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PROVINCIAL TAXATION UNDER AUTONOMY

By
B. DAS GUPTA



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TO

MY MOTHER IN HEAVEN

PREFACE

PROVINCIAL autonomy on the basis of the Government of India Act, 1935, was introduced in British India with effect from the 1st April, 1937. The new constitution functioned smoothly in the provinces till September 1939 when the ministries in eight out of the eleven provinces resigned on account of their difference of opinion with His Majesty's Government. The constitution was thereupon suspended in these eight provinces but it continued to function in the remaining three. In three out of these eight provinces ministries were subsequently formed so that the constitution was, in March 1944, functioning in six out of the eleven provinces.[1]

After the declaration of war by Japan in December 1941 conditions became abnormal. In 1943 the country was in the midst of an economic crisis. These conditions had their effects on provincial finances. In the provinces where the constitution was not functioning, the Governments had generally not departed from the programmes of the resigned ministries till about the end of the year 1941-2. After that changes had to be made on account of abnormal conditions.

The present study is generally confined to the first five years of provincial autonomy, i.e. the years 1937-8 to 1941-2. In the provinces now without a ministry, the active policy of taxation, of course, refers to the first two years and a half when ministries were functioning. In some cases figures for the year 1942-3 have also been given and the Bengal Agricultural Income-Tax Bill which is in the final stages of enactment at the time of writing has been discussed at some length. This measure was, in fact, first published in 1941, though enacted three years later.

During this period the taxation policy in the provinces was, for the first time in the history of British India, placed under popular control subject, of course, to the limitations of a rigid constitution. An analytical study of the result is, therefore, of absorbing interest.

In an appendix a brief survey has been made of the subsequent developments till about the 31st March, 1944, and in some cases up to the date of writing.

[1] The constitution has since been suspended in Orissa also.

In writing the book the author has depended wholly on original sources and on personal enquiries. The original sources consist mainly of the Acts imposing the various taxes and the rules made thereunder, official reports of the debates in the Provincial Legislatures leading to the passing of the Acts and the administrative reports issued by the Tax Collecting Departments where available. The author also made personal enquiries in the Provinces of Bengal, Madras, Bombay, Bihar and Assam in the course of which he met tax payers, tax collectors, businessmen, politicians and economists. The author takes this opportunity of expressing his gratitude to all of them, many of whom appeared to him as nameless economic *units*.

The author is grateful to Dr J. P. Niyogi, University Professor of Economics, Calcutta, for valuable suggestions and to Mr R. L. Walker, Finance Secretary, Government of Bengal, for the facilities provided by him.

B. DAS GUPTA

CALCUTTA

The 14th September 1944

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I

THE ECONOMICS OF TAXATION

THE economics of taxation deal with the effects of a tax on the economic well-being of a people and on production, distribution and exchange.

It is a wide subject with many ramifications. In this chapter it is proposed to discuss only a few aspects of the subject which will be directly helpful to the analysis undertaken in the present study.

A tax is often spoken of as a necessary evil; but it is by no means so. It is, in fact, sometimes an evil; but in such cases it is very often not necessary: extraneous considerations apart, it can be replaced by a tax or a tax-system which is good. If this were not so, a study of taxation would have been useless to the well-being of man.

The antagonistic attitude to a tax is the relic of old days when the class will was the sovereign and class good was often the policy. Government itself was then looked upon as a necessary evil. As the general will became the sovereign and the common good the policy, this idea of Government lost ground. Government is now looked upon as an organization through which man can develop and realize himself. Taxation is only an instrument by which this ideal of Government can be achieved. According to this view a tax helps the well-being of man. In those countries where class will is still the sovereign, the old conception of taxation dies hard. The modern conception thrives best in places where the general will is the sovereign and the common good the policy.

It follows from the modern conception of taxation that a tax is not to be looked upon as good or bad in itself. A tax-system that serves the good of a class or a section is bad while a tax-system which serves the common good in the State is good. The practical test in this respect is the manner in which the sacrifice involved in raising a given revenue by taxation is distributed among the citizens consistently with productive efficiency. A politically dominant class in a country may sometimes devise a tax-system which exempts itself at the expense of other classes. Such a system must be called

bad. This principle has been kept constantly in view in the present study.

An assumption underlying the modern conception of taxation is that the tax raised in a country is spent for the benefit of the same country. A distinction has of course to be drawn between sums spent in another country and sums spent for the benefit of another country; while the former may sometimes be good, the latter is always bad. Such cases may arise in the case of imperialistic exploitation of one country by another.

The levy of a tax on a commodity at once sets in motion a host of economic forces which disturb the interaction of the other forces that had been operating on it till then. The producers will try to shift the tax on to the consumers. The method by which they can do so is by threatening to cut down production. The consumers on the other hand will try to resist any attempt on the part of the producers to shift the tax on to them, and the method by which they can do so is by threatening to cut down consumption. Thus there ensues a struggle between the producers and the consumers—each side trying to squeeze the other by means of cutting down production or consumption as the case may be. The success of each group will depend in the last resort on the capacity of each to cut down production or consumption, as the case may be.

The operation of these forces can be graphically represented by the figure on page 3.

The larger the volume of a commodity that is placed on the market, the smaller must be the price per unit at which it can be sold. This relation between the quantity and price per unit of a commodity can be expressed by the demand curve DD', quantities being measured along OY and prices along OX. The rate of fall of the curve DD' will vary with various commodities according to the degree of elasticity of their demand.

The extreme case when the price is independent of quantity is represented by a horizontal line, i.e. a line which does not fall at all as it progresses forward. The same price rules in the market irrespective of any variation in the quantity offered for sale from zero to infinity. The other extreme case when the quantity demanded is independent of the price at which it is offered is represented by a vertical line, i.e. a line which falls fastest, i.e. along the shortest route. Here the same quantity is demanded irrespective of any variation in the price from zero to infinity.

But the extreme cases do not exist. In most cases price and quantity are very much interdependent. The commonest case is that of an article of which the price falls slowly as the quantity to be sold increases or rises slowly as the quantity decreases. Or, in other words, as prices fall slowly people increase their consumption slowly and as prices rise slowly they reduce their consumption slowly.

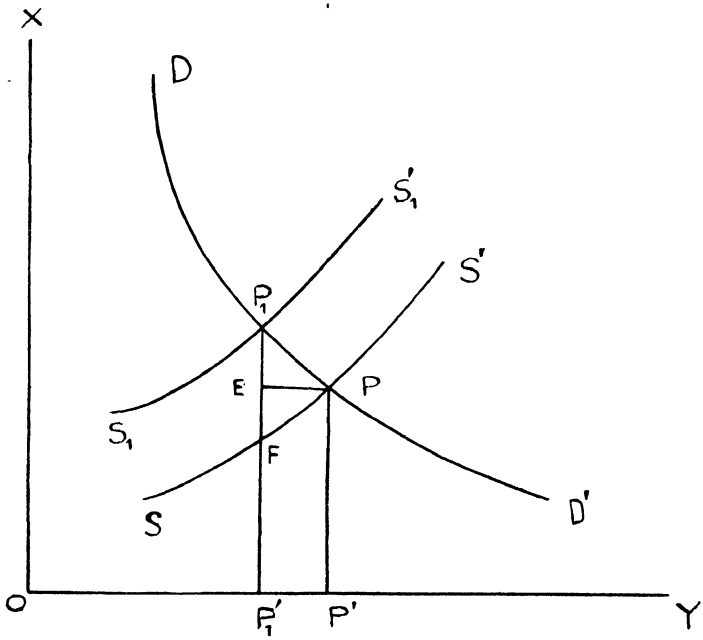


FIG. I

In the present case the demand has been assumed to be elastic like that of the commonest case so that the rate of fall of the curve is slow and the aggregate fall for a given increase in quantity is small. As regards the conditions of production of the commodity, it has been assumed that the commodity is subject to the Law of Diminishing Returns ; the larger the production, the larger the cost per unit. This relation between the quantity produced and the cost per unit is expressed by the curve *SS'*. The rate of rise of the curve will vary with various commodities according to the degree of elasticity of their supply. In the present case the supply has been assumed to be elastic so that the rate of rise of the curve is

not sharp and the aggregate rise for a given increase of supply is small.

Now under normal conditions, the forces of competition will fix the market price of the commodity at the point of intersection of the two curves, i.e. at PP'. PP' will both be the market price and the cost of production of the commodity and the quantity produced and consumed will be OP'. Cost, of course, includes normal profits, charges for insurance together with the charges for land, labour and capital, in fact anything that is necessary to get the supply on the market.

Now suppose that a tax equal to P_1F is levied on each unit of the commodity. The cost of production of each unit is at once increased by that amount. The supply curve has thus to be redrawn and shifted upwards to the new position $S_1S'_1$. This new curve will now represent the conditions of supply of the commodity. The conditions of demand, however, remain unaffected by the tax. DD' therefore remains as it is. The new point of intersection is P_1 and the price will now be fixed ultimately at $P_1P'_1$. The quantity produced and consumed will now be reduced to OP'_1. The price will rise to $P_1P'_1$, i.e. not by the full amount of the tax but by a smaller amount. The increase of price is represented by P_1E though the tax per unit is represented by P_1F. The incidence of the tax at this new equilibrium is, however, wholly on the consumer; for at this scale of production the cost of production is P'_1F and the producer realizes the price of $P_1P'_1$ which is higher than P'_1F by the full amount of the tax. The producer has been able to achieve this result by his power to reduce production, i.e. to shift the margin of production. The effects of the tax can be stated as follows:

(*i*) The margin of production is shifted; or, in other words, the quantity produced is reduced either by some producers (the marginal ones) going out of the field or by some producers reducing their production at the margin or by both processes.

(*ii*) The price is enhanced not by the full amount of the tax but by a part of it.

(*iii*) The incidence of the tax is entirely on the consumer..

(*iv*) The consumption of the commodity is reduced either by some consumers going out of the market or some consumers reducing their consumption on the margin or by both processes.

These results are not, however, achieved overnight. It takes time to reduce supply. When the tax is imposed with a given number of producers in the field, probably with expensive plants, the producers can neither cut down their production immediately nor, therefore, shift the tax. So long as the quantity supplied remains equal to OP' the price cannot rise above PP', nor can the cost of production fall below PP'. So the tax has immediately to be paid by the producers. This diminution of profits urges them to reduce production which, however, they can do slowly. As they gradually bring down their production, they are able to get a higher price and ultimately when they have reached the point P'_1 they are able to shift the whole tax on to the consumers, partly through a rise in the price and partly through a reduction in the cost of production. Thus, in analysing the effects and incidence of a tax, short-period results have to be distinguished from long-period results.

The immediate incidence of the tax on the producers is demonstrably visible when the trade practice is to sell by auction and the commodity concerned is a perishable one. The fruit trade of Calcutta is controlled by a small number of big merchants, each having an annual turn-over of several lakhs of rupees. The producers in Kabul, Bihar, Nagpur and other places send the fruit—grapes, mangoes, oranges, etc.—to this group of merchants who sell the stuff by auction to a large number of retailers. The merchants in Calcutta take no risks for the business but act as agents of the producers for which they get a commission. After selling the fruit by auction they remit the sale price minus the commission to the respective producers. The retailers know the market and the quantities that can be disposed of at particular prices; and so long as the quantities are given they will not bid higher even if a new sales tax is imposed because a tax has no effect on the demand curve. It is immaterial whether or not the auction is held subject to the condition that the buyer will have to pay the sales tax in addition to the bid money because the retailers will adjust their bids accordingly. So the immediate incidence of the tax will be entirely on the producers. This will happen the next day after the tax is imposed. But the lower return will, in time, oust the marginal producers from the field of production. They might at first try alternative markets; but the additional supplies in those markets will tend to depress prices there and thereby to lower the

return there also. The interaction of these forces will soon lead to a new equilibrium where the return from all the alternative markets will again be equalized at a slightly lower level. If the tax is low, a slightly smaller quantity of fruit will be sent to Calcutta where it will be sold at a slightly higher price. The incidence of the tax will be entirely on the consumers, though the price will rise by an amount smaller than the tax. Production will be slightly lower, i.e. either by some producers going out of business or by some reducing their production or in both ways. The alternative markets, e.g. Bombay or Madras may, as a result of the tax in Calcutta get their fruit from Kabul and other places at a slightly lower price.[1]

In the foregoing discussion it has been assumed that there was a position of equilibrium before the tax was imposed, that the tax was the only disturbing factor in this calm ocean of forces and that all other things remained equal until the new equilibrium was reached. But other things may not remain equal. The supply curve itself may undergo a change of position either way on account of either an invention simplifying production or discovery of a new use for some of its raw materials. The demand curve may similarly change in either direction on account of either a change of taste or an invention of an alternative to the commodity or an invention of an additional use for it. A case of an independent change in the position of the supply curve is discussed below.

The pressure on the producer on account of the immediate incidence of the new tax may force him to look for possible economies. Though it is presumed that under conditions of competition production takes place at the minimum cost, that is after all an ideal condition and some slack is always found in human affairs. In any case competition also presumes a constant striving for a reduction of cost and the additional energy which the new pressure must call forth may hasten success. If, therefore, the producers can reduce cost by an amount equal to the tax, the price of the commodity taxed will not rise at all; it will remain at the existing level inspite of the tax. This does not, however, alter the proposition that the long-period incidence of the tax is on the consumer because

[1] The fruit dealers of Calcutta were successful in obtaining a remission of the Bengal Sales Tax for the first two years on the ground of this short period incidence.

the long-period price of the article will still be the cost of production plus the tax. This is graphically represented as follows:

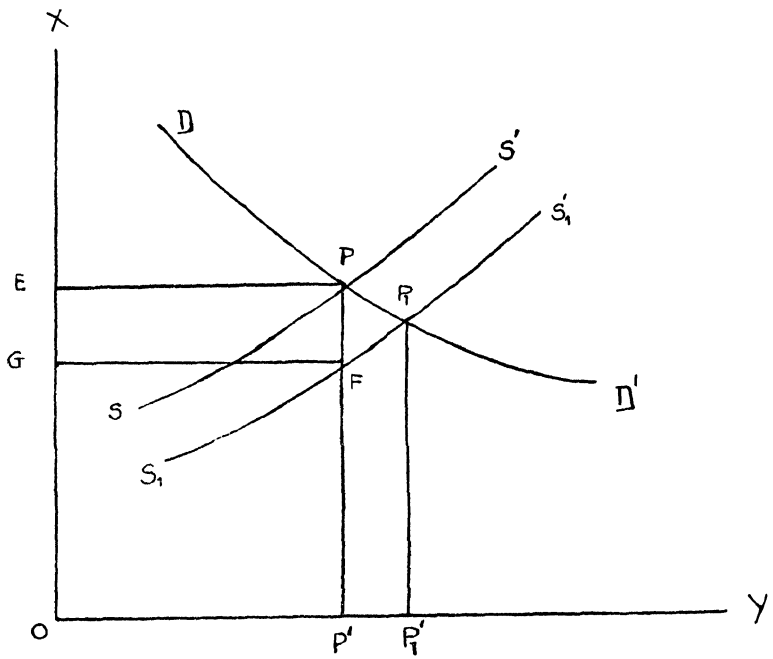


FIG. IA

DD' is the demand curve. *SS'* is the supply curve before the imposition of the tax. The normal price of the commodity therefore is *PP'* and the quantity produced is *OP'*. The rectangle *EOP'P* represents the price realized by the producer.

A tax equal to *PF* is now imposed. The volume of production before the imposition of the tax is *OP'* and it is probable that for sometime at least the production cannot be reduced. But the quantity *OP'* cannot be sold except at a price equal to *PP'*. Hence so long as the scale of production cannot be reduced, the incidence of the tax must be on the producer. He will realize an amount equal to the figure *PEOP'*, out of which he will pay to Government an amount equal to the figure *PEGF*.

This pressure of the reduced revenue calls forth additional energy as a result of which he succeeds in making economies to the extent of an amount equal to *PF* per unit of production. The

supply curve is therefore affected by two equal and contrary factors. The new economies bring down the curve to the position $S_1S'_1$, and the tax again pushes it up to the original position SS' or to put it otherwise, the tax immediately pushes up the supply curve to a height equal to PF and the new economies restore it to the original position.

After the original position is restored the result is as follows:

(*i*) There is no reduction in production or consumption but the old level of production and consumption is maintained.

(*ii*) There is no rise in the price, but the price is maintained at the old level of PP'.

(*iii*) The incidence of the tax is on the consumer. The price realized is even now divisible into two parts, i.e. $PP' = P'F + FP$ of which $P'F$ represents the cost of the producer and FP represents the tax.[1]

Similarly a change in the position of the demand curve may be represented graphically. When a war in Europe synchronizes with a sales tax in Bengal or Madras, the demand curves of many commodities will change in either direction on account of the war and the change in price on account of the tax may not be noticeable. The demand for jute or groundnuts, for example, may go down substantially both on account of want of shipping as well as on account of loss of markets in the enemy and enemy-occupied countries. The price of such commodities is likely to fall in spite of a tax on them. The demand for cloth may go up substantially on account of war purchases and the price of cloth may rise very much higher than is justified by a new sales tax in Bengal or Madras.

Such changes in the position of supply curves and demand curves of commodities are, however, independent of the tax. A study of the effects of such changes is therefore extraneous to a study of the incidence of a tax. It is clear that however much the two curves might change on account of such independent causes it will always be found that whenever the long-period equilibrium is reached, the incidence of the tax is on the consumers. This will be true whether on account of such independent disturbances prices go down instead of up or go up by an amount which is greater or

[1] This phenomenon is described by Professor Seligman as 'transformation of taxation'. See his *Shifting and Incidence of Taxation* (Columbia University Press), pp. 5–8.

less than the amount of the tax payable. The independent changes will act on the cost only. A new invention may reduce cost or a larger demand may push down the margin and thereby raise cost. But the ultimate price will always be divisible into two parts, viz. the cost plus the tax as in figure IA.

The student of taxation must, therefore, be warned that in the reality the disturbances created by a tax may be concealed or overwhelmed by other independent disturbances. What Professor Seligman calls 'transformation of taxation' is only one of such instances. The study of such cases is not essential to a study of incidence of taxation, though it is essential to recognize such cases.

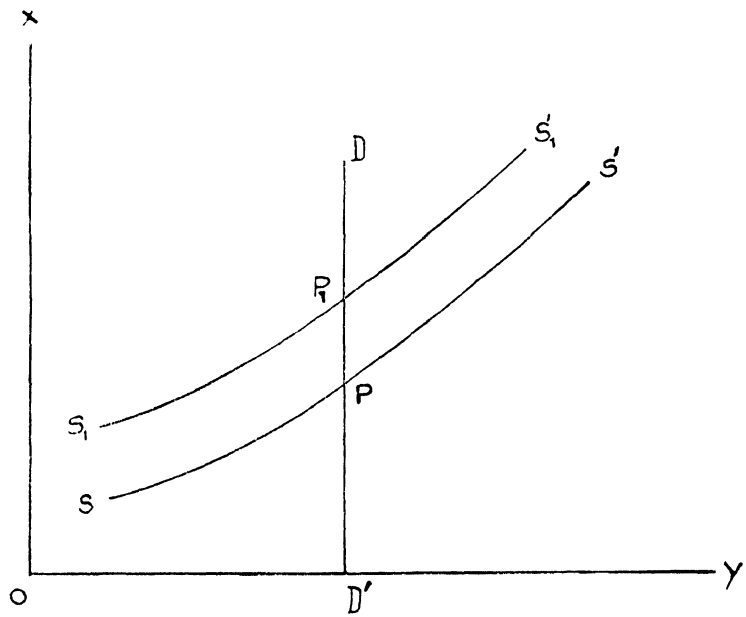


FIG. II

A thoroughly inelastic demand is represented by a vertical line, i.e. the rate of fall of DD' is along the shortest distance. The price may vary along OX from zero to infinity but the quantity demanded remains the same. DD' in figure II represents such a case. The conditions of supply of the commodity are assumed to be the same as in figure I. SS' represents the original position, i.e. the position before the levy of the tax and $S_1S'_1$ represents the position

after the levy of the tax. In the original position PD' represents the price of the commodity as well as the cost of production. As the tax is levied, the producers immediately raise the price by the full amount of the tax, i.e. to P_1D'. By doing so, they do not run the risk of a fall in demand which, ex hypothesi, is inelastic. Though the price rises, consumption does not fall, and there is no necessity to cut down production. Here, therefore, there is a coincidence between the short-period and the long-period results which are:

(*i*) There is no disturbance of the margins of production or consumption.

(*ii*) The price rises by the full amount of the tax.

(*iii*) The incidence of the tax is wholly on the consumers.

Comparing the results in figure I and figure II it appears that the difference in the elasticity of demand causes a difference in the incidence in the short period only. The long-period incidence is the same in both cases because in the long period the cost of production fully asserts itself as the factor regulating price. The question of elasticity of demand is, therefore, relevant only in the short period: in the long period it is irrelevant.

As regards the other effects of the tax, however, the elasticity of demand is fully operative in the long period. For, it is on this factor that the scale of consumption and therefore of production depends. If the demand is elastic the tax will reduce consumption and production in the long period, when the price must rise. If the demand is wholly inelastic, the tax will not reduce consumption and production in the long period in spite of the rise in the price.

The two basic factors in the interaction of these forces, when studied in isolation, are the power of the producer to reduce supply and the power of the consumer to reduce consumption. In the examples given above the producer has no power to reduce production in the short period, but his power to do so is fully operative in the long period. The consumer, however, can reduce his consumption as soon as the price goes up and this fact prevents the producer from raising price in the short period, i.e. so long as he cannot reduce production. But there may be commodities of which the consumption cannot be reduced. The demand may be very inelastic. The consumer may not be able to vary his consumption even though the price rises or falls. Commodities with an absolutely inelastic demand probably do not exist. Salt or coffins are the nearest examples. But in order to understand the implications fully,

figure II has been drawn to show the effect of a tax on a commodity the demand for which is absolutely inelastic.

We now come to the contrary case of a thoroughly inelastic supply. A thoroughly inelastic supply is represented by a vertical line, i.e. the fall of SS' is along the shortest distance. This means that the supply is independent of and does not react to the cost of production. The community may agree to incur cost up to X but the supply cannot be increased; similarly the community may refuse to spend anything for its supply but the supply cannot be reduced. In other words the community may choose to go in for any cost along OX from zero to infinity but the supply remains constant. Such a commodity does not exist in reality but gifts of nature like land and air are the nearest examples. Land is obtained free from nature and its supply cannot be increased whatever amount people are prepared to spend for it; nor can its supply be reduced even if people refuse to spend anything for it.

Though man cannot increase or reduce the supply of land he can extend or restrict the use of the land in existence. When men are few and land lies uncultivated, land may be had for the asking.[1] As population increases and more and more land has to be brought under cultivation, use must extend from better land to worse. As worse land is brought under cultivation the better land begins to earn a surplus. The price of corn is determined on the marginal land, i.e. the least fertile land under cultivation at a point of time and the other land therefore earns a surplus according to its degree of fertility. If as is likely in the case of extensive cultivation only one dose of labour and capital is applied to each piece of land, the corn produced on the marginal land must sell at a price adequate to remunerate the producer at the current rates; otherwise that land will not be cultivated at all. One dose of labour and capital applied to better land will, however, produce more than the corn produced on the marginal land but the produce will be sold at the common rate. Hence the owners of the better pieces of land will get a surplus each according to the degree of fertility of his land. The owner of the marginal land will obtain no surplus. But as the margin descends with a further increase in population, he also will begin to obtain a surplus measured by the difference of the produce on his land and that on the marginal land. This differential surplus is the rent.

[1] See Part III, Chapter I.

It is obvious that rent arises only because land of the same quality is not available without limit. If all land were of the same quality both in respect of fertility and site and there were no law of diminishing returns, rents would have been unknown. Or if land of the same quality could be reproduced at a cost, then also there would be no rent and land would sell at its cost of production, i.e. at a uniform price. But as the supply of land of the same quality is absolutely inelastic the price of land is not uniform.

The value of land to an individual depends on the size of the surplus it yields. If it yields him a larger surplus he will be prepared to pay more for its possession. If it yields him a smaller surplus he will certainly not be prepared to pay as much. To him it is an investment and he will, in buying a piece of land, expect the same rate of return[1] from it as from any other line of investment open to him. If the rate of return from any other line is, say, five per cent he would expect that the surplus which the land yields should be equal to five per cent of its purchase price. In other words the price of land to an individual is the capitalized value of its surplus or economic rent. As different pieces of land yield different surpluses the price of different pieces of land will also be different, i.e. the price of land will vary directly as the surplus it yields or the prices of different pieces of land will bear to one another the same ratio as the surpluses they yield.

Now the whole thing can be represented by a curve as shown on the next page.

The supply curve SS' must be a vertical line, as already explained. In the beginning when there were no men in the country or just enough men to be satisfied with the first grade of lands SS' would coincide with OX. As population increases SS' moves forward along OY, always retaining its vertical position.

Suppose at the moment under consideration the position of the supply curve is represented by SS' in the above figure, intersecting OY at S. This means that the pressure of population has brought into use all grades of land from the first grade to the marginal grade. The first grade is represented along OX. The second grade is represented along ab; the third grade along a_1b_1, the $(n+2)th$ grade along $a_n b_n$ and so on. The marginal grade at S yields no surplus but just remunerates labour and capital. The surpluses

[1] Before making the comparison it is necessary to eliminate such factors as risks in an investment or dignity attaching to a landholder.

of the other grades in use are represented by a_nb_n, a_2b_2, a_1b_1, ab and so on till the surplus of the best grade is represented by DO.

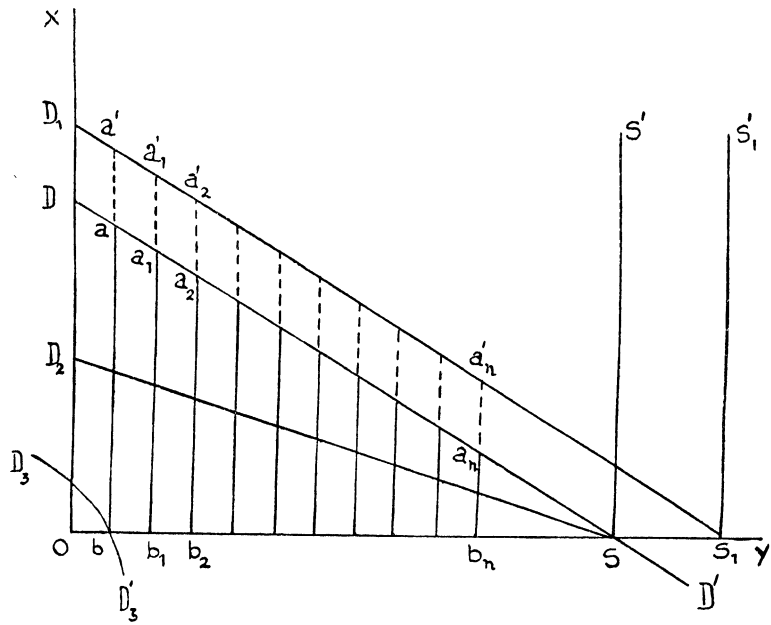


FIG. III

If population increases and pushes forward the supply curve to the position $S_1S'_1$, the margin would be at S_1 and all the previous grades will begin to earn additional surpluses represented by the extensions of ab, a_1b_1, etc., shown in dotted lines. The old margin and a few grades after that will begin to earn a surplus. Similarly, in an earlier stage of society when the supply curve coincided, say, with ab, the margin was at b, the grade at ab earned no surplus and the best grade along OX earned only a surplus of OD_3. In this way, as population increases, the supply curve is pushed forward along OY, inferior lands are gradually brought under cultivation grade after grade, the margin descends and the surplus earned by the better grades increases.

At the moment of time under consideration the position of the supply curve is at SS'. DD' intersecting OY at S and OX at D represents the demand curve. OD and the lines ab, a_1b_1, a_2b_2 . . .

etc., represent the surpluses of each grade of land under use except the marginal grade.

Now suppose a tax of fifty per cent of the surplus is imposed on all lands in use. The marginal land has to pay no tax as it earns no surplus. The tax has no effect on the supply curve as all lands above the margin are still left with a surplus each and so long as any surplus is left, it will be to the interest of the owner to use it.

The tax will, however, weaken the urge of prospective buyers of lands. As the effect of the tax is to halve the net surplus, the return from an investment in land will be only half as much as before. Hence no buyer would now offer more than half the old price. The tax will therefore push down DD' to its new position at D_2S bisecting OD, ab, $a_1b_1 \ldots . a_nb_n$, etc. The land will still produce the same surplus as before but the upper half will now go to Government and the lower half to the owners. The marginal land will neither earn any surplus nor will it pay any tax.

If the tax was raised to a hundred per cent of the surplus, DD' would coincide with OY. Landowners would be deprived of their entire income by taxation and their land would not sell; for nobody would now offer anything for the possession of land. They would be quite indifferent whether their land was used or not. The position of SS' however would still not be shifted.

If the tax imposed takes away more than a hundred per cent of the surplus the effect will be not only that landowners will not get any surplus but that labour and capital employed on land will have to bear that portion of the tax which is in excess of the surplus. Provided labour and capital are mobile, they will at once turn to other lines where they can earn more, i.e. where there is no tax. As a result land will cease to be used ; this will impel SS' to move backward along the Y axis towards O. The population of the country will, however, require the use of all the land if it is to live. The only way in which labour and capital can be still retained on land is by increasing their remuneration which causes a rise in the price of corn. The rise may also cause the death of the poorest sections of the people. When a final equilibrium is reached, some land will go out of cultivation, some men will have died, the remuneration of labour and capital employed on land will increase, the price of corn will rise and the incidence of the tax will be as follows:

(*i*) The portion of the tax equal to the surplus will be borne by the landowners; and

(*ii*) The excess will be borne by the consumers of corn.

Thus in the case of a tax on land, so long as the tax does not exceed the surplus,

(*i*) the supply curve is unaffected,

(*ii*) the demand curve comes down, and

(*iii*) the incidence of the tax is on the landowners.

When, however, the tax exceeds the surplus,

(*i*) the supply curve moves backward,

(*ii*) the demand curve coincides with *OY*,

(*iii*) the incidence of the tax is partly on the landowners and partly on the consumers of corn.

In the second case the tax is not on land alone but on land as well as on labour and capital applied to land. It is only in the former case that the tax is purely on land, i.e. on the earnings of land. It is therefore established that the incidence of a tax on a commodity with a thoroughly inelastic supply is on the owner of that commodity. If the supply is thoroughly inelastic it means that it cannot be re-produced. There is therefore no producer with respect to it but only owners.

In the second case the tax is partly on labour and capital employed in producing corn and as the demand for corn is inelastic, the ultimate incidence of that portion of the tax must be on the consumers.

The tax on land, as already explained, will also have the effect of reducing the price of land. With a tax of fifty per cent on the surplus, the land would yield a return of only half as much as it would without the tax. Hence the buyer would not offer more than half the old price. The buyer would look upon it only as an investment and unless it yielded him the current rate he would not go in for it. Hence he is not at all affected by the tax. The incidence of the tax is on the original owners only, i.e. the owners at the time of imposing the tax, and they cannot shift it. The new buyer would of course pay the tax but he has discounted the sale price by an amount equal to the capitalized value of the tax payable by him and has thus arranged to get rid of its burden. He pays it but does not bear its burden which he leaves on the shoulder of the original owner by a process of capitalization. Professor Seligman has given the name of 'capitalization of taxation' to this

phenomenon in which the payer does not bear the burden but has got rid of the burden by discounting his cost by an amount equal to the capitalized value of the tax. This phenomenon will be discussed in greater detail in the chapter on Agricultural Income-Tax.

The following figure represents the surplus from a piece of land with an intensive margin. Production from land is subject to the law of diminishing returns. As more doses of labour and capital are employed on it, the return from the land increases at a diminishing rate or, in other words, the cost per unit of produce raised increases with an increase in the quantity of produce raised.

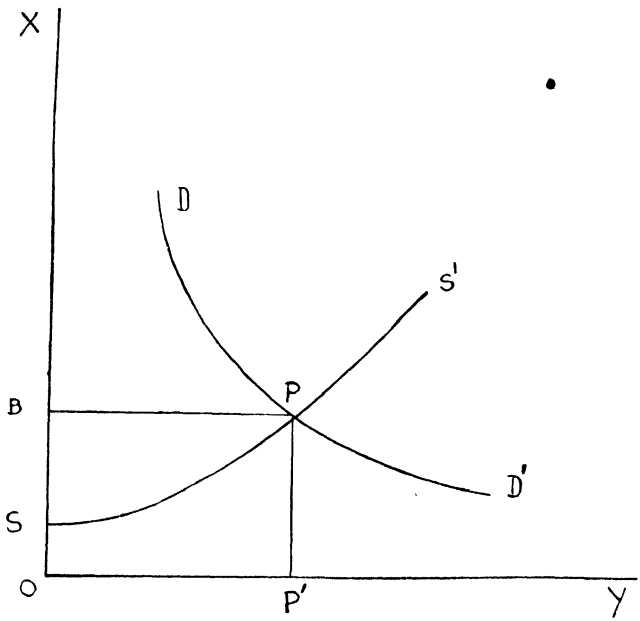


FIG. IV

SS' represents such a condition of supply. The cost per unit of crop rises as more and more crop has to be raised from the same land. So *SS'* rises vertically as it progresses horizontally. It is the demand curve for the produce, i.e. *DD'* which will determine the quantity to be raised from the land. If *P* be the point of intersection of *SS'* and *DD'*, the quantity raised will be *OP'*, the cost of raising the marginal unit of produce will be *PP'*; the price will

also be fixed at *PP'* as otherwise it will not be worth while to raise the marginal unit.

Now ex hypothesi, the cost of raising the earlier units of produce, i.e. all units except the marginal, is less than *PP'*, the cost of raising the first unit being only *OS*. Though these earlier units are raised at a lower cost, the sale price of all the units is the same and is equal to *PP'*. Hence the owner of the land earns a surplus. This surplus is measured by the figure *SBP*. The figure *OBPP'* represents the price realized for the quantity produced, the figure *OSPP'* represents the cost of the quantity produced, and hence the difference between the two figures must represent the producer's surplus. This producer's surplus is called the economic rent. Obviously Government could take away the whole of the surplus without reducing the productive activity of the producer on the land. But if Government demand more than the surplus, the land would simply not be used. The term cost, however, must be interpreted in a very comprehensive sense. It must include charges for all labour used, all capital invested, the management and supervision as also insurance charges. When all factors are adequately rewarded at the market rate, the balance of the total sale price of the crop can be attributed to the land which can be regarded as a natural resource without cost of production.

The instances given above deal with hypothetical cases, most of the complications of everyday life being abstracted away by assumption. They are, however, very useful in that they show the tendencies of each particular factor in taxation problems. They especially demonstrate the importance of elasticity of demand and supply as factors regulating the effects and incidence of a tax.

In most cases of everyday life the demand curves or the supply curves are not as independent as we have supposed. The supply curve of a commodity may represent the resultant of many other supply curves. If one of these commodities which go to the production of the taxed commodity has been earning a good profit and has no other alternative market, and if the tax is low, the producer of this basic commodity may have to bear the entire burden of the tax, without the supply of the taxed commodity being reduced and without its price being raised. This will happen if the producer of the basic commodity finds it less disadvantageous to pay the tax (i.e. reduce the price of his commodity by the full amount of the tax) than to lose the market. In such a case the tax may be shifted

backwards. But here also it will appear that the question is, in the last analysis, one of elasticity of demand and supply. A large number of articles or factors are interconnected in trade and production. When a tax is imposed on any one of them, a struggle begins among all of them till a new adjustment is reached. In this struggle the advantage of a particular commodity will vary inversely with the elasticity of its demand and directly with the elasticity of its supply. In the result the tax may be shifted backwards or forwards or both ways and the production and consumption of these articles may be reduced according to the circumstances of each case.

Apart from the question of incidence the examples given above show the effect of a tax on a commodity on the production and consumption of that commodity. In the first example production is reduced thus causing unemployment and its consequent sufferings. Many consumers have to give up consumption while others lose consumer's surplus. In the second example neither production nor consumption is reduced. But consumers have to spend more on the taxed commodities. This may reduce their spending power in other lines, causing reduction of production and of employment in those lines. Thus suffering is inflicted not only on the consumers of the taxed commodity but on many others. In the third example it is the owner of the land who pays the tax. The price of the produce of land is not increased by the tax on rent, even if it be a hundred per cent tax. The price of the land is reduced on account of the tax. If the land was earning a rent of five rupees, the price of the land with a five per cent rate of interest would be one hundred rupees without any tax. But if a tax of fifty per cent is levied on the rent, the price of the land is reduced to fifty rupees, the rate of interest remaining the same. So the only class of persons to suffer by a tax on rents is the owners of land and the tax has no effect on production. It is, however, conceivable that the tax on rent may reduce the savings of the owners and therefore reduce their investments on land, and thereby reduce production, or if the owners are poor people, it may reduce their consumption which may affect the industries which produce goods for the consumption of that class.

The examples given above make two things clear: (*a*) a tax is not always borne by the person who pays it; (*b*) a tax often causes disturbance to trade and industry.

The search for the place from where it is easiest to collect a tax is an administrative problem of the first importance. But the economist must probe deeper, find out who ultimately bears the burden of the tax, and what disturbances to trade and industry are caused by the process of shifting the burden.

The man who ultimately bears the burden must forgo either some necessaries of life or some comforts or some luxuries or some savings according to the state of his poverty or wealth. As somebody must bear the burden of a tax which is not wholly avoided, it must inflict some sacrifice on somebody. So also a tax often causes disturbances to trade and industry. The chief objective of a good tax policy is to minimize the sacrifice and disturbance involved in taxation. A tax system has therefore to be studied from two main standpoints:

(*i*) the distributional standpoint, i.e. the incidence must be detected and enquiries should be made to see whether the tax burden is equitably distributed in the country;

(*ii*) the standpoint of trade and industry, i.e. whether the disturbance caused to them is the minimum possible.

The ideal of minimum sacrifice may not always be consistent with the ideal of minimum disturbance, though there are cases in which the two ideals coincide. A tax on rents causes the least disturbance to production but in a country where land is owned in small parcels, by a large number of people, a high tax on rent may be unfair from the distributional point of view. In cases of conflict between the two ideals one has to choose according to the circumstances of each case.

Besides taxes levied on things and on lands there are taxes levied directly on persons. Persons are either

(*i*) labourers,
(*ii*) entrepreneurs,
(*iii*) owners of land,
(*iv*) owners or accumulators of capital,
(*v*) consumers.

In the first four capacities persons help in the production of things which in the fifth capacity they consume.

Taxes are seldom levied directly on persons as consumers because the object is achieved with far greater administrative convenience by levying the tax on consumable things either at the stage of production or exchange or at the customs frontier or at the stage of

transit and so on. In rare cases where a tax is technically levied on consumers directly, e.g. the Provincial Motor Vehicles Taxes, its incidence and effects are the same as if the tax were levied on the thing consumed. Such a tax is, therefore, best classified as a tax on things. A tax on persons in respect of the total expenditure of each does not exist in this country.

Taxes on things or taxes on consumption are necessarily regressive in character because the increase in the consumption of things in general does not keep pace with the increase in income. It is obvious that the richer a man, the smaller must be the proportion of his expenditure on things to his total income.

A direct tax on man as owner of land is different from a tax on land. Land revenue is a tax on land: agricultural income-tax is a tax on persons as owners of land. The two are obviously different. A tax on land, though graduated, is a regressive tax.

Graduation may, under certain circumstances, even accentuate the regressive character of the tax, e.g. when the best plot of land is in the possession of the poorest man and the tax is based on the surplus yielded by each unit of land. A direct tax on owners of land, however, can be progressive, subject to certain difficulties explained in Part IV, Chapter I. Secondly, the whole of a tax on land may be capitalized under certain circumstances; but in the case of a tax on owners of land the scope of capitalization is small. The points will be discussed more fully in the chapters on Agricultural Income-Tax.

A direct tax on man as owner of capital is similarly to be distinguished from a tax on capital.

The earning of capital is interest. When interest is taxed, capital tends to shrink. People on the margin of saving at the current rate of interest stop saving. The sum total of capital may dwindle in this way. As the margin goes up, the rate of interest goes up too. Hence the incidence in the short period is likely to be on the owners of capital but the incidence in the long period is likely to be on the consumers. Figure I represents this case.

The short period in this case, however, is much longer than in the case of an ordinary article; for it takes a long time to reduce capital —specially the fixed capital—which is already in use. The only way to reduce it in the short period is not to repair or replace it as it requires repair and replacement. A special tax on capital or a special direct tax on owners of capital does not exist in this country.

Take now the case of a tax on labourers and suppose that a tax is levied on unskilled labourers only. Unskilled labourers have the lowest standard of living in every country. The effect of a tax on them, levied either as a capitation tax or as a tax on unskilled labourers, will be to reduce immediately their standard of living. Though the supply of things tends to be restricted as the return therefrom diminishes, in the case of men, the supply often increases with diminishing income. A high birth-rate has invariably been found among the poor and a low birth-rate among the wealthy. Hence the reduction in the standard may lead to a larger supply of unskilled labourers which may further depress the standard till the death-rate also increases as fast or faster. In a country like ours where the standard is the minimum for existence, the death-rate may increase at once, which may reduce the supply, raise the margin and tend to increase wages. If the employers must maintain the number of unskilled labourers, and must therefore prevent them from dying, they must raise wages. The immediate incidence of a tax under such circumstances will be on the labourers but the ultimate incidence may be on the employers.

Another factor requires to be considered here. The agents of production co-operate as well as compete with one another in production. The principle of substitution brings about equi-marginal returns for all under a condition of simultaneous co-operation and competition. Hence as soon as the cost of one agent goes up, the other agents must either be squeezed to that extent or they must substitute the costly agent to some extent. When the wages of unskilled labourers rise, employers may find it profitable to reduce their number and employ a little more machinery or a few more foremen instead.[1] Such a change permanently reduces the demand for unskilled labourers. The excess supply will either die or, by competition, will bring about a permanent reduction in wages.

Irrespective, however, of the long-period consequence, the immediate incidence of the tax on unskilled labourers is so very painful that such a tax can hardly be levied nowadays in a civilized country.

A tax on skilled labourers or on men holding highly paid posts will not be shifted unless it is so drastic as to reduce them to the

[1] See Marshall, *Principles of Economics*, Book IV, Chapter I (Macmillan & Co., Ltd.), § 7.

standard of unskilled labourers or unless it discriminates between groups and thereby disturbs the relative desirability of different occupations. To them, under such circumstances, it is a tax on surplus and it has no effect on the margin of production, immediately or ultimately. Immediately the supply of such persons cannot be reduced. As ex hypothesi all occupations are taxed and as the relative distinction of each occupation is not distributed by taxation, there is no question of change over from one line to another. And, as the relative distinctions are maintained, persons in each line will exert themselves as much as before to maintain the distinction; so there is no question of decline of efficiency.

Nor would any father desist from training his son for a highly paid post or for some skilled occupation simply because men in those occupations were taxed. As the relative distinction of each line is maintained, a skilled labourer will still be earning larger net wages than the unskilled labourer, and a man in a higher executive, judicial or advisory position will continue to earn a still higher net income. So long as the relative distinction of each line is not affected by taxation, the supply of men in these lines will not be reduced either in the short period or long and hence the incidence of the tax will be on the men themselves both in the short period and long. The tax is therefore a tax on surplus and is similar to a tax on the surplus earned by land except that it cannot be capitalized for the simple reason that persons are not saleable.

The Bengal and the Central Provinces taxes on profession, calling, employment and business are exactly of this nature. By exempting persons who do not pay income-tax, they have confined the tax to persons having incomes above the margin of subsistence. They are also comprehensive and not discriminatory.

The municipal taxes on professions are, however, slightly different. They are discriminatory, because they do not tax men in employment but only men in professions or business. Secondly, they do not exempt smaller men and hence they are taxes on the margin.

A practising doctor or lawyer in Calcutta must pay a tax of twenty-five rupees a year to the municipality, however low his income may be.[1] If therefore his margin of subsistence without the tax is RsX, the margin with the tax is raised to RsX+25; and if he cannot earn as much, i.e. RsX+25, he has either to go to practise

[1] *Calcutta Municipal Act*, Schedule VI, Entries 36 and 44.

outside Calcutta or to take an employment with a minimum salary of RsX. The margin of subsistence in employment is still RsX as employments are not taxed under the Calcutta Municipal Act. The tax therefore has the effect of keeping out or driving some men from professions in Calcutta either to professions outside Calcutta or to employment in and outside Calcutta. As a consequence it increases the practice of those who come and remain in the taxed lines and thereby probably increases the fee rates slightly, though imperceptibly.

The justification of such a tax is an indirect regulation of profession. Doctors and lawyers in Calcutta should not, in the interest of society, indulge in cutthroat competition. The tax probably has the beneficial effect, however slight, of reducing the number of practitioners in Calcutta. A salaried employee, however, does not affect the citizens in the same way and he is justifiably excluded. The provincial licence tax on lawyers has exactly similar implications.

The purpose of the provincial taxes on employment, profession, calling and trade in Bengal and the Central Provinces being purely revenue, they justly include employment and exempt men who do not pay income-tax. The tax therefore falls on the payers and cannot be shifted.

The entrepreneur may be taxed directly as a receiver of profits from various sources or indirectly on his business according to the profits earned by each. A special direct tax on entrepreneurs is unknown. Such a tax, if levied directly on all entrepreneurs and graduated according to the total profits earned by each, is clearly a tax on surplus. It does not dissuade them from engaging in business, as long as the entire surplus is not taxed away; as the tax is comprehensive and does not discriminate between trades, there is no incentive for changing over from one line to another. Nor will the tax dissuade men from bringing up their sons as entrepreneurs as long as the relative distinction of entrepreneurs is maintained. Hence the margin of supply of entrepreneurs will not be shifted either immediately or ultimately. The tax will therefore have no effect on prices and its incidence will be on the payers, i.e. on the entrepreneurs.

Taxes are often imposed on the profits of business. Such indirect taxes on business units must be distinguished from a direct tax on entrepreneurs in the same way as a tax on each unit of land must be

distinguished from a direct tax on owners of land graduated according to the total surpluses of land received by each. Such an indirect tax on the profits of business units is obviously a tax on the surplus. The margin is not affected by it because, there being no profit in the margin, it has not got to bear any tax. The tax does not therefore restrict business nor does it raise prices. Price being determined at the margin anything which does not affect the margin cannot affect the price. The incidence of such a tax is therefore on the owners of the business units in accordance with their interest in each.

Of all the taxes on persons, income-tax is the most important. It taxes persons in respect of all their earnings whether as owners of land or capital or as entrepreneurs or labourers.

Whenever a tax affects the margin, it tends to disturb prices, production and consumption.[1] The margin is affected either by levying the tax on the margin itself or by discriminatory taxation. If, for example, lawyers are taxed but medical practitioners are not, the margin of the supply in both cases will be affected. Similarly an exclusive tax on men as owners of land will tend to divert investment from land to other lines; an exclusive tax on men as owners and accumulators of capital will tend to divert investment to land and so on. If, therefore, it is intended not to disturb prices, production and consumption by taxation, the tax system must satisfy two conditions: (*a*) no tax should be levied on the margin, and (*b*) the tax system should not discriminate between one line of investment and another or one line of occupation and another.

The income-tax stands both these tests. It is not a discriminatory tax; it taxes man on his total earnings from employment, or profession, capital, land and business. The exemption limit which goes with an income-tax ensures that men on the margin of subsistence are not taxed and hence the margin in any case is not affected. It is therefore a tax on surplus and its incidence is on the payers.[2] It cannot be capitalized because it leaves no possible line of diversion for the agents of production where a better return is possible and

[1] In the exceptional case of a thoroughly inelastic demand a tax, even if levied on the margin, does not affect production and consumption, though it raises price. But such cases hardly exist and are disregarded.

[2] For the argument that income-taxes do not raise prices see the *Report of the Colwyn Committee.*

secondly, because it is a tax on persons who are not saleable. It has also the greatest scope for progression in taxation.

The importance of the distributional aspect of taxation is obvious. Whether the taxes are imposed on things, or on persons or on land, it is persons who are ultimately affected by them and it is by their effects on human well-being that taxes are to be judged in the final analysis.

Given the amount of money required to be raised by taxation there are different ways of distributing the tax burden among citizens. In a good system the burden is distributed in such a way as to cause the minimum loss of satisfaction to individuals: the loss is also equitably distributed. In a bad system the same revenue raised causes far greater suffering or loss of satisfaction to individuals which again is unevenly distributed. A clear understanding of the principle of diminishing utility in its application to money is essential to a proper appreciation of this aspect of taxation.

The first few rupees of a man's income are spent on satisfying the most urgent of his needs—in keeping body and soul together. The marginal utility of money to him at that stage of what may be called 'pain economy' is infinity; for these few rupees are a condition of his life. As his income increases, the subsequent units of additional income are expended on less and less urgent needs. In this way each man progresses from necessaries to comforts, from comforts to luxuries and finally he prefers saving to expenditure. The marginal utility of money therefore diminishes with increasing income.

It follows that the pain inflicted by or the sacrifice involved in making a man part with the last rupee of his income decreases with increasing income and increases with decreasing income. To the State the source is immaterial: a rupee obtained from the poor man is as useful to it as a rupee obtained from the rich man. The poor man in parting with the rupee, however, goes without some necessities of life and may even die whereas the rich man in going without the rupee probably forgoes a little luxury or saves a rupee less. The pain inflicted on the two men differs greatly in magnitude though the revenue collected is the same. Conversely, the tax levied on the two men must differ greatly in magnitude, if the sacrifice involved in parting with the amounts in both cases is to remain equal. The justice of progressive taxation is thus firmly

rooted in the principle of diminishing utility in its application to money.

The truth enunciated above also indicates the extent of progression in taxation if minimization or equitable distribution of the sacrifice involved in raising a given amount of revenue is the *sole* objective in taxation policy. It is clear that with such an end in view, the State, in raising a given amount of revenue, should start from the richest stratum of society. As enough is cut out from the richest stratum so as to raise the marginal utility of money to men in that stratum to the level of the next lower stratum, the latter also should be brought under taxation. From that point onward both the strata should be taxed equally till the marginal utility of money to men in both strata equals the marginal utility of money to men in the next lower stratum. From that stage onward all the three strata should be taxed equally. In this way taxation under ideal conditions should proceed from the richest downwards.

This is the only manner of approach to taxation which minimizes sacrifice and equalizes it. It is obvious that the sacrifice involved in a scheme of taxation is at its minimum when it is equal for all. So long as it is not equal as between any two taxed men it is possible to reduce it by transferring the last rupee of the tax from the man making the greater sacrifice to the man making the smaller sacrifice.

It is further clear that by starting taxation from the lowest stratum of society, a given amount of revenue is raised with the maximum of sacrifice which again is unequally distributed. The marginal utility of money to the men in the lowest stratum is infinity. To make a man in that stratum part with an anna is perhaps to make him go without a meal. To cut anything out of the barest necessities of the poorest is to make them undertake an 'infinite' sacrifice of which there is no equal. The amount that is raised from these men will entail a smaller sacrifice if it is raised, instead, from men in more affluent circumstances. It follows, therefore, that men with the minimum standard of living should not be taxed.

We thus arrive at two principles of taxation on the basis of distributive justice. They may be enunciated as follows:

(*a*) Taxation should be so planned that it should begin from the highest stratum of society and should descend to the next lower stratum only after the income of the higher stratum has been rendered equal to that of the lower stratum. In this way taxation should descend just as far

down as is necessitated by the amount of revenue required by the State.

(*b*) Men whose means are not adequate to maintain a minimum standard of living should not be taxed.

Unrestricted pursuit of distributive justice is, however, not always compatible with the maintenance of productive efficiency in a long-range plan of taxation. There may be an exceptional case of a huge tax intended to be levied once for all for a particular purpose, e.g. to wipe out the National Debt after a war by a single effort. In such a case the taxation policy may be based solely on the principle of distributive justice without modifying the productive plans of men subsequently to the date of the levy. Ordinarily, however, taxation is a recurring phenomenon which is taken into active consideration by men in fixing up their plans of production. It will therefore invariably affect the margin of production unless it is planned with the utmost caution. In considering long-range plans of taxation, therefore, the requirements of distributive justice should be modified by the demands of productive efficiency. It has already been explained on page 19 that in a conflict of the two principles one has to act according to the circumstances of each case. Two reasons for the necessity for a general relaxation of the principle of distributive justice in taxation are discussed below.

Distinctions are the chief incentive to productive effort in modern society. If distinctions earned by productive effort are levelled out by taxation the incentive to that effort is destroyed and the margin of production is thereby disturbed. It would be highly undesirable if, in trying to secure the ideal distributive justice in taxation, the springs of productive effort were choked or dried up.

In a capitalistic society man works directly for profits but really for distinction. He prizes profits, for they are the means of establishing his distinction and superiority over his fellow-men. Possession of wealth would lose its charm if all men were equally wealthy. The wealth of the world is produced by the attempt of each man to gain some ascendency over or distinction from his fellow-men. If, therefore, production is not to be retarded, distinctions earned by productive efforts have got to be maintained. Hence our zeal for effecting an ideal distribution of the tax burden must be held in check by the necessity to keep unimpaired the condition of producing the national dividend out of which the tax must be paid.

The necessity for maintaining inequality in society is, however, not such a hindrance to progressive taxation as it appears to be at first sight. In the present state of taxation in the country which very much lacks progression a correct appreciation of the necessity for inequality would considerably enlarge the scope for progressive taxation instead of restricting it. It, of course, restricts the scope in that in our zeal for maximizing the total satisfaction from a given national income, we shall not cut the basis for augmentation of that income. It enlarges it in that so long as Government maintain the relative inequality of individuals, they can cut off large slices off their incomes without impairing their urge for production. It has been explained already that taxes on professions, employments, etc., or on entrepreneurs do not affect the margin of supply so long as the entire surplus is not taxed out and so long as the relative distinction as between lines is not disturbed by discriminatory taxation. As Marshall convincingly puts it—

'The zeal of a yachtman in a race is not lessened when an unfavourable tide retards the progress of all; and the businessman of high faculty might not be made less eager for success by taxation which took from him and his compeers a considerable proportion of their gains. What he really cares for is an increase in wealth relatively to his neighbours.'

Government can therefore pursue a policy of progressive taxation without impairing the productive efficiency of individuals so long as the richer man is not rendered as poor as his poorer neighbours by that policy.

The principle of equal sacrifice has also to be modified in application on account of another consideration. The productive organization of society, as at present based, has to depend for its maintenance and progress on the savings of individuals and corporations. The total capital of the nation undergoes an annual depreciation and if society is to progress, there must be additions to the productive apparatus. It is out of the savings of individuals and corporations that this depreciation is repaired and additions are made. The continuance of saving on an ever-increasing scale is therefore a *sine qua non* of a progressive society. It is the rich who supply the bulk of the savings. A man can think of saving only after the necessaries of life and probably some comforts and a few luxuries have been obtained. But if the State comes in with its axe of taxation to deprive the rich of the bulk of this surplus, the amount

available for saving obviously suffers a diminution. The expenditure of the tax revenue may, of course, under certain circumstances counteract this diminution. Thus, if the proceeds of taxation of the rich are expended in repayment of internal loans, the money is simply transferred from one class of rich men to another class which is probably more likely to invest the amount. But such cases are exceptional. Generally speaking, a sharply progressive tax system creates a tendency for savings to diminish; and this fact should not be lost sight of in determining the policy of taxation.

This argument has been well stated in the Majority Report of the Colwyn Committee as follows:

But there is a complementary aspect which imposes a check on the application of the ability to pay principle. Money in the free disposition of the citizen has a utility to the State as well as to himself. Saved and invested, it supplies the financial and industrial needs of the community. From this point of view, it cannot be said that there is diminishing utility in the individual's income. The utility, in fact, only begins when the income is sufficient to leave a margin over necessary expenditure; in other words, the special utility to the community only begins when the greatest utility to the individual has ceased. The larger the increase, the more room is there for saving; and the State when putting a heavy tax on incomes with the greater margin, has to consider the risk of doing too much damage to savings.[1]

This tendency may, however, often be exaggerated. It is equally necessary to guard against any exaggeration of the tendency as against the tendency itself. The progression in our taxation system is so very small, that for years to come we probably do not need to take this tendency into consideration at all.

The analysis given above establishes the following practical principle:

Apart from any socialistic or extra-fiscal consideration in taxation, equity, or the principle of equal sacrifice for all, requires progressive taxation with an exemption limit. The need for progression in taxation should, however, be held in check by (*a*) the necessity to maintain distinctions as an urge to production, and (*b*) by the

[1] Professor Pigou expressed the same idea in his evidence before the Colwyn Committee as follows:

'From a distributional point of view, it would plainly be best to take nearly all your money from the rich people but that might be so bad from a productive point of view that the poor people would in the end be damaged.' (Quoted in § 285 of the *Report*.)

necessity to maintain a standard of saving. Subject to these two conditions there need not be any fear in distributing the tax burden according to the principle of equal sacrifice for all. The first of the two principles enunciated on page 26 should therefore be modified accordingly.

Progressive direct taxation is, however, a recent development. It was during the last world war that the idea received a great impetus. The work of economists has done much to popularize it. They have proved that in respect of its effect on prices, enterprise and incentives to work and saving, a direct progressive tax does not operate harmfully to society. The present war is likely to revolutionize once again our ideas about the safe limit of progressive taxation.

Tradition, ignorance, vested interests, and the requirements of the constitution prevent the taxation system of the country from being 'rationalized' if that term may be used in this context. Though, logically, taxation ought to commence from the highest stratum of society, historically it has commenced from the lowest stratum. Taxation started in history with regressive taxes. Taking the same amount from each man was considered to be equal taxation in earlier days. In those days when the distribution of wealth was more or less even, not much injustice was involved in such taxes. Proportionate taxation was next considered to be equal taxation. They yield place to progressive taxes only very slowly in spite of economic theories and in spite of the development of great inequalities in income in recent times. Tradition, vested interests and the requirements of the constitution combine to prevent the adoption in full of the practical principle as stated in the foregoing paragraph. To judge the taxation system, therefore, on the basis of this principle will be demanding too high a standard. This may be unfortunate but this is a fact. The principle should therefore be further modified with a view to make it milder. But no milder statement of the principle than that adopted by the Minority Report of the Colwyn Committee is possible, if we are not to commit a glaring injustice. They stated the principles as follows:

(*i*) Taxation should mitigate, not aggravate, inequality in the distribution of income.

(*ii*) Taxation should not be imposed upon any whose means are not adequate to maintain a certain minimum standard of living.

Judged on the basis of these principles, taxes on commodities are bad. They are necessarily regressive in character, for—

(*a*) the incidence of such taxes is on the consumers; and
(*b*) consumption does not increase progressively nor even proportionately with income.

Complete abolition of taxation of commodities is not, however, practicable and will not be so for a long time to come.[1] The expansive need for revenue, the power of vested interests, the limitation of the constitution, the newness of the technique of progressive taxation—all these tend to perpetuate them. But if all taxes on commodities cannot be done away with, there is a great scope for selection among them. The most objectionable of them are those on the necessaries of life and they ought not to be retained. They make a regressive system more regressive and inflict the largest amount of pain in raising a given revenue.

Taxes on articles of luxury or on articles not consumed by the poorer section of the community may not be objectionable. They may even be good in a system which is already very regressive. Whether as a new measure, or as a measure to replace another tax on the poor in this country, a tax on an article not in use among the poorer section of the community is clearly a move in the right direction as it is an attempt to restore the balance or at least creates a tendency towards that direction. Within the class consuming the articles taxed, it may be regressive, but it is free from the worst fault in that it does not tax the poorest; in other words, it does not go against the second principle.

It is possible that under certain circumstances a tax on an article of luxury does not offend against the first principle either because we yet know very little about the quantitative measurement of ability to pay or the quantitative measurement of the hindrances to productive efficiency or saving caused by the strict enforcement of the ability to pay principle.

[1] *The Minority Report of the Colwyn Committee* expressed themselves very strongly on this point as follows:

> 'We are ourselves of opinion that taxes upon commodities, regarded as a part of a general system for raising the money required for State expenditure are objectionable in principle, and that the important place which they occupy in our tax system can only be defended on the ground that they are survivals from a period when the administration of direct taxation was much more difficult than it is today.'

Taxes on luxuries or such other commodities will, however, affect production and consumption in the manner explained in figure I.

An attempt is sometimes made to justify taxation of commodities of common consumption on the ground that it is the only practical means of taxing the entire population. 'It has been put to us', says the Minority Report of the Colwyn Committee, 'that members of the electorate, whatever their economic position, ought not to be wholly exempt from taxation, on the ground that, in this event, their votes will not be exercised with a due sense of responsibility.' The Minority Report answers the contention by three decisive arguments as follows:

(*a*) In the first place it appears to us difficult to press the principle of 'no representation without taxation' so long as the converse principle of 'no taxation without representation' is not observed.

(*b*) Secondly, the whole argument seems to us to be of a somewhat academic character.

(*c*) We think that the effects of good or bad Government are more marked in the lives of the poorest classes than in the case of any other section of the community; and that the less fortunate electors appreciate their responsibility as electors far more keenly on this account than through payment of a few shillings in indirect taxation, as to the very amount of which they are frequently in ignorance. In our view, society has already exacted sufficient sacrifice from those who, in the conditions that society permits, have been unable to attain a minimum standard of civilized existence (§ 78–80).

In India the question does not arise at all over a wide field. In the large field of taxation by the Central Government the elected representatives of the very restricted electorate has to shoulder little or no responsibility either as to the raising or spending of revenue and hence the question of a proper exercise of responsibility by the electors does not arise. In the Provincial sphere also a large percentage of the expenditure is by Act of Parliament charged on the revenues of the Provinces and the ministry or the people have no control over such charged expenditure.

The foregoing discussions have proceeded on the assumption that taxes are imposed with purely financial motives. In practice, however, taxes are sometimes imposed with extra-financial or mixed motives. One important group of taxes, e.g. Customs Duties are often imposed with industrial motives. Economists agree that such duties are justified only in respect of nascent industries, i.e. industries

which are yet in an infant stage but which could grow and face world competition without protection in a short and definite period, if helped with protection for a while. It is admitted that in the short period, i.e. while the duty is in force, an unequal burden or a greater burden than is necessary to raise an equal amount of money is being imposed on the people. But the burden is considered worth bearing for the sake of a benefit anticipated to accrue in the future, viz. the full development of the industry. It is like a national investment: a present sacrifice for a future gain. Without this temporary sacrifice the nascent industry would not be developed.

Nothing, however, would justify indiscriminate protection. If industries for protection are wrongly selected, i.e. if such industries are selected as would never be able to face world competition without aid, the burden would tend to be permanent and the bearing of it would go in vain. Industrially it would be a wrong step. For, as long as the inefficient industry is kept alive by such aid, it diverts labour and capital from the efficient ones and thereby reduces the national dividend. Financially the levy is obviously objectionable as it offends against practical principles.

The soundness of discriminatory protective duties does not therefore call for any modification of the practical principles which remain valid in spite of them. They are the standard principles, short-period deviation from which would be justified on very strong grounds, e.g. the infant industry argument.

Apart from the principle of equal sacrifice,[1] Adam Smith laid down three other canons of taxation which retain their validity even today. They are:

The canon of certainty

The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person.

The canon of convenience

Every tax ought to be levied at the time or in the manner, in which it is most likely to be convenient for the contributor to pay it.

[1] The canon of equality or equity, as it is called, was stated by Adam Smith as follows:

> 'The subjects of every State ought to contribute towards the support of the Government, as nearly as possible, in proportion to their respective abilities.'

The canon of economy

Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the State.

The soundness of these principles is obvious. The canon of certainty has chiefly to do with tax legislation. Tax laws must leave nothing uncertain. The amount of the tax payable and the manner of payment must be precisely laid down. The rights of the subject and the rights of the tax collector must be clearly defined. No arbitrary power should be left with the tax collector.

Secondly, if the tax has to be collected without trouble, the time of collection of the tax must coincide with the time when the subject is best able to pay it. Thus land revenue should be collected after the harvest and not during sowing time when cultivators are hard up.

Thirdly, the cost of collection must be as little as possible. A tax, a large portion of the yield of which is spent in collecting it, is no good. A tax may also offend against the canon of economy in another way without costing the State very much to collect it. Thus an indirect tax may create an opportunity for the assessees to realize a larger amount than they actually pay. This may often happen in a sales tax at a very low rate. The sellers collect from the consumers much more than they pay to the State as tax.

We have up to now discussed several principles by which taxes are to be judged. In the first place, taxation must not unduly hamper business or the productive activities of men. Secondly, taxation must not reduce savings of individuals and corporations so as to stand in the way of the maintenance and progress of the productive organization of society. Thirdly, taxation must not seek to remove inequality, though it should mitigate it. Fourthly, taxation must be progressive. Fifthly, no taxation should be imposed on those who cannot maintain a minimum standard of living though the idea about the minimum standard must vary from country to country and from time to time. Sixthly, the canons of economy, convenience and certainty must be observed.

An administrator can hardly find a tax which satisfies all of these six principles. He has often to face a conflict of principles and as a practical man he can only pick and choose. The degree of violence that a tax does to each principle is of course very relevant in the matter of picking and choosing. A tax will certainly not be

tolerated that kills business or requires the bulk of its yield for collection or hits only the poor, however well it may satisfy the other principles. Equity may often have to be purchased by an additional half per cent on the cost of collection; in order not to hinder saving, he may have to stop short of the ideal state of equity; for the sake of equity he may have to tolerate a certain impairing of productive efficiency and so on. Thus we have already said that a hundred per cent tax on rents may not impair productive efficiency but may be extremely unfair under certain circumstances. Taxes on commodities are often likely to disturb business; and they will of course be regressive and therefore unfair. But still many administrators resort to them for the sake of ease of collection and because they are concealed under a rise of price. However great a weightage one may give to these two considerations, taxes on necessaries are hard to justify; for it seeks to deprive the poor people of a part of their necessaries for existence and it makes the poor poorer while affecting the rich very little. Income-tax has been supposed by economists to be the best of taxes. It is progressive. It is a tax on surplus and as such it affects neither price nor business. As it is a comprehensive tax, disturbance of business by transference of capital and labour from one line to another need not be feared. It generally has an exemption limit and therefore does not affect those who have not got adequate means to maintain a minimum standard of living. But it is not faultless. First, it may under certain circumstances (which hardly exist in India) reduce savings. Secondly, as it is at present levied in India it does not satisfy the canon of convenience for it is due to be paid a year after the profits have been earned when the circumstances of the assessees may change very materially. Thirdly, under certain circumstances (which hardly exist in this country) it may disturb business by transference of capital to other countries.

A country's taxation cannot of course be judged except by reference to the size of the expenditure required. When a war is on, all the principles may have to be violated. A war may require not only all savings but even capital. The job of the economist under such circumstances is simply to analyse and point out the effects of particular lines of action, so that the country may choose the best taxation policy under the circumstances and when it chooses a particular line it may also be forewarned of the consequences.

This is the only way to avoid the worst consequences and to maintain the strength of the country.

In times of peace also the determination of the size of the necessary expenditure must precede the choice of the taxes to meet it. This is a simple logical sequence which requires no detailed explanation. As a tax is only a means to an end, the means can be determined and judged only by reference to the end. It is only after the amount necessary to raise is known that the taxes that will raise the amount in the best possible way can be thought of. The task of the economists is to point out the best distribution of the tax burden, given a particular volume of expenditure.

The economist's task in respect of selection of taxes cannot of course be pursued purely from the standpoint of economic science. His task is often hampered by other strong considerations.

The first and most important limitation is obviously the constitution. No tax can be recommended which the constitution does not authorize the Government to levy. The classification of taxes in the Government of India Act, 1935, is a very unscientific one, if it can be called a classification at all. Moreover the taxes that occur on the Provincial Legislative List are mostly such as economists would condemn. But Provincial Governments have to depend on these taxes alone for the support of their activities. Hence the task is often reduced to a choice between a bad tax and a worse tax. The best that can be done is therefore to improve the taxation system as far as possible within the limits of the constitution and with sufficient regard to the policy of expenditure.

But even then the politician can hardly listen to the economist's advice *in toto*. Here comes the second limitation imposed by the demands of contemporary politics. To the politician expediency may override all other considerations. He may choose those taxes which are productive and, at the same time, not objectionable to people with political influence. His political obligations may often override his sense of economic justice. But after all, he cannot but be influenced by the scientific analysis of the economist. The economist's duty is to place before the Government and the country a correct analysis of the position so that all may understand the nature and implications of the measures.

II

THE CONSTITUTIONAL BACKGROUND

EVERY man in British India lives under the taxing jurisdiction of three or four different authorities who compete with one another for taxing him within the limits set by the constitution.

The first claimant on his pocket is the Central Government with their income-tax, customs duties and excise duties. If he is poor and earns less than Rs2,000 a year, he may escape from the income-tax but no man can escape untouched through the wide net of customs and excise duties. A man may avoid paying the duties on motor-cars or on petrol or on many other things, but no man can avoid paying the duties on salt, matches, kerosene and the like.

Another claimant on his purse is the Government of the Province in which he lives or owns property or carries on business. All Provincial Governments levy land revenue, excise duties on wines, country spirit, ganja, opium, bhang, etc., various kinds of stamp duties and Court-fees. Most Provincial Governments will tax him if he uses a motor-car or an electric light or fan, or whenever he goes to a cinema or to a football match or to a race-meeting. Some Provincial Governments will also tax him if he buys tobacco for private consumption or has an agricultural income above a certain figure. If he is a man living in Madras, the Punjab or Bengal he will be taxed on almost all purchases that he may make. A man by carrying on business in different provinces or by making sales or purchases in different provinces may come under the taxing jurisdiction of all of them at the same time.

The third claimant on his purse is the district board or the municipality according as he lives in a rural area or a town area. They generally impose a cess or tax on land.[1] The municipalities levy various other kinds of taxes and fees besides the land tax.

The man living in a rural area is sometimes taxed by a fourth authority, viz. village authority variously designated. (The union

[1] As far as the district boards are concerned the cess is actually levied by the Provincial Governments and the proceeds of collection are made over to the boards.

board or a panchayat) which levies a rate on all persons except the poorest living under its jurisdiction.

A man may, of course, be subject to the taxing jurisdiction of more than one local authority at the same time, as he may be subject to the taxing jurisdiction of more than one province at the same time.[1]

The next important point about the Indian taxation system is that the powers of taxation vested in each class of taxing authority are strictly limited by enumeration. In the American or the Canadian types of the Federal Constitution, the residual powers are vested either in the federating units or in the Centre. But there is no authority in India which enjoys the residual powers or whose powers are not strictly limited by specific enumeration. As Chief Justice Gwyer points out, 'The attempt to avoid a final assignment of residuary powers by an exhaustive enumeration of legislative subjects has made the Indian Constitution Act unique among federal constitutions in the length and detail of its Legislative Lists'. (In the matter of the Central Provinces and Berar Sales of Motor Spirit and Lubricants Taxation Act, 1938.)

The Government of India Act, 1935, makes a twofold division of taxation powers. Certain specified powers of taxation are given to the Central Government while other specified powers of taxation are given to the Provincial Governments. The Provincial Legislatures again can transfer and have transferred some of their own powers of taxation to the local authorities, e.g. the municipalities, the district boards and the union boards. These local authorities can, therefore, exercise powers of taxation strictly according to the Acts of the Provincial Legislatures. A tax of a local authority is subject to judicial challenge on two grounds, viz. that it is *ultra vires* of the Provincial Act empowering the local authority to levy the tax; or that the Provincial Act itself is *ultra vires* of the Government of India Act, 1935; for in order that it may delegate a power of taxation to a local authority, the Provincial Government themselves must have the power.

The following are the two lists of taxes which the Central and the Provincial Governments are respectively competent to levy:

Taxes which the Central Government can levy:

Duties of custom, including export duties.

[1] For a detailed discussion of such double taxation see Part V, Chapter III.

Duties of excise on tobacco and other goods manufactured or produced in India except—

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics, non-narcotic drugs;

(*c*) medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (*b*) of this entry.

Corporation tax.

Taxes on income other than agricultural income.

Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies, taxes on the capital of companies.

Duties in respect of succession to property other than agricultural land.

The rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts.

Terminal taxes on goods or passengers carried by railway or air; taxes on railway fares and freights.

Taxes which Provincial Governments can levy are:

Land Revenue.

Duties of excise on the following goods manufactured or produced in the province and counterveiling duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics, non-narcotic drugs;

(*c*) medicinal and toilet preparation containing alcohol or any substance included in sub-paragraph (*b*) of this entry.

Taxes on agricultural income.

Taxes on lands and buildings, hearths and windows.

Duties in respect of succession to agricultural land.

Taxes on mineral rights, subject to any limitations imposed by any Act of the Federal Legislature relating to mineral development.

Capitation taxes.

Taxes on professions, trades, callings and employments subject to a maximum of Rs50 per year from a person or company.

Taxes on animals and boats.

Taxes on the sale of goods and on advertisements.

Taxes on vehicles suitable for use on roads, whether mechanically propelled or not, including tram-cars.

Taxes on the consumption or sale of electricity subject, however, to the provision of section 154A of the Government of India Act.

Cesses on the entry of goods into a local area for consumption, use or sale therein.

Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

The rates of stamp duty in respect of documents other than those specified in the first list with regard to rates of stamp duty.

Dues on passengers and goods carried on inland waterways.

Tolls.

The constitutional position is thus as follows:

The Central Government can levy only the eight taxes as specifically enumerated in List I to the Seventh Schedule to the Government of India Act, 1935, and can levy no other.

The Provincial Governments can levy only the seventeen taxes as specifically enumerated in List II to the Seventh Schedule to the Government of India Act, 1935, and can levy no other.

The local authorities cannot levy any tax outside the seventeen provincial taxes and within that list they can levy only such taxes for levying which they have been specially authorized by an Act of the Provincial Legislature.

This is the constitutional framework within which the taxation system functions.

There are two more general restrictions on the taxing powers of the provinces:

(*i*) They must not restrict the freedom of inter-provincial trade by the levy of a discriminatory tax on such trade (section 297 of the Government of India Act, 1935).

(*ii*) In case of conflict of jurisdiction between the Central Government and the Provincial Government, the interests of the former must prevail.

The first restriction is enacted by sub-section (*b*) of section 297(1) of the Government of India Act, 1935. It runs as follows:—

No Provincial Legislature or Government shall.....
by virtue of anything in this Act have power to impose any tax, cess, toll or due which, as between goods manufactured or produced in the Province and similar goods not so manufactured or produced, discriminates in favour of the former, or which, in the case of goods

manufactured or produced outside the Province, discriminates between goods manufactured or produced in one locality and similar goods manufactured or produced in another locality.

Thus a Provincial Government levying a sales tax or a cess or a toll cannot levy discriminatory rates as between goods produced in the province and similar goods coming from outside; nor can they levy a sales tax on goods coming from outside only, while exempting similar goods produced in the province. If the Government of Bengal with a view to encouraging the bidi-making trade in Bengal levied a sales tax on bidis coming from other provinces while exempting or levying a lower rate on bidis produced in the province, the tax will be *ultra vires* of the Government of India Act, 1935, though Entry 48 to the Seventh Schedule to the Government of India Act authorizes Provincial Governments to levy a sales tax on any commodity. Similarly, a Provincial Government levying a use tax on motor vehicles cannot levy preferential rates on cars made in the province as against foreign cars or on British cars as against French cars or on cars made in Bihar as against cars made in Bombay.

This is a fundamental restriction and governs all taxation powers of the Provincial Governments. It is important to note that taxation on goods of inter-provincial commerce is not forbidden as such. What is forbidden is not any taxation on inter-provincial trade but discriminatory taxation in restriction of such trade. As Justice Sulaiman puts it, 'The power to tax is not taken away, only preference is prohibited'. (In the matter of the Central Provinces and Berar Sales of Motor Spirit and Lubricants Taxation Act, 1938.)

A comparison of our position in this respect with that of the United States of America is interesting. There, the federal constitution provides that 'the Congress shall have power to regulate commerce with foreign nations and among the several States, and with the Indian tribes'. The Supreme Court has interpreted this to mean that no part of the power of the Centre over inter-State commerce, including the power to tax it, can be exercised by the States. At first the Court ruled out only such State taxes 'as discriminated against inter-State commerce as compared with similar intra-State business and did not look with disfavour upon taxes burdening inter-State and intra-State commerce equally. In 1877 this position was abandoned when a State licence on all salesmen

was held to be invalid, as applied to salesmen taking orders for merchants located outside the taxing States.[1] Thus in the United States of America any restriction of inter-State commerce by a State tax is unconstitutional irrespective of whether it is discriminatory or not. A sale that takes place in a State in pursuance of a contract which requires the seller to obtain the goods for his customer from outside the State is outside the taxing jurisdiction of the State even though the State might be levying a general sales tax on all goods. The idea is that the sale takes place in inter-State commerce over which the State has no power. These State taxes have got to be discriminatory to a certain extent in favour of outside goods.

Whether there is any restriction of inter-State commerce or not is, however, very strictly construed. Only direct and obvious restrictions are held to be hit by the constitution. Indirect restrictions are allowed; and here the States can choose to be discriminatory against outside goods. The Courts allow this by drawing a distinction between inter-State commerce and facts occurring after the inter-State commerce is over. Thus the *use* of an article is supposed to be a fact which takes place after the inter-State commerce is over; hence the State has got full power of taxation over it. As the State is competent to tax the use of all articles, it can on the basis of the dictum 'the whole includes the part' certainly tax the use of any specified portion of those articles, say, the imported portion only to the exclusion of other articles. Thus in the United States of America a State can impose a tax which may be discriminatory or non-discriminatory, but it must not impose any restriction on inter-State commerce directly.

In India the position is different. A Provincial Government can by their taxation policy impose any amount of restriction on inter-provincial trade provided the same amount of restriction is imposed on the internal trade of the province as well. This equal treatment of goods produced in the province and outside must not be confined to any particular stage of their trade life but must continue through all stages in their trade life. Whether it is a sales tax or a toll or a *use* tax or a cess or an *octroi*, it must apply equally to both classes of goods. The important point is that there must be no discrimination. Thus in a provincial sales tax, the Provincial Government need not consider whether the sale is the consummation

[1] Jacobi, *Retail Sales Taxation*, page 139.

of a prearranged piece of inter-provincial commerce. They can tax such sales, if they want to. But they cannot levy a *use* tax or any tax on those goods only which come from outside without at the same time imposing the same tax at the same rate on the goods produced within the province.

Thus in the U.S.A. the State Governments must not handicap inter-State commerce *directly*; they may be discriminatory if they can manage to be so without directly affecting inter-State commerce. In India the Provincial Governments must not be discriminatory as between goods produced in the province and outside or as between goods produced in different localities outside the province. They can impose handicaps on inter-provincial trade, if they can do so without being discriminatory.

The second restriction on the powers of the Provincial Governments has been enacted by sub-sections 1 and 3 of section 100 of the Government of India Act, 1935. The effect of the *non-obstante* clause in section 100(1) read with the opening words of section 100(3) is to make the federal power prevail if federal and provincial legislative powers overlap. This makes the question of definition of the various taxes appearing in the Provincial and Federal Lists an extremely important one, though the taxes have not been defined in the Act. It was on the basis of this restrictive section (section 100) that the first case between the Central Government and the Provincial Governments was fought before the Federal Court.

The Government of the Central Provinces and Berar passed an Act called the Central Provinces and Berar Taxation of Motor Spirit and Lubricants Taxation Act, 1938, levying a tax on the retail sales of petrol and lubricants. The Central Government challenged the Act on the following argument:

The commodities (i.e. motor spirit and lubricants) intended to be taxed by the Central Provinces and Berar Act could be divided into two portions, viz. the portion produced in India and the portion imported. The tax on the home-made portion was bad on the following grounds:

(*a*) A tax on the retail sales of an article produced within the country was nothing but an excise duty and as such came under entry 45 of the Federal List. The Provincial Governments were not therefore competent to levy such a tax.

(*b*) Even if the tax levied by the Act was 'a tax on the sale of goods' as contemplated in entry 48 of the Provincial List, it was a clear case of overlap (so far as the tax on the home-made article was concerned), the tax being covered both by entry 48 of the Provincial List and entry 45 of the Federal List. Hence according to section 100 of the Government of India Act, the entry in the Federal List must prevail and oust the jurisdiction of the Provinces.

It was next argued, that if the tax on the home-made portion was wrong on these grounds, the tax on the imported portion only was wrong by the operation of section 297 of the Government of India Act as it would then become a discriminatory tax, giving preference to home-made goods as against imported goods.

Important decisions were reached by the Court in this case. Justice Sulaiman held as follows:

Thus a duty on goods manufactured or produced is distinct, separate, and independent from a duty on their sale and (except probably at the stage of the first sale) there seems to be no good reason why they may not co-exist without overlapping.

He therefore found that there being no overlap, the Provincial Governments were competent to levy the tax on the authority of entry 48 of the Provincial Legislative List.

The Chief Justice and Justice Jayakar made important decisions about the interpretation of the *non-obstante* clause and from the standpoint of the Provincial Governments the decisions were as valuable as they were fundamental.

Chief Justice Gwyer held as follows:

It is a fundamental assumption that the legislative powers of the Centre and Province could not have been intended to be in conflict with one another, and therefore we must read them together and interpret or modify the language in which one is expressed by the language of the other .... A general power ought not to be so construed as to make a nullity of a particular power conferred by the same Act and operating in the same field, when by reading the former in a more restricted sense, effect can be given to the latter in its ordinary and natural meaning. This is not to ignore the *non-obstante* clause, still less to bring into existence, as it were, a *non-obstante* clause in favour of the Provinces: for if the two legislative powers are read together in the manner suggested above, there will be a separation into two mutually exclusive spheres, and there will be no overlapping between them.

On the basis of practically the same principles, Justice Jayakar held as follows:

On a careful review of the whole question, I am therefore inclined to hold that Parliament intended—

(1) that, as regards goods centrally excisable, taxes on their sale within the province for purposes of consumption, when such taxes are in no way connected with their production, manufacture, etc., within the province, but are imposed on their sale in the province merely as existing articles of trade and commerce, should be exclusively within the competence of the Provincial Legislature;

(2) that, save as aforesaid, all duties of excise on those goods, whether levied and collected at the stage of manufacture, production or any subsequent stage up to consumption (exclusive of sale in the province, as stated above), should remain exclusively within the competence of the Centre.

The value of this ruling to the Province can be easily seen. All possible cases of conflicts between an entry in the Provincial List and an entry in the Federal List should no longer be taken to nullify the jurisdiction of the Provinces. All possible attempts should be made to reconcile the two entries, if necessary by attributing a restricted meaning to the entry in the Federal List, if that would lead to a reconciliation.

This brings us to the next important feature of the Indian Constitution, viz. that the tax jurisdiction of the Central and Provincial Governments are exclusive. In many federal constitutions, e.g. U.S.A. or Australia, there are several taxes including the income-tax which can be levied by both the Centre and the Component units at the same time. But the Government of India Act of 1935 contemplated no such tax. If the Centre is competent to levy it, the Provinces cannot levy it and vice versa. Though there is a concurrent Legislative List, no tax occurs in that List. Fees, however, on subjects appearing in the concurrent Legislative List, can be imposed concurrently by the Centre and the Provinces.

The same tax, similar both in form, content and base, can be levied by a Provincial Government and by the local authorities within its jurisdiction. The local authorities derive their powers of taxation from the Acts of the Provincial Legislatures. The Provincial Legislatures can authorize local authorities to levy only those taxes which they themselves are competent to levy. The Provincial Legislatures cannot, however, by their own Acts divest themselves of a power of taxation which has been vested in them by the Government of India Act. Therefore, whenever a Provincial

Legislature passes an Act authorizing the local authorities within its jurisdiction to levy a particular tax, the power to levy that tax co-exists in the local authorities as well as in the Provincial Government. Constitutionally speaking, both of them can exercise the same power at the same time. Whether they will do so or not is purely a question of policy and not of law. The Provincial Government and the local authorities are the only persons to determine the policy in this respect.

This principle of exclusiveness of the tax jurisdictions of the Centre and the Provinces has often been forced on public attention. Some of the most energetic debates in the Provincial Legislatures took place recently on this question. More taxation measures were passed by the Provincial Legislatures during the first three years of provincial autonomy than under any equal period in the history of the Provinces. The first line of opposition was in most cases based on the ground of *ultra vires*. The argument generally was of the following pattern:

The tax proposed to be levied by the Bill under discussion comes under some entry in the Federal List and as tax jurisdictions are exclusive, the Provincial Legislatures are not competent to levy the tax.

There is hardly any taxation measure of importance in which this plea was not taken. The first important case is of course the Central Provinces and Berar Sale of Motor Spirit and Lubricants Taxation Act. The objection raised by the opposition was hotly debated and was ruled out of order by the Speaker on the merit of the case. This case, as we have seen already, was taken to the Federal Court by the Government of India, and the Court gave its decision against them, laying down certain valuable principles about the interpretation of apparently conflicting entries in the Legislative Lists. A few other important cases in which the same point was debated in the Provincial Legislatures are:

(*i*) The Madras General Sales Tax Act, 1939.

(*ii*) The Bengal Finance Act, 1939.

(*iii*) The U.P. Employment Tax Bill, which has an important history of its own.

Two incidental questions arise in this connexion. How far can or should a Speaker stop the discussion of a Taxation Bill on the ground that it is *ultra vires* and what are the checks on his power in this respect? Secondly, what is the remedy of the subject

if a Legislature proceeds to levy a tax which it is not competent to levy according to the constitution?

The Speaker's power in this respect appears to be quite autocratic. In the Assembly his rulings are final. Nor can these rulings be challenged in any Court of law. Section 87 of the Government of India Act makes them absolutely final. So a Speaker can thwart a Government and prevent the discussion of its Taxation Bills by ruling them out as *ultra vires*. If he does so, the Government have no remedy against his decision except by appealing to him to revise his own ruling. The only remedy of the Government against an obstructive Speaker is to have him removed by persuading the Legislature to pass a resolution to that effect under sub-section (2) of section 65 of the Government of India Act, and then to have a new Speaker elected.

The Speakers of the Legislative Assemblies of Bengal and the United Provinces sought to establish a very good convention in this respect. During the discussion of the Bengal Finance Bill, 1939, the Speaker, in ruling out the objection of *ultra v.res*. said:

I feel that at the outset I should make a definite decision on this point as to what extent the Speaker can interfere in this matter. I might say this is a matter which is engaging the attention of Speakers of all the Provinces as to what extent the Speaker should interfere in a matter which might ultimately come to the Federal Court, and it is the unanimous agreement that in a legal matter or any other which is likely to be brought before the Federal Court, the Speaker by his decision should not stand in the way. If it is a matter which is wholly beyond the competency of the Legislature, the Speaker should not give a decision, but it must go to the Federal Court.[1]

On further enquiry, the Speaker explained, 'I did not say, he cannot, but he should not and certainly, in case I find that I am palpably convinced that a matter is beyond the competency of the Legislature, I shall give my decision on the matter to that effect, and what I have said in this connexion should not be taken as an absolute proposition'.

This seems to be an adequate conception of the Speaker's duties in this respect.

The ruling which the Deputy Speaker of the United Provinces Assembly gave on a similar occasion during the debates on the

[1] The official *Report of the Assembly Proceedings*, Fifth Session, 1939, 7th March, 1939.

United Provinces Employment Tax Bill is still clearer and goes a step further:

From what I know of the Government of India Act and the Rules and the Standing Orders I think the Chair has not the power to declare a Bill as *ultra vires*. I asked the honourable members to point out any provision either in the Government of India Act or the Rules or the Standing Orders by which the Chair has such power. No specific provision was pointed out. Only an appeal was made to use the inherent power of the Chair. It appears to me that the inherent power cannot be extended so far. The Speaker has power to control the discussion in the House but he has no power to give his decision on the merits of the subject-matter of the discussion. If I were to decide that the Bill is *ultra vires* or otherwise I shall be giving decision on the subject-matter of the discussion. I feel that it will not be proper for the Chair to give any decision in a matter like this. From the Government of India Act, I find that there is a remedy for those who feel aggrieved by this Bill to resort to the Federal Court. In such circumstances it will not be just that the Chair should exercise the function of the Federal Court. Recently I came across a ruling of the Council of State in which a similar point of order was raised. A Bill was introduced and it was contended that the Bill was *ultra vires* of that House. After full consideration, the President of the Council of State ruled that he would be the last to kill a Bill by declaring that it was *ultra vires*.[1]

During the next day's debate on the same Bill, the Advocate General of the Province, who was called in to give his opinion on certain points of law, spoke on the floor of the Assembly regarding the ruling of the Deputy Speaker as follows:

I think the ruling that you have given is one of the soundest rulings because if it had been held that the Bill was *intra vires* or *ultra vires* it would not have been binding either upon this side of the House or upon the other side but the Government might have been placed in a very awkward position if you had ruled that it was *ultra vires* . . . .

A voice: Are we to understand that your rulings are not binding on this House? We were all along under the impression that the ruling of the Chair was binding on each and every member of the House.

The Advocate General: My friend seems to have misunderstood me. I never meant the rules upon the points of order. A ruling whether a certain measure is *ultra vires* or *intra vires* would not be

[1] *Proceedings of the Legislative Assembly of the United Provinces* (Thursday, 16th March, 1939), Volume XIV, pages 449-50.

binding upon any member of this House, or upon the public outside.

The Deputy Speaker: The Advocate General means that if I had decided that the Bill was *ultra vires* that decision may not have been binding on the merits but it would have been binding so far as the further consideration of the Bill was concerned.[1]

The Deputy Speaker very logically draws a distinction between the merit of a question and the conduct of the debate on it. A point of order concerns only the latter and the Speaker's power is supreme on that point. But as regards the former the Speaker has no power. So he should not stop the discussion of a subject by going into its merit and giving a ruling thereon, i.e. on its merit. If he does so, he goes beyond his legitimate sphere. He can, of course, control the conduct of discussion but he should not say anything on the merit of the subject under discussion. If in the name of controlling the conduct of discussion, he stops it on the ground that, in his opinion, the subject-matter of the discussion was not good either in law or in policy, he clearly oversteps the limits of his powers. There is, however, nothing to prevent him from doing so, if he so chooses. No Court of law will take cognizance of his action. The persons who are interested in the debates, in most cases the Government, are therefore put in a very awkward position. The only constitutional way to hold the debate is by removing the Speaker and electing a more reasonable Speaker. This is what the Advocate General means when he says that the Speaker's rulings *on points of order* are final. No Court, however, will take cognizance of what he says on the merit of a case. He may rule a particular Bill to be *intra vires* and the Legislature may pass the Bill into an Act but the Act may still be challenged in the Court by anybody. This is what the Advocate General means when he says that the Speaker's ruling on the merit of a Bill is not binding on anybody.

The view taken by the Deputy Speaker of the United Provinces Assembly is really 'one of the soundest rulings', as the Advocate General of the United Provinces has said. The decision given by the Speaker of the Legislative Assembly, Bengal, is also the same, though he modified his ruling by saying, 'what I have said in this connexion should not be taken as an absolute proposition'. The

[1] *Proceedings of the Legislative Assembly of the United Provinces* (Friday, 17th March, 1939), Volume XIV, page 520.

less the Speaker goes into the merits of questions or usurps the function of the Federal Court, the better for all concerned.[1]

The second question is what can be done by a citizen when the Provincial Legislature proceeds to levy a tax which it is not competent to levy and the Speaker does not rule the Bill out of order. Some enthusiastic oppositionists have thought of going to a Court for an injunction to restrain the Legislature from discussing the Bill. This is impossible. It is an established principle of British constitutional law that a Court does not take cognizance of anything short of a criminal offence happening inside the Legislature. This principle has been recognized by section 87 of the Government of India Act, 1935, which ousts the jurisdiction of Courts in this matter. So at the stage of discussion, the subject has no remedy but it does not matter as at this stage he is not affected by the decision. The remedy is available only after the Bill has been enacted and enforced. It is then that he can bring a suit to have the Act declared *ultra vires*.

The idea of exclusiveness of the tax jurisdictions of the Centre and of the Provinces has thus been quite well known and frequently made use of in debates. The simultaneousness of the tax jurisdictions of the Provinces and the local authorities has also been forced upon public attention by several important cases of concurrent exercise of such powers. The most well-known case is the Bombay Urban Land Tax Act, 1939. The city of Bombay and almost all municipalities in India levy a tax on land values which is the mainstay of their finances. The Provincial Government of Bombay also levied an additional tax of ten per cent on the annual value of land in the city of Bombay and a few other municipalities. The municipal tax and the provincial tax are levied on the same base, collected in the same way and by the same machinery. This Act drew a lot of public attention at the time it was passed. The Punjab has followed suit recently. A less well-known case is that of the Bengal Finance Act of 1939 which levies a flat rate tax of Rs 30 only on all persons in profession, calling, business or employment exempting those who do not pay income-tax. The city of Calcutta as well as several municipalities in Bengal levy a licence tax on professions,

[1] The President of the Central Legislative Assembly has held that 'the question whether a legislative proposal is *ultra vires* or not cannot be decided by the Chair on a point of order'.—*Debates*, Vol. II, dated 18th March, 1943, p. 1442.

callings, and business and in these cases the provincial tax is only an additional tax on the same base.

The constitutional position in this respect is thus as follows:

The fact that the Central Government can levy a tax is proof of the fact that the Provincial Governments cannot levy the same tax and vice versa. The fact that a local authority can levy a tax is proof of the fact that the Provincial Governments are also competent to levy the tax but not vice versa. A citizen may therefore be taxed on the same base by the Province and by a local authority; but he cannot be taxed on the same base both by the Centre and by the Province, though both can tax him on different bases.[1]

The taxation power of the Provincial Governments is subject to the general restriction that they cannot adopt a policy of preferential taxation in favour of the goods made in the province nor can they impose a tax according preferential treatment on goods made in one locality outside the province as against goods made in another locality outside the province.

There is one more overriding restriction on the powers of taxation of the Provincial Governments and that restriction applies to the Central Government as well. A law imposing a tax must not discriminate against the British or the Burmans. If it does so, it becomes *ultra vires* of the constitution. Section 112 of the Government of India Act which enacts this provision runs as follows:

112—(1) No Federal or Provincial law which imposes any liability to taxation shall be such as to discriminate against British subjects domiciled in the United Kingdom or Burma or companies incorporated, whether before or after the passing of this Act, by or under the laws of the United Kingdom or Burma, and any law passed or made in contravention of this section shall, to the extent of the contravention, be invalid.

(2) Without prejudice to the generality of the foregoing provisions, a law shall be deemed to be such as to discriminate against such persons or companies as aforesaid if it would result in any of them being liable to greater taxation than that to which they would be liable if domiciled in British India or incorporated by or under the laws of British India, as the case may be.

Thus a law imposing a tax cannot accord a preferential treatment to Indians as against the British or the Burmans.

The right to levy a tax should be kept distinct from the right to retain its yield. Though the Centre and the Provinces cannot levy

[1] For a discussion of the implications of this, see Part V, Chapter III.

the same tax they can share the yield of the same tax, or the Provinces can enjoy the entire yield of a Central tax.

First, there is the case of compulsory sharing. The constitution provides that the yield of certain taxes levied by the Centre is to be shared with the Provinces. They are taxes on income other than agricultural income and export duty on jute (sections 138 and 140).

Secondly, there is the case of optional sharing. Section 140 of the Government of India Act, 1935, provides that the proceeds of other export duties, duties on salt and the federal duties of excise may be shared with the Provinces if an Act of the Federal Legislature so provides. A share of the proceeds of these duties have not been given to the Provinces yet.

The constitution also provides for a few taxes which may be levied by the Central Government but of which the yield is to go wholly to the Provinces (section 137). They are:

(*i*) Duties in respect of succession to property other than agricultural land;

(*ii*) Such stamp duties as are mentioned in the Federal Legislative List;

(*iii*) Terminal taxes on goods or passengers carried by railway or air; and

(*iv*) Taxes on railway fares and freights.

The initiative in undertaking these measures rests with the Central Government though they will not get anything out of the proceeds. The Central Legislature is to pass the Bills imposing these taxes though it will have no control over its appropriation or expenditure. The Centre has not for obvious reasons felt interested in such measures and none of the taxes except the second, which was already in existence, has been levied yet. It is yet to be seen how this divorce between the responsibility for raising money and that for spending it works in actual practice.

No tax is contemplated in the constitution which is to be levied by the Provinces but of which the yield is to go partly or wholly to the Centre. The Provinces may, however, levy taxes for giving away the yield wholly or partly to the local bodies. Thus the yield of the road cesses levied by the Provincial Governments are given away entirely to the local bodies.

Apart from the cases expressly provided for in the constitution, the executive Governments, Central and Provincial, can make grants out of their respective revenues to each other, provided the respective

Legislatures vote the demands for grants. There is nothing in the constitution which prevents making such grants subject to the general limitation of section 150 of the Government of India Act, viz. that the revenues must be spent for the purposes of India. At present a portion of the import duty and excise duty on petrol levied by the Centre is given away to the Provinces through the Central Road Fund. A Provincial Government also could make a similar grant to the Centre or to any other Province but such cases are not likely to be many.

