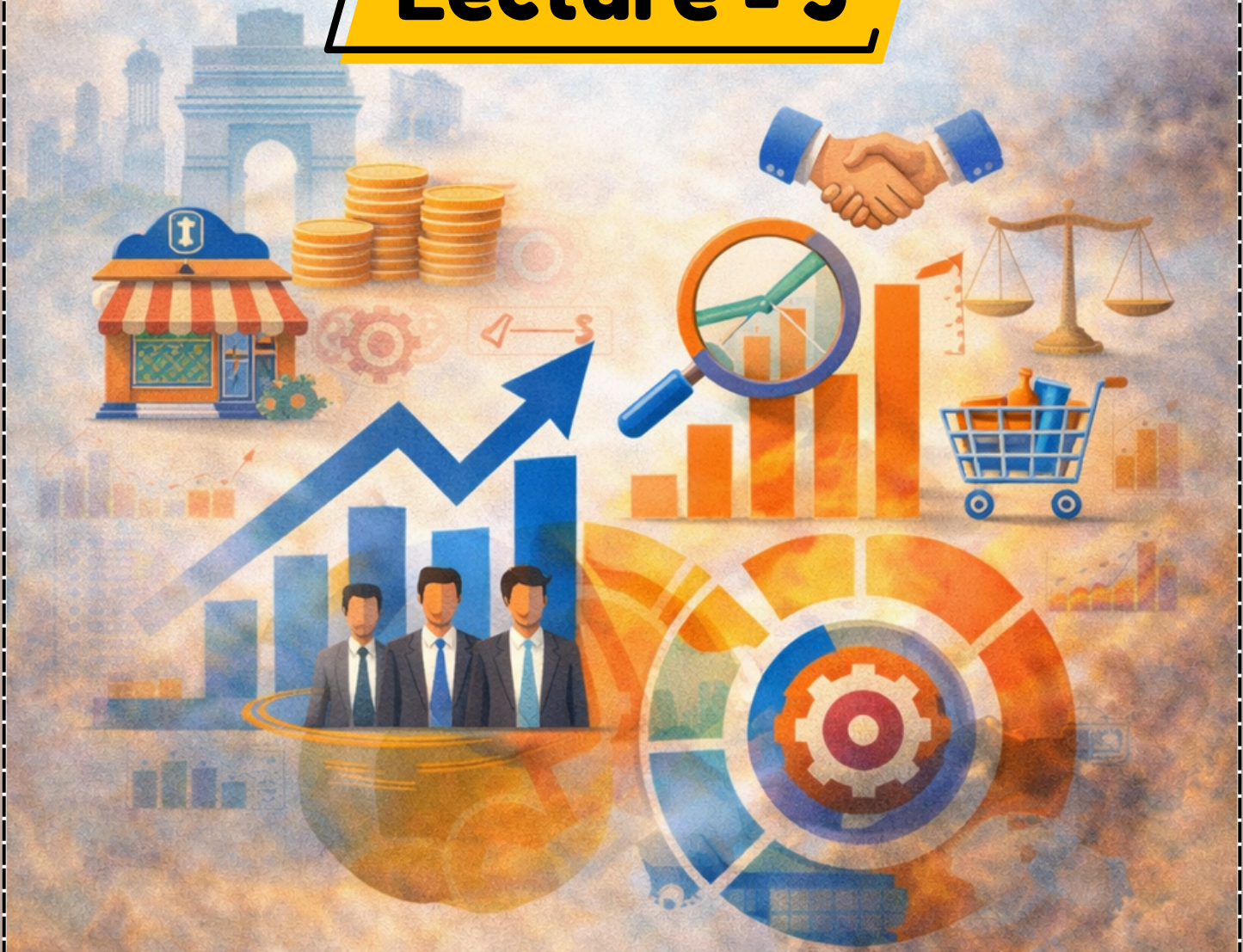
PARMAR SSC

BUDGET AND TAXATION

Lecture - 5



BY PARMAR SIR

FUNDAMENTALS OF THE UNION BUDGET

Definition and Constitutional Framework

What is a Budget?

- It is an approximation of Revenue (Receipts/Income) and Expenses (Expenditure) over a specified period, typically a Fiscal Year (April 1 to March 31).

