NEW PATTERN OF TAXATION IN INDIA

ESSAYS BY THREE STUDENTS

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"People must come to accept private enterprise not as a necessary evil. bat as an affirmative good."

—Eugene Black
President. World Bank

INTRODUCTION

WHAT is termed as the New Pattern of Taxation has given rise to a lively controversy in the country. The controversy assumes a special significance in view of the fact that the prime need of the country is rapid and large-scale economic development and taxation measures have a direct bearing on such development.

In consonance with its policy of stimulating public opinion on vital economic issues facing the country, and particularly providing opportunities to students to develop an attitude of independent thinking, the Forum of Free Enterprise sponsored in 1958 an essay competition on "The New Pattern of Taxation in India". The judges were: Dr. D. T. Lakdavala, of University of Bombay, Mr. R. V. Murthy, well-known economist and journalist, and Prof. R. J. Taraporevala. In March, 1959, the judges, who have specialised in the subject of taxation, adjudged the following as the first three prize-winners:

1st prize : R. S. Sivaramakrishnan
Christian College, Madras

2nd prize : E. S. Ganesh,
Jamshedpur Co-operative College, Jamshedpur

3rd prize : M. V. Nadkarni,
Karnatak College, Dharwar

The judges also recommended that the first three prize-winning essays should be published in the form of a booklet.

The Forum of Free Enterprise has great pleasure in implementing the suggestion of the judges. Since the writing of the essays, some changes have taken place in the New Pattern of Taxation. For instance, the wealth tax on companies will be done away with according to an announcement in the Budget for 1959/60. However, by and large, the New Pattern of Taxation remains the same. Therefore, the comments offered by the students after the analysis they have made are 'interesting in that they reveal the need for a fresh approach to the problem of taxation with particular emphasis on preserving and enhancing individual initiative, and rationalisation and simplification of the tax structure itself.

It is hoped that this study will provide food for thought to the public at large as well as the policy-makers.

December, 1959

NEW PATTERN OF TAXATION IN INDIA

I

R. S. SIVARAMAKRISHNAN

Faced with an almost insatiable demand for an increase in its developmental activities and expenditure, the Government of India seems to be hard-pressed and in constant search of more revenue. Among the many problems arising from the implementation of the Second Five-Year Plan, the role of taxation has received increasing emphasis. Even during the First Plan, although the budget proposals of the Central Government were mainly related to the successful implementation of it, every year these proposals were also greatly influenced by the exigencies of the situation. Recently, the marks of the recommendation given by the Taxation Enquiry Commission and the Report on Indian Tax Reform by Prof. Kaldor have paved the way for the changes in the pattern of taxation. I propose to outline and discuss the recent trends in personal and business taxation projected against the general background of entire gamut of taxation.

In so far as personal and business taxes are concerned, there are three dominant features which determine the tax policy — to levy heavy taxes on the higher income groups not only to raise revenue but also as part of the programme to reduce inequalities; to give relief to lower income groups

by way of family allowances, etc.; to treat the business incomes more favourably and to encourage their ploughing back. As the former Finance Minister, Mr. Krishnamachari, himself once said, "the policies and proposals add up to a varied and somewhat formidable bill of fare." The tax system is well broad-based and would develop a system of internal checks and balance as would ensure the Public Exchequer its dues throughout the Plan period. The new levies have been defended on the ground of initiating structural changes in the tax system so as to effect more progressive returns. These changes are directed towards evolving an integrated tax structure which includes Wealth, Expenditure, Capital Gains, Annual Capital and Gift taxes.

The burden of direct taxation in India is heaviest in the world. There is a tendency to introduce a number of different taxes in order to camouflage the total burden of taxation and to secure the acceptance of a new tax by stressing its reasonableness or its moderateness so as to hoodwink the public and to prevent them from realising that the new tax was being introduced on top of an already heavy structure of taxation. The kind of confiscatory direct taxation of personal wealth and income has been defended on the ground that it affects a very small minority of the total population. But the indirect effects of such a moiety of taxes on the economic development and livelihood of the millions have been conveniently forgotten. It is rather unfortunate that scant attention is paid to serious adverse economic conditions that will set in. There is also vast and undesirable discretionary powers to the tax officials for reducing evasion possibilities.