It will appear that the Provincial Governments are given the following sources of tax revenue:

(*i*) the separate provincial taxes;

(*ii*) a share in the yield of certain Central taxes which the Centre must share with them;

(*iii*) a share in the yield of certain other Central taxes which the Centre may, at their option, share with them;

(*iv*) the whole of the yield of another group of Central taxes which the Centre may agree to levy for their benefit; and

(*v*) subvention from the Central Government on the basis of section 150 of the Government of India Act, 1935.

During the short period for which the constitution has functioned, the Provinces had to depend on (*i*) and (*ii*) only, though on occasions, (*v*) has been available for specific purposes and to a very small extent. How far the arrangement works and at the same time secures financial adequacy as well as financial independence for the Provincial Governments is still to be seen.

We next come to the question of definition and classification of the taxes appearing in the Legislative Lists of the Government of India Act, 1935. The question is of great importance to the student of constitutional law in view of the exclusiveness of the tax jurisdictions of the Centre and the Provinces and in view of the necessity to resolve any conflict in the case of overlap. To the economist, however, the problem is entirely different. He studies taxes not for resolving any conflicts between the two lists but with a view to studying their effects on the economic motives and economic satisfaction of the people. The only business of the constitutional lawyer is to ascertain the correct intention of Parliament from the words of the Statute, irrespective of its economic effects. He refers to the economist, as he refers to words of common parlance, only when economic terms have been used in the Act but have not

been defined. Thus in the matter of the Central Provinces and Berar Sales of Motor Spirit and Lubricants Taxation Act, 1938, the Judges of the Federal Court frequently referred to books of Economics with a view to ascertaining the meanings of the terms 'excise tax' and 'sales tax'. But the economist's definition may not be of any use to the Court in this respect. Chief Justice Gwyer pertinently observed:

It was argued on behalf of the Provincial Government that an excise duty was a tax on production or manufacture only and that it could not therefore be levied at any later stage... This contention... confuses the nature of the duty with the extent of the legislative power to impose it.

Economists will tell us the nature and implications of a particular duty in respect of its impact on economic motives and satisfactions, but they can never tell us whether Parliament intended that this duty, in its entire scope, should be imposed by this Government or that.

The classification made by the Legislature must necessarily be different from the classification made by the economist as the objectives are different. The list of taxes given in the Statute is by no means a logical classification. Certain taxes were being levied in India when the Statute was passed and a few others, e.g. taxes on agricultural income, duties in respect of succession to agricultural land, did not exist at the time but were intended to be placed within the competence of the Governments in India. A language and a classification were used in the Statute which were thought adequate for the purpose of description and comprehensiveness. The law-maker never cared to follow the economist's classification, nor did he care for the economic effects of such taxes. In this respect there is a fundamental difference between the constitutional lawyer and the economist.

An economist in studying the taxes appearing in the Government of India Act will not divide them into 25 classes (17 Provincial and 8 Central) but would divide them probably into two classes only. If he follows Mill's classification he will divide them into direct and indirect taxes or if he follows Edgeworth's classification, he will divide them into 'taxes on surplus' and 'taxes on margin'. It is only such classifications that will help him in analysing, understanding and explaining the effects of such taxes on economic motives and economic satisfaction. He will be shocked to see a

class of taxes being described as 'taxes on lands and buildings, hearths and windows' (entry 42 of List II of the Seventh Schedule to the Government of India Act). For a tax on windows is, to the economist, the classical example of a bad tax whereas a tax on lands is to him the specimen of a good tax as it is a tax on surplus. To him it is shocking to see the best taxes and the worst grouped together. To the constitutional lawyer, however, the entry is perfectly good as it expresses the intention of Parliament quite clearly.

It is highly desirable that makers of constitutions and economists should be in close contact in order that good results may be obtained by both. This is specially important in a constitution in which it is sought to limit the powers of all taxing authorities by specific enumeration. The power of taxes to affect economic motives and economic satisfactions is too well known to require any elaboration. The business of Government is to select those taxes which, consistently with their financial needs, have the least adverse effects on economic motives and economic satisfactions. Governments by their taxation policy can materially affect production and distribution; they can create or destroy economic motives for production and can increase or decrease the sum total of human satisfaction. It follows that Governments, before making a selection of their taxes, cannot be too careful in their investigations and studies. The maker of a rigid constitution should therefore make himself conversant with the economic reactions of taxes. A knowledge of an economic classification of taxes is therefore essential to the maker of the constitution.

The economist, too, must know the taxes which can be imposed under the constitution. He must proceed on facts. It is no good studying very good taxes if only the bad taxes can be imposed under the constitution. The taxes which can be imposed under the constitution are the only taxes that can be studied by the economist in operation. His business is therefore to study them, to criticize them, to analyse their effects, to suggest improvements within the limits of the constitution and finally to suggest modification of the constitution if the bad effects of taxation cannot be otherwise eliminated.

PART II

TAXES ON THINGS

I

SALES TAXES—AN INTRODUCTION

SALES taxes are the most important group of provincial taxes introduced under the Constitution of 1937. They are based on entry 48 of the Provincial Legislative List, i.e. List II of the Seventh Schedule to the Government of India Act, 1935.

The scope of the entry was the subject of decision in two cases before the Federal Court:

(1) Re: the Central Provinces and Berar Sales of Motor Spirit and Lubricants Taxation Act, 1938.[1]

(2) The Province of Madras *vs.* Messrs Boddu Paidanna & Sons.[2]

The decisions in the two cases have established beyond doubt the competence of Provincial Legislatures to levy taxes on the sale of goods whether by the manufacturer or by the wholesaler or by the retailer.

Sale, as understood in the Indian Sale of Goods Act, is a transfer of property in the goods for a consideration. The transfer of property in the goods does not necessarily mean the physical transfer of the goods themselves, and consideration also does not necessarily mean cash payment. Hence, goods may be sold without being delivered and also without being paid for. Sale is complete as soon as there is an agreement transferring the property in the goods and there is consideration for the same act, whether cash payment or promise of payment or any other consideration.

It follows that sales may be concluded in a place different from the situation of the goods sold. Wholesale sales of standardized goods in large quantities often take place in a locality different

[1] 1939, F.C.R. 18.

[2] Federal Court Case No. 3 of 1942. (On appeal by the Government of India the Privy Council, in their judgement delivered in January, 1945, confirmed the decision of the Federal Court.)

from the locality of the goods. Personal inspection or delivery is generally insisted on in retail sale or when the goods sold are not standardized and the buyer cannot satisfy himself about their quality except by personal inspection.

It is important to note that the Provincial Governments can levy a tax on the sale of *goods* and not on the sale of services. In transactions of everyday life goods and services are often sold together and it is difficult to separate them for the purpose of taxing the one to the exclusion of the other. The commonest instances of such cases are contracts for building houses or for installing machinery. Such contracts involve the sale of goods, e.g. the materials, as well as of services, e.g. those of the labourers, the engineers, the architects, etc. The two are so mixed up in the transaction that it is difficult to separate them for the purpose of taxing only the goods involved in the transaction. Similarly, a barber may use shampoo at the time of shaving or a jeweller or a tailor may sell jewels or cloth while executing orders, and so on. These have been difficult problems for the Provinces seeking to impose the tax on the sale of goods. Different Provinces have tried to solve them differently. We shall see these different attempts at solution presently.

II

CLASSIFICATION OF PROVINCIAL SALES TAXES

THE commonest sales tax in the country is the tax on the retail sales of motor spirit which is levied in every province except Orissa. The other sales taxes in India have been imposed by the following Acts:

(1) The Madras General Sales Tax Act IX of 1939.
(2) The Madras Tobacco (Taxation of Sales and Licensing) Act VIII of 1939.
(3) The Bombay Sales Tax Act V of 1939.
(4) The Assam Sales Tax Act V of 1939.
(5) The Bengal Finance (Sales Tax) Act VI of 1941.
(6) The Punjab General Sales Tax Act of 1941.

Of these, the Bombay Act, in its application to mill-made cloth, and the Assam Sales Tax Act have not yet been enforced.

Besides, there are other statutes which impose licence taxes or fees on sellers of certain commodities, e.g.

(1) The Tobacco Duty (Town of Bombay) Act IV of 1857.
(2) The Bombay District Tobacco Act, 1933.
(3) The C.P. and Berar Tobacco Act VIII of 1939.
(4) The Madras Regulation of the Sale of Cloth Act XII of 1937.
(5) The N.W.F.P. Tobacco Vend Fees Act, 1938.
(6) The Bengal Tobacco (Sales Licensing) Act of 1935 levied such a tax for a period of three years and has since lapsed.

Apart from the licence taxes on sellers, sales taxes levied in India fall into the following classes:

(*a*) Retail sales tax on specified articles. Taxes on the sale of motor spirit are the commonest example of this class.
(*b*) A single-point wholesale tax on specified articles. The only example of it occurs in the Bombay District Tobacco Act.
(*c*) Turn-over tax on specified articles. The Madras Tobacco Sales Tax is the only example of it.

(*d*) A single-point sales tax or virtually a retail sales tax on goods in general. The Bengal Sales Tax is the only example of this type.[1]

(*e*) The general sales tax or the turn-over tax. The Madras and the Punjab General Sales Taxes are the examples of this type.

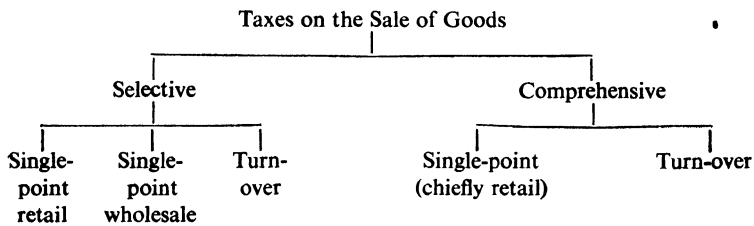
These five classes, again, come under two broad categories, viz.

(*i*) Sales taxes on selected articles or Selective Sales Taxes.

(*ii*) Sales taxes on goods in general or Comprehensive Sales Taxes. Specified articles may or may not be exempted from such a tax.

Under (*i*) would come (*a*), (*b*) and (*c*) while (*d*) and (*e*) would come under (*ii*). A single-point wholesale sales tax on goods in general is not practicable on a provincial basis.

The following table shows the classification at a glance:



[1] The Bihar Sales Tax introduced in 1944 belongs to this class.

III

SELECTIVE SALES TAXES

TAXES ON THE SALE OF MOTOR SPIRIT

TEN out of eleven provinces in British India have imposed sales taxes on motor spirit, Orissa being the only exception. They are all retail sales taxes and the retailers invariably recoup themselves from the consumers according to a well-recognized trade practice. The tax is easily collected as the sale of motor spirit is specialized and is regulated by the Indian Petroleum Act. In some provinces the tax is collected by the District Collectors, in some by the Provincial Excise Department, and in some by the Commercial Tax Department; but the manner of collection is practically the same everywhere.

There is variation from province to province in the rates as well as in the scope of the definition of motor spirit. The variation is shown in the table below:

The Scope of Taxation and Rates thereof

Name of Province	Scope	Rate
Central Provinces ..	All hydrocarbons, i.e. mineral oils and liquids containing hydrocarbons are taxed, irrespective of flash point. Hence petrol, Diesel oil, crude oils are taxed. Power alcohol in its pure state escapes taxation but in admixture with petrol, Diesel, etc., is taxable.	Five per cent of sale price.
Bihar	Ditto	One anna and six pies per gallon.
United Provinces ..	Ditto	Two annas per gallon.
The Punjab ..	Ditto	One anna and three pies per gallon.
Assam ..	Ditto	Two annas per gallon.
North-West Frontier Province	Ditto	One anna and three pies per gallon.

Name of Province	Scope	Rate
Bombay ..	Any liquids, oil or not, but having a flash point below 76° are taxed. Hence only petrol and power alcohol separately or in admixture are taxed. Diesel and crude oils are not taxed.	One anna per gallon or 6¼ per cent *ad valorem* whichever is less.
Sind	Ditto	Ditto
Madras ..	Any substance except kerosene, furnace oil, coal, or charcoal which is used for fuel for automatic or stationary internal combustion engines. Hence petrol, Diesel, crude oils, power alcohol are all taxed.	One anna and six pies per gallon on petrol or a mixture of petrol and power alcohol. Six pies per gallon on Diesel, crude oils and pure power alcohol.
Bengal	Ditto	Ditto
Orissa ..	No tax in the province.	....

The price of petrol is regulated by the trade and is well known. The sale is confined to the richer class of citizens. The tax is, in all provinces except the Central Provinces and Berar, specific and not *ad valorem*. The tax is therefore easily passed on to consumers. The trade cannot collect from the consumers something more than the tax, as it sometimes does in the cases of *ad valorem* general sales taxes or *ad valorem* retail sales taxes on goods in general.

Though it is a tax on consumption and has got the defects inherent in such a tax, it is a good tax in that it taxes the well-to-do section of the community which alone uses petrol.

It was at first causing some dislocation of trade on the borders of taxing provinces but with the extension of the tax to all the provinces (except Orissa) the area and extent of dislocation have very much narrowed down. The cause of dislocation still exists only on the common boundary of a taxing province and a non-taxing Indian State and on the common boundary of two taxing units to the extent of the difference in the rates in force in the two units.

Before Bengal had adopted this tax, the Pandu-Shillong Transport Companies of Assam were buying their petrol from Bengal and the Government of Assam found it difficult to stop this source of leakage of revenue. Now that Bengal has levied a similar tax, the strength of the motive for buying in Bengal has very much weakened

and is now measured by the difference of six pies per gallon in the rates of taxation in force in the two provinces. In 1939, the buses of Madura were taking their supply of petrol from the Padukota State with a view to avoiding the sales tax on petrol.

Bengal, however, loses no trade to Orissa as, Bengal being the only channel of supply to Orissa, the price of petrol in Orissa is higher than in Bengal by more than the amount of tax payable in the latter province.

IV

SELECTIVE SALES TAXES

TAXES ON THE SALE OF TOBACCO

NEXT to motor spirit, tobacco is the commonest subject of a selective sales tax, though it is yet a distant second. Tobacco is now taxed under special Acts in Madras, Bombay, the Punjab, Central Provinces and Berar, and North-West Frontier Province. It was taxed in Bengal under a special Act for a period of three years immediately preceding provincial autonomy, but the Act lapsed and was not renewed. Recently, however, all tobacco except hookka tobacco is being taxed in Bengal as a part of the scheme of the single-point sales tax on goods in general. In the Punjab also it comes under the scheme of the General Sales Tax recently introduced in the province.

Taxation of tobacco is not as uniform in its scope and methods as the taxation of motor spirit. There is wide variation from province to province.

In Madras, tobacco is taxed by a turn-over tax. In Bombay city, there is a combination of an octroi and a licence fee on sellers. In other parts of Bombay there is a licence fee on sellers with or without a single-point sales tax on wholesale sale. In the C.P. and Berar and in the N.W.F.P., it is only a licence fee on sellers, and in Bengal, before autonomy, it was the same under the Special Act which has since lapsed. In Bengal and the Punjab it is now a part of the bigger scheme of a comprehensive sales tax under which it is taxed along with other articles.

It will be noted that no province levies a simple retail sales tax on tobacco, as in the case of motor spirit.

MADRAS

The Madras Tobacco (Taxation of Sales and Licensing) Act, 1939, levies a high rate turn-over tax on *manufactured* tobacco. The rates are as follows:

Retail dealers:

(*a*) If the annual turn-over does not exceed Rs 200.	Rs 6 a year, i.e. 8 annas per month.

(*b*) If the annual turn-over exceeds Rs 200 but does not exceed Rs 400.	Rs 12 a year, i.e. Re 1 per month.
(*c*) If the annual turn-over exceeds Rs 400.	3% on the first 400 and 10% on any excess above that sum.
Wholesale Dealers	2% on the actual turn-over.

There is no exemption of smaller dealers as in the case of the General Sales Tax of Madras. All dealers, big or small, retailers or wholesalers, must pay the tax.

The author saw in March, 1940, a small grocer's shop in a village near Madura in Madras. A small boy of about twelve years of age was in charge of it at the time. His entire stock was worth not more than five rupees. His stock of tobacco was about a dozen bidis and about half a dozen cigarettes of a cheap variety. His daily sale of bidis and cigarettes was about one anna's worth but he paid for that a tax of eight annas a month. This worked out to over twenty-five per cent on his sales. Asked why he dealt in tobacco at all, he explained that unless he stocked it, he would lose customers who expected to find all their ordinary requirements in one place. As there was no bazaar in the village the expectation was normal.

Though the exact amount or proportion of the tobacco tax revenue collected from such small assessees is not shown separately in the Annual Administration Reports issued by the Board of Revenue, Madras, the figures furnished therein give clear indication of the importance of this group of assessees both in respect of number and the revenue. The following figures are relevant:

(1) Year	(2) Demand of the tax in the year	(3) Total number of assessees doing business on the closing day of the year	(4) Number of assessees with turn-over not exceeding Rs 200 in the year doing business at the close of the year	(5) Amount of tax payable by the number in col. 4 if all of them were in business for the whole of the year
	Rs			Rs
1939-40 (8 months)	9,63,165	203,028	136,616	8,19,696
1940-41	16,00,267	162,708	109,071	6,54,426

The figures in columns 2, 3 and 4 are taken from the Appendices to the Annual Administration Reports issued by the Board of Revenue, Madras. The figures in column 5 are obtained by multiplying the figure in column 4 by 6 (Rs 6 being the annual tax payable by an assessee of this group).

It is probable that all the assessees in column 4 did not pay the tax for the whole year but there is no doubt that the majority of them did. The figures above indicate clearly the outstanding importance of the small assessees both in respect of number and of revenue. It is these assessees who paid the bulk of the revenue in the first year and a very high proportion of the revenue in the second year.

The hardship caused to small assessees is obvious. Though the tax is as high as ten per cent on big retailers, it works out to over twenty-five per cent in the majority of cases which affects the poorest of men.

It is no wonder that many small sellers of tobacco had to give up the line on account of the tax. The first Annual Administration Report notices this as follows:

A large number of retail dealers, particularly among those whose turn-over did not exceed Rs 200 per annum, have, however, discontinued business in tobacco, presumably as a result of the tax. The majority of these are probably 'bunk' keepers who in the past have sold a little tobacco as a side line but do not find it profitable since the tax was introduced.

This process continued in the second year as the figures quoted above will show. It has been stated in the Annual Administration Report for 1940-1 that the small assessees 'who have disappeared' were mostly those petty dealers who used to sell manufactured tobacco along with other goods and who have since given up trading in tobacco.

As far as the wholesale end of the trade is concerned, the rate of the tax is two per cent on the value of wholesale sales. This creates the tendency, first, to cut down the number of wholesale sales to the minimum and, secondly, to transact wholesale business from outside the province of Madras, if possible. The first tendency operates in two ways. Either the wholesaler converts himself into a commission agent or the wholesaler is absolutely cut out. Instances of both have been noticed. A man in Madura was importing bidis from Malabar and was selling them

on his own behalf. He paid the tax for two months after its introduction and then converted himself into an agent. The bidi manufacturers of Tinnevelly have got a considerable trade with Madura. Before the Tobacco Sales Tax came into operation, they did their business through wholesalers at Madura. But since the introduction of the tax the wholesalers have been wiped out and the manufacturers supply directly to the retailers in their own buses.

The most conspicuous example of the second tendency was the transfer by the Imperial Tobacco Company of its wholesale business from Madras to Bangalore on the introduction of the sales tax.

The first reaction of business to the sales tax is to re-arrange and re-adjust itself in various ways in order to avoid the tax. The next step, when such devices fail, is to go away from the area of taxation. Retail trade, of course, cannot leave the area of taxation except on the border line; but under favourable circumstances wholesale trade can easily be transacted from a distance.

In Madras the tax is levied only on manufactured tobacco which means cigars, cheroots, cigarettes, cigarette tobacco, pipe tobacco, bidis, snuff, but does not include any preparation or mixture of tobacco intended for a further process of manufacture, e.g. tobacco dust meant for bidi manufacture. But the wholesale dealers of tobacco in any form, except the growers, have to obtain a licence. So also the retail dealers of manufactured tobacco, manufacturers of tobacco, and brokers and commission agents or dealers of tobacco in any form must obtain a licence and in each case a licence fee is charged. Retail dealers in unmanufactured tobacco, viz. tobacco leaves, hookka tobacco or chewing tobacco need not obtain any licence and they do not pay any tax.

For the North Indian student it is important to note that hookka-smoking is not popular in Madras. The agriculturists do not smoke hookka: they smoke only bidis or cheap cigarettes. So, the exclusion of hookka tobacco in Madras does not arise out of a desire to grant relief to the poorer section of the people: it is neglected because its use is negligible.

Bombay

In Bombay the tax on tobacco is levied under two Acts, viz.

(*i*) the Tobacco Duty (Town of Bombay) Act;

(*ii*) the Bombay (District) Tobacco Act.

The former Act has been in force since 1857 and the latter was enacted in 1933. Both the Acts were amended and the rates of the tax under both were raised in 1938.

The Town of Bombay Act levies two taxes, viz.

(*i*) a tax of thirty rupees per maund[1] popularly known as the maundage tax on all tobacco imported into the town of Bombay. The tax must be paid immediately on import; or the tobacco shall be stored in a public or licensed warehouse and the duty shall be paid at the time of removing the tobacco therefrom for consumption in the town of Bombay. Remissions or refunds of the tax are granted on re-export.

(*ii*) A licence fee is levied on all retail dealers who are classified into five exhaustive classes, viz.

(*a*) superior tobacco ordinary retail dealer,
(*b*) inferior tobacco ordinary retail dealer,
(*c*) superior tobacco trade retail dealer,
(*d*) inferior tobacco trade retail dealer,
(*e*) superior or inferior tobacco temporary retail dealer.

Any sale of tobacco not exceeding fourteen seers [2] (of eighty tolas to the seer) is deemed to be a retail sale and nobody is allowed to make a retail sale without a licence. Rates of licence fees on these five classes of dealers are as follows:

Class (*a*)	.. ..	Rs 48
Class (*b*)	.. ..	„ 24
Class (*c*)	.. ..	„ 2
Class (*d*)	.. ..	Re 1
Class (*e*)	.. ..	„ 1 per day (subject to a maximum of Rs 25 in the case of inferior tobacco and Rs 50 in the case of superior tobacco).

Superior tobacco is defined as cigars, cigarettes and manufactured tobacco ready for use for rolling cigarettes. All other varieties of tobacco are called inferior tobacco.

This Town of Bombay Act yielded the following revenue during the last few years:

[1] One maund equals 82·29 lb.
[2] One seer = one-fortieth of a maund = 2·057 lb.

Year	*Bombay City*
1934-35	Rs 14,34,276
1935-36	„ 16,61,531
1936-37	„ 16,56,940
1937-38	„ 17,41,299
1938-39	„ 19,78,911
1940-41 (Budget) ..	„ 20,25,000

The definitions of superior tobacco and inferior tobacco under the Bombay District Tobacco Act are the same as under the Town of Bombay Act. The definition of wholesale sale and retail sale are, however, different. Wholesale sale under this Act means a sale to traders in tobacco for the purpose of trade; retail sale means a sale other than a wholesale sale.

This Act read with the rules made thereunder levies a licence fee on sellers of tobacco all through the province except the town of Bombay and a single-point *ad valorem* sales tax in a few notified towns outside the town of Bombay. All sellers of tobacco must be licensed and a separate licence is required for dealing in each Taluka, each urban area and each area in which an *ad valorem* duty is levied.

A person holding a licence for wholesale sale is to pay the following licence fees according to his turn-over of the previous year:

Previous year's turn-over	*Rate of licence fee*
Below Rs 500	Rs 2-8-0
Rs 500 to Rs 999	„ 5-0-0
Rs 1,000 to Rs 2,999	„ 10-0-0
Rs 3,000 to Rs 9,999	„ 20-0-0
Rs 10,000 to Rs 19,999	„ 40-0-0
Rs 20,000 and over	„ 50-0-0

Besides, in a few notified towns an *ad valorem* sales tax is levied at twelve per cent on the last wholesale sale in the chain of turn-over. The retailers in the said towns are forbidden to sell tobacco bought from wholesalers outside the town.

For taxing retail sales the province outside the town of Bombay is divided into two classes of areas, as follows:

(*a*) the first class includes all the villages in the province and many of the towns. Over this area a fixed rate of two rupees per year is levied on all retail sellers;

(*b*) the second class consists of a few notified towns in which a higher licence fee is levied on superior and inferior tobacco subject to the maxima of fifty rupees and twenty-five rupees respectively.

The District Tobacco Act yielded the following revenue during the last few years:

Year	*Revenue*
1934-35	Rs 4,92,613
1935-36	„ 2,37,906
1936-37	„ 2,29,817
1937-38	„ 2,32,012
1938-39	„ 2,57,306
1940-41 (Budget) ..	„ 3,91,000

Here we have got the most important example of octroi and also the only example of a high *ad valorem* tax on wholesale sale of a specified article. The taxation of wholesale sale has been made possible in this case by the following devices:

(*a*) The tax is confined to a few notified towns and is levied in respect of sales of one article only;

(*b*) The tax is levied on the last wholesale sale in the chain of transactions; and

(*c*) The retailers in the town are, by law, compelled to buy their supplies from wholesalers within the town and are prevented from obtaining their supplies from outside the town.

The good features of the tax are:

(*a*) that a higher rate is levied on superior tobacco consumed by the richer class of people and a lower rate is levied on inferior tobacco consumed by the poorer section;

(*b*) that a higher rate is levied in the city of Bombay and in some notified towns whereas a lower rate is levied in the rural areas and the smaller towns.

But an annual tax even if it is only of two rupees may also operate harshly on a dealer like the one noticed in the village near Madura.

Bengal, North-West Frontier Province, Central Provinces and Berar, and the Punjab

Under the Bengal Tobacco (Sales Licensing) Act, 1935, tobacco meant 'the leaves and stalks of the tobacco plant and includes

any preparation or admixture thereof which is intended for the purpose of smoking or chewing or for use as snuff'. Section 4 of the Act reads as follows:

No person shall sell wholesale or retail, or for the purpose of sale, expose or keep any tobacco except under a licence. . .

Provided that a person who, either himself or with the aid of members of his family or by labour paid in cash or in kind, grows tobacco, either on his own land or on the land of another in return for a share of the produce, may, without such a licence either himself or through a member of his family acting on his behalf, sell or for the purpose of sale, expose or keep, any tobacco so grown or any preparation or admixture thereof.

Under section 5, the higher limit of licence fees was set at six rupees for a wholesale licence and three rupees for a retail licence.

This Act produced the following revenue:

Year	*Yield in thousands of rupees*
1935-36	174
1936-37	319
1937-38	337
1938-39	130

Note.—The Act came into force on 1st September, 1935, and expired on 31st August, 1938. (The figures are taken from the civil budget estimates of the province.)

The Act was to be in force for three years only, and as it was very unpopular and became an election topic in the General Elections of 1937 it was not renewed when it lapsed.

The North-West Frontier Province Tobacco Vend Fees Act, 1938, follows the Bengal Act of 1935 but does not distinguish between wholesale sale and retail sale, all sellers being taxed similarly. There is also the exemption of the grower in respect of sales of tobacco grown by him with or without some processing or preparation. The fees levied are low as was the case in Bengal.

Under the Central Provinces and Berar Tobacco Act, 1939, tobacco 'includes bidis, cigarettes and cigars, the leaf, stalks and stem of the tobacco plant and any preparation or mixture of tobacco'. Under section 3 of the said Act, 'no person other than a retail dealer in a village with a recorded population of two thousand or less than two thousand or a hawker shall deal in tobacco except under a licence . . .'

...'Provided that a grower may, without licence, sell tobacco (other than bidis, cigarettes, cigars and any preparation or mixture of tobacco) grown by him.'

The rates of licence fees levied are:

WHOLESALE

(*a*) A person, other than a manufacturer, who deals wholesale .. .. Rs 125

(*b*) A manufacturer who deals wholesale for each set of premises where tobacco is both manufactured and issued or only issued or distributed, with an additional Rs 10 for each set of premises where it is manufactured or collected, provided that no additional fee shall be leviable in respect of premises where the manufacture of tobacco is carried on without the assistance of hired labour either on daily or piece rates .. .. Rs 125

RETAIL

Every retail dealer in

(1) a village with a recorded population of more than two thousand and not more than five thousand .. Rs 5

(2) a village or town with a recorded population of over five thousand,

(*a*) in respect of a stall including a stall which can be moved bodily although it may be temporarily fixed Rs 5

(*b*) in respect of a shop with fixed premises the annual rental value of which

(*i*) does not exceed Rs 50 .. .. .. Rs 10

(*ii*) exceeds Rs 50 but does not exceed Rs 150 .. Rs 15

(*iii*) exceeds Rs 150 but does not exceed Rs 500 .. Rs 20

(*c*) in respect of a shop the annual rental value of which exceeds Rs 500—

(*i*) in which a retail dealer deals in tobacco other than superior tobacco .. .. .. Rs 25

(*ii*) in which a retail dealer deals in superior tobacco Rs 50

Explanation. For the purposes of this Schedule, 'superior tobacco' means cigars, cigarettes and manufactured tobacco ready for rolling cigarettes or for use in pipes.

The C.P. and Berar Act attempts the most complicated system of graduation in respect of the tax on retail sellers. The graduation is based on as many as five factors which are:

(*a*) the density of population in the locality of the seller;
(*b*) whether the seller is a hawker or not;
(*c*) whether the stall of the retail dealer, other than a hawker, is bodily removeable;
(*d*) the annual rental value of the stall;
(*e*) whether the tobacco sold is superior or inferior.

All hawkers are exempt. So also are all retail dealers in villages with a population of two thousand or less.

All retail dealers, not being hawkers, who sell in villages with a population of over two thousand but not over five thousand shall pay only a lump fee of five rupees a year. The other factors of graduation come into operation in villages or towns with population of over five thousand and the highest rate of fees in force there is fifty rupees a year.

The chief purpose of such a complicated system of graduation is obviously the exemption of the poorest consumers and the poorest dealers and taxation at a higher rate of the better class of dealers serving a better class of consumers. The system, however, is very complicated and probably unnecessarily so.

The Punjab Tobacco Vend Fees Act, 1934, is a simple measure. It is in force only in municipalities, small towns, cantonments, railway stations and in such other areas as may be notified. It levies a small licence fee on all dealers of manufactured tobacco in those places. Manufactured tobacco is defined to be 'tobacco in any shape or form intended for the purpose of smoking, chewing or for use as snuff, or any preparation or admixture of tobacco intended for the said purpose or use and includes bidis, cigarettes or cigars'. A grower who sells manufactured tobacco is exempt and need not obtain a licence.

The two objectionable features of the Madras Act are:

(*a*) By its system of flat rate taxation, it has been especially hard on the poorest dealers and the poorest rural population. Small sellers of tobacco have, in fact, gone out of the trade in large numbers on account of the tax.
(*b*) By its high *ad valorem* taxation of wholesalers of all grades, it is driving out wholesale trade from the province.

The province of Bombay displays much consideration for distributing the tax burden on equitable principles and for causing as little injury to trade as possible. It taxes superior tobacco at a

higher rate than inferior tobacco. In the city of Bombay and in certain other selected towns the higher taxation is effected either through an octroi or through an *ad valorem* sales tax. Throughout the province low licence fees are levied on wholesale sellers as well as on retail sellers. The relief to the poorer men comes both through the lower taxation of inferior tobacco and through the lower taxation in rural areas and in smaller towns. But the lower taxation in rural areas may yet cause hardship to a large number of petty dealers.

The C.P. and Berar Act, as pointed out already, displays the greatest consideration for equity. It carries much further the basis of graduation adopted in Bombay and has evolved the most complicated system of graduation.

The Bengal Act levied and the N.W.F.P. Act levies a very low rate tax on all dealers in tobacco. As it was or is a very low tax, there was no attempt at graduation. But a tax of three rupees on a village retailer, as noted in the case of Madras, may cause great hardship and the fact that the tax played an important part in the General Election of 1937 in Bengal goes to show that it was causing real hardship in the province.

A licence tax is an addition to the cost of a dealer. It is therefore a tax on the margin and in the long run increases the price of the article sold. In exceptional cases like those of the petty dealers in Madras villages, the tax may not go wholly into the price of tobacco. It may under such circumstances increase the price of tobacco by a portion only of the tax levied. The remaining portion may go to increase the price of other articles sold by such dealers, as the stocking of tobacco is necessary only to push the sale of those other articles, or it may, in the short period, fall partly on the dealers themselves; and this means that the dealers on the margin will in the long run be wiped out, creating inconvenience for consumers or reducing the sale of articles including tobacco.

In a tax of the graduated pattern like that of the C.P. and Berar, shifting takes place in the usual way. In a town where three shops of different sizes stand side by side, having annual rental values of fifty rupees, one hundred and fifty rupees and five hundred rupees respectively and being taxed at the rates of ten rupees, fifteen rupees and twenty rupees respectively, shifting is easily done. For, the bigger the shop, the bigger the turn-over and the

same percentage added to the price will probably yield the varying amounts of the fees to the different shops or if a uniformity in price yields more than the fee to any shop, it will really make a profit, at least in the short period, out of the tax. But when two villages stand side by side—one with a population of two thousand and another with a population over two thousand, the larger village is likely to lose custom to the smaller one. With varying rates in force in adjoining villages, administration must be difficult and such transfer of custom must to some extent frustrate the chief purpose of the variation and is a source of leakage of revenue.

The Punjab Act is a simple and mild measure confined to selected affluent localities and calls for no special comment.

From what has been said, it is clear that the taxation of tobacco is in need of reform.

The tobacco habits of the people in India are so clearly demarcated according to their means that it should not be difficult to devise a measure for an equitable taxation of tobacco which is neither difficult nor expensive to administer.

People with money smoke cigars, cigarettes and cheroots, etc., while agriculturists and people of the poorer classes smoke hookka (or sometimes bidi) in northern India and bidis only in southern India. The demands of equity will therefore be satisfied, without introducing any expensive complication, simply by exempting hookka tobacco and bidis and by confining the tax to cigars, cigarettes, cheroots, snuff and other such varieties of manufactured tobacco.

The tax may take the form of a uniform retail sales tax throughout the province. If a higher tax is intended to be levied in selected towns the Bombay example of an octroi or a tax on wholesale sales, accompanied by the same devices for safeguarding the trade, may be levied in addition to the uniform retail sales tax. Further complications as in the C.P. and Berar are unnecessary.

Such a tax will be easy to administer and will yield good revenue. It will be equitable in that it will fall on well-to-do persons. It will not dislocate trade appreciably. There will, of course, appear a tendency for transfer of consumption from the taxed varieties to the non-taxed ones but the tendency is not likely to develop very far because those who smoke these superior varieties are well off and do so mostly for distinction as well as for flavour for which most of them will be both willing and able to pay a higher price.

V

OTHER SELECTIVE SALES TAXES

THE Bombay Sales Tax Act V of 1939, imposing a sales tax on mill-made cloth and the Assam Sales Tax Act V of 1939, imposing sales taxes on several articles of luxury, are the only other Provincial Acts that were passed under autonomy to impose sales taxes on specified goods. The taxes, however, were not enforced.

ASSAM

The Assam Sales Tax Act sought to levy a tax on retail sales of such articles of luxury and at such rates as shall be specified in the annual Assam Finance Acts. It was thus merely an empowering Act. The extraordinary feature of it was that it left to the annual Finance Acts not only the fixation of the rate or rates of the tax but also the determination of the articles to be taxed, the only restriction being that they must be articles of luxury—after all a vague term.

Subsequently, the Assam Finance Act X of 1939 provided that the tax levied under Act V of 1939 shall be a tax at the rate of five per cent on retail sales of motor cars, motor cycles and wireless sets.

But the tax was not actually levied for fear of driving out the entire trade in these articles from the province.

These are high-priced articles. A five per cent tax on their retail sales would amount to a considerable sum. Even without the tax many buyers in Assam prefer to buy these goods in Calcutta where they can find a wider selection. As Assam takes her supply of these goods through Calcutta, buying in Calcutta does not involve any extra cost of transport; it may mean an additional journey to and from Calcutta but the buyer does not often mind it for the sake of the wider selection he finds there. Under such circumstances a five per cent tax on retail sales of such goods in Assam would certainly drive out the small retail trade in these goods which still takes place in Assam because the tax payable is greater than the cost of a journey. Even when the buyer is not willing to undertake

the journey to Calcutta he may just indicate his choice to the dealer, who may arrange to complete the contract of sale outside Assam. Such avoidance is inevitable as long as there is a five per cent tax in Assam with practically no tax in Bengal.

In this connexion we may examine the implications of the explanation to section 2(*g*) of the Bengal Finance (Sales Tax) Act, 1941, which is apparently intended to check avoidance consequent on arranging sales outside the province. The explanation is as follows:

> Notwithstanding anything to the contrary in the Indian Sale of Goods Act, 1930, the sale of any goods which are actually in Bengal at the time when the contract of sale (as defined in that Act) in respect thereof is made, shall, wherever the said contract of sale is made, be deemed for the purpose of this Act to have taken place in Bengal.

With such a provision in force, an essential condition of avoidance is the existence of the goods outside the taxing province at the time of sale. But in the case of Assam which takes her supply of these goods from Calcutta, the condition is already there. Hence, a provision like this would be of no avail to Assam in checking avoidance of the tax imposed under the Assam Sales Tax Act.

A provision like the one contained in the explanation quoted above is effective under the following circumstances:

(*i*) *When the goods, the retail sales of which are taxed, are imported direct into the province from overseas.* A consumer buying retail does not generally go in for buying an article which is yet lying across the seas. If then retail sale of the imported goods must take place after their arrival at the port of the taxing province, a mere shifting of the place of sale without shifting the goods themselves would be of no avail for the purpose of avoidance, with a provision in force like the one contained in the explanation quoted above. In order to avoid the tax it is necessary that the goods shall first be moved out of Bengal and then brought back into the province for consumption after a Bengal consumer has bought it outside the province. The double cost of transport involved in such a method of avoidance together with the little extra cost involved in arranging the sale outside the province is an effective check on such avoidance. It is assumed (*a*) that the tax payable is not higher than the additional expenditure required for the double transport, etc., and (*b*) that the tax payable is not higher than the

additional expenditure required for arranging to import the goods through a port outside the province.

It is clear that without the explanation the 1·9/16 per cent sales tax on articles like motor cars could have been avoided by arranging the contract of sale at French Chandernagore without moving the car itself out of Calcutta. With the explanation, it is not possible, as the moving of the car itself would not be worth while for avoiding the low tax.

(*ii*) *When the goods, the retail sales of which are taxed, are manufactured in the province imposing the tax.* For reasons exactly similar, the avoidance in respect of such cases will be effectively checked by the explanation.

Though the explanation may check avoidance under the circumstances stated above in a province which manufactures the goods or imports them direct from overseas, it may have other harmful effects. Let us suppose that motor cars freely competing with one another were manufactured in Bengal and in Tatanagar in Bihar and were also imported from overseas. Suppose also that a retail sales tax is imposed on motor cars in Bengal and that there is no such tax in Bihar. For reasons explained above, imported cars and cars manufactured in Bengal and consumed within the province cannot avoid the tax. The cars manufactured in Bihar and sent out for consumption in Bengal can avoid the tax by arranging the retail sales before the cars enter the province. The result will be that Bengal cars and imported cars will be either ousted from the Bengal market or the tax will have to be borne by the manufacturers thereof. The Bihar cars will enjoy a preference in the Bengal market on account of the sales tax in Bengal.

It is obvious that in retail sales taxation such instances occur only in the case of high-priced standardized commodities when there is a tax in one province with no tax or a lower tax in another. The difficulty would not arise if the province imposing the tax had a monopoly in respect of the production of the goods the retail sales of which are taxed. But such cases are non-existent. The difficulty would also not be felt in the case of ordinary low-priced articles as the retail sale of such articles across the provincial boundary is not a practicable proposition except very near the boundary.

The example of the Assam Sales Tax is important because it forces attention to the overriding importance of the practical

aspect of the question. It demonstrates the difficulty of isolated action on the part of a Provincial Government in imposing a retail sales tax on high-priced standardized goods, partly or wholly imported from or through another province.

It is pertinent to observe here that the Government of Assam quite unnecessarily adopted this futile tax. A *use* tax was being levied on motor cars and motor cycles in the province at the time by the Assam Motor Vehicles Taxation Act, 1936. If the Government of Assam wanted to impose additional taxation on the users of these motor cars and motor cycles, the easiest method would have been an increase in the rates of the taxes levied on these vehicles by the Act of 1936. It was also easy to levy a *use* tax on radio sets, if the Government wanted to tax them. The Government of Assam committed an obvious error in adopting the sales tax method of taxing these articles instead of the simpler and the already existing *use* tax method.

BOMBAY

The Bombay Sales Tax Act, 1939, provided for the levy of a tax at a rate not exceeding six and a quarter per cent on the values of the sale of mechanically manufactured cloth whether manufactured in the province or imported into the province. The tax was not to be levied at more than one stage and was not to be levied on the sale by a manufacturer producer or importer except on retail sale.

Thus it was a retail sales tax on mill-made cloth. Hand-loom woven cloth was not taxed. In so far as hand-loom woven cloth competed with mill-made cloth, it was a discriminatory tax and affected the mills adversely. Moreover, the finest and the costliest cloth is often hand-loom woven. It is bought by the rich and to that extent there was hardly any justification for this exemption. The discrimination was good in so far as by extending the business of the hand-looms it sought to do good to the weavers who are often very poor. It was also good in so far as coarse hand-woven cloth is worn generally by poorer people who were therefore relieved of the tax by this exemption.

The tax, however, was not enforced and was subsequently repealed. Cloth is hardly a suitable subject of a special sales tax as it is largely a necessity of life. If it is to be taxed at all, a better scheme would be to levy the tax on cloth, whether mechanically manufac

tured or hand-woven, selling for a price above a limit of, say, ten rupees a piece in the case of a dhoti or a sari, or ten rupees a yard in the case of shirting, coating, etc.[1] The twofold classification of cloth may not be exhaustive and probably other categories with a suitable price limit for each will have to be recognized after enquiry.

[1] A scheme of taxation of cloth on these lines was introduced by the Bengal Finance (Sales Tax) Amendment Act, 1944. See Appendix.

VI

LICENCE TAX ON SELLERS

The Madras Regulation of the Sale of Cloth Act

By the Madras Regulation of the Sale of Cloth Act (XII of 1937) all sellers of cloth or of articles of wearing apparel made of cloth, other than persons who sell exclusively hand-woven cloth or articles of wearing apparel made therefrom, are subjected to a licence fee in respect of each shop or place of business at the following rates:

(*a*) Two rupees, where the monthly turn-over of business in the shop does not exceed three thousand rupees.

(*b*) Five rupees, where such monthly turn-over exceeds three thousand rupees.

The motive behind the Act was protection of the hand-loom industry. A member of the Government in defending the measure on the floor of the Assembly said, 'Competition is encroaching much upon it and it is time that some protection is given to this industry'.[1]

The Act was considered by the Government as a preliminary step to further protection if necessary. The same minister said in course of the same speech:

By passing this Bill a census will be taken of the dealers of hand-loom products and of the others, they will be classified and we will then know how many of them will have to pay the licence fees and how many will not have to pay. By passing this Bill, it is such a census that we will be facilitating. We will then know how this hand-loom industry stands and how further support can be given to it.

The manner in which the Act was intended to protect the hand-loom industry was described by the Prime Minister as follows[2]:

The object of the Bill is to give protection to the hand-loom. It is not a taxation measure. It may lead to taxation but it is not a taxation measure...

[1] *Official Report*—Vol. III, No. 13, 1937, p .938: Speech by Mr Yakub Hasan.

[2] *Ibid.*, p. 987.

The idea is that some of these very poor village hawkers will not prefer to continue dealing in mill cloth paying the licence fee, but may prefer to a great extent or a small extent to give support and encouragement to their neighbour, the hand-loom weaver... We are more particular that the small dealer, the small hawker should have to make a preference in favour of hand-loom cloth. We are not so particular about taxation that is to be levied from the big dealer. That is why, Sir, that whatever the volume of his business may be, it is proposed to levy a licence fee of only Rs 5. We are very particular that the village dealer should have a hurdle across his way. He should feel the effects of the hurdle. The slightest obstruction on the footpath makes us respond to the inertia, and we make a curve and just get round the obstruction. In the same way, this Rs 2 hurdle is just a little thing standing in the way of the small hawker just to make him take a little turn aside and take to the hand-loom product for sale if he feels it hard to pay this licence fee.

The picture of the economic world that underlies the argument of the Prime Minister is too simple.

First, the choice of occupations open to the displaced hawker is not so limited as the Premier supposes. Instead of becoming a hawker of hand-loom woven cloth, he may become an agricultural labourer or a day labourer on public works or a domestic servant or a labourer in a cloth mill where by competition with the existing labour force he may depress the level of wages and thereby bring an indirect boon to the mill industry which was not at all the intention of the Act.

Secondly, simply because a few men (a large result is by no means to be expected from this small fee) give up the hawking of mill-made cloth, the market for it need not be restricted at all. It may mean the weeding out of a few unnecessary hawkers or that the villagers have to go to the nearest bazaar instead of getting their cloth at their doors. No Indian villager would agree to change his preference or to pay a pie extra only for saving himself this journey which he has to make in any case almost twice a week for a hundred other things, for marketing his own produce or even for the sake of a diversion. He is not to be judged by the standards of the rich or the upper middle class with their indifference to small sums and dislike for journeys on foot.

Thirdly, the fee may have to be borne by the hawkers themselves and the only effect of the Act in that case is an unjustifiable taxation of the poor hawkers.

The only way in which a transference of demand from mill-made cloth to hand-loom woven cloth can be effected is by disturbing their comparative prices. There is a certain field in which hand-loom woven cloth does compete with mill-made cloth. In this field, the consumers are on the margin of doubt whether to buy the one or the other. The field of competition may be very limited but there is one, specially in the cheapest varieties and in fancy varieties or in certain special lines, e.g. mosquito nets, napkins, etc. The slightest change in price in this field in favour of hand-loom woven cloth will lead to a transference of demand. The slightest rise in the price of mill-made cloth without a corresponding rise in the price of hand-loom cloth will either extend the demand for hand-loom cloth or will enable the hand-loom industry to make larger profits by pushing up their prices also to the same level. Both courses will in the long run be advantageous to the hand-loom industry. But is an Act like the one under discussion likely to do so? The incidence and other effects of a low flat rate tax on sellers of a specified article are discussed below. Though the sellers are divided into two groups under the Act, the graduation is almost of a negligible character for the present purpose. It will appear from the discussion that follows that a low flat rate tax is not likely to disturb prices and so there is no likelihood of the expected transference of demand from mill-made cloth to hand-loom cloth.

A tax on all sellers is obviously a tax on margin. The marginal sellers cannot bear it. They will either go out of the field or will have to recoup themselves by an augmentation of the price.

In the case of an *ad valorem* tax on sales or a tax which is graduated according to turn-over, a rise of price by the full amount of the tax is inevitable, though a different result may ensue in the short period on account of some existing frictions in the market that may take time to overcome. In such a case no dealer is big enough to absorb the tax in the long period. Compared to smaller dealers, bigger dealers are more often at a disadvantage in this respect. For, ordinarily, the bigger the dealer, the smaller is his profit on each sale. Though the total profit of a bigger dealer may be larger than that of a smaller dealer or the percentage that the bigger dealer makes on his capital may be larger than that made by the smaller dealer, in many cases the smaller dealer generally makes a larger percentage on each sale, the advantages of the

bigger dealer lying in his quicker turn-over. Hence in respect of ability to absorb an *ad valorem* tax on turn-over, the bigger dealer may be in a worse position than the smaller dealer. The smaller dealer cannot, of course, set the price in the market, he gladly follows the price set by the bigger dealer; for, it is only by recouping himself to the full extent of the tax that he can retain his level of profits, a lowering of which would impel him to seek other lines of employment for his capital.[1]

The case of a low flat rate tax on sellers is, however, different. Though it is big enough to turn the marginal dealers out of the market, it is small enough for the bigger dealers to bear it themselves. The bigger the dealer, the less will he feel the tax and the less will be the impelling force on him to raise the price. It is also impossible to apportion a tax of, say, five rupees or ten rupees among sales worth lakhs or crores and competition will therefore effectively prevent the transference of this small burden to the buyers. As the bigger dealers will not raise the price, the smaller dealers cannot. The only effect, therefore, of the tax will be the weeding out of the marginal dealers and the transference of custom to the bigger dealers. A different result may ensue only if there is absence of competition between bigger dealers and marginal dealers, i.e. if there is a market served only by the marginal dealers. But under conditions in the country, though villagers may choose actually to buy their requirements from hawkers, a slight difference in price is enough to persuade them to buy their requirements (specially of durable things like cloth) from the bazaars which they visit at regular intervals.

What will happen to the displaced marginal dealers? The capital and labour thus displaced will, of course, seek other avenues of employment. It is only the comparative prospects in each available line that will determine the choice. A displaced hawker of mill-made cloth will not necessarily become nor is likely to become a hawker of hand-loom cloth. For, with the transference of custom from the marginal dealers to the bigger dealers of mill-made cloth, there is ex hypothesi no scope for any more hawkers of hand-loom cloth, and nothing has happened in the mean time to affect favourably the demand for hand-loom cloth. The hawkers of mill-made cloth

[1] For how a small dealer could in the short period make a profit by choosing to bear the tax himself see Chapter X.

can easily become the hawkers of another foreign commodity or may become anything else according to the comparative prospects in each line.

Two different cases may be recognized here. If the tax is raised by a foreign Government for expending it for the benefit of another country, the effect of the tax is a net diminution of the national dividend which is thus partly drained off to another country. The displaced labour and capital will then only increase the competition in other available lines and a new lower margin will be reached in each line according to the principle of substitution. The disturbing factor is, after all, so small that the actual disturbance may not be perceptible in its wider ramifications but may be seen only in its initial stages, i.e. when the hawkers feel the pinch and are out of employment. But, theoretically, the factor must inexorably lead to its logical conclusion and it is only by this means that everybody will get adjusted to the smaller national dividend. There will be a net diminution of real income for all. Some may come out better than others in the struggle that will ensue but the fact of the diminution cannot be overcome.

If the proceeds of the tax is expended for the benefit of the country in which it is raised, the result will be different. In the process of expenditure, the tax will create some new lines of employment for labour and capital; and the labour and capital displaced by the tax will find employment either in those lines directly or they will displace others who will step into the new line. Thus, if there is more money for public works, more labour and capital will be employed there; if there is more money for agricultural improvement, more labour and capital will flow in there, and so on. The amount raised by taxation may, however, be expended by Government more effectively or less effectively than by the person taxed; or the degree of its effectiveness may be equal before and after taxation. In the last case, taxation is indifferent in the long run: it causes some disturbance in the short period for the benefit of none. If the amount is more effectively spent by Government than when it was in the hands of private individuals, there is a net gain to the country. But if it is less effectively spent, there is a net loss to the country, though the loss may not be as great as when the amount is entirely drained away.

Thus, if the cloth mills are taxed for expending the proceeds of the tax on hand-looms and if labour is more effective in mills than in

hand-looms, the effect of the tax will be a general lowering of wages. Such a tax will be prejudicial to the interests of the country.

Taxation of a home industry for the benefit or protection of another home industry is a dangerous policy. Taxation of foreign goods for the protection of home industries, though recognized all over the civilized world, is a delicate weapon which must be used with great care and within definite limits if it is not to become harmful to the nation. Taxation of one home industry for the benefit of a rival home industry can hardly be justified under any circumstances. Moreover, political considerations easily come in to influence taxation policy and to lead it astray when such a policy is adopted by a State. The Madras Regulation of the Sale of Cloth Act has not achieved its declared object, for, it has not transferred demand from mill-made cloth to hand-loom woven cloth; nor have hawkers of mill-made cloth taken to the hawking of hand-loom woven cloth. It has only turned out a few hawkers and small sellers from the field and has caused hardship to others.

It is, of course, not meant that Government should not tax any home produced commodity or expend money for the benefit of another industry. That has always to be done. What is meant is that a tax or an expenditure should be justified on different, and if possible, independent grounds. A tax should not be levied on a home industry on the ground that the levy of the tax will in itself benefit another industry. A tax should be justified on sounder grounds: an expenditure should be based on the merit of the case.

As the Act has failed to achieve its object, it should no longer remain on the Statute Book. But if it has to be retained at all, it should be reformed to become a purely revenue measure. The only way to do so is to drop the lower limit taxation. Only those shops need be taxed whose turn-over exceeds three thousand rupees a year. In such a scheme the smaller marginal dealers will not be affected. The tax will fall on bigger dealers who can afford to pay five rupees each a year. It will, of course, not be an ideal measure but will be rendered practically harmless by such modification; and it will bring in a small revenue. The question of cost of collection and yield will then assume great importance. The cost of collection will, of course, be reduced by omitting to tax the smaller shops but the yield will come down too. Unless the cost of collection absorbs a large percentage of the yield, the Act, modified as suggested above, may well remain on the Statute Book.

After all, the tax in this particular case is so small that its harmful effects hardly attract notice. But the tendencies are all there, and it is the duty of the theorist to study, disentangle and reveal the tendencies, so that the practical statesman may guard against bad tendencies and encourage good ones.

VII

A GENERAL REVIEW OF SELECTIVE SALES TAXES

THE retail sales tax on motor spirit is the commonest example of a successful selective sales tax. As the trade in motor spirit had already been specialized and regulated by law, it was easy to impose a retail sales tax on it. In many respects it was the obvious first subject of a retail sales tax.

Tobacco is the only other article on which a selective sales tax is being levied. Taxation of tobacco, however, displays great variety of methods from province to province. In Madras it is an *ad valorem* turn-over tax. Other provinces levy either a licence tax on sellers only or combine with a licence tax an *ad valorem* tax on sales or an octroi duty. The licence tax varies from a simple tax levied at a low rate with negligible graduation to a complicated tax graduated on various considerations including population in the locality of the shop and its annual rental value. The tax on tobacco, as already explained, displays great defects and stands in need of reform.

Other attempts at selective sales taxes have proved abortive, as in Assam and Bombay. The Madras Licence Tax on sellers of mechanically manufactured cloth still stands. But the motive behind it was not taxation but protection; and it has not only failed to achieve that object but is unjustifiable on merits.

The reason for the paucity of selective sales taxes in spite of the pressing need of Provincial Governments under autonomy for larger revenues is not far to seek.

In the first place, it is hardly practicable to have a provincial selective sales tax on the wholesale sale of articles unless all the provinces agree to impose the tax simultaneously at the same rates.

The reason is simple. Articles are either manufactured within the province or are obtained from foreign countries or are imported from another province.

In the case of the third category, it is easy to arrange their sale outside the province without disturbing the ordinary route of the

trade and as already pointed out a special provision providing for the taxability of sales taking place outside the province of goods situated within the province at the time of sale does not stop this source of avoidance in respect of this category. The two decisive difficulties in this case are:

(*a*) the feasibility of arranging wholesale sales far away from the location of the goods at a negligible cost;

(*b*) the incompetence of a province to impose a countervailing import duty on goods entering the province from another province or from outside. It may be noted that a province or a municipality is competent to levy an octroi or a transit duty on goods entering a particular town within the province and hence with the aid of such a duty it may be possible to levy a selective wholesale sales tax in a particular town only. But this is not possible in the province as a whole.[1]

In the case of the second category also it is possible to arrange formal sales outside the province, say, in London, with a view to avoiding the tax and this is easy as most importing firms have branches or agents overseas.

In the case of the first category, though it may be possible to arrange wholesale sales outside the province, as far as goods meant for consumption within the province are concerned, this source of avoidance can be stopped by providing for the taxation of sales taking place outside the province if the goods sold were within the province at the time of sale. But to do so is to create a discrimination against the home industry in the home market, and to favour the outside industries at the cost of the home industry. With a selective wholesale sales tax in force on an article, which is both internally produced and is imported, together with such a provision for preventing avoidance, the home produce meant for internal consumption will have to pay the tax while the imported stuff will mostly avoid it. The home industry is consequently bound to be very much worse off, if not ruined altogether. No Government can take such a step. It is assumed that there is no home industry which has an absolute monopoly over the home market.

[1] For a description of the octroi duties prevailing in some of the northern Indian towns and their harmful effects, see Husain, *Agricultural Marketing in Northern India* (George Allen & Unwin), Part II, Chap. V, pp. 130–134, and also Part III, Chap. IX, pp. 260–262.

It follows that a selective sales tax on a provincial basis on the wholesale sale of goods is not a practicable proposition.[1]

Secondly, it has already been shown that a retail sales tax on high-priced standardized articles levied in certain provinces is easily avoided. No province need adopt the sales tax technique for taxing them as the technique of the use tax is easier and already in vogue.

Thirdly, in view of the injustice involved in taxing the necessities of life and similar articles which go into the consumption of the masses, all responsible Provincial Governments have to avoid selection of such articles for taxation.

The conditions given above severely restrict in practice the scope of a selective sales tax. With the exclusion of wholesale sales and retail sales of high-priced standardized articles and articles of common consumption, all large yielders at economic cost go out of the field. Retail sales of most of the remaining articles are so mixed up and scattered and small dealers preponderate so much in most cases that administrative difficulties, high cost of collection and the risk of causing hardship to the small men who often form the bulk of the assessees, effectively stand in the way of levying, at a reasonable cost, taxes on articles selected from among the mass. Under such circumstances it is often administratively impossible to separate for taxation the sale accounts of a particular article out of the sale accounts of a whole mass of articles sold by the same dealer and even if it were possible, the cost would be prohibitive. Here a comprehensive sales tax on all these articles is an easier and more economical proposition.

In their search for selective sales taxes, Provincial Governments therefore searched for lines of retail trade which are not mixed up but specialized, not very much scattered, in which very small men do not preponderate and which do not deal with necessities of life or with standardized articles of high price in low bulk. It is obvious that not many such lines are available.

[1] In the States of the U.S.A., 'fear of driving manufacturing and wholesale business into adjoining States and inability to tax sales in inter-State commerce have restricted the tax to retail sales except where low rates are applied to the other two types of business or where the immobile extractive industries and public service corporations have proved a convenient target for high rates'. Haig and Shoup, *The Sales Taxes in the American States* (Columbia University Press), p. 5.

Motor spirit fulfilled all the conditions. Its trade is not scattered but is confined to a few licensed persons. Its trade is not mixed up with that of other articles but is specialized; hence, the examination of accounts, etc., is an easy affair involving low cost. It is not a necessity of life.

Tobacco has not satisfied all the conditions. In respect of some varieties, its trade is very scattered and is causing hardship. The tax on wholesale sale in Madras is causing trouble. But, properly reformed, it can work well.

If more selective retail sales taxes are to be levied, articles of general consumption selling above a stated price and with a more or less specialized sale have to be tried. Shoes are a probable line. Their trade is, to a great extent, specialized. But shoes worth less than, say, fifteen rupees a pair, may be exempted. In that case, the poorer consumers and the smaller dealers in villages will not be affected and the administration will have to deal with fewer dealers. Similarly, if cloth is to be taxed, a price limit is essential. Selective sales taxes with a price limit have not yet been attempted in this country, but they appear to be a development of the near future.

A small licence tax on all sellers, exempting those with an annual turn-over below a stated sum, say, fifty thousand rupees, is also likely to be levied in provinces which have not yet levied a comprehensive sales tax. This will be useful for purposes of statistics and will also bring in some revenue.

Lastly, seeing the harmful effects of isolated provincial attempts, all provinces should agree to adopt a common plan of taxation with uniform scope and rates which might be given effect to either separately by Provincial Legislation or by Central Legislation with common consent.

VIII

COMPREHENSIVE SALES TAX

MADRAS [1]

THE Madras General Sales Tax Act, 1939, levies a turn-over tax on sales of all goods except those subject to separate selective sales taxes or to the provincial excise.

The following articles, if sold by licensed dealers, are exempt, viz.

(*i*) Bullion and specie,
(*ii*) Cotton,
(*iii*) Cotton Yarn, and
(*iv*) Handwoven cloth when sold by a person dealing exclusively in such cloth.

Sales of agricultural produce by the growers are exempt.

Commission agents or brokers, except those whose principals live outside the province, are exempted if they obtain a licence to practise as such.

Hides and skins are taxed only once in the course of their trade life, if dealt with by licensed dealers.

Dealers whose annual turn-over is above ten thousand rupees but not above twenty thousand rupees have to pay a lump tax of

[1] As the Punjab General Sales Tax Act follows the Madras model, except in details, it is not discussed separately.

The Punjab General Sales Tax Act as amended in 1942 levies a turn-over tax at the following rates:

(*a*) If the turn-over exceeds Rs 10,000 but does not exceed Rs 20,000	Three annas for every one hundred rupees or fraction thereof.
(*b*) If the turn-over exceeds Rs 20,000	Four annas for every one hundred rupees or fraction thereof.

Provided that when the Government prescribes any points in the series of sales by successive dealers at which any goods or class or description of goods shall be exempted, the Government may by notification increase the rate of the tax payable under (*a*) and (*b*) above, on such goods or class of goods at any stage other than the points at which they are so exempted to such rate, not exceeding one rupee for every hundred rupees, as it may think fit.

five rupees a month. Dealers whose annual turn-over does not exceed ten thousand rupees have to pay no tax.

Subject to the above exceptions the Act of 1939 levied a tax on every article as many times as it changed hands at the rate of half per cent of its sale price. In 1940 the general rate was reduced to a quarter per cent and the lump rate was reduced from five rupees to four rupees. Neither manufacturers as such, nor exporters as such are exempt; but in the case of certain notified articles of industrial manufacture a rebate to the extent of half the tax on the last turn-over in the province is allowed.

A few articles, viz. tobacco leaf, cashew-nuts, ground-nuts and untanned hides and skins under certain circumstances are taxed on their purchase, i.e. the dealer who buys them has to pay the tax and not the dealer who sells them.

Goods are defined to be all kinds of movable property but stocks and shares are excluded.

The scheme can be said to have a basic feature, certain special features and certain negative features.

The basic feature of the scheme is that all sales of goods are taxed, whether they are sales by a wholesaler or by a retailer or by a manufacturer or by an importer or by an exporter. This means that an article may be taxed several times in the course of its trade life, i.e. during its passage from the producer or importer to the final consumer through a series of transactions in which manufacturers, wholesalers and retailers take part: it is in fact taxed as many times as it changes ownership within the province. The tax is therefore cumulative or, to use a popular expression, is pyramided.

The special features of the scheme are:

(*a*) Exemption of small dealers;
(*b*) Exemption of selected articles;
(*c*) Taxation of certain things on purchase instead of on sale;
(*d*) Limitation of the tax to one stage only in the case of hides and skins;
(*e*) Exemption of licensed agents other than agents of non-resident principals.

The important negative features of the scheme are:

(*a*) There is no provision for safeguarding home industries against unequal incidence and other adverse effects of the tax;

(*b*) There is no exemption for articles for export; and

(*c*) There is no exemption for the necessities of life.

Certain corollaries follow from the basic features of the scheme. They will be discussed later. The special features and the negative features are discussed first.

Special Features of the Scheme

(*a*) Exemption of smaller dealers

Dealers with a taxable turn-over of ten thousand rupees or less are altogether exempt from the tax.

This is a good feature of the Act. It saves innumerable small men from trouble and expense: small shopkeepers are often illiterate or barely literate. They can hardly keep proper accounts and submit returns on the lines required by the Act. In France where small men are taxed, the accounts and the returns as the basis of taxation have been given up. Instead, a system known as the *forfait* system has developed by which the tax is levied on an estimated base determined more or less by process of bargaining.[1] Such a system is obviously bad. It leaves the field open to dishonesty and fraud. The tax payable bears no relation whatever to any real base but is determined by a process of haggling. Taxation of small men is therefore not a practical proposition.

Secondly, Adam Smith's canon of economy requires the exemption of small men. The French tax figures of 1922 show that seventy-eight per cent of the tax payers could have been entirely exempted from the tax in that year with a loss of only ten per cent of the revenue, and forty-eight per cent of the tax payers could be exempted by losing only a little over two per cent of the revenue.[2] The Madras figures also show similar results. It is not therefore worth while as an administrative proposition to undertake the trouble involved in taxing the smaller men. In France it was felt that the yield of the tax could be increased if the collecting staff were free to give their full time and attention to the big men instead of trying to collect a few francs by devoting more than half their time to the small people.

The exemption limit of course exerts an economic pressure for splitting up business units at the lower end. The tendency has

[1] See Shoup, C. S., *Sales Tax in France* (Columbia University Press).

[2] Shoup, C. S., *Sales Tax in France* (Columbia University Press).

appeared in Madras. Cases are known where dealers having turn-overs of between ten thousand and twenty thousand rupees have erected a partition in their shops and have set up a minor son or a relation beyond the partition; or where a man who owned two shops with a total annual turn-over of about twenty thousand rupees has since the introduction of the tax transferred one of them to his minor son or a relation.

This economic pressure is, however, very limited in its operation. It is obviously not an economic or business proposition for big businessmen to split up their business with innumerable petty *benami* establishments. The economic pressure is therefore negligible.

Another possible objection against the exemption limit is that the smaller men may undersell the bigger men. The fear is baseless. The bigger man has a quicker turn-over and many advantages over the smaller man who is often struggling for existence. The smaller man is only too glad to quote the price set by the bigger man. This conclusion is confirmed by the experience of Madras. There is no complaint there that the smaller men are underselling the bigger men. There is, on the contrary, the complaint that the smaller retailers are making money out of the tax by taking advantage of the higher price or by billing for the tax separately though they have not to pay it.

The argument given above assumes free competition in the market. But there may be more friction in the market than is often anticipated. In the short period, therefore, i.e. till the friction is not overcome, different results may ensue. Hence under favourable conditions a man just below the exemption limit may feel tempted to undersell the man just above it when they compete in a market where the bigger dealer may not be easily accessible. To avoid such short period results, the border line may be approached by a sliding scale of rates.

The lump rate block in the Madras Act is obviously administratively advantageous and is convenient to the assessees also in so far as they have not to submit elaborate returns. But like all flat rate taxation, this acts regressively within the block. To the man having an annual turn-over of just above ten thousand rupees, a tax of four rupees per month works out at about half per cent whereas to the man having an annual turn-over of twenty thousand rupees it works out at just below a quarter per cent.

(*b*) Exemption of selected articles

The most important item of exemption is the sale of agricultural or horticultural produce by the growers or by a person who has an interest whether as owner, usufructuary mortgagee, tenant or otherwise, on the land on which it has been grown. By Government Order No. M.S. 2348 Revenue Department, dated the 11th September, 1939, the scope of the term 'agricultural produce' was extended to include coffee which has not been roasted, tea, rubber, ground-nut, crude tobacco leaf and rice.[1]

The scope of the exemption is thus so wide that it is difficult to think of any case in which the first sale of agricultural produce grown in the province can be taxed. The exemption is also unconditional.

The exemption at this stage is perhaps intended to reduce the rise in the price of agricultural produce. But the conditions of supply of agricultural produce in the country are such that even if the tax were levied at this stage, the incidence was likely to have been on the few bigger cultivators selling produce worth more than ten thousand rupees a year who alone would have been taxable. As the bulk of the produce is grown by smaller cultivators who would have been tax-free in any case, they would have set the price.

The effect of the present exemption has therefore probably been to relieve the bigger cultivators from the burden of the tax which they would have to bear without the exemption.

The next important items of exemption are the sales of the following articles:

(*i*) Bullion and specie,
(*ii*) Cotton,
(*iii*) Cotton yarn,
(*iv*) Cloth woven on hand-looms and sold by persons dealing exclusively in such cloth.

The exemption of bullion and specie is a recognition of the practical difficulties of a provincial sales tax in respect of articles of high value in small bulk. It is difficult to keep the trade of such articles within the province with a sales tax in force.

[1] In several State Sales Tax laws in America farm products sold by producers are exempted. See Haig and Shoup, *The Sales Taxes in the American States* (Columbia University Press).

Cotton, cotton yarn and hand-loom cloth complete one cycle of preference. The Government policy was to encourage the hand-loom industry and these exemptions were granted only in pursuance of such policy. The exemption of cotton and cotton yarn incidentally secured the exemption of two important raw materials of the piece goods industry.

The third group of exempted articles are:

(*i*) Electrical energy,
(*ii*) Motor spirit,
(*iii*) Manufactured tobacco,
(*iv*) Any goods on which duty is or may be levied under the Madras Abkari Act, 1886, or the Opium Act, 1878.

On each of these articles a tax is levied by some other Act at a rate higher than the rate of the general sales tax. Hence though these articles are exempted from the operation of the particular Act, they are not exempted from taxation. Taxes on these goods will be discussed later.

The exemption list does not include the staple necessities of life. Even salt and rice are not exempted. The principle of lightening the burden on the poor as far as practicable is not recognized in the scheme of the Act. Revenue seems to be the overriding consideration. Equity would, of course, have cost some revenue but the taxation of the poor man's salt and rice by a turn-over tax is hard to justify.

(*c*) Taxation of certain things on purchase instead of on sales

The following articles are taxed on purchase:

(*i*) Ground-nut,
(*ii*) Leaf tobacco,
(*iii*) Cashew,
(*iv*) Untanned hides and skins bought by a licensed tanner in the province, and
(*v*) Untanned hides and skins exported outside the province by a licensed dealer in hides or skins.

In the case of these goods the taxable turn-over of a dealer is the amount for which the goods are bought by him and not the amount for which they are sold by him.

The bulk of these commodities are exported from Madras. Three of them are agricultural produce and are grown and dealt with in the earlier stages by a large number of small men. So also

the dealers in hides and skins are small and numerous in the earlier stages. There are a few big dealers at the top who buy from these small dealers and export the goods thus purchased. Taxation of these articles on purchase is therefore more advantageous than their taxation on sale. First, it stops an obvious source of leakage. If, for example, the big exporting firms of Madras exported to their branches outside, no sale by these firms would have occurred in Madras which the Government of Madras could have taxed; and if in addition to this, all the dealers who sold to the big exporting firms of Madras were small men below the exemption limit, the entire trade would have escaped the tax if it were levied on sale. But as the big exporting firms cannot avoid buying in Madras, and as their turn-over is large, they cannot avoid the tax as at present imposed. Secondly, it is a great administrative advantage to deal with a small number of big assessees than with a large number of small assessees. It is also convenient to the small sellers who are saved all the troubles imposed by the Act on those who are taxable.

Whether it is at all desirable to tax articles of export will be discussed later. But as long as the Government do intend to tax these articles, the manner chosen by them seems to be the best.

The legality of taxing things on purchase instead of on sales has, however, been questioned. The question was debated on the floor of the Madras Legislative Assembly. The Speaker ruled that it was legal. The ruling of the Speaker, which also contains the argument of the opposition, is quoted below:

'It is contended that though the Provincial Legislature has power to levy a tax on the sale of goods, it has no power to levy it on the buyer but can levy it only on the seller.

'Item 48 of the Provincial Legislative List—List 2 of Schedule VII of the Government of India Act, 1935—is "taxes on the sale of goods and on advertisements". Under section 100(3) of the Government of India Act, "the Provincial Legislature has, and the Federal Legislature has not, power to make laws for a province or any part thereof with respect to any of the matters enumerated in list 2 of Schedule VII". That is to say, this Legislature has power to legislate "with respect to" "a tax on the sale of goods" in this Province.

'Power to legislate "with respect to" a tax includes a power to fix the rate of the tax and the mode of levy and collection of the tax.

'"Sale" is a contract, and as in the case of every contract, there are two parties to it. In the Sale of Goods Act (Act VIII of 1930),

it is expressly stated "whether under a contract of sale, the property in the goods is transferred from the seller to the buyer, the contract is called a sale". Thus, "sale" is a contract between a seller and a buyer, and a tax on such a contract can be levied on and collected from either party to the contract, the seller or the buyer.

'In one of the passages quoted by Justice Sulaiman in his judgement in the case of the Central Provinces Motor Spirit Taxation Act, it is stated that in respect of a sales tax "customarily the vendor rather than the vendee, is liable for taxation although both may be held responsible for the proper payment of the tax".

'In this connexion, I may point out also that the stamp duty payable under section 29 of the Indian Stamp Act on a sale deed, is, in the absence of a contract to the contrary, borne by the purchaser.

'The items mentioned in list 2 of Schedule VII of the Government of India Act are merely the names of subjects "with respect to" which the Provincial Legislature has power to legislate. The Government of India Act nowhere provides that the power of the local Legislature to legislate with respect to a tax on the sale of goods is limited to a power to levy it from the seller and not from the buyer. The item itself is not "taxes on the seller of goods" but "taxes on the sale of goods".

'In the circumstances, it is quite clear that the provisions in this Bill which relate to the levy of the sales tax from the buyer are not *ultra vires*.

'Then with regard to the definition of the word "dealer" the meaning of the word "dealer", according to the Oxford English Dictionary, is this: "one who deals in merchandise, a trader; specially one who sells an article in the same condition in which he bought it". A dealer is both a buyer and a seller. Therefore a dealer buys as well as sells.

'From the ruling I have given with regard to the point of order, I think it is perfectly within the competence of the Select Committee to include in the Sales Tax Bill buying also . . .'

The ruling, though plausible, is not free from ambiguity. Sale and purchase may be correlative terms and there cannot be a purchase without a sale. But the distinction between the two is clear. One who makes the sale is different from the one who makes the purchase; and sales and purchase affect men in contrary ways. Secondly, it may also make a great deal of material difference sometimes. The sale price may be quite different from the purchase price in respect of the same transaction. Thus, under the Madras General Sales Tax Act the sale price of a thing is to be taken to be the price realized from the purchaser minus any commission or discount that might have been given to a broker or agent. But the purchase price to the purchaser will include that discount. So the material

effects of taxing sales may be quite different from those of taxing purchases. The correctness of the view quoted above has, however, not yet been challenged in a Court of law.

But the difficulty can probably be circumvented by a different manner of drafting. The law, while imposing the tax on sales, could authorize the buyer to collect it from the seller. The buyer could, at the same time, be made responsible to pay to Government taxes on all sales made to him, irrespective of whether he does or does not collect the tax from the seller.

Such a scheme is, however, difficult to fit in with a scheme of exemption of smaller sellers; but, such exemption is not provided by the Madras Act in respect of the few things that are taxed on purchase.

(*d*) Limitation of the tax to one stage in the case of hides and skins

The provision about hides and skins is very complicated. The rules are different for tanned and untanned hides and skins and are as follows:

If untanned hides and skins are sold to a tanner in the province, the tax shall be levied on the tanner in respect of the amount for which the hides and skins are bought by him.

If they are exported outside the province, in the untanned state, the tax shall be levied from the last dealer not below the exemption limit. Thus if A sells untanned hides to B who sells to C who sells them to a person in Mysore, the tax is payable by C provided his turn-over is not below the exemption limit and will be calculated on the price which he paid to B. A and B will not have to pay the tax even if their turn-overs are above the exemption limit. If, however, C's turn-over is below the exemption limit, the tax will be payable by B and will be calculated on the price which he paid to A. The tax will be levied only once.

If the tanning has been done in the province by a tanner who has paid the tax at the time of buying them in the untanned stage, no tax will be levied on the sale of such hides in the tanned stage. If the tanner has not paid the tax, being exempt on the ground of his total turn-over being below ten thousand rupees, the tax will be levied on the first dealer in the chain not exempt from taxation who sells them within the province. So also, in the case of hides and skins tanned outside the province the tax is levied on the first dealer, not exempt from the tax, who sells them within the province.

Let us suppose A of Madras buys tanned skins from Mysore and sells to B in Madras who sells to C in Madras who exports them. The tax is levied on A on the sum for which he sells the skins to B. If, however, A's turn-over is below the taxable limit, the tax will be levied on B on the sum for which he sells to C.

From the description of the process, it is apparent how difficult it is to discover the taxable stage. That will depend on many things happening before or after the stage has been passed. In the case of untanned hides exported outside the province, it may be necessary to retrace the history of a piece of hide to determine who is liable. Such complications bewilder the dealers and perplex the administrators.

The concession of single-point taxation was granted to this line of trade as hides and skins are chiefly exported and have to compete in the world market. No other article of export, however, received this concession.

(*e*) Exemption of licensed agents other than agents of non-resident principals

Agents are classified into two classes for the purposes of the Act. They are:

(*i*) agents of principals resident in the province of Madras;
(*ii*) agents of principals resident outside the province of Madras.

Agents of non-resident principals are liable to pay tax on things sold by them in Madras, unless of course their turn-over does not exceed the exemption limit of ten thousand rupees.

Agents of resident principals are, however, exempt from the tax but they have to obtain licences. Before, however, a person can claim an agency licence he must prove

(*i*) that he works on an agreed commission;
(*ii*) that his principals are known, are resident in the province and are named in his accounts in respect of each transaction.

Before such a licensed agent can claim exemption in respect of any transaction he must prove that the amounts for which the goods concerned in his agency transactions have been sold have been included in the turn-over of the principal or principals and taxed, unless of course any of them has an annual turn-over of ten thousand rupees or less.

An agent has been described as a person 'who for an agreed commission or brokerage buys or sells on behalf of known principals specified in his accounts in respect of each transaction'.

Thus, agents as such are not exempt unless, of course, (*i*) their annual turn-over is below ten thousand rupees or (*ii*) unless they are selling agents of growers of agricultural produce. Other agents of resident principals are exempt only when they are licensed.[1]

The intention of the law is clear and good. It intends, first, that an article should not be subjected to an extra burden of taxation on the ground that it is bought or sold through an agent. Secondly, it intends that an article of outside origin should not escape taxation and thereby get an advantage in the home market over home products on the plea that the principal is non-resident.

In actual practice, the first intention has been fulfilled but the second has not been so fulfilled.

It is to the advantage of every agent of a resident principal to apply for a licence, for, by doing so he escapes the tax. Hence he has always done so. As a matter of fact more persons have applied for such a licence than are strictly entitled to it, and the problem of the administration has been to check the number of wrong applications. Licensing of agents is, however, a good thing from the administrative point of view, in so far as it prevents dishonesty, and therefore removes a gap in the system of revenue protection.

As regards the agents of non-resident or foreign principals the department interprets the terms so as to give it a very wide denotation. Any person who looks after the interests of a foreign seller is treated as an agent of such a seller and is assessed to tax on the seller's taxable turn-over in the province, irrespective of the fact whether he (the agent) has or has not a hand in the actual selling. Hence the term agent includes advertising agents, indent agents, advising agents or any agents who canvass orders and pass them on to the seller and often guarantee the buyer, though they may have no authority to bind the seller to supply. Local banks of foreign dealers, however, are not included in the term provided they are merely the machinery for payment and undertake no more than ordinary banking services on behalf of the foreign dealer, e.g.

[1] The law on the subject is contained in section 8, and Explanation 2 of section 2(*b*) of the *Madras General Sales Tax Act* and also in Rules 5 to 8 of the *Madras General Sales Tax Rules*, 1939.

collection of bills of exchange and furnishing of advice on the financial standing of local firms.

In spite of the justifiable anxiety of the Government not to handicap home products in the home market as against non-provincial products, Government have often failed to rope in sales by non-residents to resident dealers. The scheme of the Government is based on the assumption that there must always be a taxable local agent of a non-resident principal. The assumption is not always correct. Even when there were agents in certain lines, they dropped out of business with the imposition of the tax. Most of these agents worked on very small commission and could not bear a tax of half per cent or even quarter per cent. As the principals could easily avoid the tax by cutting out the local agents, they did not agree to bear the tax but preferred to cut them out.

The bulk of the sugar purchased in Madras city is bought from North Indian dealers who have no agents in Madras. They send the railway receipt to a local bank with orders to hand it over on payment of the price. The sale obviously takes place in Madras but as there is no agent and as the bank cannot be taxed as an agent, no tax can in fact be levied on this transaction.

The tax can be avoided in yet another way. If a firm in Madras wanted to buy sugar from, say, the Mysore Sugar Company, the usual practice was to approach the local selling agent. All sales were made F.O.R. Nandya, Mysore, which is the situation of the factory; but as the local agents collected the purchase price from the dealer against the transfer of documents, it was generally stipulated that the property in the goods would not pass till payment was made. If, however, there is an express stipulation that the property in the sugar shall pass to the buyer on delivery of the sugar to the railway company, the sale evidently takes place in Mysore and is not taxable. Whether such a stipulation will be made, of course, depends on the credit of the buyer but most buyers do command this confidence in the market; and hence the tax can be avoided even if the agent is not cut out.

Under such circumstances the infant sugar industry of Madras is being adversely affected by the turn-over tax in respect of its power of competition with North Indian sugar. The dealer can buy North Indian sugar tax-free but has to pay a tax in respect of his purchase of Madras sugar. It is no good arguing in such cases that the tax is low; for, it is not the question of the pitch of the

tax but a question of difference that determines the conduct of businessmen in this respect. The slightest difference is decisive. The dealers will not agree to push the sales of Madras sugar unless the tax payable on the first turn-over is borne by the industry itself. The incidence of this portion of the tax is therefore on the industry.

The Negative Features of the Act

This brings us to the negative features of the scheme. They are, as noted already, three in number, namely:

(*i*) There is no safeguarding of home industries against the inequalities of the tax;
(*ii*) There is no exemption of articles for export;
(*iii*) There is no exemption of the necessities of life.

The discussion about the difficulties of the sugar industry makes the point clear. The case is only illustrative. The argument applies with equal force to every case in which the product of a home industry has to compete in the home market with imports from outside the province. The organization of sales in both cases is often the same and the number of turn-overs of both the home product and the imported product will therefore be the same. But the home product will be taxed on all its turn-overs while the imported product cannot be taxed on its first turn-over. The home product will therefore bear one tax extra. The only effective way to stop this is to exempt sales of articles by the manufacturers themselves. Sale of agricultural produce by the grower is already exempt. The exemption need only be extended to non-agricultural produce also. The arguments for the two are, however, different. The justification for exempting non-agricultural produce is that otherwise there arises an undesirable discrimination against home industries. The justification for exempting agricultural produce is that most agricultural products are necessities of life. But in so far as the taxation of the first sale of agricultural products with an exemption limit at ten thousand rupees would not have led to an increase of prices, the exemption of such products from taxation may even be considered unnecessary. This point has already been discussed.

The other bad effect of the tax on home industries is that it increases their cost of production but has no effect on the cost of

production of imported articles. Machinery and raw materials are not exempt. The raw materials and the machinery that the home industry buys are subject to the turn-over tax and this substantially increases the cost of operations. This handicap is much more severe than the discriminatory incidence already discussed of a tax on the finished product. Local industries, in so far as they can buy their machinery and raw materials from outside the province, will escape taxation but in respect of raw materials it is not always possible to do so. Hence the tax will create economic pressure for the transference of trade in raw material, etc., to places outside the province and in so far as the economic pressure for such transference cannot be effective, will ruin home industries.

How the tax can be ruinous to a trade was revealed recently in a case before the Madras High Court: The Province of Madras *vs.* Messrs Boddu Paidanna & Sons. The facts of the case were as follows:

The respondents are members of a joint Hindu trading family carrying on business at Vizianagram. They purchase ground-nuts in the shell, and having decorticated the nuts they proceed to extract the oil from the kernels for the purpose of sale. Out of the residue they make ground-nut cake, which they also sell. The assessing authority constituted by the Madras General Sales Tax Act assessed the respondents to the tax imposed by the Act both in respect of their purchases of ground-nuts and their sales of ground-nut oil and ground-nut cakes. The assessing authority regarded the business of manufacturing ground-nut oil and ground-nut cake as distinct from their business as buyers of ground-nuts.

The effect of the tax on home industries is one of the worst features of the Act. The cotton industry has been saved from this bad effect by the provision for exempting cotton and yarn; but why other home industries were not considered deserving of a similar concession is hard to explain.

The second feature is equally bad. A limited concession has been granted to hides and skins by restricting the tax to one stage only; but no other article of export has got any concession. This discriminatory treatment for hides and skins is as difficult to explain as the absence of exemption for articles for export.

Exports have to compete in the world market with articles of other countries. Prices in the world market will not rise on the ground that producers of one country have now to pay a tax which the producers of other countries have not to pay. The pro-

ducers of other countries will continue to sell at the old price and the producers of the taxed country cannot quote higher prices without being replaced completely by the other untaxed countries. Hence the producers of the taxed country will either bear the tax themselves or be completely wiped out of the world market. The case of a country having a monopoly of production of a particular article, e.g. jute, may be different but such articles are extremely rare. As no country wants to lose the market for its commodities but wants to extend it by all means, exemption of exports has been a common feature of the sales tax schemes of most countries. It is conspicuous by its absence from the Madras Act.

Hides and skins, which are important articles of export, have been deemed to be deserving of a restricted concession but the ground on which they were distinguished from other articles of export is not known. The Madras Act taxes the principal articles of export on purchase instead of on sale with the intention of collecting the tax chiefly from the export houses. Though it is difficult to disentangle economic forces operating on a commodity it is the common impression in Madras that the buying firms are shifting back the tax to the growers. They cannot possibly shift it forward on account of the overriding influence of the forces in the world market. They cannot bear the tax themselves as it is a tax on the margin. Hence the forcing of the tax back on the growers is a simple logical consequence. In this case there is also not much friction which takes time to overcome, for, the exporters or wholesale buyers are much more organized than the growers and can therefore protect themselves much better than the growers. The growers can, of course, in the long run protect themselves by turning to the cultivation of other crops; but that course is limited by the nature of the soil and the marketing prospects of other possible alternatives that can be raised on it. In any case if they succeed in avoiding the tax by turning to other lines, the export trade of the province is lost.

It may appear that ground-nuts and cashew-nuts, being agricultural produce, enjoy exemption on their first sales along with other agricultural produce and hence they also get a little concession. But this concession is entirely nullified in their case by the provision for taxing them on purchase. For, the same transaction which is a sale by the grower may be taxed if the buyer's turn-over exceeds the taxable limit. The tax will, of course, be collected from the buyer

instead of from the seller but the shifting of the legal liability cannot alter the incidence of the tax.

To certain manufactured articles of export, Government grants a little concession indirectly. This is done as follows:

In the case of certain notified articles of industrial manufacture, a rebate to the extent of half the tax paid on the final turn-over in the province is allowed. The list of articles notified for the purpose has been drawn up in such a way as to include all articles that are manufactured in the province on an appreciable scale and of which the export is not inconsiderable. Government considered that only articles of Madras manufacture were deserving of this concession and that outside products which come to Madras for being exported out of the province did not deserve this concession. The argument is faulty. Madras manufactures which go outside Madras need not have any turn-over within the province. Even if the organization of trade before the imposition of the tax was such that there were a few turn-overs within the province, the imposition of the tax would exert pressure for their elimination. The stipulation with outside buyers may be made directly by the mills so that sales take place on payment to an outside agent against transference of documents. Those outside products which come to Madras for the purpose of being distributed to places outside the province may also avoid the tax by exactly similar means or they will choose other channels of distribution. Hence the taxation of such exports frustrates itself. Only those manufacturers who are not big enough to export on their own account will suffer by the tax. In their case there are generally middlemen who buy up the goods from many small men and export in large quantities. They cannot avoid a turn-over tax within the province. But, as in the case of hides and skins or ground-nuts, the tax will be shifted back. The rebate will, of course, reduce the burden to half and with the rate of taxation at quarter per cent the burden may be very small; but it is obviously unfair to impose this burden on such small businessmen. Moreover when the extra burden on account of the taxation of raw materials also is added to it, the total burden may not be negligible. The hand-loom industry, which is one of the chief small industries of Madras, escapes the burden by the special exemption granted to cotton yarn and hand-loom cloth.

Thus the treatment of exports under the Madras Act is discriminatory and injurious to the interests of the province. Such

provision cannot remain as a permanent feature of any scheme. The plain course would have been to declare tax-free all articles of export. Government probably were not willing to lose the revenue on account of this exemption. But it is obvious that in the long run all organized trade in export commodities will either avoid the tax or shift it back. In those cases where the tax is successfully avoided, there is no revenue to Government: it only causes unnecessary dislocation of trade. In those cases where the tax is shifted back, the revenue is obtained at the expense of certain groups of poor agriculturists or certain small industries and the tax therefore becomes unjust and discriminatory.

The actual extent of the mischief may not be as great as this theoretical discussion would suggest and has not been very appreciable on account of the following reasons:

(*a*) The tax is very low.

(*b*) The chief small industry of Madras, viz. hand-loom, has been exempted.

(*c*) The big export industry of cotton yarn has also been exempted.

(*d*) Hides and skins, which are a chief line of export, get a concession.

(*e*) The abnormal conditions created by the war hold the normal tendencies in check.

But the tendencies for dislocation are all there and should be carefully guarded against.

The third feature has been discussed already in connexion with the argument on the exemption of selected articles. The absence of exemption for the staple necessities of life increases the injustice of the tax. Even food grains and salt are not exempted.

It will appear from these discussions that the negative features of the scheme are its worst features and require to be remedied.

The Basic Feature of the Scheme

The Madras tax is a turn-over tax. It is a tax on all sales of goods. It taxes wholesale sales as well as retail sales; it taxes sales to and by importers, manufacturers and exporters; it taxes an article as many times as it changes hand within the province.

That the scheme creates several handicaps for the trade and industry of the province by its insistence on taxing exports, the raw materials of industry and also first sales by manufacturers has

already been explained. Similarly by its insistence on taxing all sales, it brings into play economic pressure, first, for a change in the structure and organization of business, and secondly, for the exodus of business from the province. The first reaction of business to the tax is to rearrange and readjust itself in various ways in order to avoid the tax. The next tendency of business is to run away from the area of taxation when such devices have failed. The provinces cannot set up any customs barrier to prevent goods from entering the province from other provinces or from native States. So business will tend to move towards that centre from which it can sell at the cheapest rate.

The turn-over tax generates pressure for integration of business firms, substitution of wholesale dealers by commission agents, expansion of selling on consignment and various other changes in the organization of business.

It is easy for foreign sellers to avoid the tax by cutting out the agent or by adopting the consignment method of business. Big importing houses may also have branches in other provinces or in foreign centres for direct buying in order to avoid the tax. Wholesalers will find it more profitable to do business on a commission basis and manufacturers may find it convenient to cut out the wholesalers. All such practices have developed in Madras though not yet on an extensive scale.

How outside sellers are avoiding the tax through the consignment method of selling and how agents of foreign dealers are being cut out have already been explained. Many merchants of paddy and chillis are avoiding the tax by claiming to deal as commission agents. In order to support their claim they have sometimes to change some of their business practices in respect of the financing and transfer of goods. Some wholesalers who actually paid the tax for a few months applied for agency licences after some time.

In several cases wholesalers are being wiped out. How the wholesale merchants of Madura selling Tinnevelly bidis have been cut out by the manufacturers has already been noticed.

All manufacturers cannot, however, cut out the wholesalers. All wholesalers cannot convert themselves into agents. Financial and other reasons may stand in the way. Hence the tax introduces an element of inequality in trade. Some dealers do avoid the tax while others cannot. This inequality is one of the greatest objections to the turn-over tax.

There is always a considerable volume of trade in each city which relies on small fluctuations of price for its existence. The North Indian sugar merchants generally book sugar to Madras in the name of *self* and send the railway receipt to a banker in Madras to be handed over to the buyer on payment. The bank endorses the railway receipt to the buyer on receiving payment. This railway receipt changes hands about five or six times, each buyer endorsing it to the next on receipt of payment. All these men deal on a very narrow margin, a difference of one-eighth per cent being sufficient incentive to buy or sell. Such trade is very much handicapped by a turn-over tax.

The exodus of business is of two kinds. There may be a physical transference of the trade or industry from the taxing province to the non-taxing province; or there may be a simple transference of the venue of the legal transaction of sale without any change in the route of the goods themselves.

Physical transference takes place when the home industry is ruined or loses business to outsiders on account of the discriminatory effects of the tax. How this happens has been explained already and illustrated by the example of the sugar industry. Similarly, as already explained, on account of the taxation of export articles, the province may lose its trade in such articles to countries supplying the same articles without the tax.

When foreign goods are sent to Madras under the consignment method instead of under the old method in which the sender retained his title to the goods till payment in Madras against transference of documents, the goods do not change their course but only the venue of the legal transaction is changed. The tax in such a case unnecessarily destroys economic efficiency, i.e. without bringing in any additional revenue. In so far as a change over to the consignment method is not feasible in certain cases, say, on account of the low financial standing of the importer, it creates an inequality in the market which ruins such small men and is ordinarily to be deprecated.

How agents and wholesalers are often cut out and speculative trade based on small fluctuations in price is destroyed by a turn-over tax have already been explained. In so far as such things take place, the tax does not bring in any revenue but merely destroys trade and therefore probably economic efficiency and economic satisfaction.

Wholesalers who are not destroyed by the tax will, of course, feel an economic pressure for transferring their business to those places of operation where no tax is payable. The realization of this tendency will depend on various factors:

(*a*) The geographical position of the province and the nature of its distributory trade;
(*b*) The availability of a suitable alternative centre;
(*c*) The question of cost of transport;
(*d*) The rate of the tax;
(*e*) The volume of trade transacted by a firm and so on.

A port like Calcutta or Bombay is a distributory centre not only for the province of Bengal or Bombay respectively but for many other provinces. The port of Madras, however, chiefly supplies the province of Madras. Hence the wholesale trade of Calcutta will react to a turn-over tax differently from the wholesale trade of Madras. There is real competition between the ports of Calcutta and Bombay, though the fact of the competition is not visible either in Calcutta or in Bombay. There is a line of indifference, so to say, between Bombay and Calcutta, running through several provinces. The traders on this line are on the margin of doubt whether to trade with Bombay or with Calcutta. Anything that makes trading with Calcutta or Bombay more expensive will drive them to the other centre. Hence a sales tax on wholesale dealers in Calcutta only will have the effect of moving the line of indifference towards Calcutta and vice versa.

The Government of India or the transport companies often make large purchases in provincial towns. To them the cost of transport does not play an important part in the matter of choice of markets to buy from, Calcutta, Bombay or Madras being equally convenient in this respect. If, however, a sales tax operates in one of the markets and prices are higher there on that account, that will be enough to drive out such buyers from that market.

Such considerations do not apply to provinces like Assam or Orissa which receive their supplies from ports lying in other provinces but which are themselves not distributing centres for other provinces. They are, however, handicapped in another way.

Cost of transport is the chief obstacle to the transference of business. But this obstacle is not effective in the case of a province like Assam. There are only a few articles which are produced in Assam which must take its supplies of most things from or

through Calcutta. Wholesalers can avoid a tax in Assam much more easily than in Bengal because the bulk of the wholesale trade of Assam can be operated from Bengal. The goods must come to Assam from Bengal in any case and all that is necessary to avoid the tax is to complete the transaction of sale before they reach the boundaries of Assam. But the wholesale trade of Bengal cannot be transferred to a place outside the province. The cost of transport effectively prevents the transport of goods through some other channel. Some dealers may, however, open offices in French Chandernagore where the venue of the legal transaction may be transferred. But it is not possible to move the goods out of Bengal or change the course of the goods. Hence as far as the internal requirements of Bengal are concerned, the trade can be taxed more effectively than in the case of Assam. But, as Bengal serves many other places outside Bengal, one must be extremely careful in imposing a sales tax on that portion of the goods which are distributed to other provinces from Bengal.

In Madras there are many native States. Businessmen can often operate from Bangalore as easily as from Madras. All the big firms have got branches in Bangalore, and it is easy for them to change the venue of their legal transactions to Bangalore. Small firms cannot, of course, undertake the cost of opening branches in Bangalore and so long as the rate of the tax is low they will not do so. But this introduces an inequality in the market which is much to be deprecated. Bangalore, however, is not a port and goods have to pass through Madras in any case.

Retail trade is easy to tax. It cannot be transferred to other places, except on the border line of the province. Transfers on the border line can hardly assume any appreciable proportion.

The foregoing discussion makes it clear that a provincial sales tax on goods in general must place the chief emphasis on retail sales, if it is not to cause serious damage to the trade and industry of the province. A single-point sales tax will not lead to such changes in the structure of business as is inherent in a turn-over tax; and, if the chief emphasis of the tax is on retail sales, the question of transference of business or of avoidance will not assume any appreciable proportion. Export trade and home industries can be well safeguarded under a single-point sales tax; while it is administratively impossible to ensure the complete exemption of exports and of raw materials from a turn-over tax.

Whether a particular article will be exported or used as raw material in a home industry or will be otherwise consumed at home is generally known with certainty only after it has undergone a few turn-overs.

The necessity to distinguish between goods and services has given rise to a set of problems. In many cases the sale of goods and the sale of services are so mixed up that it is difficult to distinguish the one from the other, e.g. shampoo or hair oil used by a barber.

It is not possible to deal with all cases in an even manner and some arbitrary rule has got to be adopted. A few interesting instances from Madras are given below.

The Department have ruled as follows:

(*a*) If a contractor makes a contract for building a house or a road completely without giving any details of materials used, labour supplied and professional advice tendered, the transactions will be exempt, as in that case he is selling an article which is not movable property. But if, while remaining responsible for building the whole house or road, he contracts separately for the supply of the materials and the supply of the labour and also charges for them separately, he will be liable to the turn-over tax on the materials supplied.

(*b*) Hotels and clubs are to be taxed on the meals and drinks sold but not on the accommodation provided which is a sale of service. The charge, if any, levied for hot water baths is not liable to the tax as it represents only charge for service rendered, water being produced by God or nature and cost of heating being negligible.

