

Determinants of Direct Tax in India: A Systematic Review

¹Pitresh Kaushik, ²Pooja Kansra, ³Sushanta Kumar Mahapatra

¹Ph.D. Scholar, Lovely Professional University, Phagwara, Punjab

²Professor, Lovely Professional University, Phagwara, Punjab

³Associate Professor, The ICFAI Foundation for Higher Education (IFHE) Deemed University, IBS Hyderabad

Abstract: - Tax revenue constitutes a vital source of income for governments worldwide, and India is no exception, with more than three-fourths of the Government of India's total receipts originating from tax revenue, as reported in the Annual Financial Statement for the fiscal year 2019-20. In light of this significant reliance on tax revenue, this study aims to conduct a comprehensive review of existing literature on direct taxes and the various factors influencing their collection. The objective is to offer valuable insights and a roadmap for future researchers, policymakers, and government entities.

The study elucidates the importance of tax revenue and its impact on fiscal stability and development. Through a systematic review, relevant research papers are extracted from the SCOPUS database, ensuring a comprehensive coverage of the subject matter. These papers are critically analysed to identify the key determinants affecting the collection of direct taxes in India. Key factors explored include economic growth, tax policy reforms, taxpayer compliance behaviour, administrative efficiency, and external influences such as global economic trends. Additionally, the study addresses the interplay between direct tax revenue and social, political, and environmental factors.

By synthesizing and organizing the findings from diverse research sources, this study not only provides an up-to-date understanding of the factors influencing direct tax revenue in India but also serves as a valuable resource for policymakers and government officials in formulating effective tax policies and revenue enhancement strategies. Furthermore, it identifies research gaps and areas warranting further investigation, fostering an informed and evidence-based approach to tax governance in India

Keywords: Direct Tax, Income Tax, Fiscal Policy, Systematic Review

1. Introduction

Income tax and study of income tax is assessed using the quantitative data and it is usually seen that the firm tends to disclose less details pertaining to the quantitative data in order to avoid the higher tax liabilities (Liu, 2022). This false disclosure of tax data leads to the loss in tax revenue to the governments and may further impact the economic prosperity of the nation in the long run. However, there exists a relationship between corporate to personal income tax and economic growth and usually it is seen that relative taxation of corporate to personal income has a significant impact on the corporate share of economic activities (Liu, 2014).

In an economy, when expenses exceed the revenue, the situation refers to the budgetary deficit which may lead to higher level of borrowings and higher interest payments. This situation may be tackled by cutting unnecessary expenses and focusing on simultaneously increasing the revenue sources as well.

The countries often choose their taxation policies be it flat rate or reducing rate based upon the need of the economic policies. However, in countries that choose the flat rate method, the amount of tax is so low that there is no need for other allowances (Ambrus, 2012). Apart from the taxation methodology, the model implemented in the manufacturing sector too decides the marginal taxes. For instance, in an hours model, workers make changes

in response to small changes in marginal taxes while in the jobs model, there are many workers who are not at the margin of switching to a different job (Diamond and Spinnewijn, 2011).

In the same line, this paper also discusses direct and indirect taxation policies across the globe with a major focus on Indian taxation policies.

Objectives

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2. Literature Review

2.1 Indian Economy and Taxation Policy

The study related to the direct and indirect taxation had not widely been performed in India, although the Allingham approach had been tested and it was found that the approach stands true in today's scenario as well (Kogler et. al, 2022). Although the increase in the tax cut did not have a significant impact on the economic growth (Gechert and Heimberger, 2022), the tax reforms had resulted in increase in the wages of the middle and highly educated married people and led to higher female participation in the workforce (Lyssiotou and Elena, 2022). In Indian context, it was found that the taxpayers have shown more concern for the tax base broadening measures and the utilization of tax revenue (Singh and Sharma, 2010). One of the studies in the Indian context highlighted that the Indian economy tends to adjust more strongly while lowering the rates (Lee, 2021).

2.2 US Economy and Taxation Policy

The economic activities directly impact the revenue rate as was concluded by the study which states that the curvature of the production function, the market cost of capital, and the operating costs are among the main determinants of that revenue rate (Menichini, 2020). Further, it was found that the increments in income tax leads to decline in labor supply, while increase in the same leads to the rise in individual savings as well (Echevarría, 2015) It was also found that the corporate tax negatively impacts the economic activities (Moore and Bruce, 2014) and on another hand if a nation wants to attract the capital investments by reduction in tax rates, this further leads to decline in economic growth which puts a nation in a dilemma and demands how the economic machinery of the state maneuver the economic funds for the growth (Palomba, 2008).

In recent times, online tax filing has gained a major traction and it was found that people who perform online tax filing also perceive that e-filing is safer than conventional options (Gallant et. al, 2007).

