THE IMPACT OF INFLATION ON TAXES UNDER TAXATION LAW

By Sanjana Shrivastava
From Symbiosis Law School, Hyderabad

INTRODUCTION

Before exactly analysing the impacts that inflation is likely to have on the taxes, its essential to acknowledge as to what relationship does exist between these two terms: inflation and taxes. Where taxes are clearly a monetary transfer from the public to the government, inflation happens because of the monetary policies being drafted by the central banks who more often need to keep in check the policies so as to strike a balance between inflation and the economic growth of the country. The more is the increment in the taxes, higher is the declination in the purchasing power which would eventually lead to the subtraction of the demand, ultimately making the inflation rate fall.

Inflation leads to various distortions, both in pertinence to the taxation structure and other persisting issues that take place as a result of modifications in the taxation structure in the non-inflationary scenarios. Majority of the problems that become prevalent in an economy is due the very fact that the tax laws are structured without taking into account the scraping of the purchasing power of the money by way of inflation[1]. One forgets to take into consideration that there actually exists a difference between the a real and an inflationary scenario where one cannot levy taxes on nominal basis. All these distortions being talked about above lead to miscalculations with regard to tax liabilities. The tax liabilities being talked about here is for two levels in which miscalculations happen:

1. Personal income level (personal income distribution)
2. Business income level

The personal income level gets attacked by the inflationary aspect both in regard to the tax base and the rate structure. Here, the concept of progressive taxes plays a huge role. In many countries, the income tax structure being progressive (taxes levied as per the tax paying ability of an individual)[2], leads to the heavy tax burden of individuals which otherwise wouldn't have been the same in non-inflationary scenario. For instance, in a non-inflationary scenario, an individual with lower income probably wouldn't be included in the tax payment, however, when inflation is induced, the same individual with the same income level will now have to be burdened with the tax payment which is much higher than his tax bracket. Now, this particular aspect was in relation to taxpayers who were under exemption from tax payments in a non-inflationary aspect. When it comes to individuals who used to pay taxes alongside their tax brackets suddenly have to jump to higher tax brackets and therefore, become prey to higher tax burden. In a similar manner, the distortions happen when it's the tax base under the personal income level.

[1] Glen P Jenkins, M Hedi Lahouel, *"Inflation and Taxation"*, Harvard Institute for international development, February 1981, at1,21

[2] Kimberley Amadeo, *"how a progressive tax system helps the economy"*, (7th of May,2020, 10:44 PM), https://www.thebalance.com/progressive-tax-definition-examples-4155741

Effects of inflation on capital taxation (functional income distribution)[3]

The effect of inflation i.e. the tax distortion on the functional income distribution lies in the very fact that the distortion is much more severe in the case of capital taxation than in the case of the taxation on salaries and wages. The economists are of the view that in order to analyse this very aspect, its essential to compare different, although economically interrelated aspects of income from capital.

The basic understanding required for the same would be to keep the value of initial capital intact, even though a maximum amount is spent on the consumption of the good and services. More often, even the capital gains are subjected to get taxed when inflation exists. The taxation in such circumstances ought to be adjusted for inflation. Secondly, as far as the level of business income is concerned, it's the tax base that happens to undergo distortions. It has been observed that in case of business income level, the value of capital stock or the production cost is derived from history. It's always the acquisition cost that is taken into account in order to calculate the monetary value of the goods sold or production materials sold. This leads to the non-accountability of the amount accrued by the firm due to the "inflation-induced" erosion of the actual value of the net financial liabilities.

RESEARCH QUESTIONS:

- What are the consequences of inflation on the various tax liabilities?
- What could be the probable extent of combatting the inflationary scenarios as and by the tax system?
- How have the existing reasons of failure in preventing inflation has impacted the economy?
- How are the policies that are prevalent in pertinence to coping up with the inflation effective?

RESEARCH METHODOLOGY

The methodology adopted by the author is completely doctrinal in nature i.e. it has been extracted thoroughly from the prevailing literature and the concepts that already exists as a part of macroeconomics and principles of taxation. The theoretical data on which the major part of the research is done is partly dependent on the interpretation of existing books, articles, research papers, documents and sheets of data produced by different credible websites and publications as would be mentioned in the references and the footnotes. As far as the footnotes are concerned, the 19th bluebook edition has been followed.

