaken during the period.

TABLE VII-4

208

Average Tax Rates on Nominal Total Income
(Without Inflation Adjustment)

(In percentage)

Total Income (Rs.)	A.Y. 1975-76	A.Y. 1977-78	A.Y. 1978-79	A.Y. 1979-80	A.Y. 1980-81	A.Y. 1981-82	A.Y. 1982-83	A.Y. 1983-84	A.Y. 1984-85	Total Income (Rs.)
1	2	3	4	5	6	7	8	9	10	11
8,000	1.1	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	8,000
10,500	2.3	1.1	1.1	0.7	0.4	0.0	0.0	0.0	0.0	10,500
13,000	3.1	1.7	1.7	1.4	1.1	0.1	0.1	0.0	0.0	13,000
15,500	4.0	2.1	2.7	2.0	1.6	0.8	0.8	0.0	0.0	15,500
20,500	6.0	2.9	4.3	3.6	3.1	1.9	1.9	0.7	0.2	20,500
25,500	8.2	4.0	6.0	5.4	4.6	3.2	3.2	2.2	1.6	25,500
30,500	9.8	4.7	7.1	6.6	5.8	4.6	4.6	3.8	2.6	30,500
35,500	12.0	6.3	8.9	7.8	6.8	5.7	5.7	5.4	4.4	35,500
45,500	15.6	9.1	11.6	9.8	8.8	7.7	7.7	7.9	6.8	45,500
60,000	21.4	13.8	14.7	12.2	10.7	9.7	9.7	10.8	9.6	60,000
80,000	27.8	18.9	18.5	15.6	14.0	13.1	13.1	14.0	12.5	80,000
1,00,000	31.6	21.9	20.7	19.2	17.2	16.2	16.2	17.5	15.5	1,00,000
2,00,000	39.2	27.9	28.9	30.2	27.7	27.1	27.1	28.0	25.5	2,00,000
3,00,000	41.7	30.1	33.2	34.3	31.8	31.4	31.4	32.0	29.5	3,00,000
4,00,000	42.9	32.1	35.7	36.4	33.9	33.6	33.6	34.3	31.6	4,00,000
5,00,000	43.7	33.4	37.2	37.6	35.1	34.8	34.8	36.2	33.5	5,00,000
7,00,000	44.9	34.8	39.0	39.0	36.5	36.3	36.7	38.5	35.7	7,00,000
9,00,000	46.3	35.7	40.0	39.8	37.3	37.1	38.4	39.7	38.6	9,00,000

Note : The average tax rates given under each assessment year are the average tax rates on the nominal total income levels given in column 1 or 11 under the tax structures prevalent during each year of the period applying the marginal tax rates given in Table VII.2.

From Table VII-5, it can be seen that in the terminal A.Y.1984-85, the average tax rate on each real income bracket (at constant 1974-75 prices) was lower than it was in the A.Y. 1975-76. The average tax rate on each real income bracket summarizes for our purposes the effect of changes in the tax structure comprising of changes in personal allowances, tax-nil limits, changes in income brackets and marginal tax rates. The fact that average tax rates in A.Y.1984-85 were lower than the average tax rates in A.Y.1975-76, for each real income slab means that the changes in tax structure have been effective in more than neutralizing the effects of bracket creeping due to inflation. Also during each of the intervening years, namely, A.Y.1977-78 to A.Y.1983-84, the average tax rate for each real income slab was lower than it was in A.Y. 1975-76, except three slabs of Rs.20,500, Rs.25,500 and Rs.30,500 where, in only the A.Y.1983-84, the average tax rates were slightly higher than those obtained in A.Y.1975-76. But the differences were negligible. So even during the intervening years the process of adjustment to inflation was taking place. A point of some interest is the drastic decline in average tax rates in A.Y. 1977 - 78 as compared to A. Y. 1975-76.