The corporate and individual tax planning is a daunting task for the income tax agencies and corporate tax planning and economic factors account for much of the relative decline in the tax revenue (Cornia et. al, 2005). Also tax evasion is a major issue that needs to be tackled during tax planning and it was found that there exists an inverse relationship between the tax evasion and returns on high grade municipal bonds (Cebula, 2004). Furthermore, new capital expenditures by corporations in the manufacturing sector are decreasing in the income tax burden on

property and the part of their revenue thereof, and increasing at a decreasing rate in investment-related tax incentives (Gupta and Hofmann, 2003).

It was found that the both tax rates and nontax factors appear to have had significant effects on relative income growth (Auten and Carroll, 1999) and this factor highly impacts the daily wage and part time workers which were relatively more sensitive to the changes in tax rates rather than the full time salaried and employed individuals (Bonnie, 2001).

On another hand, the major factors that impact the structure of state income tax include earned income tax credits (EITC), top bracket rates, exemptions, and income thresholds (Fletcher and Murray, 2008) and EITC has a positive impact on the health and health care of the public (Arno et. al, 2009) Furthermore, state supplements to Earned Income Tax Credit appear to be highly cost effective (Muennig et. al, 2016) but short-term impacts of EITC income receipt are not universally health promoting (Rehkopf et. al, 2014). However, EITC does not enable economic mobility (Simpson et. al, 2010) but impacts child development in a positive manner (Hamad and Rehkopf, 2016).

There exists an interesting relationship between income taxes and marital decisions (Alm and Whittington, 1995). Furthermore, there are systematic differences in progressivity among the states and that inflation and real income growth are important determinants of declining state income tax progressivity (Formby and Sykes, 1984). Although, states that raised their income tax rates more than their neighbours had slower their income growth (Holcombe and Lacombe, 2004).

2.3 Miscellaneous factors pertaining to the Global taxation policies

The taxation policy around the globe is different for the different nations as nations need to manoeuvre the tax policies as per their economic interests and the study shows that the tax norms in a nation is highly impacted by the justice and social norms while the expectations and tax regulation complexion did not have a major influence on the taxation policy of a nation (Alhempfi et. al, 2020). Further, another study dismissed the very common holding that level of unemployment, consumer price index and the number of informally employed people impacts the individual income tax receipt in a nation (Kalivoshko et. al, 2020).

Every economic activity and economic policy is aims to increase the revenue inflow for the governments and one such way to attain the same is to increase the wage and pension benefits that will counteract the negative per capita effect of aging and increase the income tax revenue for the government (Prammer, 2018) but to attain the same, the marginal cost must be kept greater than marginal tax revenue (Sandmo, 1981).

On the policy level, various studies find that multiple factors decide the taxation policies, in one of the studies it was found that dependence of VAT and personal income tax influence the individual rates to a larger extent (Tikhonova et al., 2019). Further, it was also found that the tax revenue usually falls when the government raises the marginal rates (Pellegrino et. al, 2018).

Furthermore, when a single marginal tax rate in a multi-rate income tax structure is changed, those in the relevant tax bracket adjust their incomes in accordance with the elasticity of taxable income (Creedy and Gemmell, 2013)

According to the study conducted, it was found that the optimal tax rate is being impacted by a number of factors. The same study mentions that the optimal tax rate on capital income at the steady state becomes zero in the optimal taxation problem conditioning to the two-sector dynamic general equilibrium model. Further, it was found that the optimal tax rate on labor income at the steady state depends on the initial labor, the parameter weighted on leisure in the utility function, the discount rate, and the degree of distortion of taxation. Furthermore, the initial relative price of a consumption goods in terms of investment goods decreases the optimal tax rate on labor income (Muro, 2013)

Over the past decade, the tax on chemicals or substances that possess harm to the environment has been levied so as to discourage the use of such harmful chemicals. However, the relative tax is being levied upon such chemicals in proportion to the risk they possess, the impact of these taxes in environmental regulation is yet to be assessed (Barthold, 1994). One of the major sources of environmental damage in the established centres is the factory smog

which has a negative impact on large masses and most of the economists are in favour of levying the economic penalties on such factory owners who would resist the establishments of factories in residential arenas (Coase, 1960).

Apart from the environmental taxes, the GDP plays a crucial role in determining the discretionary taxes and the same can be analyzed using the Divisia Index Method which simply uses the GDP and total tax revenue at an historical basis. However there exists a few drawbacks for the same method as it underestimates the positive revenue effects and overestimates the revenue impact which results in distorted conclusions for the comparative time series analysis (Choudhry, 1979).