The entire research has been done relying on the primary source of data. No field work or surveys have been relied upon in order to grab data for the research that has been conducted in order to establish a conclusive answer to the research objective. The present proposal is the draft of the main paper, there are numerous sources cited and acknowledged, however, the author has tried to encapsulate the insights in this paper by outlining the essential chapters in the form of headings and subheadings that were already discussed in the synopsis sent earlier as a part of the interim draft.

[3] Ewald Nowotny, *"Inflation and taxation: reviewing the macroeconomics issues"*, Journal of Economic Literature, vol. 18, no. 3 (Sept 1980), pp 1025-1049

CONSEQUENCES OF INFLATION ON VARIOUS TAX LIABILITIES

PERSONAL INCOME DISTRIBUTION

PERSONAL INCOME TAX STRUCTURE

As discussed in the introduction itself that, traditionally whatever taxes were imposed, were attached to the nominal income which had no organised system of prevention from taxes if, in future there is inflation or even the increase in nominal income. Now, this very aspect remains unrecognised when the taxes imposed are of constant rate and any distortion would not happen as far as a non-inflationary scenario is concerned. And hence, whenever there is an increase in the real income (with nominal base), the share of the taxes that goes to the government stays constant[4]. For example, in many of the countries where a progressive taxation system is followed that is to say that taxation as per the income bracket, the individual has to jump off to an upper bracket of tax payable in the situation of inflation as with inflation there is an increase in the nominal income and with that increase in income the bracket for a tax to be imposed on such income also rises as its progressive and hence, the individual now has to pay more taxes without considering the very consequence that the purchasing power remains constant or even is declined. And hence, any such monetary transfer in the form of taxation to the government is purely unintentional that the inflation forces. In such scenarios, what exactly happens is that the individual's tax burden is increased with the gross real income being constant which makes him economically stagnated. Hence, from the above discussion it could be assessed that because of the progressive tax structure in federal economy, revenue of substantial amount accrues to the federal government that makes the nominal income increase during inflationary periods. The estimation of the impact of inflation on the tax liabilities are limited and the important point to be noted here is the very fact that the requirement of this estimation of the inflation or the inflation elasticity can only arise from the fact that the real growth and the growth happened out of inflationary scenarios have completely different impacts on the distribution of income and eventually the tax liabilities. Furthermore, it would be a but obvious fact that the estimation of the general elasticities i.e. to state that the income tax (in non-inflationary scenario) would have a different impact on the distribution as compared to the one in inflation. Another fact to be taken into consideration here is the very aspect that inflation is capable of inducing real monetary transfer to the government. Here, the most suffering is afflicted to the household groups who in the scenario of non-inflation were not subject to any tax payment but due to inflation and thereby nominal increase in the real income will now have to pay taxes[5]. The very reason behind it is that the exemptions are induced to the nominal level so that even the lowest nominal income groups will have to pay taxes when inflation occurs. In addition to that, in order to diminish the real value of income, deductions are also induced at nominal levels.

FINDING: The seriousness of the confrontation that these estimations are usually resorted to and the preclusion of the

[4] Kimberley Amadeo, *"how a progressive tax system helps the economy",* (7th of May,2020, 10:44 PM), https://www.thebalance.com/progressive-tax-definition-examples-4155741

[5] Everette E Peterson, "Inflation *and its control", (*24th of October,2020, 9:11 PM), file:///C:/Users/HP/Downloads/ar590081.pdf

direct estimation due to the time constraints have indefinitely had a huge impact on the actual performance of the system due to various alternative structures being incorporated and the changes impacting the rate structure, kinds of deductions and levels of distribution income. Such haphazard systems have not taken the ground realities into consideration that the economic situations of the individuals remain constant wherein the payment of taxes become mandatory even when the purchasing power and individual growth are either constant and have even declined.