TABLE VII-5

210

Average Tax Rates on Constant Real Income

(In percentage)

Total Income*	A.Y. 1957-76	A.Y. 1977-78	A.Y. 1978-79	A.Y. 1979-80	A.Y. 1980-81	A.Y. 1981-82	A.Y. 1982-83	A.Y. 1983-84	A.Y. 1984-85	Total** Income (Rs.)
1	2	3	4	5	6	7	8	9	10	11
8,000	1.1	0.3	0.7	0.3	0.4	0.0	0.1	0.0	0.0	15,641
10,500	2.3	1.2	1.5	1.2	1.2	0.7	1.0	0.2	0.2	20,528
13,000	3.1	1.8	2.4	1.9	2.0	1.4	2.0	1.7	1.6	25,416
15,500	4.0	2.2	3.4	3.0	3.0	2.5	3.0	3.2	3.0	30,304
20,500	6.0	3.0	5.3	4.9	4.9	4.5	5.2	6.1	5.6	40,079
25,500	8.2	4.1	6.8	6.5	6.3	6.0	6.9	8.3	7.7	49,854
30,500	9.8	4.8	8.6	7.9	7.7	7.6	8.4	10.2	9.5	59,630
35,500	12.0	6.5	10.4	9.2	8.9	8.8	9.4	11.8	11.0	69,405
45,500	15.6	9.4	12.8	10.9	10.4	10.8	12.1	14.7	13.7	88,956
60,000	21.5	14.2	16.5	14.1	13.6	14.0	15.7	18.9	17.6	1,17,304
80,000	27.8	19.2	19.8	18.3	17.7	18.5	20.0	23.7	22.2	1,56,406
1,00,000	31.6	22.1	21.8	21.6	21.0	22.4	24.0	27.0	25.2	1,95,507
2,00,000	39.2	28.1	30.0	32.1	30.5	31.2	32.0	33.5	31.4	3,91,014
3,00,000	41.7	30.3	34.4	35.5	33.7	34.1	34.7	37.0	34.6	5,86,522
4,00,000	43.0	32.3	36.6	37.3	35.2	35.6	36.1	38.7	36.3	7,82,029
5,00,000	43.7	33.5	38.0	38.3	36.2	36.5	37.7	39.8	37.3	9,77,536
7,00,000	44.9	34.8	39.5	39.5	37.3	37.5	39.5	41.0	38.4	13,68,551
9,00,000	46.3	35.8	40.4	40.2	37.9	38.0	40.5	41.7	39.0	17,59,565

* Total income is in 1975-76 A.Y. rupees.

** Total income is in 1984-85 A.Y. rupees.

Note : The average tax rates given under each assessment year are the average tax rates which would have been applicable to the real total income levels of the A.Y.1975-76 during each year under the tax structures prevalent during the period applying the marginal tax rates of VII-3

This was because of the significant revision in marginal tax rates at all levels and reorganization of income slabs in that year, that is, A.Y.1977-78. It seems that the A.Y. 1977-78 revisions were so drastic in downward direction that subsequently the Finance Ministers seem to have made slightly upward adjustments. Though here the three lowest slabs of Rs.8,000, Rs.10,500 and Rs.13,000 have not only been left untouched but have been adjusted further downwards.

The next point to be considered is that although the adjustment to bracket creeping has been more than adequate for each income bracket, the extent of the benefit is uneven for different real income brackets. Here below we summarise the percentage points differences in average tax rate in A.Y.1984-85 as compared to A.Y.1975-76, and also the percentage variations in average tax rates in A.Y.1984-85 over A.Y.1975-76.

From the summary of the Table, it can be seen that while all income brackets have benefited in terms of lowering of the tax burden, the middle brackets, namely, Rs.15,500 to Rs.35,500 have benefited the least, while the higher income groups have reaped the benefit of lowering the burden to a greater extent.

It is, of course, arguable that a ~~given~~ percentage decline expressed as a ratio of the original average tax rate, will indicate a smaller proportionate decrease if the average tax rate in the initial year was high. Thus a one

percentage point decline in tax burden over the initial average tax of twenty per cent, represents a five per cent decline in burden; while one percentage point decline in tax burden over the initial tax of forty per cent, represents a two and half per cent decline.