For tax compliance, which results in collection of tax revenues, one of the crucial factors that is often overlooked is the compliance behavior of the taxpayers which are being impacted by the moral and social influences and hence we need to look into the non-economic factors for making the tax compliance policies more effective (Andreoni et. al., 1998).

Compliance being one of the crucial factors, the tax revenues and sales tax is also quite sensitive to the changes in personal income, even the elasticity for the income tax is more than double than the sales tax in the long run (Bruce et. al., 2006). Furthermore, the collected tax revenue is highly sensitive to the GDP and this metric is known as tax buoyancy. In one of the studies it was found that the estimate of constant gross tax buoyancy is positively significant and more than unity during pre tax reform period, illuminating that gross tax is moderately elastic (Upender, 2008).

Therefore, this study is an attempt to review the relevant literature on the underlying subject and synthesise the existing knowledge using Systematic Literature Review (SLR) to address that “What are the major factors that impact direct tax in a country?”

3. Methods

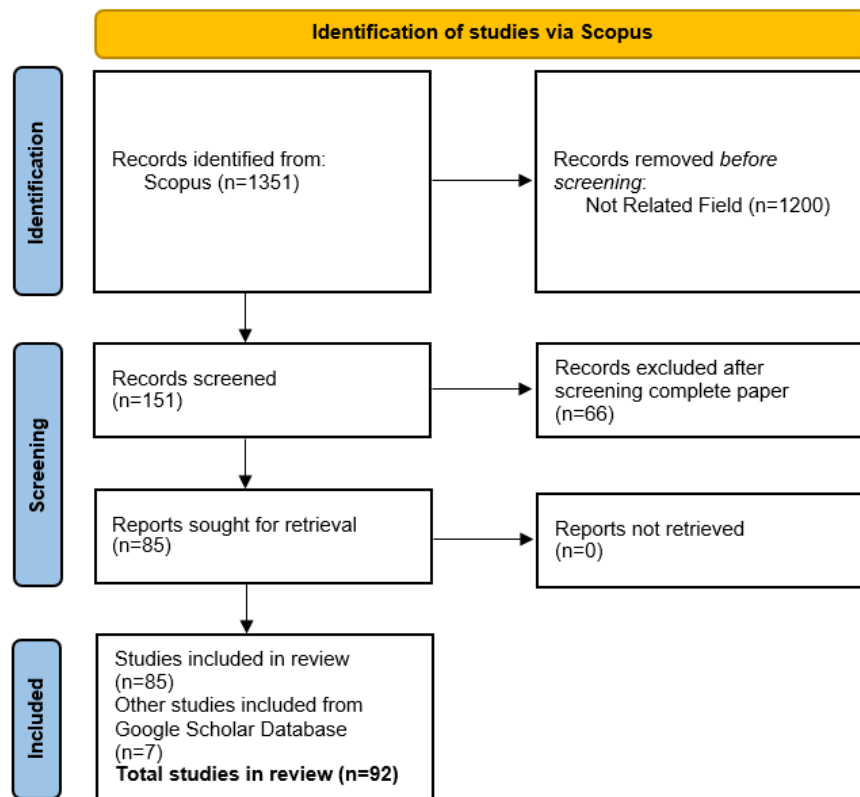
Scopus database is considered as a reliable and consistent platform to extract data for extracting data of published research papers (Silva and Moreira, 2022). Data is extracted from the scopus database using the keywords “DIRECT TAX” or “INCOME TAX” and “DETERMINANTS” or “FACTORS”. The study follows Preferred Reporting Items for Systematic Review and Meta-Analysis (PRISMA) to address the research questions. PRISMA approach is a widely accepted approach is for Systematic Literature Reviews (SLR) (Martinez and Ahmad, 2022; Macusi et al., 2022; Maffezzoli et al., 2022).

Total 1351 publications were extracted from the with the above mentioned keywords where after screening their title, abstract and relevance, only 151 papers were found relevant to the underlying subject. On extensively reviewing all 151 papers, 85 papers were found relevant and 7 additional papers were added using google search as mentioned in Fig 1 below.

3.1 Brief details and major findings from prominent studies

After extensive review of the shortlisted papers by following the underlying process, all papers were reviewed and their major outcomes were studied. A table out of top 10 most cited papers is constructed to highlight their research focus. It is evident that seven out of top 10 cited studies belong to USA.