In the realm of direct taxation, there are five taxes levied on the personal income of individuals and Joint Hindu Undivided Families. First, there is the Income-tax, Super-tax and Surcharge rates fixed on a sharply progressive scale,

the maximum being 84%. Secondly, the personal wealth of individuals in excess of Rs. 2 lakhs and of HUF in excess of Rs. 4 lakhs is now subject to Wealth tax at rates which rise from ½% to 1½% of net wealth per year. Thirdly, the personal expenditure of individuals and HUF beyond a certain exemption limit is taxed at the rate from 10% to 100% net expenditure per year. There is objection not so much to the incidence of wealth and expenditure taxes as such, as to their psychological impact on foreign investors and India's rival claimants of foreign capital. Fourthly, the Capital Gain made by an individual or HUF. When the country is engaged in rapid economic development; there is not so much of capital losses. Stable prices with technical progress are likely to end in big capital gains of share values. Hence the justification for the levy. But still, there may be cases of capital losses which must be shown due consideration by way of reduction in rates. Finally, the Estate Duty is levied with a maximum rate of 40%. The Gifts Tax, recently introduced, is a positive hit on those who evade Death Duties, fortuitously according to the time at which the Estate is unilaterally transferred. The present law in U.K. and India reduces evasion chances by treating all gifts made "in contemplation of death" as part of the property passed on death; but does not touch property transfers made well in advance of death. But even this loophole will be availed of mainly due to strong family connections in India. Since the Select Committee of the Lok Sabha on Estate Duty (Amendment) Bill has recommended reduction in the rates of Estate Duty in the cases of estates valued upto Rs. 1½ lakhs, the Gift tax rates are likely to be increased.

Thus we have reached a peculiarly tragic position in the field of personal taxation. If a man earns an income — Income-Tax; Surcharge. If he saves — Wealth Tax. If he spends — Expenditure Tax. If he reaps any capital appreciation — Capital Gains Tax. And finally when he dies —

Death Duty. Practically the ultimate limit of squeezability is reached. His despicable position is no better than the instance of taking away even the little bone from the dog and asking it to eat its own tail. At the same time we hear the evasion possibilities that come up to save the individual or the HUF from the strangulation. Notwithstanding the quip modesty of the tax proposals, the Expenditure and Property taxes have become the targets of fiscal attacks. It is said that these two are extremely difficult to assess; concealed hoardings expended without the liability of expenditure tax, problems of deductible business expenses, evasions through "benami" transactions and nominal loans to poorer persons are few known cases.

Company taxation inflicts still heavier strain on the firms. There are about nine singular as well as complementary taxes on profits and assets. Companies pay income-tax on the whole of their assessable profits at the rate of 30%. Next they pay a surcharge at 1.5% of their total profits. Then they are subject to super-tax called Corporation tax at the net rate of 20% of their profits. Further the profits of Companies are subject to three special "penalty" taxes. The first being Excess Dividends Tax charged at the rate of 10% on dividends declared by a Company amounting to between 6% and 10% of-its paid-up Capital; at 20% between 10% and 18% and at 30% beyond 18%. Secondly, under the provisions of Section 23A of the Income-Tax Act, Companies in which the public are not so substantially interested are required to distribute between 45% and 100% by way of dividends. Failure to distribute such dividends attracts a penalty super-tax at the rate of 37.5% and 50% on the undistributed profits in excess of the minimum levels laid down under Section 23A. To any discerning reader, the peculiar conflict in principle underlying these two "penalty" cases will be clear. Thirdly, the Bonus Tax. Companies have to pay a super-tax at the rate of 30% on the

value of bonus shares issued to shareholders out of reserves or accumulated profits.

There are two more taxes which are telling in their effects. All Capital Gains made by a company are subjected to flat rate of tax of 31.5%. Companies will have to pay Wealth Tax at ½% of their net assets exceeding Rs. 5 lakhs. Finally in order to get an allowance for their legitimate depreciation costs from their gross profits for income-tax purposes, companies have to deposit no less than 50% of their current profits with the Government. Further, there is the annual Capital Tax and an annual Capital levy. The net burden of the Income-tax, Surcharge and Corporation Tax amounts to no less than 51.5% of the profits of the companies. When the various penalty taxes and the Compulsory Deposit Scheme are taken into account it is 60-90% of their Gross Profits which reaches the Government's coffers. Already they have adversely affected the investment climate, severely depressed equities and created a virtual bar to fresh investment of Capital, both foreign and indigenous, on a substantial scale. For instance, applications for Capital issues during the first quarter of 1957 have been about one-fourth of the total for the corresponding period in 1956. It is rather questionable whether the new imposts will bring about any development at all; all the more, they will cramp new ventures. It is true that there has been a mitigation of the rigour of. the levy by the concession shown to new companies and shipping firms but general psychological effects will be to inhibit the desire to invest in industry. The Finance Minister himself admitted that there had been no large fresh equity capital during the last four or five years and all the expansion in industry is on credit finance and not backed up by genuine investments — a travesty!