Real Income Slab (Rs.)	Percentage point variation in Average Tax Rate in A.Y.1984-85 as compared to A.Y.1975-76	Percentage variation in Average Tax Rate in A.Y.1984-85 over A.Y.1975-76
8,000	-1.1	-100
10,500	-2.1	- 91
13,000	-1.5	- 48
15,500	-1.0	- 25
20,500	-0.4	- 7
25,500	-0.5	- 6
30,500	-0.3	- 3
35,500	-1.0	- 8
45,500	-1.9	- 12
60,000	-3.9	- 18
80,000	-5.6	- 20
1,00,000	-6.4	- 20
2,00,000	-7.8	- 20
3,00,000	-7.1	- 17
4,00,000	-6.7	- 16
5,00,000	-5.6	- 15
7,00,000	-6.5	- 15
9,00,000	-7.3	- 16

Even in this manner of looking at the changes, we find that the middle income groups from Rs.20,500 to Rs.45,500 have benefited the least. The lowest income brackets have benefited the most followed by the higher income groups.

Isolating the Effect of Inflation :

In Table VII-6, we present the average tax rates on constant real income at 1974-75 prices assuming that there was no statutory changes in tax structure subsequent to A.Y.1975-76. This will isolate the effect of inflation on tax burden at unchanged tax structure. We observe that average tax rates for all income levels would have continuously gone up in subsequent years in comparison to previous year as well as to that of the base year. This shows that tax payers of all income levels would have been paying proportionately more and more taxes in every subsequent year as a result of inflation.

We see that the lower income groups would have been most hard-hit by inflation as compared to the higher income groups because the effect of inflation becomes regressive. As for example, the average tax rates on constant real income levels up to Rs.35,500 would have more than doubled in A.Y. 1984-85 as compared to A.Y.1975-76 as a result of inflation if there had been no changes in tax structure during the period. On the other hand, the higher income groups of Rs.2,00,000 and above would not have been much affected by inflation even if there had been no statutory changes in tax structure during the period because the average tax rates applicable to them have remained less elastic to inflation because the marginal rates of tax above that income remain steady, so bracket-creeping does not take place. The inflation

TABLE VII-6

Average Tax Rates on Constant Real Income If no Statutory

214

(In Percentage)

Tax Changes were made Subsequent to 1975-76

Total * Income (Rs.)	A.Y. 1975-76	A.Y. 1977-78	A.Y. 1978-79	A.Y. 1979-80	A.Y. 1980-81	A.Y. 1981-82	A.Y. 1982-83	A.Y. 1983-84	A.Y. 1984-85	Total ** Income (Rs.)
1	2	3	4	5	6	7	8	9	10	11
8,000	1.1	1.2	1.7	1.8	2.2	2.7	3.1	3.7	4.0	15,641
10,500	2.3	2.4	2.7	2.8	3.3	3.9	4.4	5.4	6.0	20,528
13,000	3.1	3.2	3.7	3.9	4.3	5.1	6.3	7.6	8.1	25,416
15,500	4.0	4.1	4.5	4.6	5.7	7.1	8.0	9.1	9.7	30,304
20,500	6.0	6.2	7.3	7.6	8.5	9.5	11.0	12.8	13.5	40,079
25,500	8.2	8.3	9.2	9.5	10.9	12.6	13.8	16.2	17.3	49,854
30,500	9.8	10.1	11.6	12.1	13.3	15.2	17.0	19.7	21.3	59,630
35,500	12.0	12.2	13.6	14.0	15.7	17.9	20.2	23.5	24.9	69,405
45,500	15.6	16.0	17.8	18.3	20.8	23.9	26.1	28.6	29.7	88,956
60,000	21.4	21.9	24.4	25.2	27.1	29.4	31.1	33.0	33.8	1,17,304
80,000	27.8	28.1	30.0	30.6	32.0	33.8	35.0	36.4	37.0	1,56,406
1,00,000	31.6	31.9	33.4	33.8	35.0	36.4	37.3	38.5	39.0	1,95,507
2,00,000	39.2	39.3	40.0	40.3	40.9	41.6	42.0	42.6	42.9	3,91,014
3,00,000	41.7	41.8	42.3	42.4	42.8	43.3	43.6	44.0	44.2	5,86,522
4,00,000	42.9	43.0	43.4	43.5	43.8	44.2	44.4	45.2	45.6	7,82,029
5,00,000	43.7	43.8	44.1	44.2	44.4	45.2	45.7	46.4	46.7	9,77,536
7,00,000	44.9	45.0	45.6	45.8	46.3	46.8	47.2	47.7	47.9	13,68,551
9,00,000	46.3	46.4	46.8	47.0	47.3	47.8	48.1	48.4	48.6	17,59,565

* Total income is in 1975-76 A.Y. rupees; ** Total income is in 1984-85 A.Y. rupees

Note : The average tax rates given in columns 2 to 10 are calculated applying the tax structure prevalent during the A.Y. 1975-76 to the real total income levels of that assessment year during each subsequent year.

would thus have hit hard the lower and middle income groups if there had been no statutory changes in tax structure in subsequent years during the period.