Fig 1: PRISMA 2020 Flow Diagram



S No.	Representative Studies	Research Focus	Contributions/Outcomes	Country of Study
1	Alm and Whittington, 1997	The paper tries to estimate the impact of the federal individual income tax on the timing of marital decisions	The analysis concludes that there is a significant positive relationship between the marriage penalty in a year and the probability of delaying marriage until the following year	USA
2	Alm and Whittington, 1998	The paper explores the impact of the federal individual income tax, as well as other economic and demographic variables, on the marriage decisions of individuals	The paper concludes that probability of marriage is significantly affected by a range of economic and demographic variables. Furthermore, an increase in total income taxes paid by married versus single women has a negative effect on the likelihood of marriage, while the tax effect plays a rarely significant role in determining marriage probabilities among men.	USA
3	Auten and Carroll, 1999	The paper explores to what extent behavioral responses to the tax changes during the 1980s may also explain the rising inequality	The paper concludes that both tax rates and nontax factors appear to have had significant effects on relative income growth during the late 1980s	USA

4	Hamad and Rehkopf, 2016	The paper tries to analyze the associations of the Earned Income Tax Credit (EITC) on child development that is used in an instrumental variable approach to estimate the potential impacts of income.	The results suggest that EITC benefits and higher income are associated with modest but meaningful improvements in child development.	USA
5	Holcombe and Lacombe, 2004	The paper examines the impact of changes in marginal state income tax rates on per capita income by comparing income growth in counties on state borders with income growth in adjacent counties across the state border	The results depicts that over the 30-year period from 1960 to 1990, states that raised their income tax rates more than their neighbors had slower income growth and, on average, a 3.4% reduction in per capita income	USA
6	Mares and Queralt, 2015	The paper analyzes the major challenges in adoption of income taxes in Western economies since the 19th century.	The authors conclude that while countries with low levels of electoral enfranchisement and high levels of landholding inequality adopt the income tax first, countries with more extensive electoral rules lag behind in adopting these new forms of taxation.	Cross National Coverage
7	Mino, 1996	The paper addresses a two-sector model of endogenous growth in which one sector produces final goods and the other produces new human capital	The analysis concludes that the dynamic behavior of the economy and some policy effects depend heavily upon the magnitude of factor intensity used in each production sector.	Japan
8	Rehkopf et. al, 2014	The paper tries to analyze the impact of EITC on universal health programmes.	The short-term impacts of EITC income receipt are not universally health promoting, but on balance there are more health benefits than detriments.	USA
9	Sandmo, 1981	The paper is an attempt to incorporate tax evasion into the analysis of optimum income taxation.	The paper concludes that marginal cost should be greater than marginal tax revenue.	General
10	Ventry and J, 2000	The paper analyzes policy choices between costs and labor supply incentives, as well as those between ease of participation and compliance rates	The paper concludes that although economic analysis influenced the creation and development of the EITC (Earned Income Tax Credit), political factors, not economics, animated the history of the program.	USA

Table 1: Brief details and major findings from prominent studies

Discussion**4.1 Impact of tax rates**

Countries tend to adjust more strongly while lowering the tax rates than raising rates (Lee, 2021). A decrease of the tax revenue results in an increase of the redistributive power of the tax at the expense of both the average level of taxpayers' marginal tax rates and the re-ranking effect exerted by the tax (Pellegrino et al., 2019). As far as Value Added Tax (VAT) is concerned, there is no clear dependence between VAT and corporate tax rates. However, there is a correlation between the rate of VAT and personal income tax. (Tikhonova et al., 2019).

Studies also reveal that top tax rates should be substantially lower than the recommendations ignoring scale of operations (Ales et al., 2017). While higher corporate tax negatively impacts the economic activities (Moore & Bruce, 2014).

4.2 Corruption, Trust and Stable Government and Tax Compliance

Trust on the existing government and status of corruption in the country also determines the attitude of taxpayers and towards tax payment. Trust on government results in improvement in collection of tax (Batrancea et al., 2019) whereas corruption negatively affects the tax collection in the economies (Ashraf and Sarwar, 2016). Corruption is also found to be a major hurdle in the tax collection process (Amin et al., 2014). Trust of citizens on the government and authorities also have a positive impact on voluntary tax compliance by the citizens (Batrancea et al., 2019). Apart from Trust on government, stability of the government also affects the tax collection in a country (Amin et al., 2014). The above mentioned factors such as trust on government, corruption, stability of government can be obtained through various prominent indexes such as global competitiveness index.

Tax is considered to be a strong tool of state policy which is used by every nation to fulfil its national objective (Bagchi, 1974). It is a known fact that India was a closed economy till 1990s. It was only after Dr. Manmohan Singh opened the doors of Indian economy for global companies, India took its first steps towards globalization. Such a big change also affected the tax collection several ways. Government uses different type of incentives to direct the investments towards the sector that they want to channelize funds into.

Income tax policies and reforms in India have covered a long distance since independence of the country in year 1947. The maximum combined marginal rate of tax was once as high as 97.5 percent of one's income in India which resulted in widespread tax evasion and avoidance (Acharya, 2005).