Constitutional Reference (Article 112):

- The term "Budget" is nowhere mentioned in the Constitution of India.
- It is officially referred to as the Annual Financial Statement (AFS) under Article 112.
- **Mandate:** The President shall cause the AFS to be laid before both Houses of Parliament.
- **Presentation:** While it is laid in the name of the President, it is presented by the Finance Minister.
- **Preparation Body:** The budget is prepared by the Department of Economic Affairs under the Ministry of Finance.

> **Halwa Ceremony:** A customary event marking the beginning of the budget document printing process. Officials involved are "quarantined" (kept in isolation) to maintain secrecy until the budget is presented.

Historical Facts & Trivia

Category	Details
First Budget	Presented by R.K. Shanmukham Chetty (First Finance Minister of Independent India).
Second Budget	Presented by John Mathai (Also the first Railway Minister)
Max. Budgets	Morarji Desai holds the record with 10 Budgets
Notable FMs	P. Chidambaram (9 times), Pranab Mukherjee (8 times).
Current FM	Nirmala Sitharaman has presented 9 times (consecutive), equaling P. Chidambaram's record. She is the first full-time female Finance Minister. (Note: Indira Gandhi held the portfolio temporarily as PM).
Gender Budget	Introduced in 2005-06. Focuses on separate allocation of funds specifically for women/female welfare.
Presentation Date	Shifted from end of Feb to February 1st (since 2017) to ensure funds are available by the start of the financial year (April 1).

Evolution of Railway Budget

- **Separation (1921):** The Railway Budget was separated from the General Budget based on the recommendations of the Acworth Committee.
- **Merger (2016):** The Railway Budget was merged back with the General Budget based on the Bibek Debroy Committee recommendations.
- **Implementation:** The first merged budget was presented for the Financial Year 2017-18.

Vote on Account (Article 116)

- **Definition:** An advance grant allowing the government to withdraw money from the Consolidated Fund of India for essential expenses (salaries, pensions) before the full Budget is passed.
- **Duration:** Typically granted for 2 months (1/6th of the year).
- **Scope:** Covers expenditure only. It cannot be used to alter taxes or introduce new schemes.
- **Relevance:** Since 2017 (Budget moved to Feb 1).

Economic Survey

- A "Report Card" analyzing the economic performance of the previous financial year and outlining future trends.
- **Timing:** Presented to Parliament usually one or two day before the Union Budget.
- **Preparation:** Prepared by the Department of Economic Affairs under the guidance of the Chief Economic Advisor (CEA).

V. Anantha Nageswaran

For the first time in India's history, the Union Budget was presented on a Sunday — on 1 February 2026.

FUNCTIONS OF BUDGET

Allocation Functions

It refers to the process of dividing resources between public goods and private goods, essentially deciding which social services and infrastructure projects to fund.

Redistribution Functions

It aims to reduce income inequality by using progressive taxation (higher tax rates for higher earners) and providing social welfare programs like unemployment benefits.