Disposable Income :

In Table VII-7, we present the percentage variations in real disposable incomes over that of A.Y.1975-76. The figures given in column 2 are the disposable incomes of A.Y.1975-76 for different real income levels. And the subsequent columns show the percentage variations in real disposable incomes over that of A.Y. 1975-76. For each assessment year we have applied the tax structure prevalent in that year.

Table VII-7 clearly shows that the variation in real disposable income is positive in all years for all income levels against that of A.Y.1975-76 except for three income levels in A.Y. 1983-84. However, the variations are not uniform in all years for all income levels.

Another dimension of the combined effects of the inflation and statutory changes in tax structure in the tax payers of different income levels which the Table VII-7 shows is that the lower income groups have not benefited to the same extent as the upper income groups in terms of increases in the real disposable income during the whole period. The lower income groups have only maintained their base year level

TABLE VII-7

Percentage Change in Real Disposable Income

216

Total * Income (Rs.)	Disposable Income 1975-76 (Rs.)	Percentage Change Over - 1975-76									Total ** Income (Rs.)
		1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85		
1	2	3	4	5	6	7	8	9	10	11	
8,000	7,909	0.9	0.5	0.9	0.8	1.1	1.0	1.1	1.1	15,641	
10,500	10,260	1.1	0.8	1.1	1.1	1.6	1.3	2.1	2.1	20,528	
13,000	12,595	1.3	0.7	1.2	1.1	1.8	1.1	1.4	1.6	25,416	
15,500	14,883	1.8	0.6	1.0	1.0	1.6	1.0	0.8	1.0	30,304	
20,500	19,265	3.2	0.7	1.1	1.2	1.6	0.9	-0.04	0.4	40,079	
25,500	23,415	4.5	1.5	1.8	2.0	2.4	1.4	-0.1	0.5	49,854	
30,500	27,523	5.5	1.3	2.0	2.2	2.4	1.5	-0.5	0.3	59,630	
35,500	31,248	6.2	1.8	3.2	3.5	3.6	2.9	0.2	1.1	69,405	
45,500	38,380	7.4	3.4	5.6	6.2	5.7	4.2	1.1	2.3	88,956	
60,000	47,125	9.2	6.3	9.3	10.0	9.5	7.3	3.3	4.9	1,17,304	
80,000	57,775	11.9	11.1	13.2	14.0	12.8	10.7	5.6	7.8	1,56,406	
1,00,000	68,425	13.8	14.3	14.6	15.5	13.5	11.0	6.7	9.3	1,95,507	
2,00,000	1,21,675	18.2	15.0	11.7	14.3	13.1	11.7	9.3	12.8	3,91,014	
3,00,000	1,74,925	19.6	12.5	10.6	13.8	13.0	12.0	8.1	12.1	5,86,522	
4,00,000	2,28,175	18.7	11.1	10.0	13.5	12.9	12.0	7.4	11.7	7,82,029	
5,00,000	2,81,425	18.2	10.2	9.6	13.4	12.9	10.7	7.0	11.4	9,77,536	
7,00,000	3,85,450	18.3	9.8	9.8	13.9	13.5	9.9	7.2	11.8	13,68,551	
9,00,000	4,83,450	19.5	11.0	11.4	15.6	15.3	10.8	8.6	13.5	17,59,565	

* Total income is in 1975-76 A.Y. rupees; ** Total income is in 1984-85 A.Y. rupees

Note : The figures given in columns 3 to 10 are calculated on the basis of the figures of the real disposable income which would have come under the tax structures prevalent during each year at each level of the real total income.

of real disposable income where as the income levels of Rs.2,00,000 and above have benefited by more than ten per cent in the real disposable income. It means that there is progressive shift in the benefit of the statutory tax changes in favour of the upper income groups.