Income is the result and the main goal of entrepreneurial activity, which allows for the active use of the regulatory mechanism of tax (Okanova et al., 2021). Tax compliance is directly related to the degree of IRPF (personal tax) decentralization and inversely related to the use of the AC's regulatory powers to raise the tax (Laborda et al., 2020)

Study reveals that tax compliance is influenced by two factors, namely justice and social norms positively, while expectations and complexity of tax regulations do not affect tax compliance (Rudi Alhempri et al., 2020). Also, revenues collected, and compliance were directly proportional to tax structure while inflation and declining assessment intensity inverse relationship with the tax structure as well (Das-Gupta et al., 1995).

4.3 Tax Avoidance

Finding of various studies show that firms which avoid more taxes disclose less quantitative data in income tax footnotes after controlling for the readability of the income tax footnotes and the entire annual report. Therefore, firms seem to reduce the publication of measurable data accessible to revenue agencies and citizen groups (Liu, 2022). Countries with high levels of landholding inequality adopt the income tax first, countries with more extensive electoral rules lag behind in adopting these new forms of taxation (Mares & Queralt, 2015).

On average, a ten percentage point increase in the corporate tax rate is associated with a 0.2 to 0.3 percent decrease in the corporate share of economic activities, while a ten percentage point increase in the personal income tax rates applied to non-corporate income raises the corporate share of economic activities by 0.5 to 0.6 percent (Liu, 2014).

4.4 Digitization

Past decade has seen a boom in digitization across all the sectors and the same had its impact on the ways of collecting tax revenue as well. Official beginning of the digitization of the taxation system in India started in 1981 with the setting up of Directorate of Income Tax (Systems). Earlier it was limited only upto processing of challans but later on, its functioning was extended to allotment of PAN and TAN also. 33 computer centres were set up for tax administration in 1996-97 along with a National Computer Centre in New Delhi. The “dot com boom” and digitization of India was going hand in hand during the 90’s. The task to develop application software for Income Tax Department also took place during the same period from 1997-99.

According to the latest Sustainable Development Goals Report 2021 issued by Niti Aayog, 84 out of 100 people have a mobile connection whereas 55 out of 100 have got a subscription to internet in India. With a rapid growth in number of mobile and internet users in India, digitization has now become inevitable in every field and most of the areas have started transforming with the help of digitization. Following the suit, Income Tax Department have also have taken a stride forward from just processing challans and allotting PAN online. Now, the entire tax filing system has switched from manual filing mechanism to e-filing mechanism. To advance more in the same area, even the verification of income tax returns is now made through aadhar one time password. Digitization of taxation system in India has definitely helped in making the tax management and collection system much more efficient and reliable.

4.4 Economic Growth

Increase or decrease in corporate tax rate does not affect economic growth (Kogler et al., 2022). The structure of economy can be explored by analyzing the contribution of various sectors in the economy (Karagoz, 2013). There is no uniformity in the rates of taxes in different countries and reasons cited for the same can be GDP, per capita income (Pessino et al., 2010; Gupta, 2007), Foreign Direct Investment (Bird et al., 2008; Rehman et al., 2020) inflation and financial policies (Tanzi et al., 1989). Another study revealed that FDI improves healthy competition in the economy and leads to formalization of economy (Gugler et al., 2007)

4.5 Political Factors

India is world’s largest democracy which makes it a complicated democracy as well. Where such a large country is governed by state governments and central government, and there is a clash of ideologies as well. Frequent change in governments and instability of coalition partners may also affect the taxation policy of the country as well as state.

There is healthy linkage between political factors and public expenditure (Dash et al., 2014). Factors like government efficiency and political stability are also considered determinants of tax revenue (Bird et al., 2008; Martin-Mayoral and Uribe, 2010; Rehman et al., 2020).

Fiscal output of the country is affected by the characteristics of different governments (Dash et al., 2014). It was also found in the studies that the coalition governments usually collect less taxes as compared to the states where single party rule is present (Dash et al., 2014). To add more to the effects of type of government on tax collection, studies also observed that the governments with leftist ideologies have shown declining tax collections in India (Dash et al., 2014). Left-wing governments do not seem to affect economic freedom, however populist left-wing parties, when in office, are found to have a detrimental effect (Castro et al., 2021).

4.6 Other Factors

Male participants do not think of tax refunds as income; however, women appear to think of their tax refunds as a lump-sum they could lose (or would spend) if they had access to the money during the year (Krieg & Lyon, 2021)

Tax reforms increased the wages of medium and high educated married males and females significantly and also had a positive impact on work participation that was more substantial for married women, especially the medium educated (Lyssiotou and Elena, 2022).