With regard to indirect taxation, the main levy of importance is the Excise Duty. The aim with which it was imposed was one thing and the result was another. It has

only helped inflationary pressures inasmuch as it ruled out the possibility of a decline in the price of cloth, sugar and vegetable products, since the mills seem to be content with a smaller margin of profits. By the same effect, it offends against the principle of automatic increase in revenue, in step with the increase in National Income. The increase in prices has only belied the Government's claim to have given the fight against inflation the highest priority. Even new industries in their formative period are subject to heavy excise, the typical example being the rayon industry. Recently the President has promulgated an Ordinance for additional duties of excise and Customs on Mineral Oils (20th May **1958).** The rates, being considerably high, costs will increase leaving an effective incidence on the ultimate consumer.

The effects of the aforesaid taxation measures carry an adverse characteristic on the rate of domestic capital formation. There has been a decline also in Corporate Savings. India's taxation of foreign companies investment is in general the highest in the world. It is very much higher than that of other countries, both developed and underdeveloped, which are actively seeking to attract foreign investment*. The U.S. investment — not unfavourable despite the knowledge of taxation in this country — is indicative of the recognition of the basic soundness of the Indian economy.

Hence the remedies will be: Tax rates must be fairly fixed, leaving the individual and the companies with an incentive to save and invest; the structure should be rationalised; simplification is also essential; abolition of prohibition and reform of land revenue taxation must be taken into consideration; finally, a comprehensive structure based on sound economic principles.

Finally, a word about the constitutional issue arising from the levy of Expenditure and Wealth tax, as recommended

"Taxation and Foreign Investment — National Council of Applied Economic Research.

by Prof. Kaldor. He maintains that the revenue from them is exclusively for the Centre under Item 97 of List I of 7th Schedule of the Constitution. He has failed to read the same with Article 270 which clearly states that the revenue should be shared also by States. He lays the axe on the root of State financial solvency which is so much dependent on the share of divisible pool of personal taxation. Further, he is within "the error of totals" when he thinks that by merely augmenting the Central finances there will be *pro rata* economic growth. In a developing economy one can study and stimulate economic and social motivation best only at State and local levels of welfare activities*. A tax system cannot but be evaluated in terms of outlays by all levels of public authorities and benefits flowing therefrom. Failure to take note of this and concentration on spending power at the Union level would be in practice tantamount to frittering away the fruits of taxation.

II

E. S. GANESH

*Distinguishing **Features** of a Sound **Tax** Policy:*

It is said that a sound policy of taxation not only helps the Government in raising the necessary resources for its manifold functions but also serves the end of social justice and economic stability. Indeed, these two ultimate ends are more important than the immediate one of raising money. This is especially so in an underdeveloped country like India where income, savings and investment are still at a low ebb and the living standards, perhaps the lowest in the world.

*Alvin Hansen & Perloff: "State and Local Finance in the National Economy."

Greater production and better distribution are the two distinguishing features of a sound tax policy.

Emergence of the New Pattern of Taxation:

It is the accent on economic progress that has led to the formulation of two successive Five-Year Plans and again it is the vital need to secure resources to fulfil these that has been instrumental in the emergence of a New Pattern of Taxation. It is obvious that the Second Plan, compared to the limited resources available, is unduly over-ambitious. Some recent manifestations in our economy indicative of symptoms of a serious disequilibrium are regarded as a direct consequence of the magnitude of the Plan. It is a welcome indication of the Government's responsiveness to public criticism that it has now somewhat modified its stand on the inflexibility of the Plan. However, granted the size of the Plan, an increase in tax effort was absolutely necessary, the only alternative being deficit financing on a much larger scale, culminating almost in an uncontrolled inflationary pressure.