In Table VII-8, we present the percentage variation in real disposable incomes over that of A.Y.1975-76 assuming no statutory changes in tax structure during the period. It shows how the tax payers of different income levels would have fared in terms of the real disposable income in the face of inflation had there been no changes in tax structure during the period. The Table shows the percentage decline in real disposable income in all levels in the subsequent years. However, the extent of decline would have been different for different income levels. The lower and the upper income groups would have lost less real disposable income than the middle income groups if the changes in tax structure had not been undertaken during the period.

In sum, the tax payers of different income levels would have been paying more tax in subsequent years than in A.Y.1975-76 due to inflation if there had been no changes in tax structure during the period. It is also seen from this examination that the statutory tax changes made during the period have adequately neutralized the adverse effect of inflation for all income groups during almost all years. However, the benefits of these changes

TABLE VII-8

Percentage Change in Real Disposable Income if no Statutory

218

Tax Changes were made Subsequent to 1975-76

Total * Income (Rs.)	Disposable Income 1975-76 (Rs.)	Percentage Change Over 1975-76										Total* Income
		1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85			
1	2	3	4	5	6	7	8	9	10	11		
8,000	7,909	-0.1	-0.6	-0.7	-1.1	-1.5	-1.9	-2.6	-2.9	15,641		
10,500	10,260	-0.1	-0.4	-0.5	-1.1	-1.7	-2.1	-3.1	-3.8	20,528		
13,000	12,595	-0.1	-0.7	-0.8	-1.2	-2.1	-3.2	-4.6	-5.2	25,416		
15,500	14,883	-0.1	-0.5	-0.7	-1.8	-3.2	-4.2	-5.3	-5.9	30,304		
20,500	19,265	-0.2	-1.4	-1.7	-2.6	-3.7	-5.3	-7.2	-8.0	40,079		
25,000	23,415	-0.2	-1.1	-1.4	-2.9	-4.8	-6.1	-8.7	-10.0	49,854		
30,500	27,523	-0.3	-2.1	-2.6	-3.9	-6.1	-8.0	-11.0	-12.8	59,630		
35,500	31,248	-0.3	-1.8	-2.3	-4.2	-6.7	-9.4	-13.1	-14.7	69,405		
45,500	38,380	-0.4	-2.6	-3.2	-6.1	-9.8	-12.3	-15.4	-16.6	88,956		
60,000	47,125	-0.6	-3.8	-4.7	-7.2	-10.1	-12.2	-14.7	-15.7	1,17,304		
80,000	57,775	-0.5	-3.1	-3.9	-5.8	-8.3	-10.0	-12.0	-12.8	1,56,406		
1,00,000	68,425	-0.4	-2.6	-3.3	-4.9	-7.0	-8.4	-10.1	-10.8	1,95,507		
2,00,000	1,21,675	-0.2	-1.5	-1.8	-2.8	-3.9	-4.7	-5.7	-6.1	3,91,014		
3,00,000	1,74,925	-0.2	-1.0	-1.3	-1.9	-2.7	-3.3	-4.0	-4.2	5,86,522		
4,00,000	2,28,175	-0.1	-0.8	-1.0	-1.5	-2.1	-2.6	-4.0	-4.6	7,82,029		
5,00,000	2,81,425	-0.1	-0.6	-0.8	-1.2	-2.6	-3.6	-4.7	-5.2	9,77,536		
7,00,000	3,85,450	-0.2	-1.3	-1.6	-2.4	-3.5	-4.2	-5.0	-5.4	13,68,551		
9,00,000	4,83,450	-0.2	-1.0	-1.3	-1.9	-2.8	-3.3	-4.0	-4.3	17,59,565		
* Total income is in 1975-76 A.Y. rupees; ** Total income is in 1984-85 A.Y. rupees												

* Total income is in 1975-76 A.Y. rupees; ** Total income is in 1984-85 A.Y. rupees

Note : The figures given in the columns 3 to 10 are calculated on the basis of the real disposable incomes which would have been under the tax structure of A.Y.1975-76 at each level of real total income.

have not been equitable to all income levels. For example, the real income levels ranging from Rs.2,00,000 and above have received more favourable treatment by the statutory tax changes than any other income level during almost all years whereas the middle income groups ranging from Rs.15,500 to Rs.30,500 have least benefited.