Stabilisation Functions

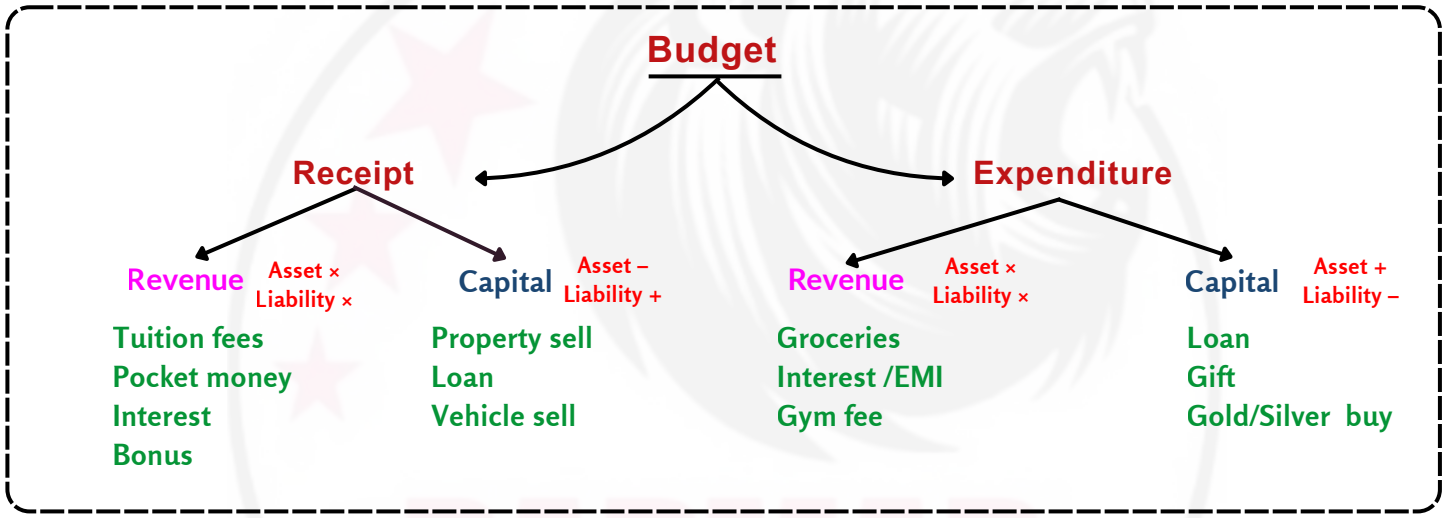
It is aimed at maintaining economic stability by adjusting government spending and taxation to counter recession (by increasing spending) or inflation (by decreasing spending).

Asset

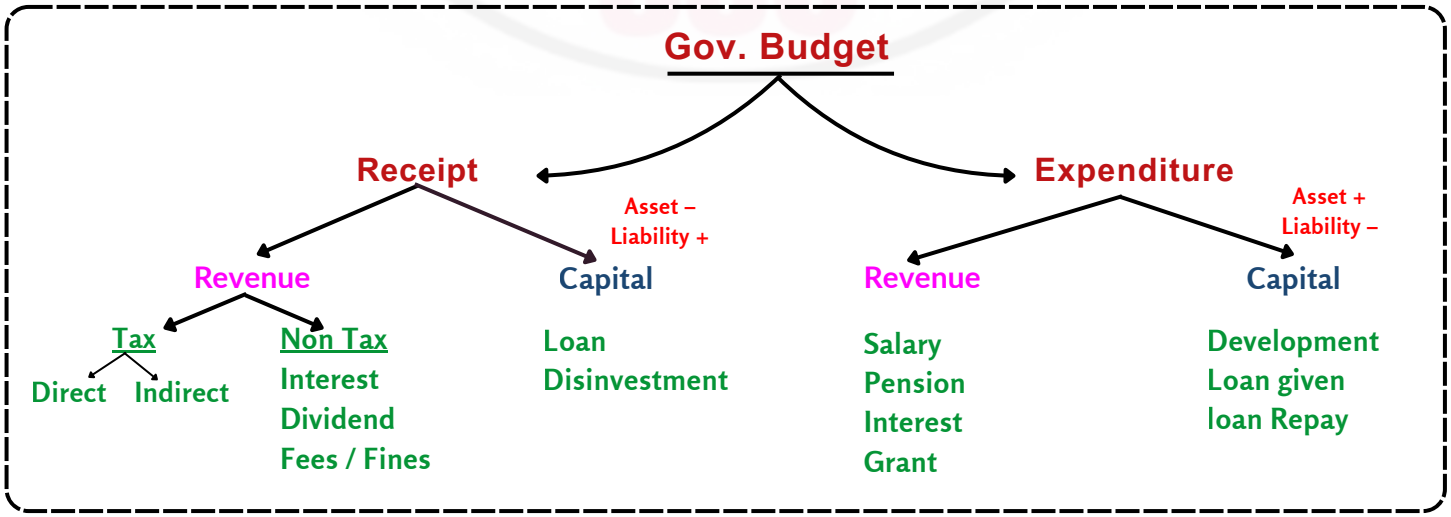
- An asset is a resource with economic value that an individual, a company, or a country owns or controls with the expectation that it will provide a future benefit.
- E.g. Gold, Property.