IMPACT OF INFLATION ON INTEREST INCOME AND TAXATION

The presence of inflation does not just distort the rate structure but it does have a destructive impact on the tax base. Usually the capital gains as well as the interest incomes are attached to the taxable base without taking into account the inflationary aspects. Under inflationary scenarios, it is an inherent fact that whatever interest receipts are accrued are by the taxpayer's actual income as the consumption being done by the tax payer is the maximum, he or she could spend providing that the real value of the initial capital is not altered at all[6]. However, as far as the inflationary surroundings are concerned, it is a fact that the initial capital loses all its value with the duration and as the time passes by and hence in order to get the correct understanding of the real income its important that the consequential capital losses as mentioned earlier be subtracted from the interest income before it gets subjected to taxation[7].

FINDING: The interest receipts that were being discussed about here are fundamentally the compensation for the loss in the value of the individual's asset and therefore, the tax that these interest receipts are usually subjected to becomes a preceding mandate of the tax that the individual's capital is being subjected to. What exactly happens here is that the tax on the real interest rate taxation gets negative because of the inflationary distortions. This happens even though still the rates are marked up well with the inflation rates.

CAPITAL GAINS TREATMENT

In an inflationary situation, the distortion of tax base is considerably constituted and this very aspect come into picture because the nominal capital gains show an overstating impact over the true and real gains. Usually, the true gains calculated by subtracting the cost price from the selling price however when the inflationary conducts are being resorted to, it leads to heavy real tax burden[8]. In a study being conducted to see this treatment of capital gains, it was found that "in 1973 the individuals were observed to have paid $500 million for $4.5 billion of nominal capital gains on a corporate stock".
However, the real loss of $1.0 billion[9] was recorded when the acquisition costs of such shares were adjudged by the inflation. This very example indicated the fictitious nature of the substantial share that the nominal

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[6] Tejwan Pettinger, "*policies to reduce inflation*", economic help, (4th of October, 2020, 8:42 PM), https://www.economicshelp.org/

[7] Ibid Supranote 4

[8] David Greytak, "*inflation and the individual income tax*", Southern economic association, Vol. 45, No. 1 (Jul., 1978), pp. 168-180

[9] J. Wilner Sundelson, *"The Federal Revenue System : Taxation during Inflation"*, A report to secretary oftreasury,(20thSeptember,1934),http://www.taxhistory.org/Civilization/Documents/Surveys/hst23740/23740-1.html

capital gains have directed towards. The previously instanced example is evident enough to portray that the taxpayers are basically subjected to compensation for whatever loss they had incurred in the purchasing power initially while making different investments.

Hence, here is a requirement to assess as to what should be the correct taxable income so as to gain clarity on the impacts that inflation have by distorting the base. In order to assess the same, the compensation that is being given in order to cope up with the loss incurred should be subtracted from the nominal gains. And this can only be done when the initial individual's assets ate taxed by some general price index.

FINDING:
To acknowledge and assess the same, in many countries, a major fraction of the capital gains is eliminated from the tax base so as to make sure that in the situation wherein the inflation comes into play, it can be corrected. However, it has been observed that this particular method has not been of much utility or even successful for that matter of fact. The above-mentioned practice was adopted so as to fit in the quote that "the larger an asset is held the larger the fraction would become over time" and hence the primary aspect here was to simply widen the amount of the fraction of capital gains. This method being insufficient was because of the very fact that if at all the rate of inflation becomes stable, the elimination of the fictitious capital gains from the said tax base would have to be raised in proportion rather than the reduction wanted over the duration of time.

FUNCTIONAL INCOME DISTRIBUTION

IMPACT OF INFLATION ON BUSINESS TAXATION

Inflation has been known to alter both the net level of income of the businesses as well as the monetary accruals that are flowing through out the activities of the business. Interestingly, both these aspects are more or less important in order to profoundly draft a design for the taxation policies. The impact of inflation on the net level of business incomes mentioned earlier basically serves the reduction of the depreciation in the allowances and cost of assets sold and thereby increases the tax liabilities[10]. And along with this very aspect, the net income also gets elevated through the unanticipated transfer of the said income from the debt holders to the equity owners. This is important to be aware of because we already are aware of the fat that the tax and the interest payments have a tendence to increase from them before inflation period and that too significantly, which cause severe obstacles in the cash flow created for the businesses. And therefore, if any kind of tax reforms are brough into the picture in order to take into account the impact of the inflation, in return it is likely to trade off the already accrued principle of income taxation with the duration of time in order to have accessed the availability of cash to pay taxes. Below mentioned points are these inflationary adjustments that have an influence and impact of inflation on them and have been briefly discussed thereafter:

[10] Ewald Nowotny, *"Inflation and taxation: reviewing the macroeconomics issues"*, Journal of Economic Literature, vol. 18, no. 3 (Sept 1980), pp 1025-1049

- Adjustment of depreciation expense of inflation:[11]

In many federal countries, the firms have got this allowance by way of which they can deduct the depreciating allowances from the gross profit obtained in a year and these depreciation allowances are basically the acquisition costs of the depreciating assets. Now, in a non-inflationary scenario, these allowances and the gross profits being talked about are denominated in the same monetary units i.e. the purchasing power is the same and that is to state that the prices will be the same. Therefore, in such a non-inflationary scenario, the depreciation based on the initial reflects the value of the economic capital that was being utilized for the whole accounting period as a physical capital.

FINDING:

In the times wherein the prices have been rising indefinitely, the firms aren't capable of recovering the real purchasing action of the investor's funds and nor are they capable of analysing the depreciated assets and these very aspects arise out of the very fact that the depreciation on the basis of the initial costs are not allowing the firms to do the same. These depreciated assts are purchased much before the accounting period and that is an aftermath of the aspect that those were purchased at higher purchasing power than as compared to the current accrual of revenues. Therefore, in order to assess to what should be the correct taxable level of business income, the adjustment of the capital cost allowances with respect to the present current values have to be taken into account in order to reflect the exact amount of capital that was used up. Because if that does not happen, the income statement would be displaying an overstate of the actual economic performances by the firms and they will be paying taxed on profits which are a consequence of the inflation.

- <u>IMPACT ON INVENTORY EVALUATION</u>

Usually what the tendency of the companies is that they carry both processed and non-processed inventories from one period to another period. These processed and non-processed inventories form a major part of the total shares[12]. What happens under the inflationary conditions is that these inventories that are bought at nominal cost or even acquired at are being done at a much lower cost than the replacement cost or the initial/historical cost of the investment. Here, when the company records in its income statement, the initial cost of the goods sold or used in production instead of the inflationary adjustment system recorder, eventually makes the true profits accrued overstated and ultimately gives the wrong impressions.

FINDING:

In order to assess as to how the accounting for the cost of goods sold or used in production during the accounting period could be done, there are two methods for the same[13].

a) FIFO (first in-first out)-

According to the FIFO method, the units of the goods that were first bought were to be sold first. Thus, the FIFO method

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[11] Ibid Supranote 3

[12] Arjun Mehta, "*strategies of combatting inflation*", economic times, (21st of October,2020, 4:00 PM), https://economictimes.indiatimes.com/

[13] Glen P Jenkins, M Hedi Lahouel, *"Inflation and Taxation"*, Harvard Institute for international development, February 1981, at1,21

fundamentally accounted for charging the manufacturing costs of the good sold and these quantities of the goods sold were valued at their cost of acquisition.

b) LIFO (Last in – first out):

This method of accounting was to make sure that the goods that were brought at the last have to be used first and should be charged accordingly. These goods were charged much close to the acquisition cost as the goods were assumed to be valued in the latest scenarios and hence the charges were much close to the replacement cost.

Taking into account the increasing prices, what the FIFO method does is that it underst6ates the cost of the production or sales and results in the taxable income which is larger than the actual or real profit of the firm. Therefore, if the amount of the holding of the inventories are not reduced, they have the capability of overstating the actual profits by an amount equivalent to the product of the historical rate of investment with a simultaneous increase in the pricing.

Impact of inflation on allocation[14]

it's a but obvious aspect that the tax distortions that are induced as a consequence of inflation on personal income distribution and capital distribution would have an impact on the allocation and growth. But however, we don't exactly have any existing theory so as to calculate this very impact of inflation on the allocation which in return makes it exceptionally ambiguous so as to calculate the tax distortions.

COMABTTING INFLATIONARY SCENARIOS AS AND BY THE TAX SYSTEM

With regards to the concept of inflation, there exists two groups that have opined for the same. While one group is of the opinion that "little inflation is good as it boosts the economic growth of the country as well as benefits some people and hence a few steps could be taken in order to take care of those who have suffered due to inflation" and on the other hand the other group is of the opinion that "inflation of any kind is bad and makes creeping inflation gets out of hand and stable prices are consistent with full employment"[15].