(*c*) Water is produced by God or nature and what a man or a corporation gets by selling it is a charge for services and is not taxable.

(*d*) The sale of ready-made jewellery is to be taxed on the total sale price of the article but when a piece of jewellery is made to order, the consumer supplying the gold or silver, the jeweller is not to be taxed as he is selling service.

(*e*) If the goods are sold exclusive of packing charges and where package is not a necessary part of their delivery and where the charges are shown separately, the packing charges are not taxed, just as freight charges shown separately are not taxed. Similarly,

where installation is necessary for delivery (e.g. electric light or plant), charges therefor should be included in the turn-over but where the installation is not essential (e.g. radio set) and the charges are accounted for separately, they are not liable to turn-over tax.

In the definition of sale given in the *Madras General Sales Tax Act*, it is provided that in order to constitute a sale the transfer of the property in the goods must take place *in course of trade or business*. Many interesting practices have grown on the basis of the italicized words. Some of them are given below.

(*i*) The catering departments of railways sell goods in course of trade or business and hence the sales are taxed; but the sale of refuse, cinder, waste paper, unclaimed articles, scrap iron, etc., has been found to be not taxable, as not being in the course of trade or business.

(*ii*) The following sales have been held to be free from the tax, not being sales in 'the course of trade or business':

(*a*) Sales of food by hostels attached to educational institutions, not run for profit.
(*b*) Sales of fixed assets by a business firm, e.g. the sale of old office-furniture by a company dealing in, say, motor-cars.
(*c*) Sales of personal property.
(*d*) Sales of scriptures by the British and Foreign Bible Society.
(*e*) Sales by local bodies of rubbish, night soil, etc.

Barter is sale under the Act and both parties to the barter are liable to the tax. Cases of barter are rare but big firms operating in the same area often replenish their stocks from each other, agreeing to return the same quantity later on. This is for mutual convenience. Suppose the Burma-Shell Oil Storage & Distributing Co. of India have a wagon load of kerosene oil in Bezwada which they do not immediately require and which is required immediately by the Standard-Vacuum Oil Company. The Burma-Shell Co. transfer free of charge this wagon load to the Standard-Vacuum Oil Company and the latter give in exchange an equal wagon load of kerosene in some other place where it is required by the Burma-Shell Co. Now although there is no sale in the sense that cash is given or even credit, yet both transactions are for valuable consideration—the other wagon load of kerosene oil—and under the Act both transactions are liable to the tax.

The economic pressure for avoiding the tax in such a case is so great that the only effect of it is to destroy economic efficiency without any increase of revenue.

Such anomalies are unavoidable in schemes of sales taxes on goods only. They destroy economic efficiency, create inequalities in the market, force trade to take unusual lines and in so far as they succeed in doing so, their very object, the procurement of revenue, is frustrated.

IX

COMPREHENSIVE SALES TAX—BENGAL

BENGAL came into the field after Madras and therefore had the advantage of the experience of Madras. The Bengal sales tax is a comprehensive tax, i.e. a tax on the sale of goods in general. It is, however, a single-point tax and places the chief emphasis on retail sales. Raw materials, exports and a group of listed articles, consisting chiefly of primary necessities of life, and articles otherwise taxed are exempted from the tax. The rate of the tax is one-quarter of an anna in the rupee on the sale price of an article, i.e. $1\frac{9}{16}$ per cent. The tax was levied with effect from 1st October, 1941. As in Madras, stocks and shares are excluded from the definition of goods.

I

The Scheme

The framework of the scheme is as follows:

Definition of dealers: Any person who sells or supplies goods is a dealer. When the principal dealer lives outside Bengal, his agent in Bengal is treated as the dealer for the purposes of the Act. A contractor is a dealer under the definition.

Basis of charge: The basis of charge is the sale price realized on taxable sales.

'Sale price' has been defined to be 'the amount payable to a dealer as valuable consideration for the sale of any goods less any sum allowed as cash discount according to ordinary trade practice, but including any sum charged for anything done by the dealer in respect of the goods at the time of, or before, delivery thereof, other than the cost of freight or delivery or the cost of installation when such cost is separately charged'.

The sale price in respect of a contractor has been defined to be the gross receipts, i.e. the total valuable consideration received by the dealer-contractor less a portion representing the proportion of the cost of labour to the cost of material. Thus in a contract where 'R' represents the gross receipts, X the cost of materials and Y the cost of labour, the taxable turn-over will be represented by

$R-R\times\frac{Y}{X+Y}$, i.e. $R\times\frac{X}{X+Y}$. The overhead charges, contingencies, profits, supervision cost, etc., are disregarded in working out the proportion. Where, again, the dealer cannot produce evidence showing the cost of labour and the cost of materials, the amount to be deducted from the gross receipts in each case is a fixed percentage of the said receipts. The percentage fixed differs in different cases as follows:

(*a*) in the case of an electrical contract—twenty per cent.
(*b*) in the case of a structural contract—thirty per cent.
(*c*) in the case of a sanitary or gas contract—thirty-three and a third per cent.
(*d*) in the case of overhaul or repair of any motor vehicle—sixty per cent.

This provides a fairly good working rule in the case of contractors.[1]

Registration of dealers: Some dealers must get themselves registered, others may get themselves registered, while there are others who are not registrable.

Compulsory registration: For the purpose of compulsory registration, dealers are divided into two classes, viz.:

(*a*) importers and manufacturers,
(*b*) others.

Any importer or manufacturer whose gross annual turn-over exceeds ten thousand rupees is liable to register. Any other dealer becomes liable to register when his annual gross turn-over exceeds fifty thousand rupees. Failure to register is punishable in the case of such dealers.

'Turn-over' has been defined to be the aggregate of the amounts of sale prices and parts of sale prices received by any dealer during a given period. That proportion of a sum received by a contractor for executing a contract which is determined according to rules to represent the sale price of goods supplied in executing the contract, of course, goes into his turn-over.

Registration, once made, cannot be cancelled for three years. Registration can be cancelled only when the business is discontinued or when the gross turn-over has failed to exceed ten thousand or

[1] See sec. 2(*p*) of the *Bengal Finance (Sales Tax) Act*, 1941 and Rule 2 of the *Rules* made thereunder.

fifty thousand rupees, as the case may be, during each of three consecutive years.

Two points need be noticed in this connexion:

(*a*) The liability to registration arises as soon as the gross turn-over exceeds a stated sum even when all the sales or any portion of them are tax-free. If a dealer's sales are all tax-free he may obtain exemption from submitting returns [1] but he cannot obtain exemption from registration.

(*b*) Only sums actually received enter into his turn-over. A dealer is not taxed on credit sales until the sale price is actually realized.[2]

Voluntary registration: Any dealer who is not an importer or a manufacturer but has an annual turn-over of fifty thousand rupees or less has the option to register himself provided his annual turn-over exceeds ten thousand rupees. As soon as he is registered, his rights and liabilities under the Act will be the same as those of the registered dealers who are compulsorily registrable.

No other dealer is registrable under the Act.

A certificate of registration is granted to each registered dealer. On it are specified:

(*a*) the goods which he buys for resale;

(*b*) the goods which he buys for use by him in the manufacture of any goods for sale; and

(*c*) the goods which he buys for use in the execution of any contract.

Liabilities of registered dealers: The Act imposes several duties on registered dealers. They must submit returns of their sales, showing separately those that are taxable and those that are not. They must pay tax on the taxable sales made by them at the rate of one-quarter of an anna on each rupee of sale price received. They must keep accounts properly and must allow the departmental officers to check them.

The Act creates no duties or liabilities for unregistered dealers who are completely outside the legal scheme of the Act.

Taxability of sales: All sales made by a dealer are taken into consideration in determining his gross turn-over on the basis of

[1] See Rule 28 of *The Bengal Sales Tax Rules*.

[2] In Madras, the sale is taxable irrespective of whether the sale price has been realized or not.

which is determined his liability to register. All sales, however, may not be taxable. Only those sales which are taxable are considered in determining his taxable turn-over on which is calculated the amount of tax payable by him.

The sales, the sale prices in respect of which are allowed to be deducted from the gross turn-over of a registered dealer in order to arrive at his taxable turn-over, are enumerated below:

(*a*) *Sales of tax-free goods*: Thirty-one articles are declared tax-free under the Act. They are grouped together in the Schedule to the Act and sales of these articles are not taxable. They are either necessities of life or are taxed under some other Acts, or are raw materials like yarn, used by small unregistrable manufacturers but often distributed through registered dealers.[1] The list is discussed separately later.

(*b*) No tax can be levied on sales to a registered dealer of goods specified in the purchasing dealer's certificate under any of the three heads or of containers and other materials for packing of such goods. Thus if the registered dealer is a wholesaler or a retailer, he can buy the goods that he requires for the purposes of his trade including containers, without any tax. If he is a manufacturer, he can buy raw materials and machinery and containers without any tax. If he is a contractor, he can buy tax-free the goods that he requires in the execution of his contract. This is the basic principle of the scheme which is discussed later in greater detail.

(*c*) Sales to the Indian Stores Department, the Supply Department of the Government of India and any Railway or water transport

[1] It may be of some interest to note that the New York City Retail Sales Tax Law (Local Law No. 20, Laws 1937), which imposed a tax of two per cent, exempted from taxation the following scheduled articles:

Cereals and cereal products;
Milk and milk products;
Meat and meat products;
Fish and fish products;
Eggs and egg products;
Vegetables and vegetable products;
Fruits, spices and salt; sugar and sugar products, other than candy and confectionery;
Coffee and coffee substitutes; beer or other similar malt beverages; tea; cocoa and cocoa products; other than candy and confectionery;
Water, when delivered to the consumer through mains and pipes;
Drugs and medicines sold upon a physician's prescription;
Newspapers and periodicals.

administration are free from the tax. This exemption is granted in the interest of trade. As these are large buyers and have the choice to buy from several markets of which Calcutta is one, they are likely to turn to other markets if their purchases in Calcutta are taxable while they are not so taxed in Bombay or Madras.

(*d*) Sales to an Electric Supply Company of goods for use by it in the generation or distribution of such energy are not taxed.

(*e*) Sales of goods which are despatched by the dealer himself to an address outside Bengal. This is just to safeguard the export trade of the province which includes Calcutta, the biggest distributing centre in India.

In addition to these deductions a further deduction of one per centum of the balance remaining after making these deductions is also allowed [1] and when all these deductions have been made, the remainder is the taxable turn-over of the registered dealer on which he is liable to pay a tax at the rate of one-quarter of an anna on each rupee.

II

The Scheme Annotated

Registration of dealers is the foundation of the scheme and exemption of sales to registered dealers is its basic principle. Dealers whose gross turn-over exceeds a stated sum are registered and by this means the work of the department is confined to tackling only a limited number of registered dealers.

By exempting sales to registered dealers, the scheme seeks to limit the tax automatically to a single stage. Suppose *A* is a big manufacturer having an annual gross turn-over of over fifty thousand rupees. *B* is a big wholesaler having a turn-over of over fifty thousand rupees, who buys from *A*. *C* is another registrable wholesaler buying from *B*. *D* is a registrable retailer buying from *B*. *E* is the consumer buying from *D*. Now sales by *A* to *B* are exempt. So also are sales by *B* to *C* and by *C* to *D*, as all these are sales to registered persons. Sales by *D* to *E*, the consumer, are, however, taxed as *E* is not registered. Thus the tax is automatically limited

[1] The purpose of allowing this additional one percentage is just to avoid the criticism that it is a tax on a tax. When the sale price rises by the amount of the tax, the tax would be calculated on the inclusive price and hence there would be a tax on a tax. This additional allowance provides for this to some extent.

to one stage. All dealers in the chain who are registered get their goods tax-free. Government collect the tax only from *D*, though the article in respect of which the tax is levied has changed hands four times.

Now, suppose *D* were a small retailer, not registrable. In that case sales by *C* to *D* would not have been tax-free. Government would not then touch *D* who would have no liability to Government, being unregistered. Government would collect the tax from *C* and from nobody else. The tax is still limited to one stage.

If, again, *C* also were a small dealer and not registrable, Government would not touch *C* and *D* but would collect the tax from *B*, sales by *A* to *B* being tax-free as *B* is registered.

If instead of there being four dealers in the chain, there were any number less than four or more than four, the same result would ensue. Whatever be the length of the chain, Government collect the tax from the last registered dealer in the chain and from nobody else. Who is to be the last registered dealer in the chain is determined by the gross turn-over of each. The choice of the amount of fifty thousand rupees or ten thousand rupees is purely arbitrary and is a matter of administrative convenience. To the consumer, it is immaterial whether the tax is transmitted to him from a dealer with a turn-over of fifty thousand or ten thousand rupees.

Similarly, there would not be any variation of the result, if, instead of all the intermediate dealers being principals, they chose only to act as agents. Such changes could not effect any change in the incidence of the tax or in the amount of the tax payable on the commodity. The tax does not therefore exert any economic pressure for changes in the organization of business.

It is important to note here that the Act does not distinguish between wholesalers and retailers and does not even define them. The distinction between the two classes has caused considerable difficulty in other countries where a single-point sales tax is levied, e.g. Australia, Canada, the United Kingdom, American States levying retail sales taxes and so on.[1] The Bengal Act avoids all such difficulties by refusing to distinguish between wholesalers and retailers. Anybody who sells things is a dealer and if his turn-over exceeds a certain sum he comes under the Act irrespective of whether he is a retailer or a wholesaler.

[1] Haig and Shoup, *Sales Taxes in the American States* (Columbia University Press), pp. 92–4.

The last registered man in the chain from whom alone the tax is collected may be either a wholesaler or a retailer or the manufacturer himself. But there are not many wholesalers whose gross turn-over does not exceed fifty thousand rupees. Hence the last registered man in the chain will in most cases be a retailer. The limit for registration is then so chosen as to place the chief emphasis of the scheme on retail sales; it is in practice, though not in theory, a scheme for a comprehensive retail sales tax.

There is a distinction to be drawn here. The registered dealer from whom the tax is collected is only one link in a chain. Sales by those above him are exempt; sales by those below him are also not taxed. But the grounds and the implications of the exemption in the two cases are entirely different.

Exemption of those above the last registered dealer is a real exemption. This means that the article has not undergone any process of taxation until it has reached the last registered dealer in the chain. But at that stage it is taxed and the dealer who buys from him buys a taxed article, i.e. an article the price of which must have been increased by the amount of the tax paid in respect of it. As the next dealer buys it at an increased price he must sell it also at an increased price. If there is a dealer below the next, he also must have bought it at an enhanced price and must sell it at an enhanced price. If the trade practice is to show the price and the tax separately on the cash memo, and if the last registered dealer in the chain as well as each of the other dealers below him charges the sales tax, it does not mean repeated taxation of the same article nor any undue temptation on the part of the unregistered dealers. They are only collecting what they have paid. As they have bought at a higher price they must sell at a higher price. The addition to the price has taken place only once, i.e. at the time of the sale by the last registered dealer; and once the increase has taken place, the increment attaches to the article till it is in the hands of the consumer. If, however, a dealer who is above the last registered dealer in the chain, and is himself registered, charges a sales tax or increases his price on the alleged ground of a sales tax in respect of his sales to another registered dealer, he obviously tries to make an extra profit but will soon be corrected by the forces of competition.

At this stage it is necessary to explain the apparently arbitrary rule that a registration cannot be cancelled for three years even

when the turn-over falls below fifty thousand or ten thousand rupees as the case may be. The rule is no doubt arbitrary but it is no more arbitrary than the fixation of the limit for registration at fifty thousand or ten thousand rupees as the case may be. The rule, however, causes no hardship because registration is neither a hardship nor a punishment under the scheme. It only marks the stage at which the tax will be collected; and, as explained already, the selection of the stage at a particular point is arbitrary and a matter of administrative convenience. If a registered dealer is liable to pay the tax, he is also given the compensating privilege of buying goods for sale tax-free. If an unregistered dealer has no such liability to pay tax to Government he has also to buy goods already taxed. An unregistered dealer has rather to prepay the tax. He prepays the tax and is left to recoup it later as best as he can. If his sales on credit prove bad debts, the taxes paid in respect of these goods also become a burden on him. The registered dealer pays the tax only after he has realized it along with the prices realized; for he has not to pay tax on sales, the price in respect of which has not been received by him. Against this advantage he has the disadvantage of the duties imposed on him of keeping accounts, offering them for inspection, submitting returns, etc. The other disadvantages of an unregistered dealer will be discussed in connexion with the criticism of the scheme. On the whole registered dealers are at par with, if not better off, in certain respects, than unregistered dealers. Hence the continuation of registration beyond the date of the falling off of the turn-over to or below the registration limit is no hardship. It is desirable that a registered dealer's name should be taken off the register only after seeing three years' results, otherwise the frequency of registration and cancellation thereof will increase greatly to the disadvantage of both the dealers and the administration.

The system is foolproof and knave-proof to a certain extent. If on account of oversight, ignorance, or dishonesty on the part of either a dealer or an administrative officer, the former does not get himself registered, being compulsorily registrable, the effect of such non-registration on the revenue is nil as long as there are others in the chain who have registered. This is a great administrative advantage.

The important point in the Bengal scheme is that it sets out to confine the tax to one sale only out of many which take an

article from the producer or importer to the consumer. There may be many dealers—importers or producers, wholesalers and retailers —through whom the article may pass but it will be taxed only at one stage and in so far as the tax will be passed on to the ultimate consumer, it is not only immaterial at what stage the tax is levied, the scheme also avoids the great economic pressure for dislocation and integration which a general sales tax exerts on the structure and organization of business.

The economic pressure for the change of the venue of the legal transaction of sale is avoided in the Bengal scheme by adding the following explanation to the definition of sale:

'Notwithstanding anything to the contrary in the Indian Sale of Goods Act, 1930, the sale of any goods which are actually in Bengal at the time when the contract of sale (as defined in that Act) in respect thereof is made, shall, wherever the said contract of sale is made, be deemed for the purposes of this Act to have taken place in Bengal.'

This is a modification of the provisions of the Indian Sale of Goods Act and hence the Bengal Finance (Sales Tax) Act, 1941, required the assent of the Governor-General under section 107(2) of the Government of India Act, 1935.

By this provision the motive for changing the venue of sale is removed because even by doing so the tax cannot be avoided. Calcutta being an important port, goods cannot find any alternative route of entry into Bengal and the cost of transport will effectively prevent the carriage of the goods themselves to some other place before sale, in order to avoid the tax. The only thing that a dealer can do to avoid the sales tax is to transfer the venue of the legal transaction of sale to, say, French Chandernagore, without any change in the normal course of the goods themselves. Such avoidance must obviously be limited to articles of high value. But the addition of the explanation to the definition of sale effectively stops this method of avoidance. This point has been already discussed.[1]

From the constitutional standpoint, such a provision of law seems to be quite *intra vires* of the Government of India Act, 1935. Under section 99 of the Act a Provincial Legislature can make laws for the 'province' and the term province of course includes

[1] Chapter V.

everything within the province—men, goods, transactions, etc. Entry 48 of List II of the Seventh Schedule read with section 100(2), gives a Provincial Legislature power to make laws in respect of taxes on the sale of goods. Obviously the power extends to legislation on those sales of goods of which either the sales or the goods are in the province. This is similar to the case of income-tax or agricultural income-tax where a province can levy taxes on all agricultural incomes of which either the source or the man to whom it accrues is in the province, and the Centre can levy taxes on all non-agricultural incomes of which either the source or the man to whom it accrues is in British India.[1]

The next notable feature of the Act is that it does not attempt to control the incidence of the tax but leaves the trade to shift it in any way it can. There are three questions connected with incidence. They are:

(*a*) whether prices will rise;

(*b*) what will be the extent of that rise;

(*c*) what form the rise will actually take.

That prices will rise on account of such a tax is inevitable. It is a tax on the margin and is payable even when there is no profit. The forces of competition will therefore push up the price of the taxed articles by an amount equal to the amount of the tax payable.[2] It is futile for Government to interfere on this question.

The short period result may, however, be different from the long period results in many cases. In the short period many dealers may not be able to shift the burden of the tax while others may raise the price by an amount greater than the amount of the tax payable.[3] The Act is silent on these points. It trusts that the forces of competition will in the long run level things out.

The Act is also silent as to the form which the rise in the price will take. The trade is left free to choose its own form. It may quote a price inclusive of the tax or it may quote the price and the tax separately. As a sale is a contract, the contracting parties are free to choose their methods. In Bengal, the usual practice is to show the price and the tax separately on the bill.

[1] See Part IV, Chapter I.

[2] See figure I in Part I.

[3] See Haig and Shoup, *The Sales Tax in the American States* (Columbia University Press), pp. 29–37.

Though the public at first opposed this practice and a criminal case was filed in the Court of the Presidency Magistrate, Calcutta, against the salesman and manager of the Manicktala branch of the Khadi Pratisthan for collecting a sales tax of one pice on a sale of eight annas, this practice is much better for all concerned because the public can know the amount of the tax.

The question of the payment and collection of taxes by shopkeepers on small sales arises in this connexion. The difficulty is that there is no small coin available for the exact payment of a tax on sales when the price is below a rupee or includes annas. Some shopkeepers neglect the tax payable on a price below eight annas but charge a full pice on a sale of eight annas or more. Shopkeepers whose sales consist mostly of small sales, of less than eight annas each, may have to charge a full pice on sales of even lower amount. This may also lead, to some extent, to the distribution of purchases by a customer but it can occur only to a negligible extent. The Act, however, is silent on these points and leaves everything to competition, the great leveller. The devices of discs, coupons, etc., adopted in some of the American States are hardly worth undertaking and do not repay the cost involved.[1]

The substance of the Bengal scheme is thus as follows:

It levies a tax on all goods except a few specifically exempted; but it does not tax all sales of all goods. An article undergoes a number of sales during its transmission from the producer to the final consumer, and the scheme aims to tax only one of these sales.

The two basic principles of the scheme are:

(*a*) registration of dealers, and

(*b*) exemption of sales by a registered dealer to another registered dealer of goods specified in the registration certificate of the purchasing dealer.

The first principle limits the work of the sales tax department to selected dealers; the second principle limits the tax to selected sales, i.e. to sales by a registered dealer to an unregistered person who may be either a dealer or a consumer.

The tax is passed on to the final consumer and the trade is left free to choose its method of shifting it. The Act does not attempt

[1] For a description of these devices, see Haig and Shoup, *The Sales Tax in the American States*, Chapter I (Columbia University Press), pp. 33–7.

any legal device to limit the rise in price to the amount of the tax but trusts that the forces of competition will do so.

The next important point in the scheme is the exemption of sales to a registered dealer of goods intended for use by him in the manufacture of any goods for sale or of containers and other packing materials. This secures tax-free to a manufacturer all machinery, all raw materials and all containers and packing materials that he requires for making and marketing his goods. This is a necessary protection for home industries and must be provided in any scheme of sales tax. Power, which is essential for home industries, is also obtained tax-free as coal and coke have been specifically exempted and coal gas and electricity are also not taxed when sold for industrial purposes.

Another important point in the scheme is the exemption of sales of articles despatched by the dealer to an address outside Bengal. This is essential. The need for this exemption was fully discussed in connexion with the Madras scheme.

The exemption of primary necessities of life is another good feature of the scheme.

The exemption of goods sold to the Indian Stores Department and the Supply Department is intended in the interest of the trade of the province as otherwise these Departments may easily turn to other markets where there is no sales tax.

It will thus appear that the Bengal scheme avoids all the negative features of the Madras scheme and all its special features. The basic features of the two schemes are of course different; the one is a turn-over tax taxing all sales (wholesale and retail) alike, while the other is a single-point sales tax putting the chief emphasis on retail sales. The similarity in respect of exemption of smaller dealers in the two schemes is only apparent. The reasons in the two cases are quite different. In Bengal the lower stages are exempted because the tax has been levied already at a higher stage: in Madras the lower stages are exempted because it is not worth while taxing them. In the Bengal scheme, the exemption limit depends on the stage at which it is convenient to tax the article. In the Madras scheme the exemption limit depends on the stage at which the increasing cost of administration will exceed the diminishing yield from each shop.

The Bengal scheme is simpler than the Madras scheme and avoids its complications.

III

The Scheme Criticized

The Bengal scheme is an attempt to make a provincial sales tax as harmless as a provincial sales tax can be. But it is not free from defects. Some defects are, of course, inherent in any sales tax, e.g. the injustice involved in its incidence and the interference it causes to trade and industry; but the Bengal scheme has tried to minimize these defects by various devices, e.g.

(1) exemption of certain primary necessities of life;
(2) exemption of machinery, raw materials, etc., and of exports;
(3) confining the tax to one stage only;
(4) extension of taxation to sales taking place outside the province of goods situated in Bengal at that time.

The scheme, however, still shows some defects, some of which are curable.

Though the scheme sets out to levy only a single-point sales tax, in practice it does not succeed in doing so in several cases and its defects arise mostly out of this failure; for, in so far as it fails to do so it introduces discrimination in trade and causes injury to home industries and to the export trade.

The scheme operates directly on registered dealers and indirectly on unregistered dealers and persons. The scheme is therefore based on the assumptions

(*a*) that every article passes through at least one registered dealer; and
(*b*) that once an article comes out of the hands of registered dealers and goes to an unregistered dealer, it does not go into the hands of a registered dealer again.

These assumptions are not always correct and, to the extent to which they are incorrect, there arises a discrimination between trader and trader.

Some articles may not pass into the hands of a registered dealer at all. They escape taxation altogether. Many articles are produced by small men and are sold either by them or through small wholesalers and retailers to final consumers. Take the case of bidis made and sold in villages or small towns. If the small producer grows his own tobacco, plucks his own leaves and prepares bidis out of them to sell them in the village himself, and if his turn-over

does not reach ten thousand rupees a year, the articles produced by him escape taxation altogether. Similarly, a small Kaviraj, who makes and sells Ayurvedic medicine in a village or small town, out of shrubs, etc., collected locally, will altogether escape taxation. Mustard, rape, sesamum, *til* and other such products when sold by small growers to consumers in the village will be exempt from taxation as they will never reach a registered dealer. If, in the village or in the small town, there are two shops—one registered and the other unregistered—both getting their supplies of mustard, rape, etc., from small growers, the former will be taxed in respect of sales of these articles while the same articles passing to the consumer through the latter will escape taxation altogether. Such cases of discrimination between two traders are, however, bound to be few, because most articles which are generally sold in the village, without coming to the stage of a registered dealer, are exempt, viz. rice, pulses, flour, bread, fish, meat, vegetables, gur, sugar, molasses, milk, etc. Ayurvedic medicine made out of materials collected in the village, ghee, *til*, mustard, rape, sesamum, fruit, wood fuel and eggs are some of the articles in respect of which such discrimination is possible. The extent of the discrimination is also limited by the fact that many of these articles are such that they do not often reach a registered dealer at all—at least in the same market. Two cases in which such discrimination is possible are ghee and Ayurvedic medicines prepared out of materials collected in the village. In a small town the *Shakti Oushadhalaya* may be faced with unfair competition from a local Kaviraj in respect of such medicines; and a registered ghee merchant may be similarly faced with unfair competition from an unregistered dealer who makes his own ghee locally or gets his supplies from those villagers who prepare ghee in small quantities for sale. In so far as such discrimination is a small advantage for smaller men and frees a number of poorer men from a part of the burden of taxation, it is good and should not be grudged. The scope for the emergence of such discrimination has been kept at a low level by fixing the registrable turn-over in case of manufacturers at the lower figure of ten thousand rupees. The limited discrimination that exists is not then serious and must continue unless the impossible step is taken to rope in all dealers.

The failure of the second assumption leads to a discrimination of a more serious type. The registered dealers scattered all

over the province may often have to obtain their supplies of certain goods from unregistered dealers who have once paid the tax. A registered shopkeeper in an outlying station generally goes to the nearest principal town and buys the articles that he requires for his shop. The articles that he requires may not always be available in registered shops only. He may require a razor or a rare medicine or a fancy article which may not be available at the time except at the shop of an unregistered dealer. These articles have once been taxed when they passed out of the shop of the last registered dealer, and they will again be taxed when they will be sold by the dealer of the outlying station who, ex hypothesi, is registered. Under such circumstances, the scheme may lead to double or treble taxation.

The smaller industries may sometimes be put to difficulty under the scheme. All small producers may not be registered. A large number of them—almost all the cottage industries and some factory industries—will be unregistered in spite of the lower limit of registrable turn-over fixed in respect of them. Moreover, these small producers may live in such out of the way places that there may not be registered dealers within reach and the distributing organization of the raw materials, etc., required by them may be such that they must pass through registered dealers. Such producers must therefore buy their raw materials, etc., from unregistered dealers who have already paid the tax. These producers will not therefore get their raw materials, machinery and containers free of tax. Their cost of production will therefore rise and they must therefore sell at a higher price if they are to remain in business.

The bigger registered industries in the same lines will, however, get their raw materials, machinery and containers free of tax. Their cost of production will therefore not rise and they will not have to raise prices on this account. But the finished products when sold will be subjected to the tax when passing from the last registered dealer in the chain of distributors and the price will therefore rise by an amount equal to the amount of the tax.

If, therefore, the finished goods of the unregistered producers are not subjected to the tax, the dealers of both classes may be considered to be at par. In the case of the former, the raw materials, machinery and containers are taxed but the finished product is not taxed; while in the case of the latter, the raw materials, machinery and containers are not taxed but the finished product is taxed.

The assumption in respect of the unregistered dealers, viz. that their finished product is not taxed is, however, not always true. In so far as this assumption fails, the small industries are handicapped in competition.

Many cottage industries produce things which never reach a registered dealer. Take, for example, a widow who manufactures bidis out of tobacco and leaves bought in the nearest market. The tobacco and leaves have been taxed as they have probably come through a registered dealer in Calcutta or somewhere else. But she will probably sell her bidis to the final consumer in the village or in the town. The finished product escapes taxation in such cases. But if she sends out her bidis for sale through big dealers in towns, her bidis are obviously handicapped in comparison with those produced by registered producers. By far the largest cottage industry of Bengal is hand-loom weaving. The hand-loom turns out various types of cloth; but chiefly they produce either coarse cloths, napkins and mosquito nets mostly for local sale, or fashionable and expensive saris and dhuties which are distributed through big dealers in Calcutta or other big towns. So far as the former line of production is concerned, the finished product is not generally taxed as it does not generally go up to a registered dealer. The expensive articles are, however, liable to the tax under certain circumstances as they do go up to a registered dealer. But to protect this particular industry from the discriminatory effect of the tax, yarn has been specially exempted. The small hand-loom weaver has, however, to pay tax on the dyes and looms that he buys; but the hand-loom cloth also has been exempted from the tax, if the dealer who sells it does not sell any other kind of cloth.

There are many small industries in which the system of distribution is such that the finished products are generally sold through big registered dealers. The bell-metal industry and the conch-shell industry are two such instances. The producers are generally small unregistered men. The raw materials and machinery come through registered dealers and are therefore taxed. The finished products are also sold through big registered dealers in towns, though a portion is disposed of locally. In so far as the finished products pass through registered dealers, the industries will suffer from the discriminatory effects of taxation.

There are also some small factory industries which suffer from a similar handicap. There are a few small manufacturers in

Calcutta who manufacture glass ampoules and sell them to chemical and pharmaceutical firms. Their annual production is often below ten thousand rupees and they cannot therefore be registered. They obtain their raw material, viz. glass tubes from big registered dealers. Thus they have to get their raw materials from registered dealers because there is no alternative source of supply. They must sell their finished product to registered dealers because there is no other buyer. The buyers, however, have got alternative sources of supply. They can buy their ampoules from registered dealers who have got their raw materials and machinery free. These registered producers can, therefore, offer their products at a price at which the smaller producers cannot afford to sell. The smaller producers are therefore likely to be turned out of the field.

The smaller producer is also often faced with another difficulty. The big registered producers who distribute their products mostly through big registered dealers often refuse to sell to any unregistered person. If all their sales are to registered persons, they can obtain a certificate from the administration exempting them from submitting returns and from several other liabilities under the Act. Hence they would not agree to subject themselves to these requirements of the Act which cost money, by selling only a small quantity to a few unregistered persons. The small producer has, therefore, to obtain his raw material from a wholesaler or retailer. The unregistered producer of ampoules has thus to obtain his supply of raw materials through a longer chain while the registered producer can obtain them directly from the manufacturers of the raw material.[1]

The instance given above illustrates how any small unregistered producer who obtains his raw material from registered persons and has to sell his finished products to registered dealers in competition

[1] The rule was amended to provide that a certificate exempting a dealer from submission of a detailed return would be admissible even if a small portion of his sales was made to unregistered dealers or persons. This, however, does not appear to have persuaded such dealers to sell to unregistered dealers or persons so that the latter have to obtain their requirements from some other intermediate dealer who is himself registered and undertakes the task of distribution to unregistered dealers and other persons. These other persons include big organizations such as the Government of Bengal and the Corporation of Calcutta. The Tata Iron & Steel Co., Ltd., for instance, do not now sell to them direct and they obtain their supplies through an intermediate dealer.

with big registered producers or importers will feel the discriminatory effect of the scheme.

These smaller factory industries can probably be relieved of the discriminatory effect by lowering the limit of registrable turn-over. As in the case of dealers other than producers and importers, there is provision of voluntary registration when the turn-over is rupees fifty thousand or below but above rupees ten thousand, so in the case of producers there may be made a provision for voluntary registration for all. Any producer who finds registration to his advantage should be allowed to register on a voluntary basis irrespective of his turn-over, though registration may continue to be compulsory in respect of producers having an annual turn-over exceeding ten thousand rupees. This is an essential reform. In a country like ours in which young men are just beginning to take up an industrial career, small industries require to be fostered and such handicaps as have been placed on them by the sales tax scheme must be removed.

This remedy, however, will not improve the position of those small producers who have no registered dealer in raw materials within reach, but the marketing organization of whose raw materials is such that they invariably pass through a registered dealer at some stage.

The scheme again makes no provision for new business. A new industry cannot be registered as soon as it starts; it has to wait for registration till it has produced and sold enough articles to entitle it to registration. But it requires machinery, raw materials, and containers as soon as it starts or at least much earlier than it can acquire a claim for registration. Hence all new industries have to pay tax on their machinery, raw materials and containers. This is a severe handicap on new enterprise. The obvious remedy is to provide that any new business will be entitled to registration on a voluntary basis.[1]

The assumed parity between the registered producers and the unregistered is sometimes disturbed in another way. The parity, as already explained, is established by the following two facts:

[1] This was to a certain extent provided for by sub-rule 4 of Rule 3 of the *Bengal Sales Tax Rules*. Under that rule, a new business can obtain a certificate entitling it to buy, free of tax, machinery, raw materials, etc., if it can satisfy the authorities that its turn-over will be big enough to entitle it to registration when its products are ready for sale.

(*a*) in the former case, the machinery, raw materials, and containers are not taxed but the finished product is taxed;
(*b*) in the latter case, the machinery, raw materials, and containers are taxed but the finished product is not.

Some cases have been discussed where the parity is disturbed by the taxation of finished products in the case of unregistered producers so that they lose their compensating advantage. Another case is given below in which the parity is disturbed because the unregistered dealers also get their raw materials free so that they escape taxation at both ends.

The case refers to the sweetmeat industry. *Sandesh* and *Rasogolla* are made out of milk and sugar which are both specifically exempted from taxation. The chief ingredients of other sweetmeats are also flour, sugar, salt, milk, and ghee. Except for ghee, all these items are specifically exempted. Hence the unregistered producer gets his raw materials free and he has also no tax to pay on the finished product. The registered dealers, of course, get their raw materials free but they have to pay the tax on their finished products. Hence there arises an element of disparity. This is, of course, a peculiar case where (*a*) all the raw materials of an industry happen to be on the exemption list, (*b*) the industry requires no machinery, and (*c*) small and big producers sell retail and in the same market. In the case of sweetmeats other than *sandesh* and *rasogolla*, ghee, which is the most costly of all the raw materials required, does not occur on the exemption list. In the case of *sandesh* and *rasogolla*, the discrimination is substantial and the only way to remove it seems to be to put them on the exemption list. The discrimination is, however, limited to big towns like Calcutta, Howrah and Dacca where big sweetmeat producers exist, and it is not unlikely that the advantages of large-scale production make up for the small discrimination arising out of the tax.

IV

An Analysis of the Effects of the Tax on the Movement of Goods

Goods are either produced in Bengal or are imported from outside.

Articles produced in Bengal are produced and marketed under various conditions. They are discussed below under four different categories.

(*a*) Articles of the first category never go up to the stage of a registered dealer. They are produced by unregistered men and are distributed to consumers through unregistered men. The raw materials they require are also produced and distributed by unregistered men. They therefore escape taxation altogether. Instances of such articles are mostly agricultural and poultry farm products and in some cases products of small industries, e.g. eggs, mustard, sesamum, *til*, ghee, fruit, wood fuel, some ayurvedic medicines, furniture produced by village carpenters out of locally grown wood, etc. Many other things which would come under this class are especially exempt; e.g. rice, pulses, mustard oil, fish, meat, vegetables, gur, milk, livestock, tobacco for *hookka*, hand-loom cloth. The trade which thus escapes taxation, though not specifically exempted, constitutes a very large part of village economy. A small villager could, in fact, escape taxation altogether, partly on account of the specific exemptions provided in the Act and partly on account of the automatic exemption which follows from the scheme of the Act, viz. exemption of that part of the trade in which registered dealers do not take any part.[1] In so far as unregistered distributors of articles of this group have to compete with registered distributors of such articles, they enjoy a preference in the market. Thus the village Kaviraj may enjoy an advantage over the local branch of *Shakti Oushadhalaya* or a village shopkeeper who gets his supply of ghee locally may enjoy an advantage over the other shopkeeper who gets his supply of ghee from Calcutta. Both features of the scheme are good, viz.

(*i*) poorer men in the villages are very little affected; and

(*ii*) smaller men trying to make a living in the village by trade have an advantage over the bigger traders.

(*b*) There is a second category of articles which, though produced and distributed by unregistered dealers, are made out of raw materials in the distribution of which registered dealers have taken part. Hand-loom cloth is the chief example of such an article, but yarn being specifically exempted, escapes taxation on the principal raw material. Bell-metal crockery, conch-shell bangles, furniture made of teak wood, *daos*, axes, etc., made by the village

[1] The only article on which the villager would find it hard to escape taxation is his cloth, the demand for which is now largely met by mill-made cloth. *The Sales Tax Amendment Act* (I of 1944) exempted the poor man's cloth in Bengal with effect from 17th April, 1944.

blacksmith are some examples of such articles. They are taxed through their raw materials only.

(*c*) The third category consists of the same articles, produced by unregistered dealers out of raw materials distributed by registered dealers but distributed for sale with the help of registered dealers. Hand-loom cloth is the chief example of such articles but both yarn and hand-loom cloth under certain circumstances being exempt, they escape discriminatory taxation. In so far as bell-metal crockery, prepared by village producers, Kanchannagar knives, conch-shell bangles, prepared by small producers, etc., are distributed through registered dealers in towns, they are subjected to discriminatory taxation. The ampoule maker described earlier comes under this group. He pays tax on his machinery, raw materials, containers and again on his finished products. The small hosiery producers also come under this category except that they get their yarn free; but they must pay tax on their machinery, containers and again on their finished product, if distributed through registered dealers. It is here that the scheme produces a discriminatory effect of an undesirable character. A provision for voluntary registration of producers irrespective of their turn-over will remove the discrimination against people like the ampoule producer and the hosiery maker but may not solve the difficulties of people like the bell-metal producers or makers of conch-shell bangles who operate in villages and are often illiterate. Such a provision is, however, essential; though it will not go as far as is necessary, yet it will go far enough to make it worthwhile. People like the ampoule makers and the hosiery producers have to face keen competition in the market and the slightest discrimination against them may discourage them.

(*d*) The fourth category of articles are produced by registered dealers and distributed through registered and/or unregistered dealers. They come directly under the Act and pay a single-point tax as is intended. They do not have to pay a tax on their machinery, raw materials, containers and power. With respect to this group of articles the only defect of the Act is the absence of provision for registration for a new business.[1]

Among imports, most articles come through registered dealers and are directly affected by the scheme. A small quantity

[1] Since removed. See footnote to p. 132.

of imported articles comes through unregistered dealers, e.g. when a Kabuliwala brings woollen wrappers from the Punjab in small quantities and sells them retail. Such trade through unregistered dealers cannot assume large proportions and if small men trying to do some trade escape the tax it is probably a good feature of the scheme.

Difficulties arising out of the necessity to distinguish between goods and services are inherent in a scheme of sales tax confined to goods only. The difficulty has been provided for adequately in the case of contractors. In other cases it is minimized by the fact that the dealers with turn-overs of fifty thousand rupees and below are not to be tackled and intermingling of goods and services occurs more frequently in case of smaller dealers than in the case of bigger ones. Barbers selling shampoo at the time of shaving, shoe cleaners selling shoe black at the time of brushing shoes, and such other cases will not have to be tackled at all. But tailors, goldsmiths and such others will have to be tackled; and the rule stated in the case of jewellery in the Schedule to the Act is the only possible guide; e.g. when the price of the cloth and the tailoring charges are shown separately, the tax is payable only on the price of the cloth and not on the tailoring charges, but when a ready made coat or a suit is sold, the tax is payable on the entire price charged. The effect of this may be discriminatory to some extent and may change trade practice also to some extent but this seems to be the only reasonable way of handling it.

Some diversion of trade on the boundaries of the province is also likely in a provincial scheme of sales tax. The men in the villages near the provincial boundary may get their supplies from the shops on the other side of the boundary or a bazaar may be transferred from this side of the boundary to the other side. There is no remedy against such diversion of trade but it cannot assume any large proportion and is negligible.

X

THE INCIDENCE AND EQUITY OF THE SALES TAX

THE sales tax is a tax on the margin. It is payable even when there is no profit. It is therefore an addition to the cost of the dealer and will enter into price.

The incidence and effects of the sales tax are represented by figure I in Chapter I of Part I. The effect of the tax is

(*a*) to reduce consumption and production, and

(*b*) to raise prices by an amount slightly less than the amount of the tax.

The incidence of the tax is wholly on the consumer.

These are, however, the *normal* consequences of the tax based on two assumptions, namely:

(*a*) that the tax is equal, and

(*b*) that there is no economic friction.

But neither of these assumptions may be true in the short period.

In so far as the tax is not equal but discriminatory the effects and incidence of the tax will be determined by the comparative strength of the parties discriminated against and the parties favoured.

Take, for example, the case of the unregistered ampoule maker described in Chapter IX. Such unregistered producers are responsible for only a very small part of the supply in the market. The bulk of the supply comes either from registered producers or from importers. The articles passing through the latter source are taxed only once while the small supply coming from the unregistered dealers is taxed more severely, i.e. once on the raw materials, containers and machinery and again on the finished products. The unregistered producers, being responsible for a negligible portion of the supply, cannot influence the price in the market. The bigger producers and importers will, therefore, determine the price which will, in consequence, rise by the amount of the tax payable on finished products only. The excess tax payable by the unregistered dealers on his raw materials, etc., will not influence the price and will have to be borne by him, even though it is an addition to his cost. He

may have to go out of business altogether and will probably be bought out by the registered producers; or the registered producers and the importers will capture the market lost by the unregistered producers. In so far as such discrimination ruins the unregistered producer, the deviation from the normal incidence is only a short-period phenomenon terminating with the ruin of the persons discriminated against.

Similarly, it was explained before that a tax on the first sale of ground-nuts by the growers with the exemption limit at ten thousand rupees need not raise the price of ground-nuts. Ground-nuts or paddy or wheat—practically all the agricultural products of India—are grown by small producers. Very few of them sell things worth over ten thousand rupees a year. Hence if the exemption limit is there, the bulk of the products are tax-free, and in view of the existence of a tax-free source of supply of such big dimensions, price cannot rise on account of the tax paid by a few large growers. The incidence is therefore permanently on the growers.

Such a discriminatory tax is not really a tax on the margin. A tax on the margin must be a tax on the margin under all circumstances. If the margin can avoid the tax by changing ownership or by going out of the area of taxation as in the case of the Madras sales tax on exported goods, it can and will remain tax-free and, therefore, prices do not rise.

Take, again, the case of the Madras general sales tax with the exemption limit at ten thousand rupees. In the city of Madras two retail shops may exist side by side—one having a turn-over of several lakhs and the other having a turn-over of less than ten thousand rupees. Both probably get their supplies from the same wholesaler. But the small retailer cannot influence the price as he is responsible for a negligible portion of the supply. If he tries to undersell, he at once has to face a rush of customers who would immediately take him above the exemption limit. Hence the effect of the discrimination is nothing but an advantage for the smaller dealers: prices will be permanently determined by the taxed part which is comparatively much more important than the non-taxed part and will always remain so.

The case of sales taxes on exports is another instance of discrimination—not in the home market but in the foreign market. If hides and skins exported from Madras are taxed in Madras, the tax can influence prices in the world market only if the exports

from Madras form and continue to form the bulk of the supply in the world market. If, however, they are not so, or, being so at the time, cease to be so, the non-taxed part from other countries will determine the price so that the tax in Madras will have to be borne by the producers of Madras.

So also it has been explained in connexion with the Madras general sales tax that the tax has discriminatory effects on the sugar industry and other home industries of the province and that the extra tax on the home industries cannot be passed on but has to be borne by the industries themselves. The imports, being favoured, will soon gain predominance in the market and will determine the price. The extra burden placed on the home industries cannot, therefore, influence price and will rest on the industries themselves.

Such discrimination is likely to be temporary as the export trade or the home industry is likely to be ruined by such discrimination and the discrimination obviously terminates with its ruin.

Two other cases of unequal taxation have been explained already. They are:

(*a*) The case of a low flat rate tax on sellers. The tax operates very unequally as between small sellers and big sellers. The incidence of such a tax has been examined and it has been explained that the only effect of such a tax is the creation of a tendency to weed out the marginal dealers and to transfer the custom to bigger dealers.[1]

(*b*) The case of the Madras tobacco tax where the bigger dealers are taxed on an *ad valorem* basis at ten per cent on the sale price but the smaller dealers are taxed, on the ground of convenience of administration, on a lump sum basis which often works out at as high as twenty-five per cent on sale price. It has been explained that in such cases in the markets served by such small dealers

'the tax may not go wholly into the price of tobacco. It will probably increase the price of tobacco by a portion only of the tax. The remaining portion may go to increase the price of other articles sold by such dealers, as the stocking of tobacco is necessary only to push the sale of those other articles. Or it may, in the short period, fall partly on the dealers themselves; and this means that the dealers on the margin will in the long run be wiped out,

[1] See Chapter VI.

creating inconvenience for consumers or reducing the sale of articles including tobacco'. [1]

Schemes of provincial sales taxes however carefully contrived cannot avoid some form of inequality; and in so far as such inequalities exist, the incidence is different from normal expectation. The difference is temporary or permanent according as the discrimination which gives rise to this difference does or does not succeed in ruining the business discriminated against.

There is no market without economic friction. More economic friction exists, in fact, than is often supposed. In economic analyses many mistakes have been made by disregarding or minimizing the existence of economic friction.

The effect of economic friction on incidence has been explained in Chapter I, Part I. Every tax on things provokes resistance and a struggle ensues in which each group connected with the production and distribution of the taxed article tries to throw the burden on the other. It takes time to arrive at a final adjustment and the short-period results are often different from the long-period results.

The first economic friction arises out of the fact that when the tax is imposed there are a fixed quantity of goods in the market and a fixed productive organization capable of producing a fixed quantity of goods. If dealers raise prices at once, they may not be able to market all the goods the stock of which again is probably being replenished at the usual rate as the producers may not be able to reduce their rate of production immediately. It will obviously take time to bring about a final adjustment between the consumption, the stock and the production. Until that stage is reached, the tax will not affect the price and the incidence will be on producers.

Paradoxical though it may seem, competition itself may, under certain circumstances, delay the process of adjustment.

Suppose there is a retail dealer with a working capital of a hundred rupees, whose capital turns over five times during a year. Thus he buys goods for resale five times during a year. He buys the goods for five hundred rupees and suppose he sells them for six hundred rupees. His gross earning is therefore one hundred rupees which works out at a hundred per cent on his capital.

[1] See Chapter IV.

Suppose now that a sales tax of one per cent is imposed. All dealers raise their prices by an amount equal to the sales tax payable. This particular dealer may feel tempted to use the occasion for enlarging his circle of customers. He may not therefore raise prices. In doing so he may not be a loser at all. If he had shifted the sales tax to his customers, he would have bought his goods for five hundred and five rupees and sold them for six hundred and six rupees, assuming that the higher prices did not reduce consumption. His gross earnings would remain practically the same. If, however, by not collecting the sales tax from his customers he could double his annual turn-over, the result would be as follows:

	Rs
His purchases during the year (100 × 10) ..	1,000
His sales during the year	1,200
Difference	200
Deduct sales tax paid by him at 1 per cent ..	10
Total ..	190

Hence his gross earnings are increased even though he chooses to bear the sales tax himself.[1] It is assumed that his working expenses have not increased by the increase in the turn-over and that the additional profit he makes on the increased turn-over is larger than the tax payable in respect of it.

Many dealers might bid for an ascendancy over their competitors in this way, provided, of course, the rate of the tax was low enough for their purpose; but if all dealers in the line adopted this policy, it would produce no result. Hence though many may, in the short period, adopt such methods, the forces of competition will ultimately bring down all dealers to par, because that alone is a condition of stable equilibrium. But this added incentive to competition will certainly delay the attainment of the ultimate result.

The ultimate result may, however, develop in either of two ways. Either all retailers may be forced back to the old volume of sales and to charge from customers the full amount of the tax payable on each sale; or some of the retailers may be eliminated so that the remaining ones will each have a larger turn-over than before

[1] The author came across a few such instances in Calcutta immediately after the sales tax was imposed.

and they will therefore be able or compelled to reduce prices to the extent of the benefit arising out of the larger turn-over, even though they shift the full amount of the tax. The second case is one of what Seligman calls 'transformation of taxation'. It is assumed that the retailers were all earning the normal rate on their capital before the imposition of the tax and will earn the same normal rate ultimately, i.e. after the tax has fully worked out its effects, there being no change in the normal rate of return in the meantime.

It is obvious that the possibility of this is limited to cases where the tax payable in respect of a rupee of sale price is lower than the net profit realized by the retailer on each turn-over of a rupee. It is common knowledge that the net profit realized by a retailer on each turn-over of a rupee diminishes as the turn-over of his working capital increases, so that the net return to capital invested in big establishments with a high frequency of turn-over remains equal to the net return to capital invested in small establishments with a low frequency of turn-over. It is, therefore, to be expected that when sales taxes are first imposed in a country,

(*a*) the higher the rate of the tax, the smaller is the size of the marginal establishment which will be immediately compelled to adopt a policy of shifting and vice versa; and

(*b*) a policy of shifting will be more common with a high tax than with a low tax.

Such difference in policy is, however, a short-period phenomenon. Ultimately all will have to shift the tax, though in some cases there may take place a 'transformation of taxation'.[1]

[1] The American experience in this respect is as follows:

'The data gathered in the present survey indicate that a large part of the burden rests directly upon the businessman himself, and that in proportion to their number, more of the retailers operating small stores shift none of the tax than is the case among the large retail establishments. In other words, economic friction, which prevents shifting appears to be much greater than has usually been noted by students of taxation, and the friction seems to be more wide-spread among small establishments than among large ones, giving rise to a type of regressive distribution of burden. Almost all the data refer to a period of a few months immediately following the introduction of the tax, and it is the writer's surmise that a similar survey a year later would show a much larger percentage of tax payers reporting a policy of shifting.' (Haig and Shoup, *The Sales Taxes in the American States*—p. 102.)

That some of the smaller retailers did not report a policy of shifting may not necessarily give rise to a regressive distribution of the burden. There may be

For some time after the imposition of the sales tax in Bengal, the market displayed considerable economic friction. All sorts of practices developed in the market. Most big retailers added the sales tax to the price. There were a few others—chiefly small dealers—who chose to bear the burden themselves with a view to attract customers. Some customers readily paid the sales tax when charged on the cash memo separately from the price; while others dragged the salesman to a court of law. The retailers of imported fruit combined against the *aratdars* who import and sell the fruit at auctions and tried to force the latter to bear the burden. Though it is easily said that the sales tax is borne by the consumer ultimately, it requires time and struggle to reach that ultimate stage and in the meantime various results may ensue.

Another economic friction arises in case of retail dealers who sell to each customer things worth a few annas only when the rate of the tax is such that the amount of tax leviable in respect of these sale prices is so small that there is no appropriate unit of currency for paying it. The Bengal rate of the tax is one quarter of an anna in the rupee. How much is the shopkeeper to charge in respect of a sale of, say, four annas, or in respect of a sale of a primer (*Varna-bodh*) worth only one pice? Big shopkeepers generally do not charge anything for sales of less than eight annas and charge a full quarter anna for sales of any higher fraction of a rupee, i.e. the sale tax is charged on the nearest whole number of rupees in the sale price. That generally evens out in the end. But there may be small shopkeepers the bulk of whose individual sales is for less than a rupee. They may have therefore to disregard only a smaller portion of the sale price for the purpose of calculating the sales tax and may charge a full quarter anna for sales of even six annas or four annas. They do find out a method of distribution by experience, and competition keeps them away from making

cases in which the smaller dealers made a bid for growing at the expense of the larger retailers and if and in so far as they succeeded in doing so, they gained by not shifting the tax. In the long period, the tax will of course be shifted.

This may also explain why Haig and Shoup found in the American States that with a low rate of tax fewer firms reported a policy of shifting than with a higher rate. The attempt to bid for ascendancy, as explained, is possible only when the tax payable per unit of money is lower than the net profit on each turn-over of such unit. This, however, must be a short-period phenomenon, as explained.

extra profits. Besides the newspaper sellers, there is hardly any dealer all of whose sales are of such a small amount as one anna each; and newspapers are exempted under the Bengal scheme.

The equity of a tax is generally judged by its normal incidence.

To say so, however, is not to minimize the importance of short-period incidence. The short-period disturbance which a tax causes to trade and industry is a very relevant factor in estimating the desirability of a new tax and is often a decisive factor against its introduction or continuance after introduction.

Normal Incidence and Equity

The normal incidence of a sales tax is on consumers. The tax therefore affects people in proportion to their expenditure on the taxed goods.

It is common experience that expenditure does not increase in proportion to one's income. The poorest man spends all his income on goods and sometimes even more, as when he runs into debt for buying food and cloth, etc. The less poor man probably succeeds in restricting his expenditure on goods within the limits of his income. At the next stage a man begins to spend something on service; he may keep a servant or a cook or may rent a house. At the next stage people begin to spend money on travel, on better houses, and so on. At the next stage they begin to save and their expenditure on services and other amenities of life, other than goods, begins to increase with their income. After a certain stage most of the increase in one's income is saved. Thus the richer the man, the smaller is the ratio of his expenditure to income, and still smaller is the ratio of his expenditure on goods alone to his total income. A tax which is proportionate to expenditure is therefore very regressive in character and a tax which is proportionate to expenditure on goods alone is still more regressive. The poorest man is taxed on more than hundred per cent of his income whereas the richest man may be taxed on less than one per cent of his income. As the rate is the same for all, the burden of the tax lies much more heavily on the poor than on the rich. The calculation is simple. If the poorest man pays as tax one per cent on one hundred and five per cent of his income, which he spends on goods, he actually pays 1·05 per cent of his income. If the richer man pays one per cent on one per cent of his income, which alone he

spends on goods, he actually pays as tax ·01 per cent of his income. This is taxing the poor man one hundred and five times as heavily as the rich man in terms of the ratio which the tax paid bears to total net income.[1]

It has been explained already in Chapter I, Part I, that if justice means equal sacrifice for all, the ends of justice can be met only by progressive taxation. There may be difference of opinion as to the most suitable rate of progression but there is no scope for difference of opinion on the main proposition. If, therefore, the net income of a man is the measure of his ability to pay, and if a tax to be equitable must slice off progressively larger percentages of men's incomes as they rise, a tax on the sale of goods must obviously be an unfair tax. It is, in fact, the exact opposite of an equitable tax as it inverts the principle of ability to pay and slices off progressively smaller percentages of men's incomes as they increase.

The exemption list in the Bengal Act is an attempt to reduce the injustice inherent in a tax on the sale of goods. The list includes most of the goods which poor men buy and are necessities of life. The sales on which they spend most of their income, therefore, are exempted. This exemption is in fact obtained by all men—rich or poor—because all of them must buy these necessities of life. But because the rich man spends a very small fraction of his income on these articles only a small fraction of his income will be exempted on account of this special exemption. As the poor man may spend as much as ninety per cent of his income on these goods, ninety per cent of his income is by this provision exempted from taxation. But that still does not remove the regressive character of the tax, though it makes it a little less regressive. The poor man is still taxed on a larger percentage of his income than the rich man. That is inevitable as an exemption list can only alleviate the burden on the poor. It cannot increase the burden on the rich on whom the burden of the sales tax is very light; it only makes the light burden lighter.

Selective sales taxes, at higher rates, on articles consumed by the rich are a device to increase the burden on the rich. As noted already, sales taxes on petrol and tobacco are the only instances in this country. The conditions under which such

[1] For an estimate of the actual extent of regression involved in the retail sale taxes in the American States, see Jacobi, *Retail Sales Taxation in America*.

selective sales taxes can operate and the difficulties in their way have been explained. It has also been suggested there that selective sales taxes on articles of general consumption above a given price limit are a likely development in the near future.

The short-period incidence of a provincial sales tax has already been analysed. It is mostly the effect of the discriminatory character of the tax. In course of discussing the various measures, and also in this chapter, it has been explained how a sales tax may, by its discriminatory character, cause serious dislocation of business, destroy or impair economic efficiency without bringing in any revenue, and may even ruin export trade and home industries, particularly the smaller ones. The harm caused by such short-period incidence may be irreparable and in so far as a sales tax causes such harm by its discriminatory and unequal incidence, the injustice involved in the short period may be greater than that caused in the long period. It has often been said that the greatest objection to a sales tax on a provincial basis is not the regression involved in it but its discriminatory effects in the short period on trade and industry, which may cause permanent and irreparable injury to the province imposing it. The actual extent of the discriminatory effect is, however, a question of fact and differs from scheme to scheme but it can hardly be eliminated.

All the measures examined have been found to have caused some deflexion in the movement of goods and, except in the case of the retail sales tax on motor spirit, the deflexion has been considerable.

The war greatly helped to conceal the defects of the provincial sales taxes—particularly the defects arising out of their discriminatory effects on trade and industry. When goods become scarcer and scarcer and their supply ceases to be free, the small discriminatory effect of a sales tax loses its significance. The conditions are then favourable for large profits to any producer. The producers cannot freely change over from one line of production to another or from one place to another. Prices under such circumstances lose their relation to cost of production and are chiefly determined by marginal demand. The dealers sell at the highest available price which is often much above their cost and the sales tax which ceases to influence the price becomes only a deduction from the marginal demand price. Though it is an addition to cost, cost itself loses its function as a regulator of price.

Hence two consequences follow: first the incidence of the tax falls on the dealer, and secondly the short-period injurious effects of a sales tax on the trade and industry of the province do not have their full effect. The normal tendencies do exist but they are overcome by stronger opposite tendencies created by the abnormal conditions. This is the chief reason why the undesirable tendencies noticed in the foregoing theoretical analysis have not been visible in operation, the war having created the abnormal conditions soon after the sales taxes were imposed. This has also prevented the emergence of any urgent desire to reform the schemes. With the return of normal times these undesirable tendencies will gather force and will make themselves felt by actually producing visible injurious effects on trade and industry. There will then arise a pressure for reform and it is not unlikely that the provinces will then think of a common scheme of taxation to be enforced in all provinces so that the effects at least of regional discrimination are avoided.

XI

PROVINCIAL EXCISE AND THE POLICY OF PROHIBITION

EXCISE revenue has been one of the mainstays of provincial finance. The following table[1] shows its importance in the different provinces.

EXCISE REVENUE OF THE DIFFERENT PROVINCES
1940-41

Name of Province	Total Revenue Receipts (in thousands of rupees)	Excise Revenue (in thousands of rupees)	Percentage of Excise Revenue to the total Revenue Receipts
1. Madras ..	18,07,51	3,39,65	18·79
2. Bengal ..	13,54,50	1,74,47	12·88
3. Bombay ..	14,48,24	2,21,12	15·26
4. U.P. ..	11,20,42	1,34,51	12·00
5. Punjab ..	12,88,97	1,09,51	8·49
6. C.P. ..	5,26,35	60,68	11·52
7. Bihar ..	6,17,79	1,18,12	19·11
8. Assam ..	3,29,25	32,77	9·95
9. Orissa ..	1,99,00	32,84	16·50
10. Sind ..	5,19,68	37,70	7·25
11. N.W.F.P. ..	1,92,12	9,60	4·96

The amounts shown under the head Provincial Excise in the provincial budgets comprise a variety of receipts[2] many of which are not, strictly speaking, taxes of excise in the sense in which economists generally understand the term. In this chapter, how-

[1] Figures extracted from the civil budget estimates.

[2] Chiefly under the *Provincial Excise Acts* and the *Indian Opium Act*.

ever, all the receipts which are entered under the budget head Provincial Excise will be discussed and an attempt will be made to classify them, determine their incidence and assess their economic merit.

Before undertaking a classification of the various levies coming under the head Provincial Excise, it is necessary to describe them. As the levies, in spite of their wide variation in detail from province to province, are broadly similar in all provinces the description of the levies in only one province—Bengal—is undertaken here.[1]

The production of opium is the monopoly of the Government of India. The Provincial Governments obtain their supply of opium from the Central Government at a price fixed annually by the Government of India.

The Government of Bengal obtain their requirement of opium from the Ghazipur factory on indents sent annually on the basis of the previous year's consumption in the province. The opium is actually dispatched quarterly and is stocked in the different treasuries and sub-treasuries from where it is distributed to licensed retail vendors.

Opium shops are strictly limited in number. Government determine the number and sites of the shops in the province and provide each shop with a specially selected vendor, who is granted a licence for the purpose.

Government levy two taxes on opium. One is called a duty and the other a licence fee. The duty is specific and is imposed at a flat rate on all opium issued from the treasury. The licence fee is levied at a graduated rate on the monthly intake of a licensed vendor.

The manner of distribution of opium and the collection of the taxes is as follows:

The licensed vendors take their supplies of opium from the nearest treasury or sub-treasury on payment of the cost price plus the duty. The present cost price and duty are:

Cost price per seer	Rs 17-5-0
Duty per seer	,, 85-11-0
TOTAL ..	Rs 103-0-0

[1] This description is compiled from the annual administration reports, the *Bengal Excise Manual* and the many notifications issued from time to time and is correct up to January, 1942.

On payment of this amount, a transit pass for the quantity required and paid for is issued to the licensed vendor and on production of the pass the opium is issued.

The licence fee is assessed monthly by the Department on the basis of the supplies taken by a licensed vendor during the previous month, and is payable by the fifteenth of every month. The fee per seer[1] of opium taken increases with the quantity taken during the month. This sliding scale is justified on the following grounds:

As the sales of a shop increase, overhead charges per unit of sale decrease. Government, therefore, take an increasing share in the increasing profits. Moreover, an increase in the rate of profit per unit with an increase in the total sale operates as an incentive to the pushing up of sales. The sliding scale removes this incentive.

There are separate tables of licence fees according as a licensee sells only opium, or opium and ganja, or opium, ganja and country spirit and so on. In fixing the scale in each case, the probable size of the profits to be made by the licensee is taken into consideration.

The retail price of opium is fixed by Government. A licensee selling it at a different price is punishable. In fixing the retail price the cost price, the duty, the licence fee, and reasonable profits per unit are taken into consideration.

Government also fix a limit of possession[2] and any one possessing a larger quantity without a licence is punishable.

The trade is thus strictly controlled. The Government of India have the monopoly of production while the Provincial Governments have the monopoly of the wholesale trade; the Government of India fix the cost price while the Governments of the provinces fix the retail price. The Provincial Governments also fix the number and sites of shops, and the limit of possession.

The production of ganja in Bengal is strictly controlled by the Government of Bengal. It can be produced (*a*) in a strictly demarcated zone in the Naogaon Sub-division of the Rajshahi district (*b*) by licensed cultivators, and (*c*) on land allotted to each cultivator.

[1] One seer = 2·057 lb. = 32·91 oz.

[2] It is twelve grains in industrial areas and one tola in other areas. 1 tola = 0·4114 oz.

The licence to cultivators is issued annually. The total area to be cultivated in a year is first determined by the Excise Commissioner on the basis of the estimated demand for the next year. A large number of cultivators usually apply for cultivating licences among whom a selection is made on the basis of their past record of good cultivation. The total area is then distributed among the selected cultivators—the principle generally being that no cultivator should be allotted less than five cottas[1] or more than two bighas.[2]

During the production season Government employ a large temporary staff for patrol duty. They guard the fields to prevent any smuggling of the crop. When harvested, the crop is removed to a place called *chattar* where it is dried and made into finished ganja. The ganja is then stocked in a warehouse. Both the *chattar* and the warehouse are under the control of the Government.

The cultivators have a co-operative society of their own called the Naogaon Ganja Cultivators' Co-operative Society. Though the ganja is at all stages kept and transported under Government control it remains, all through, the property of the Co-operative Society till it reaches the hands of the licensed retail seller. The ganja is in fact kept under double lock whether at the Naogaon warehouse or at the district warehouses and the key of one of the locks remains with the agent of the Society while the key of the other lock remains with the Government officer in charge.

From the Naogaon warehouse, the ganja is distributed among the district warehouses according to estimated needs. The retail sellers take their supplies from the district warehouses.

The cost price or rather the wholesale price of ganja is fixed by Government according to the decision made in a conference between the Commissioner of Excise and the Registrar of Co-operative Societies. In fixing the price all the factors, including reasonable profits for the cultivator, are taken into consideration.

Government levy a duty and a licence fee on ganja as on opium. The duty is levied at a flat rate of forty-one rupees and fifteen annas per seer of ganja issued from the district warehouse. The licence fee is levied on a sliding scale on the basis of total monthly sales. The retail price per seer is a hundred and five rupees.

[1] One cotta = 0·0165 acres.

[2] One bigha = 20 cottas = 0·3306 acres.

The retail price of ganja is also fixed by Government on the same principles as in the case of opium.

The manner of distribution of ganja to licensed vendors and of collecting the duty and the licence fee is the same as in the case of opium. The licensee deposits the cost price and the duty into the treasury and on production of the *chalan* (the receipt granted by the treasury) the warehouse officer issues the quantity wanted and paid for, with a transit pass. The licence fee is assessed every month on the basis of the supplies taken during the previous month and is payable by the fifteenth of each month. Government fix the number and sites of retail shops.

Thus the production of ganja, though not a monopoly, is strictly controlled. The Co-operative Society holds the monopoly of the wholesale trade. Government fix prices, both wholesale and retail. They also fix the number and sites of retail shops and select vendors who can sell from those shops.

Some other provinces take their supplies of ganja from Bengal. They intimate their estimated demand before the cultivation season begins and the Government of Bengal take that demand into consideration in determining the area to be cultivated. The wholesale price fixed for other provinces is slightly lower than the wholesale price fixed for retail dealers in the province. In view of this concession rate the other provinces do not find it worthwhile undertaking cultivation in their provinces.

Charas is the intoxicating substance of ganja in a concentrated form. It is produced in Chinese Turkistan and is distributed in India through Government warehouses in the Punjab.

The production of *charas* in these trans-Himalayan regions has been recently prohibited by the Chinese Government. The only source of supply is now the existing stocks in the Punjab[1]; with the exhaustion of this stock, consumers of *charas* will have to go without it.

There is an approved contractor in Bengal who has got the monopoly of the wholesale trade in *charas* in the province. He has to obtain his supply through the Government of Bengal who forward his demand to the Government of the Punjab on deposit of half the amount of duty payable in respect of the quantity wanted. On receipt of the supply in the Excise office in Calcutta, it is weighed in

[1] The stock is likely to be exhausted by the end of 1941-42.

the presence of a Government officer and delivered to the contractor on payment of the balance of the duty. The payment of the price is made according to arrangements between the Bengal contractor and the Punjab contractor.

After the *charas* has been delivered to the contractor he makes his own arrangement for stocking it and dispatching it to retailers on transport passes issued by the authorities free of charge. The *charas* must be sold to licensed retailers and at a price fixed by Government. The retail price is also fixed by Government.

The price of *charas* payable by the Bengal contractor to the Punjab contractor is fixed by the Government of the Punjab.

Government levy a duty and a licence fee on a sliding scale as in the case of opium or ganja. The number and sites of retail shops are also fixed by Government. The duty on *charas* is ninety-two rupees per seer and the retail price per seer is a hundred and sixty rupees.

Bhang sold from excise shops in Bengal is not produced in Bengal, though it can be produced under a licence and the plant grows wild in many districts in the province. Bengal obtains her supply of *bhang* from Bihar.

The Government of Bihar select a contractor in Bihar who is given the monopoly of the supply to Bengal. In Bengal the Ganja Cultivators' Co-operative Society at Naogaon has been given the monopoly of the wholesale trade within the province. The Society stocks and distributes *bhang* in the same manner as ganja.

The wholesale and retail prices are fixed by Government who also fix the number and sites of retail shops and select vendors who are licensed for the purpose of retail sale from those shops.

The retail vendors obtain supplies from the district warehouses on payment of the wholesale price and the duty into the local treasury. The wholesale price thus collected by Government is later on refunded to the Society. The licence fee is levied on a sliding scale and is assessed and collected monthly as in the case of ganja.

The present wholesale price of *bhang* is ten annas per seer and the current rate of duty is three rupees and eight annas per seer.

Bengal is divided into three zones and in each zone a single company has been granted monopoly of production and wholesale trade in country spirit. The factories are planned according to Government specifications; and production and distribution are

carried on under the strictest control and supervision of Government. A strong Government staff is posted in each distillery for the purpose.

After production the stock is transferred to a warehouse which is the property of Government. Government have prescribed minimum stocks for each warehouse below which they must not fall at any time. There the country spirit is kept and issued under strict Government supervision. The warehouse is under double locks: the key of one lock is held by the company's agent and the key of the other lock is held by the Government officer in charge.

Just as in the case of ganja, the stock is distributed from there among the district warehouses within the zone according to rules and estimated requirements; and the licensed retail vendors obtain their supply from the district warehouses in the same manner as in the case of ganja. As usual the number and site of retail shops are fixed by Government.

The producing company holds three licences, viz. a monopoly licence, i.e. a licence granting it the exclusive privilege to manufacture, a manufacturer's licence, called the distillery licence, and a wholesale trade licence. Thus both in respect of production and wholesale trade within the zone he holds a monopoly. Government keep a strict watch on production and fix the wholesale price. They levy a duty at a flat rate and a licence fee on a sliding scale and also fix the retail price.

The licensed vendors obtain supplies from the district warehouses on payment of the wholesale price and the duty. The licence fee is assessed and collected monthly.

No fee is charged in respect of the distillery licence or the wholesale licence. The wholesale price of country spirit varies from three annas and nine pies to thirteen annas and nine pies per gallon. The duty varies from four annas to ten rupees nine annas and six pies per gallon. The licence fee is levied on a sliding scale, the average rate being one rupee ten annas per London Proof gallon. The retail price varies from one rupee eleven annas nine pies to fifteen rupees, eleven annas and six pies per gallon.

The system of control over the production and distribution of foreign liquor is different. The chief points of difference are—

(1) Unlike other articles subject to a provincial excise, there is a multiplicity of sources of supply in the case of foreign liquor. There are three sources of supply, viz.

(*a*) Imported foreign liquor;
(*b*) Foreign liquor made in Bengal;
(*c*) Foreign liquor made in other provinces and brought to and consumed in Bengal.

It is to be noted that the term *foreign liquor* means certain types of liquor, e.g. Whisky, Brandy, etc., which may be either imported from foreign countries or made in India.

(2) The licence fee is levied at a flat rate of one rupee and two annas per gallon of foreign liquor sold.

(3) There is no limit of possession for consumers as in the case of other articles subject to provincial excise. Anybody may stock any quantity.

The system of control is as follows:

There are three classes of licences, viz.

(*i*) Compounding and blending licence;
(*ii*) Trade licence;
(*iii*) Retail licence.

All are strictly limited by Government. A compounding and blending licence entitles a man to manufacture foreign liquor.

A trade licence authorizes the holder to sell foreign liquor for resale.

A retail licence is an authority for selling foreign liquor to the consumer, not for resale.

Retail licences are of various types, the two chief types being

(*a*) Public 'off' which authorizes the holder to sell to a buyer who must not drink on the premises of the seller,
(*b*) 'On' licence which authorizes the holder to sell and to arrange for his customers to drink on the premises.

There are various sub-types of the 'on' licence, e.g. hotel, restaurant, cinema, railway refreshment room, railway dining car, steamer, bar, etc. Into all these details it is not necessary to enter here.

The Excise authorities require no licence for import. Recently they have forbidden the transport of foreign liquor from the customs warehouse into the province by a non-licensee without a pass.

When foreign liquor made in one province is sent to another, a transit pass is required. The province of origin issues the pass and sends a copy to the province of destination. Sometimes the

importing province also insists on a pass and in that case an importer from another province must obtain a pass from his Government before he can import. This is how interprovincial trade is controlled.

On India-made foreign liquor a duty is levied at the rate of twenty-one rupees and four annas per London Proof gallon.

When duty-paid foreign liquor, made in Bengal, is sent to another province, for consumption therein, the Government of Bengal grant a refund of the duty to the Government of the consuming province. All provincial Governments have agreed that duty must follow consumption, i.e. the Government of the consuming province is entitled to the duty collected on it.

The Government of India levy an import duty on imported foreign liquor. The rates are higher than the rates of excise duty.

On sales of foreign liquor a licence fee at the rate of one rupee and two annas per gallon is levied on retail licensees. A retail licensee may buy from a trade licensee, or import from foreign countries or get his supply from another province. In practice the retail licensee seldom imports from foreign countries unless he is a trade licensee as well.

A private person, and a club, may buy from a retail licensee or may import direct from foreign countries. Formerly the clubs used to escape licence fees by making direct imports. This was a great gap in the system of revenue protection and also introduced unfair competition in trade. Recently the Government of Bengal have forbidden the removal, without pass, of any foreign liquor from the customs house by a non-licensee. The holders of retail licences or trade licences require no pass for this purpose. But the private importers, including importing clubs, require a pass for this and on this pass a pass fee at the same rate as the licence fee on retail licences is levied. This has removed the leakage of revenue as well as the discrimination against ordinary traders.

On trade licences, a licence fee on a sliding scale is levied. The rates vary from three hundred to six hundred rupees a year according to the total quantity sold during the year. The rate operates very lightly and generates no economic pressure for the elimination of the trade licensees by bringing about a combination of importers and retail sellers. On compounding and blending licences the fee is twenty rupees per dealer.

Foreign liquor for which a licence fee is paid is sometimes exported to other provinces. The question of dividing the licence fee between two Governments arises in such cases. Here there is no uniform system. The rule varies from province to province according to expediency.

The foreign liquor trade of Calcutta is important. Calcutta supplies to several other provinces. In the case of foreign liquor exported, after payment of licence fees, to Assam, Bihar and Orissa a refund to the extent of half the fee is granted to the Governments of those provinces. In the case of foreign liquor exported to other provinces, however, no licence fee is collected in Bengal. The probable reason is that in the markets of these other provinces Bengal traders have to face competition whereas in the markets of Bihar, Assam and Orissa there is no such competition.

Rectified spirit and absolute alcohol used in the manufacture of medicinal and scientific preparations and of perfumes are taxed at a concession rate as follows:

For medicinal and scientific preparations Rs 5 per L.P. gallon.
For perfumery .. .. .. ,, 17-8-0 ,, ,,

No licence fee is charged on the sale of medicinal and scientific preparations or on the sale of perfumery. Moreover the hospitals and dispensaries of this province and many of those in other provinces of India get these preparations free of duty from this province.

The trade in foreign liquor is thus less controlled than the trade in other excisable articles. The chief points of difference are brought out below.

Production. The production of country spirit is a Government controlled private monopoly. The production of ganja is also restricted to a small area within the province. Outside that area production is forbidden and within that area it is limited to a few licensed cultivators who are fully controlled by Government.

Opium, *charas* and *bhang* are not produced within the Province.

Foreign liquor can be produced under a licence anywhere in Bengal, though Government restrict the number of licensees.

Export and import. In the case of country spirit, opium, ganja, *charas* and *bhang*, *toddy* and *pachwai* export and import either from one province to another or as between Bengal and a foreign country, are strictly forbidden except on Government account.

There is in fact no export or import of country spirit, *toddy*, and *pachwai*.

In the case of foreign liquor private imports and exports are permissible without limit of quantity, subject to payment of duties and fees.

Price control. In the case of country spirit, ganja, *charas*, *bhang* and *pachwai* under the fixed fee system the price control is very severe.

Prices are definitely fixed not on commercial principles but on other considerations as already explained. The articles cannot be sold except in prescribed quantities or multiples of prescribed quantities.

In the case of foreign liquor there is no price control except that there is a minimum price fixed by Government. The trade may sell at any price above the minimum. The express purpose for fixing the minimum price is to prevent the competition of foreign liquor with country spirit.

Limit of possession. In the case of all articles except foreign liquor there is a limit of possession. No one can possess anything beyond the fixed limit without a permit.

In the case of foreign liquor, anybody can possess any quantity without permit for private consumption (but not for sale).

Pachwai is pre-eminently the drink of the hill-men and the peoples of aboriginal stock. In certain areas of the province, specially in the Burdwan Division, the poorer classes of Bengalees also take *pachwai* as a drink and also as a food. It does not usually compete with country spirit. Recently a weaker strength of country spirit has been permitted to be sold at a cheap rate and this may compete with it in some cases in spite of its higher price.

Rice is used as a base for the manufacture of *pachwai* throughout the province except in the districts of Jalpaiguri and Darjeeling where millet is also used. For the preparation of *pachwai*, the husked grain is boiled and a special fermenting agent known as *bakhar* is powdered and mixed with it.

In the case of the articles discussed so far, Government charge two taxes: one is called a duty and the other is called a licence fee. In the case of *pachwai* only one tax—a licence fee—is charged.

There are two classes of licences for *pachwai*, viz.

(*a*) Licence for the manufacture and sale of *pachwai*,

(*b*) Licence for the manufacture of *pachwai* for domestic consumption.

Licences for manufacture for domestic consumption are again either annual or occasional. Some families obtain annual licences. Others, while satisfying their normal demand by purchase, want to brew *pachwai* during festivals when they obtain these occasional special licences. These occasional licences are granted in selected districts only.

In 1939-40, one thousand, one hundred and sixty-eight annual licences were issued for domestic consumption and four hundred and seven occasional licences.

Manufacture and sale are thus controlled. Home brewing is allowed under licence. Shops which sell *pachwai* brew it themselves.

The shops are charged licence fees according to two alternative systems.

(*a*) *The fixed fee system.* This is the same system as in the case of other articles discussed above but with this difference, that while in the case of other articles the basis of charge is the sale, in this case the basis of charge is the material from which the *pachwai* is manufactured. Shops under this system pay licence fees on a sliding scale at prescribed rates on the basis of the dry rice used per month in the manufacture of *pachwai*. The manufacture takes place under Government control.

(*b*) *Auction system.* Shops under this system are put up for auction and are leased out to the bidder offering the highest monthly lump fee irrespective of the quantity manufactured or sold.

The price of *pachwai* is not fixed by Government except in the shops under the fixed fee system.

The annual home brewing licence fees vary from one rupee to two rupees. The special home brewing licence fees vary from four annas to eight annas.

Under a home brewing licence a family may brew any quantity but must not sell it or dispose of it otherwise than by domestic consumption.

There is no import or export of *pachwai* to or from the province. *Toddy* is a very cheap drink. The price is not controlled by Government and varies from six pies to three annas per seer according to season and district. It is generally consumed by a class of people who are not addicted to any other drink and as such it

does not generally compete with country spirit. *Toddy* is obtained by tapping date, palmyra or coconut trees.

Ninety-five per cent of the provincial *toddy* revenue is obtained from the districts of the Burdwan and Presidency Divisions and from the district of Malda in the Rajshahi Division, only four districts, viz. Howrah, Hooghly, the 24-Parganas and Calcutta, contributing as much as eighty per cent.

The revenue from *toddy* is derived in two ways:

(*a*) By a tax on each tree tapped. In the four districts where consumption is high, i.e. in Calcutta and the surrounding industrial areas, a tax is levied on each tree tapped, whether by owners for domestic consumption or by vendors for sale. Outside this area trees are allowed to be tapped for domestic consumption up to a limit of four seers without any licence or tax. The rate of the tax is three, four and five rupees for each date, palmyra or coconut tree respectively.

(*b*) By a licence fee on retail shops. The shops for the retail sale of *toddy* are auctioned. In the tree tax area the licensees must pay, in addition to the licence fee agreed upon, the tree tax on the number of trees tapped at the prescribed rate or rates subject to a minimum amount of tree tax fixed by Government for each shop on the basis of trees tapped during the previous years.

67,699 trees were tapped by vendors and 8,834 trees were tapped for domestic consumption in 1939-40.[1]

The number and sites of retail shops are fixed by Government. As all *toddy* shops are under the auction system there is no price control. The fixed fee system goes with price control while the auction system goes with uncontrolled prices. In the case of *pachwai* the price is checked in fact by the existence of fixed fee shops and auction shops side by side. An addict may always walk up to a fixed fee shop to drink if the auction shop charges him a higher price. In the case of *toddy*, the addicts being very poor, it pays the shops to keep the price as low as possible and the weaker strength of country spirit which at present sells at three annas and six pies per seer sets the upper limit of price for *toddy*.

Both in the case of *pachwai* and *toddy* there is no wholesale trader. The same person combines manufacture and retail sale or consumption.

[1] See Annual *Administration Report of the Excise Department in Bengal.*

It appears from the foregoing description that the trade in articles under provincial excise is subjected to a very thorough control.

Imports and exports on private account are forbidden except in the case of foreign liquor. In the case of foreign liquor also its removal from the customs house into the province is forbidden except under a licence or a pass.

Production within the country is either a Government monopoly or a private monopoly granted by Government or is carried on under a strict system of licensing.

Wholesale distribution is strictly controlled and is either carried on by Government or by licensed monopolists. The number of retailers is strictly limited and they work under a system of licensing. The sites of the retail shops as well as the selling hours are fixed by Government.

In all cases except foreign liquor there is a limit of possession prescribed for consumers. No transport is permissible except under a pass; and articles other than foreign liquor and *charas* are in fact transported under direct Government control and are kept in Government warehouses till some licensed retailer takes out a quantity for retail sale.

The control has a double purpose. It is partly restrictive and partly fiscal.

In the first place, it is intended to restrict consumption. Secondly, it is necessary for protecting the revenue because the tax is so high (being several times as high as the cost of production) that any laxity in control would result in leakage of revenue. The leakage, if any, is again likely to have a cumulative effect because it leads to unfair competition between illicit production and lawful production in which the latter must yield place to the former.

It is obvious that fiscal considerations supply the direct motive for control. Both purposes, restrictive and fiscal, may be at the basis of the decision to keep the level of taxation on these articles very high; but once the taxation is as high as at present, the necessity for control arises directly out of the necessity to protect the revenue.

The articles taxed under this group are either produced within the province or are obtained from outside.

The tree tax is clearly an excise tax. It is levied at the stage of production irrespective of whether the *toddy* produced is sold or not. The liability to be taxed begins as soon as tapping starts.

The licence fee in the case of *pachwai* is clearly not a fee but a tax. There is of course an idea of special privilege associated with it but the fee is so high that it is a special burden. It is a special tax on producers of *pachwai* on the basis of the raw material used in the process of production. It is therefore an excise tax levied at the stage of production irrespective of whether the article produced is sold or not.

In the case of both *toddy* and *pachwai*, there is no wholesale dealer and the producer is himself the retail dealer.

In the case of country spirit and ganja, the duty is collected when the article passes out of the hands of the producer who is also the wholesale distributor. The duty is then actually collected from the retail dealer at the time of his taking over the article from the producer. That Government collect both the price and the duty and refund the former to the producer is a part of the system of control. Strictly speaking the liability to pay the duty is the producer's who, however, is not asked to pay it till the article is issued from his warehouse. The duty is thus an excise tax levied at the stage of issue by the producer. The basis of charge in each case is the quantity of the finished product issued.

Charas is obtained from outside British India. It is imported from Chinese territories. The duty levied on it cannot, therefore, be classified as excise tax though it is levied under the Excise Act and is classified in the budget as Provincial Excise. The excise tax, as understood by economists, is a tax on a home-made article.

The duty on *charas* is levied when the Bengal wholesaler buys it or obtains it from the Punjab wholesaler. It is therefore better classified as a tax on sale or an octroi levied at the stage of its entry into Bengal.

In the case of *bhang* the wholesale distributor is a co-operative society and the duty is not levied till the *bhang* is actually issued to the retail dealer. This concession has been possible both because the wholesale dealer is a co-operative society and because the *bhang* itself remains under Government control till it is transferred to the retailer. This duty is also better classified as a tax on the last wholesale sale of *bhang*. As it is not connected with production, it should not be classified as an excise tax, though it is levied under the Excise Act and is classified in the budget as Provincial Excise,

In the case of opium, the wholesale distribution is done by the Provincial Government. The duty is levied when the retail dealer

buys opium from Government. It may be classified as an excise tax if the Provincial Government is regarded not as a mere commercial body engaged in the wholesale distribution of opium, but as agents of the Government of India who have got the monopoly of production.

Ordinarily the name excise tax is confined to taxes levied on articles produced within the jurisdiction of the taxing Government. The excise system on these drinks and drugs was evolved during the period when the whole country was more centrally administered. Moreover, in spite of the multiplicity of taxing Governments, the country still remains one. Hence the name of a provincial tax of excise still attaches to taxes on several articles coming from another province. It might with good reason be contended that all such taxes levied by the Provincial Governments are not excise taxes but are either taxes on sale or octroi. The Constitution Act of 1935 also supports this view; entry 40 of the Provincial Legislative List authorizes Provincial Governments to levy excise duties on certain goods 'manufactured or produced *in the province*' and countervailing duties' on 'similar goods manufactured or produced elsewhere in India'. The taxes on *bhang* and opium discussed above come under these 'countervailing duties' and may now be classified as taxes on sale.

The duty on India-made foreign liquor is clearly an excise duty. It is levied at the stage of issue by the producer. The Government of the province collects it irrespective of whether the issue is for the purpose of sale within the province or for sale outside the province, i.e. in other provinces. Allocation of the yield on the basis of consumption is a matter of agreement between Provincial Governments and does not affect the nature of the duty.

The agreement for collection at the production stage and allocation according to consumption dates back to the pre-autonomy period, when India was under a more unitary form of administration. The agreement continues partly because of inertia and partly because the provinces are integral parts of one country. Ordinarily the practice in respect of excise in all countries is as follows:

(*i*) the excise tax is levied only on that part of the production which is consumed within the jurisdiction of the taxing Government;

(*ii*) exports are exempted;

(*iii*) a countervailing tax is levied on similar goods coming from outside.

In effect, the triple measures result in the taxation of the quantity consumed within the jurisdiction of the taxing Government. This is, after all, all that is possible without doing harm to the interest of the taxing country. The inter-provincial agreement achieves the same object in a simpler way which is also cheaper and involves fewer hindrances to trade.

In the cases of ganja and *bhang* the trade in which is more severely controlled, the ordinary practice is followed. Bengal does not levy any excise duty on the ganja that is exported to other provinces and Bihar does not impose any excise duty on the *bhang* that is exported to Bengal. Only an excise tax or a countervailing tax is levied on the portion consumed within the province, exempting exports. Besides ganja, *bhang*, foreign liquor and opium there is no inter-provincial trade in any other article subject to provincial excise.

The levies imposed under the Excise Acts or the Opium Act and classified under the head Provincial Excise in the provincial budgets are not all excise taxes. The duties on *bhang* and opium are countervailing taxes on sale. The duty on *charas* is an octroi.

The licence fee on *pachwai* under the fixed-fee system is an excise tax, though it is called a licence fee and is classified as such in the budget.

The excise taxes vary both according to the basis of charge and according to the stage of levy.

In the case of opium, country spirit, and India-made foreign liquor, the basis of charge is the quantity of finished product sold by the producer.

In the case of *pachwai*, the basis of charge is the quantity of the principal raw material used.

In the case of *toddy*, the basis is the number of trees tapped.

The duty is levied at a flat rate except that in the case of *pachwai*; there is a sliding scale.

The stage of levy in all cases is either the stage of production or the stage of issue by the producer.

On all the articles, except *pachwai*, a licence fee is charged in addition to the duty or the tree tax as the case may be. Before classifying these licence fees it is necessary to collate the facts about them.

The licence fee is levied on the retail seller.[1] In the case of foreign liquor it is also levied on the trade licences. In the case of *toddy*, the retail seller is also the producer.

In the case of all the articles except *toddy*, the basis of charge of the licence fee is the quantity sold. In the case of foreign liquor the licence fee is a flat rate of one rupee and two annas per gallon sold. In other cases the rate is on a sliding scale and increases with the total monthly sales of a licensed vendor.

In the case of *toddy* the licence fee, charged in respect of a shop, is determined by auction. There is no fixed rate but each shop is put up to auction and the fee is settled with the man offering the highest amount of licence fee per month. The bidder of course makes an estimate of the sales and the profits he can make and his bid must depend on that estimate.

It is obvious that the licence fee is not a *fee* in the sense in which economists understand the term. It is, of course, levied on the occasion of conferring a special privilege, namely the sole right to sell these articles in a particular area; but the rate of the fee is so high that the special privilege becomes a special burden. The licensing and the control are obviously necessary for collecting the tax smoothly and for preventing any leakage. The licence fees are therefore *taxes* and not fees, and apart from the licence fees on *toddy*, it is clear that the licence fees on other articles are taxes on sale. They are levied on the basis of actual sales, either at a flat rate per unit sold, or on a sliding scale, i.e. the rate increasing with the progress of sales.

The licence fee on *toddy* cannot be classified as a sales tax. It is, strictly speaking, a tax on the monopoly right which the licensee is granted to sell *toddy* from a particular shop. As in all other cases, so in the case of *toddy*, the number and location of retail shops are strictly fixed by Government. The man to whom a shop is auctioned, therefore, gets a monopoly. His market is secured to him by Government; for Government would not ordinarily increase the number of shops or change the site of any shop. Hence the licensee's customers are practically secured to him. He has only to find capital. He must have the shop at the fixed site, must tap and sell according to rules and must pay the tree tax.

[1] Here the purely regulative licence fees, e.g. the fees on the wholesale licences or the producer's licence are not being discussed.

The price of *toddy* is not controlled. Hence within the area served by his shop he has got a virtual monopoly of retail trade. It is in consideration of this monopoly right that he agrees to pay the licence fee.

The economies of large scale business normally benefit the consumer under conditions of competition. When competition is active the business man sells at the cheapest possible price. Any reduction in costs, therefore, reduces price in the long run. But in the case of the articles under provincial excise where competition in the market, served by a shop, is forbidden by law, no vendor would reduce price on account of the economies of large scale business, but would secure larger profits for himself. Government, therefore, fix the price and charge the licence fee on a sliding scale. By graduating the licence fee on the volume of sales, the benefit of the economies of increased sales which, but for the monopoly condition, would have gone to the consumer, is obtained by the Government. At the same time the incentive to push sales is to some extent reduced by reducing the profit on each successive unit of sale. The graduation is thus an attempt to curb monopoly revenue and to secure part of it, at least, for Government in cases where the monopoly is a creation of law. Incidentally, it also operates as a check on pushing up sales.

In the case of *toddy*, this attempt is carried a step further. When shops are auctioned to the highest bidder it is *normally* to be expected that the whole of the monopoly revenue would come to Government. The bidder must obtain from the shop at least the same return for his capital as he could have done by investing it in another line; and open competition in bidding is likely to push bids up to the limit at which the capital required yields just the normal return, as in other lines. Hence, to the highest bidder there is not likely to accrue any monopoly revenue the whole of which is likely to come to Government. The licence fee is, therefore, likely to be, in practice, a hundred per cent tax on monopoly revenue though there is no formal assessment. It is also important to note that the monopolies in the case of *toddy* are not checked by a system of price control. The seller can charge any price he likes. But he is actually held in check by the following considerations, namely:

(*i*) Though ordinarily a shop serves a particular area, the people of that area are free to buy from the shop of another area and will

do so if there is any variation in price. Hence the monopoly is not absolute.

(*ii*) The consumers being poor, the price cannot rise without curtailing consumption against the interest of the seller.

(*iii*) The price of the cheap variety of country spirit is the upper limit of the rise.

The entire system of provincial excise is nothing but the creation of so many monopolies. The monopolies are strictly controlled by price fixation except in the case of *toddy* and foreign liquor. Price fixation is an effective check on the monopolistic producers of country spirit, ganja, etc., and effectively prevents them from earning high monopoly revenue because their actual cost is taken into consideration in fixing the price. But in the case of monopolist retailers who are numerous and whose establishments vary considerably in size, the cost of each cannot be taken into consideration if a uniform price is to be maintained. Simple price fixation is, therefore, not a complete check on monopoly revenue in their case. Though cost varies with the size of the establishment, price cannot be made to vary from shop to shop. The only way to curb monopoly revenue therefore is by means of a graduated sales tax. The auction system takes it a step further.

On foreign liquor the *licence fee* or the sales tax is not graduated except in the case of trade licences. Large shops, therefore, retain their full monopoly revenue, if any. In this case though the monopoly of retail sale is as much effective as in other cases, there is neither any rigid price control nor any graduation in the licence fees. The traders therefore get the full advantage of the monopolies created by law, and Government get no part of it.

Both an excise tax and a sales tax are taxes on things which are passed on to the consumer under conditions of competition. But in levying these taxes Government have created a system of monopolies which must greatly complicate the working of normal economic forces. The case, therefore, requires special examination.

Take, first, the simple case of opium, ganja or country spirit. All are produced by monopolistic producers. But Government fix the price on a consideration of the actual cost.

Secondly, the duty is several times as high as the cost of production. Hence variation in the basic price can exert only a little influence on demand. Moreover, Government, as in the case of

opium, sometimes vary the duty in the opposite direction, with any variation in the basic price, to keep the sale price constant.

Thirdly, the number of retail shops and their location are fixed by Government, and, according to a condition of the monopoly, the producers must keep these shops regularly stocked. The producers therefore cannot reduce production according to their choice.

As a consequence of these three factors, the monopoly is rendered innocuous. The monopolists have not got that control over supply which is the key to their power. The price is controlled by Government at all stages. Hence it is clear that the incidence of the excise duty is on the consumer. In fixing price Government do add the duty to the cost and the consumer must pay it. The incidence of the excise duty is thus demonstrably on the consumers.

The incidence of the licence fees is not so simple. As already pointed out the retailers are so many monopolist sellers selling at the same price though their cost of operation must vary according to the volume of business done by each. The licence fee also increases with the volume of sales made by a shop. In fixing the retail price the highest rate of licence fee cannot be taken into consideration, for that would be paying a premium to the smaller shops who would actually pay a lower rate of licence fee. Hence prima facie it appears that the consumers pay that part of the licence fee which is taken into consideration in fixing the retail price, i.e. at the lowest rate. Any excess above the lowest rate which is collected from the bigger shops is paid out of their monopoly revenue. Hence it appears that the incidence of the licence fees is partly on the consumers and partly on the retail sellers.

The case of foreign liquor is different. There the monopolist sellers are not controlled so rigidly. But the monopoly, too, is held in check by the right of the private consumers, including clubs, to import and to possess without any limit. If the shops charged very high prices, persons could pool together into a club and import foreign liquor. Till recently the clubs were even placed at an advantage in Bengal in that they had not to pay the licence fee while persons buying from licensed shops had to pay it. Clubs have, however, since been placed at par with the shops and have to pay what are now called pass-fees. The licence fees as well as the excise duty or import duty, as the case may be, are levied at a flat rate. Hence there is no doubt that both of them are passed on to the consumer.

There is, however, still some scope for traders to earn a little monopoly revenue. First, the cost of operation of a shop varies with its size but the price and the duty payable are the same for all. The bigger shops, therefore, earn some extra profit which, but for monopoly conditions, would have trickled down to the consumer in the shape of lower prices.

Secondly, private consumers have some amount of exploitable inertia. There is a limit up to which they would not take the trouble of forming a club for direct imports. There are, of course, existing clubs which do it regularly but they are accepted by the trade as part of the existing conditions. There is still a limit up to which the shops can raise prices without increasing the number of such clubs or without increasing the membership of such clubs. If the shops find that they can raise prices anywhere up to that limit without reducing consumption in such a way that their total revenue would not decrease but would increase, they would of course do so. That is to say, within the limits set above, the trader will regulate prices as a monopolist and will fix them at that point which will bring him the maximum monopoly revenue. If, therefore, by pursuing this policy, the trade has fixed prices above the normal competitive level, a slight increase of the licence fees would not have any effect on prices, i.e. the incidence of the increase will be on the trader.

In the case of *toddy* the position is complicated by the auction system. The bidder's position is clear. It is as follows:

(*i*) He is given the sole right to sell from a shop, i.e. he is offered a monopoly in the market commanded by the shop.