Personal Taxation: Equitable but Discouraging:

Judged from the viewpoint of equity, the New Pattern of Taxation is decidedly better compared to any practicable alternatives. Under the new pattern, the minimum taxable income has been reduced from Rs. 4,200 to Rs. 3,000. Although this is a measure which directly hits the hitherto non-income-tax paying classes, even here the income taxed represents over ten times the average income in India. There is no other progressive country that exempts such a high multiple of average income from direct taxation. The minimum taxable income in countries with much higher *per capita* income is much lower.

The commodity taxation measures in the new pattern are designed to raise two-thirds of the additional tax yield. In most cases, these work out to less than 1% of the total income.

These measures, although unwelcome to the masses, are in conformity with the declared objective of making taxation more responsive to increases in national income by broadening its base.

There is a misunderstanding about the distribution of the burden of direct taxes. A reduction of the total of income-tax, super-tax and surcharge for the highest slab from the previous level of 91.3 per cent to 84 per cent for unearned and 77 per cent for earned incomes, coming as it does with a reduction of taxable minimum from Rs. 4,200 to Rs. 3,000, has been construed to mean that while the lower classes will be bearing a larger burden, the better-off will be paying less. Actually, however, the relief to the latter due to reduced income taxation is more than offset by increased taxes on wealth and expenditure. The relief is genuine only for those in higher income groups who derive most of their income from personal effort and who are thrifty enough not to come within the purview of the expenditure tax. The trend, therefore, in the new pattern is towards equity. Gift tax has furthered this aim.

But whether the present taxation pattern has been able to achieve the objective of increased income, savings and investment is doubtful. As has been seen, a sound taxation policy promotes economic stability by maintaining unimpaired the flow of income, savings and investment. Indeed, it would seem that the reduction in income-tax rates for higher income groups was effected with this specific aim in view. But it is not only the rate of income-tax which determines the incentives to earn, save and invest: it is the total tax burden of all the three — income, wealth and expenditure taxes — that is the deciding factor. A person earns with a view either to spend or to save. If both these outlets are sealed by Wealth Tax and Expenditure Tax, the fact that his income is taxed less is meaningless for him. Thus the incentive to earn diminishes. In fact, spending may become more

attractive than saving, for, in that case, a person has at least the satisfaction of enjoying the fruits of his toil. To quote Mr. Tata: "Apart from the controversial nature of the Expenditure Tax and the annual Wealth Tax, these taxes together with taxes on income will result in individual assessees in the higher brackets paying substantially more than 100% of their income. In effect, in addition to the whole of their income being taken away from them, they will now have to pay something for the right to live and work in their own country. Nowhere else in the world does such an extraordinary situation exist. . . ."

Even from the viewpoint of equity, there is not much to be said for such a Wealth Tax. If it is the aim of the Government to fix an effective ceiling on wealth, a much quicker and superior method would be a capital levy once for all. Since income from wealth does not bear any definite relation to its source, there is no check against evasion in a Wealth Tax. In the case of Expenditure Tax, it would be administratively difficult to handle such a scheme.

Company Taxation:

Companies in India are now subject to income-tax, corporate tax, dividend tax, tax on bonus shares, tax on undistributed profits under Section 23A and wealth tax. Income-tax on companies has been raised. In imposing these, the professed object has been *to* prevent tax evasion. Unfortunately, however, these have only added to the already complicated and burdensome tax structure of companies.

One of the worst features of company taxation probably is that companies are taxed by the excess dividend tax if they declare a dividend in excess of 6% and they are also taxed in the case of Section 23A, if they do not declare a dividend and instead accumulate their profits. As was pointed out by the Associated Chambers, "Section 23A has an arbitrary, fortuitous

and harmful effect on a wide range of genuine public companies. . . ." Moreover, the earning power of a company depends not on its paid-up capital but on the total investment in the company including the paid-up capital and reserves. The Excess Dividend Tax should, therefore, be linked to the total capital investment in the company to make it fair and equitable. The concessions granted in this respect are thoroughly inadequate.

Similarly, increase in tax on bonus shares to 30% will also hamper seriously the process of company financing in India. The issue of bonus shares is a vital part of the progress of private enterprises to increase their accumulated resources and then to float new ventures. The justification that such a tax will prevent evasion does not hold water as the Controller of Capital Issues now regulates the capitalisation of accumulated profits of companies. Neither Prof. Kaldor nor the Taxation Enquiry Commission had favoured this tax.