The primary responsibility of Reserve bank or for that matter any federal reserve is to control inflation and at the time making sure that recession doesn't happen. Usually, in India, the reserve bank is responsible for drafting the monetary policies to keep in check the various strategies and nuances prevalent in the path of the economic streets for the country. Federal reserve, on the other hand, is responsible for the US check of economy. Below mentioned are certain effective measures that are required sand should be taken into account to combat inflation.

- USE OF CONTRACTIONARY MONETARY POLICY[16]:

Contractionary monetary policy is basically a restrictive monetary policy wherein the banks use monetary tools to slow down the economic growth. By way of this practice the banks usually increase the interest rates so

[14] Ibid, Supranote 3

[15] Everette E Peterson, "Inflation *and its control", (*24th of October,2020, 9:11 PM), file:///C:/Users/HP/Downloads/ar590081.pdf

[16] Himani, "*role of monetary policy in combatting inflation",* IOSR Journal of economics and finance, e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 4, Issue 6. (Jul-Aug. 2014), PP 11-20

greatly that it makes difficult for the borrowers to take loan or money from bank and thereby restricting liquidity of cash. It lowers the flow of money by making lending money more expensive. This way the money supply gets tightened and that's the total amount of credit allowed in the market. All of this leads to downward pressure on the prices.

- OPEN MARKET OPERATIONS

This very concept emerged in US wherein open market operations was a defence to inflation. The reserves responsibility is to buy or sell securities from member banks. These securities are bought in order to secure availability of cash to lend money. Usually more force is exerted to other banks for them to buy securities that the reserve banks sell. What this whole procedure does is that it reduces the capital for the banks thereby making the amount of money lessen. In return, this makes the interest rates go higher as a result of which the lending money rates go up and becomes expensive thereby reducing the cash liquidity and inflation mopping.

- AVOIDANCE OF HOLDING CASH FOR LONG

In an inflationary scenario, the cash has a tendency of losing its purchasing power and therefore, keeping a large amount of money in bank is not safe as in such a situation the amount of money gets nibbled everyday thereby subjecting it to frequent reduction of purchasing power.

- ASSETS THAT HEDGE AGAINST INFLATION

One has to take into account the very fact that the commodities, stocks, treasury inflation protected securities (TIPS) are up for protection in an inflationary environment in favour of the investors.

- ASSURANCE OF TAX BENEFIT FROM INFLATION

During an inflationary scenario, the investors also tend to accrue benefits from high taxation as they help themselves in reduction of taxation from their respective capital gains. This happens as the tax rules provisions the investors with the benefit of adjustment of the cost of their assets in the holding period. That is to state that the choice of indexation option benefits these investors and they do not have to pay taxes for the same.

- DIVERSIFICATION

The certainty of whether one is to experience inflation, deflation or even stagflation, is very difficult to acknowledge or even predict[17]. Therefore, the being ready scheme for the combatting against the same should be comprised of detailing that is inclusive of assets that are capable of outperforming in every possible situation and in order to do so its very important to be diversified and be aware of what are the thing that are complied with and what are the things that are not and hence should be complied with eventually.

REASONS OF FAILURE IN PREVENTING INFLATION

Contrary to the situation in 1920s wherein even the hyperinflations were stabilized by the nominal methods such as money exchange and with minor costs as a part of outputs, inflation these days in many

[17] Ibid Supranote 16

countries have been observed to have been explicitly difficult to withstand or even eliminate in the slightest way possible. Post 1950s, it was observed that majority of the countries were trying to fight against the high inflationary scenarios that were termed as *chronic inflation* by way of introducing and implementing the stabilization programmes however the same were not of any great utility and regardless of the methods used, it took more time to fight it in compared to the hyperinflations in 1920s.