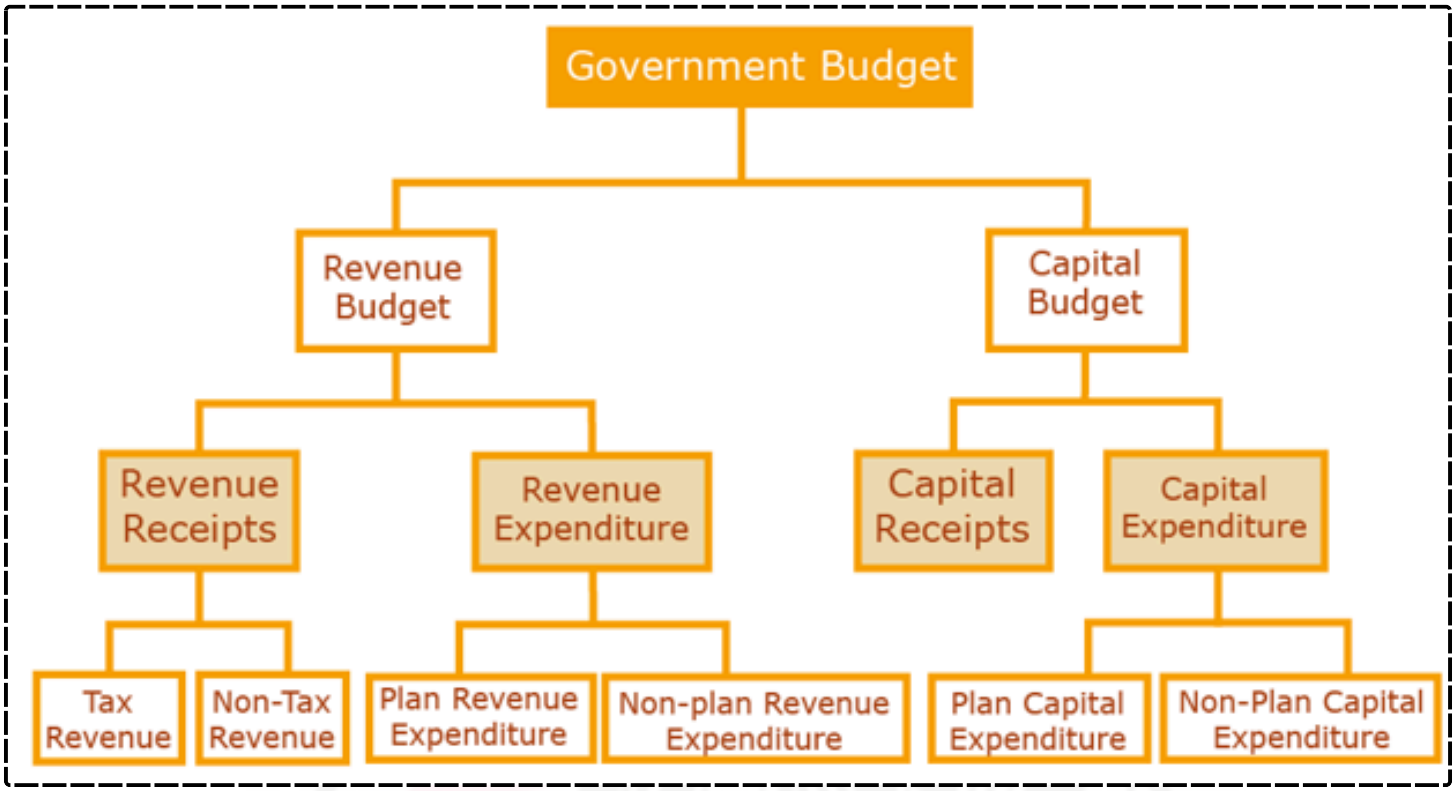
Liability

- A liability represents the obligation or responsibility to fulfill a debt or duty to another party.
- E.g. Payment of loan.



REVENUE AND CAPITAL





REVENUE

- Revenue refers to the funds that a government collects to finance its activities and public services. This primarily comes from taxes, as well as other sources like fees, fines, and duties.

CAPITAL

- It is the physical or financial resources that is used to produce value in an economy.
- It is of two types: Capital Receipts and Capital Expenditures.

CAPITAL RECEIPTS

- Capital receipts are those receipts which either create a liability or reduce government assets.
- They generate new liabilities and reduce existing assets.