Of all the taxes, the most objectionable is the inclusion of companies within the scope of the Wealth Tax. Not only is this indefensible in principle, it is likely to prove harmful in practice. It is a clear case of double taxation on the same assets, once through the company and again through individual shareholder. It bears no relation whatsoever to ability to pay. While discouraging the reinvestment of profits, it will encourage their dissipation by distribution as dividend. Even the concessions allowed in this respect have failed to lessen its rigours.

Need for a Simple Tax Structure:

The system of company taxation in India has become highly complicated, thus hindering our industrial development. There is a very urgent need of simplifying it. In this connection, Prof. Kaldor's suggestion for the levy of a single uniform rate, say 7 annas in the rupee, is worthy of consideration.

Tax Evasion and Administrative Snags:

The idea that the triumvirate of wealth, expenditure and income taxes in the realm of personal taxation and all the company taxes combined will together prevent tax evasion is a major theoretical fallacy. *As* the *Capital* remarked, "All that the imposition of these taxes will imply is increasing harassment, evasion, dishonesty and resort to cash transactions. . . ."

It needs to be adequately recognised that the deciding factor in the promotion of honest tax-paying is the conviction of the public that the tax is justified and this conviction can only be secured if there is a reasonable lowering of rates. This is not to suggest that a man who deliberately falsifies his return would suddenly become honest if the rates were less. His incentive to evade would, however, be by that much reduced and curbed by fear of detection and penalty. This leads us to another important point. No tax measure will be effective unless it is backed by severe checks and punishments. This presupposes an improvement both in the pay and training of the officers of the Income-tax Department. This need is all the more accentuated by the immense administrative difficulties brought about recently.

Alternate Proposals:

"The power to tax involves the power to destroy," said Chief Justice Marshall of the United States. Regrettably, this power is being wielded in a manner calculated literally to destroy economic activity. It is not for a country like India to experiment with smart new forms of taxes, when fiscal experts of the eminence of Prof. Kaldor himself have pointed to the inherent administrative incompetence. Whereas the Government has found it convenient to swear by the expert opinions of Prof. Kaldor and the Taxation Enquiry Commission, their second integral part of reliefs and conces-

sions has been completely ignored. *As* such, any tax suggested by them loses all its vitality.

As the Report of the Taxation Enquiry Commission states: "The kind of tax system which would be best adapted to meet the requirements of the Indian economy appears to be one which would increase the resources for investments available to the Public Sector with as small a diminution as practicable of investment in Private Sector and which, therefore, is accompanied by the largest practicable restraint on consumption by all sections. . . ." Viewed in this context, it appears that there was no need to reduce tax rates either on earned or unearned income, since the incentive to earn is not much increased thereby. A tight control over tax evasion accompanied by the extension of the compulsory deposit scheme to the lower income groups is advisable. The agricultural sector which contributes half of the national income has not yet been brought within the fold of taxation to any substantial extent. A beginning could be made by integrating income-tax with tax on agricultural incomes at State level. Scrapping of prohibition will also yield considerable revenue. Judicious commodity taxation may also be helpful, as it will be paid out of current consumption, not affecting potential savings. Levy of an excise duty on salt, stamp duty on cheques, uniform *ad valorem* on share transfers, etc., deserve consideration. To quote Dr. C. D. Deshmukh: "Government has to find out forms of taxation which were less repugnant and more voluntary."

Conclusion:

Indian tradition has always recognised personal initiative and individuality as the greatest incentives to efficiency. Such a society in which freedom and initiative can flourish demands not only political democracy but also a large measure of economic democracy. Today, perhaps more than at any time, there is the need of evolving an economic policy, which, while

doing the greatest good to the greatest number, leads to an all-round increase in income, savings, investment, production and wealth. A scientific and rational tax structure forms an integral part of such a policy wedded to mixed economy.

III

M. V. NADKARNI

It can be said that the new tax pattern was mainly guided hy the following considerations:

(i) to increase revenues to meet the requirements of the Plan;

(ii) to promote savings and check inflationary pressures;

(iii) to minimise evasion; and

(iv) to make taxes "broad-based", progressive and equitable.

But as regards incentives to capital formation and investment, the present tax pattern is not encouraging. It can also be said that despite some new measures and increase in the level of taxation, the ratio of public revenues to national income has not improved. Besides, the new pattern has not removed some inherent defects in the tax system to any significant extent. The regressive character of the tax structure, for example, still remains; the role of indirect taxation remains the same. Thus the poorer sections of the population have also got no relief.

