

# **EFFECTS OF TAXATION ON PRODUCTION AND DISTRIBUTION**

**Presented by**

**Shraddhanjali Bhattacharjee**

**Department of Economics**

**Dr. B.K.B. College, Puranigudam**

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# EFFECTS ON PRODUCTION

## 1. Ability to Work and Save-----

- Payment of tax always reduces income of the individual
- If tax takes away a large part of a large part of income, individual may find it difficult to manage budget
- Saving depends on income
- This will affect ability to work and save

## **2. Willingness to work and save----**

- **High rate of tax will affect individual taxpayers and the business farms**
- **If the taxpayer does not stick to maintain his standard of living, even after higher tax, work effort will be reduced**
- **If the taxpayer is determined to maintain the same standard of living, he will work harder to earn extra income**
- **Then taxation does not affect the willingness to work and save**

### **3. Diversion of economic resources----**

- **When high rate of tax is imposed on harmful products, it will push up their prices, demand will be curtailed.**
- **Production will fall, a part of factors of production will release.**
- **This factors will be shifted to other industries**
- **Tax may divert resources from harmful to more useful industries**
- **Tax concession on goods produced in backward region will induce diversion of resources from advanced to backward region**
- **This will help to achieve regional balance in economic development**

#### 4. **Income effect and substitution effect----**

- **Direct tax like a proportional income tax reduces disposable income and distorts resource allocation through income effect**
- **Indirect tax causes both income effect and substitution effect**
- **A consumer may substitute tax induced high price product to non taxed product available in the market**

## **5. Effect on supply of work and capital formation----**

- A very high rate of income tax will substitute work into leisure, supply of work will be adversely affected**
- Capital formation is affected more by direct tax than indirect tax when rates are heavy**
- Tax reduces investment, profit will be reduced and it will affect capital formation**

# EFFECT ON DISTRIBUTION

- **Direct taxes based on progressive rate have large re-distributive effect**
- **Taxes fall heavily on upper income classes, able to reduce inequality of income**
- **The revenue can be spent in supplying essential services to the poorer sections by providing education, health, sanitation.**

- **Indirect taxes are regressive in character**
- **Indirect taxes fall more on the poor, as everyone has to pay the same rate of tax**
- **Sales tax, excise tax will increase inequality of income instead of reducing it**
- **Commodity taxes on luxury products, harmful products will likely to make progressive taxes.**

**Thank You**