CAPITAL EXPENDITURE

- Capital expenditure includes activities in which the government acquires, creates, or upgrades long-term assets such as property, infrastructure, or equipment.
- It creates new assets for the government and reduces liabilities.

Examples:

- Repayment of loans
- Loan given
- Developmental expenditure
- Infrastructure development (roads, schools, hospitals)

ORDER OF EXPENDITURE IN THE GOVERNMENT BUDGET

- In the government budget, the largest expenditure is interest payment, followed by central sector schemes, then subsidies, and finally pensions

Interest > Central Sector Schemes > Subsidies > Pension

TAXATION SYSTEM IN INDIA

Classification of Taxes

- The Indian taxation system is broadly classified into two categories based on the incidence (who bears the burden) and impact (who pays the government).

1. Direct Taxes

- These taxes are paid directly to the government.
- They cannot be transferred to another person.
- Direct taxes are progressive in nature.
- The tax rate generally increases with income.
- **Examples:**
  - Income Tax, Wealth Tax, Gift Tax, Capital Gains Tax, Corporate Tax

2. Indirect Taxes

- These taxes are paid indirectly to the government.
- They can be transferred to another person.
- Indirect taxes are regressive/proportional in nature.
- **Examples:**
  - GST (Goods and Services Tax), Excise Duty, Taxes on petrol, diesel, aviation turbine fuel, Customs Duty

Petrol is outside GST; Central Excise is levied by the Centre and VAT/Sales Tax by States. Alcohol for human consumption is also outside GST; no Central Excise is levied. States levy State Excise + VAT/Sales Tax on alcohol and also charge licence fees.

GOODS AND SERVICES TAX (GST)

- It is destination based consumption tax.
- GST was introduced through the 101st Constitutional Amendment Act.
- It came into force on 1 July 2017.
- Assam was the first state to ratify the GST bill.
- According to Article 279A, the GST Council is a constitutional body.
- The GST Council has 33 members (2 from Centre + 31 from States).
- The Union Finance Minister is the Chairperson of the GST Council.

The **Cascading Effect** refers to the imposition of '**tax on tax**' at every stage of production or distribution

OTHER TAXES

Levied under Article 271 are not to be shared with states

Surcharge

- An additional tax levied on individuals with income above a specified limit

Cess

- A tax levied for a specific purpose.
- It is collected by the Central Government and not shared with states.

Pigouvian Tax

- A tax imposed on activities that create negative externalities to reduce harmful effects.