The determinants of corporate income tax revenues, defined through the empirical research, include tax determinants, which have a direct link to the corporate tax structure itself and affect the size and profitability of the corporate sector, and specific non-tax determinants in the form of cyclical and international (Tahlova & Banociova, 2019).

Increase in wages, pension and population have a positive relation with income tax revenues (Prammer, 2019). Level of unemployment, consumer price index and the number of informally employed people do not affect the income tax receipts for individuals (Kalivoshko et. al, 2020). Taxes are inequality reducing for the constant elasticity of substitution (CES) and the quasi-linear utility functions (Carbonell-Nicolau & Llavador, 2021)

4.7 Overview

This systematic review considers the papers from 1959-2022 from 114 sources written by 287 authors as depicted in Fig 2. Other summary stats of the study are also mentioned in Fig. 2 below.



Fig 2: Overview of the papers extracted and screened from Scopus Database

4.8 Annual Scientific Production

Annual Scientific Production is increasing with a growth rate is 3.14% as evident in the Figure 3. The number of studies significantly increased in 1981 and continued to increase post that. Next major increase were annual scientific production was seen in 2005, 2015 and 2019 respectively.

4.9 Most Relevant Sources and Impact

Figure 4 shows the most relevant sources and National Tax Journal with eleven publication on the underlying subjects becomes the most relevant source followed by Journal of Public Economics and Public Finance Review with nine and six publications respectively. As far as impact of the publication is concerned, National Tax Journal, Journal of Public Economics and Public Finance Review the above-mentioned journals repeats the story and the same is evident in Table 2.