(*ii*) He is free to sell at any price but economic factors have a great moderating influence on his right to fixing the price.

(*iii*) He must pay the tree tax at the fixed rate.

Thus he knows the market, the cost of production and probably the price at which he must sell. From these factors he can estimate the margin of profits and the proposition before him at the auction is how much of it he can surrender in favour of Government. Looked at from this point of view, the incidence of the licence fee is on him and the incidence of the tree tax is on the consumer because the licensee takes the tree tax as a part of the cost of production, but takes the licence fee as a slice out of his profits. But essentially the extent to which he can raise prices without reducing monopoly

revenue is the basis on which his profits depend. If Government created no monopoly rights, but left the market to competition, the price would have come down to the level of the actual cost of production. Nobody could offer any licence fee under such conditions. From this standpoint the incidence of the licence fee is on the consumer. Government have created the monopoly only in the expectation that the person who would get the monopoly right would be able to charge higher prices than he could have done under conditions of competition and would agree to surrender a portion thereof to Government. The consumer may be even worse off under this system. For, with a known rate of sales tax under competitive conditions, prices cannot rise by more than the amount of the tax. But in this case prices must be determined by other considerations, i.e. considerations which appeal to a monopolist and hence prices may rise higher. The system of auction of course deprives the monopolist of the monopoly revenue and brings it to the State but that does not bring any solace to the consumer. The case is comparable to the creation of road monopolies which must be bad for the passengers who use the buses. These are created monopolies for revenue purposes.

The Question of Equity of the Taxes

The excise taxes and the sales taxes discussed in this chapter, like all other taxes on things, are regressive in character and therefore unjust. For several reasons, however, the taxes just discussed are specially unjust.

The consumers of articles subjected to provincial excise belong mostly to the poorest classes. *Toddy* is the drink of the poorest labourers and cultivators. *Pachwai* is the drink of the hillmen and aboriginals who are very poor. Ganja, *bhang*, *charas* and opium are taken mostly by the common people who are poor and cannot often find two meals a day. To levy taxes at such high rates on these people is hard indeed. It is placing the heaviest burden on the economically weakest.

Among those who drink country spirit, the majority belongs to the poor and lower middle classes and the rest to the upper middle class. Only among those who drink foreign liquor do rich people preponderate. Leaving aside all questions of morality, the taxes of

this group, therefore, involve the utmost injustice. It is in fact taxation of extreme poverty at excessively high rates.

Foreign liquor being consumed by wealthy persons the tax on it is free from the above-mentioned objection. The injustice involved in the taxes on foreign liquor lies rather in the opposite direction—the rates are too low. This point will be amplified later on.

The consumption of alcohol demands other more difficult sacrifices because it is considered a vice by society and makes outcasts of those who drink. The sacrifice that they make cannot therefore be measured by money. The injustice involved in the tax is therefore immeasurable.

The following quotation from the *Administration Report* of the excise revenue in the Province of Madras for the year 1940-1 clearly shows that the extent of the burden of the excise taxes cannot be measured by money. In ¶ 76, under the heading 'Economic and Social effects of Prohibition' the *Report* says—

'The improvement in the conditions of living among the ex-drinking classes continued to be maintained. In rural areas, prohibition has materially improved the condition of the poor classes both economically and socially. The money that formerly found its way to liquor shops is now usefully spent on better food and on better clothing and what is left over is utilized generally to liquidate previous liabilities or is spent in jewels or invested in thrift societies. There is more harmony in family life and prohibition is generally considered as a great blessing.'

This picture gives a measure of the sacrifice involved in the taxes of the excise group. It cannot certainly be measured by the three and a half crores of rupees which the Government of Madras make or used to make by their excise revenue; nor is there any equivalent or comparable burden imposed on the other classes of society who are much better off. The poor drinking class is thus called upon to make a sacrifice which is disproportionate and is of a type different from the sacrifice which other classes are making.

Provinces under autonomy were either prohibitionist or reformist in respect of their excise policy.

Madras, Bombay, Bihar, Orissa, the C.P., the U.P., and the N.W.F.P., in which the Congress party was in power, were prohibitionist. Bengal, the Punjab, and Sind which were under non-Congress ministries were reformist. Assam was prohibitionist as long as it was under a Congress ministry and was reformist when under a non-Congress ministry.

All the prohibitionist provinces had started prohibition in some form or other in selected districts and were committed to extending it gradually on the basis of the experience gained. Five of the provinces passed comprehensive Prohibition Acts as follows:

(*a*) The Madras Prohibition Act X of 1937.
(*b*) The Bihar Prohibition Act VI of 1938.
(*c*) The C.P. and Berar Prohibition Act VII of 1938.
(*d*) The N.W.F.P. Prohibition Act 1938.
(*e*) The Orissa Prohibition Act VII of 1939.

Bombay, the U.P., and Assam started the experiment on the basis of the restrictive powers of Government granted under the existing Excise Acts and Bombay amended the Abkari Act to enlarge her powers adequately.

Madras not only started prohibition earliest of all but had also extended it furthest when the ministry resigned. There, prohibition has been in force in the Salem district since 1st October, 1937, in the Chittoor and Cuddapah districts since 1st October, 1938, and in the North Arcot district since 1st October, 1939.

In Bombay, prohibition was first introduced in the town of Ahmedabad in July, 1938 and was extended with effect from 1st August, 1939 to the Town and Island of Bombay, the Bombay Suburban District and that part of the Thana Mahal which is encircled by the Thana Bassein Creek.[1]

Similarly, in the other prohibitionist provinces, prohibition has been in force in selected areas.

Among the reformist provinces Bengal introduced prohibition in the District of Noakhali.[2] Prohibition was also declared to be the ultimate goal of the excise policy of the Government.[3]

But the prohibition movement has not acquired much political strength in Bengal. The reason is not far to seek. The size of the excise revenues of Bengal and of Madras is an index of the difference in the acuteness of the problem. The Bengalee cultivator is remarkably free from the drinking habit. As already pointed out, eighty per cent of the *toddy* revenue of the province is collected from the

[1] For a summary of the system see 'Annual Report on the Administration of the Excise Department in the Province of Bombay for the year 1939-40'.

[2] The district with the smallest consumption.

[3] See the speech of the Excise Minister (Mr P. D. Raikut)—*Bengal Legislative Assembly Proceedings*, 1938, Vol. LII, No. 5, p. 456.

industrial areas in and around Calcutta while another fifteen per cent is collected from the adjoining rural areas and from the Burdwan Division which has extensive mining areas. The labour population of these industrial and mining areas are chiefly non-Bengalee. The Bengalee middle class is also substantially free from the drink habit. Among Bengalees it is chiefly a section of the middle class, a section of the rich, and a section of the cultivators in and around the industrial areas, who indulge in drink. The hillmen and the aboriginals, of course, drink *pachwai*.[1]

About the desirability of prohibition there are hardly two opinions in the country. The reformist provinces have not questioned its desirability though they have questioned its practicability. Their contention is that the Provincial Government cannot afford to lose the revenue which the provincial excise system yields. They have generally urged two points in their defence:

(*i*) They are following a policy of maximum revenue with minimum consumption. 'It is a principle of excise policy applicable to opium as well as to liquor, to obtain the greatest possible revenue from the least possible consumption.' [2]

(*ii*) The excise revenue is well spent on nation-building work. 'It would be a deplorable alternative if in trying to implement a policy of prohibition, some of the important consturctive schemes have to be suspended or sacrificed'.[3]

The two points are examined below.

Maximum revenue may not be consistent with minimum consumption; and when the two ideals clash, considerations of revenue are more likely to prevail as will be explained with figures presently.

What, therefore, is really meant by the principle is that the high taxes in themselves restrict consumption by pushing up the price. Consumption is restricted and at the same time good revenue is obtained. An extraneous object of taxation is thus introduced and its effect on equity requires examination.

The utility of intoxicating drinks or drugs can hardly be judged by the consumers in the same way as that of other articles of con-

[1] See the speech of the Chief Minister (Mr A. K. Fazlul Huq)—*Bengal Legislative Assembly Proceedings*, 1938, Vol. LII, No. 5, pp. 457–9.

[2] *Punjab Excise Manual*, Volume III, Chapter 14, page 2.

[3] Speech of the Excise Minister, Bengal—see *Bengal Legislative Assembly Proceedings*, 1938, Vol. LII, No. 5, p. 457.

sumption. A man who chooses between sugar and *gur* or, between a ride instead of a walk home from office and a better dinner at night, or between sending his daughter to school and hiring a better house, does so by estimating soberly the marginal utility of the alternatives. The science of economics assumes that a man calculates accurately in this respect and therefore it is assumed that when he chooses one thing in preference to another of the same price, or involving the same expenditure on his part, he derives greater utility from the former. But this basic assumption fails in the case of intoxicating drinks and drugs for two reasons.

First, they make men lose their sobriety. While under their influence they are no longer the free agents they are assumed to be.

Secondly, these drinks and drugs make an individual anti-social by habit and what he considers to be utility may not be really utility at all, socially speaking.

Hence regulation of consumption by price control does not yield the same result in the case of intoxicating drinks and drugs as in the case of other articles such as sugar or iron. As the price of sugar is raised, the poor begin to give up buying it. But as the price of wine is raised, the result may be the exact opposite. The poorest men may adhere to wine in spite of the rise and many rich men may give it up. The result is that as the price of wine rises the poorer man may, for the sake of it, first deprive his children of schooling, may then deprive his family of clothing and food, and may even deprive himself of food and clothing or may even resort to theft. The effect of the tax is, therefore, extremely harmful. The regulation of consumption by taxation, though productive of good results in other lines, produces disastrous results in the case of articles like intoxicating drinks, and causes extreme hardship by throwing an almost inhuman burden on the poorest classes of society. The regulation of consumption by taxation is, therefore, highly undesirable in such cases.

It is not, of course, contended that the high taxes do not restrict consumption in these cases. They certainly do so. With the taxes the consumption is necessarily lower than what it would have been without them or with lower taxes. But the restriction takes place in an undesirable way and, in the process, throws a heavy burden on consumers irrespective of their capacity to pay. A similar process of restriction in respect of any other article with

an elastic demand such as sugar, or shoes, would not have involved a similar injustice.

Secondly, in certain instances the policy of restricting consumption is totally absent and the maximum revenue is the sole basis of policy. The auction system of fixation of licence fees, without price control, is one such instance. Under this system a monopoly is created for the purpose of revenue and the monopolist retailer is given freedom to vary the quantity to be supplied or the price in any way he wants to. He will make his decision about the volume of supply or the price, not on any consideration for the desirability of restricting consumption, but on the sole consideration of the size of his monopoly revenue. He will not hesitate to place a large quantity at a low price on the market if by doing so he can maximize his monopoly revenue. As the highest bid at the auction for the settlement of the shop must be correlated to the highest monopoly revenue estimated by the bidder, the question of the desirability of restriction of consumption is totally absent at all stages of the process. In these cases, therefore, revenue is the sole consideration and the need for restricting consumption does not exert any influence on the pricing process or on Government policy.

Thirdly, in the case of foreign liquor, specially in Bengal, the rate of licence fee is very low. It, therefore, has hardly any restricting influence on consumption, considering the usually affluent circumstances of the consumers of foreign liquor. The rates are even unequally favourable to them.

The second argument is, in the first place, irrelevant. The expenditure policy of the Government is not under discussion here and it is not being contended that the money is being badly spent. It is the question of equity in the manner in which the burden of the revenue is being distributed which is the subject matter of discussion here. The contention is that a great injustice is being committed in raising the money in the particular way and from the particular class. It is no answer to the charge to say that the money is being well spent; the expenditure would not have been affected at all if the burden of taxation were better distributed, i.e. if the same amount of revenue were raised from other classes who were better able to pay.

Secondly, the picture of the economic and social effects of prohibition in Madras, as given in the lines quoted above from ¶ 76

of the Report on the Administration of the Excise Revenue in Madras for the year 1940-1, demonstrates the utter futility of this argument. The Government of Madras could not, by spending their entire excise revenue of three and a half crores of rupees on anything whatever, have produced the same comfort and harmony in family life, as have followed the enforcement of prohibition in the selected districts; and these families are the backbone of the nation. If the purpose of revenue collection is the improvement of the standard of comfort and happiness in families, it is obvious that the object is better achieved by not collecting the revenue on these intoxicating drinks, i.e. by the enforcement of prohibition.

It is thus clear

(i) that the attempt to restrict consumption of intoxicating drinks and drugs by taxation increases the injustice of the tax; and

(ii) that the argument of expenditure as justification of the excise revenue is irrelevant and futile.

Prohibition was therefore a correct policy from the standpoint of the economic well-being of the people and as a simple measure of tax reform. It is unfortunate that the ministries in the prohibitionist provinces resigned without carrying the policy through.

Prohibition meant:

(i) the surrender of a large revenue; and

(ii) the additional cost of enforcing prohibition by enlarging the police force, etc.

The object of most of the taxes, under autonomy in these provinces, was to fill up the gap to be created by prohibition in their budgets. The taxes have to be judged against this background. Even bad taxes like the general sales tax may become defensible when they are intended to replace worse and more unjust taxes like those discussed in this chapter. Replacement of the excise taxes by the sales tax can be defended as a simple measure of tax reform; though both are bad, one is a lesser evil. This does not of course absolve the Government from the criticism that they ought to have found a still better tax. Whether a better tax or taxes of the same magnitude were available under the present constitution is of course a different matter.

Instead of attempting total prohibition all at once, a gradual system may be better in many respects. Such a system would involve the registration of addicts and a strict rationing of the drinks and the drugs among them. New registration after a certain date might be refused or allowed at a diminishing rate till it stops by a fixed date.

Gradual prohibition by such means, though delayed, is likely to be permanent once it is completed. The pressure for breaking the law and for boot-legging will be small and prohibition will not have to pass through the strains which have often proved too much for it. It would also not bring about a sudden dislocation of the finances of the provinces and there would be time for developing fresh sources of taxes to replace the gradual loss of revenue. The rationing system would help addicts to accustom themselves gradually to smaller quantities and would at the same time make the distribution of the tax burden more equitable.

The reformist provinces found it impracticable to surrender the excise revenue and carried out small reforms here and there in the excise administration. Such small reforms hardly deserve notice here except one in Assam and Bengal.

Both in Bengal and Assam, when a club sold foreign liquor to its member the transaction was not treated as sale, though in Bombay it was. Clubs were treated as private individuals in these two provinces and could import foreign liquor. Hence, as already explained, it was an advantage for men to form a club and import foreign liquor; by doing so they could avoid paying the licence fees. Clubs obtained cheap liquor by this means, revenue was lost, and the retail traders suffered.

The Assam Excise (Amendment) Act, 1939, was enacted to put a stop to this. It was enacted thereby that:

Any club which has transactions with its members in respect of foreign liquor, shall be deemed to be conducting retail sales and shall be required to take out a licence under this Act on payment of such fees and subject to such restrictions and on such conditions as the Provincial Government may prescribe.

In Bengal the same object was achieved by issuing certain rules in 1941, by which transport passes were required for taking out foreign liquor from the Customs House, and pass fees at the same rate as licence fees (which are levied at a flat rate) are levied on these passes.

Another small reform which seems to be due in some provinces is the increase in the licence fee on foreign liquor. In some provinces it is very low compared with that in other provinces and is even lower than the licence fee on country spirit. Moreover, it is not graduated. As foreign liquor is consumed by the richer class of people there is no justification for this discriminatory treatment in their favour.

For the purpose of a comparison the duty and the licence fee should be taken together. They are as follows in Bengal:

	Duty	Licence fee	Total
Foreign liquor ..	Rs 16-6-6	Rs 1-2-0 (Retail off)	Rs 17-8-6
Country spirit ..	Rs 10-9-3	Rs 5 (maximum)	Rs 15-9-3

The price of an ounce of country spirit is one anna and nine pies while the price of an ounce of foreign liquor is three annas and six pies. Thus though the price of the one is double that of the other, the taxes are almost equal. In view of the fact that foreign liquor is consumed by the richer section of the community, the taxation on it ought in fairness to be more than double the taxation on country spirit. As it is, there is an element of injustice in it.

An important point deserving notice is that in spite of the declared policy of Provincial Governments to subordinate all considerations of revenue to the need for restriction of consumption,[1] the consumption reacts quickly to changes in economic conditions in the province. The following figures of revenue derived from this source in Bengal will show how there has been a steady increase in consumption during recent years. As the increase is most marked under the head country spirit, the receipts under that head are shown separately.

(*The figures are in thousands of rupees.*)

	1935-6	1936-7	1937-8	1938-9	1939-40
Country spirit ..	38,21	42,81	52,42	55,52	60,02
Total receipts under Provincial Excise	1,33,73	1,36,37	1,54,56	1,59,35	1,65,28

There are similar tendencies in other provinces also.

[1] 'Their settled policy, however, is to minimize temptations to those who do not drink, and discourage excess among those who do, and to the furtherance of this policy all considerations of revenue must be absolutely subordinated.' (*Punjab Excise Manual*, Volume III, Chapter I, page 2.)

This result is inevitable as Government do not adjust the taxes to any increase or decrease of consumption. The regulative device remaining constant, changes in economic conditions must produce their effects on the volume of consumption, though some variation may also be due to the state of facilities for illicit production and its control. The labourer thus throws away a good part of his prosperity on drink. It is difficult for Government to resist the temptation of an easy increase of revenue, even if the tax which produces the revenue is unjust.

XII

SOME OTHER TAXES ON THINGS

FROM the economic aspect things pass through three stages. They are produced ; they are sold ; they are used or consumed. Provincial taxes on the production of things have been discussed in the chapter on provincial excise. Provincial taxes on the sale of things have been discussed in the chapter on sales taxes. In this chapter will be discussed taxes levied by Provincial Governments on things at the final stage of use or consumption.

Governments also tax things on the occasion of their crossing a national or municipal boundary. Such taxes are known as customs duties and octroi respectively. The former is outside the scope of the Provincial Governments while the latter is seldom imposed for provincial purposes. The important cases of provincial octroi have already been discussed in connexion with the tax on tobacco.[1]

There are three important cases of provincial taxes on the use or consumption of things. They are taxes on motor vehicles, electricity and amusement. These taxes were levied in some provinces before 1937. Under autonomy they spread to the remaining provinces. Two other taxes, namely those on betting and on prize competitions will also be discussed in this chapter.

The tax on motor vehicles was levied before autonomy in almost all the provinces.

The Acts levying the tax in the different provinces together with the year of enactment of each are noted below:

(*i*) The Punjab Motor Vehicles Taxation Act, 1924.
(*ii*) The Bihar and Orissa Motor Vehicles Taxation Act, 1930.[2]
(*iii*) The Madras Motor Vehicles Taxation Act, 1931.
(*iv*) The Bengal Motor Vehicles Tax Act, 1932.
(*v*) The Bombay Motor Vehicles Taxation Act, 1935.
(*vi*) The U.P. Motor Vehicles Taxation Act, 1935.

[1] Octroi is mostly levied by municipalities. For a description of octroi duties prevailing in some of the Northern Indian towns, see Husain—*Agricultural Marketing in Northern India*, Part III, Chapter V, pp. 130–4.

[2] Amended by Bihar and Orissa Act VI of 1934 and again by Bihar Act VI of 1940.

(*vii*) The Assam Motor Vehicles Taxation Act, 1935.
(*viii*) The Central Provinces and Berar Motor Vehicles Fees Act, 1938.
(*ix*) The Sind Motor Vehicles Tax Act, 1939.
(*x*) The N.W.F.P. Motor Vehicles Taxation Act, 1936.[1]

There is no province now without a tax on motor vehicles.

This tax is levied on the *use* of motor vehicles. All the Acts make the point clear. Thus Section 3 of the Bombay Act says that 'a tax shall be levied on all motor vehicles *used* or *kept for use* in the Presidency'.

All the other Acts have similar provisions.

In all provinces, except the Punjab, the types of vehicles taxed are motor cycles, private cars, taxis, buses, lorries. In the Punjab trams also are taxed. In Bengal and some other provinces trailers drawn by tractors are not taxed; while in others they are taxed. Trailers drawn by lorries are taxed in all provinces.

In all provinces the tax payable in respect of a bus or taxi varies with the seating capacity. In the case of lorries the tax varies with the unladen weight. Tram cars are taxed in the Punjab at the flat rate of fifteen rupees per vehicle per quarter. The basis of graduation in the case of private cars is not uniform in all provinces. In some provinces, e.g. the Punjab, the basis is the seating capacity. In other provinces, e.g. Bengal, the basis is the area measured by wheel base multiplied by track. In a third group, e.g. Madras and Bombay, the basis is the unladen weight. In the case of cycles the basis is everywhere the unladen weight.

In addition to the above general basis of graduation, there is also a special basis of graduation in the case of public service buses in some provinces, e.g. Bombay, U.P. and the Punjab. In Bombay and the Punjab there are differential rates for town buses and rural buses. In Bombay the buses running in towns and cantonments get a concession and pay tax at two-thirds of the ordinary rates. In the Punjab, however, it is the rural buses which are taxed at a concession rate. In U.P. three classes of routes are recognized which are called *A*, *B* and *C*. The tax payable is highest in respect of buses running on *A* class routes and is lowest in respect of buses running on *C* class routes.

[1] Amended by N.W.F.P. Act I of 1940.

A discrimination is also made in all provinces, except in the Punjab, on the basis of the tyres of the vehicles. If fitted with pneumatic tyres they pay the ordinary rates. But if fitted with solid tyres, they have to pay tax at higher rates which are usually fifty per cent more than the ordinary rates. This discrimination is intended to prevent the use of solid tyres which damage the roads.

The rates of the tax vary from province to province. They are the highest in Madras. It is not necessary to quote all the rates here in detail; some specimens will show the comparative levels in the major provinces.

For taxis and buses the rates are as follows:

Bengal—

Seating capacity	*Annual rate of tax*
Not more than 8 persons	Rs 75
For each seat from the 9th to the 30th ..	Rs 3
For each seat after the 30th	Rs 2

Madras—

Seating capacity	*Annual rate of tax*
Not more than 4 persons	Rs 160
For each additional seat	Rs 40

Bombay—

Seating capacity	*Annual rate of tax*
Not more than 2 persons	Rs 88
For each additional seat	Rs 16

The above rates are subject to two limiting factors; no bus shall pay a tax of more than five hundred rupees a year; and a bus running in a town or in a cantonment shall pay two-thirds of these rates.

Similarly, for private cars the rates are:

Bengal—

Area in sq ft	*Annual rate of tax*
Not more than 40	Rs 40
More than 40 but not more than 60 ..	Rs 48
60 and above	Rs 70

Bombay—

Unladen weight in cwts	*Annual rate of tax*
Not exceeding 15..	Rs 40
Exceeding 15 but not exceeding 30 ..	Rs 60
Exceeding 30 but not exceeding 45 ..	Rs 80
Exceeding 45	Rs 110

Madras—

Unladen weight in cwts	*Annual rate of tax*
Not more than 15	Rs 70
More than 15 but not more than 30 ..	Rs 100
,, ,, 30 but not more than 45 ..	Rs 130
,, ,, 45 but not more than 60 ..	Rs 160
,, ,, 60	Rs 200

In all these cases rates for vehicles with pneumatic tyres have been given.

The rates on the other types of vehicles in the three Presidencies differ almost in the same ratio.

The revenue derived from this tax in the different provinces has been as follows:

(*In thousands of rupees*)

	Actual receipts of 1939-40[1]
Madras	80,50
Bombay	41,78
Bengal	21,31
U.P.	12,16
The Punjab	13,49
C.P.	4,56
Bihar	31
Assam	4,09
Orissa	1,07
Sind	2,68
N.W.F.P.	2,38

Some Provincial Acts, passed before autonomy, repealed existing Acts authorizing local bodies to impose taxes on motor vehicles, and provided for compensation on the basis of the income of the local bodies imposing the tax.[2] The yield of the tax was also in

[1] Figures taken from the civil budget estimates of the provinces.

[2] Bengal, Madras, Bombay and the U.P.

many cases credited to a separate fund earmarked for construction, improvement and maintenance of roads, but such provisions have been deleted by the Adaptation Order in Council on grounds of law. Under Section 136 of the Government of India Act, 1935, Provincial Revenue must include all money collected on the basis of a provincial law. Hence it is against the Act to credit such money to a fund outside provincial revenues.

The question of the incidence of this tax is not very simple.

The tax on private cars falls on the users. They cannot pass it on to anybody else.

The tax on vehicles running for hire enhances the cost of providing the service and hence must raise the price of the service. The incidence of the tax on buses is therefore normally on the passengers, and the incidence of the tax on lorries is normally on the persons whose goods are carried in them.

In so far as the lorries carry goods not for consumption by the owner of the goods, but for sale by him or for being used by him as raw materials for the manufacture of some other goods, the tax is passed on further to the buyers of the goods in the first case and it enters into the cost of the goods manufactured out of them in the second case. The tax may therefore pass through a long chain till it falls on some final consumer.

A tax on lorries thus affects their competing power with other means of transport, e.g. railways, carts or boats; and a tax on buses affects their competing power with alternative means of conveyance, e.g. trams, railways, etc., if such alternative means exist.

The Bombay law of granting concession to town buses in respect of taxation is probably based on this consideration. In towns there are alternative means of conveyance, e.g. trams. Trams are not taxed and therefore enjoy a favourable position *vis-à-vis* buses. In the Punjab the trams are also taxed. So buses and trams are almost at par.

Tram Companies in all the cities are granted monopoly rights of electric traction. In cities owners of buses usually form an association of their own which generally determines the fares. In this way they also acquire monopolistic characteristics. But the two monopolies compete with one another because the services they render are of the same type. Though some men will travel only by tram while some others only by bus, to most men trams and

buses offer alternative means of transport. Further the preference for the one means of conveyance or the other is not entirely independent of the charges.

In Calcutta, in the early twenties, when there were no buses, tram fares were very high. As buses started running, fares for both began to come down on competitive routes till they settled down to the minimum. On non-competitive routes, however, the fares remained high. Similarly, on the Upper Circular Road route, the bus fares were high when no trams ran there. The fares dropped appreciably as soon as trams came in. These facts go to show that both are monopolistic in tendency though the one holds the other in check.

Now if taxation keeps the cost of one service high while not affecting the other, the favoured service takes advantage of the situation. The taxed service can reduce fares only up to the cost including the tax. The favoured service also adopts the same scale of fares though it is untaxed. The public has to make the same increased sacrifice, whether they travel by this service or that, but while the increased sacrifice made in respect of journeys by the taxed service brings additional revenues to the Treasury, the increased sacrifice made in respect of journeys by the favoured service results in the accession of additional profits to its proprietors.

This argument is based on the assumption that neither of the services can fully replace the other. If the assumption were not correct, i.e. if it were possible for one of the services to replace the other fully, the effect of a discriminatory tax might be the extinction of the taxed service, so that the field would be left entirely to the favoured service, the only check on its monopolistic tendency being fear of the re-emergence of the extinct service. In such a case any fiscal purpose of levying the tax would be entirely frustrated. But in a big city the assumption is generally valid that it is not possible for any one of the services to replace the other completely. In such cases it is clearly desirable that both the services should be similarly treated in respect of taxation. There is, in this view of the case, hardly any case for the exemption of trams from the motor vehicles tax.[1]

If trams and buses are taxed at the same rate, there is no reason why rural buses should pay a higher rate of tax than town buses.

[1] This argument applies equally when the same company has the monopoly of running buses as well as trams.

Town buses are better able to bear higher taxation in that they can make a larger number of trips per day and generally get a larger number of passengers also. But conditions vary from place to place and no generalization is possible.

As regards the basis of graduation, the most suitable basis, i.e. the basis which will best correlate taxation to the earning capacity of vehicles or to their price, in the case of private cars, is as follows:

For private cars ..	.. unladen weight or square measure.
For taxis and buses..	.. seating capacity.
For lorries ..	.. laden weight.

Though taxes on private cars, buses and lorries are imposed under the same Act, they are fundamentally different in character. The tax on private cars is a tax on luxury. Its incidence is on the payer. Even when a car is required for the conduct of a profession or a business it is only the well-to-do in that line who keep cars. It therefore falls on a few rich people.

The taxes on buses, taxis and lorries, however, are taxes on business. The tax on taxis is likely to be passed on to rich people but the taxes on buses and on lorries generally affect poorer people because they are passed on to the passengers or to the consumers of the goods which they transport. The private cars and taxis should therefore be taxed at a fairly high rate but buses and lorries should not be taxed so high. This distinction is often overlooked on account of the fact that all are taxed by the same Act.

The tax affects the demand for motor vehicles and therefore has an adverse effect on the motor car industry. There is, however, no such industry existing in India.

A noteworthy feature of the Central Provinces and Berar Act is that it calls the levy a 'fee' while all other provinces call it a 'tax'. In the previous Act which expired on 31st March, 1938, the levy was called a tax. The Minister in charge of the new bill, while introducing it, explained the change of name by saying that it was necessary in order to bring the measure into conformity with the Government of India Act, 1935.[1] This is a technical question of law and is briefly as follows:

[1] The C.P. and Berar Legislative Assembly Proceedings, Volume III, page 23; proceedings dated 2nd March, 1938.

Entry 48A of List II of Schedule VII reads,

'Taxes on vehicles suitable for use on roads whether mechanically propelled or not, including tram cars.'

This entry was introduced by the India and Burma (Miscellaneous Amendments) Act, 1940. Before its introduction, therefore, it was not at all clear whether the Provinces could levy a tax on motor vehicles or whether even the then existing Provincial Acts levying such taxes were *intra vires* of the Government of India Act, 1935.

Entry 25 of the Concurrent List is, 'Fees in respect of any of the matters in this Part of this List but not including fees taken in any court.'

Hence a Provincial Government could levy fees on mechanically propelled vehicles and the Government of the C.P. based their law on this entry. The entry No 48A, in List II, came later.

But is the levy a 'fee' or a 'tax'? Here economic definitions will not coincide with legal definitions. According to the former, it is clearly not a fee. No question of a special benefit arises here. There may of course be a question of regulation, etc., but that is controlled by an all-India Act and the levies made under that Act are correctly called 'fees'. The Provincial Act simply lays down that nobody shall use a motor vehicle without first paying a certain amount. The payment of the tax does not authorize the use of the vehicle; that is done by the all-India Act. Hence it is purely a tax and an economist will have no doubt that it is not a 'fee'.

The C.P. Act has not been challenged and now that Entry 48A has been inserted in List II nobody is likely to challenge it. What view a court will take of this levy will therefore remain unknown.

A tax on the consumption of electricity was levied for the first time in India by the Bombay Finance Act, 1932. Bengal adopted it in 1935. Under autonomy it spread to Madras. No province besides Bombay, Bengal, Madras and Sind, has adopted this tax.

The Acts levying the tax are:

(*a*) Bombay Finance Act, 1932, as modified by the Bombay Finance (Amendment) Acts, 1938 and 1939.
(*b*) The Bengal Electricity Duty Act, 1935.
(*c*) The Bombay Finance Act, 1932, as modified by the Bombay Finance (Sind Amendment) Act, 1939.
(*d*) The Madras Electricity Duty Act, 1939.

In all the four provinces the basis of the tax is electrical energy consumed for the purpose of lights and fans. In Bombay, Bengal and Sind the Acts expressly restrict the tax to energy consumed for the purpose of lights and fans. In Madras the tax is levied on energy sold at a price of more than two annas per unit; this practically restricts the tax to energy consumed for lights and fans, for energy consumed for other purposes, including its use as power for industrial undertakings, is sold at a cheaper rate.

In Bombay, Bengal and Sind the tax is levied on the consumer and the Electric Supply Companies are made responsible for collecting it. They collect it along with their own bill and pay it to Government, deducting a small amount as collection charges.

In Madras, the tax is levied on the companies themselves in respect of the sales of electrical energy. Government may, under the Act, authorize the companies paying the tax to reimburse themselves, of the whole or any part of the tax paid, from the consumers; but no such authorization has yet been made. The companies are thus no mere collecting agents; they are the assessees. The Act therefore correctly exempts smaller companies. If a company sells less than sixteen thousand, six hundred and sixty-six units of energy, at any price, during a month, and if the total annual sales, at any price, do not reach two hundred thousand units, no tax is payable on the sales during the month.

In Bombay, including Sind, consumers using not more than twelve units per month were specially exempted by the original Act whereas in Bengal the exemption limit was and has been fifteen units. In Bombay and Sind the position has changed: in Bombay there is now no exemption for small consumers whereas in Sind the exemption limit has been reduced to four units per month.

Bombay (including Sind) and Bengal started with the same rate of taxation, namely six pies per unit. Bengal has stuck to the original rate till now[1] while Bombay and Sind have increased it.

The present rates in Sind are nine pies per unit in Karachi and certain notified areas and six pies in other areas.

In Bombay the rate was increased to nine pies in 1938. In 1939 the Government of Bombay persuaded the Electric Supply Company of Bombay to reduce the price of energy by six pies per unit

[1] The rates were increased in 1943. See Bengal Finance Act V of 1943.

and at the same time increased the tax in Bombay city by the same amount. The exemption limit was abolished at the same time. The present rates in Bombay city are as follows:

When the total consumption per month does not exceed 12 units .. .. 1 anna per unit.

When the total consumption per month exceeds 12 units .. .. $1\frac{1}{4}$ anna per unit.

In other areas the old rates continue.

The bigger consumers did not feel the burden of the tax, for they were paying the same charge per unit though the charge was now differently apportioned between price and tax. Government took advantage of this opportunity for abolishing the exemption limit.

The incidence of the tax is clearly on the consumer. In Bengal, Bombay and Sind, it is levied directly on him. In Madras though the tax is levied on the supplier, it must raise price, being a part of the cost of supply, as in the case of other sales taxes. The supply of electricity is of course undertaken under monopoly conditions. But as the monopoly is controlled by Government who determine the sale price, it cannot be said that the price is fixed solely with an eye to the size of the monopoly revenue. In determining price Government must take into consideration that a duty is payable in respect of each unit supplied and so, with the tax, the price must stand higher than without it. In this view of the case the exemption of the smaller suppliers may not be necessary from the standpoint of equitable distribution of the tax burden; it has to be justified as a bounty to a struggling concern.

The tax is easy to collect. The supplying companies collect it along with their own bills and make over the amounts thus collected to Government. Among the provincial taxes it is one of the cheapest to collect. It therefore satisfies the canon of economy.

The tax is confined to urban areas only. There is hardly any other tax which is so exclusively confined to urban areas.

It is an expansive source of revenue. The revenue derived from it though small has progressed steadily from year to year as the following figures[1] of actual yield will show:

(*In thousands of rupees*)

Province	1935-36	1936-37	1937-38	1938-39	1939-40	1940-41
Bengal ..	9,06	17,02	18,02	19,25	20,25	21,53

[1] The figures are taken from the civil budget estimates of the province.

The Bengal figures are a good index of the progress as there has been no change of rates or basis in that province during the period.

The exemption of electricity used as power in industrial undertakings is a good feature of the tax. It keeps down the cost of production of things in the production of which electricity is used as power; it also encourages the use of electricity as power as against petrol which is heavily taxed and keeps it at par with coal, gas, etc.

Being a tax on things, it must be a regressive tax. But it has got the great merit that it does not hit the poorest who do not generally use electric lights or fans. In Bengal there is the further provision for the exemption of persons consuming fifteen units or less per month.

In Bombay the abolition of the exemption limit has not increased the total charge to the poor consumer by the full amount of the tax. But that does not make the abolition of the exemption limit less unjust. The poor man does not get the advantage of the reduction of the price which he would have got but for the tax. Falling prices may conceal taxation but do not justify it.

In Madras, every consumer, rich or poor, must bear the burden of the tax in the shape of a higher price which must apply equally to all.

In Sind the exemption limit is too low.

The amusements or entertainments tax was first introduced in Bengal in 1922. Bombay (including Sind) adopted it next year. In Madras local authorities were empowered to levy this tax in 1926, but it was not levied for provincial purposes before autonomy. The Punjab levied the tax in 1936. During autonomy this tax spread to the U.P., N.W.F.P., Bihar, Assam and Madras.

The different Acts introducing the tax in the different provinces are noted below with the years in which they were passed.

(*i*) The Bengal Amusements Tax Act, 1922.
(*ii*) The Bombay Entertainments Duty Act, 1923.
(*iii*) The Punjab Entertainments Duty Act, 1936.
(*iv*) The U.P. Entertainments and Betting Tax Act, 1937.
(*v*) The N.W.F.P. Entertainments Duty Act, 1937.[1]
(*vi*) The Bihar Entertainments Duty Act, 1937.
(*vii*) The Assam Amusements and Betting Tax Act, 1939.
(*viii*) The Madras Entertainments Tax Act, 1939.

[1] Amended in 1939.

(*ix*) The Bombay Entertainments Duty (Sind Amendment) Act, 1939.

The tax is thus now in force in all the provinces except Orissa and the C.P.

It is a simple tax. It is charged at a prescribed rate on the value of tickets to places of entertainment or amusement, e.g. race-courses, theatres, cinema shows, circuses, sports, etc. The tax is thus confined to amusements to which admission is by tickets sold for money.

In all provinces amusements for charitable or religious purposes, or educational or propagandist purposes, for the advancement of agriculture, industry or public health are exempt. In Bengal, Indian theatres are excluded from the scope of the tax by a special order.

In some provinces there is a lower limit of the value of tickets below which the tax is not charged. In Bombay, the limit is four annas[1]; in Bengal it is three annas, while in others, e.g. in the U.P., the limit is two annas only. In several provinces, e.g. Madras, Assam, etc., there is no such exemption limit.

The rates vary from province to province. In most provinces a common schedule applies to all cases. In Bengal there is an ordinary rate of twenty-five per cent but a schedule on a lower scale for cinemas, circuses, etc.[2] In Assam, admissions to race meetings are taxed at a higher rate, i.e. at twenty-five per cent; while a schedule on a lower scale applies to all other cases. In the Punjab, on the other hand, admission to race meetings are exempt. This discrimination in favour of race-goers has no justification as it is the richer class of people who go to organized race meetings.[3] There are other minor provincial peculiarities into which it is not necessary to enter here.

In Madras the Entertainments Tax Act, 1939, repealed the Local Authorities Entertainments Tax Act and provided for the compensation of local authorities on the basis of the previous three years' average income from the local tax, if any.

[1] The exemption limit was abolished in Bombay in 1943.

[2] The rates were increased in Bengal by an amending Act in 1943.

[3] See *Report of the Punjab Resources and Retrenchment Committee*, 1938, p. 208.

The incidence of the tax is clearly on the consumers. The tax is mostly added to the price of the ticket and collected at the time of selling the ticket. The sellers are responsible for paying the tax so collected, less certain costs, to Government.

The justification for exempting certain classes of shows, e.g. educational or propagandist shows, even when run for profit, is to encourage a larger number of visitors. It is expected that when tickets are cheaper, there will be a better attendance.

The tax, by-raising the price of tickets, creates a tendency to reduce the number of visitors to places of entertainment. Some visitors may also go to a class lower than the one to which they would have gone but for the tax. This in its turn generates a depressing tendency in the cinema industry.[1] The actual effect, however, appears to be quite negligible.

The exemption of tickets of value below a fixed limit is a good feature of the tax. This not only mitigates the regressive character of the tax but also probably makes for ease and economy of administration.

In some provinces, e.g. the U.P., N.W.F.P., etc., complimentary tickets are taxed while in others, e.g. Bengal, Bihar, Assam, they are not taxed. There is hardly any justification for exempting them.

On the whole the tax is a good one in the provincial system of taxation. It satisfies the canons of economy, certainty and convenience. Though not perfectly equitable, it does not affect the poorest. The sooner, however, the exemption of lower value tickets is universalized, the better.

The Betting Tax was first introduced in Bengal in 1922. Bombay adopted it in 1925 but did not extend it to any town in Sind. Under autonomy it spread to the United Provinces, Sind and Assam.

The Acts levying the tax in these provinces are noted below with the year of their enactment:

(*i*) The Bengal Amusements Tax Act, 1922.
(*ii*) The Bombay Betting Tax Act, 1925.
(*iii*) The U.P. Entertainments and Betting Tax Act, 1937.
(*iv*) The Sind Betting Tax Act, 1938.
(*v*) The Assam Amusements and Betting Tax Act, 1939.

[1] Vide Part I, Chapter I.

Betting is prohibited by law in all provinces except on horse-racing, promoted by recognized persons or associations. The Betting tax is therefore necessarily confined to betting on horse-races.

There are two methods of betting both of which are taxed. In race meetings, men wishing to bet, pay money into a totalizator and a tax called the totalizatcr tax is levied on all money paid into it.

People also bet through licensed bookmakers. A tax called the betting tax is levied on all money paid or agreed to be paid by a licensed booker to a backer in consequence of the winning of a et by the backer.

In the case of the totalizator tax, the promoter of the race meeting is responsible for deducting the tax when paying out the money to the backer and for paying it to Government.

The rate of the tax varies from four to seven per cent. In Bengal it is four per cent [1] and in Assam it is seven per cent.

The incidence of the tax is on the winners. People who win and therefore share the money get so much less on account of the tax.

The tax satisfies the canons of ability and convenience. It is really a tax on windfalls. A man who wins a bet suddenly finds himself richer and can pay a tax.

A man who loses ordinarily hopes that he will make up, or more than make up, the loss by future gains. In so far as the tax reduces the expected gains, the tax is a discouragement to betting. But other considerations are so important in betting that it is doubtful whether such a small tax exerts any appreciable influence in this respect.

The tax also satisfies the canons of economy and certainty. The collection of the tax is simple and cheap. The promoters and the bookmakers who are controlled by Government collect the tax for them. This is thus one of the few provincial taxes which satisfies all the canons of taxation including that of equity.

The goodness of the tax, however, does not imply that betting is a good thing. Betting is obviously without economic justification. It results in a net loss of utility to society because more often than not the marginal utility of money to the winner is less than the

[1] The rate was enhanced to ten per cent in Bengal and Bombay in 1943. In Bengal it was further enhanced to fifteen per cent in 1945.

marginal utility of money to the loser. Secondly, gambling is, after all, an unproductive occupation and offers an undesirable incentive to the unproductive propensities of man. Prohibition of gambling by law is therefore justified. The Government of Bengal did the right thing by putting a stop to dog-racing in Calcutta in 1939, in preference to imposing a betting tax on it. In that year a certain organization started dog-racing after obtaining a temporary local relaxation of the provisions of the Gambling Act. Government introduced the Bengal Amusement Tax Amendment Bill, 1939, with a view to legalize dog-racing permanently and to impose the same taxes on it as on betting on horse-races. Government subsequently dropped the measure and put a stop to dog-racing. It was clearly the right decision.

The Bombay Prize Competition Tax Act, 1939, levied a tax on prize competitions for the first time in this country. No other Province has adopted this tax. Bombay is perhaps the province which contains the biggest organization for prize-competitions on an all-India basis.

Prize competitions include—

(*a*) cross-word prize competitions, missing words competitions, picture prize competitions, number prize competitions, or any other competition for which the solution is prepared beforehand by the promoters of the competition or for which the solution is determined by lot;

(*b*) any competition in which prizes are offered for forecasts of the results either of a future event or of a past event the result of which is not yet ascertained or not yet generally known; and

(*c*) any other competition, success in which does not depend to a *substantial* degree upon exercise of skill.

No prize competition is to be conducted in the Presidency unless a licence in respect of such competitions has been obtained by the promoter thereof from the Collector. The promoter must keep and submit an account of all money handled by him. The tax is levied at the rate of twelve and a half per cent of the total sum received in respect of each competition.

An entry fee and a reward on success are the common features of these prize competitions. The entry fee is small and the reward is large. A large number of men pay the small entry fees in the

hope that they may get the large reward. The reward is, however, obtained by a few. The whole principle is to collect a big sum in driblets from a large number of men and to distribute most of the sum so collected to a few men in the shape of reward, a percentage being retained by the promoter.

The prize competition is thus akin to betting. The same psychology of growing rich easily is at the root of both; though in the former case the sense of competition is strong on account of the skill required for the solution while in the latter case the element of luck is predominant. A prize competition has sometimes got an educative value which does not make it as unproductive as gambling but the element of education is not often commensurate with the expenditure of time and money involved. In prize competitions, as in betting, winners get a windfall. The taxation of this windfall is quite equitable.

XIII

SOME OTHER TAXES ON THINGS

STAMP duty is often merely a manner of collecting a tax and does not mean a particular tax. All taxes could be collected by means of stamps and some are in fact so collected. Thus in Bengal those houses of entertainment which default or delay in crediting in cash the entertainment tax collected by them, are called upon to pay the tax by means of a special type of stamp. They have to affix an entertainment tax stamp of the proper value to the ticket at the time of selling it. Similarly, a man called upon to pay a sales tax or an income-tax may be allowed to pay it in stamps. Instead of crediting it in cash to the treasury, he may buy stamps of the same value and affix them on his return.

The term stamp duty is, however, understood in this country in the sense of stamp duties or taxes on documents only. In the discussion which follows the term will be used in that sense.

The legislative power with regard to the levy of stamp duties is controlled by Entry 51 in the Provincial Legislative List, and Entry 57 in the Federal Legislative List. The Federal Legislature is competent to fix 'the rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts'. The Provincial Legislature is competent to fix the rates of stamp duty in respect of other documents.

The proceeds of the stamp duties come to Provincial Governments even when they are fixed by a Federal Act.[1]

The stamp duty in the sense in which it is used in this chapter is a tax on things. It is a tax on documentary evidence. If documentary evidence of certain transactions has to be created, the tax must be paid in the form of a stamp duty on the document evidencing the transaction.

It might, at first, appear that the assessment and collection of such a tax must be difficult, as transactions take place everywhere and under all sorts of circumstances. But, in fact, it is so easy

[1] See sections 137 and 144 of the Government of India Act, 1935.

to collect the tax in this form, that it really collects itself. The facility of collection is secured by the following devices:

(*i*) The documents taxable and the amount of tax payable in respect of each of them are clearly set forth in a schedule. The canon of certainty is of the utmost importance in a tax of this nature in which the public at large are left to assess it in the first instance.

(*ii*) It is enacted [1] that with a few exceptions no document chargeable with stamp duty shall be admitted in evidence in any court of law unless it is duly stamped. The document is created for evidentiary purposes and if non-payment of stamp duty obstructs that purpose no one would draw up a document without paying the duty; the Act levying the tax therefore carries its own sanction.

It is, however, essential that the tax should not be prohibitive. It must always be worth while for a man to have the evidence after payment of the stamp duty.

It is often stated that the stamp duty is a tax on transaction. It is not. The duty is not payable as soon as the transaction, say, a gift or a sale of land takes place or as soon as a loan is granted. It is payable only if any documentary evidence of the transaction of gift or sale or loan is created. In certain instances the document invariably follows the transaction but in all cases it is not so. It depends on the credit and mutual relations of the parties and also probably on the rates of stamp duty. In the villages of India innumerable transactions in land and money take place without any documentary evidence being created. *Howlat* or friendly financial accommodation for short periods without any formal documentary evidence is quite a usual thing in the business circles of the country. In the stock exchanges a series of transfers of a share take place with only one document being created. [2] Courts will of course admit

[1] See sec. 35 of the Indian Stamp Act.

[2] This is made possible through the practice of blank transfers which is quite common in the stock exchanges. According to this practice, the original transferer of a share executes a transfer deed and pays the appropriate stamp duty but the space for the name of the transferer in the deed is kept blank. The share together with the blank deed changes hands quite a number of times without any other transfer deed being executed. The final transferee who intends to hold the share gets his name written on the blank space. In this

oral evidence of such transactions if they become points for decision in suits.

In deciding whether he will go in for documentary evidence of a particular transaction, the person interested of course puts the greatest importance on the credit of the other party or his relationship with him. But the rate of the duty payable on the document, if any is created, is also a factor which he takes into consideration. In certain instances, again, though he may go in for documentary evidence, he may avoid the usual document with a high tax and choose to adopt an indirect way. Thus in granting a loan he may have a promissory note instead of a bond or in selling a piece of land the buyer may be satisfied with a simple receipt for the price paid by him to the seller. Documentary evidence has undoubtedly a great value to the person interested. But the demand for it is not inelastic as substitutes are available in the form of oral evidence or indirect documentary evidence and, in the case of parties with high credit, it may even be dispensed with. Hence the sacrifice involved in obtaining documentary evidence must be compared with the advantages to be derived from it. It is this idea which lies at the root of two of the three principal guides to the rates of stamp duty laid down by the Indian Taxation Enquiry Committee, 1924, namely:

(*a*) The point at which the value of the convenience or utility attaching to the use of a particular kind of document or to the resort to a particular kind of transaction approaches the amount of the stamp duty involved.

(*b*) The point of diminishing return, or, in other words, what the traffic will bear.

The following conclusions stand out:

(*a*) The stamp duty is a tax on documentary evidence. It is not a tax on a transaction.

(*b*) The duty collects itself and in order that it may collect itself smoothly it is essential to lay great stress on the two following points:

(*i*) the schedule of the rates must satisfy the canon of certainty to the utmost;

(*ii*) the rates must not be too high.

way a large number of transfers take place without any transfer deed being executed and the stamp duty is avoided.

(*c*) The demand for documentary evidence is elastic and depends on various extraneous factors, e.g. the credit and mutual relationship of the parties.

The demand for a thing, say sugar, generally varies with two factors: its marginal utility and the marginal utility of money to the consumer. The marginal utility of sugar diminishes as the quantity consumed increases. So a man is willing to offer a diminishing price for it as the quantity consumed by him increases. But if, in the meantime, his income increases so that the marginal utility of money itself diminishes he may be willing to offer the same price per unit even for an increased quantity.

The demand schedule for documentary evidence is not so simple. First, the demand for it is confined to persons doing certain transactions. This group of persons varies from year to year. Not only may the persons be different but they may belong to different classes altogether from year to year. The persons who divorce their wives or husbands or swear affidavits this year may be or will be entirely different from persons who will be divorcing their wives or husbands or will be swearing affidavits next year. So, persons who buy and sell land this year may be different from the persons who will buy and sell land next year. This year's groups may consist chiefly of rich men and the next year's groups chiefly of poor men.

Secondly, which of them will go in for documentary evidence is primarily determined by considerations which have little relation to the wealth or poverty of the persons concerned. A poor man may choose to go in for it while a rich man may not think it necessary.

Thirdly, it is often not clear which party to the transaction bears the stamp duty, for the scope for individual powers of bargaining is very great in such transactions.

It is therefore impossible to correlate the stamp taxes to the faculty of the tax-payers. In other cases of taxation we generally know whether the tax is progressive, proportionate or regressive. In the case of stamp duties it is not possible to make any such generalization. In fact it operates arbitrarily on tax payers. The simple reason is that the consumption of documentary evidence cannot be reduced to any law like Angell's law by which the consumption is correlated to the wealth of the consumers. It is also not possible to correlate its demand with its price.

It is this peculiar character of a stamp duty which makes it unfit for a place in a rational system of taxation, i.e. in a scheme which attempts to correlate taxation to faculty by an act of deliberate policy. In this respect it is worse than a regressive tax. For, a regressive tax may be fitted into a system of taxation correlated to faculty. We know what classes of society it affects and in what way. The inequity involved can be compensated by other taxes operating in the opposite direction. The character of the stamp duty being indeterminate it is impossible to think of compensatory taxes, as we are absolutely in the dark about its incidence.

No generalization is possible about the incidence of the stamp duty. Though in every case it is a tax on documentary evidence, a wide variety of transactions is covered by it, and incidence depends on the nature of each transaction. Moreover, in several cases it is the power of individual bargaining which determines the incidence.

Thus it is impossible to generalize as to who pays the stamp duty on a deed of divorce. A stamp duty on a deed of adoption is obviously paid by the person who adopts the child and cannot be shifted. A person swearing an affidavit, say to prove his son's age before the son's employer, must bear the stamp duty himself. A man who swears an affidavit to prove the age of his younger neighbour before an insurance company so that the claims on the former's matured policy may be paid will not bear the stamp duty: it is the insured who will bear it. Stamp duty on a bill of lading enters into the operating cost of the business and is usually passed on to the consumer. Stamp duty on a bond for a loan is usually borne by the debtor. If the loan is an unproductive loan, the tax rests on him finally but if the loan is a productive one, the duty increases the cost of production and is generally passed on. A stamp duty on a conveyance of land is usually borne by the seller but may be borne by the buyer also under certain circumstances which increase the bargaining power of the seller. Thus incidence varies not only among different classes of documents but also from document to document in the same class.

This fact enhances the uncertain and indeterminate character of stamp duties.

Stamp duties are either *ad hoc* or *ad valorem*. Broadly speaking, the documents chargeable to *ad valorem* duty fall under three groups, namely:

(*i*) Conveyances and other transfers of property;
(*ii*) Bonds, mortgages, debentures and allied documents;
(*iii*) Bills of exchange and promissory notes (payable otherwise than on demand). [1]

Ad hoc duties must be fixed arbitrarily. How they are fixed is evident from the following paragraphs of the Report of the Punjab Resources and Retrenchment Committee, 1939.

'Article 22.—Composition deed: The duty under this article is twenty rupees in Bombay and Assam, fifteen rupees in Madras and Bihar, twenty rupees and eight annas in the United Provinces and the Punjab and ten rupees elsewhere. The rate of duty in the Punjab should be raised to fifteen rupees.' [2]

'Article 4.—Affidavit: Exemption (*b*)—"for the immediate purpose of being filed or used in any court or before the officer of any court"—should be removed, and the duty on such affidavits should be charged at a reduced rate of one rupee, other affidavits to be charged two rupees as at present. It is understood that between one hundred and three hundred—say, on the average, two hundred—affidavits are executed monthly in each district. The addition to revenue by the adoption of this recommendation is estimated at about Rs 69,600 ($200 \times 29 \times 12$) or Rs 60,000 at a minimum.' [3]

It is not possible to justify these recommendations by correlating them with the means of the persons bearing the duty. Some arbitrary standard has to be fixed. One province sometimes gives the lead and other provinces follow. It is not possible to forecast whether the persons executing affidavits or composition deeds will be rich, poor or of the middle class. The consumption of affidavits or composition deeds does not also increase with the income of the consumers and has in fact no relation to the wealth of the consumer.

Ad valorem Duties

(*i*) Conveyances of land. Though in fixing the price of land the individual power of bargaining has very great scope, the stamp

[1] See *Report of the Indian Taxation Enquiry Committee*, 1924, ¶ 283, page 223.

[2] Page 181.

[3] Page 180. The figures within brackets are explained as follows:
200 = the average number of affidavits in each district per month at Re 1 each.
29 = the number of districts.
12 = the number of months in a year.

duty on conveyances creates a tendency for depressing the value of land. The price of land is normally the capitalized value of its net earnings and the buyer will not normally pay anything more than that even with a stamp duty levied by law. The duty has been condemned by economists from Adam Smith onwards.

According to Adam Smith, 'such taxes even when they are proportioned to the value of the property transferred are still unequal, the frequency of transference not being always equal in property of equal value; when they are not so proportioned, they are still more unequal'. [1]

According to Bentham, a man sold his property only when in want and such a tax was therefore 'an extraordinary tax upon personal misfortune'. [2]

According to Mill such a tax was a tax 'on a necessitous person in the crisis of his necessities'. [3]

According to Professor Cannan, such taxes are 'a survival from a bygone age in which the art of collecting taxes was so little developed that the stamp method seemed very excellent'. [4]

(*ii*) Bonds, mortgages, etc. Loans are taken either for productive purposes or by a necessitous person for consumption. In both cases if bonds are insisted upon, the incidence of the stamp duty is likely to be on the executor of the bond, i.e. the person taking the loan.

Now the loan taken by a person has no necessary relation to his ability to pay taxes. As a matter of fact, wealthy people hardly take loans while poorer people often stand in need of loans. When again a rich man takes a loan, in consideration of his standing the creditor often does not insist on a bond. In Indian business circles loans and advances without any document are common to an extent unknown in any other country.

The incidence of the tax is therefore not only unequal but arbitrary.

(*iii*) Bills of exchange and promissory notes. The same remarks apply to the stamp duties on these documents. They are unequal and arbitrary in incidence. They hamper business and act as a restraint on trade.

[1] *Wealth of Nations*, Vol. II, page 458.

[2] Theory of Legislation, Principles of the Civil Code, Chapter XV.

[3] *Principles of Economics*, Book V, Chapter V.

[4] *Report of the Parliamentary Committee on National Debt and Taxation*, 1924, popularly known as Colwyn Committee, p. 200.

In spite of these serious drawbacks of stamp duties they are well established and are accepted by the people without demur. They have existed for long and people have accepted them as a part of the existing order of things. Governments in India have exploited this attitude to the full. Provincial amendments of the Indian Stamp Act with a view to increase the rates have been more frequent than in the case of any other measure of taxation.

The stamp duty, as already pointed out, satisfies the canon of certainty and economy.

The schedule of rates is and must be so clearly expressed that the people readily understand them.

Practically the only cost of collection is the cost of printing and distributing the stamps. The courts and the Collectors have of course to keep a watch on the adequacy of stamps in documents produced before them; but that being an incidental function costs very little. The duty almost collects itself. This is the chief cause of the popularity of stamp duties with practical financiers.

The duties also generally satisfy the canon of convenience. When a man takes a loan he has funds; when he buys a property he must have acquired the price; and if the incidence is on the seller, it is convenient for him to pay when he receives the price. It is on such occasions, i.e. when a man has funds, that he is called upon to pay the stamp duty. This, and its fulfilment of the canon of certainty, contributes much to the popularity of the stamp duty.

These duties therefore satisfy the canons of certainty, economy and convenience. They, however, entirely fail to satisfy the canon of ability.

The Colwyn Committee expressed their opinion of stamp duties as follows:

'It may be said of the duties generally that they are not an advanced type of taxation. Their incidence is not clear, they have not only a casual relation to ability to pay, and they tend somewhat to hamper business transactions. On the other hand, they are quite well-accepted by the taxpayer, partly, no doubt, because they have been established so long.' [1]

After a brief review of the different categories of stamp duties in the United Kingdom the Committee conclude:

'The stamp duties are a cause of occasional irritation to the citizen, and of some recurrent friction in business, and particularly in

[1] Page 200, ¶ 551.

finance. While they are open to many objections, they do not seem in practice to meet with much opposition from the general taxpayer, and they may be held to illustrate the saying that an old tax is a good tax. Nevertheless, in relation to their moderate yield, we are disposed to think them one of the less satisfactory parts of the British tax system.' [1]

In the British tax system the stamp duties form rather a subsidiary part and it is not generally sought to increase their prominence in view of their various drawbacks.

In this country the position is just the reverse. Here the prevailing rates are much higher than those prevailing in the United Kingdom. The proceeds of stamp duties constitute a substantial part of the provincial revenues. Moreover, the tendency has been constantly to increase the rates.

The importance of stamp duties in the provincial revenue is shown in the following table:

(*In thousands of rupees*)[2]

(Actuals 1939-40)

(1) Name of Province	(2) Total Revenue Receipts	(3) Receipts from stamp duties	(4) Percentage of col. 3 on col. 2
Bengal ..	14,31,66	82,69	5·7
Madras ..	16,65,90	71,59	4·3
Bombay ..	13,14,23	78,82	5·8
U.P.	12,08,52	25,86	2·1
Punjab ..	11,69,48	29,11	2·4
C.P. and Berar ..	5,08,50	9,46	1·8
Bihar ..	5,47,68	29,50	5·3
Orissa ..	1,87,88	4,52	2·4
Assam ..	2,93,33	5,11	1·7
Sind	4,28,87	8,98	2
N.W.F.P. ..	1,82,61	2,34	1·2

[1] Page 209, ¶ 579.

[2] Taken from the Provincial Budgets.

Under Provincial autonomy the following amendments to the Indian Stamp Act have been made. Each one of them increased certain rates.[1]

The Bihar Stamp (Amendment) Act VI of 1937.

The C.P. and Berar Indian Stamp (Amendment) Act VI of 1939.

The U.P. Stamp (Amendment) Act XVIII of 1938.

The Bombay Finance (Amendment) Act VII of 1938.

The Bombay Finance (Amendment) Act IV of 1939.

Besides, the Bengal Expiring Loans Act, 1937, placed on a permanent basis the enhancement of the rates of stamp duties made temporarily for a period of three years by the Bengal Amendment Act of 1935.

The amendments adopted before autonomy are also numerous. They substantially increased the rates.

The previous Acts were consolidated into the Indian Stamp Act, 1899.[2] It was amended by the Indian Legislature in 1904, 1906, 1923 and 1925 by Indian Stamp (Amendment) Act and in 1927 by the Indian Finance Act, 1927.

Under the Government of India Act, 1919, the Provincial Governments were permitted by the Governor-General to legislate with regard to stamp duties except on a few items. Many Provincial Governments took advantage of the opportunity to increase the rates substantially during the years 1922 and 1923.

Some Provinces again increased the rates shortly before autonomy was introduced. They are Assam, the United Provinces and Bengal.

The following is a list of the Provincial amendments made before autonomy:

(*i*) The Indian Stamp (Madras Amendment) Act, 1922.

(*ii*) The Indian Stamp (Bombay Amendment) Acts, 1922, 1926 and 1932.

(*iii*) The Indian Stamp (Bengal Amendment) Acts, 1922, 1935.

(*iv*) The Indian Stamp (United Provinces Amendment) Acts, 1923, 1932 and 1936.

[1] For a comparative statement of the rates of stamp duties in the different provinces see the *Report of the Punjab Resources and Retrenchment Committee*, Appendix F.

[2] For the previous history of the stamp duties in British India, see Dr P. N. Banerjee's *History of Indian Taxation*.

(*v*) The Indian Stamp (Punjab Amendment) Acts, 1922, 1924, 1935.

(*vi*) The Indian Stamp (Bihar and Orissa Amendment) Act, 1921.

(*vii*) The Indian Stamp (Central Provinces Amendment) Act, 1923.

(*viii*) The Indian Stamp (Assam Amendment) Acts, 1922, 1935 and 1937.

(*ix*) The Indian Stamp (N.W.F.P. Amendment) Acts, 1923 and 1932.

It thus appears that Provincial Governments in India have been continually pushing up the stamp duties and this tendency cannot be said to have stopped though in some provinces the highest point seems to have been reached in the sense that beyond that point the stage of diminishing returns may ensue.

A few important rates of stamp duty in England and in India are compared below:

English rates *

(1) Consideration or amount not exceeding —but exceeding the figure going before	(2) Conveyance			(3) Mortgage, bond			(4) Explanatory remarks
£	£	*s*	*d*	£	*s*	*d*	
5	0	0	6	0	0	3	The rates above the double lines in column 2 represent half per cent of the corresponding figures in column 1; and the rates below the double lines represent one per cent of the corresponding figures in column 1. An instrument claiming the lower scale above the double lines must contain a statement certifying that the transac-
10	0	1	0	0	0	3	
15	0	1	6	0	0	8	
20	0	2	0	0	0	8	
25	0	2	6	0	0	8	
50	0	5	0	0	1	3	
75	0	7	6	0	2	6	
100	0	10	0	0	2	6	
125	0	12	6	0	3	9	
150	0	15	0	0	3	9	
175	0	17	6	0	5	0	
200	1	0	0	0	5	0	
225	1	2	6	0	6	3	

* See Schedule to the Stamp Act, Halsbury's *Laws of England*, Vol. XVI.

(1)	(2)			(3)			(4)
£	£	*s*	*d*	£	*s*	*d*	
250	1	5	0	0	6	3	tion thereby effected does not form part of a larger transaction or of a series of transactions in respect of which the amount of value, or the aggregate amount of value, of the consideration exceeds £500.
275	1	7	6	0	7	6	
300	1	10	0	0	7	6	
350	1	15	0	0	10	0	
400	2	0	0	0	10	0	
450	2	5	0	0	12	6	
500	2	10	0	0	12	6	
550	5	10	0	0	15	0	
600	6	0	0	0	15	0	
650	6	10	0	0	17	6	
700	7	0	0	0	17	6	
750	7	10	0	1	0	0	
800	8	0	0	1	0	0	
850	8	10	0	1	2	6	
900	9	0	0	1	2	6	
950	9	10	0	1	5	0	
1,000	10	0	0	1	5	0	
Above 1,000.	10*s* per £50 or fractional part of £50.			2*s* 6*d* per £100 or fractional part of £100.			

The rates on conveyance and mortgage with possession are as follows in the major provinces of India:

(1) Consideration or amount not exceeding—but exceeding the amount going before	(2) Bombay			(3) Bengal, Madras,[1] Punjab, Bihar		
	Rs	As	P	Rs	As	P
50	0	8	0	0	12	0
100	1	0	0	1	8	0
200	2	0	0	3	0	0
300	4	8	0	4	8	0

[1] By the Madras Stamp (Increase of Duties) Act XVI of 1943, the duties as stated here were doubled.

After this stage in each of the specified province, the rate increases by one rupee and eight annas for each increase of one hundred rupees or part thereof in the amount of the consideration till it reaches the figure of one thousand rupees. After that the rate increases by seven rupees and eight annas for each increase of five hundred rupees.

Thus in all these provinces (except Bombay in the first three stages) the rates shown against the figures in column 1 represent one and a half per cent of those figures as against only half and one per cent in England. The difference in the rates in England and in these provinces is therefore very substantial. It is still greater in the case of mortgages with possession, which in India pay stamp duties as on conveyances.

In these provinces the rates of stamp duties on bonds or mortgage without possession (which rank together for the purpose of stamp duty) are also substantially higher than the rates on those documents in England.

So also in most other lines including such small things as affidavits, the rates are higher in India than in England.[1]

England is known to be the country with the highest level of taxation in the world. In stamp duties, however, which are an undesirable form of taxation both from the standpoint of equity and of the hindrances it offers to business, British India beats Britain.

It is thus clear that we in India are relying too much on this undesirable form of taxation and that there is still a tendency to place increased reliance on it from time to time. It is necessary in the interest of tax reform that this tendency should cease once for all and reliance on this form of taxation should be reduced, if possible.

The Indian Registration Act XVI of 1908, provides for the registration of documents and the levy of certain fees thereon.

Registration is primarily intended to render special benefit to the persons registering documents. The following are the benefits it renders:

(*i*) It provides reasonable guarantee of the genuineness of the document.

(*ii*) It affords publicity to transactions.

(*iii*) It prevents frauds.

[1] For the rates see the *Indian Stamp Act* and the *English Stamp Act*.

(*iv*) It makes it easy to ascertain whether a property has already been dealt with.

(*v*) It affords security of title-deeds and facility of proving titles in case the original deeds are lost or destroyed.

Registration is therefore an essential feature of modern communities and is necessary for the reasonable protection of persons engaged in transactions of certain kinds, e.g. buying land, or lending money.

Registration, though conferring a special benefit, is not, in all cases, left to the option of the persons having documents to register. Certain documents are made compulsorily registrable.[1] The usual sanction behind the provision is that a compulsorily registrable document is not admissible in evidence unless registered.[2] As documents are created for their evidentiary value, and registration is but a means of guaranteeing or increasing their evidentiary value, a man who prepares a document will surely register it also, if the document is not admissible in evidence without registration.

This legal compulsion is justifiable on two grounds:

(*a*) In transactions involving important rights, title and interest the evidence must be guaranteed to a reasonable extent and if the private citizen neglects his own interest the State can interfere in his interest, without depending on his good sense.

(*b*) When an organization for registration is brought into existence at public expense, it is necessary to ensure that it will at least pay its way by providing that certain persons must take advantage of it.

The special benefit must, however, be paid for. No injustice is involved if the person deriving the special benefit is charged the price for it. This is a pure commercial principle and hardly needs justification.

The next important point is the principle of charge. The cost of the whole organization has to be distributed over individual documents registered. How is this apportionment to be made?

The organization must necessarily be a State organization and monopolistic. The competitive principle of price fixation on the

[1] See sec. 17 of the *Indian Registration Act.*

[2] See sec. 49, *ibid.*

basis of normal cost is therefore substituted by the monopolistic principle of what the document will bear. The justification for the principle is the same as the justification for a similar principle in the case of Railways—charging what the traffic will bear. But for this principle many Railways would not have repaid their cost and society would have been deprived of the great service of the lines. By adopting this discriminatory principle the Railways pay their costs and render the maximum service to the community. This is clearly the justification for levying registration fee *ad valorem* according to the value of the right, title and interest affected by the document registered. These *ad valorem* fees, as pointed out by the Indian Taxation Enquiry Committee, are neither progressive, nor proportionate but regressive. But that is not a fault of the rates as they have nothing to do with the principle of faculty.

In the next stage the special privilege is converted into a special burden and an element of taxation is introduced. The scale of rates is increased so as to yield a net revenue to the State but the principle of charge is not changed.

There is nothing unusual or wrong in this conversion of a special privilege into a special burden or, in other words, in utilizing this occasion for the conferment of a special benefit for the imposition of a tax; but as soon as the element of taxation is introduced it has to be examined according to the principles of taxation and not according to any commercial principle, whether it is the competitive principle of normal cost or the monopolistic principle of what the documents will bear that determines the rate.

The following table shows the net revenue derived from Registration in each province:

(*In thousands of rupees*)

(Actuals for 1939-40)

Province	Receipt	Expenditure	Net Revenue
Assam	2,01	1,52	49
Bengal	27,31	24,81	2,50
Bihar	13,28	5,92	7,36
Bombay	13,77	5,29	8,48
C.P. and Berar ..	5,25	1,89	3,36
Madras	32,96	28,73	4,23

Province	Receipt	Expenditure	Net Revenue
N.W.F.P.	69	12	57
Orissa	2,38	1,47	91
Punjab	8,50	59	7,91
Sind	2,07	86	1,21
U.P.	8,92	4,47	4,45

The principle of the charge, namely, what the documents will bear, has however no relation to the faculty of the payers and as such this taxation cannot satisfy the canon of ability.

Moreover, like stamp duties the special burden involved in registration is a tax on documentary evidence levied once more at a subsequent stage of its life. The stamp duty is payable when the evidence is brought into existence and the registration fee is payable when it is registered. It is therefore subject to the same objections as stamp duties. The demand for registration, like the demand for documentary evidence, can by no means be related to the wealth of the consumer and hence arises the injustice involved in the levy and also its indeterminate character. In that respect it is, like stamp duties, a leap in the dark; it has no determinable relation to the income of the payer.

It, however, satisfies the canons of convenience and certainty in the same way as stamp duties do. It satisfies the canon of economy even better. The expenditure involved in registration is not to be taken as the cost of collection of the revenue. The expenditure is incurred for organizing the special benefit which is paid for. If no element of taxation was introduced and the charges were so arranged that the organization just paid its way, the expenditure would remain the same and the receipts would have just equalled it. By raising the scale of charges no extra expenditure is incurred but the receipts increase. This increase in the receipts above expenditure represents the result of introducing the element of taxation and can be said to have been earned without any additional cost at all.

The Indian Taxation Enquiry Committee, 1924, have expressed the opinion that the fees charged on documents, the registration of which is optional, must not include an element of taxation. The Committee state:

'In deciding what portion of the receipts is to be classed as taxation, it is necessary to exclude those paid for the optional registration of documents. On the other hand, the fees paid for the

registration of documents of which the registration is compulsory possess an element of taxation.'[1]

This distinction is obviously based on a confusion. There is no reason why the fees charged over and above cost should not possess an element of taxation in the case of optional registrations but should be considered to possess an element of taxation in the case of compulsorily registrable documents. In both cases the charge is compulsory and it is this compulsion and not the compulsion at the earlier stage which is essential to taxation.

A tax on the purchase of sugar, if one is levied, does not cease to be a tax because the purchase of sugar is not compulsory. A tax on the purchase of cycle lamps does not possess any greater element of taxation on the ground that the use of lamps on cycles at night is compulsory. Similarly, registration is a service for sale. Anybody who wants to buy it *must* pay something over and above cost. It is this compulsion to pay something more which introduces the element of taxation and this compulsion is present in both cases. In the case of compulsorily registrable documents there are indeed two compulsions: first, the man is compelled tc register the document and secondly he is compelled to pay something more than the cost. The first compulsion, like the compulsion to use lamps on cycles, is based on quite different grounds and has nothing to do with the question whether the payment made includes an element of taxation. If, for example, the State decided to register compulsorily registrable documents free of charge or at a rate of fee which would not or would just cover cost, no element of taxation would have been there in spite of the compulsion. The element of taxation therefore exists in the case of both classes of documents as both classes of persons have to bear a special burden levied by the State over and above the cost of service.

Rates of registration fees vary from province to province. But unlike stamp duties, they seem to have been more or less stabilized. During the period of autonomy no province has made any substantial change in the rates of registration fees. It is important to note that any increase in the rates does not necessarily mean an intensification of the element of taxation in them. Some variation of the rates may be due to variation in the cost of providing the service.

[1] ¶ 326 and 327, page 243.

In criminal cases nominal court fees are charged and criminal justice is provided almost wholly at Government cost. There is, therefore, no element of taxation in court fees realized in connexion with criminal justice.

The following statement shows the receipts under the head 'judicial stamp'[1] and the expenditure under the head 'administration of justice' in the different provinces.

(In thousands of rupees)

Province	Receipts from judicial stamps	Expenditure under administration of justice
Assam	12,59	10,59
Bengal	1,73,75	96,86
Bihar	75,55	36,46
Bombay	60,11	60,43
C.P. and Berar ..	28,34	25,28
Madras	1,00,66	88,44
N.W.F.P.	4,71	7,95
Orissa	14,60	6,48
Punjab	46,52	54,55
Sind	8,18	12,86
U.P.	1,04,24	70,58

Administration of civil justice is a special service rendered by the State to those who seek it. Justice is not provided free and the court fees charged are a payment for this service. The provision of the service costs the Government a great deal and on an analogy of competitive conditions of price fixing, the prices charged should just cover the normal cost. If over and above the normal cost a special burden is levied, an element of taxation is introduced. In that case the fees would include two elements, the price for the service and an element of taxation.

It appears from the statement given above that in the Western Indian Provinces of Bombay, Sind, Punjab and the N.W.F.P., the receipts under judicial stamps do not cover the cost of providing the service and a part of the expenditure is borne by the general revenues. In these provinces therefore there is no element of

[1] Actuals for 1940-1.
The figures are taken from the Civil Budget Estimates.

taxation in court fees; on the contrary a special privilege is bestowed on the seekers of justice.

In the other provinces a surplus is earned above cost. The statement, however, does not fully and correctly indicate the size of the surplus for the following reasons:

(*i*) The receipts include certain items like probate duty which is a pure tax and not a fee for a service, though it is realized by means of court fees.

(*ii*) The receipts also include receipts from the criminal courts in the shape of court fees and these should be excluded.

(*iii*) The expenditure includes the entire expenditure on High Courts and District Judge's courts though they devote a lot of their time to criminal cases. A proportionate deduction ought to be made before a correct comparison can be made.

It is probable that if the amounts could be brought down to correctly comparable figures, the small surpluses in Assam and the C.P. and Berar might disappear. In Bengal there is still likely to be a considerable surplus. In Madras, the U.P., Bihar and Orissa there might be hardly any surplus.

Thus the taxation element in court fees is not important in the last four provinces; but it is quite important in Bengal.

In Bengal the volume of litigation is large. The judicial organization therefore gets full advantage of the economies of large scale production. The economies, instead of being transmitted to the consumers, i.e. the litigants, in the shape of lower fees, are retained by Government. It is this difference in the volume of litigation and not so much the difference in the rates of fees that makes this source of revenue important in Bengal. A comparative table indicating the difference in the volume of litigation in the different provinces is given below:

1940

Name of Province	Number of original suits instituted
Bengal	6,03,023
Bihar	2,25,156
Bombay	1,51,367
Punjab	91,184
Central Provinces and Berar ..	83,297
Assam	38,045
North-Western Frontier Province ..	12,800

The principles of fixing the rates of court fees are entirely different from the principles of taxation. The former is the province of the jurist who largely adopts the monopolistic principle of what the traffic will bear and modifies it by his special requirements at the time of application. This principle has no relation to the faculty principle.

The incidence of court fees is attempted to be controlled by courts. The man who files a suit, of course, has to pay the fees but if the suit is decreed he is usually given a decree for cost also. Except when he can get such a decree for cost and can execute it successfully, the incidence of the fees is on the person initiating a suit. This principle of control is all right from the judicial point of view but is wholly extraneous to the science of economics. The control is based not on economic considerations but on other considerations.

The demand for justice has no relation to the faculty or income of the consumer, i.e. the seeker for justice. It does not increase with increasing income nor does it decrease with decreasing income. The demand depends on wholly extraneous considerations. The necessity for going to court or its frequency cannot be correlated to a man's income.

When therefore court fees include an element of taxation, the latter is a greater leap in the dark than the element of taxation in stamp duties. It does not follow the faculty principle. It does not satisfy the canon of convenience because a man may not have funds when he requires to file a suit. When the fee is realized on decree from the judgement debtor, the latter may be in a still worse position to pay it. In fact, this is not in the sphere of economics at all. Here other principles hold the field. Charges are determined by other principles. Incidence is controlled by extraneous principles. If the tax operates harshly against the judgement debtor, it is actually so intended and the intention is justified on principles of jurisprudence. It is not sound to condemn such control by economic arguments as it does not lie in the sphere of economics.

This analysis, however, shows the injustice involved when a substantial element of taxation is introduced in these fees. Fortunately the element of taxation is absent in almost all provinces except Bengal. The rates of fees have also been more or less

stabilized and under autonomy there has been no attempt to raise them. [1]

Whether justice should be provided altogether free is a question which is outside the scope of this study. The questions that generally arise in this connexion are:

(*i*) Whether justice should be provided free of charge or on payment; and

(*ii*) If it is decided to charge for it,

- (*a*) Whether the charges should fully cover the cost of providing it, or
- (*b*) whether an element of special privilege should be retained; or
- (*c*) whether an element of taxation should be introduced in the charges, i.e. whether a special burden should be imposed on the persons seeking justice.

Another question that also arises in this connexion is what the principles of the charge should be. It is important to note that when an element of taxation is introduced in the charges, the principles of fixing the charge are not and cannot be changed, but only the scale of charges is raised according to the same principles.

All these questions except (*ii*)(*c*) above are clearly outside the scope of this study. The analysis in this chapter is intended to indicate the consequences of introducing an element of taxation in the charge. Once an element of taxation is introduced, it is possible to judge whether its effect on the economic well-being of the people affected is justified. The conclusion indicated by this analysis is clear; the introduction of an element of taxation in court fees has a harmful effect on the economic well-being of the people and often operates with great harshness.

[1] Before autonomy the rates were increased in all the provinces more than once during the twenties and thirties of the present century.

XIV

TAX ON RAW JUTE

Introductory

THE Bengal Raw Jute Taxation Act, 1941, which came into force in 1942, levies a tax of two annas on every *maund*[1] of raw jute purchased by a jute mill or by a person exporting jute out of Bengal. No jute mill or exporter is to carry on his manufacture or trade unless he has been registered for the purpose of the tax. Each such registered person must keep books of account and furnish to the tax authorities a monthly return of all the jute purchased during the month, tendering at the same time the amount of tax payable on the basis of the return. The tax authorities retain the right to inspect his accounts and demand additional amounts if found payable as a result of the inspection.

The tax is clearly a 'tax on things'. Its constitutional classification is, however, not free from doubt. The Speaker of the Madras Legislative Assembly ruled in connexion with the Madras General Sales Tax Act that a tax on sales includes a tax on purchases also, inasmuch as sale and purchase are but two aspects of the same transaction. On the basis of that ruling, this tax can be classified as a tax on sale. This, however, is a question of law into which we need not enter. It is clear that the incidence and other ultimate economic consequences of the tax would have been the same even if it was levied on the sale of jute to the jute mills and the exporters. Jute purchased by jute mills and exporters is identical with jute sold to them and whether the tax is levied on the purchase or the sale, the material base of the tax remains the same. The time when the tax becomes payable during the progress of the commodity from the producer to the consumer also remains the same. The incidence and other ultimate economic consequences should therefore also be the same.

The general average of the quantity of fibre retained for local consumption has been estimated at six lakhs of bales, i.e. about

[1] One maund = 82·29 lb.

six per cent of a normal crop.[1] The remaining ninety-four per cent finds its way from the innumerable growers to the jute mills and exporters in Calcutta. The stage of levy has thus been rightly chosen. It ensures:

(*i*) that only a few persons have to be dealt with by the Department, such persons being big dealers who know how to keep accounts and how to deal with a tax authority, and

(*ii*) that the cost of collection is kept at the minimum, and the administration is carried on smoothly.

The small fraction of jute retained in the villages for local consumption, of course, escapes the tax. But that is a negligible quantity, and being retained for the domestic requirements, for ropes, etc., of the villagers, the exemption is justifiable. This source of demand is obviously limited, and the exemption can by no means act as an incentive to draw away increasing quantities of jute for this purpose at the expense of other lines of consumption.

Jute is dealt with in bulk at the stage chosen for the levy of the tax. For each such transaction in bulk, the amount of tax payable is considerable. The economic pressure for avoidance is therefore great. This may encourage the emergence of a tendency towards arranging the legal part of the transaction of purchase, say, at French Chandernagore, without in any way causing a deviation in the usual movement of the goods. Goods will move and be delivered in the usual way; only the contract for the change of ownership, which lawyers call sale, will take place in French Chandernagore. There is no evidence that such a tendency has emerged. Moreover, if and when it does emerge a provision like explanation (2), Section 2(*g*) of the Bengal Finance (Sales Tax) Act, 1941, will put a stop to it. The effect of enacting the explanation will be to bring within the scope of the tax all sales of goods situated in Bengal even when the sale takes place outside Bengal. Successful avoidance, with such a provision incorporated in the Act, will require not only the arranging of the legal transaction outside Bengal but also the diversion of the goods to a place outside Bengal at the time of such sale. If both these steps become necessary for avoiding the tax, it will no longer be worth-while to adopt them for the purpose of avoiding the tax because the two steps together will cost more than the tax payable. It is important to note that

[1] *Annual Report of the Indian Central Jute Committee*, 1941-2, page 189.

Bengal jute, on its way from the areas where it is grown to Calcutta, does not pass through French Chandernagore or any other place outside the Province of Bengal.

The next striking feature of the tax is that it chooses for taxation (*a*) the raw material of a home industry, and (*b*) exports. Schemes of sales taxes ordinarily take particular care to exclude these from their scope.

Why is taxation of exports objectionable? Because ordinarily exports have to compete in the world market with the same commodity drawn from other sources of supply and if a provincial sales tax puts an initial handicap on the export trade of the province, while the other competing sources remain untaxed, the discrimination created by the tax against provincial export trade may easily prove ruinous to it. Similarly, if the raw material of a home industry is taxed by a province, while the competing industries in other countries continue getting their raw materials free of tax, the provincial tax creates a discrimination against the home industry both at home and abroad, and this may well cause its ruin. Apart from grounds of equity, sales taxes on raw materials of a home industry or on exports are therefore especially objectionable on account of this discriminatory effect which tends to kill the goose that lays the golden egg.

In the case of jute, however, no such discriminatory effect is produced by the sales tax or the purchase tax. Raw jute is scarcely produced outside India. In India, it is not produced outside Bengal and the neighbouring provinces of Assam, Orissa and Bihar. Within these four provinces again the production is distributed as follows [1]:

	1935-36	1936-37	1937-38	1938-39
	%	%	%	%
Bengal	87	77	75	78
Assam	5	5	8	10
Bihar	6	16	15	10
Orissa	1	1	1	1
Indian States ..	1	1	1	1
	100	100	100	100

[1] See Indian Central Jute Committee's *Economic Research Bulletin*, No. 1, on the 'World Consumption of Jute', 1938-9 and 1939-40.

Moreover, the best quality jute is grown almost exclusively in Bengal—a very small quantity of such jute being grown in Assam also.

There are jute mills outside India—in Dundee, in America, in Germany and in many countries. But they have to obtain raw jute from Calcutta. In pre-war years the Calcutta mills consumed about sixty per cent of jute grown in the country, the remaining forty per cent being exported to feed the foreign mills.[1]

The Bengal purchase tax by taxing the raw material of a home industry therefore does not create a discriminatory effect on home industries as foreign industries also have to take their raw material from Calcutta where also it is taxed. By choosing to tax the export trade, it does not create a discrimination against it, as there is no other source of supply with which the taxed trade has to compete; while, but for this tax on exports, there would have been created a discrimination against the home industry.

The tax, however, does create a discrimination in favour of the jute of Bihar, Orissa and Assam. But Bihar and Orissa jute and most of the Assam jute being of lower quality and very limited in quantity by natural conditions it is not possible to replace Bengal jute by outside jute to any appreciable extent.

Thus it is the natural localization of the production of raw jute in Bengal which makes possible

(*a*) the levy of a tax on it even when it is exported or used as a raw material of a home industry without ruining the export trade and the home industry; and

(*b*) the levy of the tax at a stage when it is bought and sold in bulk. If there were an alternative expansible source of supply, say, through another province or from a foreign country, taxation at that stage would have been avoided completely.

The natural localization of the world supply within the jurisdiction of a Provincial Government is, however, a rare phenomenon. Jute is the only important instance of its kind.

This discussion proceeds on the assumption that the incidence of the tax is on the buyer. Before discussing the question of incidence, it is necessary to know the conditions of supply and demand of the commodity taxed.

[1] *The Report on the Marketing and Transport of Jute* issued by the Indian Central Jute Committee, Diagram opposite, p. 12.

On the supply side it is important to note the following basic facts:

(*a*) Jute is produced by innumerable small cultivators.

(*b*) There are a few other crops, chiefly paddy, competing directly with jute on the supply side.

It is also important to note the following figures of jute acreage for all India:

Year	Acreage in millions of acres
1929	3·42
1930	3·49
1931	1·86
1932	2·14
1933	2·52
1934	2·67
1935	2·18
1936	2·89
1937	2·89
1938	3·17
1939	3·16
1940	5·67
1941	2·16
1942	3·29

(Source—Final Forecast of Jute Crop)

It would appear that the acreage has varied from 1.86 million acres in 1931 to 5.67 million acres in 1940. The range of variation is thus very wide. In deciding whether he should plant jute in a particular field, a cultivator is guided by various considerations. On some of these factors he has no control and must accept them as they are. There are other factors which he tries to control by his action.

The most uncontrolled factor is the nature of the soil itself. There are some lands which are entirely unsuitable for producing any crop other than jute. The cultivator has no choice but to grow jute on it. The proportion of such lands is very small and can be neglected for our present purpose. Apart from the question of absolute unsuitability, there are various degrees of suitability of lands for growing jute or any other competing crop. Crop-cutting

experiments conducted by the Indian Statistical Institute in 1942 have shown that the yield per acre of jute has varied from 11·1 md. to 20·6 md., whereas the yield of *aus* paddy per acre has varied from 4·5 md. (in Pabna) to 31·5 md. (at Dacca). These are factors which the cultivator must accept. Thirdly, the cultivator has no control over weather conditions. The expectation of yield from an acre of land may be considerably increased or decreased on account of weather conditions.

Having taken the above factors as given, the cultivator is chiefly guided by the expected net profit from each unit of land by growing jute on it or any other competing crop. This depends on two factors:

(*a*) the expected price relationship between jute and the other competing crop, chiefly paddy, and

(*b*) the degree of suitability of each piece of land for growing jute or any other crop.

If, for example, a particular acre of land is expected to yield either twelve maunds of jute or twenty-four maunds of paddy, the cultivator would grow jute on that land as long as he expected that the price relationship of jute and paddy would not be less than 2 to 1. If he expected a price relationship which was less than 2 to 1, he would not grow jute on it but would put it under paddy. After he has put the land under a particular crop, unexpected weather conditions may disturb the expected results very considerably, but as that is a factor over which he has no control, it hardly affects his choice of the crop at the time of sowing.

Studies conducted by the Indian Central Jute Committee established a high degree of correlation between jute acreage of a particular year and the price of jute prevailing in the first quarter of that year or during the last quarter of the previous year.[1]

Though this correlation has been shown to exist for a large number of years, it has been found to be absent also for several years. Thus, ¶ 42 of the Report states:

'A close study of the acreages during the last 14 years, shows that when prices reach a low level the growers do reduce the area under jute; but, if low prices continue for a few seasons, they are prone to consider the prevailing conditions as normal and thus

[1] This correlation between the acreage and the price has been demonstrated by the graph facing page 31 of the *First Report on the Marketing and Transport of Jute* published by the Indian Central Jute Committee in 1940.

put more land under that crop. In 1931-32 and 1932-33, during the world economic depression, the calculated estimates of the all-India jute acreage amounted respectively to about 70 and 85 per cent of the 1930-31 jute area. But in 1933-34 and 1934-35, in spite of very low prices more land was sown with jute. This attitude of the growers may partly be attributed to the lack of an equally remunerative alternative cash crop.'

It is obvious that the cultivator is influenced in his choice of the crop not by the price of jute alone but by the comparative prices of jute and any other alternative crop. The Marketing Enquiry of the Indian Central Jute Committee failed to take notice of this fact but tried to establish a correlation between jute acreage and the price of jute only. Hence, though they could find some correlation for a number of years, it was absent for some years. In the early thirties, the acreage began to increase in spite of the fall in the price of jute. This was possible probably for two reasons: first, the price of another competing crop also fell in the same proportion so that the margin of jute cultivation was not disturbed by a fall in the price of jute itself. Secondly, the early thirties recorded such low prices of jute that there was always a large number of cultivators who thought that the bottom had been reached. This wishful thinking must have influenced their position to a very large extent, especially as the yield from any alternative crop was equally depressing. This speculative bent of mind was further encouraged by the fact that during those years the position of the cultivator was almost desperate from which the only hope of quick recovery was by a rise in the price of jute to the level of the twenties. Similarly, we should expect a fall in acreage in 1943 in spite of an increase in price. Though the price of jute was on the increase in the beginning of 1943, the price of paddy had risen much higher and the price correlation had been disturbed very severely against jute and in favour of paddy. It is therefore to be expected that we shall find a smaller acreage under jute in spite of its higher price.

It is thus clear that in any particular year, cultivation of jute will be pushed up to that stage at which a cultivator would expect equal returns from the land whether he puts it under jute or paddy, having regard to the suitability of the land in growing jute or paddy, and having regard to the expected price correlation between jute and paddy.

It is clear that jute is not produced under monopolistic condition though it has often been called a monopoly. It is an incorrect

expression loosely used to mean a natural localization of the produce. Actually, it is produced by innumerable small cultivators under full competitive conditions; the growers have not got that control over supply which characterizes a monopoly. The growers have not only got no control over supply but they are often very helpless in this respect as was amply demonstrated by conditions in the early thirties of the present century. The following passage from the *Minority Report* of the Bengal Jute Enquiry Committee, 1934, will bear quotation in this respect:

'The manufacturing interests, moreover, readily took an alarm from such developments and addressed themselves seriously to a curtailment of production which arrested the fall in the prices of jute goods....The growing interests, on the other hand, being scattered all over the province and ill-organized, could not take a similar concerted action for the curtailment of production. The only attempt made in this direction was to be found in the propaganda campaigns launched by official and non-official agencies in 1930-31 which bore a temporary effect of reducing the crop of that particular season and the following season. These reductions, however, did not help the price of jute which continued to fall, except for temporary spurts for special reasons, such as the linking of the rupee to the depreciated sterling in the third quarter of 1931. The inability of the price of raw jute to resist continuous decline can easily be explained by heavy reductions in demand, much heavier indeed than that in the supply of the fibre. Even in 1931-32, when the crop was the smallest recorded since 1923, there was hardly any improvement owing to the fall in the demand for jute products and the accumulation of heavy stocks in nearly all the consuming centres of the world, which could not be absorbed even at a very low price. A further restriction of the output was, in view of these facts, looked for, but unfortunately the season 1932-33 has again a much larger crop with the result that at the end of the season 1932-33, the stock of raw jute in the hands of the local mills is enough to meet the requirements of another 12 months, while the stock abroad, is considered adequate for 6 months' consumption. Evidently, these circumstances further worsen the position of jute, prolonging the depressed condition of the jute market.' [1]

On the demand side, it is important to note the following points: Jute goods are required chiefly for the packing of other goods. The price of the jute required for packing a certain volume of goods is a very small fraction of the price of the goods. It is therefore to be expected that the trade will put up with a fair increase in the

[1] Pp. 86-7.

price of jute packing rather than go without it, assuming that at that price an alternative packing material does not become available. Assuming further that there is no economic friction preventing any increase or decrease in the demand for jute goods being smoothly passed on to the demand for jute fibre, this gives a certain amount of inelasticity to the demand for jute. The Bengal Jute Enquiry Committee, 1939, was of opinion:

'From the balance of opinion we have received on this subject, as well as on *apriori* grounds we are inclined to think that at a time, when stocks of the fibre have been reduced to the minimum, even a small reduction in the total output is bound to be felt as a severe pinch, and is likely to lead to a substantial increase in the price. This will be particularly so when business and trade are on the upgrade.' (Vol. I, ¶ 39, p. 31.)

The demand for jute packing varies directly with the volume of world trade, provided the price is not such as to make it worth-while to use substitutes for jute. The demand for the packing material must expand or shrink with the world trade. As the total volume of world trade fluctuates a great deal, it follows that the demand for jute must also fluctuate correspondingly.

Thus, two conclusions are indicated:

(*a*) The total demand for jute may fluctuate sharply and frequently from year to year;

(*b*) At a point of time the demand is more or less inelastic provided a substitute does not become available at the prevailing price.

In this connexion it is interesting to note the actual fluctuations that have taken place in world consumption and the prices of raw jute. The following table gives the world consumption of jute from 1923-4 to 1940-1:

Year	Lakhs[1] of Bales [2]
1923-4	93·87
1924-5	91·11
1925-6	93·51
1926-7	123·83
1927-8	115·50
1928-9	108·83
1929-30	112·08
1930-1	101·52

[1] Lakh=100,000.

[2] Bale=400 lb.

Year	Lakhs of Bales
1931-2	70·50
1932-3	75·91
1933-4	96·7
1934-5	100·9
1935-6	102·1
1936-7	123·8
1937-8	109·3
1938-9	107·8
1939-40	108·6

The table has been compiled as follows:

The figures for the years 1923-4 to 1932-3 have been arrived at by adding five to the figures on page 73 of the *Minority Report* of the Bengal Jute Enquiry Committee, 1934, on account of the extra-factory consumption of jute. The figures for the remaining years have been taken from Table IV on page 7 of the Indian Central Jute Committee's *Economic Research Bulletin*, No. 1, on the 'World Consumption of Jute'.

The following table shows the variation of prices of pucca bales of jute *Firsts* for the years 1924-5 to 1939-40:

	Rs	As	P
1924-5	87	11	1
1925-6	106	14	8
1926-7	62	1	4
1927-8	65	5	1
1928-9	68	8	3
1929-30	54	14	4
1930-1	30	7	3
1931-2	32	11	9
1932-3	28	0	9
1933-4	16	12	4
1934-5	29	7	10
1935-6	34	5	11
1936-7	34	8	10
1937-8	33	13	4
1938-9	41	5	10
1939-40	66	4	8

(*Second Marketing Report*, issued by the Indian Central Jute Committee, page 198.)

The same table states that in November, 1925, jute touched Rs 140-8-0 per bale. Again, from Table LXI on page 208 of the Indian Central Jute Committee's *First Report* on the Marketing and Transport of Jute, it will appear that in certain districts the price of jute fell as low as three rupees per maund for several years during the early thirties.

It would thus appear that the price of jute has varied from three rupees per maund to about twenty-five rupees per maund, and the world consumption has varied from seventy lakhs of bales to one hundred and twenty-three lakhs of bales. The range of variation of price is much larger than the range of variation in the world consumption of jute.

We have assumed that the effect of a rise in the demand for jute goods is passed on without any economic friction to the jute growers by a rise in the demand for jute fibre. In fact, however, there is a great deal of economic friction which prevents this. Two important causes for such economic friction are: (i) The mills usually hold substantial stocks of raw jute so that they are not in urgent need of buying raw jute when the season opens. (ii) The jute growers, being small men, require to dispose of jute as quickly as possible in the harvest season partly because they are in urgent need of money to discharge their monetary obligations and partly because they have no storage facilities available at their houses and the little storage capacity which exists in those houses must be made free for other crops in proper time. (iii) There is also the third reason that transport in eastern Bengal depends wholly on rivers and *Khals*, and the jute must be brought to the markets while these *Khals* remain navigable. The Indian Central Jute Committee, in their *Bulletin*, No. 1, on the 'World Consumption of Jute' has, after studying the correlation between mill production and mill purchases, said: 'The mills do not appear to have followed any uniform policy with regard to their purchase of raw jute.'

The third factor introduces an additional element of instability in the demand and increases the range and the frequency of price fluctuations from month to month during the same year.