Fiscal matters

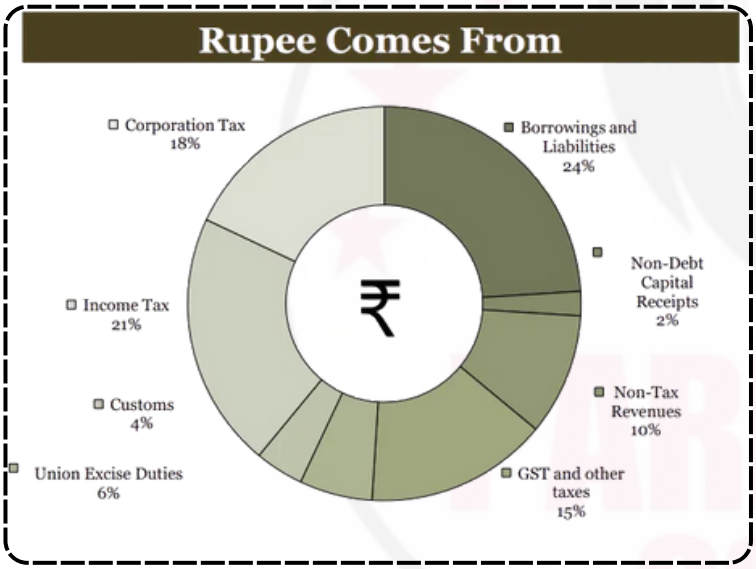
16th Finance Commission

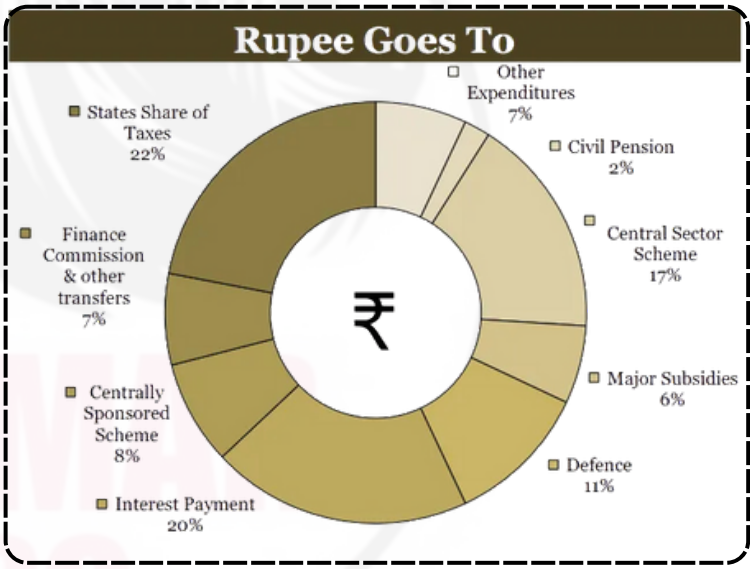
- The Government has accepted the recommendation of the Commission to retain the vertical share of devolution at 41%.
- Provision ₹1.4 lakh crore to the States for the FY 27 as Finance Commission Grants. These include Rural and Urban Local Body and Disaster Management Grants.

Fiscal Consolidation

- Central Government will target reaching a debt-to-GDP ratio of 50±1 percent by 2030.
- The debt-to-GDP ratio is estimated to be 55.6 percent of GDP in BE 2026-27, compared to 56.1 percent of GDP in RE 2025-26.
- In RE 2025-26, the fiscal deficit has been estimated at par with BE of 2025-26 at 4.4 percent of GDP. In line with the new fiscal prudence path of debt consolidation, the fiscal deficit in BE 2026-27 is estimated to be 4.3 percent of GDP.

Factor	Weight	What it means
Income Distance	45%	Poorer states get more share (gap from richest state)
Population (2011)	15%	States with larger population need more funds
Area	15%	Bigger states need more resources to govern
Forest & Ecology	10%	States preserving forests are rewarded
Demographic Performance	12.5%	States that controlled population growth get incentives
Tax Effort	2.5%	States that collect taxes efficiently are rewarded



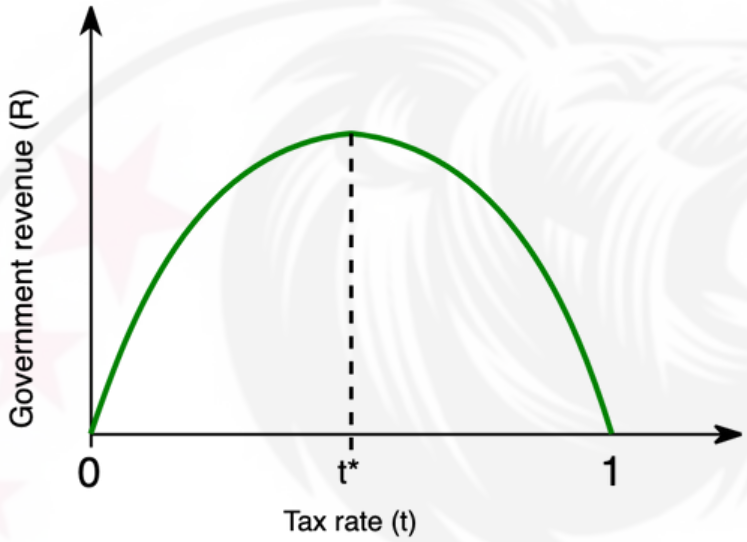


PAPER TAXES

- Paper taxes are those taxes which exist only on paper and do not contribute significantly to revenue collection.
- Other names:
  - Nominal Tax, Symbolic Tax
- Examples:
  - Wealth Tax, Gift Tax, Estate Duty (now abolished)

LAFFER CURVE

- The Laffer Curve is a graph that shows the relationship between tax rates and government revenue.
  - It suggests that beyond a certain point, increasing tax rates can reduce total revenue.
  - High tax rates may discourage investment and consumption.
  - Workers may reduce effort if they feel additional income will be heavily taxed.