To fight against the high inflation that was termed as chronic and that is to state that it persisted for a long duration of time and could not be measured in days or months rather such measurement was done in years[18]. A lot of stabilization plans to prevent inflation were dragged into picture and since the chronic inflation impact on every country's economy is different because of different structures and forms, the regularities and irregularities were also different in these stabilization programmes and are elaborated upon on one to one basis hereunder:

- ***Exchange rate-based stabilization [ERBS]***

As mentioned earlier that the hyperinflations were indeed managed with the output costs and small exchange anchors however the same could not happen in the case of high inflations. The time taken to have observed the impact and prevention took really long and ultimately the exchange system method was observed to be futile as this very stabilization procedure failed miserably and on the contrary the impact was opposite as the inflation had an outrageous comeback. The reasons being:

a) Inflation is not reduced with the same pace as it is supposed to be in comparison to the reduction in the depreciation of the currency.
b) the price of domestic goods increases relative to foreign goods, with a consequent loss of competitiveness
c) the current accounts and the trade balance or we can say that the relation between the two is negatively impacted or deterioted
d) the sceptical response from the public as there becomes huge elevation in the interest rates.

- ***Money based stabilisation [MBS]***[19]

MBS as a matter of fact was a great initiative for appreciative the divergence of the currency. This was possible only because of initial rise in the interest rates, sticky inflation and imperfect floatation of the exchange system. The duration takes to move from the growth of monetary aspects to the slower convergence of the inflation, this medium was much faster than the ERBS stabilization method. However, the reason for its failure was:

a) Smaller incidence was being given to such a plan and especially among the countries suffering from chronic inflation.
b) To make generalisations as in the case of exchange rate-based stabilisation was not possible.

[18] Francisco Jose Veiga, "*What causes the failure of inflation stabilization plans?*", University of Minho, 2321-5925.Volume 4, Issue 6. (Jul-Aug. 2014), PP 11-20

[19] Ibid Supranote 18

- ***Model of plan failure***[20]

Balance of payment crisis is what the model of collapse refers to. Here, the eventual declination of the reserves was turning towards the concept of balance of payment crisis. This was an aftermath of the very incident that the peg showed that the agents could gradually and ultimately be abandoned and could use the trading as much as domestic for the foreign currency as one could. The evidence regarding this is utmost prevalent about the fact that now the agents were prone to get hit by the capital loss if at all there were unintentional gaps in the pricing level as those were the consequential disadvantages that had the capability of abandoning the reserves and exhaustion of the exchange rates.

- ***Misfortunes of the individual taxpayers***[21]

This was seen in the case of chronic inflation witnessed by Germany. Inflationary taxations usually drag up the tax system levying techniques so as to nullify the legislative interference of tax reforms by an intention of unforeseen tax movements. It has been observed by a study that even a slight increase in the level of prices has distributed tax burden in the most unjust manner possible. The treasury that any country has, has its own purposes and hence consideration has to be focussed on the very fact that the neglection of the equity principles can definitely make the authority divert or distract from prevention of gross injustices happening in the form of tax burden thereby defeating g the very purpose of the treasury. This might result in the hostile spirits of the taxpayers that might eventually lead to the maximum reduction in the revenue yields. This is what happened in the case of Germany wherein even though the Germans had taken into account t the misfortune of the individual taxpayers, they avoided to take into consideration the excessive burden on the individual taxpayers that were supposed to be reflected by the vagaries of the inflation and had to get attacked by the organised and authentic militants of opposite taxpayers.

EFFICACY OF THE POLICIES PREVALENT IN ORDER TO COPE UP WITH THE INFLATION

The government can levy taxes or print money if at all there is a constraint in the yearly budget. But however, to fight against the inflation, it has no other option but to incorporate monetary policies[22]. Because when there is an inflationary scenario, the transaction techniques get worsened and inefficiency roots for the contracting that has a huge impact on the economy of the country. Also, in an inflationary surrounding, tightening the policies so as to make the lending capacity more and more expensive won't be of much utility because that has an explicable impact on the economy as higher taxes may have a distorting impact on the labour supply, investment decisions and the saving options.