From this discussion it is now possible to form an idea of the working of the law of supply and demand in its application to jute. The margin of cultivation is determined by the cultivator having regard to the expected price correlation between jute and any other competitive crop and also having regard to the comparative

suitability of the lands for growing jute or any other competitive crop. When once this margin has been determined and the land has been put under jute, the situation passes out of the control of the cultivator. This decision for sowing jute is taken in or about the months of January and February, and the jute is harvested in or about the months of July and August, while the jute so harvested is marketed from July to June of the next year. It would thus appear that the cultivator has to determine the margin of cultivation of jute about eighteen months ahead and in this respect he has to act on his forecast of world conditions for the next eighteen months, a task for which he is hardly competent. He therefore goes chiefly by present conditions. The supply also may be further affected by weather conditions. Good weather may give the farmer a crop much above his expectation, while bad weather may give him a crop much below his expectation. This is outside the control of the cultivator. When once, however, his crop has been harvested and retted, the supply must be taken as fixed and, at this stage, to use Marshall's well-known simile, the other blade of the pair of scissors, namely demand, begins to operate on the fixed supply. It is by the operation of the forces of demand on the fixed supply that the price of jute is determined from month to month during the year. The expectations of the cultivator may be severely reversed either way by the demand proving different from what he had expected. He might get a price of three rupees per maund, much below his expectation, or a price of twenty-five rupees per maund, much above his expectation. Over these factors he has no control until the next sowing season begins when he can adjust his programme of sowing accordingly.

It is clear, however, that however much the price may fluctuate, it will always have the tendency to return to a *normal* over a series of years. This is the normal which the cultivator expects and on the basis of which he determines the margin of his cultivation, this margin being determined by him on the principle of equi-marginal returns, i.e. at that point at which jute or any other competitive crop would yield him the same net return. The price of jute cannot remain for any long period of years below this normal. It remained below the normal for several years during the early thirties because, as has already been explained, the cultivator, being in a desperate position was always inclined to believe that the bottom had been reached and therefore developed a speculative

bent of mind. Similarly, the actual price cannot persistently remain substantially above the normal without having the effect of enlarging the supply which must have the effect of depressing the price. But it is also clear that the daily price is seldom equal to the normal because the margin has to be determined eighteen months in advance and once the supply is placed on the market, it is powerless to modify the daily price. Thus though the price will oscillate about a mean position taking several years together, the day to day or month to month fluctuation will be determined not by reference to the marginal cost but by the condition of the demand in the market, i.e. by reference to marginal utility. To quote the excellent summary of Marshall's discussion of a corn market:

'Even in a market of very short period, such as that of a provincial corn-exchange on market-day, the "higgling and bargaining" might probably oscillate about a mean position, which would have some sort of a right to be called the equilibrium price: but the action of dealers in offering one price or refusing another would depend little, if at all, on calculations with regard to cost of production. They would look chiefly at present demand on the one hand, and on the other at the stocks of the commodity already available.' [1]

When the analysis of the operation of the forces of supply and demand on the pricing process of jute is clearly understood, the question of the incidence of the tax on raw jute becomes simple. If the tax is passed on to the cultivator it reduces his return from jute while the expected return from the land, if paddy is sown on it, remains unaffected. The tax therefore influences him in his decision as to the margin, that is, the point up to which he is going to push his cultivation of jute. If, therefore, the margin is pushed up by this tax, the supply is curtailed and the price also is pushed up. The incidence of the tax is thus on the buyer though the price may not rise by the full amount of the tax. The position is exactly the one represented by Figure I, Chapter I, Part I. As the cultivation of jute is chiefly localized in Bengal, the tax does not assume a discriminatory character and no margin of any practical importance remains untaxed. Hence there is no possibility of any untaxed crop competing with the taxed crop and thereby shifting the tax entirely on to the cultivators of the taxed portion.[2]

[1] *Principles of Economics*, Book V, Chap XV, § 1.

[2] Marshall's discussion of a tax on crops in his *Principles of Economics*, Book V, Chap X, Sec. 5, may be seen in this connexion.

This is no doubt the normal position but, as has already been explained, actual prices from day to day or month to month in the jute market during the year are generally determined by the forces of demand, the supply remaining fixed during the year. It is therefore probable that the cultivator may have to bear the tax himself under certain conditions. The price that he gets, being more or less fixed by the demand, is not affected by the tax and, in that case, the incidence of the tax is on him. But, as already pointed out, the cultivator will always try to determine next year's margin of cultivation by the expectation of net return from his land, and if he finds that his net return from jute is lower than his net return from paddy on account of the tax on jute, he will obviously prefer cultivation of paddy to the cultivation of jute. Thus, here again, there will be a normal tendency for the tax to rest on the buyer though in actual practice the cultivator may have to bear it on many occasions.

The distinction between the normal incidence of the tax and its day to day incidence requires a little further clarification. The normal incidence is based on the assumption that the cultivator can refuse to sell his crop except at the marginal cost of production which includes the tax, i.e. he can either refuse to produce at all or can withhold the supply. This power of the cultivator can be asserted only over a long period and is absent from day to day. When once the supply has been brought on the market, it has got to be sold at that price which would equate supply to demand. Suppose the marginal cost of production, including the tax, is Rs X, and the cultivator has, on his anticipation of the state of world trade, pushed up his jute cultivation to a certain margin. Now when the supply is on the market his anticipations prove to be false and he is faced with a demand which is much less than what he had expected. In view of this smaller demand, the supply already brought on the market can be sold only at a smaller price, say Rs $X-Y$. This sum, $X-Y$, is fixed not by any consideration of the size of the tax but by an entirely different set of considerations. Hence, given the actual supply, the price would be fixed at a figure which is independent of the tax. The cultivator would get that price only, irrespective of whether he has got to pay the tax or not. Similarly, if after bringing the supply on the market, the cultivator is faced with a demand which is much larger than what he had anticipated, the price at which the supply would be equated to the demand would be much higher than X, say Rs $X+Z$. Hence,

again, this price of $X+Z$ is entirely independent of the tax and he would get that price irrespective of whether he has got to pay the tax or not. Here also the price is fixed by considerations which are entirely independent of the tax, and he would get that price whether the tax is there or not. He cannot get anything more nor anything less. So, in either case, where the anticipated demand proves to be false, the incidence of the tax can be stated to be on the cultivator, i.e. the tax is a deduction from the amount that he can get under the circumstances, and the amount remains the same whether he has got to pay the tax or not. But, in all this, we have assumed a given supply. This given supply has, however, been determined on a full consideration of the tax and the supply would have been larger but for this tax and, secondly, next year's supply will also be determined on a full consideration of the tax together with the state of the market, and if the cultivator finds that his net return from jute is persistently below or above his net return from a competing crop, say paddy, this cannot but affect the margin of cultivation of jute. In this way the tax has always got a tendency to be shifted on to the buyer. The mean position about which the price will oscillate will include the tax, but the price in actual practice may seldom rest for any length of time at that position. The actual prices may be determined at a position higher or lower than the mean position, but the oscillations must always be about the mean position and cannot remain only on one side of it for a series of years.

It is interesting to note in this connexion that as soon as the Bengal Raw Jute Taxation Act, 1941, was passed and published, the Committee of the Indian Jute Mills Association decided to amend the standard form of contract for raw jute and jute-cuttings so that 'the amount of tax payable under the said Act is to be on the sellers' account and to be deducted by the buyers from the price quoted for payment to the Provincial Government in the prescribed manner unless at the time of concluding the contract the sellers satisfy the buyers by the production of satisfactory evidence that tax is not payable on the sale'.[1] Does this prove anything about the incidence of the tax? This obviously takes full advantage of the process by which the daily price of jute is actually fixed in the market. In this process, the supply must be taken to be given and the price is

[1] Indian Central Jute Committee's *Bulletin*, December, 1941, p. 378.

fixed by the operation and movement of demand only. The price must be fixed at that point at which the given supply can be sold. As that point is independent of the tax, the tax can be said to be a deduction from the price otherwise obtainable by the cultivator. The amendment in the standard form of contract is but an expression of this fundamental economic process. In the short period a seller cannot make this device of shifting infructuous by quoting a higher price, i.e. by quoting a price which is higher by the amount of tax payable than the price which he would have quoted without the tax. As the marginal cost of production and, therefore, the tax is unimportant in the daily pricing process, it can be stated that the grower bears the tax ultimately by a process of anticipatory backward shifting. But the grower asserts himself in the long run and he can adjust the next crop and can probably to a certain extent withhold a portion of the year's supply also. Thus, this amendment in the form of contract does not in any manner influence the actual incidence of the tax. The conclusion we arrived at remains true, that the mean position about which the price will oscillate will include the tax, but the price in actual practice may seldom rest for any length of time at that position.

The next point for consideration is whether the recent compulsory regulation of the crop affects the incidence. The ostensible purpose of regulation is to equate supply to demand. It has already been noted that that is exactly what the cultivator tries to do. Equating supply to demand hardly means anything unless there is to be assumed a particular price at which that equation is to be established. This equilibrium price in the mind of the cultivator is given by the return that he might expect from any other competitive crop, e.g. paddy. Thus, the cultivator considers the respective returns from paddy and jute and also considers that he has got to pay the tax in case he puts the land under jute, and he will go in for just so much jute as will equate the supply to demand at that price which will bring him the same return from jute, after paying the tax, as he will get by putting the land under paddy. The cultivator, however, as has already been pointed out, is unequal to the task because he cannot forecast world conditions eighteen months in advance. Further, even when world conditions have been forecast as correctly as possible, the cultivators are individually averse to reduce acreage as each is inclined to think that his insignificant acreage would, without materially affecting the total acreage, give

him substantially increased profits. They, being small men with scattered holdings, are hardly capable of collective action as was amply demonstrated in the early thirties. By introducing regulation, Government have taken upon themselves, first, the responsibility of forecasting world conditions during the next eighteen months and, secondly, the responsibility of forcing the cultivator to adjust his crop accordingly. By the experience of the few years of working of this compulsory regulation it appears that Government have succeeded in the second objective. They have been successful in reducing supply to the desired extent. It has still to be proved whether Government can forecast world conditions correctly for the purpose of regulation. It does not appear that Government have up to now realized that the adjustment of supply to demand must proceed on the basis of a particular price which must be considered suitable and that this price must give the jute-grower the same return as he would have got from the same land by growing paddy or any other competitive crop on it. If this point is not properly appreciated and is not kept in view at the time of fixation of the acreage, two consequences may follow. If the supply contemplated can be equated to demand at a price which is lower than the norm, i.e. the equi-marginal price, the cultivator will either put a smaller acreage under jute than that fixed by Government or the jute-grower will lose in comparison with the paddy-grower.[1] It is apprehended that such a state of things was brought about in 1943. Secondly, if the acreage fixed by Government produces a supply which can be equated to the demand at a price which is above the equi-marginal price, the industry will suffer unnecessarily and substitutes may come into being. The weapon of regulation is therefore a delicate one and must be handled carefully.

Now in so far as Government only help the cultivator in his estimate of the supply to be produced and also help him in acting up to that estimate, there is no disturbance of the economic processes already analysed, and therefore, the conclusions already established remain valid. When, again, the cultivator's estimate of the acreage is lower than the Government estimate and the cultivator actually puts a small acreage under jute, the Government regulation is non-effective and, in that case also, the conclusions

[1] The acreage fixed by Government is the maximum and hence there is no statutory objection to reducing it still further on the cultivator's own initiative.

already established remain valid. But there will be a third case in which Government may try to control supply in the same way as a monopolist does. Instead of trying to adjust supply at that point where it can be equated to demand at a price which will equalize the net return from paddy and jute, they might try to fix or restrict supply in such a way as to bring the maximum net profit to the cultivator. Such a policy is possible as practically the entire acreage of jute in the world is localized within the jurisdiction of one Government. Such a policy would be full of danger inasmuch as it might bring into existence substitutes which might mean the ruin of jute. But in so far as that policy is pursued, the incidence of the tax will be altered. The margin will no longer be determined by reference to the equi-marginal return after taking into consideration the tax, but by an entirely different set of considerations ; it will be fixed at the point at which the cultivator will obtain the maximum net profit. That point will have to be determined independently of the tax. The price that will bring the maximum net return will also be independent of the tax and therefore it will always be worth-while for the cultivator under such circumstances to pay the tax out of his own pocket, because even with the tax, it would still be the point of maximum net return. This is, however, theoretical as such a situation has not yet arisen and Government's policy is not to fix the acreage on monopolistic principles.

XV

TAX ON SUGAR-CANE

THE following table shows the number of sugar factories working in each province during the year 1937-8, the estimated quantity of cane crushed, and the amount of sugar produced.

Province	No. of mills working	Quantity of cane crushed, in tons	Sugar produced, in tons	Percentage of total production in India
United Provinces	68	57,85,500	5,31,300	57·1
Bihar ..	33	23,50,200	2,25,300	24·2
Punjab and Sind	3	1,39,200	11,700	1·3
Madras ..	8	2,18,500	20,700	2·2
Bombay ..	7	3,70,900	40,700	4·4
Bengal ..	6	2,22,500	19,800	2·1
Orissa ..	2	15,900	1,300	0·1
Indian States ..	9	8,13,700	79,900	8·6
TOTAL ..	136	99,16,400	9,30,700	100·0

[Table extracted from Table No. III on page XIV of the Indian Sugar Industry (1938) Annual.]

The outstanding importance of the United Provinces and Bihar in the sugar industry of India is apparent from the table given above. It is in these two provinces that a technique of organization and State control has developed which has not yet been adopted by Governments in other provinces. A tax on sugar-cane is levied in these two provinces only, chiefly as a part of the measures of control. In all these matters of control and taxation, the Governments of these two provinces act in consultation and follow a common policy.

The recent history of the sugar industry in India, which is chiefly the history of the industry in the United Provinces and Bihar, dates from the year 1932. It was in that year that, on the recommendation

of the Tariff Board, protection was granted to the sugar industry for the first time. The protection has continued since then. The variation in the extent of protection from time to time is shown in the following table:

(1) Date of imposition	(2) Rate of Import duty per cwt	(3) Rate of Excise Duty per cwt if any	(4) Difference between col 2 and col 3
	Rs As P	Rs As P	Rs As P
1-4-1932 ..	9 1 0	Nil	9 1 0
1-4-1934 ..	9 1 0	1 5 0	7 12 0
28-2-1937 ..	9 4 0	2 0 0	7 4 0
1-4-1939 ..	8 12 0	2 0 0	6 12 0
1-3-1940 ..	9 12 0	3 0 0	6 12 0
1-4-1941 ..	11 1 $7\frac{1}{5}$	3 0 0	8 1 $7\frac{1}{5}$

The grant of protection gave a strong impetus to the industry and a period of quick and uncontrolled development followed. Before 1932 India depended almost wholly on imported sugar. In the course of a few years she could produce all the sugar she consumed and more. The rate of growth of the industry will appear from the following table:

NUMBER OF CANE FACTORIES WORKING IN EACH YEAR

Province	1931-2	1932-3	1933-4	1934-5	1935-6	1936-7	1937-8	1938-9	1939-40	1940-1	1941-2
United Provinces	14	33	59	65	67	68	68	69	70	70	70
Bihar ..	12	19	33	34	35	33	33	32	32	32	32
All India including U.P. and Bihar ..	32	57	112	130	137	137	136	139	145	148	150

It will appear that the period from 1932 to 1937 was a period of rapid development. Little or no State control was exercised on the growth of the industry during this period. The Sugar-cane Act,

1934, was passed to secure a fair price to the grower. Under this Act a Provincial Government could declare any specified area to be a controlled area and fix a minimum price or prices for purchases of sugar-cane in that area for use in factories. For the years 1934-5 to 1936-7 a minimum price was fixed in the two provinces every fortnight, varying with the price of sugar realized by the factories. Except for this measure of price control there was no attempt at planning the crop or regulating its marketing. The inherent weakness of the position was soon exposed.

The subsequent development was described as follows by P. M. Kharegat, Vice-Chairman, Imperial Council of Agricultural Research, at the 12th meeting of the Sugar Committee held in Simla on the 17th June, 1940:

'The sliding scale of price-fixation worked satisfactorily during the 1934-35 and 1935-36 seasons, and also in the first portion of the 1936-37 season. Towards the end of February 1937, it became clear that there was a bumper crop and that a large area of cane would be left uncrushed unless factories could be induced to continue as long as possible. It was at this stage that the excise duty was increased and the factories represented that partly this additional burden and partly the fact that cane deteriorates rapidly towards the end of the season, they could not continue to crush the cane at the prevailing price of 4½ annas a maund.

'In order that cane might not have to be burnt, it was agreed that factories would continue crushing but would pay a lower price for cane, varying from 3 to 3½ annas, although there was then no fall in the price of sugar justifying such a reduction. By this arrangement the difficulties of the growers were tided over. But a new situation soon developed for the factories.

'They found before long that there was a surplus of sugar some of which had been manufactured at a low price paid for cane and as a result cutthroat competition began among the factories to try and dispose of the same. The result was that the price of sugar dropped to uneconomic level and the industry was faced with very serious situation.'

At that stage the Provincial Governments of Bihar and the United Provinces took up the question and the Bihar Sugar Factories Control Act, 1937, and the United Provinces Sugar Factories Control Act, 1938, were passed. These two Governments approached the question chiefly from the standpoint of the growers and wanted to assure to them a market for their crop at a reasonable price so that they might not again be faced with a situation where they must either destroy the crop or sell it at an uneconomic price.

Now the factories in this country have not got large plantations of their own on which they can rely exclusively for the supply of cane. They depend for their supply of cane on innumerable cultivators with small holdings and scattered plots. These growers are illiterate, unorganized, ignorant of modern developments, and incapable of collective action.

Secondly, the entire sugar-cane crop is very much larger than what the factories can consume. The table below gives the proportion of the crop crushed in factories:

PERCENTAGE OF CANE CRUSHED IN FACTORIES OF THE TOTAL CANE CROP

Season	U.P.	Bihar	All India
1934-5	13·2	30·9	12·3
1935-6	16·3	40·4	16·0
1936-7	15·6	49·3	17·6
1937-8	23·0	62·3	17·8
1938-9	22·0	44·5	16·2
1939-40	33·0	71·1	26·9

[Taken from Table No. 12 in the statistical tables given in the Indian Sugar Industry (1940 *Annual*), page 100.]

The bulk of the crop is thus used for the manufacture of gur and for consumption as sugar-cane, gur being mostly made by the growers themselves. This competitive demand for cane from these two sources is, however, weak and sale to sugar factories is almost always more profitable than use of the crop for gur-making. It is seldom, therefore, that the two sources of demand operate in the same market, except in exceptional circumstances.

Thirdly, there are other crops which compete with sugar-cane on the supply side. The competition of alternative crops is very strong in Eastern Bengal, the land of jute, but is not at all keen in the United Provinces and Bihar.

Fourthly, the most important characteristic of sugar-cane which exerts a decisive influence both on its supply and demand is that it is a perishable crop. After the crop has been harvested, the grower cannot keep it even for a day without losing weight or sucrose content. As a result of certain analytical tests carried out in laboratories, the Sugar Enquiry Sub-Committee of the Bengal

Industrial Survey Committee got the following correlation between the number of days lost between harvesting and crushing and the loss of weight and sucrose content. [1]

Number of days	Loss of weight per cent	Loss of sucrose (kilogram of sugar per ton of sugar-cane)
1	$3\frac{1}{4}$	..
2	$6\frac{1}{2}$	17
3	$8\frac{1}{2}$	31
4	11	44

The perishable character of the crop affects both the grower and the factory. It makes the grower nervous that he may not be able to sell his crop in time, as delay in disposal of the crop may mean the total loss of the crop. Hence, as the U.P. Premier put it ' whenever the cane season approaches there is a scramble and a rush to the mills and it is easy for the millowner to tire out the cane-grower and to reduce him to a position of helplessness so as to force him to part with the cane at any price and that is what actually happened last year '.[2] The helplessness of the grower is accentuated whenever there is overproduction as in the season 1936-7. Further, the perishable character of the crop restricts the growers' market to an area in which the cane can be transported without much loss of weight and sucrose content.

The mills also cannot carry over any stock of cane on account of their perishable character. The cane must be crushed as it arrives and it is essential that it must arrive fresh, i.e. not later than the day following the date of harvest. Late arrival or delay in crushing means loss of sucrose content which has an adverse effect on the cost of production and therefore on the competing power of the mills. This, therefore, is a factor which makes the factories helpless *vis-à-vis* the growers and this helplessness is accentuated whenever there is underproduction of cane. Further this makes the cane grown in the vicinity of the mill preferable to cane drawn from a distance. The preference for the 'gate' cane, as the former is called, is measured not only by the greater cost of transport of the distant cane but also by the greater loss of sucrose on account of the longer haulage period required by such cane.

[1] ¶ 59 of their *Report*.

[2] U. P. Legislative Assembly *Proceedings*, Vol III, 1938, page 81.

The perishable character of the crop makes the sugar industry a seasonal one. It cannot produce sugar all the year round. It must work for a few months and then wait for the next season. This period of enforced idleness enhances the cost of production of sugar. Hence it is always to the interest of the industry to lengthen the period of crushing as much as possible and to shorten the period of idleness correspondingly. The greater the success of a mill in this direction, the lower will be the cost at which it can produce and the greater will be its competing power. In these circumstances it follows that:

(*i*) The marketing of cane is extremely important to the grower. He must have an assured market. Uncertainties about the prospects of marketing may prove ruinous to him. The market must also be within a short distance of the field so that the cane may be transported to the factory and sold on the very day on which it is harvested.

(*ii*) A proper organization of supply is essential to a factory. The cane must come daily. It must come fresh, i.e. on the day on which it is harvested. Only as much cane as can be crushed daily must arrive on a day—neither more nor less. This daily supply of fresh cane must continue as long as possible during the season. There must be an arrangement for the prompt weighing and receiving of the cane as it arrives.

These two considerations make the growers and the factories equally interested in the agricultural aspects of cane-growing in the areas near factories.

First, as the factories are interested in getting an adequate supply from the areas in the vicinity, they are definitely interested in seeing that the yield of cane on such lands increases.

Secondly, as the sucrose content of cane has a direct effect on the cost of production and therefore on the competing power of a mill, the mills and the growers are jointly interested in raising the sucrose content of cane grown on lands near the mills.

Thirdly, as the mills are interested in a longer season, they and the growers are equally interested in developing suitable varieties. If the early, late and mid-season varieties are well distributed so that all the cane does not get its maximum sucrose content at the same time, the mills can get an even supply over a longer period

and the growers also can sell cane as it ripens without being under pressure to rush the sale of all the cane at once.

Now, all these conditions create economic pressure for the concentration of cane cultivation in the vicinity of the factories. The pressure acts on both the intensive and extensive margins of sugar-cane cultivation in such areas. The intensive margin tends to be lowered by attempts at improving the yield and the sucrose content of cane. The extensive margin tends to be lowered by pressing on other alternative crops grown on that area.

The pressure for the displacement of other crops is held in check by two limiting factors. First, the nature of the soil and secondly, the value of the alternative crop. How the nature of the soil acts as an effective check on the concentration of sugar-cane cultivation near the factories in certain districts of Bengal was explained as follows by the Sugar Enquiry Sub-Committee on the Sugar Industry in Bengal.

'In the districts of North and Central Bengal, in particular, the level of land is found to be very irregular, where small patches of high and dry lands are found juxtaposed with fairly low lands or swamps. This condition of the lands naturally compels the cultivator to grow different crops even in adjacent plots according to their respective soil conditions.'

The nature of the competition from alternative crops was described as follows in the Report of the Tariff Board on the Sugar Industry (1938):

'In most parts of India gur-making is still of far more importance than sugar manufacture. Consequently, the fluctuations in the acreage of sugar-cane are mainly dependent on the price of gur relatively to the price of alternative cash crops such as jute in Bengal, wheat in the Punjab and cotton or groundnut in Bombay and Madras. In the United Provinces and Bihar the position is not quite the same. In the first place, speaking generally, alternative cash crops play a less important part in the domestic economy of the cultivator than in other parts of India; secondly, though in most parts of the two provinces the price of gur is still of great importance the price paid for cane by factories has become a matter of consequence in areas where gur-making has tended to decline or die out owing to the competition of factories for the available supply of cane.' [1]

The size of the area, in which the economic pressure for concentration will act, depends on the size of the factory, and the nature

[1] Chap. III, ¶ 39.

of the roads and transport facilities available in the area. The better the roads and the better the transport facilities, the greater is the distance from which cane can be transported to the factory on the very day on which it is harvested.

From the above analysis it is clear that as the sugar industry comes to be well established, the sugar-cane areas tend to be divided into two distinct zones, the gur zone and the sugar zone. Manufacture of gur is a cottage industry. Growers are small men and each grower makes gur from cane grown on his own lands. There is, therefore, no pressure for concentration of cane in the gur zone. Thus in a sugar zone the crop is concentrated, the margin of cultivation (both intensive and extensive) is low and the marginal cost of production is high. In a gur zone, on the other hand, the crop is scattered, the margin of cultivation is high and the marginal cost of cultivation is low. The economic or normal price of sugar-cane must, therefore, be different in the two zones. It will be higher in the sugar zone and lower in the gur zone. The marginal demand price of sugar-cane in the sugar zone is clearly higher to the factories than that of sugar-cane grown at a distance, and this higher marginal demand price generates a pressure for the lowering of the margin of cultivation and hence for increasing the marginal cost of production in the sugar area.

In the cane cultivation of this country, the optimum degree of concentration has not yet been reached and factories have often to depend to a considerable extent on rail-borne cane. Agricultural research, together with improvement of roads and transport facilities, will in due course bring about the optimum degree of concentration. But at present the price acts as an active cause of diverting cane from gur areas to the factories as happened in the early part of the season 1939-40.

A table is given below to show the proportion which gate cane bore to the total quantity of cane crushed in factories.

FACTORY CONSUMPTION (PER CENT) OF GATE CANE IN BENGAL AS COMPARED WITH BIHAR AND THE UNITED PROVINCES.[1]

Provinces	1934-5	1935-6	1936-7	1937-8	1938-9	1939-40
Bihar ..	48	50	58	53	53	53
U.P. ..	65	66	68	72	66	62
Bengal ..	22	26	45	55	54	33

[1] Taken from ¶ 60, Chap. V, of the *Report of the Sugar Enquiry Sub-Committee of the Bengal Industrial Survey Committee* (1942).

The nature of the season has a considerable influence on the ratio of gate cane to distant cane; for, in a good season, more gate cane is available while in a bad season, with a poor yield, the factories have to draw supplies from a distance.

The Sugar Factories Control Acts of the U.P. and Bihar were an attempt to organize the cultivation and supply of cane to the factories on the economic lines set forth above. The principal objects of the Act were the improvement of quality and yield of sugar-cane in sugar areas, the provision of a regular supply of cane to the factories and the provision of an assured market and an economic price to the grower.[1] The Acts sought to divide the sugar-cane area into three distinct parts:

(*i*) an area reserved for a factory;
(*ii*) an area assigned to a factory; and
(*iii*) areas which are neither reserved nor assigned.

The difference between a reserved area and an assigned area was explained as follows in the statement of objects of the Bills:

'There are three important differences between a reserved area and an assigned area: firstly, in a reserved area, a factory is bound to enter into agreements with all cane-growers or cane-growers' co-operative societies,[2] whereas in an assigned area the only obligation is to enter into agreements for a specified quantity of cane; secondly, in an assigned area, cane may be purchased through a licensed purchasing agent whereas in a reserved area it can only be purchased direct from cane-growers or cane-growers' co-operative societies; and thirdly, in a reserved area, only the factory for which the area is reserved may purchase cane whereas in an assigned area any factory or its licensed purchasing agent may purchase cane.'

All factories must be licensed. They are also to take out a crushing licence every season. Each factory is required to publish, before the sowing season, an estimate of the quantity of cane that it proposes to buy in the next crushing season. This announcement serves as a good guide to the cultivators in regulating their sowing. A factory must keep a record of all growers and their cane lands within the area reserved for it. Thus, cane-growers in the reserved area are assured that the factory will buy their cane in accordance

[1] See speech of the Minister-in-charge of the Bill in Bihar—Bihar Assembly *Debates*, 1937, Vol. II, p. 185.

[2] The agreement is optional with the cane-growers, but if the cane-growers want to enter into on advance agreement, the factory must do so.

with the terms and conditions of an agreement subject to prescribed limits. The limit for each grower is prescribed with due regard to his cane lands and need for a proper rotation of crops.

The intention of the Acts is that the factories should draw their supplies of cane chiefly from the reserved areas. They should draw from the assigned areas to make up for any deficiency after taking the entire supply of the reserved areas. Though the factories are free to draw from the free areas after meeting their obligations in respect of the reserved and assigned areas, it is clear that the free areas are intended to develop as gur areas only. The arrangement, while securing an assured market to the growers of reserved areas, makes the factories directly interested in the improvement of the quality and yield of the reserved areas.

The Acts authorize the Provincial Governments to fix the minimum price of canes sold to the factories. This is essential in view of the fact that a factory is given the monopoly to buy in a reserved area. The Provincial Governments appoint Inspectors to supervise the working of the Acts and to see that the growers get a fair deal from the factories in respect of weight, price and everything else.

The Acts authorized the two Provincial Governments to levy a tax on sugar-cane sold to factories. Originally the levy was made with the express object of financing the scheme of control introduced by the Acts.

Lastly, all the factories in the two provinces were required, under the Acts, to be members of an organization for the marketing of sugar known as the Sugar Syndicate.

The main provisions of the two Acts were agreed upon in two joint Conferences—one at Lucknow and the other at Patna—in which the representatives of the two Provincial Governments, the industry and the growers took part.

Though the industry had made rapid progress, the organization of the supply of cane was, in 1937, found to be far from satisfactory. The yield of cane and its sucrose content were low, the growers were not getting an economic price for their cane, the factories suffered from irregularity in the supply of cane and they had often to bring cane from distant areas. The factories again were indulging in cutthroat competition which reacted unfavourably on the unorganized growers because they were the most easily squeezable,

particularly in view of the perishable character of their crop.[1] It was necessary that during the continuance of the protective tariff this unsatisfactory state of things in respect of sugar-cane supply should be set right, if the industry was to have a firm and permanent footing in the land. New provincial ministries had just come into office under the new constitution. They at once attacked the problem, their line of approach being chiefly from the standpoint of the grower. They wanted a fair price and an assured market for the growers. The industry took this opportunity of organizing itself. The factories had just then started a voluntary marketing organization known as the Indian Sugar Syndicate to save themselves from internal competition. The membership of the Syndicate was not yet universal. The factories agreed that they could pay a higher price to the grower provided membership of the Indian Sugar Syndicate was made obligatory for all factories and each factory was given a reserved cane area. Though the parties approached the question from sectional standpoints, the agreed Acts were steps in the right direction. The gur zone was separated from the sugar zone. The growers in the gur zone knew that they would have to depend on gur-making. The sugar zone could specialize in growing cane suitable for factories and it seemed that they were reasonably assured of a market. The factories also were reasonably assured of a regular supply of gate cane and they became interested in the proper development of the reserved areas. In bad years they could of course turn to assigned and free areas to a greater extent. The factories also formed a combination of their own for the marketing of sugar under the protection of the law. It seemed that everything was now placed on a sound footing and that the difficulties were tided over. But soon it was found that there were some faults in the organization and a second crisis developed in the affairs of the industry.

It has been stated before that during the seasons 1934-5, 1935-6 and the first portion of 1936-7 the price of cane was fixed fortnightly in Bihar and the U.P., according to a sliding scale schedule. The schedule in force in the U.P. was as follows:[2]

[1] For a vivid description of the position from the growers' standpoint, see the U.P. Premier's speech in the Legislative Assembly—U.P. Assembly *Proceedings*, 1938, Vol. III, p. 81.

[2] The Indian Sugar Industry (1940 *Annual*), p. 101.

Average price of sugar per maund [1]				Corresponding minimum price of sugar-cane per maund [1] sold to vacuum factories	
Rs	As	Rs	As	As	P
Above		To			
6	0	6	8	4	0
6	8	7	0	4	3
7	0	7	8	4	6
7	8	8	0	4	9
8	0	9	0	5	0
9	0	9	8	5	3
9	8	10	0	5	6

The Bihar Schedule was almost the same.

As already stated the sliding scale was abandoned in 1936-7. A single minimum price of five annas and three pies per maund for gate canes was fixed for the whole season of 1937-8. The season 1938-9 opened with the minimum price of six annas and nine pies for gate cane. In the course of the season the Governments of U.P. and Bihar twice increased the minimum.

In 1939-40, the sliding scale was adopted again and the minimum price of cane was fixed fortnightly according to a schedule.

According to this new schedule the minimum price for cane would be five annas per maund as long as the price of sugar remained under seven rupees and ten annas per maund. As the price of sugar began to exceed that figure, the minimum price of sugar-cane would increase by three pies per maund for every increase of four annas per maund in the price of sugar, until the price of sugar reached ten rupees and two annas per maund. From that stage onward the minimum price of sugar-cane would increase by three pies per maund for every increase of three annas per maund in the price of sugar, so that when sugar would sell for more than eleven rupees and thirteen annas per maund, the minimum price of cane would be ten annas per maund.

The new schedule was less favourable to the manufacturers and according to it the share of the manufacturer in the increased price of sugar diminished while that of the grower increased as the price

[1] One maund = 82·29 lb.

of sugar exceeded ten rupees and two annas per maund. It was hoped that by this device the temptation to inflate the price of sugar would be held in check.

As the European war broke out in September, 1939, all prices began to move upwards. As the crushing season began in November, it was estimated by the industry that:

'There would be a substantial shortage in the supply of cane owing to the serious damage to the crops in certain parts. The output was then expected to be below the requirements of the country and with rising commodity prices as a result of the war the season opened with a feeling of over-optimism. The Syndicate fixed and maintained a high basic price; the manufacturers were out to make as much sugar as possible with the hope of realizing better prices later on, while the majority of the growers, encouraged by the expected shortage of cane and high prices did not take the precaution of entering into bonds with the factories. Sugar prices rose as the season advanced and cane prices had to follow suit in the sliding scale. The higher cane price attracted larger supplies of cane, and cane, which would have ordinarily been made into gur, was also diverted to the factories.

'By the end of February, the stocks had risen to a high level. The stocks at the end of March were 1½ crore maunds and there was a certainty of overproduction and a possibility of a large carry-over for the next season. In other words, the situation that was now facing the industry was that more than three-fourths of the total output of sugar had already been manufactured on the basis of an exceptionally high price of cane, that it was unlikely that all the accumulated stocks would be marketed except at a loss and that any further production except at a considerably reduced price of cane was bound to aggravate the position still further.' [1]

By the operation of the sliding scale, the minimum price of cane had reached the figure of ten annas per maund in January, 1940. It remained near about that figure during February. From March, it began to fall slightly, till on the 10th of April, 1940, it was eight annas and nine pies per maund. The seriousness of the position was now fully understood. The Syndicate thought that the sliding scale was to blame and they urged Government to abandon it. At a special meeting held on 10th April, they decided to close down the mills unless Government immediately reduced the cane price to five annas and nine pies per maund. The Provincial Governments thought that the Syndicate was to blame and that it had taken

[1] Joint Communiqué of the Bihar and the U.P. Governments, dated 10th April, 1940.

advantage of its monopolistic position to keep up as high a price as the market could bear without regard to the supply position. As the supply side was now going to assert itself, the Syndicate wanted to pass on all the losses arising out of its own mistakes to the growers. There were still standing on the field at least 25,000,000 maunds of cane in the U.P. and 15,500,000 maunds in Bihar [1] which, if not crushed in the factories, would have to be destroyed; for it was not at that stage possible to convert them into gur.

A compromise was, however, soon reached. Government reduced the minimum price to six annas and three pies per maund with effect from 11th April and to five annas and six pies per maund with effect from 30th April. The Syndicate agreed to continue crushing. It gave an undertaking that in case it was able to sell the sugar manufactured after April 11th, at prices higher than those corresponding to the cane prices in the sliding scale, the mills would make a further payment to the growers calculated according to the sliding scale.

This arrangement worked for sometime. The crushing continued. The price of sugar was not being reduced sufficiently. The off-take of the market was slow. Heavy stocks accumulated. It was estimated that the closing stock on 1st November, 1940, would be abnormally high, probably about 400,000 tons. Serious problems of storage and finance faced the mills. The Syndicate proposed to meet the situation by curtailing production during the next crushing season. It advised the factories not to submit their estimates of cane requirements for the next season unless the Governments declared in advance a very low price for cane. At this stage the two Governments thought that the Syndicate was exploiting its monopolistic position. The two Provincial Governments simultaneously cancelled the statutory recognition of the Syndicate so that members of the factories could withdraw from it after giving due notice. The Governments also expressed some vague ideas about setting up a better marketing organization.

The result, however, was far from satisfactory. As the two Governments themselves stated in their joint Communiqué, dated 3rd August, 1940:

[1] The estimates are those of the Joint Communiqué of the two Governments, dated 10-4-1940.

'While the withdrawal has brought down the prices to a certain extent, it has let loose the forces of disorder, and speculation and malpractices are rampant in the sugar market Some of the factories have cut down prices below the economic level to clear their stocks while others are threatened with foreclosure by banks. The dealers are afraid of buying through fear of a further fall in prices with the result that the sugar is not moving in spite of the large accumulation of stocks. As a result of this confusion, a large number of factories in Bihar and the U.P. are in danger of complete breakdown, bringing out the urgency of strict Government control in the interests of the industry and the cane-grower.'

An agreement was soon arrived at between the Governments and the Syndicate. The statutory recognition of the Syndicate was restored on 3rd August. The Governments took greater power of control over its affairs. It was agreed:

(*i*) That the selling price of sugar would be fixed by the Governments.

(*ii*) That the Governments would fix the production quota.

(*iii*) That a Sugar Commission consisting of Government officials would be set up who would be the final authority, subject to Government control, on all matters connected with the production and sale of sugar.

(*iv*) That the Syndicate would be a selling organization only for the purpose of regulating sales within the limits of prices and quotas fixed by Government.

(*v*) That the basic prices and quotas for individual mills would be fixed by the Syndicate subject to the approval of the Commission.

(*vi*) That the Executive officer of the Syndicate would be nominated by the Government and the election of the chairman would be subject to Government approval.

After taking power as above, Government took the following steps:

(*i*) The production quota for the two provinces taken together was fixed at 720,000 tons of sugar for the season 1940-1.

(*ii*) It was decided that the selling price of standard sugar in the U.P. and Bihar during the season 1940-1 shall not, except in the Port markets, be less than nine rupees and two annas per maund, ex-factory.

(*iii*) It was realized that as the sugar now to be sold at this price had been mostly made at a higher cost, financial assistance

to the mills would be necessary if the price was to be maintained. The two Provincial Governments accordingly decided, with the consent and help of the Government of India, to assist the industry by assuming immediate responsibility for payment to the Government of India of one rupee of the excise duty payable on each maund of sugar manufactured during the last season and remaining unsold on 25th August, 1940. It was agreed that the two Governments would recoup themselves of the amounts so paid, by levying a special cess of six pies per maund of cane crushed in the factories.

(*iv*) With a view to support as high a minimum price for cane as possible, consistently with the low price of sugar fixed, higher manufacturing cost on account of the small production quota and the need for the levy of the special cane cess, Government decided to reduce the ordinary cane cess from six pies per maund to three pies per maund and to keep the manufacturers' profits at the minimum.

(*v*) An invariable minimum price for cane was accordingly fixed at four annas and six pies per maund for the season 1940-1.

(*vi*) It was soon clear that the crop to be tackled in the season 1940-1 was a very large one chiefly because of the high prices ruling in January and February 1940. While, therefore, making arrangements for converting into gur, rab or *khandsari* sugar, a considerably greater proportion of the cane crop than was so converted in the previous season, Government prepared a scheme of compensation to growers in those areas where gur, etc., is not generally made and where cane was left uncrushed and could not otherwise be utilized. To start a fund for the payment of such compensation, the Government of Bihar and the Government of the U.P. reduced the minimum price of cane by three pies per maund and increased the cess by the same amount in the whole province of Bihar and in the trans-Gogra areas of the U.P. respectively.

By the adoption of these strict measures, the crisis was soon tided over. The 1941-2 season was the shortest on record, as the crop was an unusually small one. The outbreak of the Russo-German

War, the uncertainty regarding the Far Eastern situation, and the hopes of experts led to boom conditions. By June 1941 not only had all stocks of sugar manufactured in 1939-40 been sold out, but a portion of the production of 1940-1 was also released. The subsequent off-take exceeded all expectations and by June 1942, not only had all the sugar made in 1940-1 been sold off but more than half the sugar manufactured in 1941-2 had also been released.

The control over sugar prices and sales quotas, which started in the two provinces in August 1940 was taken over in April 1942 on an all-India basis, by the Sugar Controller for India under the Sugar Control Order, 1942.

It will appear from this survey that the recent history of the sugar industry in Bihar and the U.P. which dates from 1932, falls into three distinct periods.

First, there is the period of rapid and uncontrolled growth, culminating in the crisis of 1937.

The second period starts with the passing of the Sugar Factories Control Acts. By these Acts power was taken by Government to regulate the supply of cane and also to improve their yield and quality. A combination of the factories was at the same time recognized on a statutory basis but its power of regulating the production, the price and the marketing of sugar was left uncontrolled. Both on account of the absence of control over the Syndicate and the adoption of a defective technique of price control this period culminated in the crisis of 1940. It was then realized after a considerable amount of friction and confusion that it was necessary in the interest of both the industry and the grower that the marketing and the price of sugar should be co-ordinated with the supply and price of sugar-cane and that it was necessary to extend Government control over the Syndicate for that purpose. Without co-ordination and control the industry and the growers could easily bring about each other's ruin in the face of world competition as the crop was a perishable one. There is a clear economic pressure for co-ordinated action, if not for integration in such a case. If the Indian industry is to attain stability in the face of world competition there should either be a complete integration of a factory and its plantations or Government, by a wise policy of control, should bring about a complete co-ordination between the two complementary parts of the process which results in the production of sugar.

The third period started with the assumption of control over the Syndicate by Government. During this period the technique of price control was also improved and the sliding scale yielded place to the deferred payment system. The former is economically unsound in view of the long interval between the production and the sale of sugar which sometimes extends up to a year or more. The latter system is economically sound as it provides for the participation by the grower in the profits of short period fluctuation already realized by the industry. The third period is still continuing. During this period there has not been much trouble. The surplus sugar of the previous period was cleared off during this period. The scheme of an invariable price for the season, together with a deferred payment to growers according to a schedule, was put into operation. During the season 1941-2 the minimum price of cane was five annas per maund. A deferred payment of two annas per maund in addition to the minimum price of five annas was announced by Government after the close of the season.

Now the power to levy a tax on sugar-cane was taken by the Governments of Bihar and the U.P. under their respective Sugar Factories Control Acts. When the factory buys the sugar-cane, a sales tax under Art. 48, of list II, of the seventh schedule to the Government of India Act is levied. When the factory grows cane on its own lands, the tax is levied as an octroi under Art. 49 of the same list as the cane enters the factory premises. All cane crushed in a factory has, therefore, to pay the tax.

The tax has been levied for various purposes.

Originally, the levy was intended to meet the expenditure involved in the scheme of control and improvement adopted by the Sugar Factories Control Acts.

Secondly, as was stated before, a special cess was levied in 1940, for recouping the excise loan advanced by the Provincial Governments in respect of sugar manufactured during the previous season and remaining unsold on 25th August, 1940.

Thirdly, a levy of three pies per maund was made during the season 1940-1 to start a fund for compensating growers in selected districts whose cane could not be sold to factories or otherwise utilized.

Fourthly, the tax has often been levied for purely revenue purposes.

The rate of the tax was six pies per maund when it was first levied at the beginning of the season 1938-9. It continued at that

rate till April 1940 when, in view of the crisis then facing the industry, Government decided to forego the tax for the rest of the season so that the minimum price of cane could be fixed as low as possible. During the season 1940-1, the ordinary cane tax was reduced to three pies per maund and a special cane tax of six pies per maund was levied in order to recoup the excise loan. Shortly afterwards the total cess was raised to one anna per maund instead of nine pies per maund in order to create a compensatory fund for growers. During the season 1941-2, the tax was levied at the rate of nine pies per maund out of which three pies was the ordinary cess and six pies was intended for the recoupment of the excise loan. As the excise repayment loan was completely recouped, the ordinary cess was restored to six pies per maund and during the year 1943-4, this ordinary cess was doubled as an anti-inflationary measure.

The reason for choosing this particular form of the levy is interesting. As already stated, conferences took place between the Governments and the industry in 1937. It was in those conferences that the provision of the Sugar Factories Control Acts were generally agreed upon. The Minister in charge of the Bill in the U.P. Legislative Assembly stated:

'In the conference that we had both at Lucknow and Patna and afterwards again at Lucknow, with the factory owners, each one of them said that they were prepared to pay to the Government as a cess or as a tax a certain sum ..... Then came the question how this tax was to be imposed. The Government of India Act was examined and it was found that there were some legal difficulties in putting the tax on the quantity of sugar produced in the factories. The whole question was, in what way the tax was to be raised. And after the study of the various provisions of the Government of India Act, the Federal List of Legislative subjects and the Provincial List of Legislative subjects it was thought that we could do it in one of the three ways which are enumerated in this Bill.' [1]

The tax which is levied on sugar-cane grown on lands owned by a factory is clearly an addition to the cost of production of sugar and will therefore enter into the normal value thereof. The tax paid by a factory on sugar-cane bought by it is also an element in the cost of production of sugar and will enter into its normal value. Normally, therefore, the tax, howsoever levied will be passed on to the consumer of sugar.

[1] The U.P. Legislative Assembly *Proceedings*, 1938, Vol. III, pp. 1203-04.

Two questions arise in this connexion.

First, whether under certain circumstances the tax on sugar-cane bought by a factory can be shifted back to the grower. Secondly, whether the tax paid by a factory either on sugar-cane grown on its own lands, or on sugar-cane bought by it has, under certain circumstances, to be borne by the manufacturers.

Now during the whole season 1938-9 the minimum price of sugar-cane was fixed. The Syndicate was free to fix any price of sugar that the market could bear. The price of sugar was rising all the time. It is, therefore, safe to infer that the market value was being determined by the conditions of demand or rather that the Syndicate, with its power of combination, was fixing the selling price of sugar so as to maximize profits with due regard to the conditions of the market. The day to day price of sugar could not have been governed under such circumstances by the cost of production and hence the tax, which could influence price only through cost of production, must have ceased to enter into price. The Syndicate, again, must have utilized its power of combination to pay to the growers just the minimum price permissible under the law. Hence technically speaking the tax was being borne by the factories. Tax or no tax, the price of sugar as well as that of sugar-cane would have remained the same. But for the statutory minimum price, the price of sugar-cane might have fallen lower. Whether the Governments should have fixed a higher minimum price is a different question. As a matter of fact Government twice raised the minimum price during the season.

In 1939-40, the minimum price of sugar-cane was fixed fortnightly on the basis of a sliding scale schedule. Till February 1940, the price of sugar was steadily rising. The price of sugar-cane was following suit till, in February, it rose as high as ten annas per maund. It is clear that the Syndicate was fixing the price of sugar as high as the market could bear. The price of sugar was, therefore, independent of the tax on sugar-cane. The tax could not also be shifted back to the grower in view of the sliding scale method of fixing the statutory price. The price of sugar was, however, being fixed too high. A highly artificial position was created which would have ruined growers, but for the intervention of Government. The industry had to bear the consequences of this position but was rendered assistance by Government.

Since 1940, the price of sugar is being fixed by Government. An invariable minimum price for sugar-cane is being fixed for the season and there is provision for deferred payment by factories on the basis of a schedule. The process of working back the minimum price of sugar-cane, from a price of sugar fixed earlier in consideration of the market condition and the immediate available supply, started from 1940-1. An idea of how this process is worked can be had from the Joint Communiqué, dated 19th October, 1940, issued by the Governments of Bihar and the U.P. In such a process, the grower being in the position of a residuary claimant with the industry, it is they who obviously bear the burden of the tax. Since then, on account of the abnormal conditions created by the war the demand for sugar has often been greater than its supply. Under such circumstances the prices of both sugar and sugar-cane are likely to be fixed above cost. Prices above costs are obviously fixed on considerations independent of any consideration of the tax. Hence the incidence of the tax under such circumstances is technically on the manufacturer; and as the tax reduces the deferred payment to the growers a part of the incidence is on the growers also.

The analysis made and the conclusion arrived at in respect of the incidence of the tax on raw jute is also valid in respect of the tax on sugar-cane. The mean position about which the price will oscillate includes the tax but the actual market price may seldom rest for any length of time at that position. The working of the above tendency to oscillate is, in the case of sugar-cane, governed by two peculiar factors. *First*, sugar-cane being a perishable crop, the market price may differ very widely from the mean position either way. The price of sugar-cane has actually varied from four annas to ten annas per maund, in the course of the same season. *Secondly*, the *raison d'être* of most combinations in industry is to obtain protection against adverse short period fluctuations at the expense of the grower, and to obtain a monopoly of the benefits of favourable short period fluctuations. In the case of the sugar industry, the Syndicate is prevented from pursuing such a policy by the direct intervention of Government. The system of Government control almost invariably assures to the grower a minimum price equal to the cost of production. Through the deferred payment system, he is also enabled to participate in the profits of short period fluctuations. He has not, however, to share the losses of these

short period fluctuations except in very exceptional times as when the growers of the trans-Gogra area in the U.P. could not utilize their cane in the season 1940-1. There is a definite tendency towards a complete co-ordination of the industry and the growers of sugar-cane under the leadership of the two Provincial Governments with a view to maximize the profits of both. This tendency is good in so far as by eliminating ruinous and wasteful competition between the industry and the growers it increases the capacity of the industry to face world competition. It is harmful in so far as, under the protection of the war or of the high import duties, it encourages monopolistic behaviour; and in so far as prices are fixed on monopolistic principles, the incidence of the tax is different from its normal incidence.

PART III

TAXES ON LAND

I

LAND REVENUE

THE taxation of land raises a few especial questions connected with the nature of land and its earnings.

The question of the incidence and other effects of a tax on land has been discussed and illustrated by means of graphs in Chapter I, Part I. While other agents of production are reproducible, land is not. The supply of the former reacts to their earning but the supply of the latter does not. Higher rates of wages or higher rates of interest will encourage efforts to put on the market a larger supply of labour or capital. Similarly, lower rates of wages and interest will in the end reduce the supply of labour and capital respectively. But the supply of land is a fixed quantity. It neither increases nor decreases and its supply is independent of its earnings.

When land of the best class in a country is already under cultivation and the demand for corn still increases on account of growth of population or otherwise, less fertile or otherwise inferior land has to be brought under cultivation because the land of the best type cannot be reproduced. This is the especial characteristic of land as an agent of production. If more machinery is wanted, machinery of exactly the same type can be reproduced. But land of any type cannot be reproduced, however much the demand may increase. It is strictly limited by nature. It follows, therefore, that the price of corn at a point of time must be such as will adequately remunerate the producer on the least fertile land, for, otherwise he will not produce at all.

In a competitive money economy where ownership of land and capital rests in different persons and the labourer also is a different person, the result of bringing less fertile land under cultivation is to push up the price of corn so as to remunerate adequately the labour and capital applied on the least fertile land, because, the forces of competition must level down the remuneration

of labour and capital irrespective of the quality of the land on which it is applied. The corn produced on the least fertile land will sell for just as much as will remunerate the labour and capital applied on it. The corn produced on more fertile land will sell for something more and will leave a surplus after remunerating the labour and capital applied on it. This surplus will go to the owner of the land as rent. This differential surplus is the earning of land and is called rent in economics.

Land may differ in value not only on account of difference in fertility but also on account of difference in site. Sites nearer markets are more valuable than sites far away from the market. In primitive society the site of land may be unimportant but in a highly commercialized country, site is often the most important factor. Hence, though difference in fertility is probably the cause of the emergence of rent, difference in site is the most important factor in intensifying the magnitude of the differential surpluses as between different plots of land.

It follows that in countries where large tracts of virgin land are available, rents, if any, are likely to be low because there the people will cultivate only first class land. As there will be no difference in fertility or site as between different bits of land, there will be no rents either. The entire produce of the land will be exhausted in remunerating labour and capital. This is, of course, an ideal condition; but a condition approximating it existed in Burma during the last century. An idea of the huge quantity of virgin land available in Burma, at the time, can be had from the following figures showing the expansion of cultivated area in that country from the fifties of the last century onward:

Year	*Area sown in paddy in acres*
1852-3	600,000
1872-3	1,871,542
1882-3	3,446,439
1892-3	5,086,853
1902-3	6,712,799
1912-3	8,081,677
1922-3	8,870,342
1932-3	9,711,396
1936-7	9,855,258

(Taken from *An Introduction to the Political Economy of Burma* by J. S. Furnivall, page 56.)

Two systems of land-tenure which are very characteristic of the times, developed during those days and are described as follows in the *Report of the Committee on Land and Agriculture*, 1938:

'Under the Burmese kings a valid title to land could be acquired under the tenure known as the *dama-u-gya*. A man could with his *dama* (agricultural knife) clear jungleland into which no one else had penetrated, cultivate such land and acquire ownership forthwith over such land. The squatter system of occupation introduced by the British Government of Burma roughly corresponds to the *dama-u-gya* but is not identical with it. Under the squatter system, a person may occupy a piece of land at the disposal of Government and not especially protected against such occupation.' [1]

But it was not long before rents emerged though they were very low at first. As the Report points out in the course of the same paragraph:

'Cleared land was of some value even in those days and commanded a rent measured by the labour of clearing fresh jungle and the amenities of being nearer to roads and villages.'

As the limit of expansion was reached, the least fertile land was brought under cultivation. The rents of the best lands soared high. In 1933–5 the rent of an acre of paddy land in the Insein District was fifteen rupees and five annas.[2]

Rents increase not only on account of extensive cultivation but also on account of the intensification of cultivation. As demand for corn increases not only is more land brought under cultivation, but efforts are also made to produce more corn on the same land by applying more labour and capital on it. Both processes may go on simultaneously; but extensive cultivation soon reaches its limit. Hence, as countries reach a certain state of development, intensive cultivation assumes a more important rôle. Land, however, is subject to the Law of Diminishing Returns. The application of each succeeding dose of labour and capital on a piece of land will produce a steadily decreasing quantity of corn. When therefore pressure of demand requires the production of more corn the margin may go down either intensively or extensively. The producer is often neutral in his choice between extension of the margin or an intensification of the margin; for the application of one dose of labour and capital on less fertile land will produce the same quantity

[1] Part II, ¶ 38.

[2] *Report of the Land and Agriculture Committee*, Part I, ¶ 15.

of corn as its application as an additional dose on the land already under cultivation. So long as this neutral stage is not reached, he will gain by a transference of labour and capital from the one to the other land. The forces of competition will therefore lead to the co-existence of both an intensive margin and a corresponding extensive margin at the same time, i.e. the first dose of labour and capital applied on the least fertile land (which is the extensive margin) will generally produce the same quantity of corn as the last dose of labour and capital on land more fertile than the marginal land and these last applications will be intensive margins. The intensive margin will, however, vary from one class of land to another, i.e. the application of the tenth dose may be the marginal use of one land while in another case the marginal use may be the application of the second dose.

Economic rent of a unit of land is, therefore, in the case of extensive cultivation, when only one dose of labour and capital is applied to each unit of land under cultivation, equal to the surplus which the unit in question yields over and above the produce of the marginal unit; or, in the case of an intensive margin, rent is the sum of the surplus yields of all the pre-marginal doses above the yield of the marginal dose applied on the same land.[1] The produce on the intensive margin must be equal to that on the extensive margin on account of the forces of competition.

Though different doses of labour and capital applied in succession on a piece of land will yield different results, they will have to be paid for equally, and the price of corn must be such that the yield of the marginal dose remunerates that dose adequately. Hence there will emerge a surplus after all the doses of labour and capital have been paid for. This surplus is the rent.[2] As payments made for these doses are equal to the cost of production, the surplus which each land produces above the cost of production may be called its economic rent. The term cost of production is used here in the widest sense and includes the payment of all labour, all capital, and all management together with charges for insurance; in short, everything necessary to place the produce on the market.

If the forces of competition were given free play and were not impeded by custom, law or any other cause, the actual rent of

[1] See Figure IV in Chapter I, Part I.
[2] See Figure IV in Chapter I, Part I.

each land would coincide with the economic rent. In Bengal the tenancy law holds competition in check over a wide area; but wherever the law gives free scope to competition, the rent soars very high, e.g. in the case of the lowest grades of *underryots* [1] or *bargadars*.[2] So also in the case of the sub-tenants in Madras or the tenants-at-will in the Punjab, the actual rents approach very near the economic rents. But in the case of occupancy *ryots* or tenure-holders in Bengal, the rent is controlled rigidly by custom and by law both of which favour the *status quo* and abhor change. In the other provinces also the *ryots* or other holders protected by law or custom do not pay anything approaching the economic rent.

As all the doses of labour and capital must be paid for equally, and as all corn (of the same kind) must sell at the same price in the same market, the price of corn must be equal to its cost of production on the marginal land or the cost of production in the case of the marginal use of land above the extensive margin. As neither the extensive margin nor the intensive margin earns any surplus or rent and as the price of corn must be equal to the cost incurred at the margin, rent is clearly no element in that cost and cannot affect price.

An individual cultivator may be bewildered by the statement that rent does not enter into price. He has to pay rent and must recoup himself to the full extent of his outgoings, including rent. He finds normally that actually his total outgoings, including rent, are equal to his total receipts by the sale of corn. How, then, can it be said that rent is not a part of his cost which determines price? The answer would appear to be simple if it was assumed that all cultivators were owners of the land they cultivated, and that the cultivation was extensive so that only one dose of labour and capital, costing in all, say, ten rupees, was applied to each unit of land under cultivation. Under such conditions, the cultivator of the best land would find that at a cost of ten rupees he was getting, say, four maunds[3] of corn whereas the cultivator of the worst land would find that at the same cost he was getting, say, only one maund of corn. Now, if costs differed from plot to plot, what cost would determine the price of corn? Obviously, the price must be equal to the cost on the marginal land, for, if it was less, i.e.

[1] Persons holding interest in land below that of the *ryot*.

[2] A man who cultivates another man's land on a produce-sharing basis.

[3] One maund = 82·29 lb.

if one maund of corn sold for less than ten rupees, the least fertile unit would not be cultivated. So if society requires it to be cultivated, the price must be ten rupees per maund. The cultivating owners of the pre-marginal units would of course sell at the same price and would each earn a surplus according to the degree of fertility of his land. The marginal land earns no rent. It produces only one maund of corn which sells for ten rupees, an amount just equal to the remuneration of the labour and capital employed on it. Thus in the pricing process, rent plays no part. Rent arises as a result of the pricing process.

In modern economic life when owners and users of land are different, the owners appropriate the varying amounts of surpluses, in the shape of rents. As the surpluses vary from land to land, so the rents also vary from land to land. As the margin goes down with the growth of population, the price rises and so do rents. If the margin went up in a decaying country, the price would go down and so would rent. In actual life, the varying amounts of rents equalize the conditions of all cultivators by neutralizing the effects of the varying degrees of fertility of their respective lands. Hence to the individual cultivator rent is a material consideration. He must take it into consideration in the calculation of his profit and loss. But rent does not enter into the pricing process. Rent follows the price, does not precede it, or in other words, it is the result of the price and is not a cause of it. A cultivator pays higher rent for one plot of land than for another not because he expects to sell the produce of the one at a higher price than the produce of the other but because he expects a larger quantity of corn from the one than from the other so that his gross profits will be higher in the former case. This difference in the profits or the differential surplus is appropriated wholly by the owner of the land as rent.

It follows that the price of corn will not be affected whether the landlord charges the full economic rent or only a portion of it. What the landlord will charge will only determine how the economic rent or the earning of the land will be distributed between the landlord and the producer who uses the land. Similarly, a tax on rent, even a hundred per cent on it, will not affect the price of corn because the price will be fixed on the marginal land which does not earn any rent and therefore does not bear any tax.

If the landlord charged more than the economic rent of a piece of land or if the State levied a tax which appropriated an amount

greater than its rent, it would no longer be worth-while to cultivate the land unless the price of corn rose to an extent necessary to recoup that part of the tax which was in excess of the rent. In that case the charge would not be pure rent or the tax would not be a tax on rent only; it would be partly a charge or a tax on labour and capital as well, which, being then faced with the prospect of a reduction of remuneration would tend to seek other lines of employment where they could still earn their normal remuneration. Such a tax will therefore hit the margin and through the margin the price of corn.

The above analysis indicates the normal behaviour of the three agents of production, land, labour and capital and their reaction to a tax. But in practice it is extremely difficult to isolate economic rent from the earnings of labour and capital. The difficulty is further increased by the general immobility of agricultural labour and capital. In the analysis it has been assumed that as soon as more than the economic rent is charged, labour and capital will move to other lines of employment. But in actual life agricultural labourers are hardly free to move to other occupations, at least in the short period; and capital once sunk in land may not be moved at all for employment elsewhere. Under such circumstances, labour and capital may continue to be used on land long after they have ceased to earn their normal remuneration.

The three special features of land are thus as follows:

(*i*) Rent is a surplus.

(*ii*) Taxation of rent does not affect production or price of the produce.

(*iii*) Labour and capital applied to land is of very imperfect mobility.

These three facts make rack renting or excessive taxation of land very easy. If a tax is put on any other commodity, the price goes up, and the production is restricted. In the most common case, i.e. the case of Figure I in Chapter I, Part I, the incidence is on the consumer, production is restricted, and price rises, though not by the full amount of the tax. Land has not got this power of protecting itself by reducing its supply. Rent being a surplus, in the sense that it remains after remunerating the other agents of production, production will continue undiminished up to the point of wiping out the surplus altogether, and till that point is passed, neither production

nor the price thereof will be affected by the tax. A tax on land is, therefore, the best from the standpoint of productive efficiency; because, it does not impair productive efficiency at all.

But productive efficiency is not the only thing by which a tax is to be judged. The principle of equal sacrifice is equally important.

In determining the ability of land to bear taxation according to the principle of equal sacrifice, the following special factors have to be taken into consideration:

(*i*) Income from land is free from the ordinary risks of industrial investment.

(*ii*) In a progressive society rent has a tendency to increase; and the increments are unearned and are of the nature of windfalls.

(*iii*) Taxation of rent does not impair productive efficiency of land and therefore causes the least suffering to other sections of society, which other taxes often do.

These factors enhance the ability of land to bear taxation even according to the principle of equal sacrifice. It is therefore justifiable to tax rents at a higher rate than other classes of incomes, other things being equal.

The extent to which taxation of rent should exceed the taxation of other incomes depends on many factors. In the first place, it is necessary to recognize that as land changes hands, it loses its special significance as a producer of surplus to each new buyer. The price of a piece of land is equal to the capitalized value of the surplus it yields and the seller appropriates the whole of it. To the buyer it is like an ordinary investment yielding the normal rate of return on capital.

Secondly, the factors justifying higher taxation of rent must be considered along with the actual state of the distribution of incomes in the society in question. If, for example, most receivers of rent are poor men, unable to maintain a minimum standard of living, they should be exempted from taxation, though a rich landlord should be taxed at a higher rate than a rich businessman. It is meaningless to point out to a starving man that his income is very secure or is in the nature of a windfall or that even if he is taxed, the little land that he possesses will not remain uncultivated. Hence the principle enunciated in Chapter I, Part I, that taxation should not be imposed upon any whose means are not adequate to maintain

a certain minimum standard of living, is not altered by the greater ability of land to bear taxation.

Before proceeding further we may once more look into these special features of land.

Rent is a surplus. The surplus is the result of differences in fertility and other advantages attaching to land and of the law of diminishing returns. It is a surplus in the sense that it is left over after rewarding all other agents of production. This comparatively advantageous position of the owner of the more fertile or better situated land is, however, sold as a commodity and the surplus is always capitalized in its price. So when a man buys good land at the market price, it does not yield him any abnormal profit. He gets out of the land just as much as he would have got by investing the same amount in any other line. To him it is an ordinary investment. But in his hand also, the surplus earned by the land may increase on account of the improvements of communication or pressure of population and these increments are unearned. He also may capitalize these increments and sell the land to another man. This third man may again earn some unearned increments or, if the situation deteriorates, may suffer from decrements also. As land is bought and sold in the open market, it loses its special significance to the new buyers to whom the land is worth just as much as any other form of investment. Thus though rent itself is unearned and may often acquire unearned accretions in a progressive society, it loses its significance as an unearned surplus to each new buyer of land.

It has been shown that rent or taxation of rent does not affect the price of corn. It follows that the reduction of a tax on rent has also no effect on the price of corn. Whatever percentage of rent the State takes as tax, the price is not affected as it is independent of rent. So taxation of rent is a concern of the landowners only. A tax on rice or wheat will affect all consumers of rice or wheat and will raise the cost of living of all. A tax on capital may lead to reduced saving and to a reduced amount of capital for society. So society as a whole may be affected by a tax on capital and will be interested in a reduction of such a tax. But a tax on rent will not reduce land nor reduce production; it will have no effect on prices. The tax will affect only landowners and a reduction of the tax will benefit only landowners. The other sections of society are not interested in it.

Rack renting or excessive taxation of land is further facilitated in India by the almost perfect immobility of agricultural labour and capital. For centuries agriculture has been practically the only occupation of the masses of the people in this country. They have sometimes been owners of land, or have *de facto* participated in a large share of the rent, even when the ownership rested in a landlord. But they have mostly been small holders, often on the bare subsistence level. As they have no other alternative line of employment, they have to remain on land even when the rent charge or the tax appropriated an amount greater than the economic rent. But Government in India has often depended almost exclusively on the taxation of land. Sometimes the tax was light but sometimes very oppressive. It may be argued that when taxes or rent charges are so high as to make agriculture unprofitable and people have no alternative occupation to turn to, they will simply die in large numbers. This will reduce the demand for corn and for land and will bring down rents in the long run. This is no doubt a very cruel process of adjustment but it is a very long process, too, and the ordinary landlord or tyrant need not worry about such a contingency. India has passed through such cycles, too, at times. The Indian agriculturists, in this way, have been practically helpless against rack renting or excessive taxation. It was this helplessness which made possible the rack renting or the excessive taxation of the Bengal tenantry in the eighteenth century when the Moghul power had declined and there was no strong central government in the country.

II

LAND REVENUE

THE excessive taxation of land continued in an aggravated form under early British rule. After the acquisition of the Diwani of Bengal, Bihar and Orissa in 1765, the East India Company got a firm foothold there and were not disturbed in that area by any serious warfare. They, however, undertook extensive wars of conquest in other parts of India outside Bengal. These wars had to be financed chiefly with money raised in Bengal. As Radha Kumud Mukherjee has stated:

'The Rohilla war, the two campaigns against Tippoo Sultan, the prevention of the hostile Maratha demonstration against Oudh, the mission despatched to Nepal, the reduction of Pondicheri, all these brought the finances of the Company to a low ebb. As R. C. Dutt has pointed out, "In India an Empire was being acquired, wars were waged and the administration carried on at the cost of the Indian people without the British nation contributing a shilling". And the brunt of the cost was borne by the people of Bengal [1] upon whose resources other provinces like Madras and Bombay had freely drawn to meet the deficits of their administration. At home at this time England was also passing through the worst days, with France, Holland, Spain and Italy allied against her, the United States alienated and national debt was mounting up. R. C. Dutt further stated: "It may be said with strict truth that the conquests of Lord Hastings, like the conquests of Lord Wellesley, were made out of the resources furnished by permanently settled Bengal".'[2]

The actual budget figures of the three Presidencies of Bengal, Madras and Bombay fully confirm these conclusions. 'The annual revenue and expenditure of Bengal, on an average of the six years which followed the acquisition of the Diwani were £2,202,207 and £1,504,934 respectively. The accounts of the Madras Presidency during this period were as follows: average annual revenue, £405,191; expenditure, £595,920. The accounts of Bombay were

[1] 'Bengal' here does not mean the present province of Bengal, but a far wider area.

[2] Dr Radhakumud Mukherjee's Note on the Indian Land System—*Report of the Bengal Land Revenue Commission*, Vol. II, p. 222.

on a still smaller scale, namely, average annual revenue, £76,057; expenditure, £306,391'.[1] 'The Financial position of the different provinces during the next eight years may be gathered from the following annual averages: Bengal—revenue, £2,626,519; expenditure, £1,435,789; Madras—revenue, £496,476; expenditure, £468,390; Bombay—revenue, £169,452; expenditure, £396,451'.[2] The deficits in Bombay and Madras were being made good by aid received from Bengal.

During the remaining period of Warren Hastings' administration, the financial difficulties increased substantially on account of his entanglements in several military campaigns. As the money could be found only from Bengal the pressure on her people increased.

'Bengal's revenues, as usual, were more than sufficient to meet her expenditure. But year after year, she was called upon to meet the deficiencies of the other Presidencies and to finance most of the schemes of conquest. In 1780, Sir Eyre Coote, then Commander-in-Chief, wrote to the Governor-General and his Council informing them that the treasury at Madras was empty, and that the immediate needs at Fort St George would rather exceed seven lakhs of rupees per month, "every *cowrie* of which must come from Bengal, as he found there were no resources from which a single *pagoda* could be expected". In a letter to the India House, the Commander-in-Chief lamented the necessity there was of "both the army and the inhabitants, in the state in which the country then was, being maintained chiefly by supplies from Bengal".'[3]

To the pressing needs of the Company was added the rapacity of the officers of the Company. 'English administration began with extortion and corruption. Officials were often rapacious.'[4]

The excesses caused by the combined pressure of the Company's needs and their officers' rapacity were revealed at their worst during the historic famine of 1770, than which Bengal has not seen a severer famine in recorded history. During this famine 'thirty-five per cent of the whole population and 50 per cent of the cultivators perished'.[5] But as Warren Hastings wrote at this time, 'Notwithstanding the loss of at least one-third of the inhabitants of the province and the consequent decrease of the cultivation, the

[1] Dr Banerjee's *Provincial Finance*, p. 5.

[2] Dr Banerjee's *Provincial Finance*, p. 6.

[3] Dr Banerjee's *Provincial Finance*, p. 7.

[4] Lord Bryce: *Studies in History and Jurisprudence*, Vol. I, p. 23: Roman and British Empires.

[5] Hunter: *The Annals of Rural Bengal*, Chap. II.

net collections of the year 1771 exceeded even those of 1768'.[1] The Court of Directors expressed their conviction 'that the Ryots were compelled to sell their rice to the monopolizing Europeans who could be no other than persons of rank in our service'.[1] When this period of the Company's rule was debated in Parliament, Walpole described the Company's 'tyranny and plunder as making one shudder', while Chatham described their 'inequities so rank as to smell to earth and heaven', followed by Burke's famous speeches in Parliament and the impeachment of Warren Hastings.[2]

The following are some of the actual figures of assessment and collection of land revenue in Bengal during the period:[3]

	Gross Settlement	Collection	Balance
	Rs	Rs	Rs
1762-63 (Cossim Ali) ..	2,41,18,912	64,56,198	1,76,62,713
1763-64 (Nund Coomar)	1,77,04,766	76,18,407	1,00,86,358
1764-65 „	1,76,97,678	81,75,533	95,22,144
1765-66 (Md Reza Khan)	1,60,29,011	1,47,04,878	13,24,135

It will appear that the very first year of the Company's rule made an increase of nearly eighty per cent in the collection. The assessment continued to increase till it was permanently fixed at Rs 268 lakhs. Dr Radhakumud Mukherjee writes in his Note on the Land System of Bengal:

'Although Cossim Ali's Assessment * * made in 1763 has been described by Shore as nothing short of "rack renting and pillage" and was practically an assessment on paper, considering that only Rs 65 lakhs could actually be collected, yet the Company since 1765 had been always trying even to improve upon that assessment. Shore, in his Minute of 18th June, 1789, frankly points out that "in 1786, the revenues of the Dewani lands of Bengal were more than they were for 1765", although conditions created by successive famines and floods had reduced cultivation by half.'[4]

We have it on the authority of Hunter that 'Bengal had lost one-third of its people and one-third of its surface speedily became

[1] Quoted in Dr Radhakumud Mukherjee's Note on the Land System of India in the *Report of the Bengal Land Revenue Commission*, Vol. II, p. 192.

[2] Quoted in Dr Radhakumud Mukherjee's Note on the Land System of India in the *Report of the Bengal Land Revenue Commission*, Vol. II, p. 217.

[3] Figures taken from p. 205, Chap. II of the *Minority Report of the Bengal Land Revenue Commission.*

[4] *Report of the Bengal Land Revenue Commission*, Vol. II, p. 219.

waste', and 'for the first fifteen years after the famine depopulation steadily increased' and 'until 1785 the old generation died off without there being any rising generation to step into their places'.[1] But the assessment and collection of land revenue were increasing during the period. The period has been described as one of 'huge deficits, defaulting zemindars, deserting ryots, and absconding farmers'.[2] Nothing short of the Permanent Settlement backed by the rigorous sale law together with the power of distraint granted to the zemindars could secure to the Company a regular collection of such heavily assessed revenue which was so essential to the prosecution of the wars by the Company during the period.

The Permanent Settlement recognized the proprietary rights of the zemindars to the lands in Bengal and vested in them all future increments of assets. The position of the zemindars was, however, far from enviable. The portion of their assets which they were to pay as revenue was stated to be 10/11ths; but in fact it was much more. Dr Radhakumud Mukherjee writes in his Note on the Land System of India:

'Since 1769, the assessment had been always determined by farming at highest bids. Thus it is not quite correct to assume that the Permanent Settlement demand represented 10/11ths of the rental when the amount of the rental still remained to be ascertained.'[3]

As zemindars could not collect so much and pay their revenue regularly, it is normally to be expected that they would adopt all methods of squeezing money out of the ryots and when they failed to pay the revenue they would default and run away. The Company, however, needed money urgently, so they gave them the strongest possible incentive for retaining their estates by vesting in them the right to all future increments of the assets thereof and at the same time armed them with powers over the person and property of the ryots. In the circumstances of the time the Permanent Settlement appears to be a permanent mortgage of the lands of Bengal given by a necessitous foreign Government in consideration for a regular payment of an oppressively excessive revenue. This is exactly what the two zemindar members of the Bengal Land Revenue Commission say in polite language when they claim that the demand made by the Permanent Settlement was an 'advance assessment'

[1] *The Annals of Rural Bengal.*
[2] Dr Mukherjee's Note on the Land System of India, p. 217.
[3] *Report*, Vol. II, p. 219.

on the zemindars (Para 23 of their *Report*; page 208 of the *Report*, Vol. I).

The period after the Permanent Settlement in Bengal has been described in the Report of the Land Revenue Commission, Bengal, as follows:

'The period immediately after the Permanent Settlement, and indeed for three or four decades, was one during which the zemindars were struggling for their existence against the sale law. At that time, one-third of the total area of Bengal according to Lord Cornwallis, two-thirds according to Colebrooke, and four-fifths according to Grant was uncultivated; and the only way in which the zemindars could improve their assets was by bringing waste land under cultivation. The competition was not for land, but for tenants to cultivate it. Consequently if the ryots withheld their rent, or abandoned their holdings, the zemindar was hard put to it to pay a revenue amounting to ten-elevenths of his assets. The records of that period and the Fifth Report show that more than half the estates in Bengal were sold for arrears of revenue; many of the large zemindars were dismembered; and most of the original zemindars reduced to poverty.' [1]

'The situation that developed led to the passing of the notorious "Haptam" (Regulation VII of 1799) by which zemindars were vested with wide and arbitrary powers of distraint.' At the end of over half a century it was found that the landlord had so much consolidated his position and tightened his grip over the ryots that it was the latter who required protection. The first Tenancy Act was passed in 1859.

This period between 1793 and 1859 reveals how the forces of economic laws were exactly reversed by the fiat of the State. An economist would expect that when tenants are in great demand by the landlords, there being a large surplus of land, the tenants must automatically improve their position. A more favourable economic position for the tenants can hardly exist than when 'the competition is not for land but for tenants to cultivate it'. But we find that at the end of half a century it is the tenants who have been worsted and their rights have been encroached upon while the zemindars improved their position. Writing about the zemindars during this period the Bengal Land Revenue Commission observes:

'Economically, the period commenced disastrously for the zemindars; but as a feeling of security developed, and large areas of

[1] *Report*, Vol. I, Para 50.

jungle and waste land were brought under cultivation, the zemindar's margin of profit increased, and by the middle of nineteenth century they were far less vulnerable to the sale law.' [1]

The excessive assessment of land gradually came down not by the active intervention of Government but by slow natural development. As assets increased the weight of the permanently fixed burden diminished. But by then the tenants had suffered much by the previous policy of arming zemindars with powers to reverse the operation of economic forces. The British Government had also by then established themselves in the country. The regularity of payment of the revenue was no longer in danger as the weight of the assessment had by then become very much lighter. Government had also nothing to lose by restricting the rights of the zemindars to the future increments of assets in favour of the tenants as they themselves could not participate in the increase. So a series of legislation began which gave some much needed relief to the tenants. The tenancy laws together with the economic solvency of the zemindars and their aristocratic indifference have resulted in giving the tenants the bulk of the benefit of the unearned increments. The Land Revenue Commission, Bengal, notes:

'Our conclusion therefore is that considering the level of rents obtaining in the provinces we have visited, the value of the produce, and the prevailing economic conditions, there would be justification for enhancements rather than reductions of rent in Bengal.' [2]

Mr W. H. Nelson, Member, Board of Revenue, Bengal, was of opinion that the ryots appropriate about eighty per cent of the unearned increment. [3]

This of course does not mean that the tenants are rich and the landlords poor. With even eighty per cent of the unearned increments as their share, some cultivators in Bengal, as is well known, do not have two square meals a day all the year round. Moreover the ryots have sublet to underroyts who are sometimes very poor.

As the Bengal Land Revenue Commission finds:

'Taking into account the various estimates which have been made of a family's consumption of rice, we believe that about 30 maunds

[1] *Report*, Vol. I, ¶ 57.

[2] *Report of the Bengal Land Revenue Commission*, Vol. I, ¶ 204 of the Majority Report.

[3] *Report of the Bengal Land Revenue Commission*, Vol. I, p. 231, ¶ 40 of the Minority Report.

of rice, or 45 maunds of paddy, is sufficient to provide two meals a day for the average family though many families may not be able to afford even 24 maunds of rice'. [1]

Another important development of the period is the growth of sub-infeudation. A long hierarchy of rent-receiving interests grew up which were in most cases completely divorced from any cultivating interest in the land. A very interesting and vivid description of the process of the growth and development of this hierarchy is given in J. C. Jack's Final Report on the survey and settlement operations in the District of Bakarganj. The process is a result of social forces operating with the aid of tenancy legislation. The subject of land-tenure is, however, outside the scope of the present study.

To recapitulate, the assessment of land in Bengal was oppressively excessive during the early years of British rule. As assets of landlords increased with the progress of the country, the revenue remaining fixed, the assessment became lighter and lighter till today it is very low in some cases. As some of the zemindars, e.g. Burdwan, had very early in the period given away their estates in permanent leases to third parties, thereby surrendering their right to future increments, and as the progress in each district has not been uniform, the land revenue payable by landlords now bears no uniform relation to their assets. Further, as the country progressed, the economic rent produced by land increased considerably. A social system which attached greater dignity to higher non-cultivating interests in land and a system of tenancy legislation which protected such interests led to the growth of a hierarchy of rent-receiving interests who divided the increasing amount of economic rent among themselves. At present the economic rent is partly appropriated by the occupancy ryots (who also are gradually growing to be a non-cultivating interest) and is partly drawn upwards till it reaches the zemindars who pay land revenue to Government. Thus the land system in the province functions freely through a long hierarchy, subject firstly to the land tax payable by the landlords at the top and secondly to the large volume of tenancy legislation.

The fact that stands out from this brief survey is that the development of the present system has taken place without any intelligent planning; necessity and expediency have played the biggest

[1] ¶ 201 of the Majority Report.

rôle, so that there are today (*i*) a system of tenancy legislation which hardly seeks to remove the many hindrances to the best utilization of the land, and (*ii*) a land tax which has lost all relation to the assets of the person paying it.

The Bengal Land Revenue Commission of 1938-40 gives the following table showing approximately the relation between ryoti assets and revenue in each district:

Table No. VII on p. 111 of the *Report of the Land Revenue Commission, Bengal*, Vol. II.

District	Revenue (in lakhs)	Ryoti assets (cash rent plus valuation of produce rent in lakhs)	Estimated assets of Khas cultivated lands of proprietors and tenure-holders (in lakhs)	Total assets (in lakhs)
1	2	3	4	5
Bakarganj ..	30 08	70·09	19·75	89·84
Bankura	4·98	31·07	3·46	34·53
Birbhum	10·43	34·32	2·51	36·83
Bogra	4·93	24·46	2 55	27·01
Burdwan	30·43	45·10	2·91	48·01 (63·3)
Chittagong ..	15·44	26·68	8·39	35·07
Dacca	6·65	48·42	4·27	52·69 (12·4)
Dinajpur	15·34	48·15	8·36	56·51
Faridpur	7 62	47·52	4·07	51·59
Hooghly	9·34	30·77	15·17	45·94
Howrah	4·54	21·88	1·03	22·91
Jalpaiguri ..	15·05	11·79	3·53	15·32
Jessore	8·96	39·28	3·70	42·98
Khulna	9·23	46·65	5 23	51·88
Malda	4·81	23·48	·56	24·04
Midnapore ..	26·51	95·65	12·08	107·73
Murshidabad ..	10·83	38·07	2·33	40·40
Mymensingh ..	9·30	94·59	7·13	101·72 (9·1)
Nadia	9·87	40·65	2·80	43·45
Noakhali	12·33	27·19	14·45	41·64
Pabna	5·29	32·01	1·99	34·00
Rajshahi	10·28	51·19	3·88	55·07
Rangpur	10·25	59·85	2·79	62·64
Tippera	11·98	42·20	7·65	49·85
24-Parganas ..	23·49	96·82	8·83	105·65
Darjeeling ..	3·88	4·16	·62	4·78
	311·84	1,132·04	150·04	1,282·08 (24·3)

(Figures within brackets represent percentage of revenue to total assets.)

It appears that the ratio of revenue to ryoti assets is the lowest in Dacca and Mymensingh, being 12·4 and 9·1 per cent respectively, while the percentage is the highest in Burdwan, being 63·3. The total revenue assessed in the province is 24·3 per cent of the total ryoti assets. It is important to note that the ryoti assets are not identical with the assets of the revenue payers because there are a varying number of middlemen intervening between the revenue payer and the ryots. The ryoti assets are therefore no measure of the taxable capacity of the revenue payers.

The only other area outside Bengal, Bihar and Orissa to which the Permanent Settlement was extended was a portion of Madras and a small area in the United Provinces. The rest of British India is now under temporary settlements which are sometimes made with the peasants direct on the basis of the net produce of their land, as in Madras, or with a landlord on the basis of his net assets as in the United Provinces. The actual amount charged as land revenue varies from settlement to settlement but remains constant during the currency of a settlement.

The share of the net produce or the net assets taken by Government in the temporarily settled areas was examined by the Government of India in 1902 and the resolution of the Government was published by the Government of Lord Curzon. This resolution is the most authoritative document on the land policy of the Government of India. The Imperial Gazetteer which was issued in 1907 contains a chapter on Land Revenue which is based on this resolution. This book also contains an authoritative statement of facts and policy.

As regards the share of net assets or net produce taken by Government the Imperial Gazetteer states as follows:

'In the other Provinces where the assessment is subject to periodical revision, it has been the policy of the Government to reduce gradually the proportion borne by the assessment to the net assets, and this is nowhere better exemplified than in the Province of Agra, where the standards of assessment at various periods during the last century have been:

In 1812	90 per cent	of the net assets.
,, 1822	80	do.
,, 1832	72½	do.
,, 1849	66⅔	do.
,, 1855	50	do.

* * *

Another notable example of the gradual reduction of the proportion claimed by Government is furnished by the case of Orissa. There the standard was in 1822 declared to be 83·3 per cent of the assets; in 1833 it was lowered to 70·75 per cent; in 1840 to 65 per cent, with a permissive reduction to 60 per cent; while at the resettlement lately concluded it has been brought down to 54 per cent.' [1]

Speaking of contemporary conditions, the Imperial Gazetteer states:

'In the United Provinces the normal standard is 50 per cent, but deviations for good reasons are allowed, assessments of over 55 or less than 45 per cent alone requiring special sanction; and the actual share taken averages less than 50 per cent in the Province of Agra and less than 47 per cent in Oudh. In the Central Provinces, which have been for a shorter period under British rule, the standard prescribed is from 50 to 60 per cent, assessments up to 65 per cent being allowed only where the existing revenue already exceeds this proportion of the newly ascertained net assets and has been paid without difficulty: and the average percentages taken in the districts recently settled vary from 47 to 59. In the Punjab 50 per cent is regarded as the maximum, and in most districts the assessments are much below this. In Madras also the prescribed maximum is 50 per cent, and the rates actually taken on the net produce, depreciated for settlement purposes in a manner highly favourable to the ryot, are on the whole considerably below this figure. In Lower Burma, again, 50 per cent is nominally the maximum, but for the present a provisional standard of 25 per cent is accepted. For India as a whole, therefore, it is a fair generalization to say that the standard share of the calculated net assets or produce to be taken by the Government for public use is approximately one-half.' [2]

The Bengal Land Revenue Commission which recently toured the three provinces of Madras, the Punjab and the United Provinces writes as follows about the proportion between the land revenue and the net produce or the net assets as the case may be. About Madras it says:

'Up till 1855, the rate of assessments varied from half to three-fifths of the produce from irrigated lands, and about two-fifths of the produce from unirrigated lands. These rates were considered to be excessive, and it was decided to survey the whole raiyatwari area and to base the assessment on the productive powers of the soil. The maximum assessment was to be 30 per cent of the gross produce. In 1864 it was decided that the assessment should be made not on the gross produce, but should be half of the net

[1] Vol. IV, Chap. VII, p. 221.
[2] Vol. IV, Chap. VII, p. 222.

produce, i.e. the value of the gross produce after deducting all costs of cultivation. This is still the maximum Government demand.' [1]

About the Punjab, the Commission writes:

'Throughout the British administration, and up till 1928, it was considered that the State could fairly claim one-half of whatever was left over after the needs of the peasant-proprietor had been satisfied. In 1928, the Unionist Party succeeded in having the State's share of the produce reduced to one-fourth of the net assets.' [2]

About the United Provinces, the Commission writes:

'As in the Punjab, the State is considered in the United Provinces to be the supreme owner of land and to be entitled to a share of the produce. That share is ordinarily 40 per cent of the proprietor's assets. Previously it was two-thirds of the assets until 1855; half from 1855 to 1895 and between 48 to 45 per cent from 1895 to 1925.' [3]

The above brief survey of the state of taxation of rents under British rule in India brings out the following facts clearly:

(*i*) The taxation started at over ninety per cent of the net assets. In 1907 it was about fifty per cent all over India except in the permanently settled areas. Today the rate differs in different provinces, being twenty-five per cent in the Punjab, forty per cent in the United Provinces and fifty per cent in Madras.

(*ii*) The rate is a flat rate applying to all grades of rent receivers irrespective of whether they are rich or poor and without an exemption limit. In Madras, for example, a rich landowner, owning large estates, will pay fifty per cent of his net assets and a poor peasant proprietor owning less than an acre and hardly able to find two meals a day will be taxed at the same rate.

(*iii*) The basis or the rate of taxation is not regulated by any law. In Bengal the amount in each case is supposed to be unalterably fixed while in other provinces the rate depends on the policy of the Government and on the discretion of local officials. This is the most extraordinary feature of the levy.

It is interesting to compare the rates of income-tax with the rates of land revenue from time to time. Incomes from sources other

[1] Report, Vol. II, App. VI, p. 25.
[2] Report, Vol. II, App. VII, p. 37.
[3] Report, Vol. II, App. VIII, p. 61.

than land were for a long time immune from taxation under British rule. Though rents have been taxed to the maximum limit, profits, interest and salaries were exempt for long and then were only very lightly taxed till recently.

The present income-tax falls on all incomes except income derived from agricultural land and has been in existence since 1886 without any break. Before that there were only two short periods in which an income-tax was in force. The first period was one of five years only from 1860 to 1865 and the second period was one of four years only from 1869 to 1873. During both these periods rents as well as other sources of income were subject to the income-tax. The maximum rate during the nineteenth century was only four per cent. The rates in each year are tabulated below:

The First Income-Tax

Year	Exemption limit	The maximum rate
1860	Rs 200	4 per cent
1862	,, 500	,,
1863	,, 500	3 per cent
1865	Tax dropped.	

From 1860 to 1862, incomes between Rs 200 and Rs 500 paid a tax of two per cent while incomes above Rs 500 paid a tax of four per cent. After 1862 when the exemption limit was raised to Rs 500, all incomes above Rs 500 paid the same percentage.

The Second Income-Tax

Year	Exemption limit	Rate of tax
1869	Rs 500	1 per cent (raised to two per cent in the second half of the year).
1870	,, 500	6 pies in the rupee or about 3⅛ per cent.
1871	,, 750	2 pies in the rupee or a fraction over 1 per cent.
1872	Rs 1,000	,,
1873	Income-tax dropped.	

During this period the same rate applied to all taxed incomes irrespective of the size of individual incomes taxed.

The Third Income-Tax

The third income-tax was imposed in 1886 and has continued to the present day without a break. There have, however, been many important changes from time to time, and the rates increased substantially during recent years. Up to 1919 the rates were as follows:

Year	Exemption limit	Rates
1886	Rs 500	5 pies in the rupee on incomes above Rs 2,000. A lower rate on taxable incomes below Rs 2,000.
1903	„ 1,000	As before.
1916	„ 1,000	Taxes on incomes up to Rs 5,000 remained as before. Rs 5,000–9,999 = 6 pies in the rupee, Rs 10,000–24,999 = 9 pies in the rupee, Rs 25,000 and upwards = 1 anna in the rupee.
1917	„ 1,000	Supertax was levied on incomes above Rs 50,000 at the following rates:— First Rs 50,000—one anna in the rupee. The next Rs 50,000—1½ „ The next Rs 50,000—2 „ The next Rs 50,000—2½ „ All incomes above Rs 2 lakhs—3 annas in the rupee.
1919	„ 2,000	As before.

These rates continued in force for some time. A corporation tax was levied in 1920 but with that we are not concerned here. Omitting the various changes that took place for some years after 1919 we note below the rates that were enforced in 1936 and in 1939. Till 1939 a man's total income was taxed at the same rate and the rate depended on the size of the total income. In 1939 the 'slab' system was introduced under which a man's total income is considered to consist of a series of vertical slabs and different rates apply to different slabs, slabs at the same height being taxed at the same rate irrespective of the size of the total income. Thus the first fifteen hundred rupees of each man's income is exempt irrespective of the size of his income or the 20,000th rupee of each man's

income is taxed at the same rate irrespective of the size of the income.

The supertax however has always been levied under a slab system since it began in 1917.

The rates in 1936 were as follows:

PART I

Rates of Income-Tax

A. In the case of every individual, Hindu undivided family, unregistered firm and other association of individuals not being a registered firm or a company—

	Rate
(1) When the total income is Rs 2,000 or upwards, but is less than Rs 5,000	Six pies in the rupee.
(2) When the total income is Rs 5,000 or upwards, but is less than Rs 10,000.	Nine pies in the rupee.
(3) When the total income is Rs 10,000 or upwards but is less than Rs 15,000.	One anna in the rupee.
(4) When the total income is Rs 15,000 or upwards but is less than Rs 20,000.	One anna and four pies in the rupee.
(5) When the total income is Rs 20,000 or upwards but is less than Rs 30,000.	One anna and seven pies in the rupee.
(6) When the total income is Rs 30,000 or upwards but less than Rs 40,000	One anna and eleven pies in the rupee.
(7) When the total income is Rs 40,000 or upwards but is less than Rs 1,00,000.	Two annas and one pie in the rupee.
(8) When the total income is Rs 1,00,000 or upwards.	Two annas and two pies in the rupee.
B. In the case of every company and registered firm, whatever its total income.	Two annas and two pies in the rupee.

PART II

Rates of Supertax

In respect of the excess over thirty thousand rupees of total income—

(1) In the case of every company—

(*a*) in respect of the first twenty thousand rupees of such excess.	Nil.
(*b*) for every rupee of the remainder of such excess.	One anna in the rupee.

(2) (*a*) in the case of every Hindu undivided family—

(*i*) in respect of the first forty-five thousand rupees of such excess.	Nil.
(*ii*) for every rupee of the next twenty five thousand rupees of such excess.	One anna and three pies in the rupee.

(*b*) in the case of every individual, unregistered firm and other associations of individuals not being a registered firm or a company—

(*i*) for every rupee of the first twenty thousand rupees of such excess.	Nine pies in the rupee.
(*ii*) for every rupee of the next fifty thousand rupees of such excess.	One anna and three pies in the rupee.

(*c*) in the case of every individual, Hindu undivided family, unregistered firm and other association of individuals not being a registered firm or a company—

(*i*) for every rupee of the next fifty thousand rupees of such excess.	One anna and nine pies in the rupee.
(*ii*) for every rupee of the next fifty thousand rupees of such excess.	Two annas and three pies in the rupee.
(*iii*) for every rupee of the next fifty thousand rupees of such excess.	Two annas and nine pies in the rupee.
(*iv*) for every rupee of the next fifty thousand rupees of such excess.	Three annas and three pies in the rupee.
(*v*) for every rupee of the next fifty thousand rupees of such excess.	Three annas and nine pies in the rupee.

(*vi*) for every rupee of the next fifty thousand rupees of such excess.	Four annas and three pies in the rupee.
(*vii*) for every rupee of the next fifty thousand rupees of such excess.	Four annas and nine pies in the rupee.
(*viii*) for every rupee of the next fifty thousand rupees of such excess.	Five annas and three pies in the rupee.
(*ix*) for every rupee of the next fifty thousand rupees of such excess.	Five annas and nine pies in the rupee.
(*x*) for every rupee of the remainder of such excess.	Six annas and three pies in the rupee.

(Appended to the Indian Finance Act, 1936.)

These rates, expressed in terms of percentages of the individual incomes taxed, are as follows:

Income Rs	Percentage borne by the tax to the income
1,999	Nil
4,000	3·1
14,000	6·2
30,000	11·9
50,000	17·7
6,00,000	41·4

The rates introduced in 1939 are as follows:

Income-Tax

A. Individuals, unregistered firms, Hindu undivided families and associations of persons (other than companies):

	Rate
First Rs 1,500 of income	Nil.
Next Rs 3,500 ,,	9 pies in the rupee.
,, Rs 5,000 ,,	1 anna 3 pies in the rupee.
,, Rs 5,000 ,,	2 annas in the rupee.
Balance of income	2 annas 6 pies in the rupee.

No tax payable on incomes not exceeding Rs 2,000.

Income-tax on incomes first above Rs 2,000 to be restricted to half the excess of the income above Rs 2,000.

B. Rate for companies 2 annas 6 pies in the rupee.

Supertax

A. Assessees other than companies:

First Rs 25,000	Nil.
Next Rs 10,000	1 anna in the rupee.
,, Rs 20,000	2 annas in the rupee.
,, Rs 70,000	3 annas in the rupee.
,, Rs 75,000	4 annas in the rupee.
,, Rs 1,50,000	5 annas in the rupee.
,, Rs 1,50,000	6 annas in the rupee.
Balance of income	7 annas in the rupee.
B. Companies	1 anna in the rupee on the whole income (no exempted slab).

The rates, expressed in terms of percentages of the incomes taxed, work out in a few cases as follows:

Income Rs	Percentage borne by the tax to the income
2,000	Nil
3,000	2·3
4,000	2·9
5,000	3·2
50,000	18·3
5,00,000	43·0
6,00,000	45·0

The following facts stand out from the above survey:

(1) Before 1886 there was no income-tax except for two short periods of five years and four years respectively.
(2) Till 1916 the maximum rate of income-tax was four per cent.
(3) In 1916 the rate on the highest non-agricultural income was just over six per cent.
(4) Even today the rate is below twenty per cent on incomes of Rs 50,000 a year and does not reach fifty per cent in the case of the highest incomes counted in terms of crores.

The contrast between taxation of rent and taxation of profits, interest and salaries is therefore very marked. In 1902 when Lord Curzon's Government announced, by an official resolution, that in respect of land revenue 'progressive moderation is the keynote of the policy of Government' and that (¶ 38) 'it cannot but be their

desire that assessments should be equitable in character and moderate in incidence' (¶ 4), rent was being taxed at fifty per cent while profits, interest and salaries were being taxed at only five pies in the rupee, i.e. at less than three per cent. Even today, in some provinces, incomes from profits, salaries and interest are taxed at a lower rate, than incomes from rent.

Moreover, with a four per cent tax on incomes, it was considered necessary to exempt people with a minimum standard of living. But in the scheme of taxation of rents, nobody, however poor, is exempted, whether the rate of the tax is ninety per cent or twenty-five per cent.

Before ending this comparison between the rates of income-tax and the rates of land revenue, it is necessary to make a few comments on the comparability of the two.

The Indian Income-Tax is a tax on incomes derived from profits, interests, salary and rent of non-agricultural land. The land revenue in the temporarily settled areas is a tax on rents of agricultural land. *Prima facie*, therefore, there is no reason why the two should not be comparable in a study of the incidence of taxation.

The points of distinction between the two are, however, important and they must be kept in view in making any inference from a comparison of the two.

First, the Indian Income-Tax is assessed every year. The rate has therefore a constant relation to the basis. The land revenue, however, is assessed only once in fifteen, twenty or thirty years as the case may be.[1] This rate therefore soon loses its original relation to the basis and may show considerable variation from case to case and from year to year during the period of a particular settlement.