The present pattern is considered as integrated and comprehensive. There is Income-tax on what one earns, Expenditure Tax on what one spends, Wealth Tax on what one saves, Gift Tax on what one gives, and an Estate Duty on what one has left after death. There is also a compulsory deposit scheme. Theoretically it may seem to be a good pattern, but doubts can be raised as to whether it is not a

complicated structure. One may grumble and groan merely because he does not know how many taxes he has to pay, how many forms to fill or how many legal formalities to face, apart from the actual burden of taxation itself. The complicated structure, besides causing inconvenience to the taxpayer, makes tax-collection costly, and consequently necessitates still higher rates of taxes, which in turn make evasion profitable. The vicious circle can be broken only by making the tax structure simple.

Another serious defect of the tax system is that it is difficult to reconcile with the sweeping changes it undergoes. There is instability and uncertainty, and any calculations made in the previous year will be upset by the time the new budget is prepared; such changes are introduced even in the middle of the financial year. Frequent and shortsighted experimentation in the tax system eliminates stability, essential for the healthy growth of our economy. Instead of a "coherent, continuous, planned policy", the aim is always just to adjust budgetary needs.

After these general considerations, we may now examine some of the taxes themselves.

The highest marginal rate of income-tax was reduced from 91.8% to 84% for unearned income and 77% for earned income. But this rate need not have been reduced so much for unearned income. Besides there is a serious thing to note in the lowering of the limit of non-taxable income (it is now Rs. 3,000), which was defended on the ground that tax should be broad-based and that even in countries with higher standards of living, the limit is still lower. But this measure severely hits lower middle class people, who have suffered most by inflation, by the rising costs of education, medical facilities, etc., and who have also to bear the burden of almost all indirect taxes. Besides, the comparison with other countries is misleading. These countries, to which the com-

parison has been made, enjoy many free or cheap facilities and also social security benefits, while those advantages are absent, in India. Some relief in this respect is granted by children's allowances and reduction in the excise duties on tea, etc. However this does not seem to be sufficient.

Expenditure Tax is designed to promote savings and check unnecessary expenditure on luxuries or on vulgar display of wealth. This is really necessary at a time when adequate savings of the community are an utmost necessity. However, there should be a sound administrative backing, proper safeguards and exemptions. But the exemptions provided are not sufficient, because expenditure may have to be incurred on several other items also, tax on which will be unjust. Allowances for old and infirm are to be provided. Again, persons with immovable property have to pay Wealth Tax, and to tax them further on expenses for maintaining their property or expenses for repairing or replacing the loss caused by theft, fine, etc., is not proper. Besides, "the rates of this tax will have to be so adjusted that they do not have in combination with other taxes an expropriatory impact." However, the non-taxable limit of expenditure is fairly just for individuals, if the suggested exemptions are provided.

Personal savings, especially in a country where social security schemes are absent, are vital. Sufficient income should be left with the individuals to invest and consume. More so with regard to company savings. Company profits should not be taxed heavily, with the exception of companies producing purely luxurious consumption goods, not vital to national economy. The additional revenue or social benefits (if any) out of a heavy tax on profits of an entrepreneur or company is doubtful, but its effect on investments is certain and harmful. Thus taxes on dividends together with bonus share are a serious disincentive. Bonus shares come from profits already taxed and to tax them again may prove harmful, though the purpose is to avoid evasion. Again, by

this measure, "the Finance Minister was penalising companies which had been soundly managed." The value of share-holders' holdings is also reduced. All this has resulted in discouraging companies and they have to place more reliance on loans rather than on their own savings or equity capital.

Wealth Tax, if applied to new concerns or companies making no adequate profits, is inequitable. Besides, it may become an expropriatory tax also instead of being a tax on accruals. Even Prof. Kaldor, on whose recommendations the present pattern is mainly based, made it clear that the amount of new taxes on wealth should not in individual cases exceed the total income from all sources. Unfortunately, this safeguard has been neglected. Consequently, quite a number of assessees will be forced to sell their property, securities or equity-holdings to pay these taxes and earn their living. Among these are also included some of our best businessmen who have contributed to our industrial development. Such a situation discourages them and eliminates any lingering incentive, at a time when all talents in the country are to be mobilised to build up our economy. Care should be taken that taxes will not adversely affect capital formation and economic development. The Government should see that the combined incidence of Wealth Tax and Income-tax does not exceed in any case 100%. Wealth Tax should also take into account liabilities met on account of capital Gains Tax.