FRBM ACT, 2003
(Fiscal Responsibility and Budget Management Act)

- An Act of Parliament aimed at improving fiscal discipline.
- Ensures better management of public funds.
- Reduces fiscal deficit

Under this Act, the government must present the following with the budget:

1. Medium-Term Fiscal Policy Statement – sets 3-year fiscal targets.
2. Fiscal Policy Strategy Statement – outlines financial objectives and strategies.
3. Macroeconomic Framework Statement – assesses economic conditions (GDP growth etc.).

TYPES OF BUDGET

1. Balanced Budget

Total revenue = Total expenditure

2. Surplus Budget

Total revenue > Total expenditure

3. Deficit Budget

Total expenditure > Total revenue

DEFICIT

1. Budget Deficit

Budget Deficit = Total expenditure – Total receipts

2. Revenue Deficit

Revenue Deficit= Revenue expenditure – Revenue receipts

3. Fiscal Deficit

Fiscal Deficit = Total expenditure – (Total receipts excluding borrowings)

4. Primary Deficit

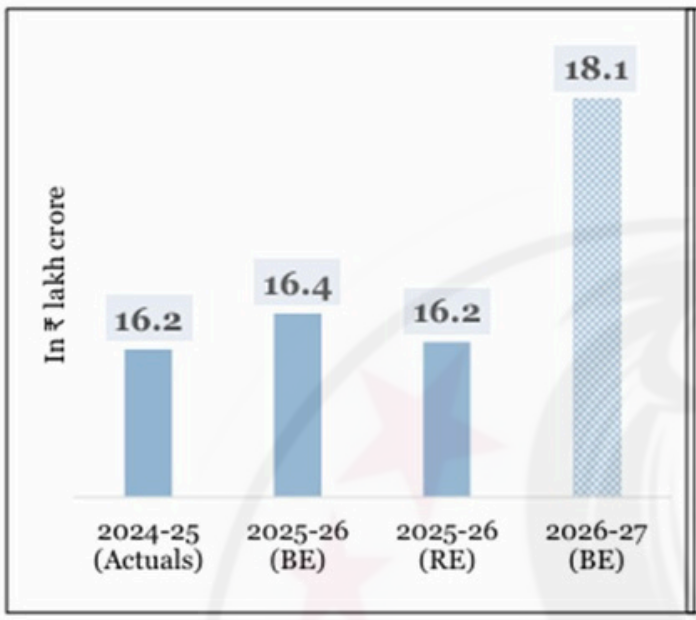
Primary Deficit = Fiscal deficit – Interest payments

5. Effective Revenue Deficit

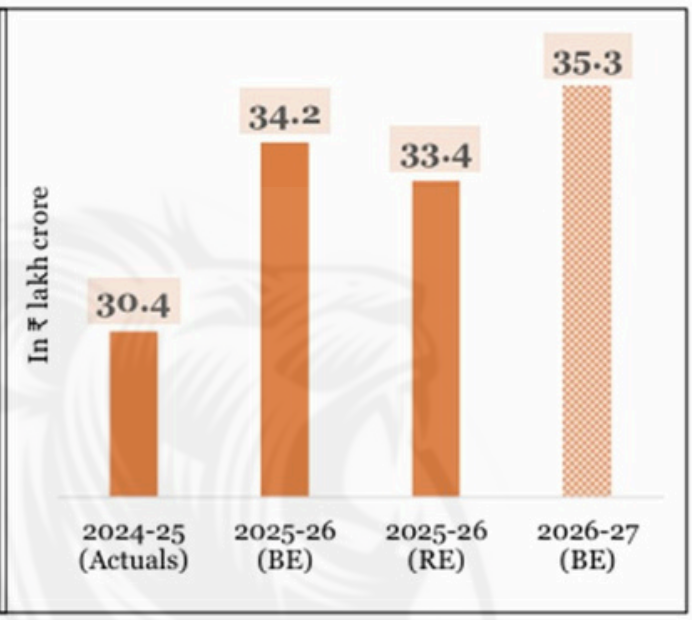
Effective Revenue Deficit = Revenue deficit – Grants for creation of capital assets