Secondly, while it is not possible to shift the income-tax, land revenue is often shifted by a process of capitalization. In case of income-tax, he who bears the tax bears the burden. In the case of the land revenue, he who pays the tax may not bear the burden if he has purchased the land after the assessment. To him the purchase of land is like an ordinary investment which must yield him the current rate of return on capital. He therefore discounts the purchase price by the capitalized value of the land revenue at the time of purchase, and gets rid of the burden by this process.

[1] In the case of the first income-tax in India, the same assessment continued in force for five years.

Thirdly, income-tax does not touch people below a minimum standard of income. Land revenue being a tax on land, not on persons, no such exemption of the poor is possible.

Fourthly, income-tax falls with graduated incidence on large incomes, while land revenue is levied on a flat rate basis.

Any comparison between the rates of income-tax and land revenue must therefore be subject to these points of difference.

The importance of land revenue in the finances of the Government of British India has been very great; for, land revenue has been, till recently, the mainstay of the finances of the country. As the Imperial Gazetteer pointed out in 1907, 'it approximates more than most forms of taxation to the "single tax".'[1] The figures quoted below fully support this contention[2]:

Year	Receipts from land revenue	Total revenue of India	Percentage which land revenue bears to the total revenue
	£	£	
1793-4 ..	.. 4,048,128	5,860,361	69·0
1794-5 ..	.. 4,197,137	6,005,520	69·8
1795-6 ..	.. 4,123,982	5,756,665	71·6
***	***	***	***
1808-9 ..	.. 5,335,789	8,722,053	61·1
***	***	***	***
1814-5 ..	.. 11,749,294	16,468,404	71·3
***	***	***	***
1818-9 ..	.. 13,490,589	18,440,577	73·1
***	***	***	***
1839-40 ..	.. 13,159,569	18,633,034	70·6
***	***	***	***
1850-1 ..	.. 16,693,065	25,096,281	66·5

The following figures relating to subsequent years are taken from Table X of Volume II of the Treatise on the *Science of Public Finance* by Mr Findlay Shirras. Column 4 has been added by me:

[1] *The Imperial Gazetteer*, Vol. IV, p. 234.

[2] *Finance and Revenue Accounts*, Part III, 1870, Account No. 4.

(*In thousands of rupees*)

Year	Receipts from land revenue	Total tax revenue (Central and Provincial)	Percentage of Col. 2 to Col. 3
1861-2	19,91,80	40,00,93	49·7
1871-2	20,52,03	44,73,14	45·7
1881-2	21,94,80	52,78,00	41·6
1891-2	23,96,58	58,02,66	41·3
1901-2	27,39,80	65,57,55	41·8
1911-12	31,14,70	78,37,95	39·9
1913-14	32,08,74	77,24,83	39·9
1919-20	33,91,49	122,15,32	27·8
1921-2	34,87,44	135,30,04	27·2
1926-7	35,04,06	148,02,94	23·5
1929-30	33,58,20	151,90,39	22·1
1930-1	30,39,99	137,41,76	22·0
1931-2	33,13,29	140,47,56	23·5
1932-3	31,02,34	145,79,20	21·2
1933-34	30,11,57	138,29,18	21·8

(It is to be noted that these figures compare land revenue with the total *tax* revenue while the figures of the Finance and Revenue Accounts compare land revenue with the total revenue, tax and non-tax.)

The following table, which has been compiled from the budgets of the different Provincial and Central Governments, shows the position in recent years. It is to be noted that the foregoing figures include figures for Burma while the following figures exclude those of Burma. Except for this difference, all the figures quoted include both Central and Provincial revenues taken together.

(*In thousands of rupees*)

Year	Receipts from land revenue	Total tax revenue (Central and Provincial)	Percentage of col. 2 to col. 3
1	2	3	4
1936-7	26,68,47	123,57,88	21·5
1937-8	26,36,47	129,18,55	20·4
1938-9	25,93,95	128,45,00	20·2
1939-40	26,80,98	134,62,23	19·9

The figures show the importance of land revenue in the finances of the country. In the first period, i.e. before the imposition of the income-tax in 1860, land revenue constituted between sixty-one and seventy-three per cent of the total revenues of India. During the second period, i.e. from 1861 to 1919, when income-tax or professional or certificate taxes were levied at low rates, the percentage which land revenue bore to the total tax revenues of India (Central as well as Provincial) came down considerably and varied between forty and fifty. During the third period of higher income-tax rates and high customs duties, i.e. from 1916 onwards, the percentage came down still further and now it is round about twenty. During this period the fiscal policy of the Government of India underwent a great change and took a definite turn towards protection; and in 1921-2 the customs revenue exceeded land revenue for the first time in the history of India. Income-tax also increased in importance in that year and came third. The figures for that year are:

	(*In thousands of rupees*)
Customs	35,36,31
Land revenue	34,87,44
Income-tax	25,11,53

Land revenue therefore no longer retains its unique importance in the finances of India. It is, however, still of outstanding importance in the finances of the Provincial Governments. Under the new reforms, land revenue is easily the largest item of revenue in each province. Its actual importance in provincial finance may be seen from the following figures relating to the year 1940-1.

1940-41

	(1) Name of Province	(2) Total Revenue Receipts (*In thousands of rupees*)	(3) Land Revenue Receipts (*In thousands of rupees*)	(4) Percentage of col. 3 to col. 2
1.	Madras ..	18,07,51	5,00,11	27·66
2.	Bengal ..	13,54,50	3,58,94	26·49
3.	Bombay ..	14,48,24	3,45,54	23·85
4.	U.P.	11,20,42	6,19,46	55·28
5.	Punjab ..	12,88,97	2,95,53	22·92
6.	C.P.	5,26,35	2,50,21	47·55
7.	Bihar	6,17,79	1,32,10	21·38
8.	Assam ..	3,29,25	1,23,35	37·46
9.	Orissa ..	1,99,00	52,91	26·58
10.	Sind	5,19,68	47,94	9·22
11.	N.W.F.P. ..	1,92,12	20,24	10·53

III

LAND REVENUE

A BRIEF examination of the arguments which were used by administrators in support of the excessive and unequal taxation of land will be interesting.

It is possible to distinguish three schools among them. The first school admitted that land revenue was an unequal tax and attempted its defence on that basis. The second school denied that land revenue was a tax. According to them land revenue was rent and hence the canons of taxation should not be applied to it. The third school did not care whether it was rent or tax: they said that they would be satisfied if the levy did not cause hardship.

The argument of the first school is best stated in the *Imperial Gazetteer*. The statement will bear quotation. The Gazetteer notes the anomaly as follows:

'Minds accustomed only to European systems are apt to start with a prejudice against a form of revenue which may absorb half the rent, and to advocate its immediate conversion into taxation of the standard type.'

The Gazetteer then adduces three distinct arguments in support of the inequality. They are:

(*i*) 'A reference, however, to the chapter on Indian rents in this Gazetteer will show that historically the existence of the land revenue is anterior, and not subsequent, to that of private rents; that it finds its origin and present basis in the immemorial right of the Crown in India to a share of the produce of all land within the State; and that rent, and rent-yielding property in land, owe their existence to the policy, adopted during the last hundred years, of gradually reducing the incidence of the revenue; so that, *as a matter of history, the right of the State to the rent is superior to that of the private landholder.*' [1]

(*ii*) 'Moreover, in view of the fact that a land revenue of the Indian type is practically unknown to European readers, it is advisable to note that in comparison with most known forms of taxation it has merits which should not be overlooked. It is, for instance, the only considerable class of state revenue which (obtained as it is from profits on the staple industry of the country) can be

[1] The italics are mine.

raised without enhancing prices or diminishing general consumption. It approximates more than most forms of taxation to the "single tax" which has, *rightly or wrongly*,[1] been advocated by some theorists as the ideal type of assessment, and effects, in a measure, that "nationalization of the land" which is not without strenuous supporters. It falls on that part of the produce which goes (or which under ordinary circumstances would go) not to the cultivator, but to the intermediary rent receiver. Even in respect of the latter, it is when permanently fixed a charge the burden of which has long been discontinued, and when not fixed in perpetuity it approximates to a charge of this nature in so far as it is fixed for long terms.'

The Gazetteer concludes:

(*iii*) 'It is scarcely to be imagined, therefore, that a form of revenue which has these merits, and has besides the great advantage of having been from time immemorial known and accepted by the people in India, should be exchanged in any wholesale manner for other sources of taxation which would as a rule involve *more unpopular* [2] and inquisitorial methods. That the proportion of the land revenue to the total income of the state is, however, gradually diminishing with the general development of the country will be evident from the following figures:

	1870-71	1880-81	1890-91	1900-01
	p.c.	p.c.	p.c.	p.c.
Proportion borne by the Land Revenue to:				
The gross income of the State	39·0	29·5	28·0	23·2
The taxation proper ..	43·9	41·6	40·8	38·6'[3]

These arguments are analysed and examined below *seriatim*.

The problem or the anomaly which the Gazetteer seeks to explain is the inequality of the incidence of taxation on rents and on other incomes. It is no answer to the problems to say that 'the right of the State to the rent is superior to that of the private landlords'. The subject under discussion is not political but economic. We are not discussing here whether the State has a right to tax rents. That is an ordinary incidence of sovereignty and does not extend to rents alone. It is a comprehensive right and extends to all incomes, all property and all subjects. The sovereign State *can* tax any income, any property or any subject in any way it wants to. It *can* impose unequal taxation if it wants to. For the establishment

[1] The itailcs are mine.

[2] The italics are mine.

[3] *Imperial Gazetteer of India*, 1907, Vol. IV, Ch. VII, pp. 233-4.

of that power, one need not go into the ancient history of India. It is a truism in political science and in the science of public finance. But the question of the existence of a right is distinct from the question of the manner of its exercise. The subject under discussion is not whether the right exists but whether the right is being exercised in a proper manner, i.e. in such a manner as to secure distributive justice to all. The answer to the second question is as clearly in the negative as the answer to the first is in the affirmative. The first argument of the Gazetteer is therefore irrelevant and is based on a confusion of issues.

The second argument is a direct and rational approach to the problem and concerns itself with the merits of unequal taxation of rent. Five points are urged in favour of it, viz.

(*i*) A tax on rents does not raise prices and therefore does not diminish consumption.

(*ii*) The Indian land revenue is the nearest approach to the 'single tax' which some theorists advocate *rightly or wrongly* as the ideal form of taxation.

(*iii*) The Indian land revenue has in a measure effected 'nationalization of land' which is not without ardent support.

(*iv*) The incidence of the land revenue is not on the cultivator but on the intermediary, and

(*v*) The land revenue, when fixed permanently, has ceased to operate as a burden and when it is fixed for long terms, its burden gradually diminishes and soon approaches the vanishing point.

That rent or a tax on rent does not enter into price is a scientifically demonstrable fact. This has already been proved in Chapter I. It is therefore correct to say that taxation of rent does not ordinarily impair productive efficiency.

But it is wrong to state that taxation of rent does not diminish consumption. Obviously it does. Taxation is nothing but a forced transference of purchasing power. If the taxed subject is a rich man the transference may not affect his immediate consumption but may affect only his savings. But if the subject taxed is a poor man, as almost every assessee of land revenue is in India, the tax must affect his consumption. Many of the poor peasant proprietors have to go without some necessary items of consumption on

account of the fact that they have to pay land revenue at a high rate.

Secondly, the fact that tax on rent being a tax on profits does not enter into prices, does not, in itself, justify an unequal taxation of rent. In the first place from the standpoint of distributive justice the tax burden ought to be equally distributed among the subjects according to the doctrine of equal sacrifice. Rent is not the only surplus available for taxation. Income-tax is also a tax on surplus and does not raise prices. To say that a tax on rent is a tax on surplus and does not raise prices is therefore no answer to a charge of discriminatory treatment in respect of rents. Taxes on surpluses are of course better than taxes on margins, but this does not justify unequal taxation of different kinds of surpluses.

It is to be remembered that rent in the economic sense is distributed in India among the vast mass of the people, the bulk of whom are poor.

The second point reveals a peculiar attitude. It is not stated whether a 'single tax' on land is right or wrong. That point is kept open and it is said that a single tax may be right or it may be wrong; but the Indian land revenue is the nearest approach to it. All economists agree that a single tax on land is bad: the point is therefore easily disposed of.

The single tax on land or *l'impôt unique* was advocated in the seventeenth century first by the Spaniard Centum, who was of opinion that 'land is the only real wealth' and next by the Physiocrats, who also held that land is the ultimate source of all wealth. These gentlemen denied the productive capacity of all other agents of production, labour, capital and enterprise, and therefore found no justification for imposing taxes on them. To them the view was quite consistent with their ideas of production. As the science of economics established the productivity of all the agents of production, the theory of exclusive taxation of the earnings of one agent only to the exclusion of all others was exploded, for, the injustice involved in such a course is obvious.

Thirdly, the question of a just distribution of the tax burden is different from the question of the method by which Government may choose to impose the burden. Whether there is a single tax or multiple taxes the burden must be equitably distributed. The argument that land revenue is a single tax is therefore no answer to a charge of unjust distribution.

The third point is clearly wrong. Land has not been nationalized in India. Though the State owns and manages a few estates here and there, land generally is in the ownership and management of private persons. If the argument means that rents are so highly taxed that they mostly flow into the coffers of the State in spite of private ownership and private management of land, it may be said to be a correct statement of facts; but, then, this practically becomes an admission of the inequality and not a defence of it. This argument therefore begs the question.

The fourth point, again, is only partially correct. In many parts of the country, as in Bengal, it is correct, but in many others, as in Bombay, it is not. Peasant proprietors are at least as numerous as landlords.

Secondly, whether a man earns his income as a cultivator or as a middleman hardly affects the question of distributive justice in taxation. Men make themselves useful to society in various ways. Everybody renders some productive service or he is ousted in due course. Taxation should not discriminate between this service or that.

The subject under discussion in the present study is not purposive or propagandist taxation but taxation for purely financial purposes. So we should not take notice of the political importance of classes as a relevant factor in a good taxation system. As there may be poor cultivators, there may be poor intermediaries too. High taxation of a poor intermediary cannot be justified on the simple ground that he is an intermediary.

The fifth point is correct. In the permanently settled areas, the assessment was made once for all but the estates continued to develop. If the assessment was equal to ninety per cent or more of the net assets in 1793 in these areas, today it is much less. This has, however, given rise to another sort of inequality in the opposite direction in these areas. Today some of the zemindars are very lightly taxed. We shall come to this point later.

In the temporarily settled areas, the assessment is not annual as in the case of the income-tax but takes place at intervals of fifteen, twenty, thirty or forty years, fixed according to the state of development of the area. Though the assessment may be fifty per cent at the time of settlement the percentage generally goes down during the currency of the same settlement on account of the almost continual development of estates due to socio-economic causes. This may

be correct in a progressive society ; but the abatement of the burden here is only temporary and the burden is again pushed up to the standard level at the time of the next settlement. The question of frequency of assessment is hardly relevant in the discussion about the equity of the standard assessment. Moreover, the relief derived from assessment at intervals is not without a corresponding hardship. The assessment at the new settlement suddenly goes up causing great inconvenience and a deterioration in the standard of living. To quote the report of the Taxation Enquiry Committee:

'A second source of inconvenience is apt to arise out of the long period of the settlements. A tax based on the income of the year is met out of it and forms part of the family budget and standard of living. One that is changed once in a generation, and which is in many cases amortized, does not make itself felt in the same way, and when the change does come, if it is in the direction of increase, it is felt as a serious hardship. This is mitigated, it is true, by arrangements for bringing in the enhancements by degrees, and still more so by reducing the extent of the increase to be taken. But that again has the result of reducing the yield of the tax, while perpetuating the inequalities in its incidence.' [1]

The third argument is quite unconvincing. The Government is supposed to be given two alternatives, namely, land revenue and income-tax. The former is assumed to be good and the latter is assumed to be bad and the conclusion is obvious. This is begging the question.

Another point in this argument calls for notice. It is said that the income-tax will be more unpopular than the land revenue. This was always in the old days the stock argument of the non-official English community and the Indian landed aristocracy against an income-tax. And this argument was used in 1860, 1869 and again in 1886. An income-tax in those days sought to take only two or three per cent of the income of a few lakhs of people while the land-revenue took in those days about seventy-five per cent of the income of almost all the people. But it was maintained that the former was more unpopular than the latter. A statement like this can only be understood if we bear in mind the vested interests of the person who makes it.

We come now to the arguments of the second school which saw the futility of all attempts to defend an unequal taxation of

[1] *Report*, Vol. I, ¶ 87.

land. They, therefore, took the scholastic line of throwing the critics on the defensive. They argued that before land revenue could be criticized on the ground that it was an excessive or an unequal taxation of land, it was necessary to prove that it was a tax at all. According to them, land revenue was not a tax but rent and hence the question of unequal taxation or excessive taxation did not arise. Sir John Strachey, who was the Finance Member of India during the most formative period of the British Indian administration, was an important champion of this view. He writes as follows:

'We hear a great deal that is undeniably true regarding the poverty of the people of India and their inability to bear heavy taxation; and to persons accustomed to judge by an English standard it seems a terrible thing that this poor country should be forced to raise every year a revenue exceeded only by that of two or three of the greatest and richest of European nations. The truth is, however, that the public burdens in India are light to a degree absolutely without precedent, because the State has reserved to itself resources which in other countries belong to individuals, and possesses sources of revenue which rend r it in a great measure independent of taxation.

'The most important of these resources is the land revenue, a rent-charge in favour of the public, a portion of the rent of land reserved by the State from time immemorial for its own purposes.' [1]

According to this view, the land revenue is rent and not a tax and hence it is erroneous to apply to it the canons of taxation. The attitude taken here is rather peculiar. Shorn of all adornments, the statement amounts to this:

You say that we are taxing the poor Indians. But we are not. For, instead of imposing a tax on the profits of agriculture, we consider that all the lands are reserved to ourselves and hence our receipts are nothing but our share of the profits from those lands. We could have taken the entire profits, but we, out of our generosity, have left a share of the profits with the peasants. Where, then, is the excessive taxation? We have been rather charitable.

The absurdity of such an attitude is palpable. Sir John was not an economist but an administrator. Though we need not accept his classification of land revenue as a scientific one, we could certainly accept the description he gives of the levy and that would give us

[1] Strachey, *Finances and Public Works of India*, Chap. II, Kegan Paul, Trench, Trubner, and Co., Ltd., 1882.

a better clue to its correct classification. 'The State in India', says he, 'has been entitled to receive from the occupier *such portion of the surplus profit after defraying the expenses of cultivation as it has appeared possible or expedient to take. The land revenue of India is this portion of the surplus.*[1] If this is the definition of land revenue, it is nothing but a tax, as economists understand it. It is a portion of the profits of agriculture compulsorily intercepted by the State without any *quid pro quo*: and this is exactly how economists define a tax. As a slice compulsorily cut off from profits by the State is not profit and as a slice compulsorily cut off from salary by the State is not salary, so a slice compulsorily cut off from rent by the State is not rent. All such slices compulsorily cut off by the State are taxes.

To quote precedents from Indian history about the rate of the levy is of little use. The history of India is long—longer than that of many other countries of the world. During those long millenniums, ideal kings as well as tyrants ruled in India. The needs of the public exchequer must have varied widely from time to time. The levy, therefore, must have varied within wide limits. Sometimes it must have been oppressively excessive, sometimes fair and sometimes light. To say that the lesson derived from this history is that the Crown has the right to take such portion of the surplus profit as is 'possible or expedient to take' is to draw a wrong conclusion. Reference to history for the purpose of establishing the right of the Crown to levy a tax on the profits of agriculture is unnecessary because that is an ordinary incidence of sovereignty and is undisputed. Reference to history for the purpose of justifying the pitch of a particular levy is also irrelevant, for such justification must be sought with reference to existing conditions. It is the contemporary needs for expenditure, contemporary national income and its distribution, and the contemporary avenues of employment that will or will not justify a particular pitch and distribution of the tax burden. Reference to history in these discussions during the last century and the present has therefore often led to a confusion rather than a clarification of the issues.

There is yet a third group among the British Indian administrators who saw the absurdity of the views of both the schools discussed above. In fact, they saw the futility of attempting any positive

[1] Italics are mine.

view justifying the unequal levy. They said: 'In effect, we do not care whether you call it rent or tax. A discussion on that is of academic interest. All that we care for is that the land revenue must be assessed *fairly and justly*.' This attitude begs the question. What is the standard of fairness in land revenue assessment? That is our question. To say therefore that we do not care whether it is rent or tax, provided it is fair, is to say nothing.

The standard of fairness defined by this group has been often unfair and also impracticable. The Land Revenue Resolution of the Government of India, 1902, which attacked the problem more or less from this standpoint, defined the standard thus:

'It cannot but be their desire that assessments should be equitable in character and moderate in incidence; and that there should be left to the proprietor or to the cultivator of the soil, as the case may be, the margin of profit that will enable him to save in ordinary seasons and to meet the strain of exceptional misfortune.'

The definition is, after all, too vague to be a basis of action. It could be called in to support widely varying levels of assessment in the same case. Such vagueness as to the basis and rate of a compulsory levy (be it a tax or not) is strongly to be deprecated.

Secondly, in this Resolution the cultivating proprietors are allowed to retain only that margin of profit to themselves which would enable them

(*i*) to *live* in ordinary years and

(*ii*) to save in such years just enough to meet the strain of exceptional misfortune, i.e. of famine years.

Government, it is said, would take anything above that margin.

The principle is entirely impracticable. Land revenue is not assessed on the basis of the total assets of a cultivator. It is assessed on the net produce of each plot of land or each collection of plots. It takes a common percentage from the net produce of each unit of land, and takes no notice of the total income of the owner. It follows that the principle is not and cannot be followed but only remains there as a part of the Government Resolution. In consequence, results ensue which are the opposite of what seems to be the apparent intention of the principle quoted above. A man who cannot find two meals a day and possesses only a couple of *bighas* of land in a backward rural area will be taxed to the extent of fifty per cent of his net produce, in spite of the Government principle that everybody must be left with enough to live on and to save for

lean years, while rich proprietors owning large areas of land do not have to part with more than the standard percentage in spite of the Government principle that Government is entitled to the whole excess above what is necessary to live and to save a little for lean years. Such a principle would indeed demand a very sharp graduation in assessment which is not possible in a land tax of the Indian pattern. The result is that in spite of the principle, the poorest peasants are deprived of their very means of livelihood by this tax while the richer proprietors retain much more than they should according to this principle. It is no good adopting a principle which cannot be applied in practice.

The Land Revenue Resolution of the Government of India, 1902, though attacking the problem from the third point of view, contains a frank admission towards the end which will bear quotation. The Resolution says:

'In thus defining their policy, the Government of India would not desire to claim for the land revenue system of British India an exactitude or a freedom from blemish to which it cannot pretend. Historically it owes its immediate origin to practices inherited from the most decadent period of native rule, and its form to changes made slowly, and not without mistakes, by men who were aliens to the country, and could only with difficulty, and by slow degrees assimilate the requirements or enter into the feelings of the people. Where habit and precedent count for more than wisdom, there has been need for caution in reform; and logical completeness or simplicity could not be expected of a system born amid such surroundings, applied to such manifold conditions and to so heterogeneous a population, and subject, in the various stages of its development, to considerations of practical expediency rather than of abstract symmetry or scientific perfection.' (¶ 39)

The statement contains two very important points:

(*i*) In land revenue policy habit and precedent have counted for more than wisdom, and

(*ii*) Consideration of practical expediency rather than of abstract symmetry or scientific perfection have been the chief factor in the land revenue administration of the British Indian Government.

It is also stated that the immediate predecessor of British rule was the most decadent period of native administration. It has already been seen that rent was being heavily taxed under it. The British, on succeeding to that administration, found themselves involved in a long series of wars for which money had to be raised.

This, instead of relieving the taxation of rent, led to an intensification of the pitch and as British interests got a firm foothold in India and became friendly with the Indian upper classes, the taxation of commercial wealth and salaries or the income of the landed aristocracy became difficult.[1] As a result, the unequal taxation of rent continued. Relief came, not by any reduction of the demand, but by a natural growth of the agricultural wealth of the country. The Mutiny was followed by the beginnings of an income-tax and it was during and after the last world war that the inequality diminished considerably in extent. So it is quite correct to say that practical expediency required more stress on habits and precedents than on wisdom.[2] It required a mutiny and a world war to break the inertia of habit entrenched in strong political influence. As late as in 1936, Sir Otto Niemeyer in his *Report* (popularly known as Niemeyer Award), remarked:

'The general scheme of Indian taxation (Central and Provincial) operates to relieve the wealtheir commercial classes to an extent which is unusual in taxation scheme.' (¶ 31 of the *Report*.)

The confusing controversy over this simple issue persisted for decades and bewildered many minds. It had its effect on the Report of the Taxation Enquiry Committee. The Report discusses at length the question whether land revenue is a rent or a tax and comes to the following conclusion:

'The Committee can best sum up their conclusions by saying that, though they are divided in opinion as to whether or not the land revenue should be regarded as a tax on the individual who pays it, they are agreed that, since it forms a deduction from the national dividend, it should be taken into consideration in dealing with the question of the incidence of taxation on the country as a whole.' [3]

[1] Speaking about the attitude of the English community, Lord Lawrence, a Governor-General of India wrote: 'They desire that all taxation should fall on the natives and more especially on the poorer classes. Thus, they would advocate an increase of the Salt Tax, which is already, in my mind, too high.' (*Vide* his letter to Sir Stafford Northcote, dated 28th March, 1867, in Chap. X, Vol. II, of the *Life of Lord Lawrence* by R. Bosworth Smith.)

In another letter to the same person, dated 14th May, 1867, he said that the Englishman 'practically considers it his prerogative, while in India, to pay no taxation at all'. *Ibid.*, Vol. II, p. 384.

[2] Lord Bryce saw in the heavy taxation of the masses the weakest point in the British Empire in India. See his *Studies in History and Jurisprudence*, Vol. I, Essay on 'Roman and British Empires'.

[3] *Report*, Vol. I, ¶ 84.

This, in plain language, means that land revenue may or may not be a tax on the individual but it is a tax on the society as a whole. This is a curious, illogical position. The national income is composed of the incomes of individuals and of corporations, etc. If it is a deduction from the national dividend, it must correspondingly reduce individual incomes as well. If the total is affected, the components making that total must necessarily be affected; for if the components remain unaffected how can the total be affected?

The Committee have clearly displayed a confusion of thought here. What they apparently meant was that the incidence of land revenue is not always on the individual who pays it and he has therefore not always to bear its burden. This is, of course, true. The buyer of a piece of land, as explained in Chapter I, often successfully discounts the price by the full capitalized value of the land revenue assessed on it. But that cannot remove land revenue from the category of a tax. The impact and incidence of most taxes are not often identical and this is particularly true of taxes on things. But because a tax is shifted, that does not alter its character as a tax. Identity of impact and incidence is not part of the definition of a tax.

Again, in the chapter on 'The Distribution of the Tax Burden', the Committee speak of the small holder as follows:

'The small holder, if he is not a tenant, pays, generally speaking, in addition to the land revenue and the cesses, the same taxes as the daily labourer and has a standard of living not much higher than that of the daily agricultural labourer, though perhaps the proportion of his earnings which he spends on intoxicants is less. His lot is undoubtedly a hard one.'

But then the Committee without at all stating whether the tax burden is inequitable or not go on to say:

'But his difficulties are not primarily the result of taxation. The absence of alternative occupations, the crowding of the population on to the land, the fractionization of holdings, the uncertainty of the seasons, the failure to save in a good year with a view to meeting inevitable charges in a bad one, wasteful expenditure on marriages and the high rates of interest form a combination of causes which make it difficult for the cultivator of a holding which is actually uneconomic or very nearly so to keep his head above water.'

This is irrelevant. The Committee were discussing, in that chapter, not the causes which have brought about the poverty of the small holder but the question whether the taxation in the country

is equitably distributed among the classes. The state of poverty of a particular class must always be due to some causes. A study of the distribution of the tax burden takes the existing distribution of wealth for granted (we are here not speaking about socialistic ideas of taxation), and then proceeds to examine whether the tax burden has been equitably distributed in relation to the wealth of each man and class. The plain conclusion that the Committee ought to have reached is that the tax burden on the small holders is unjustly high. The burden may be very small—only a rupee or two a year on the smallest holder—but it probably deprives him of a few meals and hence the marginal utility of that rupee is very high, sometimes as high as infinity. It is hardly relevant in the context to say that the poverty of the small holder is not *primarily* caused by taxation. That the remission of a tax does not make a poor man rich or that the man is poor even without the small tax does not justify the levy of a tax on him. This is clearly an unscientific attitude in a study on the distribution of the tax burden.

IV

LAND REVENUE

UNDER autonomy the injustice and hardship involved in the imposition of a high land tax on the poor peasants were clearly recognized and unequivocally condemned by the Ministers in all the provinces in which land revenue is temporarily settled. The Ministers lived among the people. They did not require to plunge into historical researches or to learn the abstruse theories of economics in order to come to this conclusion. The hardship was apparent to them. Moreover, for the first time in the history of British India, Ministers came into power on the votes of the people, the peasants' votes being the most important among them. The condition of the peasants was therefore constantly forced on the attention of the Ministers.

To alleviate the hardship of a high land revenue, all Provincial Governments, in the temporarily settled areas, granted liberal remissions. A policy of remission to alleviate special hardship was already in vogue. The popular Ministers boldly liberalized that policy and extended its scope considerably.

The actual remissions of land revenue granted in Bombay and Madras during the years of autonomy and in the year just preceding the introduction of autonomy were as follows:

	(*In lakhs of rupees*)	
	Madras	Bombay
1936-7	84·77	20·01
1937-8	105·64	42·80
1938-9	129·54	22·88
1939-40	103·61	22·18

(The figures have been compiled from the Land Revenue Administration Reports of the two provinces.)

In his first Budget speech, the Finance Minister of Bombay explained the remissions as follows:

'The anomalies which had crept into the system of the classification of lands and the rate of assessment dependent on that classification became more striking than they had ever been. Our first duty was

therefore to give relief by way of reduction of the State demand against them. Government have therefore decided, firstly, to abolish all grazing fees, which would cost us Rs 5 lakhs a year; secondly, to write off all the revenue arrears in respect of all years except the one that closed at the end of July last; and thirdly, to sanction a permanent reduction in land revenue in cases where for various reasons that demand had become unbearable. . . . As the House is aware, Government have been reducing their revenue demand by nearly 8 lakhs of rupees a year in order to give relief to those who had been suffering heavily on account of fall in prices. In addition to this form of relief, Government have decided to sanction remission of Rs 5 lakhs in the course of the next six months to lighten the burden on such areas as are found to be too heavily taxed in land revenue. This remission, I may add, is intended to be permanent and therefore a recurring loss of revenue.'

The remissions granted in Madras in 1937-8 and 1938-9 included the following special remissions:

(*i*) Cancellation of percentage enhancements imposed at resettlement on dry, wet and garden lands in certain tracts resettled in recent years;

(*ii*) Grant of a remission of two annas in the rupee of the net assessment in the remaining areas in the province;

(*iii*) A temporary reduction of water cess from Rs6-4-0 to Rs 5-12-0 an acre for a first crop with corresponding reductions for other crops in the East and West Godavaris and Kistna districts and in the deltaic tracts of the Guntur district.

The actual cost of the above concessions came to Rs 71·4 lakhs.[1]

In Assam during the first year of autonomy the Ministry granted:

(*i*) thirty-three per cent reduction of revenue to all holdings with *pattas*[2] of twelve rupees or less;

(*ii*) reduction at rates varying from district to district to all holdings with *pattas* of over twelve rupees. It was twenty-five per cent in five districts, twenty per cent in one, and twelve and a half per cent in three.

During the second year of autonomy, the remissions were further increased and the rates were varied still further with reference to the pitch of land revenue in each district. The scope of the thirty-three per cent concession was not disturbed except in one district

[1] Report on the Settlement of the Land Revenue of the Districts in the Madras Presidency for 1937-38.

[2] *Pattas* are 'leases' executed in favour of the lessee.

(Sylhet) where it was limited to *pattas* of eight rupees or less. The lower rate of concession was, however, thirty per cent in one district, twenty-nine in one, twenty-eight in one, twenty-seven in one, twenty-six in one, twenty-three in one, twenty in two and fifteen in one.

Thus in both years there was, in each district, a higher rate of reduction and a lower rate of reduction. The higher rate was the same in all districts and its scope was also the same in all districts in the first year; and the same in all but one district in the second year.

The variation in the rates of reduction was made according to the pitch of the assessment in each district. As the Finance Minister explained on the floor of the Legislature:

'The average incidence of land revenue in the temporarily settled areas of Sylhet is 6 annas and 6 pies per *bigha* and in Cachar it is 8 annas and 10 pies. It rises to 15 annas and 5 pies in Sibsagar. This means that a man paying land revenue of Re 1 in the Assam Valley districts is cultivating one *bigha* while in Sylhet two *bighas*. Sir, from these figures, it can easily be seen that, we have given proportionate and equal reductions to all the poor *raiyats* all over Assam.' [1]

The total remissions granted in Assam during the first two years of autonomy are compared below with those granted in the year just preceding:

1936-7	..	..	.. Rs 16,91,720
1937-8	..	..	.. „ 26,75,560
1938-9	..	..	.. „ 38,84,000 [2]

A similar policy of a more liberal remission of land revenue payable by the poor peasant proprietors was adopted in all provinces with temporary settlement during the period of autonomy.

The liberalization and extension of the already existing policy of remission was, of course, good so far as it went. But it did not go very far. It appears a little anomalous that in spite of the strong popular feeling for a reform of the system and in spite of the unequivocal pronouncements of Ministers that it required a change, nothing was done to change the system. Not to speak of a change of system, land revenue still continues to be the only tax in the country without any statutory principle of assessment. It still

[1] Assam Legislative Assembly *Debates*, Vol. II, 1938, p. 1,177.

[2] See Assam Legislative Assembly *Debates*, Vol. II, 1938, p. 1,086.

continues to be determined by the individual discretion of executive officers within the limits of certain executive instructions issued by Government from time to time.

The reasons for this disparity between expectation and result are discussed below.

In the first place, there was hardly any clear thinking or any plan of action on the subject. As the people wanted relief without knowing in what way it would come, so the Government also could not make up their mind as to the best system of land revenue assessment. To evolve or formulate such a system required long and laborious study and nobody actually undertook it. There was no expert to show the way clearly. The inevitable result was that all the popular feeling found vent in a policy of liberal remission.

In his first Budget speech, the Finance Minister of Bombay stated:

'Our ultimate object is to cease taxing the uneconomic holdings in which our land is at present divided. To begin with, however, we think it necessary to introduce a graded tax on the larger agricultural income . . . . . Such resources as will become available by the adoption of a policy of higher taxation on landed incomes which could bear the burdens, should, we think, be largely utilized for making the burden of land tax easily bearable by the actual tiller of the soil and for making their lives better.'

This statement, it is obvious, indicates a mere wish, not a plan. It gives no indication as to the means by which the wish is to be translated into action. It even contains impracticable ideas. In all this, it exactly reflects the popular demand for a change, without any idea of how to bring it about. As no plan was actually forthcoming during the period of autonomy, Government's well-meaning desire to do something exhausted itself in a mere extension of the policy of remission.

Secondly, it soon became clear that a mere policy of tax remission could not be carried to any great length. The real problem to be tackled was not one of tax remission but one of redistribution of the tax burden. The revenue was necessary; all that could be done was to remove the burden from weaker shoulders and to place it on stronger ones. This redistribution required time. As the Finance Minister of Assam said, while speaking about the decision to grant reductions up to thirty-three per cent:

'We feel that the *raiyats* are entitled to 50 per cent of reduction, and we stand by that resolution. During the coming year, it will

be our effort to implement our revenue by taxing those who can afford to pay and then give effect to our pledge.' [1]

The period of autonomy before the outbreak of the war was too short for completing the action.

Thirdly, the magnitude of the task of redistribution was often so great that it could not be completed within the powers and resources granted to the provinces under the constitution. The work of redistribution was taken up in right earnest; but the lines on which redistribution of the tax burden was required were various and the powers of taxation granted to the Ministers, together with other sources of revenue available to the provinces under the constitution, were so inadequate for the purpose that not much progress could be achieved. Thus, for example, in Madras, practically the whole range of constitutional powers of taxation granted to the Ministry was exhausted in redistributing the provincial excise which was unquestionably a bad tax. Nothing could therefore be done to tackle the question of redistributing the burden of land revenue on a sounder basis though the need for it was clearly recognized. As the Finance Minister of Madras said in his first Budget speech:

'We are fully aware that the burden of the land revenue assessment is heavy, but the grant of relief on a scale which would be of material assistance to the individual small *ryot* would involve such a dislocation of the Budget of the province that not even a beginning could be made with other ameliorative measures and reform for the well-being of the masses which, in the opinion of the Government, are of great and urgent importance, and which it would not be right thus for the Government to disable itself from undertaking.'

But even this does not explain why the Ministers did not try to remove the most obvious defect of the system in the temporarily settled areas, namely that there is no definite statutory principle of assessment either as regards the basis of the tax or as regards its rate. Both are left to the discretion of executive officers at the time of assessment—a most extraordinary and undesirable state of affairs.

Though the question of codifying the principles of assessment including its basis and rate is apparently independent of the question of redistribution of the burden (which includes the question of a fair basis and a fair rate), the former question can hardly be tackled without at the same time raising a sharp controversy on the latter.

[1] Assam Legislative Assembly *Debates*, Vol. II, 1938, p. 1,170.

When the question is raised, it is not possible either politically or in equity to resist a demand for sharp reduction. The Ministers, however, had not got any plan ready with which to face or meet the demand when raised. Naturally, they thought best not to attempt any codification in this respect but to confine their remedies to a more liberal policy of remissions effected by executive orders.

In the permanently settled areas also there was a persistent demand for reform. The reform actually carried out generally took two forms:

(*i*) extensive tenancy legislation and regulation of rents;
(*ii*) imposition of an agricultural income-tax.

The present study is not concerned with the first, and the second measure will be discussed in Part IV.

There was also in the permanently settled areas a demand for Government purchase of the proprietory and other rights to land not connected with actual production. The Bengal Land Revenue Commission recommended such a step.

Such a step, however, appears to be of dubious utility for the following reasons:

First, the Commission finds that the ryots are better off in Permanent Settlement areas than in ryotwary areas.[1]

Secondly, a well-devised agricultural income-tax would remove the distributive inequality inherent in the system.

Thirdly, Government purchase of superior interest in land has often been advocated, first, on the ground that it would make Government directly interested in land questions, and secondly in the hope that it would bring in large additional revenues to the treasury.

The first ground can hardly be seriously pressed in the modern age. To assume that the State would take greater interest in the improvement of agricultural production only if it could impose a land tax directly on the cultivators is to take too narrow a view of the scope and functions of the modern State and to lay too much emphasis on the benefit theory of taxation. The functions of a modern State are very wide and it certainly does not depend on benefit taxes only. It steps in wherever it is in the national interest to do so and it imposes a tax wherever it is possible. State-

[1] *The Bengal Land Revenue Commission Report*, Vol. I, paras 202–4 of the Majority Report.

landlordism should not therefore be necessary as an incentive to the State to take greater interest in the improvement of agricultural production.

Again, in estimating the additional revenue which the Government purchase of superior interests in land is likely to produce, the following facts must be kept in view:

(*i*) compensation has to be given;

(*ii*) the scale of operation is gigantic, involving a loan of several times as much as the annual revenue of the Government; [1]

(*iii*) the Permanent Settlement has determined the very structure of society in Bengal and to strike at it may be to strike at the social structure and may lead to financial dislocation.

Hence, a scheme of nationalization, advocated on financial grounds, includes an element of speculation. It is like a gamble which may ruin the country but may bring in some profit also if the ruin can be averted. An agricultural income-tax, properly devised, would bring in almost as much additional revenue to the State without disturbing the social structure and without any element of speculation at all. With an agricultural income-tax in force those who advocate nationalization for reasons of revenue alone would find very little ground for such a policy.[2]

Apart, however, from the question of its desirability, such a step is hardly likely to be feasible in the near future.[3] We need not go

[1] *The Bengal Land Revenue Commission Report*, Vol. I, ¶ 128 of the Majority Report; also Vol. II.

[2] See *The Bengal Land Revenue Commission Report*, Vol. V. Evidence of the Finance Department of the Government of Bengal.

[3] On 15th March, 1943, the Revenue Minister of Bengal announced on the floor of the Bengal Legislative Assembly the following decision of the Government of Bengal:

'(*a*) Government accepted the policy of bringing the actual cultivator into direct relation with Government, and of acquiring, in the first instance, the interests of all classes of rent receivers above the lowest grade of cash paying under-ryots.

(*b*) Rates of compensation to be paid to persons whose interests were acquired should vary between 10 to 15 times the net profit according to the nature and circumstances of each estate as interests.

(*c*) A tribunal of a judicial character should be set up for the assessment of compensation in each case, and that the tribunal's decision should be final.

(*d*) Government should undertake legislation in the matter on these lines as early as possible after going through the technical formalities enjoined under the Government of India Act.

into the question in further detail as, strictly speaking, it is outside the scope of the present study.

It is important to note that land is the biggest single problem in India, whether in the permanently settled provinces or in the temporarily settled provinces. Though there are obvious anomalies and injustice in the taxation of land, it is difficult to tackle the question of taxation alone, without at the same time raising the other questions connected with it, which affect the bulk of the people of every province and also the bulk of the voters. No ready-made solution of the land problem is, however, available, though there is no lack of enthusiasm to do something. Hence, as in the temporarily settled provinces the Ministries contented themselves with a policy of remission of revenue, so in the permanently settled provinces the Ministries could only reduce or limit rents and enact some tenancy laws to grant some additional facilities to the peasants.

(*e*) In view of the financial and other risks involved, State acquisition should first be undertaken on an experimental basis in one district where the revisional operations now going on were almost in the process of completion.'

The experiment, when undertaken, will be watched with the keenest interest particularly with reference to 'the financial and other risks' mentioned in para (*e*). The Ministry, however, resigned soon after the announcement was made and it has not been acted upon yet.

V

TAX ON URBAN PROPERTY

APART from land revenue, there was no Provincial tax levied on urban property before anutonomy. Urban property was, however, taxed at varying rates for local purposes. Bombay was the first province under autonomy to impose a Provincial tax on urban property. The Punjab followed Bombay a few years later.

The Bombay Finance (Amendment) Act, 1939, imposed a tax on the 'annual letting value' of urban immovable property. The tax is known as the Urban Immovable Property Tax and is levied in selected towns which are the bigger towns in the Presidency and are as follows:—

(*i*) The City of Bombay.

(*ii*) The limits of the Municipal boroughs of Thana, Kurla, Bandra and Ahmedabad.

(*iii*) The limits of the Municipal districts of Ville Parle, Ghat Kopar, Kirol and Juhu in the Bombay suburban district.

(*iv*) The notified areas of Malad, Kandivali, Borivali, Chembur and Mulund in the Bombay suburban district, Bhayandar in the district of Thana and Sabarmati in the district of Ahmedabad; and

(*v*) The limits of the Cantonments of Ahmedabad.

The basis of the tax is the annual letting value of the property as determined for the purpose of local taxation.

The municipal authorities are made responsible for collecting the Provincial tax along with their own rates on the same property. In Cantonment areas, however, the Collector of the District collects the tax, as the Provincial Legislature cannot legislate with respect to a Cantonment authority. The local bodies collecting the tax credit the money so collected to Government after deducting as cost of collection an agreed percentage on the sum actually collected. The percentage in the case of each municipality is supposed to represent the actual cost in each case and varies from one to three and a half.[1]

[1] In the case of Bombay Municipality the percentage is two.

The responsibility for paying the tax lies on the owner, if he occupies the property under taxation. If the occupant is a person other than the owner, the responsibility lies on the lessor, superior lessor, or the person in whom the right to let vests, as the case may be.

The original rate of the tax was ten per cent of the annual letting value of the property, i.e. the land and the building standing on it. If, however, the annual letting value of a property did not exceed a fixed sum, the tax was levied at half rate, i.e. at five per cent. This fixed sum has been two thousand rupees in Bombay City and one thousand rupees in other towns.

The tax is thus a surcharge on the local property tax and is collected along with it. It reduces the scope for raising local taxation. It yielded one crore and ninety-eight thousand rupees in 1939-40, and one crore thirty-three lakhs and thirty-eight thousand rupees in 1940-1. [1]

This tax is easy to collect and the cost of collection is small. The entire machinery of assessment and collection existed already for local purposes. As no new machinery had to be set up for the purpose, the tax pre-eminently satisfies the canon of economy.

The tax is one on land and buildings, i.e. on fixed capital, and is restricted to selected localities. In a tax of combined basis of this nature, a struggle must ensue between land and capital in which each will try to throw the burden on the other. Land is obviously more squeezable than capital and ultimately the tax is likely to rest wholly on land.

A tax on rent, as explained already, cannot be shifted. Rent is a differential surplus and is not affected by a tax and as rent does not enter into price, a tax on rent cannot also affect the price of the produce of land. A tax on rent is, however, soon capitalized and its incidence rests permanently on the owner of the land at the time of the first imposition of the tax.

A tax on capital when limited to a particular locality is different. If it cannot earn its current rate of interest in that locality, it will leave that area. Hence by a local tax on capital the return of capital cannot be affected. Hence when the tax is levied on the letting value of the land and capital together, the tax is normally to be borne by land alone. Nobody would build in that area unless

[1] The figures are taken from the Civil Budget Estimates of the Province.

he can get the same return as from capital invested elsewhere or in other lines. Capital can change site but land cannot. Hence the effect of the tax will be to reduce the price of the land by an amount equal to the capitalized value of the whole of the tax.

In the short period, the result will be different. Those who have already built cannot remove the buildings. The supply in the short period is rigidly inelastic. So the tax will reduce the income of present investors. Thus, if any one has taken the lease of a land (say) for forty years, on an agreed rent and has built houses for letting, his expectation of return from the investment will be reduced by the new tax because he cannot reduce the rent payable by him, nor will the rent of the houses increase because of the tax but his expenses will increase on account of the new tax.

The tax may, however, under certain circumstances raise the letting value of houses in the short period because the pressure of the tax on the owners of the houses will act as a pressure for enhancement of rent and if the demand for hired houses is inelastic, as it is likely to be in a big city in the short period, the letting value may easily go up till it is reduced again by capital squeezing land. In a town where there is still scope for extension, the struggle between capital and land soon ensues and land is soon squeezed. But in a city where the scope for further extension is nil or negligible, the question of a struggle between capital and land does not arise except through the question of repair and replacement; and land is not squeezed soon. There, buildings partake of the nature of land and the return from them becomes what is called quasi-rent. If land and the building thereon are generally owned by the same man and are transferred together, the two together merge into 'land' and the joint return becomes rent. There, the incidence is on the owners and the tax will not increase the letting value. But if the land and the buildings are owned by different sets of men, the struggle appears at the end of each lease when capital tries to squeeze land and succeeds only if it has the power to migrate. This mobility may, however, be absent except through the necessity for repair and replacement and in such cases the final adjustment of the incidence as between land and capital will obviously take a long time.

There are thus three factors in the struggle that ensues on the imposition of such a tax. They are land, capital, and the demand for houses. The normal incidence will never be on capital except

in so far as it partakes of the nature of land. The normal incidence is always on land and on capital also in so far as it partakes of the nature of land. In the short period the incidence of a part of the tax may be on the occupiers but that is not likely to be the normal result.

The tax will of course be capitalized, and its permanent incidence will be on the present owners, i.e. those at the time of the imposition of the tax.

It has been suggested that the tax is a drag on house-building enterprise. If the above analysis is correct, the normal incidence of the tax will be on land. Hence in the long run building enterprise will be curtailed only if and in so far as the owners of land find it less profitable to let their lands for building purposes than for other purposes. There is on the outskirts of some cities, land on which market gardens are grown. There must be equimarginal return from lands used for building purposes and lands used for gardening purposes. This margin is likely to be disturbed by the imposition of a tax of the nature of the Bombay immovable property tax. For, if the land is used for building purposes, it must normally bear the full tax levied on the value of the land and the building constructed on it. If, however, the land is used for gardening, it will have to bear a tax on the value of the land only. This disparity will certainly weaken the motive for utilization of land for building purposes, provided that there exists in the city a competition between building and gardening.

As already pointed out, the building societies may have to bear the burden in the short period. A society which has bought pieces of land, developed them and erected buildings on them for the purpose of selling them will immediately, on the first imposition of a tax of this nature, find the value of its property reduced by the full capitalized value of the tax payable on it. The society will here suffer as an owner of land and as an owner of buildings which partake of the nature of land for the time being. In respect of any new enterprise to be undertaken after the first imposition of the tax, the society need not bear any burden of the tax.

Hence, although the tax may have to be borne in the short period by building societies under certain circumstances, it will not affect new enterprise in house-building except in so far as it disturbs the margin between building and gardening uses of lands. In big cities the demand for houses may be so great that the question

of competition between building and gardening use of lands may not exist and may not arise with a ten per cent tax on land and buildings.

The examination of the question of incidence of the tax shows that like land revenue, it is not an equitable levy. It falls at a flat rate on all property owners irrespective of ability to pay. There are very rich property owners and very poor property owners. There are men who own small houses and let out a portion of them for getting a small income—just enough to live up to a minimum standard. The tax does not spare anybody.

The value of immovable property, again, is not a correct measure of a man's ability to pay. As was pointed out by a member of the Bombay Legislative Assembly: 'If a census was taken of people holding property whose income was over Rs 25,000 in the city of Bombay or Ahmedabad, I am sure a majority of the people holding large properties will be those who have invested their money not in immovable property but in other kinds of property.' [1]

But as already pointed out, income derived from immovable property is better able to pay a tax than income derived from other sources. Hence, if there were an exemption limit, there would not have been any objection to the tax. In fact, in the system of Provincial taxation, as it is today, it would have been one of the best taxes. The analogy of local taxation as an argument against an exemption limit is not a good one in view of the fact that local taxation is spent for the benefit of the property taxed while the Provincial taxation is spent for general purposes. [2]

This tax should not be taken to be a tax on unearned increments of land. Though an attempt has been made to confine the tax to such towns in which unearned increments have been considerable, it is clearly not a tax on such unearned increments. It is a tax on the entire letting value. It does not care to distinguish between how much is earned and how much is unearned. It does not care to distinguish between how much is rent of land and how much is return of capital invested. The disregard of such considerations certainly simplifies the administration of the tax and lowers

[1] *Official Debates*, Vol. V, p. 1058.

[2] In the Punjab the tax is not levied on buildings and lands the annual value of which does not exceed Rs 300 in the rating areas of Lahore and Simla and Rs 240 in other areas. This is a distinct improvement on the Bombay measure.

the cost of collection to a very small figure but at the same time increases its injustice. The canon of ability has got to be sacrificed here to some extent in favour of the canons of certainty, economy and convenience.

The tax is a direct attack on a municipal source of revenue. The property tax has been the mainstay of municipal finance. To appropriate it for provincial purposes severely restricts the expansiveness of municipal revenue and may seriously affect municipal activities. This point of view was clearly expressed by a member of the Bombay Legislative Assembly, during the debate on the Bill.

Speaking of the Thana Municipality he says:

'The first and the greatest need of the Municipality is of water supply. . . . . They thought of having a water work . . . . . learnt that water could be made available to them from the Ambernath Water Works. The Municipality naturally expected that it could . . . . . increase this tax when this water would be available to them; but now suddenly it finds that this tax has been increased by ten per cent without any kind of provision for water supply to them. That means the Municipality will be debarred for a certain number of years at least from providing their necessary amenities. It was said that the Municipality might raise other taxes and the other tax proposed was the professional tax. It is not possible to have a large revenue from any other tax so far as the Thana Municipality is concerned.' [1]

The Finance Minister in replying to the argument said:

'I do not know whether a provincial taxation can be objected to because a particular Municipality is not able to provide the necessary amenities for its citizens. They must find some other ways. At any rate it is not a reason why they should object to a measure which is intended to serve the whole province. If there are any difficulties in Kalyan and Thana, they must be placed before Government who will consider them in due course.' [2]

The case for the municipality is very well put. It is clear that the Finance Minister has not been able to meet the argument. Because the province is bigger than the municipality, it does not follow that the province can appropriate to itself the municipal sources of revenue. In both cases, it is a question of balance between growing expenditure and revenue. If municipalities have

[1] *Official Debates*, Vol. V, p. 1062.
[2] *Official Debates*, Vol. V, p. 1129.

to perform certain duties, they must have adequate revenue. Anything that impairs the adequacy of that revenue also impairs the capacity for work of the municipalities and thereby impedes progress. To say that a municipality must not protest because the province wants it is simply to evade the issue. In the last sentence of the Finance Minister's speech, there is a hint that the municipalities could come up for a grant-in-aid from Government. Grants-in-aid play a much larger part in municipal finance in England than in this country. The opinion is also held in certain quarters that the grant-in-aid system is a more satisfactory system of local finance. But the Finance Minister did not in his speech express any willingness to take that responsibility on Government and the taxation was expressly intended for provincial purposes and not for substituting local taxation by a system of grants-in-aid. So such an answer is not appropriate to the objections taken.

It was also stated that though the municipality of Bombay had been given by the Statute the right of levying a rate varying from eight to seventeen per cent, the municipality had not actually levied a rate higher than twelve per cent on any occasion and that the present rate was only eleven per cent. It would obviously be a wrong inference from this that the municipality did not require more revenue. The untapped portion is a reserve which ensures the expansiveness of the revenue which is essential for a progressive municipality. To appropriate any part of that reserve strength for provincial purposes is to weaken the reserve and to impair the expansiveness of the revenue and therefore to hinder progress.

If the Province adopts a policy of forbearance and adjusts its demands to municipal requirements, and if the two taxes together do not impose on property a greater burden than it can or ought to bear, there need not be, in theory, any objection to such double taxation of property. But such forbearance is not likely and as this is the mainstay of municipal finance, the municipalities are likely to be handicapped by a policy of double taxation. Moreover, as the municipal commissioners are directly responsible to the citizens of the town whereas the Provincial Government look for support to a much wider public, among whom the townsmen are a negligible factor, it is the municipalities which will generally have to adjust their demand to the size of the provincial levy. That may prove to be a serious handicap to municipal progress.

PART IV

TAXES ON PERSONS

I

AGRICULTURAL INCOME-TAX : ITS BASIS

IT is common knowledge that the first and the second Income-Tax Acts in India, which were in force for the periods 1860-5 and 1869-73 respectively, applied equally to agricultural and non-agricultural incomes and that the third Income-tax Act of 1886 for the first time drew a distinction between the two classes of income and exempted the former.[1] The Government of India Act, 1935, debarred the Central Government from imposing a tax on agricultural income and empowered the Provincial Governments to impose a tax on it.

Bihar was the first province under autonomy to impose a tax on agricultural income (1938-9), and was followed, a year later, by Assam. On 2nd September, 1941, the Government of Bengal published a Bill to impose a tax on agricultural income but allowed it to lapse. The Bill was republished on 21st August, 1943, and is at its final stages of enactment at the time of writing.[2] In provinces other than Bihar, Assam and Bengal, agricultural income is still exempt from taxation.

The basis of the tax in Bihar, Assam and Bengal is agricultural income as defined in the Indian Income-tax Act.

Item 41 of the Provincial Legislative List in the Seventh Schedule to the Government of India Act, 1935, empowers Provincial Governments to impose 'a tax on agricultural income'. Section 311(2) of the same Act defines Agricultural income thus:

'"Agricultural income" means agricultural income as defined for the purposes of the enactments relating to Indian income-tax;'

The counterpart of item 41 of the Provincial Legislative List is item 54 of the Central Legislative List which empowers the Central Government to impose 'taxes on income other than agricultural income'.

The effect of the two items in the two Lists read with the definition of agricultural income in section 311(2) of the Government of

[1] See Report of the Indian Taxation Enquiry Committee, ¶¶ 257—271.

[2] The Bill has since been enacted and enforced with effect from the 1st April, 1944.

India Act, 1935, is that no Government in India can levy a comprehensive income-tax. The Central Government must confine themselves to non-agricultural income leaving agricultural incomes to be taxed by the Provincial Governments if and when they so desire. Bihar, Assam and Bengal are the only three provinces which have up to now chosen to tax agricultural incomes. In these three provinces there are now two income-tax measures operating simultaneously and independently of each other. They are, however, not rivals but complementary: they operate in mutually exclusive fields.

The situation of the land is important in the definition of agricultural income. The land from which agricultural income is derived must be assessed to Land Revenue in British India or subject to a local rate assessed and collected by officers of the Crown as such. Thus income derived by agriculture from land in the United Kingdom or in Burma or in an Indian State is not agricultural income within the meaning of the Indian Income-tax Act and such income received by an Indian in India will be taxable not by the provinces but by the Centre.

Though the definition of agricultural income must be the same as in the Indian Income-tax Act, this source of provincial revenue has not been left entirely to the discretion of the Central Legislature. The provinces have been protected against any encroachment of the Central Government on this source of revenue by section 141 of the Government of India Act, 1935, which enacts:

'No Bill or amendment....which varies the meaning of the expression "agricultural income" as defined for the purposes of the enactments relating to Indian Income-tax....shall be introduced or moved in either Chamber of the Federal Legislature except with the previous sanction of the Governor-General in his discretion.'

The legal implications of the definition are many and have been the subject of innumerable judicial decisions. They are outside the scope of the present study.

Apart from the question of the scope of the term agricultural income or, given a particular meaning of that term, it is necessary to determine the full extent or scope of the concept of a 'tax on agricultural income' as occurring in item 41 of List II to the Seventh Schedule to the Government of India Act. This is a question of constitutional law rather than of economics. But as public finance must operate within the limits of the constitution, it is a question

of outstanding importance to the practical statesman and financier under a rigid constitution.

The tax must be imposed on agricultural income. Income is necessarily related to a person. There are various stages in the relationship between a person and his income. Income accrues to a person, it is received by him, it is enjoyed by him.

As accrual, receipt and enjoyment are three successive stages in the development of the relationship between a person and an income, it follows that the subsequent stages presuppose the earlier stages but not vice versa. Income accrued has, therefore, the widest scope and income enjoyed has the smallest scope. The largest amount of income that can be related to a man is that which accrues to him.

As at the one end income is related to a person so at the other end it is related to its source which, in the case of agricultural income, must be land or buildings connected with such land.

Thus income has got two correlatives—one subjective and the other objective. The subjective correlative is the person to whom the income accrues or by whom the income is received or enjoyed. The objective correlative is the source from which the income is derived.

Now, the two correlatives of an income may not always be in the same taxing jurisdiction. The source may lie in Assam but the person related to that income may reside in Bengal. The source may lie in Burma or Java or an Indian State but the person related to that income may live in British India. In the case of agricultural income, however, as at present defined, the question of international juxtaposition may arise only in one way. By definition, agricultural income derived from land not assessed to land revenue in British India is not 'agricultural income'. The source of agricultural income cannot therefore be outside India. The question of international juxtaposition can arise only when the source is in India and the person entitled to the agricultural income is outside India. But the source of and the person entitled to an agricultural income may and often do lie in different provinces of British India.

The Indian Income-tax Act which is based on item 54 of the Central Legislative List, viz. 'taxes on income other than agricultural income', taxes all income of which either of the two correlatives is in British India, and in case of the subjective correlative the largest scope is given to the term by bringing in the accrual concept. Under

section 4 of the Act, if a person is resident in British India, any income *accruing or arising* to him shall be chargeable to tax irrespective of whether it *accrues or arises in British India or without British India*; i.e. all the British Indian income as well as all the foreign income of such a person is liable to tax. If, however, a person is not resident in British India only his British Indian income shall be taxable; but even in this case, under section 17 of the Indian Income-tax Act, his total world income is under certain circumstances taken into consideration for the purpose of determining the rates of taxation.

Entry 54 of the Central Legislative List is thus wide enough

(*a*) to authorize the taxation of incomes of which either the subjective or the objective correlative is in the jurisdiction of the taxing authority;

(*b*) in case of the subjective correlative, to authorize the taxation of the largest amount of income that can be connected with it through the accrual concept; and

(*c*) in case of non-residents, to authorize the taking into consideration, for purposes of determining the rates, those incomes of which neither of the two correlatives is in the jurisdiction of the taxing authority.

By a parity of reasoning, item 41 of the Provincial Legislative List is wide enough

(*a*) to authorize the taxation of agricultural income of which either of the two correlatives is within the taxing province;

(*b*) in case of the subjective correlative, to authorize the taxation of the largest amount of agricultural income that can be connected with it through the accrual concept; and

(*c*) to authorize the taking into consideration, for purposes of determining rates, those incomes of which neither of the correlatives is within the taxing province, i.e. the total world income. This is really indicative of the right to introduce any extraneous consideration for the purpose of determining the rates.

On these three points the three Provincial Legislatures which have passed an Agricultural Income-tax Bill have provided as follows:

(*a*) The tax is imposed on the basis of origin and not on the basis of residence. All agricultural income which has its origin in the province is taxed irrespective of whether the recipient is a resident of the province or not. Agricultural income received by

a resident of the province from land in another province is not taxed.

(*b*) Secondly, the tax is imposed on the basis of receipt and not on the basis of accrual. Only agricultural income actually received by the assessee during the year of assessment is taxed irrespective of the date of its accrual and irrespective of the amount of agricultural income accrued to him during the same period.

(*c*) The total world income is taken into consideration for one purpose only, namely the determination of the amount of refund admissible to a shareholder of a company the agricultural income of which has been taxed at the maximum rate. This will be explained more fully in chapter IV.

The second point is subject to one important exception. No independent computation of the agricultural income of tea gardens is made by the provincial officer. As it is difficult to make a separate computation of the non-agricultural income of a tea garden, the Central Income-tax Department compute the whole of its income according to the provision of the Indian Income-tax Act and impose the central tax on forty per cent of the income so computed, leaving sixty per cent untaxed as agricultural income. The provincial offices accept the said assessment and impose the provincial tax on the amount so left untaxed by the Centre. Thus here the computation really takes place according to the provisions of the Indian Income-tax Act which has adopted the accrual basis of income.

Whether income received is a better or worse measure of the faculty of the recipient than income accrued is a controversial question into which we need not enter.

We now come to the question of the implications of the division of the basis as between the Centre and the provinces.

The first implication is that 'a person whose income from agricultural and non-agricultural sources was just below the limit in either case, would escape assessment altogether'.[1] This is the only implication noticed by the Bengal Land Revenue Commission but there are others equally or more important.

Persons who pay both the Central income-tax and the agricultural income-tax get off lightly because income in their hands is treated as two separate incomes. Thus in Assam, today, a man

[1] *Report of the Bengal Land Revenue Commission*, 1938–40, Vol. I, ¶ 135.

who has an agricultural income of Rs 15,000 and a non-agricultural income of the same amount will pay tax as follows:

Agricultural income	Non-agricultural income	Rate	Amount payable
First Rs 1,500	First Rs 1,500	Nil	Nil
Next Rs 3,500	Next Rs 3,500	Nine pies in the rupee	Rs 164- 1×2
Next Rs 5,000	Next Rs 5,000	One anna three pies in the rupee	Rs 390-10×2
Next Rs 5,000	Next Rs 5,000	Two annas in the rupee	Rs 625- 0×2
Rs 15,000	Rs 15,000	= Rs 30,000	TOTAL .. Rs 1,179-11×2 = Rs 2,359-6.

But a man receiving the same amount of income from non-agricultural sources only or, if both the agricultural and non-agricultural income of the same man were taxable under the same Act, i.e. the Central Income-tax Act, he would have paid tax as follows:

Slabs	Rate a. p.	Amount payable
First Rs 1,500	Nil	Nil
Next Rs 3,500	0 9	Rs 164- 1-0
Next Rs 5,000	1 3	Rs 390-10-0
Next Rs 5,000	2 0	Rs 625- 0-0
Next Rs 15,000	2 6	Rs 2,343-12-0
Rs 30,000		Rs 3,523-7-0

Thus the amount payable under the single basis is Rs 3,523-7-0 as against Rs 2,359-6-0 under the divided basis, i.e. the former is fifty per cent more than the latter. This calculation does not take into consideration the supertax which is now levied only in the case of the Central Income-tax.

Assuming that the Centre and the Provinces imposed the tax at the same rates and had the same exemption limit, the following effects would follow from the division of the base:

(*i*) Persons deriving their income from one source only, i.e. either agricultural or non-agricultural would not be affected by the division of the base.

(*ii*) In the case of persons having mixed incomes—

(*a*) those who have large incomes under both heads and are taxed under each head get off lightly;

(*b*) Many men are altogether exempted either on both heads or on one though their total income may be above the exemption limit; and

(*c*) the division of the base does not concern persons whose total income from both sources does not reach Rs 2,000.

Thus the division of the base has the effect of hindering progression and introducing inequality in the taxation system of the country. It favours the richer section of the community, having mixed incomes, but has no effect on the poorer section or persons deriving their income from one source only. The division therefore creates a discrimination in favour of a particular class.

Thus in the case of a tea company making a net profit of Rs 25,000 a year, Rs 10,000 only will be considered to be non-agricultural income and the balance of Rs 15,000 will be considered to be agricultural income. When the rates under the two Acts are equal as in Assam, such a company would pay—

Income tax ..	..	Rs 554-11-0
Agricultural income-tax	..	Rs 1,179-11-0
		Rs 1,734- 6-0

A company dealing with, say, the manufacture of jute which derives the same amount of net income, namely Rs 25,000 a year will, however, have to pay a tax of Rs 2,742-3-0.

The difference between the two sums of Rs 1,734-6-0 and Rs 2,742-3-0 is a measure of the inequality involved in the system.

II

AGRICULTURAL INCOME-TAX

AN EXAMINATION OF THE RATES OF TAXATION WITH REFERENCE TO THE DOCTRINE OF PROGRESSION

(*a*) *The different parts of the Central Income-Tax*

WHEN Bihar introduced the Agricultural Income-Tax Bill in 1938, the Indian income-tax was still being levied on what was called the 'step' system, i.e. a uniform rate applied to the total income of a person, the rate increasing by steps as the total income increased. When Assam introduced her bill next year, the Indian income-tax had already changed over to the slab system, i.e. different rates applied to the different slabs of the total income of a person, rates rising with the slabs.

Both under the old Act (i.e. the pre-1939 Act) and the new, the central income-tax has consisted of three parts, namely:

(*i*) A basic tax applying to individuals. This is called the income-tax.

(*ii*) A supertax on individuals which is nothing but 'an additional duty of income-tax' [1] on higher ranges of their incomes.

(*iii*) A supertax on companies.

On companies a tax is also levied at the maximum rate of the basic tax. This tax is supposed to be paid by the companies on behalf of the shareholders who, if their total income would not justify the maximum rate, can apply for and get refund on the basis of their total income. Thus though the tax is collected from the company and at the maximum rate, it is ultimately paid by the shareholders in their individual capacities and the rate is also adjusted on the basis of their individual incomes; and the Act provides machinery by which this transfer and the adjustment can be made.

To the general statement made above there is a small exception. The exception arises with regard to that portion of the profits of

[1] *Vide* Sec. 55 of the Indian Income-Tax Act.

a company which is not distributed to the shareholders but is credited to the reserve fund or some other fund of the company. The tax deducted on account of the undistributed profits, of course, ultimately affects the shareholders but there is no machinery in the Act by which this portion of the tax can be adjusted according to the individual capacity of the shareholders. Barring this small exception the tax on the companies (other than the supertax) is nothing but a tax on individuals.

The distinction between the supertax on individuals and the basic tax on individuals is also artificial. The Act itself calls the supertax an additional duty of income-tax. It only means that when the income exceeds a particular amount, an additional tax has to be paid which again is graduated. This is nothing but an augmentation of the basic tax on higher ranges of incomes and steepening the graduation on the higher ranges.

The supertax on companies is, however, quite distinct in character. Economists would not call it an income-tax at all. Economic welfare has reference to natural persons only and not to fictitious legal persons. When Adam Smith enunciated the faculty theory, he obviously referred to the faculty of individuals or natural persons; for it is with reference to natural persons only that utility or ability or welfare can be thought of. The income-tax is called the ideal tax because it is related to the ability of individuals, which again is measured by their incomes. A company has got only a legal personality and a tax on the company as such does not affect the individual welfare of all the shareholders in the same way because the shareholders may belong to all stages of poverty or wealth. The amount of profit made by a company has no necessary relation to the wealth or poverty of the shareholders. To tax a company as such is to affect the shareholders, not in relation to their individual ability to pay, but in proportion to their interest in the company. Hence the justification for a tax on a company must be quite different from the justification of an income-tax.

A company enjoys a number of advantages under the law. The right of incorporation, which is a creation of the law, confers many advantages. A group of persons incorporating as a company can claim a separate personality, can collect and borrow money with limited liability and enjoy a number of other advantages in respect of acquisition, transfer and ownership of property. These advantages are created by the State.

Now if there are two groups of individuals, one group doing business in their individual capacities and the other doing business as a company, it would be unfair to treat both groups equally in respect of taxation, because the law is conferring definite benefits, having money value, on the latter group. If the State is conferring special benefits, having money value, on a particular group, it would also be equitable to levy a special tax on that group. The supertax on companies is such a special tax. Economists often call it a privilege tax.

If it is a tax on the privilege of incorporation, no company, however small, need be exempted from this tax. The Taxation Enquiry Committee of 1924-5 observed: [1]

'If the tax is recognized as a corporation profits tax, it becomes clear that the exemption limit of Rs 50,000 is illogical. Small companies derive relatively as much advantage as large ones from the privilege of incorporation, and the amount of profit made by a company bears no necessary relation to the wealth or poverty of its shareholders. It is recommended therefore that the present exemption limit, which seems to have been based on a false analogy, should be abolished.'

The Income-Tax Enquiry Committee, 1936, also strongly favoured the acceptance of this recommendation. [2]

The exemption limit in the case of supertax was accordingly removed by the Indian Income-Tax Amendment Act of 1939.

Similarly, in the case of a privilege tax, there is no scope for graduation or progression. Graduation or progression is a practical application of the faculty theory of taxation. But as the tax is not based on the faculty theory, graduation is out of place here. This is simply because the income of a company has no necessary relation to the incomes of the shareholders; there may be poor shareholders in a big company and rich shareholders in a small company. The graduation of the supertax on companies under the previous Income-tax Act was based on a false analogy. The removal of the graduation under the present Act, together with the abolition of the exemption limit, is a recognition of the fundamental distinction between an income-tax and the supertax on companies.

Now if the tax is a tax on the privilege derived from the right to incorporate, the best place at which to levy the tax is the company

[1] *Report*, p. 203.

[2] *Report*, p. 18.

itself, i.e. on its fictitious personality which is created by law. If money invested through a company is likely to derive some additional advantages having money value, it is only equitable that the yield of that investment should be taxed before it is distributed to the owners of that money. The State which conferred the additional advantages can in equity claim a share of the money value of those advantages. This is the basis of the supertax on companies which is called the corporation tax.

Thus the Central Income-Tax practically levies two taxes. One is an income-tax, pure and simple. The basic tax on individuals, the supertax on individuals and the basic tax at the maximum rate on the companies, all came under this category. They are all directly or indirectly correlated to the incomes of individuals and are based on the faculty theory of taxation. An exemption limit and progression are the essential features of such a tax.

The other is not an income-tax at all. It is a corporation tax or a privilege tax, levied on corporations on account of the special advantages which are conferred on them by law. The fact that it is correlated to the profits of the corporations does not make it an income-tax based on the faculty theory of taxation, as it has no relation to the income of individuals. An exemption limit or progression is out of place in such a tax.

(*b*) *Rates of Agricultural Income-tax on individuals*

Assam has got the same basic rates as in the Central Income-tax Act. It is based on the slab system and the slabs as well as the basic rates on each slab are exactly the same as in the Central Income-tax Act. No supertax, however, is imposed on individuals and the exemption limit is at Rs 3,000.

The Bihar Bill, when introduced in the Legislature, contained rates based on the then prevailing Central rates, but the exemption limit was Rs 5,000. Paragraph 3 of the statement of objects and reasons ran as follows:

'Rates of agricultural income-tax in respect of incomes above Rs 5,000 and less than Rs 30,000 are proposed at the same rates as those fixed in the Indian Income-tax Act, 1922. The rates for incomes over Rs 30,000 are higher than those in the Indian Income-tax Act, but as no provision is made for the levy of supertax on agricultural income, the actual tax payable on agricultural income above Rs 30,000 is in all cases smaller and in the case of higher

incomes considerably smaller than the tax (taking income-tax and supertax together) payable under the Indian Income-tax Act on other incomes of a similar size.'[1]

Thus the rates in the original bill were the then prevailing basic rates of the Central income-tax plus a part of the supertax imposed on individuals under the Central Act. No separate supertax was provided for. It was announced with some satisfaction in the paragraph quoted above that the higher incomes were dealt with very lightly.

The effective rates on individuals under the Indian Income-tax Act are obtained by adding up the basic tax and the supertax imposed on them. The effective rates are as follows:

	Rs	Rate per rupee
First	1,500	nil
Next	3,500	-/-/9 pies
Next	5,000	-/1/3
Next	5,000	-/2/-
Next	10,000	-/2/6
Next	10,000	-/3/6
Next	20,000	-/4/6
Next	70,000	-/5/6
Next	75,000	-/6/6
Next	150,000	-/7/6
Next	160,000	-/8/6
Balance		-/9/6

People with incomes of Rs 2,000 or below are exempt.

Do the figures given above satisfy the requirements of a correct progression? It is a difficult question. The rates are, however, examined below with reference to certain principles of progression.

In this country no table or graph of diminishing utility of money has been attempted to be drawn. But the following principles may be postulated:

(*i*) Up to the subsistence level of income the marginal utility of money is very great—almost infinity.

(*ii*) As soon as the bare necessities of life are found there is still a stage at which the marginal utility of money remains very great, though it begins to diminish at a slow rate.

[1] *The Bihar Gazette*, Dec. 15, 1937, Part V, p. 156.

(*iii*) A third stage is then reached after which the marginal utility begins to diminish at a sharply falling rate. This stage starts after the necessities for a decent existence and some comforts have been found and the man feels that he has a few luxuries in his life. This stage of sharply diminishing utility extends over a wide range of income.

(*iv*) In the fourth stage the rate of diminution declines. From necessities to comforts and from comforts to luxuries are big jumps. But when most of the common luxuries are found, the change over to newer luxuries or additional luxuries does not mean any such big jump.

(*v*) After a certain stage, i.e. in the fifth stage, the marginal utility of money becomes almost stationary, however much the income may increase. It is low but it never becomes zero.

It is thus possible to distinguish between five stages generally:

(*i*) The stage of infinite utility;
(*ii*) The stage of very high marginal utility, though slowly diminishing;
(*iii*) The stage of a sharply diminishing marginal utility;
(*iv*) The stage of low and slowly diminishing marginal utility;
(*v*) The practically stationary stage with a low marginal utility.

In the case of a tax based on the faculty theory the first stage of infinite marginal utility must be exempt. A large part of the second stage also ought to be exempt, if possible. In a country like ours, with a low standard of living, the exemption limit at Rs 2,000 probably satisfies this test. The limit is certainly beyond the first stage and lies in the earlier portion of the second stage.

The taxation starts at nine pies in the rupee. The slab which is taxable at that rate is also in the second stage of high marginal utility and it is correctly taxed at a low rate.

As a man's income goes beyond Rs 5,000 a year, he does not at once go into the third stage. The whole of the next slab, i.e. the third slab, is also probably in the second stage. The third stage starts probably with the fourth slab, i.e. only when the income exceeds Rs 10,000. The third stage, as stated, must cover a wide range of incomes and it is not passed until at least an annual income of Rs 50,000 is reached. If the fourth stage begins there, the stationary stage is probably not reached till an income of about Rs 5 lakhs is exceeded.

The stages according to this analysis will be as follows:

The first stage of infinite utility ..	up to Rs 2,000
The second stage of slowly diminishing high marginal utility	Rs 2,000—10,000
The third stage of sharply diminishing utility	Rs 10,000—50,000
The fourth stage of slowly diminishing low marginal utility	Rs 50,000—5,00,000
The fifth stage of practically stationary utility	Beyond Rs 5,00,000

The limits or the starting points of the stages have obviously been fixed arbitrarily. They are more illustrative than accurate and indicate the general tendency.

It is thus correct, according to the principle of progression, that the rate of taxation does not increase after the income has exceeded Rs 5,10,000. This also removes the general objection against the income-tax that it reduces savings and therefore hampers the maintenance or increase of capital in society. It is the men in the fifth stage who save most and therefore contribute most to the maintenance and increase of capital which maintains and augments the productive power of society. Hence though the marginal utility of money to the men in the fifth stage is low, its utility to society is high. From this point of view taxation ought not to increase at that stage.

It is also correct according to the theory of progression that the size of each slab increases considerably after the income exceeds Rs 50,000. This is a recognition of the principle that in this stage the marginal utility of money is low and diminishes slowly.

The following comments are possible on the rates of taxation in the third, fourth, fifth and the sixth slabs according to the principles laid down above:

From the second to the third slab, the increase in the rate is by	6 pies
From the third to the fourth slab, the increase in the rate is by	9 pies
From the fourth to the fifth slab, the increase in the rate is by	6 pies
From the fifth to the sixth slab, the increase in the rate is by	12 pies

The third slab is in the second stage where the marginal utility diminishes slowly. Hence an increase only of 6 pies from the second to the third stage seems justifiable.

The fourth, fifth and the sixth slabs are all in the third stage of sharply diminishing utility. Hence the increase of nine pies from the third to the fourth slab also seems justifiable. But a sudden reduction in the rate of increase when passing over from the fourth to the fifth slab is hardly justifiable. That the rate of increase again mounts up in the sixth slab seems to be in order.

A more correctly correlated table of rates on these slabs would have been as follows:—

	Proposed rate	The amount of increase on the tax on the previous slab
Second slab	9 pies	..
Third slab	-/1/-	3 pies
Fourth slab	-/1/6	6 pies
Fifth slab	-/2/3	9 pies
Sixth slab	-/3/3	-/1/-
Seventh slab	-/4/6	-/1/3

The rates on the remaining slabs need not be disturbed.

It may be noted that these remarks have nothing to do with the pitch of the rates. They relate only to the correct correlation of the rates. The rates could be increased or reduced without disturbing their correct correlation.

The following conclusions emerge from the analysis:

(*a*) The exemption limit at Rs 2,000, the spreading out of graduation over such a wide range, i.e. from the income level of Rs 2,000 to the income level of Rs 5,10,000, and the stoppage of further graduation after that level, satisfy the tests of a correct theory of progression.

(*b*) The rates on the different slabs within the range of graduation are also correctly correlated except that there is no justification for the sudden drop in the rate of increase on the fifth slab.

This analysis of the rates of the central income-tax indicates the principles according to which the rates can be correctly graduated. The pitch of taxation is always determined by other considerations of which the necessity for revenue is the most important. But given a particular pitch of taxation or given a particular size of the revenue required, the rates may be graduated and correlated in

various ways. This discussion indicates the methods of determining the best correlation according to the principle of progression. The rates of agricultural income-tax imposed in Bihar and Assam and proposed in Bengal are examined below according to that method.

The Bihar rates of agricultural income-tax are as follows:

The rates follow the 'step' system and the same rate applies to the whole of the income.

	Rate
When the total agricultural income exceeds Rs 5,000 but does not exceed Rs 10,000	six pies in the rupee
When the total agricultural income exceeds Rs 10,000 but does not exceed Rs 15,000	seven pies in the rupee
When the total agricultural income exceeds Rs 15,000 but does not exceed Rs 20,000	eight pies in the rupee
When the total agricultural income exceeds Rs 20,000 but does not exceed Rs 30,000	ten pies in the rupee
When the total agricultural income exceeds Rs 30,000 but does not exceed Rs 40,000	twelve pies in the rupee
When the total agricultural income exceeds Rs 40,000 but does not exceed Rs 75,000	fifteen pies in the rupee
When the total agricultural income exceeds Rs 75,000 but does not exceed Rs 1,00,000	eighteen pies in the rupee
When the total agricultural income exceeds Rs 1,00,000 but does not exceed Rs 1,50,000	twenty-two pies in the rupee
When the total agricultural income exceeds Rs 1,50,000 but does not exceed Rs 2,50,000	twenty-four pies in the rupee
When the total agricultural income exceeds Rs 2,50,000 but does not exceed Rs 5,00,000	twenty-six pies in the rupee
When the total agricultural income exceeds Rs 5,00,000 but does not exceed Rs 10,00,000	twenty-eight pies in the rupee
When the total agricultural income exceeds Rs 10,00,000 but does not exceed Rs 15,00,000	twenty-nine pies in the rupee
When the total agricultural income exceeds Rs 15,00,000	thirty pies in the rupee

The exemption limit of Rs 5,000 is obviously too high.

Up to Rs 20,000 the rise is slow. It is one pie in the rupee for each advance of Rs 5,000. Between Rs 20,000 and Rs 40,000 the rate of rise is double and the intervals are also double, i.e. the rise is two pies in the rupee for each advance of Rs 10,000. This is as it should be.

From Rs 40,000 upward, the rise takes place at longer intervals. From Rs 40,000 to Rs 1,00,000 the rise is by three pies in the rupee. These increases seem to be adequate.

Between Rs 1,00,000 and Rs 1,50,000 the rates rise still further but the rate of rise begins to drop gradually after this point. There is no rise after the income has exceeded Rs 15,00,000.

The tendencies in the rates seem to be in the right direction, though it may be stated that the rate of increase might have begun to drop at an earlier stage.

The other criticism is that the maximum rate is placed at too high a stage which is the same thing as saying that graduation is carried too far. But as the maximum rate is low and as graduation is very mild, there is not much objection to this. The pitch of taxation is of course very low in Bihar.

The Assam rates are:

(Assam follows the slab system)

		Rate
The first slab of	Rs 1,500	Nil
The next slab of	Rs 3,500	.. 9 pies in the rupee
,, ,, ,, ,,	Rs 5,000	.. -/1/3 ,, ,, ,,
,, ,, ,, ,,	Rs 5,000	.. -/2/- ,, ,, ,,
The balance		-/2/6 ,, ,, ,,

The exemption limit is Rs 3,000.

The fault here lies in exactly the opposite direction; the graduation stops too early and the maximum rate is placed too early.

The exemption limit at Rs 3,000 is also probably too high.

The Assam table follows exactly the Central table in its basic rates. The chief argument used in support of this table is that it follows the Central rates and therefore stands for equality of treatment for agricultural and non-agricultural incomes. This argument has been made much of but it is misleading.

The basic rates of the central tax, as has been stated above, are accompanied by the supertax. The supertax is nothing but an extension of the basic tax. The fact that they are given different names does not alter their character. The difference in the name is a matter of history and administration.

Now if the basic rates are retained without the supertax, the entire balance is destroyed because lower incomes are taxed very heavily while higher incomes are taxed very lightly. The basic rates in the Central Act are correlated to very high rates in the upper ranges but if the rates in the upper ranges are not adopted, there is obviously no justification for adopting the rates in the

lower ranges which are correlated to those high rates in the upper ranges. The result is hard on lower incomes and lenient to higher incomes. The result can be seen by an analysis of the rates themselves.

The maximum is reached as soon as the income exceeds Rs 15,000. Though after this point marginal utility diminishes very sharply at least up to Rs 50,000 and less sharply from then till about Rs 5,00,000, the rate does not increase at all. This is unjustifiable leniency towards the higher incomes.

Secondly the graduation is very steep in the lower stages. The maximum is reached in the course of four slabs only, none of which is bigger than Rs 5,000. This is unfair to the lower incomes.

It has often been stated that on account of the omission of the supertax the rates are very much more favourable to the recipients of agricultural incomes than the Central rates are to recipients of non-agricultural incomes. But the argument by classes is very misleading in the science of taxation. The rates are no doubt very favourable to the rich receiving net agricultural incomes of Rs 10,00,000 or Rs 15,00,000 a year but they are equally severe on persons in receipt of agricultural incomes up to Rs 25,000 only. The favourable treatment of the rich does not benefit the poorer men of the same class, however much it may be proclaimed that the class, as a whole, is getting off lightly. The way in which the favour is being distributed within the class is only creating another injustice in the matter of distribution of the tax burden. In fact the rates are absolutely out of balance.

This criticism, it may be pointed out again, has nothing to do with the pitch of taxation. It does not say that the revenue which this tax is being made to yield is too high and should be lowered. It only says that the same amount of revenue could be raised from the recipients of agricultural income by a more equitable distribution of the tax burden within the class and that the way in which it has been actually distributed by the present Act is unjust. The argument that the rates follow or are more favourable than the Central rates is a half-truth.

Bengal follows the slab system. The rates are:

	Rate
First Rs 1,500 ..	Nil.
Next Rs 3,500 ..	Nine pies in the rupee.

	Rate
Next Rs 5,000 ..	One anna in the rupee.
Next Rs 5,000 ..	One anna and six pies in the rupee.
Next Rs 5,000 ..	Two annas in the rupee.
Balance ..	Two annas and six pies in the rupee.

The exemption limit is at Rs 2,000.

It will appear:

(*a*) that there is one more slab than in Assam.

(*b*) that the minimum and the maximum rates are the same as in Assam.

(*c*) that the graduation, therefore, is slightly less steep and the maximum rate applies to incomes in excess of Rs 20,000 and not to incomes in excess of Rs 15,000 as in Assam.

(*d*) that the rate on each of the earlier slabs except the first and the second is also slightly lower than in Assam.

The criticism applicable to the Assam table applies equally to the Bengal table though it has slightly extended the limit of graduation. Here also the maximum is reached too early and therefore the graduation on the lower incomes is too steep. The rates therefore treat higher incomes too leniently and the lower incomes more severely. Here also, therefore, the rates are out of balance. Though it is an improvement on the Assam table, the improvement is only slight. The Bengal rates are also slightly lower than the Assam rates. It should be reiterated that the criticism has nothing to do with the pitch of the rates. There is nothing unjust in the desire of the Government of Bengal to raise this sum or even a larger sum from the recipients of agricultural income. What is unjust is the way in which the burden has been distributed. The Government has been too lenient with the richer men of the class and therefore too hard on the poorer men of the class. It is no reply to the criticism to say that they have treated agricultural incomes as a whole much more leniently than non-agricultural incomes. It is no consolation to the poorer man to feel that the richer members of his class are getting favourable treatment.

It must be recognized that it is impossible to fix exactly correct limits of slabs. It is therefore not worth while quarrelling over that point, i.e. whether a slab will begin at Rs 50,000 or Rs 55,000. Subject to this remark, the following principles of graduation may be laid down:

(*a*) The exemption limit should be at Rs 2,000.

(*b*) The graduation between Rs 2,000 to Rs 10,000 should be slow.

(*c*) The graduation between Rs 10,000 and Rs 50,000 should be sharp.

(*d*) The graduation between Rs 50,000 and Rs 5,00,000 should again be slow.

(*e*) Graduation should stop after Rs 5,00,000. But if the maximum rate is low, graduation may continue higher, till (say) Rs 10,00,000 or Rs 15,00,000.

According to these principles, the exemption limit is too high in Bihar, Bengal and Assam.

The great fault of the Assam and the Bengal rates is that the graduation stops too early and is comparatively very steep in the lower ranges. The result is a great injustice in the distribution of the tax burden within the class taxed.

The fault of the Bihar rates is that they carry graduation too far. The other probable fault is that the rate of increase in the rates begins to come down rather late. Compared to Bengal and Assam, however, the Bihar rates are more equitable.

It may be stated once more that these principles have nothing to do with the pitch of the tax. The Bihar tax is, of course, very low but it is not good because it is low. Whether the decision to raise a particular sum of money from a particular class is right or wrong is to be judged by other considerations. But given the decision to raise a particular sum of money from a class, the principles laid down above ought to govern the manner of distributing that burden among the individual members of that class. There is nothing wrong in the decision of Bengal or Assam to raise the amount they are raising now by the tax on agricultural income. The complaint is that they have not distributed the burden equitably among the recipients of agricultural income.

The discussion so far ignores the correction which is necessary on account of the existence of other regressive or proportionate taxes in the country. Income-tax is the only tax based on the faculty theory of taxation. There are a number of other taxes in the country, both Central and Provincial, which are regressive or proportionate in character. The excises, the sales taxes, the customs duties, the land revenue, etc., are all regressive taxes which reduce the faculty of the poorer men very substantially and treat

the richer section of the community very favourably. The only tax by which this injustice can be mitigated is the income-tax. When therefore the actual rates are determined it is necessary from the standpoint of justice:

(*i*) to fix the rates on the principles enunciated above, and

(*ii*) thereafter to correct them on the basis of the extent of regression in other taxes.

Such correction may require the raising of the exemption limit or a still lower rate on the lower ranges of incomes and a still higher rate on the higher ranges.

This aspect of the question need not be considered here in detail.

(*c*) *The 'step' system and the 'slab' system*

Under the 'step' system, the whole income is taxed at one specified rate which rises step by step with the size of the income. Under the 'slab' system, the total income of a person is divided into slabs of specified sizes and the rate applicable to each slab is different, the rates being so arranged that the higher the slab, the higher the rate.

The comparative merits of the two systems have been discussed in Chapter II of the *Income-tax Enquiry Report*, 1936, and have been illustrated by a graph in Appendix 4 of the *Report*.

A step system operates with obvious jerks. Within the range of each step, the taxation is proportionate and not progressive. As a step ends and a new step begins, the rate of taxation takes a vertical jump and again becomes proportionate. Thus a curve representing the step system will be exactly like a flight of steps, i.e. will proceed horizontally in each step and will take a vertical jump as it passes from one step to another. Apart from the jerky nature of the curve other great anomalies occur at margins of steps. Thus an assessee with an income of Rs 14,999 paid, under the pre-1939 Act, a tax of Rs 1,015 as compared with a tax of Rs 1,399 payable on an income of Rs 15,500, an increase of Rs 384 in tax on an increase of Rs 501 in income.

The tax under a step system cannot therefore be uniformly progressive. In each step it is only proportionate. At the end of each step it takes a sudden jump and becomes more progressive than is equitable, the inevitable result of which is that it becomes

regressive again for some time. A step system therefore cannot satisfy the demands of progression: it hampers progression.

A real and equitable progression is possible only under a slab system. The tax is progressive not only from slab to slab but remains progressive in relation to the total income of each man having the same number of slabs. This is simple arithmetic. The average rate on the total income of a man must be smaller than the rate applicable to the highest slab of his income. This is obvious as there is one exempted slab and there are slabs to which rates lower than the highest are applicable. The average rate will, for each increase of income with the slab, approach the maximum rate till the income passes into another slab and the highest slab is taxable at a higher rate which has the effect of increasing the average rate still further. The result is that the tax remains progressive all through and, provided the rates and the slabs are appropriate, does not work with jerks. The average rate will slowly but steadily approach the maximum rate though the two will never become identical. The curve representing such a tax will rise progressively and probably with some uniformity also. The slab system therefore can be made to carry out the fundamental principles of progression more correctly than the step system.

In Australia, they have carried the slab system still further with a view to increase its potency as an instrument of progression. The chief feature of the Australian system is that instead of graduation at intervals, every successive pound of the income within a slab is made to pay a little more than the preceding pound. By this device there vanishes the probability of a sudden rise in the average rate of tax payable in respect of a man's income as it passes from one slab to the other and the curve representing the tax can have an absolutely uniform rise. By a suitable determination of the rates and the slabs, such a system can be made faithfully to carry out the fundamental principle of ability to pay.

The other peculiarity of Australian schemes of income-tax (State or Federal) is that instead of the fixed statutory exempted slab, there is one on a sliding scale. In recent years this has been £250, diminishing by £1 for every £2 by which the net income exceeded £250 and thus vanishing at £750.

People have sometimes wanted to compare the *step* system with the *slab* system from the *revenue* point of view which, however, is entirely irrelevant. If a particular amount of revenue is wanted,

it can be obtained under either system. All that is stated here is that the slab system can carry out the faculty theory of taxation or the doctrine of progression in taxation much more faithfully than the *step* system. This conclusion is independent of the pitch of taxation. If a particular series of rates applied on a particular series of slabs has not been able to yield as high an amount of revenue as was yielded by another series of rates applied under the *step* system, the fault lies not in the system but in the choice of the slabs and the rates.

Secondly, the slab system of rating is not a merit in itself. It is a means to an end. If it is decided to apply the principles of graduation in practice, the slab system will further the purpose or it is the best method of executing that purpose. But if the principles of graduation, as broadly enunciated in the previous section, are themselves disregarded, there is no point in adopting the slab system. Thus the Bengal rates and the Assam rates are faulty in spite of the slab system while the Bihar rates are much better in spite of the step system.

(*d*) *The pitch of taxation*

The actual pitch of taxation is determined by many considerations of which the need for revenue and expediency play the largest part. Another factor which greatly influenced the rates adopted in the provinces was the Central rates. Assam rates are exactly the same as the basic rates of the Central tax. Bihar rates also, as has been pointed out already, were originally modelled on the then prevailing Central rates. The Bengal rates are also modelled on the basic rates of the Central tax though the pitch is slightly lower.

The reason why the Central rates exerted so much influence on the provincial rates is obvious. The division of the base between the Centre and the provinces is purely artificial. The agricultural and non-agricultural incomes of a person are really one income. In every country outside India where there is an income-tax they are treated as one income and taxed as such.

In this country the constitution and history have raised a barrier between agricultural and non-agricultural incomes, and they are to be taxed by different authorities; but there is no reason why the two incomes should not at least be taxed at the same rate. The logic of this is so simple that it was difficult to resist it in any province.

In spite of the compelling character of the logic of the argument it appears that though Governments in these three provinces were intellectually convinced of it, they had some vague fears that they should not go so far as that; they were also pressed by the representatives of the would-be assessees, namely the tea planters and the zemindars. The justification for such an attitude will be discussed later and the need for gradualness will be established. But the actual result was disappointing. Though leniency was claimed and given in the name of the class receiving agricultural incomes, it is only the few rich members of the class who derived the benefit. This happened to the greatest extent in Assam, to a lesser extent in Bengal and a little less in Bihar. The Bihar Government announced with some satisfaction that the incomes of the rich were lightly taxed.[1] Assam and Bengal announced that they were doing a great favour to the recipients of agricultural income by omitting supertax though in fact they were actually favouring only the few rich members of that class because it is only they who would have paid the supertax if imposed.

The extent of the favour shown to the richer recipients of agricultural income will be evident from the following table:

[1] Para 3 of statement of objects and reasons.

Amount of income	Tax payable if the income was agricultural						Tax payable if the income was non-agricultural					
	Assam		Bengal		Bihar		Income-tax		Supertax		Total	
Rs	Rs	As	Rs	As	Rs	As	Rs	As	Rs	As	Rs	As
5,000	164	1	164	1	Nil.		164	1	Nil		164	1
10,000	554	11	476	9	312	8	554	11	Nil		554	11
25,000	2,742	3	1,570	5	1,302	1	2,742	3	Nil		2,742	3
50,000	5,648	7	5,476	9	3,906	4	6,648	7	2,500	0	9,148	7
1,00,000	14,460	15	13,289	1	9,375	0	14,460	15	11,562	8	26,023	7
5,00,000	76,960	15	75,789	1	67,708	5	76,960	15	1,37,625	0	2,14,585	15
20,00,000	3,11,335	15	3,10,164	1	3,12,500	0	3,11,335	15	7,93,875	0	11,05,210	15

III

AGRICULTURAL INCOME-TAX

COMPARABILITY OF AGRICULTURAL INCOME AND NON-AGRICULTURAL INCOME FOR PURPOSES OF TAXATION

DURING the debates on the agricultural income-tax bills in the different Provincial Legislatures persistent efforts were made to prove that in respect of taxation of income, agricultural income and non-agricultural income were on a different footing. The point of view of the Governments generally was that a rupee of agricultural income (net) was worth as much as a rupee of non-agricultural income (net). The representatives of the would-be assessees without denying the truth of the principle tried to prove that there were other important considerations which affected their ability to pay income-tax. The reasons given were generally three:

(*a*) Income derived from land is already subject to land revenue and cess whereas the income derived from business or salaries is not subject to it. In Bengal, land also bore a recently imposed primary education cess which townsmen did not bear. These facts, it was said, must be taken into consideration in determining the rate of the tax to be imposed on agricultural income.

(*b*) Tenancy legislation passed recently has substantially reduced the incomes of landlords and hence their ability to pay must not be treated as at par with that of the businessmen.

(*c*) Peasants' movements and no-rent campaigns which recent tendencies in politics have intensified have further reduced the taxable capacity of the landlords.

The three arguments are examined below:

Of the three provinces under discussion, Bengal and Bihar are almost entirely permanently settled. In Assam, there is no landlord assessee in the temporarily settled areas; in that province, the tax is paid wholly by the tea companies and the landlords of the two permanently settled districts. In all these cases, the land revenue was settled in or about 1793. The *touzis*, or revenue-units are even today paying the same amount of revenue as was settled in 1793 or thereabouts. It is common knowledge that the income

from those *touzis* has increased many times since then and that the land revenue now bears a much smaller ratio to the income than at the time of settlement. It is also common knowledge that *touzis*, or permanent tenures under them, change hands and that there are not many cases in which the *touzis* are still in the occupation of the original proprietors of 1793.

