

Determinants of Sales Tax Revenue : An Econometric Study

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Studies on tax revenue identify state income as the major determinant of sales tax revenue. However, state income is a proxy to the tax base and is purely exogenous from the point of view of tax revenue changes. This leaves with the alternative to identify endogenous variable that could be used as suitable policy instrument to affect changes in tax yield. The study finds tax rate as the suitable alternative to state income that affects sales tax revenue collection as and when desired by the policy makers.

Introduction

Most of the studies on State tax revenue demonstrate the fact that per capita income is a major determinant of sales tax revenue. It is assumed that due to the increase in the income of the people sales tax yield increases. However, this is not always true. Due to persistent rise in price, state income gives an inflated figure and there is evidence that tax is more responsive to price than the real state income [Rao (1979), Meher (1993)]. This leaves with the alternative to identify other major determinants of growth of sales tax revenue that could be used as policy instruments to affect the former as and when desired. Variables, like tax rate can also influence tax yield. According to the supply-side economists there exists an inverse relationship between tax rate and tax revenue. High tax rates, by reducing the consumption of taxed commodities, yield in low revenue. Similarly, high tax rate can result in substitution of out-of-state purchases for purchases within the state. This would be particularly important in the border regions, where the cost of making purchases out of the state is zero or negligible. In such cases tax cannot be shifted to the consumers. This would result in reduced tax yield. Hence, tax rates can be considered as an important instrument influencing sales tax revenue.