RECEIPTS

Capital Receipts

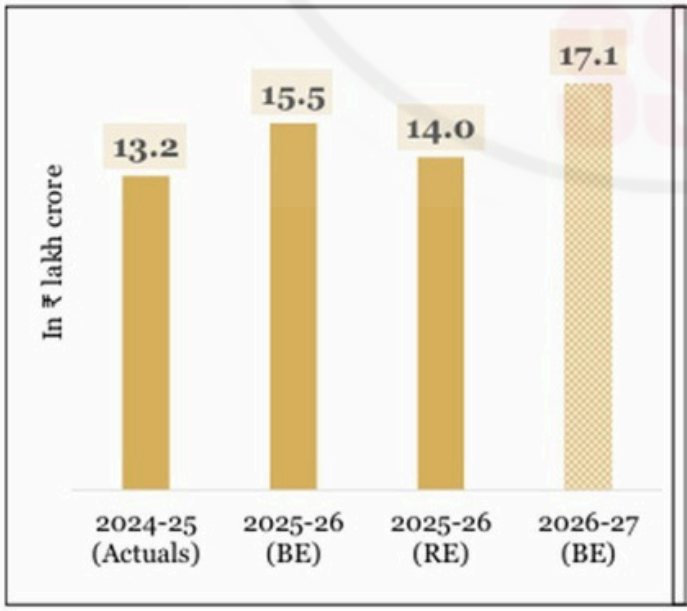


Revenue Receipts

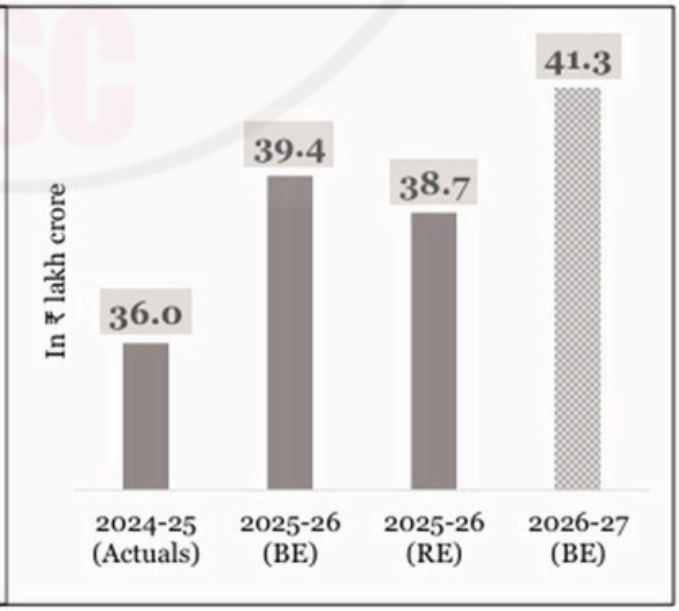


EXPENDITURES

Effective Capital Expenditure



Revenue Expenditure



DEFICIT FINANCING

- The concept of **Deficit Financing** was popularized by the economist **John Maynard Keynes.**

1. Debt Financing

- **Method:** Raising Money by Borrowing
- **Impact:** Liab + (Liability Increases)

2. Equity Financing

- **Method:** Raising Money by Selling Ownership (Shares)
- **Impact:** Asset - (Asset Decreases)



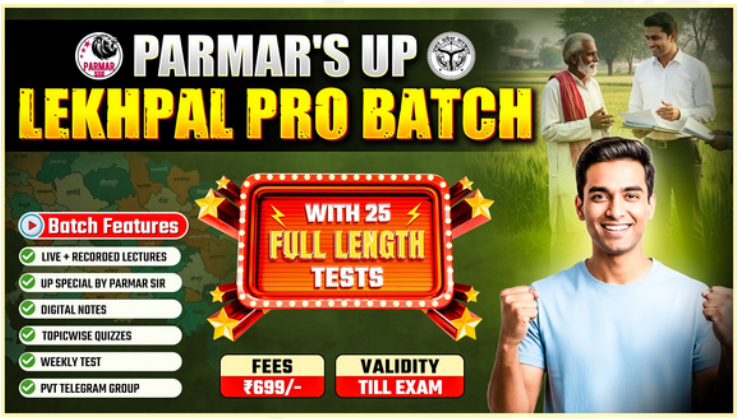


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