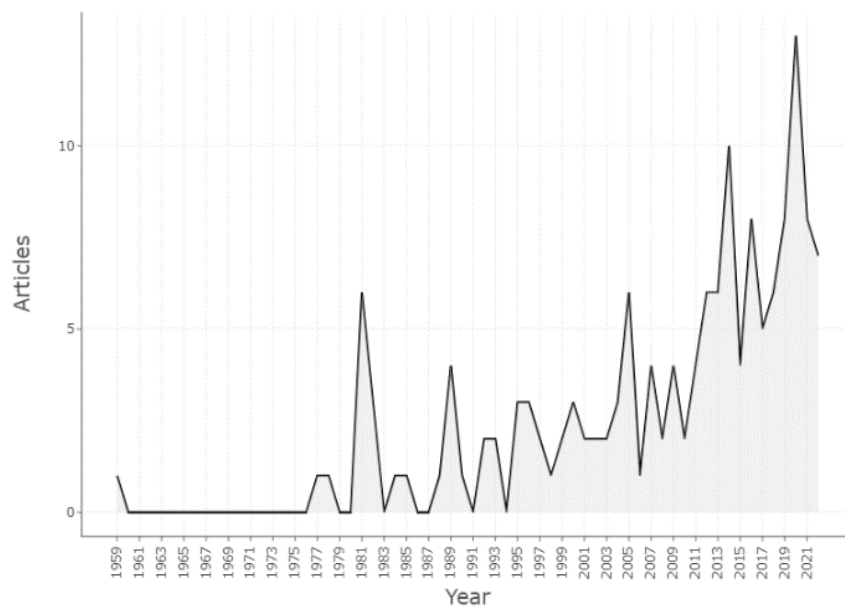


Fig 3 Annual Scientific Production

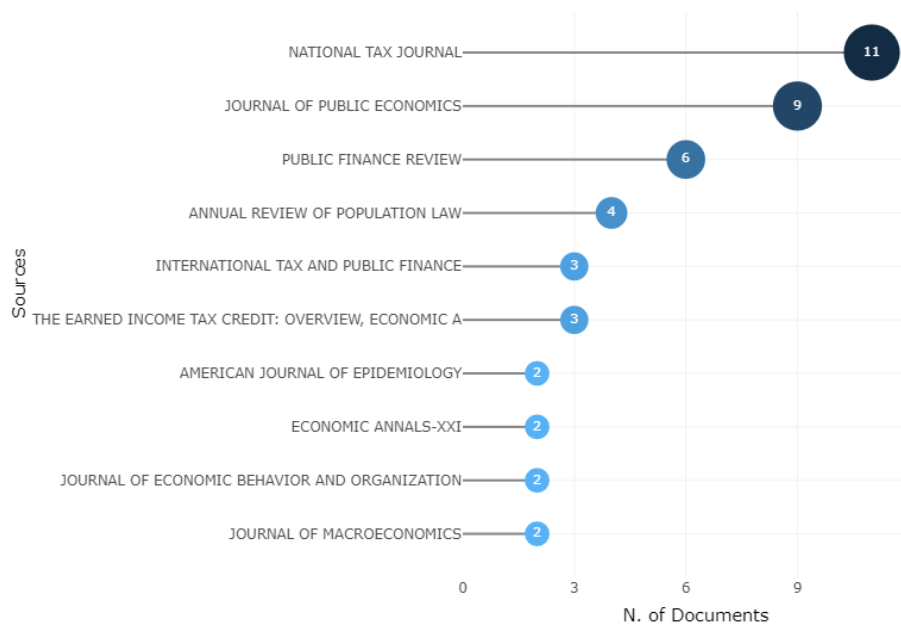


Fig 4 Most Relevant Sources

Element	h_index	g_index	m_index	TC	NP	PY_start
NATIONAL TAX JOURNAL	10	11	0.345	250	11	1995
JOURNAL OF PUBLIC ECONOMICS	7	9	0.149	434	9	1977
PUBLIC FINANCE REVIEW	6	6	0.140	103	6	1981
AMERICAN JOURNAL OF EPIDEMIOLOGY	2	2	0.250	56	2	2016
INTERNATIONAL TAX AND PUBLIC FINANCE	2	3	0.105	44	3	2005
JOURNAL OF ECONOMIC BEHAVIOR AND ORGANIZATION	2	2	0.333	4	2	2018
SCANDINAVIAN JOURNAL OF ECONOMICS	2	2	0.100	24	2	2004

2020 IEEE INTERNATIONAL CONFERENCE ON PROBLEMS OF INFOCOMMUNICATIONS SCIENCE AND TECHNOLOGY, PIC S AND T 2020 - PROCEEDINGS	1	1	0.333	2	1	2021
ACCOUNTING HISTORIANS JOURNAL	1	1	0.026	7	1	1985
AHURI FINAL REPORT	1	1	0.167	4	1	2018