A chronic inflation or high inflation that has the capability of persisting for a long duration of time is an environment where the prices rise. In this very condition, it is the prime

[20] Ibid Supranote 18

[21] Kimberley Amadeo, *"how a progressive tax system helps the economy"*, (7th of May,2020, 10:44 PM), https://www.thebalance.com/progressive-tax-definition-examples-4155741

[22] James M Poterba, "*inflation and taxation by optimizing governments"*, National bureau of economic research, e52-250 Cambridge MA

responsibility of the government of the particular economy to take charge by incorporating the monetary policies. These monetary policies basically reduce the demands by elevating the interest rates so as to bring the prevalent inflation under control. However, there are some other policies too that are rendered equivalent when it comes to controlling inflation. Such as fiscal policies, supply side policies, wage control exchange rate appreciation and money supply stringent controls. Where these are prevalent to tighten the controlling techniques so as to bring the inflationary environment under control, they do have certain li9mitations which are the reasons as to why the control takes time and why isn't there a 100 percent efficacy as far as the prevention or coping up with inflation is concerned.

These policies are elaborated on under one by one with their regularities and the adjacent limitations hereunder[23]:

- MONETARY POLICY: this is one of the most efficient tools that is used mostly in the UK and US in order to make sure that the inflation is maintained at a lower level. Here, the respective countries try to predict the future inflation and the overheating of the economy and then plan their strategies accordingly.as soon as the overheating is diagnosed the countries are ready to implement the increase interest rates. The rates are increased so as to slower down the growth of the economy. It reduces the demands as:
- Elevated interest rates increase the cost of purchasing and borrowing and hence discouraging the borrowing feature and the expenditure.
- It encourages to save money.
- Higher the interest rates lower will be the disposable income
- It will increase the exchange rate.

LIMITATION:

- Cost-push inflation is difficult to deal with.
- The time taken to observe an impact of the higher tax rates over the reducing demands will be very much higher than expected.

➢ SUPPLY SIDE POLICIES:

As far as the productivity and long-term competitiveness are concerned, the supply side policies have a role to play. It is normal tendency to expect that the deregulation and privatisation can make the firms productive and competitive thereby reduction of inflationary pressure is maintained.

LIMITATION

As far as this very policy is concerned, the sudden emerge of inflation cost cannot be dealt with under it.

➢ FISCAL POLICY

This is more or less similar to the monetary policy and can be termed as the demand side policy. Here, what needs to be taken into account is that there is a government involvement in the alteration of the tax policy to as to keep in check the aggregate demands. The government in order to reduce the inflationary pressure even goes to the extent of decreasing the government expenditure.

LIMITATION

[23] Tejwan Pettinger, "*policies to reduce inflation*", economic help, (4th of October, 2020, 8:42 PM), https://www.economicshelp.org/

Taking into consideration the likes of the public who aren't really in favour of the cuts in government spending, this policy in return becomes politically costly as it also has to attract the public.

- EXCHANGE RATE POLICY

This comes from the UK joining ERM to reduce inflation. While keeping the rate of the currency high, reduction in the inflation is maintained. A stronger currency would make the imports cheaper. In addition to that it will reduce the domestic demands.

LIMITATION

This was somehow working but then recession happened that destroyed almost all the efforts. In order to increase the currency value, it had to increase tax rates to more than 15 % that lead to recession.

- INCOME POLICIES

It was observed and studied that the increase in wage growth will lead to high inflation and hence, wage control policies were given an attempt.

LIMITATION

It could not be widely enforced as it was not possible to generalise it for everyone.

- MONETARISM

This emerged as an extraction from the United Kingdom in the year 1980, where in order to decrease inflation government came up with controlling inflation by controlling money supply. To over come the same the government increased tax rates and decreased budget deficit.

LIMITATION

Such a policy has a tendency and is prone to deep recession which actually happened and hence ethe economy broke miserably.

CONCLUSION AND RECOMMENDATION

Taking into consideration all of the above-mentioned aspects, it is evident enough to portray that tax systems have to be designed while making sure that at least some predictions are made in that regard. The removal of the inflationary surroundings and aspects have witnessed major tax distortions because of the progressivity of of the tax rates in the federal economies. In general, what can be extracted in a summarised manner is that a definite plan can never be sufficient to deliberately put the nation's economy stress free. There will always be the slightest of the possibility that the policies or even the recommendations by the economists might go wrong. However, below mentioned recommendations are advised by the author of this paper with a view that if not a 90 percent reduction in pressure could be achieved during the times of inflation, at least in some wat or the other the economy could be saved if certain things are kept in mind and implementation is being successfully executed.