Now these *touzis* are often sublet to tenure-holders in separate lots and there are tenures under tenures. The degree of subinfeudation varies from *touzi* to *touzi*, from district to district and from province to province. The rents payable by tenure-holders are often fixed and sometimes enhancible. There are also *ryots* holding directly under proprietors of *touzis*. The rents of *ryots* are often enhancible and in some cases fixed in perpetuity either by contract or by the operation of law.

Of the cesses, the road cess and the public works cess were levied in the seventies of the last century. They are levied on the annual valuation of a holding, tenure, or *touzi* as the case may be. The valuation is, however, made at very long intervals, sometimes thirty or forty years or more. In Bengal, a primary education cess was levied after 1938, the basis of assessment being the same as the other cesses. It has not yet been levied over the whole province. It has actually been levied in a few districts and is being gradually extended.

In the case of all these cesses, the landlord is the person through whom Government collects them. The ryot pays an amount on the basis of his rental at the rate of so much per rupee of rental. The tenure holder above him pays the amount collected by him from the ryot plus so much per rupee of his net income, (i.e. current demand minus rent payable by him) to the man next above him. By this process the amounts collected are pushed up to the proprietor of the *touzi* who adds to it his own share and pays the whole amount to Government.

This is the background against which the question has to be considered.

It is an easy reply to the landlords' objection to tell them that land revenue is not a tax. That is exactly the reply which the Advocate-General of Bihar gave them on the floor of the Bihar Legislative Assembly. The Advocate-General said:

'The assumptions were that a zemindar has to pay, firstly revenue, secondly cess and thirdly he will have to pay agricultural income-

tax. The professional men or the traders or the commercial houses have to pay only one tax. I submit that revenue is not a tax, cess is not a tax.'[1]

His arguments were as follows:

'I refer my friend to any standard dictionary, it need not be a dictionary of law, and he will find that tax is a compulsory contribution levied from every individual or class of subjects of the Government for the purpose that Government may choose to fix or for the purpose of maintenance of Government and for which there is no return. Revenue is something which is paid to a sovereign body or to a superior body for the privilege of securing total possession or enjoyment of land. Cess is something which is levied and for which there is a return.'[2]

He then proceeded to say:

'Revenue is paid for the advantage of holding land; cess, when it was levied, it was levied for a clear purpose, and in fact everybody knows that cess does not come to the Provincial exchequer. It goes back to the payers either in the shape of establishment of hospitals, schools or maintenance of roads. Tax is a different proposition and I concede that the present tax is a tax for which Government can promise no return.'[3]

This argument is based on the popular meanings of the words *revenue*, *cess* and *tax*. It is in fact no reply to the objection taken by the landlords but is only an academic evasion of the issue by means of changing the definitions of words. When the zemindars claimed that land revenue was a tax, they obviously used the word in the scientific sense, i.e. in the sense in which it is used in the science of economics. In Part III it has been explained at some length that land revenue is nothing but a tax on rent. The first argument of the Advocate-General is therefore obviously wrong.

The Advocate-General next says that land revenue 'is just like a licence tax which a pleader has to pay every year for the purpose of securing a right to practise. But after the pleader has secured the right to practise and has earned a certain amount of money he has again to pay a tax'.

Here the suggestion is that the payment of one tax does not, in justice, necessarily preclude the levy of a tax on income. This argument, however, is only hinted at and is not developed.

[1] *Report*, Vol. III, No. 21, p. 1567.
[2] *Ibid*, p. 1567.
[3] *Ibid*, p. 1567.

As regards the cesses, it is said that because, for the cesses paid, the cess-payers get back a return in the shape of hospitals, roads, etc., cess is not a tax. This is a misinterpretation of the definition of a tax. According to the interpretation of the Advocate-General hardly anything can be a tax. For all taxes collected and spent, there must be a return at least in the shape of greater security, greater justice, etc. Government also make roads, build hospitals, etc., out of their tax-revenue. No tax is thrown away after collection by Government. It is spent and it produces some return. When economists say that for a tax paid there is no *quid pro quo*, they mean that there is no direct and immediate return to the payer himself and that the return bears no relation to the amount paid or that the payment is not a condition of enjoying the return. When I pay the price of a piano, I get a piano immediately and directly. The price is directly related to the piano and is a condition of my enjoying it. When I pay college fees I get education directly, immediately, and though the education provided may cost much more to Government in a Government College and the fee may bear no fixed relation to the cost of education, yet the return is direct, and immediate, and is conditioned by the payment of fees because only those who pay the fees get the education. A cess is entirely different. I pay cess with which roads or hospitals are built. But I may not use them at all. One set of men may pay cess and another set of men may enjoy the free treatment in hospitals. The use of the roads, etc., by a person is not conditional on his having paid cess. Thus there may or may not be a return at all to the payer himself. Even if there is, i.e. even if he happens to use the road, it is not direct, nor immediate nor in any way related to or conditioned by the payment. Many persons use the roads, etc., without paying the cesses. Cess has therefore all the characteristics of a tax.

Land revenue and cess are both taxes as understood in the science of economics. To deny that they are taxes is no answer to the objection taken by the landlords.

The present objection taken by the landlords is based on a sound economic principle regarding the distribution of the tax-burden. They contend that (*a*) persons having equal incomes must pay equal amounts of tax; and that (*b*) a proper comparison is made not by comparing the amounts payable under one head

only but by comparing the sums of all the different amounts paid under all heads.

This is a very sound contention. It is quite scientific to say that in comparing the tax burdens on men, the total income of each from all sources should be considered against the total amount of taxes payable by each under all heads.

The real fallacy of the argument of the landlords lies in confusing the impact and the incidence of a tax. The incidence of a tax is often different from its impact; and only the incidence of taxes should be considered when comparing the taxes payable by two persons. The landlords, however, compare the incidence of the taxes in the case of businessmen and the impact of taxes in the case of landlords; the conclusion is therefore bound to be wrong.

Businessmen also pay a number of taxes besides the Central income-tax. Many of them pay high excise duties. In Bengal, Madras and the Punjab, they pay sales taxes. Most of them pay very heavy customs duty. The impact of all these taxes is on the businessmen but the incidence of such taxes often lies elsewhere. Hence when discussing the distribution of the tax burden, such taxes are not to be put against them (though they are the payers) but should be shown against persons—very often the unsuspecting public at large—on whom the incidence really lies. The landlords rightly exclude them from the comparison between the businessman and the landlord. The landlords are, however, at fault because they assume that because the landlords pay land revenue and cess, they also bear their burden. The question of the incidence of land revenue and cess is examined below.

Land revenue and cess are special levies on land. They are special in the sense that they are not levied on other agents of production. Hence they are *unequal* levies. This inequality is soon ironed out by the process of capitalization. This special levy at once depresses the capital value of land by an amount equal to the capitalized value of the tax. Hence the only person who suffered from the imposition of the land revenue in 1793 or from the imposition of the cess in 1870 is the owner of the lands at the time of the levy. At the time of the next transfer the buyer reduced the market price of the land by an amount equal to the capitalized value of the revenue or the cess. Hence to the transferee the land revenue or the cess is no burden, even though he has to pay them. To him the land yields the market rate of interest on his investment even

with the revenue and cess and it would not have yielded him more without revenue or cess, though without them the transferer would not have suffered.

If, for example, an estate yielded a net income of one hundred rupees and there was no land revenue or cess, it would *normally* sell at two thousand rupees when the market rate of interest was five per cent. A man buying the estate for that sum would earn a return of five per cent on his investment. If it yielded less, he would not buy it for two thousand rupees because he could earn five per cent elsewhere. If it yielded more, competition would soon push up the price and level down the return to five per cent.

Now suppose a land revenue of ten rupees and a cess of five rupees were imposed on the estate. The net income would at once be reduced to eighty-five rupees, the capitalized value of which at five per cent would be one thousand and seven hundred rupees. Hence nobody would now buy the estate for more than that sum, assuming that the rate of interest had remained constant. Though the buyer would now have to pay both land revenue and cess, he would still earn five per cent on his investment. The only man who has suffered by the imposition of the tax is the owner at the time of the imposition of the levies; because the levies at once reduce the value of his land by reducing the net income derivable therefrom.

The incidence of land revenue and cess is therefore *permanently* on the owners at the time of the imposition. The owners of 1793 or the owners of 1870 have paid the taxes once for all when transferring their estates after those dates, and the present owners have not to bear the burden at all. As the Chief Minister of Bihar put it: 'He never pays land revenue to the State: he pays simply interest on the deduction which he has made from the seller of the property.'[1] In other words, the amount he pays to Government as land revenue and cess is equal to the interest on the amount by which he reduced the market price of the estate at the time of buying it and which he would not have been able to retain to himself but for the existence of the land revenue and the cess. To pursue the last example, without land revenue and cess, he has to pay two thousand rupees to the original owner; with land revenue and cess he has to pay one thousand and seven hundred rupees to the original owner

[1] Bihar Legislative Assembly Debates—*Report*, Vol. III, No. 21, p. 1581.

and to set aside three hundred rupees as a fund which will yield annually as much interest as is adequate for payment of land revenue and cess; or to put it otherwise, the net profit which he makes on his investment with or without land revenue and cess is the same, other things remaining equal.

Professor Seligman has enumerated the conditions favourable for the capitalization of a tax. They are:

(*a*) First, the tax must be imposed on commodities with a capital value, susceptible to diminution. This would, for instance, hold true of land.

(*b*) Secondly, there can be no capitalization if the tax is imposed on a commodity used in further production, where it will increase the price of the product instead of lessening the value of the principal or source of the product.

(*c*) Thirdly, the commodity must be relatively durable in character, and subject to the expectation of repeated taxes.

(*d*) Fourthly, the process is accentuated by the inequality of taxation. Wherever there is an excess of burden, the excess tends to be capitalized.

(*e*) Fifthly, the degree to which the capitalization will take place, or the exact point at which the new equilibrium will be established, depends on the marginal demand. If the amount of the overtaxed goods is relatively small, the whole of the tax will tend to be capitalized; if, on the contrary, it is relatively large, the new equilibrium will be established at a point somewhat remote from the old one, and accordingly less of the tax will be capitalized.

(*f*) Finally, the process of capitalization is especially true in the case of a flat or proportional tax, and is not applicable to the same extent to a system of graduated taxes. [1]

All these six conditions are true of the land revenue and cess. Hence the tendency to capitalize them is the strongest. As the present owners are mostly different from the owners of 1793 or of 1870, they do not bear the burden of the land revenue or the cess. Though they bear the impact, they do not bear the incidence. Land revenue and cess therefore stand to the present owners in the same relation as excise duties, customs or sales taxes stand to the businessmen but with this difference that whereas the businessmen constantly shift the excises, etc., by a process of pricing, the present owners of land in the permanently settled areas have once for all shifted the burden of land revenue and cess by a single process of capital-

[1] Seligman: *The Shifting and incidence of Taxation*, Part II, Chap. I, pp. 219–225.

ization. Though both the landlord and the businessman pay the tax, neither bears the burden.

The position is summarized below:

The argument of the landlords, if put in the form of a syllogism, is as follows:

Equity in taxation means that persons with equal incomes from all sources must pay equal amounts of taxes under all heads.

Landlords pay land revenue and cesses while businessmen pay only income-tax.

If, therefore, an income-tax is placed on the landlords also, there arises an obvious inequality and therefore an iniquity in taxation.

The fallacy involved in this argument is a fallacy of ambiguous premises. The term 'pay' has been used in the syllogism in two different senses. The first premise is unassailable as a statement of principle, only if the term 'pay' has been used in the sense of 'incidence'. Equity demands equality in 'incidence' and not equality in 'impact', nor equality between incidence in one case and impact in the other.

In the minor premise, however, the word 'pay' has been used in respect of businessmen to mean incidence but in respect of landlords to mean impact.

This twist in the sense of the term 'pay' causes confusion in the common mind, but on analysis the fallacy becomes apparent. The syllogism ought to compare tax-burdens borne by each class as distinct from taxes paid by each class; but it actually compares incomparables, i.e. taxes paid by one class with the tax-burdens borne by another class.

The Bengal Rural Primary Education Act was passed in 1930. It imposed a cess on land for the purpose of financing a scheme of rural primary education which in time is to become universal and compulsory. The Act, however, was not enforced until 1938, i.e. until sometime after the first Ministry under autonomy had come into power. It has not yet been enforced all over Bengal but is being gradually extended. In September, 1941, it was in force in fifteen districts of Bengal.[1]

[1] 24-Parganas, Nadia, Murshidabad, Birbhum, Pabna, Bogra, Rangpur, Jalpaiguri, Dacca, Mymensingh, Faridpur, Bakerganj, Chittagong, Noakhali and Tippera.

The primary education cess is payable in respect of all immovable property on which the road and public works cesses are payable.

The manner of collection is as follows. Each ryot pays to his immediate landlord a primary education cess of three and a half pice for each rupee of rent payable by him. The immediate landlord, if he is a tenure-holder, adds to that amount one and a half pice for each rupee of net profit, i.e. his current demand minus the rent payable by him in respect of his tenure, and pays the whole amount to the man next above him in the chain of tenures. In this way, the amount is pushed up till the zemindar pays the whole amount collected together with one and a half pice per rupee of his net profit (current demand minus revenue payable by him) to the Government.

Thus the basis of charge is rent payable in the case of a ryot and the net profit in the case of a tenure-holder. The net profit is understood in the sense of the current demand of an estate minus rent or revenue payable for it.

On the proprietor is imposed the liability of paying the entire amount of education cess payable by all the tenure-holders and all the ryots in his estate. In return, he has got the right to collect from the tenure-holders holding directly under him the whole amount of education cess payable by everybody holding under them. This right to collect descends step by step down to the last tenure-holder in the chain.

In law, the liability to pay the cesses to Government is independent of the right to collect from the subordinate tenure-holders and the ryots. Non-collection of the primary education cesses from holders of the lower strata is no plea in law for deferring payment by the holders in the higher strata. In this respect and in respect of the manner of collection, the education cess is exactly the same as the road and public works cess. Basically the cesses are nothing but taxes on land and the zemindars and tenure-holders are partly tax-payers and partly collecting agents. What they collect they pay to the man next above them in the chain or to Government as the case may be, together with their own share, though there may be a substantial time-lag between actual collection and actual payment either way.

The opposition against the Bengal rural primary education cess has been very strong and persistent and is comparable to the

opposition to the road cess and public works cess in the seventies of the last century when they were first imposed. The opposition takes two distinct lines which have been kept separate by the objectors. First, they oppose the levy itself. An unequal levy on land hits the present owners of land doubly; they have to pay the tax; and the value of their land is reduced by the capitalized value of the tax. In other words, the incidence of such a tax is permanently on the present owners. Even when they part with the land, they have to lose the capitalized value of the tax, i.e. they have to leave behind a fund, as it were, which would yield annually in interest a sum adequate for paying the tax for all times to come.

It is remarkable that there is now no similar agitation against the road and public works cess, though the agitation against it was as strong at the time of its imposition as the present agitation against the primary education cess. This only proves the principle established earlier in this chapter that though an unequal levy on land hits the contemporary owners doubly, it is soon ironed out by the process of transfers of lands. To quote Professor Seligman again, 'the inequality will diminish with the passage of time until it entirely disappears in the newly established equilibrium'. The road and public works cess imposed as long ago as 1870 is no burden on the present owners of land, whether zemindars, tenure-holders or ryots. That the ryots pay it as promptly as rent and more promptly than primary education cess is due not only to the fact that they have got accustomed to it but also and more primarily to the fact that it is no burden on the present owners, whereas the primary education cess is.

Secondly, the landlords object to the manner of collection under which they have to pay to Government the entire cess payable by themselves as well as by the ryots in anticipation of collecting the ryots' portion. The ryots' portion is difficult to collect in time because—

(*a*) the ryots in the permanently settled areas are accustomed to run up arrears for three years in respect of rents and cesses.

(*b*) the primary education cess being new, the ryots make difficulties about paying it. Hence the landlords have always to pay in advance of collection. This causes hardship to them.

As between the two points, the landlords have emphasized the second point more than the first, and they have always expressed

their willingness to pay their own share provided they were relieved of the obligation to pay the ryots' share as well.

As regards incidence, the primary education cess stands on the same footing as the other cesses on land. It is a tax on land and the incidence of such a tax, as already explained, is permanently on the present generation of owners. The present generation will lose capital values which will, as it were, be set apart as a fund on which will be charged the cost of primary education of all future generations up to a standard now contemplated. Future generations will not have to bear the burden of the cess as the present generation has not to bear the burden of the road and public works cess or the land revenue in the permanently settled estates. It partakes of the nature of a capital levy on land.

The burden of the cess is not evenly distributed among the present generation of owners of interest in land. Among the zemindars and tenure-holders, the incidence is one and a half pice per rupee of net profit. So the incidence is at best proportionate. An arbitrary element is again introduced by the definition of net profit. Net profit means current demand minus rent or revenue payable. No notice is thus taken of the cost of management or bad debts.

Among the ryots the cess has no relation to the income. It is a function of the rent payable by a ryot. Rent, as is well known, has lost all relation to income in the permanently settled areas. It is mostly customary and is controlled by law. It has no fixed relation with the income derived from the land.

The absence of the exemption limit, i.e. its universality, adds to the hardship caused by the levy. It falls on all persons having an interest in land. Even owners of uneconomic holdings who cannot find two meals a day have to pay it.

In course of time the hardship will of course disappear by the process of capitalization but that is little consolation for the present generation because:

(*a*) It hits them doubly: they have to lose income as well as capital value.

(*b*) The burden is distributed very unevenly and often arbitrarily.

The Bengal primary education cess is therefore quite relevant in a comparison of tax burdens between two persons—one paying taxes on land and another paying the Central income-tax because

the Bengal primary education cess is a burden on the present generation of holders of interest in land.

Two questions emerge at once:

(*a*) Does the levy of an agricultural income-tax in addition to the primary education cess create an inequality as between businessmen and landowners in respect of taxation?

(*b*) If so, is the proposed agricultural income-tax in Bengal unjust?

In discussing the first question it is necessary to distinguish between three groups of tax-payers.

First, there is the vast bulk of the education cess payers who are poor and are outside the scope of the proposed agricultural income-tax, their net incomes being below the exemption limit. There may be inequality as far as they are concerned because there is no corresponding tax on men earning the same non-agricultural incomes. But the agricultural income-tax has nothing to do with this inequality which is independent of the proposed agricultural income-tax.

Secondly, there are the big landlords at the other end. As already explained in Chapter II, under the Bengal Agricultural Income-tax Bill, it is proposed to tax them at much lower rates than the corresponding rates of the general income-tax. As far as they are concerned, the amounts of agricultural income-tax plus the primary education cess payable by them are together smaller than the amount of agricultural income-tax that would have been payable by them if their incomes were taxed at the general income-tax rates and there were no primary education cess. The actual limit up to which this group descends is a matter of calculation but it is clear that the first question in regard to this group should be answered in the negative.

Thirdly, there is another group in between the first two who would suffer on account of the co-existence of the two taxes. These are the persons whose net income is above the exemption limit, but is not above a certain limit. What that limit is, is a matter of calculation but it is well over five thousand rupees. A person paying agricultural income-tax in Bengal on an income of five thousand rupees would be paying at the same rate as a person paying the general income-tax on the same income; but the former would be paying the primary education cess in addition, while the latter would not pay it or any corresponding tax. As the income rises

to the next slab, the rates of agricultural income-tax become lower than the rates of the general income-tax but in that slab also the combined agricultural income-tax and the education cess will be higher than the general income-tax payable on an equal amount of non-agricultural income. In this way a point of equilibrium will be reached beyond which the inequality in favour of non-agricultural income turns into inequality in favour of agricultural income. The exact line of demarcation, as already stated, is a matter of calculation.

The inequality that will arise when the primary education cess and the agricultural income-tax will be levied simultaneously is a result of two factors:

(*a*) the extreme inequality arising out of the proportionate character of the primary education cess; and

(*b*) the defective graduation in the rates proposed in the Bengal Agricultural Income-tax Bill as explained in Chapter II.

The cess, being at best a proportionate levy, is partial to the bigger landlords. The effect of this partiality is enhanced by the added effect of the bias displayed by the proposed rates of agricultural income-tax in their favour. The result is as follows:

(*a*) the bigger landlords get the advantage of the inequality. In spite of both the levies, they are better off than men with the same non-agricultural incomes.

(*b*) The intermediate group of a few thousand men suffer slightly on account of the combined effect of the two levies. They are slightly worse off than men with the same non-agricultural income.

(*c*) The third group, consisting of crores of men, suffer from an inequality inherent in the primary education cess, though they are outside the scope of the proposed agricultural income-tax. They are worse off than men with the same non-agricultural incomes.

It is obvious that all these inequalities cannot be removed by dropping the Agricultural Income-tax Bill; that will only enhance the inequalities in the system. The only way to cure these inequalities is to remove the causes, i.e.

(*a*) by abolishing or reforming the primary education cess, and

(*b*) by removing the defects in the graduation in the proposed rates of agricultural income-tax.

The answer to the second question is therefore clearly in the negative. The agricultural income-tax, just in itself, does not

become unjust because, when combined with an unjust tax, the total effect is unequal.

In this connexion it is important to note that equity in taxation is not properly studied on a class basis. Though in an equitable system of taxation there is perfect equality of taxation as between classes, the converse of this proposition is not true. Agriculturists and non-agriculturists may be paying the same amounts of taxes for the same levels of income but still the graduation within each class may be very unfair, so that the burden on the poorer sections in each class may be out of all proportion to the burdens on the richer sections. The demands of equity are not satisfied by establishing equality as between classes; equity further demands equal distribution of the burden within each class. Hence it is a wrong approach to the study of equity if we frame a question on the class basis. Equity in taxation is not a class question, it is an individual question. The burden is not on a class, it is on individuals. Taxation is equitable only when the individual burdens are equal. When, however, individual burdens are equal, equality as between classes follows automatically.

In fights and debates over measures of taxation, the discussion often takes place on class lines and the result is often unsatisfactory. The Agricultural Income-tax Bills in the provinces—particularly in Bengal and Assam—are good illustration of this proposition. It has already been explained how in the name of lenient treatment to the 'class' with agricultural incomes, the advantage was distributed to the richer sections within the class.

So in answering the second question, it is to be remembered that the demands of equity are not satisfied by establishing equality between classes. If this is remembered, the question would appear to be rather inappropriate in a study of equity and the answer to it becomes clear. Even if Government could manage to establish equality between the two classes either by reducing the rates of general income-tax on the richer sections or by imposing a tax similar to the primary education cess on persons with non-agricultural incomes of below two thousand rupees, the tax system would not become equitable thereby; in fact that would greatly enhance its iniquity.

The Provincial Governments under autonomy, in the permanently settled provinces, have enacted a number of tenancy laws. In

volume and importance tenancy laws passed under autonomy are only next to taxation laws passed under that regime.

Tenancy legislation has adversely affected zemindars and tenure-holders in all these provinces in various degrees. Only those measures need be considered here which have actually reduced the present income of zemindars and tenure-holders.

Such measures have been most numerous in Bihar. In Bengal apart from the abolition of landlord's transfer fees there is nothing which actually reduced the present income of zemindars and tenure-holders. Though the provisions for enhancement of rents were suspended for ten years, that did not reduce present income. In Bihar the following were the principal measures which had the effect of reducing present incomes of landlords, namely:

(*i*) the system of *Danabandi* was altered in favour of the ryots and against the landlords;

(*ii*) all enhancements of rents obtained between 1911 and 1936 were cancelled;

(*iii*) rents payable by ryots were generally reduced without reducing rents or revenue payable by holders of superior interests. This reduction was effected on the basis of comparative prices prevailing at the time of the preparation of the records-of-rights and the current prices.

The argument was advanced that these measures impaired the faculty of the zemindars in such a way that the imposition of an agricultural income-tax immediately after these measures was not equitable.

Mr. Chandreshvar Prashad Narayan Sinha, M.L.A., Bihar, urged this point of view on the floor of the Legislature as follows:

'The system of *danabandi* that we have abolished alone will take away nearly 10 to 20 per cent, because of the reversal of the shares of the two parties. The second thing, which we have ourselves done and of which mention was made, is that enhancement had been made from two annas in the rupee to anything like four annas to six annas in the rupee. This has been automatically cancelled. It comes to anything from 12 per cent to 25 per cent or in some cases 30 to 35 per cent. The third thing which we have done and which is still being done with a certain amount of injustice, which Government have not justified yet, is the reduction of rent under section 112 and not under section 112A. That takes away again from 12 per cent to 40 per cent at places. I will not take for my purpose the maximum. I will take the minimum figures that are invariable in all cases. If we put down *danabandi*

at 10, enhancement at 12 and reduction of rent at 12, you will find that we at once get at least a sum or a percentage of 32 or nearly one-third. Now, one-third has been definitely lost by every zamindar. But this is not all, as I have told you. There are others who, if you properly calculate the figures, have lost as much as nearly 60 to 70 per cent. You will again tell me that after all these deductions on realizations it does not matter. I am going to tax only when the realized amount has been above Rs 5,000. I say that will not do. That may be so theoretically, but in practice you have got to see what amount of hardship has been caused to the individual or to the family that is going to suffer.'[1]

The figures in the speech are not to be taken as accurate and are probably exaggerated. But it is a good general statement of the case.

The Chief Minister of Bihar replied as follows:

'Sir, where is the hardship? Certainly, there have been reductions in rent; certainly, the *danabandi* system has been abolished, but it has been abolished not because this Government wanted to ruin the landlords but because Government wanted to make equitable adjustment of relations between the landlords and tenants. Rent has been reduced, Sir, because Government wanted the landlords not to be ruined but to live on that income which Government wanted them to have on grounds of justice. After they realized rents, the State wanted to come in and ask them to pay a certain portion of these rents.'[2]

Both the speeches contained an element of truth but neither contained the whole truth. Each was seeing only one aspect of the question independently of the other aspect. The two together would probably give the whole truth.

The Chief Minister's statement was quite sound as a general principle. Social legislation must be independent of taxation. Social legislation must have for its object an equitable adjustment of relations between classes and must not be held up for any other reason. The faculty theory of taxation again postulates no particular social arrangement; it holds good under any arrangement. Hence the progress of social legislation and the progress of taxation measures must go on independently of each other: one should not influence the other.

In business and industry, for example, nobody wants lower income-tax rates on account of factory legislation or other labour legislation. In all civilized countries labour legislation is progressing fast and that has not been urged as an argument for

[1] *Official Report*, Vol. III, No. 21, 1938, pp. 1573-4.

[2] *Ibid.*, p. 1580.

favourable treatment of business and industry in the matter of taxation. Taxation has progressed as fast as labour legislation in the countries of the West.

Social legislation therefore has nothing to do with taxation. As the tax is levied on net incomes realized, the income not realized, of course, does not make a man liable to tax. But in the short period the other view has also an element of truth. In the short period, sudden changes in a man's income affects his ability to pay. If the ability to pay tax of a man earning fifty thousand rupees is normally four times as high as that of a man earning twenty-five thousand rupees, a sudden variation of the income of any one of them to the other figure affects his ability to pay in a higher proportion. This principle is recognized by economists. It is accepted in practice also and is the basis of all taxation of windfalls, e.g. excess profits taxation or succession duties. If my income suddenly rises from twenty-five to fifty thousand rupees, I am taxed at a rate which is higher than the rate ordinarily applicable to that income. Similarly if my income suddenly drops from fifty thousand to twenty-five thousand rupees I ought to be taxed at a rate lower than the rate normally applicable to that income.

It is essential to draw a distinction here. Variation of incomes is a common phenomenon. If the principle enunciated above is pushed to its logical limit, there must be two sorts of progression—one for variation of income from man to man and another for the variation of the same man's income from year to year, or in other words there must be rates for normal variation and rates for abnormal variation. But it is extremely difficult to distinguish between normal variation and abnormal variation. Large variations take place in the incomes of men which are due only to the normal risks of business. There are common business risks which everybody must face.

Secondly, variation often takes place in a man's capacity to forecast and this may cause very large variation in incomes. The entrepreneurs take risks and undertake their tasks with widely varying degrees of capacity, which also varies over time. Naturally, the range of variation of incomes is often very wide not only from man to man but from year to year in case of the same man. The entrepreneur is the maker of modern society and society is to him a severe taskmaster as well as a liberal rewarder. Society punishes him severely for small mistakes and rewards him lavishly

for success. People take to this line with the full knowledge of the conditions and the variations of income are therefore normal to this line. He suffers large losses for slight miscalculations and earns liberal rewards for successes. Taking one with the other, most men carry on at a level till some one of them has a great success. This is normal to the line and must be recognized as such in matters of taxation. Hence to admit the justice of separate rates for abnormal variations is not to admit the justice of separate rates for all variations.

What then are abnormal variations which justify separate rates? At present two cases are generally recognized as justifying such separate rates. They are:

(*i*) War profits. When a war breaks out and gives men unexpected opportunities of making profits, such profits are taxed at specially high rates. The rates are withdrawn as soon as the war ends.

(*ii*) Succession. When a man inherits property, this sudden accession to his estate is considered to increase his taxable capacity at a specially high rate.

War profits are obviously abnormal. They accrue from purely extraneous causes for which the makers of the profits are in no way responsible. Similarly, in Western countries where the son starts off independently of the father very early in life, the sudden accession to his estate by the death of his father is clearly a windfall, though this is not abnormal in the same sense as war profits are. The question of succession duties has been influenced by other considerations also, e.g. social justice.

Factory legislation, tenancy legislation, banking legislation, money-lenders' acts—all these affect the incomes of individuals. But such variations as these cause in the incomes of individuals are never considered abnormal variations justifying special rates of taxation. Social standards about these things are already well recognized and if anybody makes money by according a worse treatment to a class than it deserves, any deprivation of that income, caused by legislation preventing such bad treatment, cannot be a ground for special treatment in respect of taxation. The faculty theory does not require it; it is also bad policy from the social standpoint. The entrepreneur should *normally* expect that if he accords bad treatment to his workers, the State must step in and interfere.

Exactly the same considerations hold good in the case of tenancy legislation. If the zemindars have so far accorded a worse

treatment to the tenants than they deserve, the State must step in. Such equitable adjustment of social relations by legislation cannot be a ground for favourable treatment in respect of taxation. The case as stated by the leader of the Opposition in the Bihar Legislative Assembly must therefore fail. Social legislation cannot be a ground for favourable treatment in respect of taxation.

What then is the element of truth in his version?

That taxation causes suffering is obvious. That, however, is no argument against a tax. If a tax causes suffering to the payer personally, it is essential as an instrument of developing social efficiency and social well-being in which the payer also participates. It is, however, incumbent on the Government to see that a tax does not cause severe hardship. The minimization of suffering is an ideal in taxation.

Now, it took about three quarters of a century for the Central income-tax to develop to its present stature. It started with very low rates which rose step by step till they are as high as they are today. The tax payers got ample time to get themselves accustomed to gradually rising rates. This, in itself minimized hardship. If the present rates were levied all at once, say, in 1860, the hardship would have been very great. Gradualness in taxation is therefore a merit.

Social legislation also may cause hardship to classes. The hardship may be necessary and required in the interest of justice but the hardship is certainly there. In the case of tenancy legislation in Bihar, it came rather suddenly though not too soon. It was probably all fair and just legislation but it certainly reduced the incomes of zemindars. As the agricultural income-tax synchronized with it, the hardship increased. This cannot be denied. This is what the leader of the opposition must have meant when he said, 'in practice you have got to see what amount of hardship has been caused to the individual or to the family that is going to suffer'.

If the State allowed these inequalities to grow without interference for such a long period and allowed people to acquire vested interests in them till they have become very strong, they cannot be wiped out overnight without causing great suffering to a class, however much the removal may be required in the interests of social justice. Gradualness is called for in such cases as urgently as the removal. If therefore tenancy legislation suddenly reduces the income of a class substantially after a certain level was allowed

for about a century, taxation, though equitable in the long run and on principle, should be gradual.

Thus on grounds of equity it is necessary that the full income-tax rates should be imposed on agricultural incomes not at once but gradually; because, first, the injustice of a century cannot be liquidated in a day without causing great hardship and secondly, rates which took three quarters of a century to develop in one case cannot be imposed in another case suddenly and all at once. Full income-tax rates must be levied on agricultural incomes in the long run. But if equity demands parity of rates, it also demands gradualness in the establishment of that parity.

The Chief Minister of Bihar without sticking inexorably to the theoretical principle could have easily added to his answer that as far as agricultural income-tax was concerned, he was for gradualness and the rates he was going to impose were very mild compared to the Central income-tax rates. He had actually taken the hardship of the zemindars into consideration when he decided to impose lower rates. Bengal and Assam also, have gone in for gradualness though, as already pointed out, they have been too gradual in the case of the richer and not gradual or not gradual enough in the case of the poorer assessees. The gradualness may mean the continuation of an injustice, but it is necessary in the interest of equity and is a part of the price which society must pay for the inactivity of a century.

The question of peasants' movements has nothing to do with the question of agricultural income-tax. Peasants must have the freedom to organize for the betterment of their condition as much as the landlords have freedom to organize in assocations for improving their conditions. All peasants' movements are not subversive and all landlords' movements are not reactionary. The State will deal with both according to the standards of justice prevailing at any point of time. But the question of justice in taxation is independent of either movement. To introduce this issue into the question of agricultural income-tax is obviously illogical. It is clear, however, that political influence within the narrow sphere of provincial autonomy is passing from the landlords to the peasants; but that is entirely a different question. Neither labour movements nor peasants' movements nor any social movements for the amelioration of the condition of a class should be imported into a discussion of taxation.

IV

AGRICULTURAL INCOME-TAX TAXATION OF COMPANIES

IN Chapter II it has been explained that under the Indian Income-tax Act, two taxes are payable by companies in respect of their income, other than agricultural income. One is the income-tax proper, payable at the maximum rate and without any exemption limit. This tax is paid not on their own behalf but on behalf of the shareholders. In assessing the income-tax payable individually by the shareholders, the amount of dividend received by each together with the income-tax paid on it by the company is treated as his personal income and he is given credit for the amount of the tax so paid on his behalf by the company. After such individual assessments have been made, each shareholder is entitled to a refund at a rate equal to the difference between the maximum rate at which the company has paid on his behalf and the rate appropriate to his individual income as so assessed. Thus this tax is not a tax on the company. It is a tax on the incomes of shareholders, though collected from the company. The justification for collecting it at the maximum rate is that at the time of collection, the rate applicable to each shareholder is not known. The rate so applicable must not only vary from case to case but there may also be cases in which the income of a shareholder is larger than that of the company. Hence the tax is collected at the maximum rate, refunds being admissible to the shareholders after the rate appropriate to each has been determined. There is thus a complete machinery by which refunds are made and the rate finally adjusted thereby to the income of each shareholder.

The other tax payable by the company is the supertax which is a tax on the company itself. It is correctly classified as a corporation tax. As its justification is based on the privileges of incorporation and not on faculty, neither any exemption limit nor any graduation is appropriate to this tax.

Bihar

The Bihar Act makes no distinction between a company and an individual. According to it, the same exemption limit and the

same scale of graduation apply to the agricultural income derived by both.

Any dividend received by a shareholder from a company deriving agricultural income is also included in his agricultural income and taxed.

This scheme may lead to any one of four results. (1) The income may be taxed twice—once in the hands of the company and again in the hands of the shareholder. (2) The income may escape the tax altogether: the company's income may be below the exemption limit and the income of the shareholder may also be below the exemption limit. (3) The income may be taxed in the hand of the company and may escape taxation in the hands of the shareholder, whose income is below the exemption limit. (4) The income may escape taxation in the hand of the company, its income being below the exemption limit, but may be taxed in the hands of the shareholders.

Now there is no provision, either in the Act or in the Rules, according to which the tax paid by the company can be considered as being paid on behalf of the shareholders. Hence the shareholders cannot get any credit for the tax paid by the company. The company and the shareholders are quite independent as tax-payers.

The Rules made under the Bihar Act, however, provide that if a shareholder of a company, the agricultural income of which has been assessed to agricultural income-tax, can prove that the rate at which the company paid agricultural income-tax on such agricultural income was greater than the rate applicable to his total agricultural income, including the dividend, or that his total agricultural income was below the exemption limit, he is entitled to get a refund. In the former case the amount of refund will be an amount by which the tax paid by the company on the dividend distributed to him exceeds the tax payable by him on that dividend, and in the latter case the whole of the tax paid by the company on the dividend distributed to him will be refunded to him.

The Rule may clearly lead to anomalous results. Suppose, for example, the company has paid the tax at the rate of two annas in the rupee and the shareholder has paid the tax at the rate of one and a half annas in the rupee. The refund admissible to the shareholder will be equal to a sum which is obtained by multiplying the dividend received by him by half an anna in the rupee. Thus the

total amount of tax collected on the sum distributed as dividend to him will be (2+1½) three and a half annas in the rupee out of which half an anna in the rupee will be refunded. The remaining three annas is a rate which is appropriate neither to the company's income nor to the shareholder's income. The rate paid by the shareholder direct on this part of his agricultural income works out at one anna in the rupee which also is not the rate appropriate to his income.

Secondly, it is quite possible that the agricultural income of a company is lower than the total agricultural income of a shareholder in that company. In that case no refund would be admissible. If the company had paid at the rate of one and a half annas in the rupee and the shareholder had paid at the rate of two annas in the rupee, Government would collect a total tax of three and a half annas in the rupee but would grant no refund.

Where the company paid no tax, being below the exemption limit, no anomalous result would ensue and the tax would be a pure income-tax on the shareholder. Similarly, where the company paid the tax but the shareholder was exempt, the latter would get back all that was paid by the company on the portion of the dividend distributed to him. Where neither the company nor the shareholder paid any tax, both being below the exemption limit, no anomalous result could thus arise.

The above analysis of the Bihar scheme clearly brings out the confusion of thought underlying it. The Act, in making companies taxable as individuals with the same exemption limit and at the same graduated scale, wrongly applied the faculty theory to companies. The legislators obviously intended that the tax would be levied on the company as such. The Rule-makers, not recognizing the distinction between a tax on the company and taxation at the source, made confusion worse confounded so that extremely anomalous results, illustrated above, arise under the operation of the Rule.

Assam

In Assam the agricultural income of a company is taxed at the maximum rate of two annas in the rupee. There is no exemption limit and the rate is not graduated so that the maximum rate is applicable to the whole of the agricultural income of the company.

The dividend received by a shareholder in a company is exempt from the tax. The shareholder, however, receives no refund of

any portion of the tax paid by the company. The tax is paid by the company on its own behalf and there is no machinery provided in the scheme by which the tax can be adjusted to the agricultural income of the individual shareholders.

The tax on companies in the Assam scheme, therefore, corresponds to the supertax on companies in the Indian Income-tax Act.

The objection of the Indian Tea Association to this method of company taxation was expressed by Mr J. R. Clayton on the floor of the Assam Assembly as follows:

'The principle of income-tax is that the person who actually enjoys the income is to be taxed and at the rate applicable to his income. For convenience of collection for the Revenue, the Acts permit of the taxation at source, i.e. taxation of the company, taxation of the firm, in the case of co-owners of property taxation of one person on the whole income, or in the case of a trustee and beneficiaries taxation of the trustee and so forth. The elaborate machinery to enable taxation at source for the benefit of the Revenue correspondingly involves elaborate machinery for the allowance of refunds to the tax-payer.

'The system of taxation at source means that until the refunds are granted the Revenue have had more tax than they are entitled to and the tax payer is correspondingly out of pocket. Since this intricate system is introduced into the Bill as effective clauses to assist the Revenue in taxation at source, it follows that it is equally important to introduce into the Bill as effective clauses the detailed provisions for refunds. Such is the scheme of the United Kingdom Income-tax Acts and of the Central Income-tax Acts and it has never been suggested anywhere (apart from the Bihar Bill) that refunds should be left to the rule-making powers.'[1]

The Finance Minister's answer to this objection was given as follows:

'The manner and circumstances in which refunds should be allowed will be prescribed by rules. Sir, it is not necessary for us to make provision in this Act specifying all the circumstances.'[2]

Accordingly, section 39 of the Assam Act was enacted and it reads: '39. Refunds shall be admissible under this Act. The circumstances and the manner in which refunds shall be allowed shall be prescribed by rules under section 50.'

[1] Assam Legislative Assembly Debates—*Report*, 1939, Vol. I, No. 15, p. 1429.

[2] *Ibid.*, p. 1432.

Section 39 is extremely vague, and is against the canon of certainty.

If the tax imposed on the companies was intended to be correlated to the incomes of individual shareholders, the criticism of Mr Clayton was quite just and the reply of the Finance Minister was rather evasive and vague. If the tax imposed on the companies was meant to be a privilege tax on the companies corresponding to the supertax on companies in the Indian Income-tax Act, the Finance Minister ought to have said so explicitly. In that case no question of refund would arise and this would have been a complete answer to Mr Clayton's objection.

It appears, however, that both Mr Clayton and the Finance Minister were probably suffering from a confusion of thought. The confusion arises from a conflict between a legal concept and an economic concept, which, though the same in name, are different in their connotation.

The distinction made in the science of economics between an income-tax and a corporation tax has been already explained. Income-tax is correlated to the income of individuals, is graduated and has got an exemption limit: it is based on the faculty theory of taxation. A corporation tax is levied on the legal personality of a company, should not be graduated, and should have no exemption limit: it is a privilege tax and is based on the grant of special privileges to companies as such by law. It is not correlated to the incomes of individuals and is not based on the faculty theory of taxation.

In the Government of India Act, 1935, both the concepts of income-tax and corporation tax are recognized but with slightly different meanings. The concept of the corporation tax has been limited in the Act and the concept of agricultural income-tax has been correspondingly enlarged. The following is the definition of a corporation tax given in section 311(2) of the Government of India Act, 1935:

'"Corporation tax" means any tax on income, so far as that tax is payable by companies and is a tax in the case of which the following conditions are fulfilled:

(*a*) that it is not chargeable in respect of agricultural income;

(*b*) that no deduction in respect of the tax paid by companies is, by any enactments which may apply to the tax, authorized to be made from dividends payable by the companies to individuals;

(*c*) that no provision exists for taking the tax so paid into account in computing for the purposes of Indian Income-tax the total income of individuals receiving such dividends or in computing the Indian Income-tax payable by or refundable to, such individuals.'

Conditions (*b*) and (*c*) are quite compatible with the economic concept of the corporation tax. They ensure that the tax must be a tax on the company as such and that no machinery should exist by which the tax can be transformed into a tax on individual shareholders and correlated to their personal incomes. But condition (*a*) is new and restricts the content of the term as understood in economics. It means that agricultural income-tax payable by companies cannot be a corporation tax even if the other conditions are fulfilled.

Thus a tax paid by a company as such on its agricultural income is a corporation tax in economics but in the Government of India Act, 1935, it is an agricultural income-tax and not a corporation tax. The supertax on companies in the Indian Income-tax is a corporation tax both in economics and in the Government of India Act, 1935. But according to the Government of India Act, 1935, a similar supertax on companies deriving agricultural income, if imposed by a Provincial Act, will be an (agricultural) income-tax and not a corporation tax, though it will be a corporation tax according to the science of economics.

The right of the provinces to levy a privilege tax on companies deriving agricultural incomes is based on this legal distinction. The Central Legislature derive their power of imposing the income-tax on individuals, including the supertax, which is nothing but 'an additional duty of income-tax' from item 54 of the federal legislative list—'taxes on income other than agricultural income'. They cannot impose the supertax on companies on the strength of that item: but they impose the supertax on companies on the strength of item 46 of the same list—'Corporation tax'.

The Provincial Legislature, however, can impose both the taxes in respect of agricultural income on the strength of a single item in the provincial legislative list, namely item 41—'taxes on agricultural income'. Any tax on agricultural income is a provincial subject and the Provincial Legislature is the only authority which can impose such a tax. A supertax or a privilege tax on the agricultural income of a company will be such a tax and as it is outside

the scope of the 'corporation tax' as defined in section 311(2), no question of conflict with a Central subject arises.

It is extremely important to bear the distinction in mind. Though a tax on companies deriving agricultural income is, in the legal sense, an agricultural income-tax and not a corporation tax it is in the economic sense a corporation tax and not an income-tax. When looking for the constitutional competence of the provinces to levy such a tax, it has to be treated as a tax on agricultural income but when looking for its economic justice, it has to be treated as a corporation tax.

Mr Clayton, in his speech quoted above, was examining the tax on companies in the Assam Act as an income-tax, though it was not so in the economic sense. The Finance Minister fought shy of calling it a corporation tax in the economic sense because a corporation tax in the legal sense was outside the competence of the Provincial Legislature. The tax imposed is really a corporation tax in the economic sense, though quite within the competence of the Provincial Legislature. But as it was not recognized as such by Government nor by the opposition, it could not be examined as such but a vague provision for refund was added to the Act.

Examined in the correct perspective, a corporation tax of two annas and six pies in the rupee was too high in view of the fact that the Central rate was only one anna in the rupee. Secondly, the levy of a corporation tax is no ground for exempting individual shareholders in respect of their incomes derived from companies. Nor is the exemption of individual incomes derived from companies a proper ground for raising the rate of the corporation tax as the incidence of the two taxes is different, one falling on shareholders according to their faculty and the other falling on them according to their interest in the company. Two confusions seem to have influenced the Assam Act in this respect.

They are:

(*i*) A confusion between taxation of companies as such and taxation at the source.

(*ii*) A confusion between the legal concept of the corporation tax and agricultural income-tax and the economic concept of the corporation tax and agricultural income-tax.

Apart from any confusion, there was a good reason for the opposition of the European Party in the Assam Legislature to this manner of taxation of the agricultural income of companies.

According to the law of double taxation relief, as prevailing in the United Kingdom, British tea planters in Assam would have been able to get a refund of the whole of the tax levied in Assam from the United Kingdom treasury, if the tax was an income-tax proper in the economic sense. No refund of a corporation tax (in the economic sense) levied in any country of the British Empire is admissible in the United Kingdom. Hence the European Party was materially interested in changing the form of the tax, apart from the question of its rate. This point, however, does not appear to have been specifically raised during the debates in the Assam Legislature. The point will be explained at some length in connexion with the Bengal measure.

Bengal

The Bengal scheme is the same as the Central scheme. No tax is levied on the companies as such. Income-tax at the maximum rate is levied on the whole of the agricultural income of a company. The tax so paid is deemed to have been paid on behalf of the shareholders and there is admissible to each shareholder a refund equal to a sum obtained by the following formula:

$$D \times (m_r - w_r)$$

where D = the amount of dividend received by him,

m_r = the maximum rate at which the tax has been paid by the company, and

w_r = the average rate of the tax that would have been payable by him if his total world income were all agricultural income.

This is the income-tax proper levied on individual shareholders.

The adoption of world income as a basis of refund has been criticized on the ground that its net effect is to tax dividends at a higher rate than other forms of agricultural income. The criticism is obviously correct. To it the following answer has been given by Government. If the artificial distinction between agricultural and non-agricultural incomes had not existed in the country, the only basis on which a claim for refund would have been admissible would be the world income of the shareholder and the basis could not have been considered discriminatory in that case. It is this artificial distinction which brings into being some discrimination as already explained in Chapter I; the adoption of world income as a basis

of refund only reduces the area of iniquity created by the distinction. Hence though this particular provision is discriminatory as between persons coming within the scope of the agricultural income-tax, it only reduces the extent of discrimination, if we take into consideration all persons earning incomes, whether agricultural or non-agricultural.

Secondly, shareholders of tea or sugar companies are not likely to have much agricultural income from other sources. The reasons for the belief are two. First, it is the business people—not landlords having other source of agricultural incomes—who mostly invest in the shares of such companies. Secondly, by definition, agricultural income is restricted to agricultural income arising from lands in British India. As a substantial proportion of the shares in such companies is held by persons resident outside British India, they will not have any other source of agricultural income because even if they are agriculturists in their own countries, the agricultural income derived there will not be agricultural income within the meaning of the term as defined in the Indian enactments. Further, the whole of the dividends received from such companies will not be agricultural income. In the case of the tea companies only sixty per cent of the dividends received will be agricultural income. In the case of the sugar companies such portion of the dividends received by the shareholders will be considered to be agricultural income as will bear to the whole of the dividend received the same ratio which the agricultural income of the company bears to its whole income. From the reasons given above, it appears that that portion of the dividends received by a shareholder which will be agricultural income is not likely to exceed the exemption limit, namely three thousand five hundred rupees, in many cases and as this portion will in most such cases be the only agricultural income of the individual, he can claim a refund of the whole of the tax paid by the company on his behalf, if the total agricultural income—and not the total world income—were made the basis of refund. Government might have, in such a case, been called upon to refund most of the sums that they would collect from the companies—except of course the tax collected in respect of that portion of the profits which were not distributed. A tax collected with one hand and refunded with the other is not worth having and does not satisfy the canon of economy. All these difficulties are clearly due to the artificial distinction made

between the two parts of a man's income, and would not have arisen if the distinction were not there. The adoption of world income as a basis of refund avoids these difficulties and makes the tax both equitable from the wider standpoint and economical to collect.

The absence of any tax on companies as such unnecessarily continues an existing inequality which it was one of the purposes of the measure to remove. When companies earning non-agricultural income pay such a tax, there is no ground in equity to exempt companies earning agricultural income from this tax. Similarly, there is no reason in equity why companies deriving mixed incomes should pay the corporation tax only on the non-agricultural portion but should be exempt in respect of the agricultural portion.

It appears that a confusion was at the root of the omission of the tax from the Bengal measure. The confusion was one between the supertax on individuals and the supertax on companies. The two, as explained already, are identical only in name but are fundamentally different. But because there was no supertax on the agricultural income of individuals, it was apparently considered unjust to impose a supertax on companies. The statement of objects and reasons published with the Bill mixes up the two and says that in the Bill 'there is no supertax'. As already explained, the justification of a tax on companies and the justification of a tax on individuals are based on entirely different grounds and the one can exist, in equity, without the other. The ostensible purpose of introducing the agricultural income-tax was that it would remove, at least in part, the then existing disparity in the treatment accorded to agricultural and non-agricultural incomes in the system of taxation prevailing in the country. The Bengal measure actually sought partly to remove it only as far as individual incomes were concerned; it did not touch the disparity in respect of the income of companies. There was no justification for such a course of action, particularly when the province was adopting other less desirable forms of taxation.

In this connexion reference may be made to the opinion held by some distinguished economists that the corporation tax should be altogether abolished in the interest of industrial development.[1] Savings made by corporations, they say, play an increasingly

[1] See Professor J. P. Niyogi's article on 'Tax Relief and Industrial Enterprise in British India'—*Calcutta Review*, July, 1942.

important part in the industrial development of the country and at the same time such savings are very susceptible to the imposition of the corporation tax. Hence it is suggested that the abolition of the corporation tax will increase such savings which, in their turn, will lead to an increase in the pace of industrial development in the country. There is undoubtedly an element of truth in this argument. But it is clear that this does not affect the validity of the position, taken up in the foregoing paragraph, which is based chiefly on the existing inequality of treatment accorded to the two classes of companies or to the two parts of the income of the same company. Further, when, pressed by the need for additional revenue, the Provincial Government adopt measures like the increased rates of provincial excise and the sales tax of which the effects are positively harmful to production, besides being undesirable in other ways, the special argument for the abolition of the corporation tax altogether loses its force. The case for the retention of the corporation tax in the form of the agricultural income-tax is further strengthened by its equality of incidence on British and Indian investments in this country, the income-tax form of the tax being discriminatory in character in this respect as will be presently explained.

While the Bengal measure was before the legislature it was criticized in some Indian business quarters on the ground that the form chosen for the levy would have the effect of completely exempting British investors in tea and other companies deriving agricultural income in Bengal, while the Indian investors in those lines would have to bear the full rate of taxation. It has been stated above that the chief reason for the opposition of the British planters to the Assam measure was that the form chosen for the tax in Assam would deprive them of any double taxation relief in the United Kingdom. The two points are allied or are but two aspects of the same question, for the understanding of which, the law of double taxation relief as prevailing in the United Kingdom requires to be explained first.

The law of double taxation relief in respect of countries within the British Empire is contained in Section 27 of the United Kingdom Finance Act, 1920. It provides that when income-tax proper is levied on the same income once in a dominion and again in the United Kingdom, the United Kingdom treasury would grant to

the tax-payer a refund equal to the amount of income-tax paid in the country in which the rate of taxation is lower subject to a maximum of half the amount of income-tax paid in the United Kingdom. As the rate of income-tax now prevailing in the United Kingdom is several times as high as the rate of agricultural income-tax prevailing in Bengal or in Assam, a tax-payer who can prove that he has paid tax on his income once in Bengal or Assam and again in the United Kingdom will get from the United Kingdom treasury a refund equal to the whole of the tax paid in Bengal or Assam. But as already pointed out, an essential condition of getting the refund is that the dominion tax also must be an income-tax proper. It has been explained that of the two taxes paid under the Indian Income-tax Act, by a sterling company operating in India, one is a corporation tax while the other is an income-tax proper. Hence when such a company is again charged income-tax proper in the United Kingdom the shareholders can claim from the United Kingdom treasury a refund in respect of the income-tax proper paid in India, though no refund in respect of the corporation tax paid in India would be admissible. Similarly, a shareholder in a sterling tea company which has paid the agricultural income-tax in Bengal and has also been charged income-tax in the United Kingdom will get from the United Kingdom treasury a refund of the whole of the tax paid in Bengal. A similar refund would not, however, be admissible to the shareholder of a sterling tea company working in Assam, as the agricultural income-tax paid in Assam is not income-tax proper but a corporation tax. Thus the form chosen for the tax in Bengal makes it possible for the shareholder of a sterling tea company working in Bengal to escape the burden of the tax altogether. But the form in which the tax has been adopted in Assam gives no such facility to the shareholder of a similar sterling company working in Assam. This must be the explanation why the British interests strongly opposed the measure in Assam and supported it in Bengal.

The implications of these remarks require further examination. Under the United Kingdom income-tax law, there is no artificial distinction between agricultural and non-agricultural income. In the United Kingdom they tax all incomes on which they can lay their hands either through the objective correlative or through the subjective correlative; i.e. they tax (*a*) all incomes arising in the United Kingdom whether the person to whom it accrues resides in

the United Kingdom or not, and (*b*) all incomes accruing to persons resident in the United Kingdom wherever in the world that income may arise. Hence when a person resident in the United Kingdom derives income from India, he is taxed on that income in the United Kingdom irrespective of whether that income is taxed in India or not. The agricultural income of such a British resident derived from British India was exempt from taxation in this country before 1938 and even now it is exempt if derived from places in British India outside Bengal, Bihar and Assam. But such agricultural income of a British resident has always been subject to taxation in the United Kingdom at the full rate which has invariably been higher than the present Indian rate. As such agricultural income was not subjected to double taxation before, it was also not eligible for the relief provided in the United Kingdom law on account of double taxation. As Bengal is now taxing such agricultural income, the British resident paying such tax in Bengal will be eligible for the relief from the United Kingdom treasury; and as the rate of agricultural income-tax in Bengal is less than half the United Kingdom rate, he will be able to recoup from the United Kingdom treasury the entire amount of the tax paid in Bengal. He therefore escapes the burden imposed by the Agricultural Income-tax Act in Bengal. This does not mean that the British investor in tea, sugar or zemindary in Bengal is paying a total amount of tax which is lower than the total amount of tax payable by the Bengal investor in such lines, or that the Bengal treasury is being deprived of revenue. It only means that the British treasury is, in the interests of British investments in India, taking upon itself the burden imposed by the Bengal measure on the British investors, and is distributing that burden among the general body of tax-payers in the United Kingdom. As the extent to which the United Kingdom treasury will be prepared to take upon itself the burden imposed in Bengal is limited to the amount paid in the country with the lower rate of taxation subject again to a maximum of half the amount paid in the United Kingdom, the British investor in such businesses in Bengal will never bear a *total* burden of taxation which will be less than the total burden borne by the Bengal investor.

The British investor in tea, sugar or zemindary in Assam, however, cannot claim any relief in the United Kingdom, because the provisions of the law for double taxation relief in the United Kingdom do not apply to the form in which the tax has been imposed in

Assam. In the United Kingdom there is no corporation tax. The British shareholder in a tea company in Assam cannot prove that he has been subjected to double taxation. For though he has paid income-tax in the United Kingdom he has not paid any income-tax in Assam. The agricultural income-tax imposed in Assam is really a corporation tax which is different from an income-tax and is payable by the company and not by the shareholder. Hence both the taxes would have to be paid simultaneously and the United Kingdom rules about relief of double taxation would not apply.

It has already been pointed out that the choice of the income-tax form (the Bengal form) of the tax does not mean—

(*i*) that the British investor pays a total income-tax less than the Indian investor in tea, sugar or zemindaries in Bengal, or

(*ii*) that the Bengal treasury loses any revenue in respect of agricultural income arising in Bengal to British residents.

What, then, if any, is the substance in the criticism made of the Bengal measure, in Indian business quarters, that the form of the tax chosen in the Bengal Act completely exempts the British investor while imposing the full rate on the Indian investor?

The only point is that the imposition of the agricultural income-tax in Bengal causes a difference in the comparative (net) return made by an Indian and a British resident from investments in tea, sugar, zemindaries, etc., in Bengal. The British resident escapes the levy altogether and hence the net normal return that he expects from such investments in Bengal, after the imposition of the tax, remains the same as it was before the imposition. The Indian has to bear the full burden of the new tax and hence the net normal return that he expects from such investments in Bengal is reduced by the full amount of the tax paid on account of the imposition of the levy. The margin of Indian investment in the line must therefore be pushed up on account of the imposition of the tax while the margin of British investment in it will remain at the same position in Bengal. The tax will be an additional hurdle to cross for the new Indian investor in these lines while the new British investor in such lines in Bengal will not have to face it. As a new and additional discouraging factor the tax will operate only against the Indian investor and not at all against his British competitor in Bengal. It is in this sense that it can be stated that the form chosen for the tax in Bengal worsens the position of the Indian investor

vis-à-vis the British investor in these lines in Bengal. The fact that the British investor will still be paying a total income-tax larger than the Indian investor does not affect the validity ot the argument.

The Assam measure, while depriving the British resident from any double taxation relief in the United Kingdom is free from this defect. According to the Assam measure, no shareholder whether Indian or British is eligible for any refund of a portion of the tax paid by the company. The burden of the tax has to be borne by all shareholders whether Indian or British in proportion to their interest in the company. If the tax imposes an additional burden on Indian investors, it also imposes an equal additional burden on British investors.

To sum up, each of the three Provincial Governments displayed some confusion in respect of the taxation on companies. In Bihar, the confusion is at its worst. Though there the tax is in substance a corporation tax, provision is made for graduation and for an exemption limit. The *Rules* by providing for some refund without making the tax appropriate to the income of the individual shareholders make the position highly anomalous. In Assam the tax on the company is in substance, though not in law, a corporation tax. Examined as a corporation tax, the rate of the tax is excessive. Further the provision for the exemption from the income-tax of dividends received by shareholders is not justified and is probably the result of a confusion between the income-tax and the corporation tax. In Bengal, the Act is free from any confusion in this respect as far as it goes. But the omission of the supertax on companies was perhaps due to a confusion arising out of a mistaken identity between the supertax on companies and the supertax on individuals. Further the discriminatory character of the income-tax form of the tax as against Indian investors does not seem to have been considered.

N.B.—The Government of Assam by a notification issued in December, 1943, made certain rules of refund by which the tax on companies was transformed into an income-tax proper. The tax paid by companies was by these rules deemed to have been paid on behalf of the shareholders and provision for refund to shareholders on their world income basis was introduced. This made the Assam scheme identical with the Bengal scheme in respect of taxation of companies.

V

AGRICULTURAL INCOME-TAX DOUBLE TAXATION

THE phenomenon of double taxation is said to occur when the same person is taxed by two different Governments in respect of the same basis (income or property).

Facilities of quick communications, establishment of empire by certain powers, facilities of transactions across national frontiers, and the emergence of new forms of legal personalities, e.g. corporations, have led to far-reaching developments in the economic world. Wealth and its owners no longer live invariably under the same Government. They are very often to be found living under different Governments, so that it is possible for each of them to impose a tax on the owner in respect of the same wealth or the same income which that wealth yields. The country of location of the wealth taxes him on the ground that the wealth is situated or the income thereform arises within its borders. The country of residence of the owner taxes him on the ground that he lives within its borders and is a wealthy man. Apart from any question as to the respective claims of the country of location and the country of residence to tax such wealth or income in fairness and economic justice, most countries find it impossible in practice to restrict their taxation either to the principle of origin or to the principle of residence. In the highly developed countries of the West a considerable proportion of wealthy inhabitants derive large incomes from outside the country. To confine taxation to wealth or income on the location principle only would not only be impracticable in such countries but would lead to a widespread anomaly of a far-reaching character which it would be impossible to support or maintain. For, the scope of taxation will be so severely restricted in that case that the exchequers of these countries will not be able to afford such restriction. Further, rich men would be exempt on the ground that they derived their income from outside the country while their poorer neighbours would have to bear the burden of the country's taxation on the ground that they derived their income from within

the country. This is an anomaly which it would be impossible to justify politically.

Similarly, the undeveloped countries of the East cannot give up the origin principle. Very few of their citizens have got investments abroad while a large number of foreigners own property or business in such countries. To levy taxation in such a country on the residence principle alone, to the exclusion of the origin principle, will throw too severe a strain on the country's exchequer and at the same time the anomaly caused by the wealthy foreigner deriving large incomes within the country but going tax-free will be impossible to justify politically.

For reasons explained above most countries adopt the double principles of origin and residence. They tax (*i*) all incomes arising or originating within the country as well as (*ii*) all incomes accruing to a resident within the country, in whatever part of the world his income may have origin. As a result the phenomenon of double taxation has emerged and has assumed considerable importance in modern times.

The economic consequences of double taxation have been discussed at some length in the *Report on Double Taxation* submitted to the Financial Committee of the League of Nations by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp. The discussion assumes that the rate of taxation in the country of residence is fixed and that double taxation starts by the imposition of a tax in the country of investment, which is given a fictitious name Morania to avoid the raising of any prejudices or presumptions which might be associated with the use of an actual or specific country. There is a further assumption underlying the discussion, though not expressly stated, namely that residence is not mobile while capital is mobile. The double taxation may, however, start on the other end as well, i.e. by the country of residence increasing the rate of tax, or by levying a new tax like a capital levy. It is also not clear that residence does not react to taxation or that taxation exerts a greater pressure on capital to change location than on the owners to change residence. Without entering into the question of validity of these assumptions, it will be enough for the present purpose to point out that the validity of the conclusions is based on the validity of these assumptions and any incorrectness in these assumptions may alter the conclusions to some extent.

Further, the assumptions clearly make the discussion incomplete. While it analyses the effects of a tax imposed in the debtor country on the foreign investments made in that country, there is no analysis of the effects of a tax imposed in the creditor country on the economic well-being of that country. This defect may have materially vitiated the final conclusion of the Report, but it is not very material to the very limited purpose of this chapter which is to determine what is good policy in this respect as far as the Provincial Agricultural Income-taxes of India, which is a debtor country, are concerned.

In course of the discussion a distinction is drawn between two types of economic consequences. With respect to some investment, the double taxation imposes a *burden* on the investor, whereas with respect to others, it imposes no burden on him. The double taxation, however, acts as a *barrier* in respect of some other investments which are effectively shut out from the country on account of the tax. This distinction between the 'burden' effect and the 'barrier' effect of a tax is important. These two classes of effects also appear in the case of an import duty. The extent to which each class of effects will emerge in the case of double taxation is indicated below:

(*a*) Any non-resident investor placing his investment in Morania, knowing it will be subject to taxation, throws back upon the borrower the burden of the Moranian tax primarily or apparently placed upon himself (the non-resident investor), and as an investor, is not in this event subject to double taxation.

(*b*) Taxation imposed in Morania on investments placed there by investors of other countries will act as an impediment to the movement of capital to Morania. The reason of this restriction of movement is that a marginal quantity of British capital, for example, has by reason of the imposition of the Moranian tax been induced to seek other fields of investment.

(*c*) Taxation imposed in the country of investment, after the date of investment, which is heavier than that anticipated or provided for by the investor will impose double taxation in a true sense, from which the investor will find it difficult to escape owing to the effect of amortization.

The economic consequences of double taxation are, at the end of the discussion, summarized as follows:

'Hence, double taxation sets up, first, a tendency for new investment to be restricted to capital available within the borders of the

country itself. It acts like a tariff for concentrating manufacture within the country and restricting international intercourse. It sets up a tendency for old investments to change ownership from foreigners to Moranian investors and to make the country still more self-contained. In throwing the body of foreign-held securities upon the Moranian market, it doubtless tends to depress capital values (i.e. to increase the rate of interest in Morania to a point where the non-resident investor would sacrifice in the reduced sale price the whole of the possible advantages he gets in escaping his double taxation by sale).'[1]

Now it is apparent that these consequences will ensue from any tax imposed in Morania on the foreign investor or on his Moranian investment irrespective of whether there is double taxation or not. Even if the investor's country has a tax system which taxes only such wealth as is situated within the country, the same set of consequences will ensue on the imposition of a tax in Morania even though there will be no double taxation.

Further the discussion is obviously incomplete in that it does not proceed to determine whether these consequences are good or bad from the standpoint of the country of investment. The answer to this question will obviously depend on the stage of economic development of the country and also to some extent on its political power. The tax will no doubt retard the economic development of the country, unless it is a very highly developed country, and in so doing it will impose a burden on the people of the country of investment. But there may be circumstances under which it may be good policy to bear these consequences, in the expectation of a future gain, just as it is sometimes good policy for a country to bear the consequences of an import duty in the expectation of a future gain. A country may be politically developed but economically undeveloped, e.g. the U.S.A. in the nineteenth century; in such cases it is certainly good policy to encourage the import of foreign capital. But a country may be at a stage at which she wants the stimulus of a higher rate of interest to draw out large potential volumes of internal capital whereas cheap foreign capital may not only retard the development of the habit of investment but also may be a cause of her political subservience which in its turn may react very badly on the economic condition of her people. Under such circumstances it may be good

[1] Part I, pp. 16-7.

policy to impose a tax on foreign investments. At least under such circumstances it will not be desirable on the grounds of immediate economic benefit to exempt the foreign investor while imposing the tax on the home investor.

The above arguments which are contained in Part I of the Report are self-contained and are hardly material to the rest of the Report. In the rest of the Report a doctrine of economic allegiance is developed. The economic allegiance of a person in respect of certain classes of wealth is attempted to be apportioned as between the country of his residence and the country of location of the wealth and finally an attempt is made to indicate the proportion in which a person should pay tax to the two countries on the basis of the economic allegiance as apportioned. It is the action of the person on the source or rather the interaction as between the source and the person that makes the source productive. To determine which of these two elements plays the more important part in the productive process is obviously a task of the utmost difficulty. In fact in most cases, the task baffles any precise analysis. On the one extreme, there is the income from land in the derivation of which the owner's part is negligible, and on the other extreme there is the income from professions in which the personal element is all important. In between the two extremes, there are other sources of wealth in respect of which the proportionate importance of the two elements varies very widely. The Report classifies wealth into twelve classes and further divides the classes into two groups according as origin or domicile is of predominant influence in making it productive. The classification and the grouping are as follows:

Category of wealth	*Preponderant element*
Land	Origin
Mines, oil wells, etc. ..	,,
Commercial establishments ..	,,
Agricultural implements, machinery, flocks and herds.	,,
Money, jewellery, furniture, etc.	Domicile
Vessels	Origin
Mortgages	Origin in case of the property tax but domicile in case of the income-tax.

Category of wealth	*Preponderant element*
Corporate shares ..	.. Domicile
Corporate bonds ..	.. ,,
Public securities ..	.. ,,
General credits ..	.. ,,
Professional earnings	.. ,,

This table indicates only the preponderant element in the productive processes involved in the items of wealth mentioned. No attempt is made for any exact apportionment of the importance of the two elements. The Report says:

'To allocate the exact proportion of economic allegiance to origin or domicile in each particular category is well nigh impossible. Such an attempt would savour too much of the arbitrary. But where any two countries desire to make such an allocation, they would do well to be guided, ideally at least, by the above analysis.

Where it would be too complicated to make the exact apportionment between the claims of origin and domicile in each category of wealth, a certain rough justice can be attained by turning over all the categories in the first division completely to the place of origin, and by turning over all the categories in the second division completely to the place of domicile. What each country would lose in the one case it would roughly gain in the other, and there would be the great additional advantage of comparative simplicity.'[1]

The idea of equality of gains and losses as stated above is to be understood with reference to the assumed abstract norm. Such an ideally normal condition is a condition in which an exact apportionment of allegiance and an exact allocation of revenues on the basis of such apportionment are possible. Thus the equality of gains and losses postulated in the foregoing statement of the experts does not mean an equality of actual losses and gains. As a matter of fact the acceptance of the suggestion might be very favourable to one country and very unfavourable to another from the standpoint of the actual revenues. The importance of the point has been recognized in an earlier part of the Report as follows:

'There may be a conflict between the fiscal principle arrived at on a purely theoretical ground and the desirable financial or economic expedients, having regard to the state of the national budget in each country. In other words, what ought to be done may be quite clear; but what it may be practically possible for a Government to give up in the way of revenue, in the light of its

[1] Part II, p. 39.

historical development, may be quite another thing. In what follows we shall limit ourselves to the principles which ought to govern the *ideal* fiscal allocation of the tax.'[1]

The gains and losses are to be understood by reference to this *ideal* allocation and not by reference to the revenues which the countries are actually deriving.

The Report then proceeds, in Part III, to discuss four possible alternative methods of relief from double taxation, which are:

(*i*) *The method of deduction for income from abroad.* According to this method, a country deducts from the tax due from its residents any tax paid by them on their income abroad. This is analogous to the United States practice in the case of its own citizens.

(*ii*) *The method of exemption for income going abroad.* This is the converse of the first method. According to this method, the country of origin should exempt all non-residents from taxation imposed on income drawn from sources within its borders.

(*iii*) *The method of division of the tax.* Two countries may by convention try to divide specified taxes so that a portion should be borne by the country of origin and the remainder by the country of residence.

(*iv*) *The method of classification and assignment of sources.* This method flows from the doctrine of economic allegiance. Taxes from those sources in respect of which origin is predominant will be assigned to the country of origin while taxes from those sources in respect of which the element of domicile is predominant will be assigned to the country of residence. It might be agreed that the country of origin would retain in full the specified origin taxes, e.g. taxes on rents of land and of houses and mortgages on real property, but would exempt the non-resident in respect of income derived from 'domicile' taxes, e.g. taxes on income derived from business securities. The country of residence would allow the whole of the foreign tax as a deduction from the income-tax levied on the resident in respect of those sources in regard to which the element of origin is predominant but would charge other sources in full.

It is clear that the fourth method is the only method which follows logically from the doctrine of economic allegiance. The Report establishes, in Section II of Part III, that this method is

[1] P. 21.

capable of application in respect of taxes on property like death duties or capital levies. How the acceptance of this method in respect of such taxes would react on the financial equilibrium of a country's exchequer or on its economic interests is, however, not discussed, and it is this reaction which will always prove decisive for a country in choosing this method.

The Report then proceeds to discuss the question of double taxation relief in respect of income-tax. It establishes that income is such a composite and complicated concept that the application of the doctrine of economic allegiance will in most cases prove impracticable, even if countries could agree upon the principles underlying the doctrine. The doctrine of economic allegiance and the discussion of the economic consequences of double taxation will, however, be very useful to countries trying to arrive at an agreement on the point.

If all the world was one State imposing one tax, there is no doubt that each man would be taxed only once on his entire property. The rival principles of origin and domicile would in that case lose all significance.

Secondly, when conditions in two countries are fairly equal so that there is a balance of income arising in one country to the residents of the other, an agreement may be easy on the basis of the second method or even on the basis of the first method.

Difficulties, however, arise when conditions are not balanced. They become insuperable when the interests of two countries are diametrically opposed. A particular country in its relations with the rest of the world or with another country may be solely a country of origin, while the other country, in its relations with the rest of the world or with the first country, may be solely a country of residence. That is to say in the case of the one country none of its residents derives income from abroad though a large number of non-residents derive income from sources within its borders while in the case of the other country there is no non-resident deriving income from sources within its borders though a number of its residents derive income from abroad. It will be difficult if not impossible, to reconcile the interests of two such countries. Again, the difference in the system of taxation which usually exists as between such countries, introduces further complications. While the more developed countries rely more and more on income-tax, based on the entire faculty to pay tax of its residents, the backward

countries mostly rely on taxes on things or on specific sources. The advanced countries would not agree to give up the residence principle while the backward countries could not give up the origin principle. 'It is to be doubted', says the Report, 'whether such creditor countries as the United States, Great Britain and the Netherlands, having regard to their interest abroad, would ever agree permanently to put their exchequers at the mercy of all the unknown increases of taxation of foreign Governments.'[1]

Similarly, as the Report points out: 'Countries of origin, such as tropical and agricultural countries, see only the beginnings of production; recipients of the final wealth live abroad. Are such countries to be at the mercy of every kind of legal conception of income, and income taxation in all these different countries with which they have relations before they know what their taxation is to be? They would say at once "We must take for granted the existence of the economic and legal apparatus for the rest of the world; we know what the value of the produce is when it leaves our shores in the light of the world economic organization. All that we can do is to measure the taxation due to us from the person who takes that away by reference to that value".'[2]

'Such countries', continues the Report, 'would refuse to be bothered with questions as to whether the whole of the operations ultimately resulted in a profit or a loss to some unknown foreign recipient.'[3]

The Report suggests that an agreement might possibly be attempted on a combination of the second and fourth methods. Some origin taxes may be specifically allocated wholly to the country of origin, e.g. taxes on rents from lands and houses, etc. Subject to such allocation, the non-resident should be exempt from taxation in respect of other sources. In this way an equality of the sacrifices involved on two sides may be arrived at in some cases.

It is thus clear that double taxation cannot be avoided as long as countries are organized into separate States. No solution for removing all double taxation has yet been found. When a country is urgently in need of capital from the foreigner, e.g. during a war, it has often offered him tax-free securities, and in such cases there is no double taxation. The United States of America refunds to her citizens the whole of the taxes they pay abroad. In the British Empire, there is a certain rule of double taxation relief as between

[1] P. 42. [2] Pp. 26-7. [3] P. 27.

the countries composing the Empire. Except for these few instances of limited scope, double taxation has always existed. Every country retains the right to impose a tax on all incomes arising within the country and all incomes arising to its citizens, wherever in the world it may have origin. The extent to which it will restrict itself or the extent to which it will grant a refund has been always determined on grounds of purely national interest with sole reference to the economic and financial consequences of such taxation or refunds.

The Royal Commission on the United Kingdom Income-tax, 1920, considered this question at some length and the conclusions arrived at by them will bear quotation. Referring to the suggestion that British residents should be exempted in respect of their incomes earned abroad, the Commission say:

'On the plea that British-controlled concerns trading in a foreign country should be put on the same level as their foreign competitors, it has been suggested, for example, that such a far-reaching alteration should be made as to restrict their liability to the profits earned in this country, plus the amounts remitted here out of profits earned abroad. While we should be very reluctant to recommend the continuance of any provision that would in any way prejudice the conduct and extent of our foreign trade, we cannot recommend that a burden should be lifted from any particular class of tax-payers unless we are satisfied that the effect of that relief, considered in conjunction with the heavier burden consequently to be placed on all the remaining tax-payers, will result in a fairer distribution of the total burden to be borne.'[1]

The Report continues, 'In view of the present demand for capital to develop home industries, should we be justified in recommending differential taxation which will become more and more favourable to the British resident as he employs more and more of his capital abroad? Presumably capital is attracted to foreign countries owing to the higher rate of profit it can earn abroad. If we acknowledge, as we do, the principle of "ability to pay", could we say that two traders residing here with equal incomes, one derived from foreign trading (after deducting all foreign taxes) and the other from trading within the United Kingdom, should pay very unequal amounts of tax? We feel we cannot answer these questions in the affirmative. Moreover, we should be reluctant, in our present national circumstances, to suggest any measure that could possibly be interpreted as a suggestion that a bonus should be given on the export of capital.'[2]

[1] Part I—Section II, ¶ 32.

[2] Part I, Sec. II, ¶ 33.

On the subject of double taxation, the Commission state as follows:

'This country imposes a tax on all income arising within its borders; it also taxes the income of a person resident here, in whatever part of the world his income may have its origin. In those foreign countries where an Income-tax exists, the tax is, for the most part, levied by each country only upon income arising within its own boundaries. Without a somewhat serious departure from the principle of "ability to pay", one of the fundamental principles underlying the United Kingdom Income-tax, we could not abandon our claim to base our tax, where necessary, on residence alone; for, if we did abandon it, the anomaly would arise of two British residents with equal incomes paying very unequal taxes. Each would be enjoying the privileges of residence in this country, and the only justification of differential treatment for the purposes of taxation which could be advanced would be that one British resident had contributed to the revenues of a foreign State while the other had not done so, an argument which would certainly not carry conviction to the ordinary tax-payer who would be called upon to make good the tax lost by any relief granted, unless the arrangements were based on a principle of reciprocity or national policy.'[1]

The Report continues:

'In considering the results that may follow a continuance of the liability of certain classes of income to be taxed both in this country and in a foreign State, it must be admitted that the high rate of United Kingdom Income-tax may possibly cause foreign subjects, now resident in this country, to return to the country whence the bulk of their income is derived. They may feel that the privileges of residence within the United Kingdom are too costly. We do not, however, think that the loss of revenue under this head will be serious. With the case of British subjects resident in this country who derive their income from abroad, we have already dealt. It must be frankly recognized that the British subject who is resident in this country will not normally send his capital abroad *unless the net return on that capital* (*i.e. the return after deducting foreign taxes*) *exceeds the yield obtainable on capital employed within the United Kingdom*,[2] and we have already discussed the consequences that might ensue if a bounty, in the form of a remission of United Kingdom Income-tax, were given to the British resident who, in existing circumstances, finds it to his advantage to employ his capital abroad.'[3]

[1] Part I, Sec. VII, ¶ 81.
[2] The italics are mine.
[3] Part I, Sec. VII, ¶ 82.

The Commission then recommend: 'In the present circumstances we cannot recommend any change in the existing situation as to double taxation of the same income by the United Kingdom Government and by the Government of a foreign State.'[1]

The question is attacked purely from the standpoint of national interest and on the basis of the economic consequences and the financial results of the tax. There are really three chief points underlying the argument:

(*i*) The United Kingdom is much more interested in the 'residence' tax than in the 'origin' tax and hence to give up the residence principle is neither financially practicable nor politically possible.

(*ii*) In most cases, the double taxation in only nominal, and the double taxation does not mean a double 'burden'. This has been explained while discussing the economic consequences of double taxation.

(*iii*) In the present economic conditions of the United Kingdom, it will be against her economic interest to adopt any measure which would in effect be a grant of a bounty on the export of capital.

On the basis of these three points it is concluded that there is no urgent necessity to remove the double taxation.

The counterparts of the first and the third points and the second point can be used under certain circumstances, by a debtor country to support the same conclusion and the same action.

It is important to note that double taxation imposes a double burden only to a very limited extent. Only existing investments in so far as they did not anticipate and provide for increased taxation in the country of investment, would have to bear the double burden. Even then the foreign investor will have under certain circumstances a chance of selling out his investments to a resident of the country at a price existing prior to the imposition of the burden.[2] Hence an income-tax in the country of investment seldom leads to the imposition of double burden, even though it may lead to double taxation. The double taxation may, however, impose certain burdens on the country of taxation which have been well summarized in the Report on Double Taxation and already quoted earlier in this chapter. Hence in most cases the term 'relief of double taxation' in the sense in which it is usually

[1] Part I, Sec. VII, ¶ 83.

[2] *Report on Double Taxation*, Part I, p. 16.

used is misconceived. Very often the foreign investor is not in need of any relief. It is the country of taxation which really imposes a burden on itself by the taxation. The burden is not measured by the incidence of the tax but is of far-reaching character and causes other economic changes involving suffering. In this respect the incidence and the effects are comparable to those of a protective tariff. But there may be circumstances under which the country of investment may choose to undergo that hardship in the hope of a future gain of a permanent nature. In this respect also a tax on foreign investment is similar to a protective tariff. The substance of all the arguments is that the question of double taxation must be determined by each country on the ground of national self-interest taking into consideration the economic consequences, immediate and ultimate, of such a tax. Two or more countries may try to enter into an agreement on such questions arising between them but there also each country must obviously be guided by its own national interest and reference to a higher principle is not only futile but inappropriate.

It is also to be recognized that in the world, as at present organized, no objection can be taken to double taxation as such. Every country depends on multiplicity of taxation for its finances and in countries with federal Governments, the same citizen may pay two income-taxes in the same country. So the question of double taxation has always to be attacked from the standpoint of national interest on the basis of its economic consequences. In a country with a federal Government, multiple taxation has also to be considered on the basis of an equitable distribution of the tax burden but in international affairs such a consideration is obviously out of place.

The Royal Commission took a different view on the question of relief of double taxation within the Empire. There they considered some measure of relief urgent because of 'all that is implied in our conception of the British Empire, the sharing of common burdens, the common interest in the well-being of every part of the Empire, and the desire for free circulation of capital within the Empire'.[1]

The Commission deputed a sub-committee of some of their members to confer with representatives of the self-governing

[1] Part I, Sec. VII, ¶ 79.

dominions and of India and they invited the United Kingdom Board of Inland Revenue to send a representative to the Conferences.[1] On the recommendation of this sub-committee, the Commission made the following recommendation:

In respect of income taxed both in the United Kingdom and in a Dominion there should be deducted from the appropriate rate of the United Kingdom income-tax the whole of the rate of the Dominion income-tax charged in respect of the same income, subject to the limitation that in no case should the maximum rate of relief given by the United Kingdom exceed one-half of the rate of the United Kingdom income-tax to which the individual tax-payer might be liable.

Any further relief necessary in order to confer on the tax-payer relief amounting in all to the lower of the two taxes (United Kingdom and Dominion) should be given by the Dominion concerned.

This recommendation was in due course implemented by the Government of the United Kingdom and the Governments of the Dominions including India. Section 27 of the United Kingdom Finance Act which gives effect to this recommendation does not make the relief conditional on the grant of the remaining part of the relief by the Dominion Government. Further, considering the great disparity between the United Kingdom rate of income-tax and the Dominion rates of income-tax, the burden of the relief has mostly been borne by the United Kingdom exchequer.

Section 49 of the Indian Income-tax Act gives effect to the second part of the recommendation in its application to India, and this provision is protected by Section 108 of the Government of India Act, 1935, which enacts that without the previous sanction of the Governor-General given in his discretion there shall not be intro-

[1] The position of the representatives was stated by the Chairman of the Commission to be as follows:

'The Delegates from the Dominion and Mr Harrison are more or less in the position of assessors sitting with a Court. It is obvious that instead of calling a number of witnesses, the sub-committee, with these Delegates sitting with them, may be able to arrive at conclusions which will commend themselves as practicable, and also as more or less politically expedient to the various Governments concerned; but in my judgement, it is the members of this Commission, forming the sub-committee, who must come to a conclusion and make a Report.'—Para. 4 of the Report of the sub-committee.

Neither the sub-committee nor the Commission examined any Indian witness.

duced into or moved in either Chamber of the Federal Legislature, any Bill or amendment which affects the grant of relief from any Federal Tax on income in respect of income taxed or taxable in the United Kingdom. In the matter of granting his previous sanction to such legislation, the Governor-General is subject to the control of His Majesty's Government.[1]

The ground on which the above recommendation of the Royal Commission is justified is, as already stated, 'the common interest in the well-being of every part of the Empire and the desire for free circulation of capital within the Empire'. The recommendation no doubt secures the free mobility of British capital throughout the Empire. It ensures that wherever within the Empire, British capital will go, the income derived from it will be taxed at the same rate prevailing in the mother country.[2] This arrangement is obviously good for British capital. It is, in fact, necessary for a country with an Empire. That the mother country puts great importance on this is proved by the facts—

(*a*) that a burden which would have been borne by capital, but for this arrangement, is by this arrangement distributed mostly among the general body of British tax-payers, a portion under certain circumstances being thrown on the tax-payers of the Dominions; and

(*b*) that a provision is inserted in the Constitution Act protecting this portion in the Indian Income-tax Act against any amendment by the Indian Legislature.

From the Indian standpoint the arrangement is to be judged solely by reference to her economic interest. The Indian Income-tax Act, like the United Kingdom Income-tax law, taxes incomes both on the origin principle and on the residence principle and hence there is nothing wrong in trying to have an agreed basis of double taxation relief. The only question is, having regard to the very limited interest of India in the residence principle, is the sacrifice of revenue she is making or has undertaken to make, if necessary, commensurate with the benefits Indians are getting in the United Kingdom; or is the free circulation of capital within the Empire of any net advantage to India after fully considering the advantages Indian capital and Indian industry obtain by this arrangement and

[1] Sec. 14, Government of India Act, 1935.

[2] Assuming that the United Kingdom rate continues to be the highest in the Empire.

the disadvantages suffered by Indian capital on account of the increased competing power of British capital secured by this arrangement? It is not necessary to go into this question for our present purpose. Indians have often been of opinion that the arrangement is unfair to India and the fact that any alteration of this arrangement has been placed beyond the scope of the Indian Legislature indicates the awareness of such a feeling. Most Indians have refused to consider the arrangement on an extra-economic plane, though the Royal Commission justified it chiefly on extra-economic grounds, namely the need for mutual sacrifice for the common interests of the Empire. The proposal was in fact made and discussed on the basis of mutual sacrifice.[1] Such arguments have seldom appealed to Indians.

This arrangement came up for consideration by Professors Bruins, Einaudi, Seligman and Stamp in their Report on Double Taxation. Their comments are as follows:

'It may be said that method 3 has been actually adopted by the British Imperial Government in relation to its Dominion Governments, and this aspect needs very careful consideration. If it has been successfully adopted there, why should it not be possible elsewhere? There are, however, other important considerations. First of all, the amount of relief afforded by each Government. Under this head it will be recognized that the relations existing between the Dominions and the British Government introduce factors hitherto not discussed by us, namely, the factors of Imperial allegiance and common Imperial service, which induce the respective Governments to make concessions to each other. This would enable a proportion to be arrived at on particular lines which has no present parallel or analogy as between two entirely distinct Governments, whatever may be the ultimate development of feelings of interdependence and consequent spirit of concession fostered by the League of Nations. The ease, therefore, with which a proportion has been agreed upon may be deceptive if it is thought that it indicates any really economic or theoretical principle, or that it would be equally acceptable at present between two entirely unconnected Governments.'[2]

Thus it is recognized that the apportionment of the cost of relief in this case has not been made on an economic basis but has been possible on account of the special connexion existing between the

[1] See ¶ 26 of the Report of the sub-committee at Appendix I of the *Report of the Royal Commission.*

[2] P. 47.

Government of the United Kingdom and the Governments of India and the Dominions.

In none of the Provincial Agricultural Income-tax Acts is there a provision for double taxation relief on the line of Section 49 of the Indian Income-tax Act. An unsuccessful attempt was made to include such a provision in the Assam Act during its passage through the Legislature. The Bengal Bill, as first published, contained such a provision but it was deleted at the Select Committee stage.

The need for and the desirability of such a provision can be judged from three standpoints.

(*a*) Both in Assam and in Bengal, the Governments pointed out that as they had adopted a single basis of liability, namely origin, any provision for double taxation relief was not appropriate to the measure. The United Kingdom Government having adopted more than one basis of liability, i.e. both origin and residence, were really responsible for double taxation and it is they who should be held responsible for the relief, if any, of their residents whom they are taxing in respect of agricultural incomes derived from the Indian provinces.[1] The provinces have not attempted to derive any revenue by going in for taxation of incomes arising outside the province. The United Kingdom Government are, however, deriving substantial revenue by levying a tax on incomes arising outside the United Kingdom and in the Indian provinces. Hence the responsibility for relief, if any, is theirs both because they are responsible for the double taxation of their residents and because they are deriving enough revenue by the adoption of the residence basis of liability.

The arguments of the Governments of Assam and Bengal are exactly similar to those mentioned in the Report of Double Taxation on behalf of countries of origin in which an all-inclusive conception of income has not yet developed. The Report says:

'Countries of origin, such as tropical and agricultural countries, see only the beginnings of production, recipients of the final wealth live abroad. Are such countries to be at the mercy of every kind of legal conception of income and income-taxation in all these different countries with which they have relations before they know what their taxation is to be? They would say at once, "We

[1] Assam Legislative Assembly Debates—*Report*—1939, Vol. I, No. 15, pp. 1438–42.

must take for granted the existence of the economic and legal apparatus for the rest of the world; we know what the value of the produce is when it leaves our shores in the light of the world economic organization. All that we can do is to measure the taxation due to us from the person who takes that away by reference to that value".'[1]

It is to be noted that the Provincial Agricultural Income-taxes are neither an all-inclusive income-tax nor an all-inclusive agricultural income-tax. Income derived from land situated outside British India is by definition not agricultural income. Hence the Provincial Governments cannot tax agricultural income of their residents, arising outside British India, even when it arises in an Indian State. Secondly, all the Provincial Acts imposing the tax have restricted it to agricultural income derived from lands situated within the province, to the exclusion of such income accruing to their residents in other provinces of British India. In view of the double restriction on the scope of the tax—one constitutional and the other voluntary—any provision for double taxation relief becomes inappropriate in such a measure, consistently with the financial interest of the Governments of the provinces. The provision is quite appropriate in the Indian Income-tax Act which, like the United Kingdom, has adopted the double basis of liability on account of which the Indian treasury is profiting. There the question is whether the profits are commensurate with the losses on account of the provision for double taxation relief. But in the provincial measures, the provision is entirely inappropriate.

(*b*) The question may next be considered from the standpoint of the doctrine of economic allegiance. It has been very well established in the Report on Double Taxation that income from land owes its allegiance practically solely to the country of origin and that any tax on this source should go wholly to the country of origin. The Provincial Agricultural Income-taxes can hardly be treated as income-tax proper on account of the double restriction on its scope as stated before and are more similar to the schedule income-taxes of France and Italy and hence they should, as suggested in the report, be assimilated to the taxes discussed in the Report in connexion with taxes on property. Further, it is also recommended in the Report that when a debtor and a creditor country try to enter into an agreement about double taxation relief in respect of income-

[1] Pp. 26-7.

taxes levied in the two countries, it would be appropriate to assign taxes on incomes from land wholly to the country of origin and divide the burden of relief in respect of the taxes on other sources of income suitably between the exchequers of the two countries.

Thus provisions for double taxation relief in the Provincial Agricultural Income-tax Act similar to those in the Indian Income-tax Act are clearly ruled out by the doctrine of economic allegiance, so well expounded in the Report on Double Taxation.

Finally, the question may be attacked from the standpoint of the economic consequences to India of such a provision for double taxation relief. It has been explained in the previous chapter that Section 27 of the United Kingdom Finance Act together with the form of the tax chosen in the Bengal Act has the effect of completely exempting the British resident's agricultural income in Bengal from liability under the Bengal Act as long as the Bengal rate does not exceed half the United Kingdom rate of taxation. The inclusion of a provision like Section 49 of the Indian Income-tax Act in the Bengal measure would have the effect of extending the exemption still further, i.e. in that case the complete exemption would continue as long as the Bengal rate did not exceed the full United Kingdom rate. Thus neither the 'burden' effect nor the 'barrier' effect of the new tax would be operative in respect of the British investor in lands in Bengal but both its 'burden' effect and the 'barrier' effect would be fully operative against the Indian investor in lands in Bengal. This is a highly undesirable economic consequence and is more serious than the financial losses that such a provision may cause to the Bengal treasury.

Thus whether the question is approached from the standpoint of the scope of the tax, or from the standpoint of the doctrine of economic allegiance or from the standpoint of the economic consequences to India, there is no case for the inclusion of a provision for double taxation relief similar to Section 49 of the Indian Income-tax Act in the Provincial Agricultural Income-tax Acts. The Provincial Governments of Bihar, Assam and Bengal, therefore, acted rightly in not including such a provision.

VI

AGRICULTURAL INCOME-TAX
THE INCIDENCE

AN income-tax is a tax on surplus and therefore cannot be shifted by a process of pricing. Profit is the result, not a condition, of the price. Hence a non-discriminatory taxation of the profit does not affect price. This is a well-established principle, and has been discussed in Chapter I, Part I.

Does an agricultural income-tax cause a loss of capital value? Can it be shifted by a process of capitalization either wholly or partly?

When a piece of land which yields a net income of less than two thousand rupees a year (or whatever be the exemption limit), is sold, it may affect the buyer in various ways. The buyer may not be taxable even after buying it and may still remain below the exemption limit. The addition of this piece of land to his estate may, again, make him liable to the tax, if he was free before or may make him liable to pay the agricultural income-tax in respect of the income derivable therefrom at any rate up to the highest. A buyer who would not be liable to the tax would be prepared to pay to the seller the full capitalized value of the net profits derived from the land without discounting it by anything for the tax. The price of the land may, therefore, be fixed at this highest point by the simple law of competition. In this case no capital value is lost by the tax.

If the estate to be sold itself yields an income above the exemption limit, the buyer will always have to pay a tax in respect of its income. The rate may vary but it will not be lower than that applicable to the income of the estate itself. Hence any buyer will discount the price by the capitalized value of at least the minimum tax payable in respect of its income.

This may create a tendency among sellers to sell in small parcels but that is not always feasible. Hence though the price may not be discounted by the capitalized value of the highest rate of the tax, there will often be a tendency towards fall. The principle formulated by Professor Seligman in such a case is:

'In the case of a steeply-graduated tax, the wider the market and the more general the distribution of the property, the greater the probability that the capitalization of the tax will apply only to a tax rate comparatively low down in the graduated scale.'[1]

As the tax is a graduated one and as land is widely distributed in India, only a slight fall is likely to take place.

The discrimination between agricultural and non-agricultural incomes in respect of taxation has existed in India for long. The period of discrimination has been long enough for the purpose of establishment of a new equilibrium on the basis of the discrimination. Land has been in India similar to income-tax-free securities. To quote an example of Professor Seligman:

'Let us take the reverse case of an issue of securities which are exempted from a new and steeply-graduated income-tax. It is true that if there is only a small issue of the tax-exempt bonds which will be quickly snapped up by the wealthiest investors, the price will rise by a capitalization of almost the highest rate of tax paid by the wealthiest investor. But in the more ordinary case of a comparatively large issue of tax-exempt bonds, coupled with a wide-spread distribution among all calsses of investors, small and large, the market price will settle, as in the United States in 1923 in the various classes of the so-called "tax-exempts", including the national as well as the State and municipal securities, at a point which more nearly corresponds to the rate of tax paid by the less opulent investor.'

As the distribution of land in our country is very wide and as land is often owned in small parcels by a large number of poor men, its 'tax-exempt' character must have created only a slight tendency towards an increase of price; and returns have been equalized on that basis. Now if that favourable discrimination is removed after a long time a similar downward tendency of the same magnitude will appear at once in the price of land till a new equilibrium is reached neutralizing the slight upward tendency which was ushered in by the old discrimination. Persons who got the benefit of the upward tendency would generally be different from those who would now be victims of the downward tendency because land has changed hands in the meantime.

The artificial increase in value caused by the discrimination will now be removed by the removal of discrimination and land and other forms of investment will be put on an equal footing. But the

[1] *Shifting and Incidence of Taxation*, p. 225.

long period of discrimination enabled the old proprietors, who got the benefit of the increase, to pocket the increase permanently by selling their lands. The present proprietors who have not benefited by the increase will lose capital values, however slight. In this respect the incidence of the agricultural income-taxes in the different provinces is likely to differ from the normal incidence of a general income-tax. Though it will chiefly be borne by the payers of all times, capital values will be slightly lost to the present assessees.

But there is no hardship or injustice caused by this difference. Most land interests are in the hands of persons who will not come under the tax. Only a few hundreds out of crores are generally taxed. Hence most lands will remain unaffected.

Secondly, in those few cases, in which the value will be at all affected, the decrease as has been pointed out, will be only slight.

Thirdly, there is justice in taxing land at a higher rate than other sources of income. Land acquires unearned increments to its value simply by the development of society and there is therefore no injustice involved if the bigger estates are taxed so that there is a slight reduction in their value.

Fourthly, all the Provincial Acts levy rates lower than the Central rates of income-tax and to that extent land still continues to get favourable treatment. (Except in the case of incomes up to Rs 5,000 in Bengal and incomes up to Rs 15,000 in Assam.)

VII

AGRICULTURAL INCOME-TAX
A GENERAL REVIEW

THE Agricultural Income-tax Acts in Bihar and Assam and the proposed Bill in Bengal are, in spite of their defects, steps in the right direction. The defects, it is hoped, will be cured in course of time, though injustices supported by strong vested interests, having political power or influence, tend to last long.

The controversy over an agricultural income-tax in India carried on for over three quarters of a century is interesting history. The first objectors based their objection on the law of the land, i.e. on the Permanent Settlement Regulation of 1793. When that was overruled by a Court of Law, it was urged that there was injustice on account of the existing land revenue and cesses. When that also was disposed of by the Taxation Enquiry Committee, the question of administrative difficulty was raised. When Assam and Bihar demonstrated how easy it was to administer such a tax, the question of tenancy legislation, etc., was raised. The full significance of such objections has already been discussed. The tax, in fact, did not come into being till after the zemindars had lost most of their political influence with the Government.