It is, however, a welcome gesture that new concerns are given certain concessions, e.g., additional depreciation allowances, development rebate on new machinery, and new undertakings may also declare tax-free dividends of 6% of the capital employed for the first five years. Moreover some additional concessions are also given to foreign investors. These should also be accompanied by the above suggested reforms. But it may be said that despite these concessions, the psychological effect of the complicated tax structure inhibits investment.

Excise duties, it is true, have a prominent place in the Union tax structure; but here the guiding consideration is merely 'to get additional revenues, not industrial development. The recent Textile Inquiry Committee pointed out several defects in the excise duties on cotton textiles. It is good that the Government has accepted its recommendations. Besides these, to consider excise duties on mill cloth as a means of protecting the handloom sector is very harmful, if we think in terms of overall economic development and promotion of our export markets.

The Sales Tax structure is also yet to be rationalised. Apart from the controversy regarding single-point and multi-point Sales Tax, which we may not enter into, one cannot deny that sales tax is even imposed on necessities, which affect the common man who is already ill-fed and ill-clothed. If we cannot lift these taxes, they should at least be fairly light. However, taxes on luxuries need not be light.

Taxation as an anti-inflationary measure has severe limitations.. It may even act as a drain on capital and past savings. Today the country does not so much suffer from profit inflation, as cost inflation. Compared to the June 1955 level, prices of foodgrains and raw materials have shot up by 54% and 40% respectively, while the rise in the price of manufactures is only about 6%. So we have to first check inflation in the field of food and raw materials rather than manufactures. If the former is done, the cost of production will fall which will have a wholesome effect on our economy and also over export position. Besides, if taxes are levied to check inflation, it raises the prices of the commodities, and thus the purpose is not served. Moreover, it is also said that taxation has already reached a stage where the law of diminishing returns has started operating, so that no further taxation is helpful for any purpose.

It may also be noted that to compensate the evil of evasion, there should not be an additional evil of unjust assessments.

Promotion and prospects of the tax officers should not depend on how much revenue they get for the Government; otherwise, they will not be sincere.

As regards the incidence of the tax structure, the level of urban taxation is higher as compared to the rural, and urban indirect taxation is also more progressive than rural taxation. There is greater room for increased taxation on higher rural income. One has to admit that the total burden of taxation has increased much more in the urban than in the rural sector. It is unfair, in view of the fact, that due to our development programmes a greater part of the national income must have gone to the rural sector. The 1957-58 budgets have not improved the situation. Thus there is no equity in the tax pattern. So it can even be said that the new pattern does not mobilise resources from where they can be obtained with much less harm.

Thus we have to admit that a thorough rationalisation of the tax pattern is our primary need, which has never been so imperative as today. The recent decline in our industrial output and the slack in our export position is in no small measure due to the misconceived tax pattern. We are now facing critical problems and cannot afford sentimental or purely idealistic considerations to have sway on us. Co-operation from the businessmen and entrepreneurs is also necessary to make our plan a success, and therefore a healthy atmosphere for investment, both foreign and domestic, has to be created. So, several defects pointed out above have got to be removed.

Among other things, the following measures can also be undertaken, so that the Government may get revenues for the Plan without affecting industrial development:

(i) minimising State expenditure on items not vital for the Plan and our defence. If the common men and also the entrepreneurs are to make sacrifices, there is no reason why

ministers and persons holding high political ranks should not make such sacrifices. State extravagance in many respects can be minimised;

(ii) evasion should be met with ruthless punishment. But such a measure should be accompanied by the removal of above stated defects; there should not be unjust assessments also;

(iii) heavier taxes can be imposed on industries producing purely luxury items and having meagre employment potential;

(iv) rural savings are to be tapped more systematically and intensively. Heavy taxes can be imposed on higher slabs of agricultural income in all the States;

(v) more reliance should be placed on mobilising savings and borrowing programmes by the State.

(The views expressed in this booklet do not necessarily represent the views of the Forum of Free Enterprise)

Free Enterprise was born with man and shall survive as long as man survives.

—A. D. Shroff

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