As far as the impact of inflation on the tax liabilities are concerned, with respect to the personal distribution,

- To make sure that the proportionate downward adjustment is being done with regards to the inflationary rate and this should be done in compliance with the statutory marginal rates. This should be done so as to make sure the tax liabilities (real) are reduced for the lower income groups. As there will be elimination in the higher rates, this would eventually lead to the reduction in the progressivity of the tax system.

- A deduction of the component that is equivalent in element as the inflationary component (product of this year's inflation rate and last year's nominal income) from the nominal income.
- To eliminate the distortion by way of subtracting the inflation induced loss from the nominal receipts of the income. This could be very well done by taking into effect the rate of the inflation i.e. to state that the change in the CPI i.e. consumer price index.
- A comprehensive suitability or even adjustment should be taken into account by way of which the declination that had happened due to the inflation induced fictitious overstating of real value should not be brought inro the real income. This should be done so as to make sure that the real profits of accrued by the firm or the company at the end of the year or annually is maintained and verified.
- The firms should be allowed to adopt the concept of LIFO instead of FIFO so that it is made easier to check on and re evaluate the initial inventories as a general price index.
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LITERATURE REVIEW:

- ***Inflation and taxation by Glenn. P Jenkins[24]***

The author in this very article has completely elaborated upon the different tax liabilities present with the help of empirical evidence introduced in the form of different statistics and tables. In addition to that, the author, in order to display and make its audience more understanding to the concepts has also subjected the principles of taxation to the various formulae. The author has also given illustrations in general to make the audience more and more intrigued and to make the concept become anti-complex. In addition to that, the article involved profound elaboration on the alternatives so as to give a detailed idea of different situations and analysis of all of them differently so as to portray a practical resemblance of the taxation system and the according impact of inflation over it.

- ***The federal revenue system: taxation during inflation by J. wilner sunderson[25]***

The author in this very article has taken into account two countries and has elaborated on how have they fought against the chronic inflation. The author has given a detailed analysis of the combatting techniques and the misfortune of the tax payers in the times of recession and inflation in the country of Germany and simultaneously has also defined what went wrong. The author of this paper has taken these illustrations from this very article only to analyse the combatting techniques to prevent the persisting inflationary surroundings.

In addition to that, the author has made it evident that there is no definite or even they cannot b3e a definite or certain plan to fight against the inflation. He has used the term "hit and trial" to see if it diversifies the economy successfully or rotates it in a different dimension. Furthermore, the author has also elaborated upon the different needs

[24] Glen P Jenkins, M Hedi Lahouel, *"Inflation and Taxation"*, Harvard Institute for international development, February 1981, at1,21

[25] J. Wilner Sundelson, *"The Federal Revenue System : Taxation during Inflation"*, A report to secretary oftreasury,(20thSeptember,1934),http://www.taxhistory.org/Civilization/Documents/Surveys/hst23740/23740-1.html

of the economy especially in the case of federal government and how can these government be responsible for having a great knowledge of the economy as well as the fight against recession and any unprecedented aspect that could possibly stand out or persist and how to tackle with them in the most effective manner.

- ***What causes the failure of inflation stabilization plans? by Francisco Jose Veiga[26]***

This article has been especially utilized by the author of the present paper to extract details about the aftermath of certain combatting techniques and the reasons for their failure. The author of this article has taken into consideration the stylized facts and aspects of the inflation stabilisation and has taken into account the profound analyses of various models that have entailed the stabilization awareness for fighting against the inflation. The author in order to make the audience understand the reliability of the techniques and policies utilized during such unprecedented situations, has come up with the elaborate assessment of the model of *balance of payment crisis* by highlighting the major reasons for such failures.

- ***Inflation and its control by Everette. E Peterson[27]***

The author by way of this article has very interestingly come forwards with the perspectives of various economists regarding the inflation being good or bad. By way of this technique only the author has tried to incorporate empirical evidences of the extent up to which the inflation could be termed as mild and the beyond extent up to which it can be termed as dangerous for the economy. The author of this article has also profoundly elaborated upon the situations of the recession along with the inflationary situations and has recommended various practices for the predictability and reliability on the techniques and especially the credibility of the controls.

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