Table 2: Source Local Impact

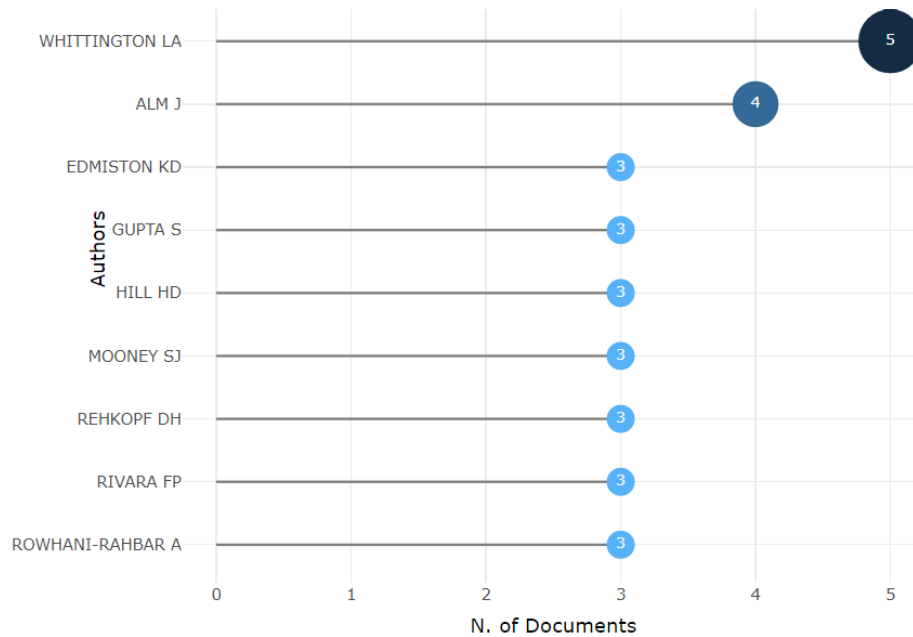


Fig 5 Most Relevant Authors

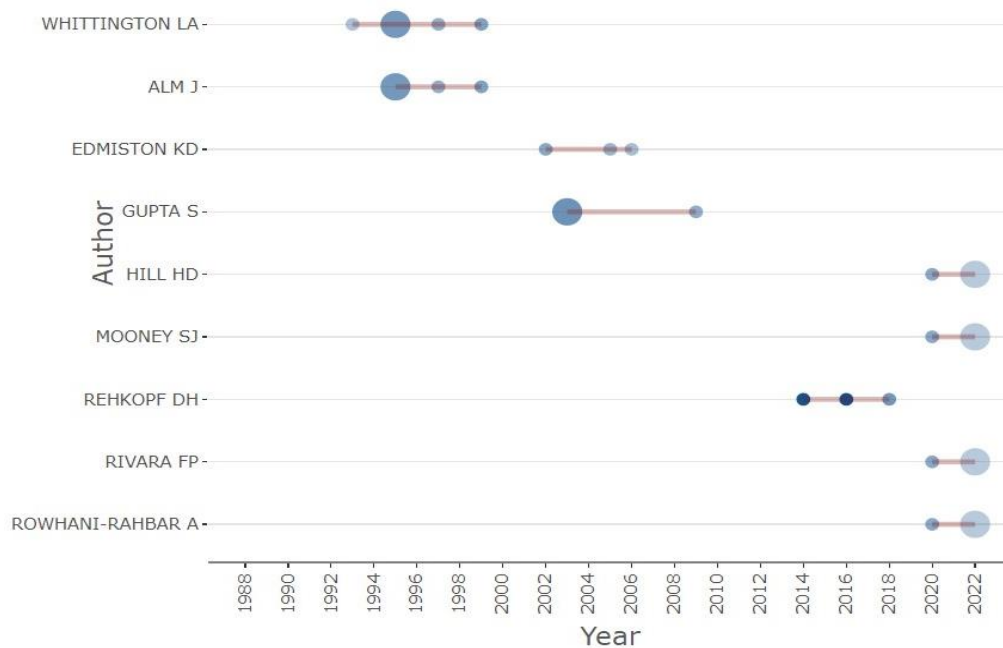


Fig 6 Author's Production Overtime

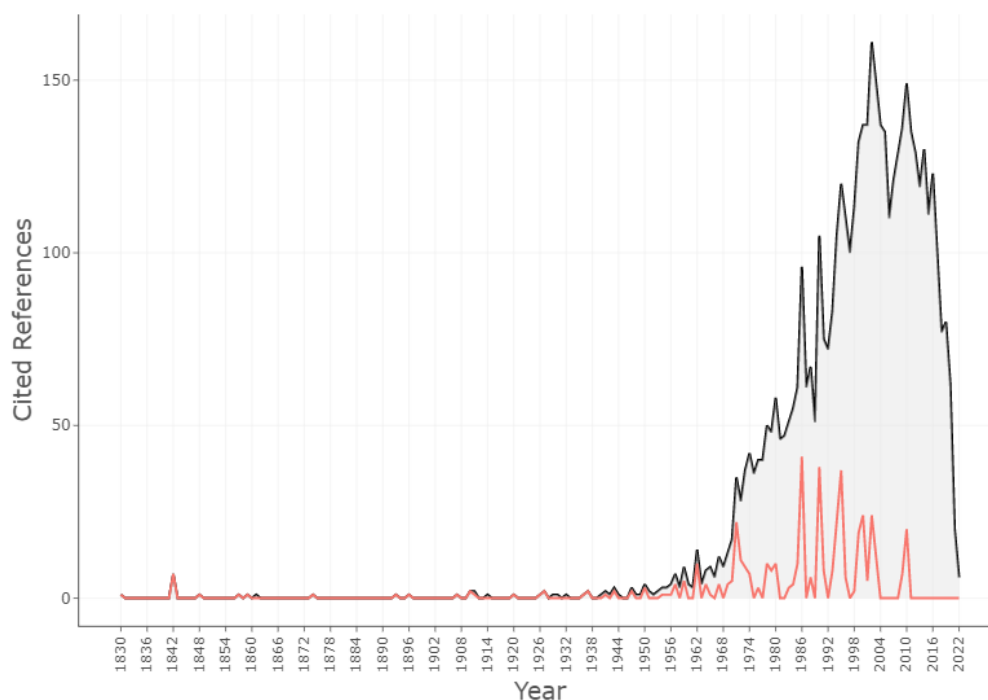


Figure 7 Reference Spectroscopy

4.10 Most Relevant Authors, Author Production Overtime and Reference Spectroscopy

Whittington and Alm J are the most relevant authors on the subject with five and four publications respectively and are followed by Edmiston, Gupta and others as mentioned in Figure 5. While Whittington and Alm were more active from 1994-2000, Edmiston and Gupta were more active during 2002-2008 (Figure 6). References on the underlying topic increased from 1968 onwards and reached its peak around 1998 as depicted in Figure 7.

Conclusion

There are various factors that affects direct tax and its collection. These factors may vary from country to country but the major determinants of direct taxation on the basis of this extensive review are change in tax rates, tax avoidance, tax compliance, political orientation etc. Apart from these factors, online tax filing has also gained a major traction and it was found that people who perform online tax filing also perceive that e-filing is safer than conventional options. However, it is surprising to find that increase in the tax cut did not have a significant impact on the economic growth.

Finding of all these variables that affect direct tax and its collection can pave a roadmap for the research scholars to dig deeper into each of the determinant and find the impact on various sectors of the economy.

The limitation of this study is the use of Scopus as the only database for extracting papers. Although, it is known to be largest database available for research papers, but other database such as ProQuest, ABI-inform, WoS, etc. may be explored for analysis of data from these sources as well.

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