All the three Acts have done well to start with the origin basis of taxation and with a low pitch. A higher pitch of taxation on incomes derived from land than on incomes derived from other sources is of course compatible with practice in other countries and with theory. A time is likely to come when this will be realized in practice in this country also. The present pitch of the Indian income-tax and the various complexities thereof, took a long time to develop and for reasons already stated, namely the hardship involved in a sudden change, a sudden adoption of the same pitch would have been hard on many.

All the three measures, especially the Assam and the Bengal ones, display serious defects in graduation from the standpoint of equity. In the name of lowering the pitch, the benefit is monopolized by the richer section of the assessees while the pitch of taxation on lower incomes is the same or almost the same as in the

Indian Income-tax Act. Similarly, in the name of equality, an injustice has been allowed to be continued by way of exemption of companies from supertax. These defects, it is hoped, will be removed as soon as they are correctly appreciated.

The exemption limit is also too high and should be the same as that in the Indian Income-tax Act. This inequality will also disappear in course of time.

The administration of the Agricultural Income-tax Acts in the three provinces reveals some very interesting facts.

The number of assessees is very small and the bulk of the yield is paid by the few rich landlords. In Assam the tea gardens pay about ninety-five per cent of the yield.

The task of assessing the tax on these few men and of collecting it from them is easy and the cost is low.

The administration is very much simplified by three facts:

(*a*) In the case of tea and other mixed incomes, the Central Income-tax Department determine the whole income including the agricultural income. The provincial authorities take full advantage of it. They simply accept the certified copy of the assessment orders and levy a tax on the agricultural portion of the income as determined by the Central Income-tax authorities.

(*b*) In the case of rent receivers, who form practically all the assessees in Bihar and all the assessees outside tea areas in Bengal and Assam, the determination of income has been very much simplified by the percentage basis of cost of collection. There are the finally published records of rights, and the statutory rent receipts and hence collection can also be determined easily.

(*c*) The number of cultivating assessees is negligible outside tea and sugar companies.

The published statistics reveal (*i*) that practically no cultivator in Bihar and Assam is above the exemption limit, and (*ii*) that the number of tax-payers is very small.

In Bihar, for instance, only 12,900 persons[1] were assessed to the Central income-tax in 1939-40 and only 1,372 persons[2] were assessed to agricultural income-tax in 1940-41. Thus only about 14,272 persons in all out of a population of 360 lakhs, i.e.

[1] Return No. IVB on p. 29 of the 'All India Income-tax Report' and 'Returns for the year 1939-40'. (This is the last published Report.)

[2] Vide Appendix V of the 'Annual Administration Report of the Bihar Tax', 1940-1. (This is the last published Report.)

only ·049 per cent or in other words about forty-nine persons in a lakh are usually above the exemption limit which is not much above the bare subsistence level. The mistake caused by the omission of those few having mixed incomes who are neither taxable under the one Act nor under the other but would be taxable if the two portions of the income were treated as one income, is negligible.

We get from this a picture of the state of poverty in the country.

VIII

TAXES ON PROFESSIONS, TRADES, CALLINGS AND EMPLOYMENTS

BEFORE Autonomy there was no provincial tax on professions, trades, callings and employments, but a local tax on these bases was levied in a few provinces, namely Madras, Bengal, the Punjab and the Central Provinces.

Under Autonomy, the Government of the Central Provinces and Berar were the first to impose this tax for provincial purposes. Bengal soon followed the Central Provinces and Berar. The attempt of the Government of the United Provinces to impose a graduated tax on the limited base of employments only brought them into conflict with certain strong interests and the Government of India Act was amended to fix a maximum for this tax at fifty rupees, protecting existing local levies above that figure until the Central Legislature chose to enforce the limit fixed by Parliament. A private member's Bill has since been enacted to enforce the limit partially.

The Central Provinces and Berar Act[1] levies a tax of twenty-eight rupees per annum, or seven rupees per quarter, on any man having a trade, profession, calling or employment in the province, but exempts persons who do not pay income-tax. In Bengal,[2] the rate of the tax is thirty rupees per year and there also persons not paying income-tax are exempted.

For administrative reasons it is not possible to have a synchronization in a man's pursuit of a certain calling, etc., his liability to income-tax on his income derived therefrom, and his liability to the tax imposed under this Act. Actually the position is as follows:

A is employed or is in business in Bengal in 1940-1 and in that year his net income exceeds two thousand rupees. He will be assessed to income-tax in 1941-2 in respect of his income of the previous year. His liability to pay the tax on profession, employ-

[1] The C.P. and Berar Act, No. XIII of 1938.

[2] Bengal Act, No. IX of 1939.

ment, etc., will arise in 1942-3, provided he continues in employment or business in the province. So there is a necessary time lag of two years between the assessment and the pursuit of the trade or employment in respect of which he is taxed.

This may create considerable inconvenience to assessees and is a violation of the canon of convenience in taxation. A man who was doing good business in 1940-1 may be suffering a loss in 1942-3. A man who was drawing a good salary in 1940-1 may find his salary reduced to a nominal sum, (say) ten rupees per month in 1942-3 or may find himself unemployed in that year after having served for a few days only in the beginning of the year on a nominal salary. He will not be called upon to pay the tax in 1940-1 when he is prosperous but will be called upon to pay it in 1942-3 when he may be in indigent circumstances.

Again, a man escapes taxation for two years when he first enters service or business because he was not assessed to income-tax in the previous year. He cannot be assessed, on that account, for two years after retirement because when the assessment will fall due, he will no longer be in employment, etc.

Pensioners, persons receiving income from investments, or house-property owners escape the tax, because they are not in employment or business. Whether receiving income from investment or rents from house-property is a business is a question of fact but in several cases of purely unearned income, the man can hardly be said to be in business. This discrimination in favour of men with unearned incomes is hardly justifiable.

If, however, a pensioner happens to be a lawyer he will be liable to the tax provided he is assessed to income-tax on his total income. He cannot escape his liability to this tax even if his income from the practice is only nominal, (say) ten rupees a year. It is a tax on all professions, all employments and all trades, but if a man is so poor that the Income-tax Department does not touch him he is exempt. The tax has nothing to do with the income from the profession, trade or employment taxed. The exemption of poorer men in professions, trade and employment is a good feature of the Acts. In order to claim exemption it is not enough that his income from the profession, trade or employment must be low—he must be really poor, i.e. his total income from whatever source it may be (except, of course, agricultural income which is outside the scope of the Indian Income-tax Act) must be too low to come

under the Indian Income-tax Act. This stringent requirement for exemption not only makes the exemption rational and equitable but also ensures administrative convenience and economy in collection by making it possible to depend on the Income-tax Department for a preliminary list of assessees. Such a double function of the exemption limit is a very good feature of the Act.

Within the taxed class, however, the distribution of the burden is obviously unfair. All are taxed at a flat rate, whether they are rich or just above the exemption limit of the Indian Income-tax Act. The tax therefore unduly favours the rich.

The tax levied in the two provinces is unfair, discriminatory and often inconvenient in respect of the time of payment. It hits the lower middle class hardest, exempts men with unearned incomes and is unduly favourable to the rich.

The Provincial Governments imposing the tax can, however, hardly be blamed for retaining these glaring defects in their Acts. They had to work within the limits of the constitution and had to keep the cost of collection as low as possible.

At that time it was contended by many that a graduated tax on professions, trades and employments would be an income-tax by levying which the Provincial Legislature would be encroaching on a Central subject. The position is explained in the following speech of the Finance Minister of Bengal made on the floor of the Legislature during the debates on the Bill:

'I quite appreciate that the rich people have been lightly treated, but that is not intentional . . . . I have tried my level best to make it a graduated tax. Not only myself but the Governments of the Central Provinces and Madras have tried their best to do likewise, but we could not persuade the Government of India to allow us a graduated tax. Their contention is that any tax for the levy of which the determination of a man's income is necessary is an income-tax and comes within the exclusive sphere of the Centre. . . .

'Sir, there was another difficulty why we could not take recourse to graduated taxes. This is that if we want to realize this 12 lakhs of rupees without the least amount of expenditure, it is necessary that we must have the co-operation of the Income-tax Department, but if it is against the decision of the Government of India, the Income-tax Department will not co-operate with us; and for this reason I refrained from having a graduated tax.'[1]

[1] Assembly Proceedings of 7th March, 1939, p. 247. For a similar statement, see C. P. & Berar Assembly Proceedings of 2nd March, 1938, p. 53.

It is thus clear that the injustice of the tax was necessitated by the constitution or by the peculiar interpretation of it by the Government of India which it was essential to adopt to obtain the co-operation of the Income-tax Department without which the cost of collecting the tax would have been prohibitive.

The discrimination in favour of persons with unearned incomes is also imposed by the constitution. The entry on which the tax is based is 'Taxes on professions, trades, callings and employments', and the tax must be confined to these classes only.

It may, however, be contended that the limitation of a tax to a particular class need not cause such a great injustice as it at first appears to do. Every tax need not be comprehensive in its scope: one tax may operate on one class and another on another class. Such taxes limited to classes do not become really discriminatory if the tax system of the country as a whole maintains the balance. The same remark applies to the complaint of injustice against the tax. But the tax system of the country is already loaded against the poor and is not as progressive as it should be because all the taxes that are levied in this country are regressive with the single exception of the income-tax, the progression in which cannot compensate the regression on account of so many taxes. Hence, any tax which treats the rich lightly or exempts men with unearned incomes must disturb the balance in the wrong direction.

If, again, persons not assessed to income-tax had to be excluded from the scope of the tax and if the cost of collection had to be kept down by depending on the list of assessees to be supplied by the Income-tax Department, the time lag of two years and the consequent inconvenience were unavoidable. In the case of income-tax itself there is a time lag of one year between the earning of the income and the assessment. A tax that would rely on assessment to income-tax must therefore have a time lag of at least two years.

In spite of all the defects, the taxes have the great merit that they do not touch people below the subsistence limit—a merit shared by few other taxes in this country.

The two chief differences between the Bengal and the Central Provinces Acts are: In the Central Provinces the tax is assessed quarterly. There are two conditions of assessment:

(*a*) The person must have been assessed to income-tax in British India during the previous year on his earnings from employment, etc.

(*b*) He must have been in employment, etc., within the province for not less than forty-four days during the previous quarter.

In Bengal, the tax is assessed annually. Condition (*a*) is the same as in the Central Provinces but condition (*b*) is different. A man in order to be assessable in Bengal must satisfy condition (*a*) and must be in employment, etc., in the year of assessment. No minimum period is prescribed. Hence a day's employment in the year will satisfy the second condition. A man who was in employment in Bengal in 1940-1 and was assessed to income-tax in 1941-2 would be liable to the tax in 1942-3 even if he retired on the 1st of April, 1942, and was out of employment during the rest of the year. In the Central Provinces, however, he would not be liable at all to the tax in 1942-3. If he retired after serving forty-four days he would be liable to pay only seven rupees. In Bengal, the man is either liable to the full amount of the tax or not liable at all: fractional liability does not occur under the Bengal Act except in cases of marginal relief provided for in the rules under the Act.[1]

In Bengal, again, it is possible that a businessman from Bombay or a lawyer from Allahabad or a Government servant from Bihar become liable to the tax simply by coming to Bengal for a day or two on business, or on a professional visit or on duty respectively. But such cases must be rare and hard to detect because the location of business in Bengal will be required as a condition of assessibility not only in 1942-3 but also in 1940-1. For, he must be assessed to income-tax during the previous year on his earnings from employment, etc., pursued in Bengal and he must be in employment, etc., in Bengal in the year of assessment. Such continuity in occasional visits by outsiders is hard to trace and such people do evade the tax.

[1] The rule of marginal relief is as follows:

Where an assessee proves to the satisfaction of the assessing officer that the payment of the tax under the Bengal Finance Act, 1939 (Bengal Act IX of 1939) and also of the tax under the Indian Income-tax Act, 1922 (Act XI of 1922) on the basis of the assessment of income-tax made in the preceding financial year, will reduce the income according to the said assessment, to below the lowest assessable limit under the latter Act, remission of the tax under the former Act shall be granted to an extent which will leave the said income, after deduction of these taxes, at the aforesaid assessable limit.

There are some servants of the Government of India with headquarters in other provinces who regularly come to Bengal on duty. The Viceroy and his court are among them. Such servants of the Government of India with headquarters outside Bengal have been specially exempted by a rule made under Section 7 of the Act.

The difficulty of the Central Provinces Act is that the administration has to enquire and establish that a man has been in employment, trade, etc., for at least forty-four days in a quarter. Actually, however, such enquiries may be few but the fact remains that a man can call upon the administration to make such enquiries about him. This may enhance the cost of collection.

Thus the Bengal scheme is a violation of the canon of convenience while the Central Provinces scheme is a violation of the canon of economy. In practice, neither scheme probably violates the canons to any appreciable degree.

In the Central Provinces there is a provision for relief of double taxation as between the province and local bodies. In Bengal there is no such provision. In the Central Provinces a man who has paid a local tax on profession and is also liable to this provincial tax gets a rebate to the extent of the tax paid to the local bodies. Thus he has only to pay difference to the Provincial Government.

In Bengal such a provision would render the Provincial Act practically ineffective and objectionable. For in Calcutta, and in several other municipalities, the rate of the profession tax payable by such persons as do come under the Provincial Act is often equal to or higher than the provincial rate. Such a provision would confine the tax practically to a few rural shop-keepers or rural money-lenders. The yield would be low while the cost of collection would be high. Such a provision is therefore not possible in Bengal. The tax must either be levied without such a provision or should not be levied at all. In view of the low provincial rate, such a provision for relief is hardly called for.

As regards the two provincial taxes, however, there is no provision for relief either in Bengal or in the Central Provinces. Thus it is possible for a man to be liable to the Bengal tax and the Central Provinces tax in the same year.

The United Provinces Employment Tax Bill, 1939, had for its object the imposition of a graduated tax on employments only,

classified, on the basis of salary, into twenty-seven grades. The actual grades and the rates were as follows:

Rates proposed in the United Provinces Employments Tax Bill, 1939

When the total salary earned in the United Provinces by an employee during the year ending March 31 exceeds	But does not exceed	The tax payable for the year shall be
Rs	Rs	Rs
2,500	3,500	90
3,500	4,500	150
4,500	5,500	225
5,500	7,500	325
7,500	10,000	475
10,000	12,500	650
12,500	15,000	850
15,000	17,500	1,100
17,500	20,000	1,400
20,000	22,500	1,725
22,500	25,000	2,100
25,000	30,000	2,500
30,000	35,000	3,000
35,000	40,000	3,600
40,000	45,000	4,300
45,000	50,000	5,100
50,000	60,000	6,000
60,000	70,000	7,000
70,000	85,000	8,200
85,000	1,00,000	9,500
1,00,000	1,25,000	11,000
1,25,000	1,50,000	13,000
1,50,000	1,75,000	16,000
1,75,000	2,00,000	20,000
2,00,000	2,50,000	25,000
2,50,000	3,00,000	30,000
3,00,000	..	32,000

In the 'Statement of Objects and Reasons' of the Bill, it was said:

'Employments are of various kinds and of divergent description. Employees differ from each other in respect of the nature and class of this employment and their rank and status and seniority. There are various methods by which employments and employees can be differentiated from each other. One of these methods and the most practicable and equitable is that of defining and classifying employments in the light of emoluments attached to various employments and earned by different classes of employees. It is therefore proposed to impose tax on different employments according to that method on a definite graded scale. It would be manifestly unjust and arbitrary to treat all employees alike for purposes of such a tax. Persons employed in His Majesty's Military, Naval and Air Forces and those whose emoluments from their employment do not exceed Rs 2,500 per annum will be exempt from this tax.'[1]

This was a definite attempt to remove the injustice complained of in the case of the Bengal or the Central Provinces tax. The tax, however, was more discriminatory than in those provinces as it was confined to employments only. The probable reason for this exclusiveness was that the expenses involved in undertaking a classification of trades and professions on the basis of income was prohibitive. No help would be forthcoming from the Income-tax Department, on whom secrecy was imposed by law. The determination of the salary of employments was, however, a simple affair. It could be elicited from the employers at a little cost and in a large number of cases the employer was the Government.

A lively discussion in the Press followed the introduction of the Bill. It culminated in an amendment of the Constitution Act by Parliament which expressly made such Acts *ultra vires* of the Provincial Legislatures.

At first the ground of objection against the tax was legal. It was urged that the tax was really a tax on income which was exclusively a Central subject. The Advocate-General of the United Provinces, however, in the course of a speech in the Legislature expressed the opinion that the tax proposed to be levied was not a tax on income but a tax on employment as contemplated in item 46 of List II of Schedule VII to the Government of India Act, 1935. This was purely a question of law.

During the debates in the House of Commons on the amendment of the Constitution Act, the chief point made was that if a tax of

[1] *United Provinces Gazette*, 4th March, 1939, Part VII, p. 28.

the nature of the proposed United Provinces employment tax was possible under item 46 of List II of Schedule VII, it would seriously hit the revenues of the Central Government. Hence, whether or not the Schedules as then existing included a right to levy such taxes for the provinces, they should be definitely taken out of the scope of the provinces for the sake of maintaining the financial stability of the Government at the Centre. This financial argument put into the back-ground the legal argument. This is how the Under-Secretary of State justified the action in not referring the matter to the Courts:

'But the main reason—and I will put it quite plainly and it is probably obvious to every Hon. member in this House—why the matter was not referred to the Court was because, supposing the decision of the Federal Court had been adverse and they had decided that the Indian Provincial Legislature was within its rights and this was a legal tax, clearly it would have been essential to come to this House to get the matter reversed. We look upon this question of income-tax as being one solely for the Central Government, and as being one of such vital importance to the whole structure of Indian finance that it could not possibly have been allowed to stand otherwise. That, I think, is the real reason why, if I may put it so, it was not worth-while going to the Court to get an opinion when if it had been in a certain direction it would have been just as necessary as it is now to come to this House and to amend this Clause.' [1]

Now the amendment that was made by Parliament was as follows:

Before amendment, item 46 of List II read as follows:

'46. Taxes on professions, trades,c allings and employments.'

After amendment it is as follows:

'46. Taxes on professions, trades, callings and employments, subject, however, to the provisions of section one hundred and forty-two A of this Act.'

Section 142-A which was added to the Act by this amendment reads as follows:

'142-A (1) Notwithstanding anything in Section one hundred of this Act, no Provincial law relating to taxes for the benefit of a Province or of a municipality, district board, local board or other local authority therein in respect of professions, trades, callings or employ-

[1] Hansard—*House of Commons*, Vol. 356, Col. 645.

ments shall be invalid on the ground that it relates to a tax on income.

(2) The total amount payable in respect of any one person to the Province or to any one municipality, district board, local board, or other local authority in the Province by way of taxes on professions, trades, callings and employments shall not, after the thirty-first day of March nineteen hundred and thirty-nine exceed fifty rupees per annum:

Provided that, if in the financial year ending with that date there was in force in the case of any Province or any such municipality, board or authority a tax on professions, trades, callings or employments the rate, or the maximum rate, of which exceed fifty rupees per annum, the preceding provisions of this sub-section shall, unless for the time being provision to the contrary is made by a law of the Federal Legislature, have effect in relation to that Province, municipality, board or authority as if for the reference to fifty rupees per annum there were substituted a reference to that rate or maximum rate, or such lower rate, if any, (being a rate greater than fifty rupees per annum) as may for the time being be fixed by a law of the Federal Legislature; and any law of the Federal Legislature made for any of the purposes of this proviso may be made either generally or in relation to any specified Provinces, municipalities, boards or authorities.

(3) The fact that the Provincial Legislature has power to make laws as aforesaid with respect to taxes on professions, trades, callings and employments shall not be construed as limiting, in relation to professions, trades, callings and employments, the generality of the entry in the Federal Legislative List relating to taxes on income.'

Thus the provinces or local bodies can now levy graduated taxes on employments, professions, etc., classified on the basis of income but the maximum tax levied on one person by a province or a local body shall not exceed fifty rupees per annum. Thus a man or a company operating in a town may have to pay at most two taxes under this head not more than fifty rupees each—one to the Provincial Government and the other to the municipality.

From a perusal of the debates in the House of Commons the following points are clear:

(*i*) The Government intended 'to keep alive the right which Provincial Governments had exercised in the past of empowering local authorities, such as municipalities and district boards, to levy rates for local purposes, which were commonly described as taxes on professions and taxes on circumstances and property,'[1] and at the same time to restrict the entry in List II to that much and no further.[2]

(*ii*) The restriction sought to be imposed was imposed in the particular way, i.e. by fixing a maximum limit, on account of practical difficulties of drafting, and the maximum was placed at fifty rupees as it was believed that that was sufficient to protect the existing taxes. To quote the Solicitor-General, 'I am told that 50 rupees would more than cover the normal taxes that used to be within the power of the provinces before the Government of India Act was passed'.[3]

The Under-Secretary of State for India explained it as follows:

'The limit has been put down at 50 rupees largely owing to practical difficulties in confining it in any other way, and I would ask the Right Honourable and learned gentlemen to notice that in the proviso to Sub-section (2) of the Clause it is clear that any province which at present has an employment or profession tax which is larger than 50 rupees may keep it; I believe that there is no province where the tax is now over 50 rupees, and this Clause will not affect it.'[4]

Thus Parliament had no intention of abolishing the existing taxes though they definitely intended that entry 46 of List II should not authorize a tax of a more ambitious nature than what existed at the time in the local bodies.

Two comments are, however, necessary. First, the information of the Solicitor-General and of the Under-Secretary of State was wrong. There was more than one province where the maximum rate of profession tax levied for local purposes was more than fifty rupees. This was unfortunate.[5]

Secondly, though the Under-Secretary of State stated that the proviso was intended to maintain existing taxes, he omitted to

[1] Hansard—Vol. 356, Col. 275.
[2] Hansard—Vol. 356, Col. 276.
[3] Hansard—Vol. 356, Col. 299.
[4] Hansard—Vol. 356, Col. 646.
[5] The maximum amount of profession tax leviable by the local authorities in the city of Madras was Rs 2,000.

mention the important rider that the protection operated only until 'provision to the contrary is made by a law of the Federal Legislature'.

On the basis of this rider in the Section, a member of the mercantile community in Madras introduced the Profession Tax Limitation Bill in the Indian Legislative Assembly which had for its object the reduction of the limit of all existing profession taxes to fifty rupees per year. The Bill has been passed with certain modifications. The criticism of the measure is obvious. It affects adversely the finances of local bodies for the benefit of the richer section of the community, who are easily able to pay. This measure, of course, was not necessary for securing the financial stability of the Centre which was the express object of enacting section 142-A of the Government of India Act, 1935.

There was a political aspect of the question. In fact, it was the political aspect which was discussed most in India and in Parliament. The political aspect of the question was based on the fact that it was a direct restriction of the powers of that part of Government which was recently made responsible to the people of India. This aspect of the question was well put by Sir William Jowitt, M.P., in the course of his speech in the House of Commons as follows:

'What they feel is this: "You have settled the rules of the game; we are playing the game according to the rules which you laid down in your very carefully considered Act of Parliament, and directly you find the rules are a bit awkward for you, you change them".'[1]

An economist is not, however, concerned with the political aspect of the question. He can only regret that the amendment increased the pressure for regression in the Indian taxation system to an extent wich was not necessary. Further, the discussion forces attention to a difficulty inherent in a federal scheme of taxation, namely, the difficulty of co-ordinating Central taxation with provincial taxation. First, the interests of the Centre have to be reconciled with the interests of the provinces. Secondly, the interests of the tax-payers have to be safeguarded against the rivalry of competing taxing authorities. Though the interests of all the three parties may be the same in the final analysis, the fact may be forgotten in the heat of the day-to-day administration.

[1] Hansard—Vol. 356, Col. 295.

IX

SOME OTHER TAXES ON PERSONS

I

Death Duties

UNDER the Indian law of succession, probate or letters of administration, as the case may be, are compulsory in all cases of succession for Europeans, Eurasians, Armenians, Jews and persons of foreign domicile. Parsis have to take out probates or letters of administration in those cases only where a right of succession is to be established in the courts. Indian Christians have to take out a probate

(*i*) in the case of testamentary succession;
(*ii*) when there is a right of succession to be established in the courts.

Hindus must take out a probate when the following conditions co-exist:

(*i*) it is a case of testamentary succession;
(*ii*) the will relates to immovable property;
(*iii*) the immovable property is situated either in the province of Bengal or in the city of Madras or in the city of Bombay;
(*iv*) right of succession is to be established in the courts.

In other cases probate or letters of administration, or succession certificates are optional and people apply for them only when they are compelled by other circumstances to do so. The Imperial Bank of India, for example, would not transfer its share without a succession certificate. A life assurance company would not ordinarily pay up money to the heir of the insured without a succession certificate in the absence of an assignment or nomination. Similarly, under the Government Savings Banks Act, 1873, the Post Office Cash Certificates Act, 1917, the Provident Fund Act, 1897, the production of a succession certificate or of a probate or letters of administration can be insisted on as a condition precedent to the payment of money to the heirs of a deceased person. It is under these and similar circumstances that persons are compelled

to apply for probate or letters of administration or succession certificates, as the case may be.

On probate, letters of administration and succession certificates court fees are levied in all provinces under Articles 11 and 12 of Schedule I to the Indian Court Fees Act, 1870, the basis of charge being the value of the property in question. The rates that are being levied in some of the provinces under Article 11 (Probates and Letters of Administration) are given below:[1]

BENGAL

Where the value of the property does not exceed Rs 2,000 .. .. .. Nil.

When the value of the property exceeds Rs 2,000 the fee is levied under a slab system except that there is no exempted slab. The rates are as follows:

1st slab of Rs	10,000	..	..	..	2	per cent.
2nd „ „	40,000	..	..	..	3	„
3rd „ „	50,000	..	..	..	4	„
4th „ „	1,50,000	..	..	..	5	„
5th „ „	50,000	..	..	..	5½	„
6th „ „	1,00,000	..	..	..	6	„
7th „ „	1,00,000	..	..	..	6½	„
The balance	..	..	..	..	7	„

BOMBAY

Here also the rates are levied under a slab system and here there is an exempted slab also. The rates are as follows:

1st slab of Rs	1,000	..	..	..	Nil.	
2nd „ „	9,000	..	..	..	2	per cent.
3rd „ „	40,000	..	..	..	3	„
4th „ „	50,000	..	..	..	4	„
5th „ „	1,00,000	..	..	..	4½	„
6th „ „	50,000	..	..	..	5	„
7th „ „	50,000	..	..	..	5½	„
8th „ „	1,00,000	..	..	..	6	„
9th „ „	1,00,000	..	..	..	6½	„
The balance	..	..	..	..	7	„

[1] Bengal rates are taken from the *Bengal Court Fees Manual*, 1940. The rates of the other provinces are taken from Bhoumik's *Indian Court Fees Act*, Fourth Edition, 1938.

MADRAS

Here the rates are the lowest and are levied under a step system as follows:

Where the value of the property exceeds Rs 1,000 but does not exceed Rs 5,000.	2 per cent on the whole value.
Where the value of the property exceeds Rs 5,000	3 per cent on the whole value.

PUNJAB

Here also the rates are levied under the step system but there are three steps as follows:

Where the value of the property exceeds Rs 1,000 but does not exceed Rs 10,000.	2 per cent on the whole value.
Where the value exceeds Rs 10,000 but does not exceed Rs 50,000.	2½ per cent on the whole value.
Where the value exceeds Rs 50,000 ..	3 per cent on the whole value.

U.P.

Here there is a combination of the step system and the slab system, the slab system coming into operation when the value exceeds a certain point. The rates are as follows:

Where the value of the property exceeds Rs 1,000 but does not exceed Rs 10,000.	2 per cent of the whole value.
Where the value exceeds Rs 10,000 but does not exceed Rs 50,000.	2½ per cent on the whole value.

Where the value exceeds Rs 50,000, the slab system comes into operation and the rates then are as follows:

1st slab of Rs 10,000	2 per cent.
2nd „ „ 40,000	2½ „
3rd „ „ 50,000	3 „
The balance	4 „

It is apparent that the rates vary considerably from province to province and that the rates in Bengal and Bombay impose a considerable burden on the inheritor of property.

Though the amount is levied by means of court fees, there is obviously an element of taxation in it. It is of course an occasion for conferring a special privilege but the levy is pitched so much higher than the cost of providing the service, particularly in Bengal

and Bombay, that it is clearly a case of a special burden and therefore of a tax. This tax has been called death duty and is the only instance of its kind in this country. In so far as the levy includes an element of taxation, the classification is correct.

It is clear that the death duty, as levied, is not a universal levy. The bulk of the people have not got to pay it as they have not got to apply for probates or letters of administration or succession certificates. The levy is confined to certain races, religions, localities and sometimes to people in certain peculiar circumstances.

Another element of inequality arises out of the fact that even when a Hindu or a Muslim or anybody other than a European, Eurasian, Jew, Armenian or a person of foreign domicile is required to take out a probate or a succession certificate as the case may be, he need not take it out in respect of the entire estate inherited by him but only in respect of that part of it which he cannot get without it. Thus when a Muslim inherits a large estate which includes a few Imperial Bank shares, he has to take a succession certificate only for those shares and the court fee is payable on the valuation of these shares only.

The tax, as now levied, is therefore obviously discriminatory. It was very sharply criticized by the Taxation Enquiry Committee as follows:

'The existing duties are very inequitable in their incidence. This is determined by race, religion or locality. The assets in India of Europeans, Eurasians, Armenians, Jews and persons of foreign domicile must pay duty whether there is a will or not, or whether any right is sought to be established in Court or not. The estates of Parsis, whether there is a will or not, and the estates of Indian Christians, where there is a will, must pay duty wherever the estate be situated in India, though only when a right is sought to be established in the courts. The estates of Hindus, where there is a will made in, or relating to, immovable property situated in the Lower Provinces of Bengal or the cities of Bombay or Madras, must also pay duty, but again only when a right is sought to be established in the courts. The estates of all Muhammadans who die testate or intestate, the estate of all Hindus and Indian Christians who die intestate, and the estates of all Hindus who die leaving wills not falling within the scope of the Hindu Wills Act need pay no duty, unless the parties themselves apply for and obtain probate or letters of administration.'[1]

[1] *Report*, Vol. I, ¶ 361, p. 281.

It is doubtful whether such severe remarks are deserved by the two apparently modest articles 11 and 12 of the Indian Court Fees Act. It is, however, clear that the burden on these communities and localities and on persons who are compelled by certain circumstances to apply for succession certificates, cannot be increased any further except as part of a scheme for levying a general death duty. We are thus brought face to face with the questions:

(*i*) whether the imposition of a general death duty in this country is desirable; and

(*ii*) whether such duties, if desirable, are at all practicable.

In theory a death duty is justified on two grounds.

(*a*) *It reduces distributive inequality.*—The first ground is extraneous in nature and has no reference to the canons of taxation. It is socialistic in character and was first used by Bentham and Mill as a reason for a mild attack on unrestricted right of inheritance. Subsequently, Professor Rignano's scheme sought to appropriate for the State the entire property acquired by a person in course of a few successions. Their argument is based on two basic assumptions:

(*i*) The institutions of private property and inheritance are necessary for the productive efficiency of society.

(*ii*) It is equally necessary to restrict the scope of the institutions to the minimum required for the purpose. For, it is argued that if the institutions are allowed to develop unrestricted under the modern system of production, the result would be large accumulation of wealth in a few hands. This, besides giving rise to great inequality and distributive injustice, would reduce productive efficiency; for, after a point property and efficiency lose their correlation.

The relation between productive efficiency and the sense of security about the continued possession of the produce of one's efforts from generation to generation is not of constant strength throughout. Personal distinction is the strongest urge to productive efficiency and therefore private property must not be touched during the lifetime of the earner. Paternal feelings are also a strong incentive but the earner does not feel as much interested in the generations to follow his sons and the interest dwindles with the progress of each step in the family line. Hence productive efforts will not be affected if the earner is assured—

(*i*) of the full enjoyment of the produce of his efforts during his lifetime;

(*ii*) of the fact that his sons or sons' sons will be allowed to enjoy the bulk of the property left by him; and

(*iii*) of the fact that at least a portion of the property left by him will pass on to a few subsequent generations. Beyond that he may not be interested at all, whereas beyond that property encourages inefficiency and idleness in the hands of distant successors who become completely status-minded and cease to be efficiency-minded.

From this line of reasoning it is deduced that the death duty should be graduated according to the distance of relationship between the successor and the original earner so that the whole property left by a man may be wiped out in the course of a few occasions when the tax is levied. Thus, for example, the inheritance tax on a first transmission of the inheritance may be one-third of the property, on a second transmission it may be two-thirds of the balance and on a third transmission, the entire property should be taken away.

Such a death duty is advocated as a measure of securing distributive justice in modern capitalistic society without affecting its productive efficiency. The institution of private property, it is claimed, is thereby elevated into a lever for productive efficiency and is prevented from degenerating into an encouragement for idleness and inefficiency. The beneficial character of private property is thus maintained in tact.

(*b*) *Succession is a windfall and therefore enhances taxable capacity.*—The second ground is based on the canons of taxation. An inheritance, it is said, is a sudden accession of unearned wealth and is of the nature of a windfall. The faculty to pay taxes of the recipient of such a windfall stands higher than that of a man with an equal amount of wealth who has been enjoying it for long. This higher faculty can be best tapped by means of the death duty. As the income-tax is the best method of tapping the faculty which results from continued possession of wealth, death duty is the best method of tapping the faculty resulting from a windfall arising out of an inheritance.

Secondly, the windfall element increases with the distance of relationship between the deceased owner and the heir or the beneficiary. A son inheriting his father's wealth cannot regard his

inheritance as a windfall as much as a nephew inheriting the wealth of his maternal uncle. Hence in theory, there is justification for taxing the inheriting nephew at a higher rate than the inheriting son. This is the reason for graduating death duties according to the distance of relationship between the deceased owner and the inheritor. Other taxes are usually graduated on two bases, namely the size of the income or the capital received or owned. But here a third base of graduation is common. In most of the death taxes in force in different countries, three principles of graduation are recognized either singly or in combination. They are:

(*i*) Graduation according to the size of the estate left by the deceased.

(*ii*) Graduation according to the size of the share of each heir or beneficiary.

(*iii*) Graduation according to the distance of relationship between the deceased owner and each inheritor.

The estate duty form of the tax has also been justified as a 'deferred additional income-tax collected at a time which has conspicuous advantages in mitigating its burdensome character or perhaps even promoting rather than retarding the accumulation of capital'.

It can be stated at once that both these arguments in justification of death duties assume an economic structure of society which does not exist in this country or at least is not generally prevalent.

The first argument assumes the modern capitalistic or time-consuming system to be the predominant type of productive system under which those who can 'wait' or 'abstain', in expectation of the future, gain control over the productive apparatus of society and gradually get richer and richer while the labourers who cannot 'wait' or 'abstain' continue in their poverty. This results in great inequalities—a host of Rothschilds, Carnegies, Fords on the one hand and the ever-increasing poor on the other, who, not being able to 'wait' or 'abstain' are entirely dependent on the other group for employment and their daily bread. They are in a constant position of great weakness which again is enhanced by the largeness of their number. Capitalistic society, when left to itself, constantly tends to such unbalanced development and the State must step in to restore the balance by curbing the inequalities as far as practicable within the framework of capitalism. Death duty is a good weapon in the hands of the State for giving effect to this purpose.

In this country, we have not reached such a state of development. Capitalistic production, in the modern sense, being far from the predominant method in this country, is yet in its early infancy when it requires not control but opportunity. Our problem is not too many Carnegies and Rothschilds but the utter absence of them. In the Western countries the capitalistic system has reached a high state of efficiency and the stress on efficiency is so great that in their devoted pursuit of efficiency they develop a disregard for the human side of the problem. But the problem in this country is not too much emphasis on efficiency but the lack of it. The efficiency of our productive apparatus is at such a low state that it is very artificial to talk of over-emphasis on efficiency on the lines of the thinkers of the West. The growth of efficiency in this country is yet in its early infancy and requires delicate handling.

Professor Carver has observed:

'After one's accumulation has increased beyond that which is necessary to safeguard one's offspring and to provide for the genuine prosperity of one's family, the motive to further accumulation changes. One then engages in business enterprises because of a love of action and a love of power.'

This is no doubt true of his own country. Here in this country there are not many cases where one's accumulation has gone beyond what is necessary to provide for the genuine prosperity of one's own family: there are even fewer cases where men engage in business enterprises because of 'a love of action'. The problem in this country is the paucity of men going in for business enterprise and the State has to encourage such enterprise by various means. To quote these statements in justification of death duties in this country is therefore extremely unrealistic.

Inequality among the people of the country is hardly our problem. The vast bulk of them are equal in poverty. Inequality there is, but that is neither our chief problem nor is it inherent in our methods of production. Our main problem is productive inefficiency with too much dependence on agriculture—and not distributive injustice. The bulk of the people pursue agriculture and there is no modern capitalistic system of production in that line. The holdings are not too large but too small.

There are of course a few large estates but they do not arise out of the method of production but out of the system of land tenure. In fact the large estates are seldom units of production because

these large landlords do not take part in production. They hold certain superior rights unconnected with production and receive rents. Whether they should stay or go is an entirely different question: it is not a question of the failure or evils of the system of production. Darbhanga, Burdwan or Cossimbazar are not created by the productive system of the country in the sense in which Ford and Rothschild are. They owe their rise and existence to an entirely different set of causes connected with the history and politics of the country. These estates have been recognized by the Political Power and such estates are not likely to emerge constantly as they would have done if they were inherent in the system of production. Emergence of inequality in the West is a perpetual problem. It is not that a few men grow rich and they are not multiplied. There big captains of industry emerge in every generation, for they are inherent in the system of production. Hence a perpetual death duty is required to solve the perpetual problem. To confuse them with our Burdwans and Darbhangas is a great mistake. If Burdwan and Darbhanga are a problem at all, it is a problem not of the failure of the productive apparatus but of the land tenure system.

Secondly, the really large estates are very few. Moreover, they constantly tend to be broken up by the operation of the Hindu and Muslim laws of inheritance which recognize a multiplicity of heirs.

On the agricultural side therefore death duties are necessary neither for breaking up the few large estates nor as a means of holding in check the constant emergence of inequality inherent in the system of modern production prevailing in the West.

On the industrial side too we are only on the threshold of development. Here also our problem is (*a*) lack of efficiency; not distributive injustice on account of over-emphasis on efficiency; (*b*) paucity of captains of industry; and not too many of them.

Modern capitalistic methods of production are not yet the prevailing method in this country and hence there is no question of a constant tendency to develop sharp inequalities in distribution. Huge production with a bad distribution is not our problem. Our production is low and we are poor. A tax which arises out of a policy of cutting down the share of big captains of industry with a view to reducing the inequalities of distribution inherent in the capitalistic system of production is out of place in this country.

To adopt it in imitation of the Western countries would be a mistake as the conditions are so different.

The second argument assumes a highly individualistic make-up of society. It postulates that the unit of production is the individual and not the family—a postulate which holds good of Western countries. There sons set up in life independently of the father quite early in life. The establishment and standard of living of the sons are quite different from those of their father and from those of each other and are correlated to the separate earning capacity of each. Partly on account of this early separation of the son from the father, bequests are much oftener than in this country made to persons who are either distantly related or not related at all to the deceased owner. Under such social conditions, an inheritance clearly takes the nature of a windfall—a sudden accession of unearned and at least partly unexpected wealth to the inheritor who has got his own earning, own establishment, own standard of living quite independently of the deceased owner. Such a windfall is a good occasion for imposing a tax according to the faculty theory of taxation. Further as Dalton has said:

'An inheritance tax, again, is often less keenly felt than might be supposed, since its payment is generally made through the agency of executors, before the inheritors receive the balance of the property, and since the payment coincides both with a positive accretion of personal wealth to the inheritors and with other events, which should generally force considerations of tax payments into the background of their minds.' [1]

The conditions in this country are quite different. Here the family and not the individual is still the unit of society. Here it is only rarely that sons set up independently of the father, and consequently, the father and the sons together have almost invariably got a common establishment, a common standard of living and a common pool of earnings. It is seldom that a father bequests his property outside the family. When therefore the father dies, the inheritance is in no sense a windfall. The death of the father in a family rather throws extra responsibility on the sons without in any way increasing the wealth or the income to which they have been accustomed. This holds true of the rich and the poor alike. The conditions depicted by Dalton are not therefore true of this country. There are no doubt exceptions to this general rule but they only

[1] *Public Finance*, ch. IV, pp. 48-49.

prove the rule. In such a constitution of society there is no windfall following on the death of the father and therefore no augmentation of the taxable capacity of the sons. There is therefore no justification for imposing a tax of the nature of death duties on such an occasion.

Recognition of this basic difference in the constitution of society as between this country and the West is essential in all discussions about the introduction of death duties in this country because non-recognition of this fundamental difference would lead to grievous errors. It may be pointed out in this connexion that the State also takes advantage of the difference in the condition in this country in that it does not provide for old age pension on the analogy of the countries of the West but relies entirely on the family to look after its old and infirm.

There is a third difference between this country and the countries of the West which is also important in this respect. In the Western countries units of production are mostly owned by companies. The integrity and continuity of the production units are therefore independent of the mortality of shareholders. In this country the units of production are mostly individually owned and hence the death of the owners is often a turning point in the history of a particular unit of production. The device of 'the Company' and its prevalence in those countries have brought about a divorce between the ownership of the plant and the ownership of the right thereto. This makes it possible to collect death duties without impairing the integrity and continuity of particular units of production, which can normally be assumed to be of a size best suited for securing the maximum economy in production in that line. When a man dies, his heirs may sell out a few shares in order to pay the death duties and this transaction of sale does not in any way affect the integrity or continuity of the plant itself. In this country, on the other hand, when a man dies leaving behind an individually owned plant, the heirs, if they were called upon to pay a high death duty, may have to sell a part of the business itself to pay it. This might have a serious effect on the productive capacity of the plant. The divided plants may not produce as much or as cheaply as they did when united; for, apart from the economies of a large scale production there is an economic size in each line of production or business. The death duty, if introduced in this country, is therefore likely to have a very undesirable effect

and will in many cases lead to the breaking up of plants and business organizations at a stage of development of this country when such break up will have a far-reaching retrograde influence on our industrial progress.

On the agricultural side, the actual producers are all small holders. Uneconomic holdings are their chief problem. The few large zemindars in the permanently settled provinces hold large estates but they are not actual producers. They are owners of certain superior rights and receive rents without taking any part in production. These large estates could therefore be broken up without disturbing production. That would not, however, solve the real problem of the land tenure system which is the existence of these superior rights which share the produce without taking part in production. The break up of the zemindaries by a system of death duties would not do away with the system of zemindary. New zemindaries would arise and they may be larger or smaller. A high scale of death duties would only help in breaking up the existing families and creating new ones. This may not be an unmixed evil and it will not solve the land tenure problem.

This, however, is a subsidiary argument. The main argument is the second one. If death taxation is windfall taxation there is no element of windfall in succession in this country and hence there is no justification for taxing such succession in this country. It is also clear that the justification of an estate duty as a deferred additional income-tax is also not applicable to the conditions in this country; for, the time for collecting it is obviously not such as would, having regard to the social make up of the country, mitigate its burdensome character. Nor would it, having regard to the industrial structure in this country, promote the accumulation of capital. To levy an estate duty at the time of death would be specially burdensome and would definitely retard the accumulation of capital. It will only enhance the process of destroying capital.

A death duty takes one of two forms. It is levied either in the form of a transfer or mutation duty or in the form of a succession duty. In the former case the entire estate of the deceased is the base of the tax; in the latter case the share received by each inheritor is the base of the tax. The English estate duty is an example of the former while the English legacy or succession duty is an example of the latter.

A succession tax is clearly more equitable than an estate duty; for the base in the former is an exact measure of the windfall and the tax can also be graduated according to the degree of relationship between the deceased proprietor and inheritors. The succession tax is, however, more difficult and therefore more expensive to administer, for, it involves the search for all the heirs, the determination of the separate share of each and a separate assessment in each case. When again assessees are more numerous, collection charges become very much higher. The estate duty is free from all these difficulties. It involves only the valuation of one estate in the case of each death and the levy of one tax only on the estate. The British estate duty with the principle of compulsory representation often collects itself. In this conflict between the canons of equity and economy, most countries including England prefer the latter and rely chiefly on the estate duty.

In this country a succession duty will be specially difficult to administer. As the Taxation Enquiry Committee have put it:

'The system of inheritance both among the Hindus and among the Muhammadans recognize a plurality of heirs, and the calculations connected with the division of property among them, and more particularly the minute fractions into which the shares of particular heirs may run, would render the imposition of a succession duty, as distinguished from an estate duty, impracticable. Nor would it be easy, in the medley of laws and customs of inheritance that exist side by side, to arrive at a uniform classification of heirs and a satisfactory scale of graduation according to relationship which would apply to all communities in India.'[1]

Secondly, it is doubtful, legally speaking, whether the succession duty form of tax would cover the movable property situated in British India of a dead person not domiciled in British India. Non-domiciled persons own considerable movable property in British India and many of them are even residents in British India. They are chiefly European British subjects, and subjects of Indian States. Exclusion of the movable property, situated in British India, of non-domiciled persons, whether resident or not, would introduce a serious inequality in taxation and a succession duty is ruled out on this ground also.

If, therefore, death duty is to be introduced in this country, it must take the form of an estate duty or mutation duty.

[1] *Report*, Vol. I, ¶ 357.

The constitution offers a difficulty here. It permits the levy of a succession duty and not of a mutation or estate duty. The authority to levy death duties is derived from two different entries in the Legislative Lists. They are:

(*a*) Entry No. 43 of List II (Provincial Legislative List) which reads,

'Duties in respect of succession to agricultural land.'

(*b*) Entry No. 56 of List I (Federal Legislative List) which reads,

'Duties in respect of succession to property other than agricultural land.'

The scope of the duties contemplated in the lists has not yet been decided by any Court; but the language seems to indicate that the scope is to be restricted to true *succession duties* in the sense in which that term is used in other Parliamentary enactments. An estate duty form of the tax is therefore excluded. Before levying an estate duty, it is therefore essential,

(*a*) that a ruling should be obtained from the Federal Court that the entries do include an estate duty form of the tax;[1] or,

(*b*) that two additional entries authorizing the levy of the estate duty form of the tax be inserted either by a notification under Section 104 of the Government of India Act, 1935, or by a Parliamentary amendment, in case the decision of the Court is adverse.[2]

It is important to note in this connexion the principal requirements of the Constitution.

A death duty in respect of agricultural land is to be levied by a Provincial Act. A death duty in respect of property other than agricultural land is to be levied by a Central Act but the proceeds of the tax are to be distributed among the provinces according to such principles of distribution as may be determined by an Act of the Federal Legislature.[3] It follows that a comprehensive Act covering all property is not possible and hence the two taxes must be separately graduated according to the size of the separate bases on which they are levied.[4] Secondly, one tax may theoretically

[1] In answer to such a reference the Federal Court decided in August 1944 that the levy of an 'estate duty' is not authorized by the constitution.

[2] A bill for amending the Government of India Act for this purpose was introduced in the House of Lords in January 1945.

[3] Section 137 of the Government of India Act, 1935.

[4] The tax levied by Articles 11 and 12 of the *Indian Court Fees Act*, in so far as they are duties in respect of succession to agricultural land and other

exist without the other though practically it will be almost impossible to levy the tax on agricultural land without first levying the tax on other property. For, the formation of a company by the owners will make possible a successful avoidance of the tax on agricultural land if there is not also levied a tax on other forms of property. A share in a company owning agricultural land is not agricultural land and a law levying a duty in respect of succession to agricultural land will not, therefore, cover succession in respect of such shares. Hence such a law will not yield anything if the owners of all the agricultural land within its scope formed themselves into companies. In any case, a substantial portion of such land will certainly be owned by companies and in so far as that portion will successfully avoid the tax, a serious discrimination will ensue between the company-owned portion and the individual-owned portion. Under the present constitution, therefore, it is difficult to levy the provincial tax until after the Central tax has been levied.

The greatest legal difficulty is the law of succession among the Hindus, Muslims and Indian Christians which does not require compulsory representation. In the absence of such compulsory representation, the administrative difficulty both in tracing cases of taxability and in collecting the tax assessed becomes very much greater.

The Taxation Enquiry Committee recommended the introduction of compulsory representation among all communities in India. They claimed certain advantages for compulsory representation apart from the fact that it would facilitate the administration of death duties. The Committee said:

'Apart from any question of taxation, the extension of a general system of representation to the communities in which it is not at present in force, would be of manifest advantage to the communities themselves. Their laws of inheritance recognize a plurality of heirs and interests requiring protection, and this fact itself renders an intermediate representation necessary. At present among the Hindus, the laws relating to adoption, self-acquisition, partition, and reversionary rights give facilities for dishonest debtors or designing relatives to traffic in family dissentions when property

property is a comprehensive tax so far as it goes; and to that extent it is repugnant to the provisions of the *Government of India Act*, 1937. But the tax is either protected by Section 143 of the *Constitution Act* or may, in the eye of the jurists, be classified as 'fees realized in Courts'. This is a nice point in constitutional law.

passes at death. A system of universal representation would curtail these activities. In the case of both Hindus and Muhammadans it would be of practical value to the honest debtor as an indemnity. It would clothe the nearest relative or the person who has the greatest interest in the estate with a representative capacity which could not fail to be of great use and assistance in dealing with strangers, either creditors or debtors of the deceased's estate, instead of leaving the estate to be got in and distributed by such fortuitous means as might be available. Besides, where property had to be sold to discharge debts, or even for the purpose of making a division, the purchaser could deal with a duly appointed legal representative instead of with a number of persons claiming to be interested in the estate: purchasers would obtain a more secure title and this security would in turn lead to an enhancement of the value of the property. The fact of representation would thus save the estate from loss and spoliation. It would also solve a very difficult question which arises where a Hindu or Muhammadan suitor, plaintiff or defendant, dies, and it becomes necessary to appoint a representative to carry on the suit or to defend it.' (¶ 363.)

If these are the advantages claimed for a system of compulsory representation, they would hardly justify its introduction in order that the levy of the death duty may be easy. It would no doubt curtail the scope of dishonest debtors in taking advantage of a plurality of heirs though it will not put a stop to it. It would also facilitate the sales of estates or parts thereof. It would further make it easy to carry on a suit after the death of the plaintiff or defendant when one of the parties dies before the conclusion of a suit. These advantages will no doubt ensue. But the number of persons who would enjoy this advantage will be very small and the advantage in each case is after all small. A system of compulsory representation will, on the contrary, affect one and all in the country and the disadvantage to which each will be put will be real and substantial and in most cases unnecessary; for, in most cases in this country the succession takes place without any hitch at all as it is often confined to the nearest relatives, namely sons or daughters or widows. The disadvantage following from a system of compulsory representation would, therefore, be universal and out of all proportion to the small advantage that would be derived from it by a very small minority.

People also feel strongly about their laws of inheritance which are based on age-long tradition. They would hardly take kindly to a change on the lines proposed.

The introduction of compulsory representation is, therefore, neither desirable nor practical. It obviously cannot be justified as a means of facilitating the administration of death duties; for, as already pointed out, the introduction of death duties in this country is not defendable in view of our social system and economic structure.

Apart from the general legal difficulties, Hindu families governed by the Mitakshara School, and Wakf-alal-aulads of the Muslims present special difficulties. Under the Mitakshara School, the property belongs to the family and not to any individual. The family like a Corporation never dies and hence there is no succession or no transfer of property.

Similarly, Wakf-alal-aulads are trusts created for the benefit of one's descendants until, if at all, the line becomes extinct, when the property goes to charity. In this case also there is no transfer or succession.

In both cases it is not possible to levy an estate duty or a succession duty. If these cases have to be left out of any scheme of death duties, it would involve discriminatory taxation of such an order as would make this tax both undesirable and impracticable. Some fiction or device has therefore to be adopted to bring these cases under taxation, if death duties are ever to be introduced. It might, for instance, be provided that on the death of any member of the family or any beneficiary, as the case may be, duty should be levied on what would have been the deceased's share if partition had taken place at the time of his death. This is stated not as a definite suggestion but just to indicate the nature of the difficulty involved in introducing death duty in this country.

The discussion makes it clear that death duties are not likely to be a live issue in the near future. The prevailing social system in this country deprives this duty of the justification on which it is based in the West. The structure of our productive organization deprives the State of any justification for a policy for occasional correction of the distributive inequality inherent in a capitalistic system of production. Our legal system clothes the administration of death duties in this country with certain peculiar difficulties unknown in other countries. The constitution again divides the death duty in such a way as between the Centre and the provinces that the provinces will not be able to adopt it until the Centre has adopted it. It is also doubtful whether the constitution will

permit the estate duty form of the tax, the only form which is administratively feasible in this country.

II

The Bombay Race Course Licensing Act

This Act, enacted under autonomy, levies a lump fee of three lakhs of rupees a year on the Western India Turf Club. It is a licence fee. The club has to take out a licence every year for its continued existence and the tax is levied on that occasion. The club being the only institution of its kind in the province is the only tax payer and the amount payable as licence fee by it is simply mentioned in the Act without disclosing the basis of calculation. The amount is probably correlated to the income of the club and it is likely that it was levied as a lump fee as the Provincial Government were not competent to levy a tax on income. The levy, however, is by no means a fee. It is no doubt levied on the occasion of conferring a special privilege but the levy is clearly a special burden which is nothing but a tax in the eyes of the economist. Constitutional lawyers may call it a fee but economists would not.

This levy is best classified as a tax on persons. It is in fact a tax on one 'person' only as there is no one else of the class in existence.

The tax is easy and cheap to collect. It is also very certain, being a lump sum payable by a specified institution. Nor is it inconvenient for the club to pay it. So it satisfies the canons of economy, certainty and convenience.

It is not possible to say whether the tax is causing hardship because the basis of the calculation is not revealed. If it can be presumed that the club is left with sufficient money to function properly, there need not be any objection to the tax. On that assumption it is in fact one of the best provincial taxes. This is not to say that betting, on which the club thrives, is in itself good; but if it is allowed, there is no reason why the bulk of the profits made out of betting by the promoting club should not go to the State instead of going to swell private profits or even to private charities.

PART V

I

COST OF COLLECTION OF THE NEW PROVINCIAL TAXES

THE cost of collection of the new provincial taxes[1] is analysed below, as far as figures are available. The figures are all in thousands of rupees.

The Agricultural Income-tax

The figures of receipts from and expenditure on this tax in Assam and Bihar are given below:

		1940-1	1941-2	1942-3 (Actuals)	1943-4 (Revised)
Assam	Revenue ..	39,20	27,12	25,50	35,50
	Expenditure ..	31	37	43	40
	Percentage of expenditure on receipts ..	·8	1·3	1·6	1·1
Bihar	Revenue ..	14,96[2]	15,45	17,81	17,88
	Expenditure ..	62[2]	50	52	54
	Percentage of expenditure on receipts ..	4·1	3·2	2·9	3·0

Thus the tax has not been expensive to collect. The reason why it has been particularly cheap to collect in Assam is that the bulk of the tax is collected there from the tea assessees. The tea companies combine business and agriculture. They both grow the tea plant and manufacture the tea for the market. As it is difficult to assess separately the non-agricultural income of such companies, the Central Income-tax Department assess the whole of the income of each such company and treat forty per cent of it as non-agricultural income for the purpose of imposing the Central Income-

[1] The figures have been taken from the budget statements of the provinces for the years 1943-4 and 1944-5, except where otherwise indicated in the context.

[2] Annual Report.

tax. The Provincial Government take full advantage of this assessment and impose the Agricultural Income-tax on the balance. In these cases the detailed assessment proceedings are thereby avoided and the provincial officers proceed on the basis of a certified copy of the order of assessment, as made by the Central Income-tax Department. As such assessment forms the bulk of the work in Assam, the cost has been specially low in that province. In Bihar though the cost has not been very high, it is likely that it will go down further. There Government have recently reduced the number of officers as the number of cases has been much below their original estimate. It is possible that the process can be carried a little further.

Betting Tax, Electricity Duty, Petrol Sales Tax, Entertainment Tax

The figures of receipts from and expenditure on these taxes have been as follows:

			1941-2 (Actuals)	1942-3 (Actuals)	1943-4 (Revised)
Bengal	Entertainment Tax	Receipts ..	8,58	11,96	30,00
		Expenditure ..	6	7	36
		Percentage of expenditure on receipts	·7	·6	1·2
	Betting Tax	Receipts ..	13,07	13,45	25,00
		Expenditure ..	5	5	5
		Percentage of expenditure on receipts ..	·4	·4	·2
	Electricity Duty	Receipts ..	19,57	15,80	27,33
		Expenditure ..	92	91	82
		Percentage of expenditure on receipts ..	4·6	5·7	3·10
Madras	Entertainment Tax	Receipts ..	14,61	15,40	19,14
		Expenditure ..	11	2	2
		Percentage of expenditure on receipts ..	·8	·1	·1
	Electricity Duty	Receipts ..	6,71	6,38	6,61
		Expenditure ..	4	4	2
		Percentage of expenditure on receipts ..	·6	·6	·3
	Petrol Sales Tax	Receipts ..	13,90	13,11	14,00
		Expenditure ..	1	1	1
		Percentage of expenditure on receipts ..	·07	·07	·07

			1941-2 (Actuals)	1942-3 (Actuals)	1943-4 (Revised)
Bombay	Entertainment Tax	Receipts ..	12,18	21,32	36,00
		Expenditure ..	20	21	23
		Percentage of expenditure on receipts ..	1·6	·9	·6
	Betting Tax	Receipts ..	15,96	24,23	57,00
		Expenditure ..	6	6	9
		Percentage of expenditure on receipts ..	·3	·2	·1
	Electricity Duty	Receipts ..	36,52	34,52	38,87
		Expenditure ..	1,09	1,11	99
		Percentage of expenditure on receipts ..	2·9	3·2	2·5
	Motor Spirit	Receipts ..	12,08	16,92	48,48
		Expenditure ..	5	3	3
		Percentage of expenditure on receipts ..	·4	·1	·06

It appears from the figures given above that the cost of collection of these taxes has been remarkably low. In the case of the entertainment tax, the cost has been between half and one per cent; while in the case of the betting tax and the motor spirit tax it has been less than half per cent.

Tax on employment, professions, etc.

The figures of receipts from and expenditure on this tax are:

		1941-2 (Actuals)	1942-3 (Actuals)	1943-4 (Revised)
Bengal	Receipts	10,47	8,59	10,00
	Expenditure	57	64	70
	Percentage of expenditure on receipts	5·7	7·4	7·0

Separate figures for the cost of collection of this tax in the Central Provinces are not available.

The cost of collection seems rather high for a simple tax of this nature, of which the assessment is based entirely on a list of persons furnished by the Central Income-Tax Department.

Sales Taxes

In Bengal, one organization deals with three measures of sales taxation, namely, the comprehensive Sales Tax, the Petrol Sales Tax

and the Raw Jute Tax. The three taxes have yielded revenue as follows:

	1941-2 (Actuals)	1942-3 (Actuals)	1943-4 (Revised)
Sales Tax	15,62	68,94	90,00
Raw Jute Tax	..	32,06	50,00
Petrol Sales Tax ..	2,49	11,91	22,00
TOTAL ..	18,11	1,12,91	1,62,00

The organization which collects the three taxes has cost Government as follows:

1941-2 (Actuals)	1942-3 (Actuals)	1943-4 (Revised)
2,34	3,64	4,69

Expressed as a percentage on receipts, the cost works out as follows:

1941-2	1942-3	1943-4
12·8	3·2	2·8

In Madras one organization deals with the General Sales Tax and the Tobacco Sales Tax. The two taxes have yielded revenue as follows:

	1941-2 (Actuals)	1942-3 (Actuals)	1943-4 (Revised)
General Sales	67,02	89,03	2,20,00
Tobacco	19,48	20,87	21,38
TOTAL ..	86,50	1,09,90	2,41,38

The collecting organization has cost as follows:

1941-2 (Actuals)	1942-3 (Actuals)	1943-4 (Revised)
12,02	12,59	13,77

Expressed as a percentage on receipts, the cost works out as follows:

1941-2	1942-3	1943-4
13·9	11·4	5·7

In the Punjab one organization deals with the General Sales Tax and the Urban Immovable Property Tax. The two taxes have yielded revenue as follows:

	1942-3	1943-44
General Sales Tax	6,25	28,04
Urban Immovable Property Tax	17,98	22,12
TOTAL ..	24,23	50,16

The collecting organization has cost as follows:

1942-3	1943-4
4,05	4,87

Expressed as a percentage on receipt, the cost works out as follows:

1942-3	1943-4
16·6	9·6

It will appear that the cost of collection of the Sales Taxes in Bengal is remarkably lower than that in Madras or in the Punjab. The difference becomes all the more remarkable when it is considered that a large number of articles of mass consumption which account for a considerable proportion of the yield in Madras and in the Punjab are on the exemption list in Bengal. Further, in the case of the Punjab the Town Property Tax which costs sc little in Bombay is collected by the same organization which collects the sales tax and it may be presumed that but for this combination, the independent cost of collecting the sales tax would have been higher. Then again in Bengal, it is a single-point tax while in Madras and the Punjab, it is a turn-over tax; but the rate in Bengal is higher than the rate in either of the other two provinces. It is likely that the difference in the rates neutralizes the difference in the frequency of the impact of the tax on a particular commodity. On the other side, it is to be considered that in Bengal, the sales taxes on raw jute and petrol require only a small effort to collect and the collection of the comprehensive sales tax, if organized independently, would certainly have cost a little more.

But all things considered there cannot be any doubt that the cost of collection of the Madras tax and the Punjab tax is too high while that of the Bengal tax represents a more or less correct proportion of the yield. The chief reason for the difference is certainly the difference between the two schemes. The Bengal

scheme can safely place the exemption limit for dealers at as high a figure of annual turn-over as fifty thousand rupees, whereas in the Madras scheme the exemption limit must be low. The exemption limit serves different purposes in the two schemes.

It is interesting to refer to American experience in this respect.

In some of the sales tax laws of the American States a statutory ceiling is put on the cost of collection.

Thus the *North Dakota Retail Sales Tax Act* (Act No. 80 of 1937), which imposes a tax of two per cent on the gross receipts from retail sales of tangible personal property consisting of goods, wards or merchandise, provides as follows:

'Section 25. Allocation of revenue.—All moneys collected and received under this Act shall be credited by the State Treasurer into a special fund to be known as "The Retail Sales Tax Fund". Out of this fund the State Treasurer shall first pay the expenses of administrating this Act, not to exceed, however, an amount not to exceed three per cent (3%) of the gross collection and the payment of refunds allowed under this Act.'

The following table gives a summary of similar provision in a few other State Acts:

Name of the Act	Rate of the tax	Maximum cost of collection allowed under the Act, expressed as a percentage of the annual receipts
Arkansas Retail Sales Tax Law (Act 154 of 1937)	2 per cent[1]	3 per cent[2]
Colorado Emergency Retail Sales Tax Act of 1935	2 per cent[3]	5 per cent[4]
California Retail Sales Tax Act of 1933	2½ per cent[5]	2½ per cent[6]

The statutory ceiling is, however, not there in all the States. Again, even when there are statutory ceilings, the actual cost may not rise as high as that. The actual cost of administration has ranged 'between 1 and 4 per cent of the revenue from the tax, the figure for most of the States being between 2 and 3 per cent'.[7]

[1] Section 4. [2] Section 7. [3] Section 4(*a*).
[4] Section 43. [5] Section 3. [6] Section 29.
[7] Haig and Shoup—*The Sales Tax in the American States*, Part 1, p. 28.

Judged by American experience, it is only the Bengal scheme which can be considered satisfactory while the Madras scheme, which is followed in the Punjab, is unsatisfactory.

The Town Property Tax in Bombay has cost as follows:

	1941-2	1942-3	1943-4 (Revised)
Receipts	97,76	96,22	1,00,00
Expenditure	2,45	2,41	2,10
Percentage of expenditure on receipts.	2·5	2·6	2·1

No separate machinery was brought into being in Bombay for the collection of this tax. This was of the nature of a surcharge on the municipal rates and the municipalities were entrusted with the collection of the taxes along with their own rates. The municipalities, however, were given a percentage of the yield as their remuneration. Compared to the other new taxes, this tax has cost the Provincial Government more.

The increasing revenue requirements of the Provincial Government will exert a constant pressure for increase in the rates of the taxes mentioned above. As the rates increase, the cost of collection is likely to consume a smaller percentage of the yield of the taxes. This, in itself, may exert a pressure for increase in the rates. It is important that the Provincial Government should, as far as practicable, ascertain the independent cost of collection of each tax and keep the public informed about it through their budgets and annual administration reports.

II

TAXATION UNDER AUTONOMY

IN his budget speech of 1939-40, the Finance Minister of Madras said,

'What is this thing called Excise Revenue? It is a heavy indirect taxation on the poorest classes; and therefore, the demand that Prohibition should not be extended in order that we might not have an increased gap between revenue and expenditure means, in fact, a demand that the poorest should be taxed through drink rather than that alternative taxation should be devised, the incidence of which would be on classes better able to bear the burden. Interpreted truly in this manner, the illogicality, if not the cruelty, of the criticism is made plain.'

This is a new note in Government pronouncements on taxation in British India remarkable alike for its refreshing boldness as well as for the correctness of approach tc the problem of taxation.

The short period of Provincial autonomy has, in fact, been the period of the greatest attempt at tax reform ever made in British India. In no other period was it felt so clearly that the distribution of the tax burden was unfair and in no other period was such a great and persistent attempt made to redistribute it in a more equitable manner within the limits set by the Constitution. The different provinces met with varying degrees of success but in all of them there was a strength of conviction and an earnestness which were unmistakable.

The stimulus for tax reform came not from any expert study of the subject but from purely internal causes. For the first time in the history of British India a ministry responsible tc the elected representatives of the people was placed in charge of the provincial administration with powers to determine the financial policy of the provinces subject, of course, to the limitations of the Constitution. Two things automatically followed.

First, the detached, disinterested approach to the problem at once gave place to a realistic approach. The new Finance Minister did not require to engage in a discussion as to whether land revenue was a tax or rent before understanding its effects on the cultivators. To him the discussion became meaningless and he approached

the problem directly; he could see and feel the effects directly and they were real to him. To the non-Indian Finance Member of old the effects were merely the conclusions of a syllogism and hence he was more anxious about the premises from which the conclusion was an intellectual deduction. Similarly, to the new Finance Minister the 'freedom' of a labourer to drink toddy was meaningless and he naturally began to dislike the money which had to be earned by allowing such freedom. To the non-Indian Finance Member, revenue was a hard reality and was also associated with the higher principle of 'freedom'. This is no criticism of the ability of those Finance Members all of whom were able and earnest: the difference is not a difference in ability at all. It is a difference in attitude. With all the ability in the world a man cannot appreciate other peoples' affairs as realistically and sympathetically as they themselves can. The wearer of the shoe may not be an expert shoemaker but it is he who knows best where the shoe pinches.

Secondly, a popular ministry has to undertake beneficent activities for the amelioration of the conditions of the people. A Government responsible not to the people but to a foreign Government living thousands of miles away must lay the greatest stress on peace in the country and may neglect other beneficent activities. No wonder that the expenditure on beneficent activities has increased with the increased association of persons responsible to the people with the Government of the country. It first showed a tendency towards increase under the dyarchic constitution of 1919 and took a fairly big jump with the introduction of Provincial autonomy.

The Finance Minister of the Punjab Government drew attention to this aspect of the question in his first budget speech as follows:

'But the broad fact remains that under the charge of the reformed Government, expenditure on what are known as the beneficent or nation-building departments rose steadily—in 1921-22 it stood at 1,70 lakhs, in 1936-37 the estimates were 2,90 lakhs. It is on this inheritance of close attention to beneficent State activity that the present Government has entered.'

This necessity to incur larger expenditure compelled the attention of the ministries to the question of taxation.

The problem of the ministries was therefore a difficult one. They required larger revenues but considered the principal existing sources of revenue to be wrong. They had to face this dilemma boldly.

The problem was clearly stated by the Finance Minister of Bombay in his first budget speech as follows:

'Although taxation in this province is very high, it is clear to us that most of this taxation is being borne by the poorer people in the province. The land tax, the excise tax, the stamps and court fees, the taxes on public conveyances, the tax on country-grown tobacco —all these are being mostly paid by the poorer classes. The income-tax is the only tax paid by the rich, and that at present is beyond the reach of the Provincial Government ..... Hedged in as we are by numerous restrictions, it is no easy task to devise taxes which will affect only the taxable untaxed.'

He went on to say that they must find proposals for taxing this 'taxable untaxed' which must yield adequate funds 'for not only recouping themselves from the loss which a policy of prohibition may involve but will also enable them to undertake some expansion, though not all the expansion that they desire, in the many fields of social service'.

The problems then were:

(*i*) to remove the taxes on the 'untaxable taxed', e.g. by prohibition;
(*ii*) to find money for beneficent activities;
(*iii*) to tax the 'taxable untaxed' with a view to filling up the gaps created by (*i*) and for (*ii*), subject, of course, to the numerous restrictions imposed by the Constitution.

The Finance Minister of Assam stated the same problems in his budget speech of 1939 as follows:

'We have accepted the office and responsibility with a definite object and purpose, that is, of easing the burden of taxation on the poor and of providing means for the uplift and betterment of the masses ..... This will necessarily mean fresh and new taxation on those who can afford to bear it.'

The Finance Minister of the Punjab Government expressed the problem in his first budget speech almost in the same manner:

'Reforms have forced pointed attention to the rigidity of our revenues and the narrowness of our finances, for reforms mean increased expenditure, and our provinces have not even now the means of making proper or adequate provision for beneficent or nation-building activities ..... But serious students of Indian economics have in recent years stressed with growing emphasis the excessive character of our land revenue burden, a main source of provincial income; while even with this burden and without contemplating any relief in this regard, our provincial Finance Ministers in India are in despair as to any fruitful schemes of enlarging their

revenues. The resourcefulness of Government experts, as individuals and in Committees, is exhausted in merely canvassing adjustments, hardly a single additional or further source of income is suggested, while Provincial Governments naturally press for a larger share of what the Central Government absorbs at present. The pessimistic tone of experts and the frantic advocacy of individual provincial claims is a saddening fact—for it is a rock on which the realities of reform may easily split.'

It was thus clearly recognized from the beginning that the success of the new Constitution depended on the ability of the Provincial Governments to discover and adopt a system of taxation which was both more equitable and more productive.

The problem was indeed difficult. But there was no want of boldness to face it. The Finance Minister of Assam, referred to above, after having adopted a policy of large remissions of land revenue and of gradual prohibition was bold enough to announce in his budget speech of 1939 the introduction of as many as five measures of taxation [1] which he claimed would only tax the taxable. The Finance Minister of Madras displayed unprecedented boldness in deciding to give up in the course of a few years a fifth of the total revenues of the province and to fill up the big gap thus created by new and more equitable measures of taxation. The same boldness characterized all the Provincial Governments under autonomy, though all did not achieve the same amount of success.

We have just seen the general attitude of the Provincial Governments to the problem as a whole; their approach to and actual handling of individual taxes are discussed below.

All the provinces recognized that land revenue and provincial excise were bad taxes which ought not to be extended or intensified so as to yield larger revenues.

With regard to land revenue all provinces, as already pointed out, adopted a reformist attitude. They remained content with a more liberal scale of remissions (in the temporarily settled areas) without making any substantial changes in the system or pitch of assessment.

In respect of the excise revenue, the attitude of the Provincial Governments was more uncompromising. The seven Congress Governments were out for abolishing it altogether and they started

[1] Taxes on (i) agricultural income, (ii) petrol and lubricating oil, (iii) amusement and betting, (iv) foreign liquor, and (v) certain articles of luxury, i.e. the Assam Sales Tax. All these taxes have been discussed already.

a plan of action designed to achieve complete abolition in a few years. The attitude of the four non-Congress Governments towards excise revenue was similar to that of Madras towards land revenue. They recognized that that particular taxation was bad but considered that it was not possible to abolish it altogether in view of the necessity for increasing expenditure and in view of the limitations on their powers of adopting other forms of taxation. Bengal, however, did start prohibition in a small area though there was no plan for achieving complete prohibition in a short or definite period.

In respect of the stamp revenue all Provincial Governments took a complacent attitude. Though the scale of court fees was not generally raised, stamp duties were raised in several provinces.

The different attitudes to the three major taxes correctly reflect the popular feeling towards the three measures. Public opinion in this country hardly objects to stamp duties. It considers land revenue to be a fair levy and a proper due to the Government but its burden is often felt and there is a feeling that it is excessive. Public opinion is, however, very strong against drink and other intoxicating drugs.

As already pointed out, the popular Governments under Autonomy approached the problems not from the standpoint of experts but merely as agents of the public. Their actions naturally reflected public opinion and they were uncompromising against excise revenue, compromised with land revenue and were complacent so far as stamp revenue was concerned.

On the other hand, all Provincial Governments set out to develop a system of taxation which would altogether exempt the poor agriculturists (who formed the bulk of the population in every province and on whom the burden of existing taxation was too great) and would be mainly if not solely confined to townsmen and richer agriculturists—in the words of the Finance Minister of Bombay —the 'taxable untaxed'. This tendency had started under the constitution of 1919 when for the first time a popular element was associated with the Provincial Governments and reached its culmination under autonomy. Taxes on motor vehicles, electricity, amusements, betting, prize competitions, urban property, agricultural incomes and professions, employment, business and calling are the result of the working of that tendency. The pages of the Constitution Act were searched to discover taxes of this nature and almost all that were possible under it were adopted, taking all the provinces

together. The capacity of the Constitution to yield taxes of this nature was soon exhausted.

The Government of Madras derived the largest revenue from provincial excise. It required great boldness to give up that revenue. All the taxes under the Constitution which would exempt the poorer sections in the province from their operation could not possibly fill up the wide gap which prohibition would cause. The Government of Madras therefore adopted the general sales tax. It was frankly admitted that it was a bad tax and it was defended on the ground that there was no other tax or taxes permitted by the Constitution which could make up the large loss of revenue caused by prohibition. The Prime Minister in defending the bill imposing the tax said on the floor of the House:

'I have proved that it is necessary to raise money. I have proved that the schedule is framed in such an exhaustive manner that it is idle to think of any other form of taxation, and therefore the sales tax being the only thing that we can have, it is a necessary disturbance of the existing order and we must put up with that amount of difficulty that will arise on account of the disturbance of the existing order of things . . . We stand here with the single alternative of the sales tax.'[1]

Here was a case of choice between two bad taxes. In so far as excise revenue was derived mostly from the poorest section of the people of the province, the choice was quite in the right direction, for, it lifted that burden from the poorest and distributed it among the general population including the richest. It was not the imposition of an additional burden but a better redistribution of the same burden.[2] Moreover, prohibition meant a great social reform. As the Prime Minister of Madras said in his budget speech of 1939-40:

'The Government regard prohibition as the greatest single measure for the economic improvement of the masses and the readjustment of the tax-burden on a fairer basis.'

That the readjustment could not be made on a still fairer basis is due to the limitations imposed by the Constitution. That the measure as adopted contained serious defects harmful to the trade and industry of the province is the responsibility of the Government.

[1] *Official Report*, 31st March, 1939, Vol. XII, No. 1, p. 52.

[2] See 'The Sales Tax in Bengal' by N. R. Sarker, *Modern Review*, December 1940.

These defects have been fully discussed in the chapter on sales taxes.

The analysis given above shows the tendencies in operation under autonomy in the sphere of taxation.

First, the ministries approached the problem from the standpoint of the general public and not from the standpoint of experts.

Secondly, they made the biggest and boldest attempt at tax reform in the history of British India. There is no other period in the history of British India in which

(*i*) taxes yielding such large revenues were given up or reduced on the one hand, and

(*ii*) so many new taxes were introduced in quick succession of one another.

Thirdly, their attitude towards the principal existing taxes reflected the public attitude towards them. Thus they were out to abolish the taxes of the excise group, made a compromise with land revenue and felt indifferent to the stamp revenue.

It was for the first time in the history of British India

(*a*) that excise revenue was openly condemned by Government and was attempted to be abolished altogether; and

(*b*) that land revenue was openly declared to be an unequal tax.

Fourthly, a group of taxes were adopted by policy which affected only or chiefly the townsmen or the better off agricultural classes and which deliberately exempted the poorer agricultural classes. In their search for new taxes as a measure of tax reform, they adopted taxes which would hit the poorer agricultural classes only when they were convinced that that was the only alternative. This tendency, as already pointed out, had appeared in some provinces under Dyarchy when a popular element was for the first time introduced into the Government.

Fifthly, if they selected taxes from the point of view of the layman they also made the mistakes of the layman. The Assam sales tax was clearly a mistake of that nature. The Madras Regulation of the Sale of Cloth Act was similarly based on a wrong idea of the operation of economic forces. The Madras General Sales Tax Act also contained many sources of mischief which an expert would have avoided.

In spite of this, however, it is apparent that the popular approach to the problem of taxation in the provinces yielded results which

almost coincided with the results which would have been yielded by the experts' approach. There are of course defects in the measures actually adopted and it is possible that an expert might have avoided many of the defects or that he would not have adopted one or two of the measures at all. But in the matter of choice of the measures within the framework of the Constitution, an expert could hardly have done better. The short experience under Autonomy confirms the statement made in Chapter II of the present study that taxation is at its best where 'general will' is the sovereign and 'common good' the policy. It demonstrates the popular dictum that the wearer of the shoe knows best where the shoe pinches.

Some speculation about the future of the provincial taxes will be interesting as a conclusion to the present study.

It may be stated at once that many of the taxes have come to stay. They are:

Taxes on electricity, amusement, motor vehicles, betting.

These are some of the best provincial taxes. They conflict least with the canons of taxation, namely equity, economy, convenience and certainty. No Provincial Government is likely to abolish them. On the contrary, we should expect attempts to make them more and more fruitful.

The tax on agricultural income is also likely to stay. The legal objection and the objection on the ground of equity have been decisively disposed of. Assam and Bihar have demonstrated the administrative ease and economy with which the tax can be collected. Landlords are also not likely to regain their political influence. The tax therefore is likely to stay and to extend to other provinces where land revenue is permanently settled. Moreover, after the initial controversy about its desirability has died down, there is likely to be popular pressure for pushing up the rates to the general income-tax level.

In the sales tax group, the tax on the sale of motor spirit is very likely to be permanent. It has spread in a short time to all provinces except Orissa and is a tax at once fair and easy to collect.

The Madras tax on tobacco is not likely to continue in its present form for long. It is obviously causing some hardship and has to be substantially modified before it can be permanently retained.

The Assam sales tax and the Bombay sales tax on mill-made cloth were cancelled even before they were enforced.

As regards the comprehensive sales tax, the future is uncertain. One point seems fairly certain that if a tax of the kind is to remain in force permanently, it must be one of the Bengal type—laying the chief emphasis on retail sales and exempting the necessities of life, exports and raw materials, machinery, etc., required in the process of manufacture. The experience of the cost of collection under the two schemes also confirms this expectation. Further, under the Bengal scheme it is possible to fix a high minimum registrable turnover so that besides keeping the cost of collection low the rural trade in articles which are never dealt with except by small dealers can be kept undisturbed.

The need for an expanding revenue is going to be a permanent feature of all Provincial Governments. Hence it is not unlikely that the rate of the tax will rise in the provinces in which it has appeared and the tax will extend to other provinces also. It is not also difficult to visualize that as the comprehensive sales tax becomes more common and as the provinces become conscious of the defects arising out of its discriminatory character, all the provinces will agree to adopt a common pattern of the tax.

The future of the tax on urban property is also difficult to prophesy. The main objection against it is neither its injustice nor its expensiveness but its conflict with the interests of the municipalities. It is not unlikely that municipal interests will try to gather strength and not only prevent its extension to other provinces but will also succeed in abolishing it in those provinces where it has been introduced. But in the Provincial Assemblies as constituted under the Government of India Act, 1935, the municipal interests are hardly ever likely to gain ascendancy.

As regards the tax on business, profession, calling and employment, the provinces at one time showed great interest in it. It, in fact, had a great future in the form in which the provinces were at first authorized to levy it. The amendment of the Government of India Act has shorn it practically of all its contents. Hence other provinces are not likely to adopt it though the provinces that have adopted it may not give it up. Its danger is the directness and inequality of its incidence which almost make it a capitation tax, though as already explained, with its exemption limit, it is a better tax than most other provincial taxes in force.

So much about new taxes; as regards the old taxes, the onslaught on provincial excise has been one of the severest and if the Congress Governments had remained in office for a few years more, it would have been easily abolished altogether. With seven out of eleven provinces going dry, the remaining four would have found it difficult to retain it, particularly as they also were not able to defend this source of revenue on merit. After people were accustomed to prohibition for several years there would have been little danger of bootlegging especially as drink is considered a social evil. The future of this source of revenue is therefore bound up with the continuation of the Congress ministries in office and if this source of revenue is abandoned, it must exert great influence on the question of continuation of other taxes like the urban property tax or the comprehensive sales tax.

Land revenue is bound to remain a permanent feature of provincial taxation. The assessment is gradually being lowered and is likely to be lowered still more in the future under popular governments which must rely on the agriculturists for political support. Moreover, in theory and justice there is a good case for reform. This tax lacks equity and certainty. The system is likely to be based on definite statutory principles of assessment in the future; but as the subject will be highly controversial and one in which the bulk of the political supporters of any government will be directly interested, governments may at first feel inclined to postpone the settlement of the major question on a statutory basis, preferring to rely on remission only. Some bold tackling of the problem is obviously necessary.

As regards stamp duties, court fees and registration fees, they have clearly become permanent features of provincial finance. People have got accustomed to them, consider them as a part of the existing state of things and accept them without demur. The tendency to raise their rates has not yet stopped. It is therefore not unlikely that the rates will show a tendency to increase in the future.

III

CO-ORDINATION OF TAXATION

IF the federal form of government is allowed to develop freely in this country, there may be felt at no distant date the need for some tax-co-ordinating machinery. The Federal Court is there to resolve conflicts between the Centre and the provinces or between one province and another in so far as the conflicts are resolvable by reference to the law. But many things may be permissible in law which may be undesirable in the common interest of all. The need for common or co-ordinated action arises from such considerations of policy.

The constitutional pattern of taxation in British India has been explained in Chapter II, Part I. In this country, as in other federations, there are several authorities competing with one another for taxing the same flow of income and the same fund of wealth. The need for ever-increasing expenditure on the part of Governments brings this competition to a high pitch. As a consequence, there often occur, first, conflicts between the competing authorities and secondly, the imposition of excessive or unjust taxes. These are recurring problems in a federation.

The extent of the problem is much more limited in this country than in other federations. In other federations, some of the most important taxes are levied concurrently by the Centre and the States. In the United States of America, for example, both the Federal Government and the State Governments are competent to levy and do levy the income-tax and the estate tax simultaneously.[1] In Australia also income-taxes and taxes on land values are levied concurrently by the Central and the State Governments.[2] As explained in Chapter II, Part I, the Indian constitution is unique in restricting the taxing power of the Centre and of the provinces by specific enumeration. There is a complete segregation of the tax

[1] For a description of these taxes in the U.S.A., see *Public Finance* by Lutz, Chapters XX and XXVII.

[2] See 'Essays in Taxation by Seligman—Chap. XVII'. With effect from 1st July, 1942, the State Governments in Australia gave up their separate income-taxes in exchange for fixed grants from the Commonwealth.

bases as between the Centre and the provinces and their taxing jurisdictions are mutually exclusive.

The exclusiveness of the tax jurisdictions of the Centre and of the provinces reduces the extent, the urgency and the seriousness of the problem but does not remove it. The problem may be reviewed from two aspects. The conflict may arise as between the Centre and the provinces; it may arise as between one province and another.

There are two reasons why such a conflict may arise as between the Centre and the provinces in spite of the exclusiveness of the tax jurisdiction.

(*i*) First, as pointed out in Chapter II, Part I, the enumeration of the taxes in the constitution does not follow any classification recognized by economists. A distinction is drawn between excise duty, customs duty and sales tax, the first two being given to the Centre but the third to the provinces. Hence the same commodity can be taxed both by the Centre and by the provinces by means of an excise-cum-customs duty and a sales tax respectively. The court has ruled that an excise duty levied by the Centre and a sales tax levied on the same commodity by the provinces do not constitute a legal overlap. To the economist, however, both of them belong to the same category, namely a tax on margin, and their incidence and other economic implications are similar. Cases where such taxes co-exist on the same commodity are common, e.g. petrol, tobacco, sugar. In these cases there is no legal double taxation but there is clearly economic or real double taxation.

(*ii*) Secondly, a tax may be levied on one particular base but the amount payable in respect of it may be measured by reference to a different thing. Thus in the United Provinces Employment Tax Bill, the tax was proposed to be levied on the base 'employment' but the amount payable was to be determined by reference to the earnings of employment. This made the bill very nearly an income-tax in substance, though the legal experts were of opinion that there was no legal overlap. This is a good case of real overlap in the absence of a legal overlap.

The distinction between the base of a tax and the measure of a tax is quite common. In certain instances of taxation a particular correlation between the base and the measure is usual. Thus a tax on the privilege of incorporation is often determined by reference to the income of corporations. The sale price is the usual measure of a tax on sales. The amount involved in a bet is the usual

measure of a tax on betting. The price of the ticket purchased is the usual measure of a tax on entertainments. Though this is the usual correlation in these cases, there is no reason to suppose that the correlation is immutable either in fact or in law. Some future Finance Minister may break away from the usual correlation as the Finance Minister of the United Provinces did in the case of the employment tax. The courts also may not rule him out of order. This distinction between the base of a tax and the measure of a tax may therefore frustrate any attempt to prevent concurrent taxation by means of legal segregation of the bases.

It is clear that any provision in the constitution for limiting the taxing powers of Governments is bound to develop on legalistic lines and can only prevent legal overlap. But as the legal connotation of terms and their legal interpretation are entirely different from their economic connotation and interpretation, such provisions can hardly prevent economic or real double taxation.

The constitution does not provide any legal device to prevent or limit the conflicts between one province and another. The same bases of taxation are open to all the provinces, whether the bases are persons or things, property or income. One person may own property or carry on business or a profession in different provinces. In the course of the same year, he may be employed in several provinces or may have to live in several provinces in connexion with the same employment. The same commodity may pass through or be sold in several provinces. The property may be situated in one province while its owner may live in another province. Agricultural income may arise in one province, may be received in another and enjoyed in a third. Within the limits of one country such cases are bound to be numerous. Hence there is always scope for double or multiple taxation by the provinces.

The manner in which double or multiple taxation may arise and the extent to which they may develop has been indicated above. Double or multiple taxation has, however, not yet assumed any serious proportion in this country. Some of the important cases in which it has already arisen are given below.

(*i*) As between the Centre and the provinces the most important cases of concurrent taxation are those in which an excise-cum-import duty and a sales tax are levied simultaneously by the Centre and the provinces respectively. The tobacco excise duty levied by the Centre co-exists with tobacco duties in Madras, Bombay,

Bengal, the Central Provinces, the North-West Frontier Province and the Punjab. The high excise-cum-import duty on petrol co-exists with the sales tax on it in all the provinces except Orissa. Sugar, kerosene and salt are taxed by the Centre and their sales are taxed in Madras and the Punjab. Tea, coffee, betelnuts and matches are taxed under excise by the Centre and their sales are taxed in Bengal, Madras and the Punjab. Similarly, the export duty on jute co-exists with the raw jute tax in Bengal.

As regards taxes on persons, the scope for conflict as between the Centre and the provinces is negligible. There was only one substantial point of possible conflict, namely that between the tax on business, profession, employment and calling and the Central income-tax. But the former has since been reduced to a minor tax by an amendment of the constitution and the possibility of a conflict is now negligible.

(*ii*) As between one province and another, there is very little double taxation in existence. We have already seen that under certain circumstances it is possible for a man to be liable to the Bengal tax and the Central Provinces tax on employment, etc., in the same year. In certain cases it is possible that a motor vehicle may be charged to two provincial taxes during the same quarter. Most Provincial Governments, however, abstain from taxing a newly arrived motor vehicle during the quarter of its arrival if it has paid tax to another Provincial Government for the same quarter. A commodity may have to pay sales tax or transit duty in more than one province but such instances are rare. All these cases are really minor and negligible instances of double taxation. There are two major taxes in which double taxation may assume serious proportions. They are the agricultural income-tax and the succession taxes on agricultural land. The former has been adopted in the three provinces of Bihar, Assam and Bengal, but all of them tax income derived from land situated within the province. As the taxation is limited to the principle of origin, no double taxation as between provinces has arisen yet. But if one or more of the provinces chose to adopt the residence principle as well, i.e. if they chose to tax all agricultural income accruing to a resident of the province (wherever it may have origin), in addition to all agricultural income originating within the province (to whomsoever it may accrue, whether resident or non-resident), double taxation would at once ensue. Many landlords of Bengal have property in Assam and many residents of

Bengal hold shares in the tea gardens of Assam. If the two provinces adopted the double principle of origin and residence, these persons will be taxed on the same income both in Bengal and Assam. Bengal will tax the income because it has accrued to a resident of Bengal. Assam will tax it, because it has arisen in Assam. The same result will ensue if the provinces levied a succession tax on agricultural land on the double principle of *situs* and residence. This tax has, however, not been levied in any province yet.

The cases of double taxation as between one province and another are clear cases. There both the taxes are of the same form, are levied on the same base and are known by the same name. A car or a lorry sometimes pays the tax of the same name, namely the motor vehicles tax, in two provinces. A person sometimes pays two employment taxes in respect of the same employment in two provinces. A person may pay two agricultural income-taxes in two provinces in respect of the same agricultural income. These may be called clear cases of double taxation.

The cases of double taxation as between the Centre and the provinces that exist or may come into being in the future are not so clear. The two taxes have not got the same name, are not levied on the same legal base and are not often collected from the same person. They are called instances of double taxation only because their incidence and economic implications are similar. The two taxes are not the same on the surface but are the same in their economic effects, e.g. the excise tax and the sales tax on the same commodity. They may be called constructive cases of double taxation to distinguish them from the other category which have been called the clear cases.

A clear case of double taxation arises when two taxes of the same legal class as well as of the same economic class are levied on the same person or thing. A constructive case of double taxation arises when two taxes of the same economic class but *not* of the same legal class are levied on the same person or thing. Clear cases of double taxation are peculiar to a federation: they do not exist in countries with a unitary form of government. Constructive cases of double taxation are common to federations and unitary governments: a sales tax or a purchase tax and an excise-cum-import tax co-exist on many commodities in the United Kingdom and France. Such cases must, however, be more common in federations than in unitary governments.

No nation has yet adopted the single tax, in whatever form advocated. Multiplicity of taxes is the accepted economic order. No Government has yet agreed to take from the citizen all that it wants to take from him by taxation by one single effort. It chooses to contact him for the purpose on several fronts—sometimes directly and sometimes indirectly. This is the accepted practice which has never been questioned. Economists and Finance Ministers consider it a good practice. An economist would, however, consider the taxes levied in a country both individually and together. The taxes are considered individually when discussing their incidence and other economic effects. They must be considered together when discussing the nature of the distribution of the burden of taxation in a country.[1]

Admitting that the State must confront the citizen on several points, is there any harm, if on a single point he is contacted more than once? Is there any harm if he pays the income-tax once to the Centre and again to the State or if he pays the estate tax once to one State and again to another State and once more to the Centre? The answer depends largely on the answer to another question, are the two or three taxes that he is called upon to pay equal to, less than or greater than the tax that he would have to pay, if he had to pay only once? A man would prefer paying ninety rupees to paying a hundred rupees even though in the former case he may have to pay it to three different persons. When the two sums are equal he is indifferent but he may dislike submitting the same return to more than one person. There is another point also about which the citizen is very particular. Is he being discriminated against by being subjected to double tax? When double taxation applies equally to all and does not result in any excessive or discriminatory taxation, it is harmless. People subjected to double taxation clamour against it in the hope that if one of the taxes were removed, they would have to pay a lower sum. But this is very often a delusion. In the case of the indirect taxes, the consumer who is to pay the tax ultimately does not care at all whether a tax of (say) ten rupees has been collected from the producer alone, by means of an excise tax, or equally from the producer and the seller by means of an excise tax and a sales tax respectively. Even a

[1] For an attempt to determine the distribution of the tax burden in a country see Shirras and Rostas—*The Burden of British Taxation* (1942).

State with a unitary form of government may consider the latter course expedient.

Double or multiple taxation, whether clear or constructive, whether occurring in a federation or in a country with a unitary form of government, has to be examined from three standpoints:

(*i*) the cost involved in it,
(*ii*) the effect on production and consumption,
(*iii*) the effect on distributive justice.

That two income-taxes are more expensive to collect than one with a rate equal to the sum of the two is obvious. This is true both for the Government and for the assessee. Similarly, it is more expensive to collect an excise tax and a sales tax on the same commodity than to collect one excise tax at a rate equal to the sum of the two. Unitary Governments, therefore, resort to double taxation not very frequently and they do not resort to clear double taxation at all. But in federations this cannot be helped. There must be double taxation, clear or constructive, in order that the federation and the component units may function properly and as independently as possible. In this country clear double taxation as between the Centre and the provinces has been prevented by the constitution. That is a great advantage in itself.

In this connexion it will be of some interest to quote an American view on double taxation of the same object by both Federal and State Governments. Prof. Lutz on page 409 of his book *Public Finance* (3rd Edition) states as follows:

'There is nothing inherently wrong or unjust in the taxation of the same object by both Federal and State authorities. A parallel case of double taxation is found everywhere, in the taxation of property by municipal, county, and even by State Governments. It is admittedly vexatious to make tax returns to two authorities, but the weight of the combined taxes is a far more serious situation than the fact that two Governments are taxing the same object. Yet, if administration of any tax were surrendered to the Federal Government, which thereupon proceeded to collect enough to permit State sharing through a tax credit, or to provide for distribution of a portion of the yield to the States, there would not be much relief from the tax burden. Whether one Government or two make the levies is immaterial under such circumstances.'

The more serious objection to double or multiple taxation arises when the concurrent taxes are not co-ordinated so that they give rise to harmful effects on production and consumption or become

unequal in their total effect on distributive justice. This danger is non-existent in a country with a unitary government. But it is always present in a federation. In a State with a unitary government, even when constructive double taxation exists, there is only one authority who is responsible for both the taxes and is at the same time competent to adjust or modify them according to the requirements of the situation. It has complete control over the position as a whole and takes full responsibility for it. In a federation, on the other hand, while the taxpayers and the traders have to bear the total burden of all the taxes, central and provincial, imposed on a particular commodity, the different authorities imposing them will each assume responsibility for only one of them and each may think that the tax imposed by it is a small one which, by itself, would not cause any mischief. There is no one to assume responsibility for the position as a whole and each may even feel powerless to improve the position by separate action. Further as all the authorities are likely to be equally in need of revenue, a sense of competition may easily develop among them. Though the Governments as well as the assessees belong to the same country and their ultimate interests are common, the fact may be forgotten in the heat of the day-to-day administration. The Centre and the provinces in their unco-ordinated rivalry to get the maximum revenue out of tobacco, sugar or salt may kill the trade or may impose an unequally excessive burden on the poor. Two provinces in their unco-ordinated effort to get the maximum revenue out of agricultural income may impose a very unequal total burden on those persons who live in one province but derive agricultural income from another. It is this absence of an authority to assume responsibility for the position as a whole and this rivalry which are the sources of danger in a federation. The courts are of no help here because double taxation which is lawful may still be undesirable in the common interest of all. It is a matter of policy to decide how the interests of the two or more Governments concerned are to be reconciled in such cases consistently with the interest of industry, which it is in the interest of all to foster, or with the interest of the taxpayer, on whom it is not equitable to impose a discriminatory burden. So far the problem has not assumed any serious proportion and the capacity of the Governments for co-ordinated action has not been tested. But as time goes on, such questions are likely to grow in importance and magnitude. The future of the federal

form of government depends not to a small extent on the success with which such questions will be tackled in the future. Imagination, foresight, forbearance and an active consciousness of a common good are essential for the development of co-ordinated action in this respect.

Besides double taxation there is another good reason which also may create pressure for co-ordinated action. With a federal form of government in operation, regional inequality in taxation is bound to arise in this country. The inequality in some instances may be harmless, e.g. a higher betting tax in Bengal than in Assam or Bihar. In some instances again the inequality may be necessary on grounds of equity, e.g. a higher property tax in the cities of Bombay and Calcutta than in any other town. But in other instances the inequality may cause various degrees of mischief. We have seen that a petrol sales tax in Assam without a similar tax in Bengal was somewhat troublesome. An agricultural income-tax in Bengal without such a tax in Orissa causes a little more mischief, for this creates a tendency for investments in agricultural land to be diverted from Bengal to Orissa. The mischief will grow in magnitude, if, in addition to the agricultural income-tax, Bengal adopts a succession tax on agricultural land while Orissa adopts none. A higher stamp duty on share transfers in Madras than in Bombay or Bengal diverts business from Madras to the other two provinces.[1] A turn-over tax in Madras without such a tax in other provinces causes serious injury to the trade and industry of that province. This has been explained with particular reference to the sugar industry. A sales tax levied on the sale of raw materials to the manufacturers, or on the sale of a commodity to be sent to a person outside the province, causes very serious injury. In some instances it may appear to be a tax on the person outside the province, but in most cases it will ruin or injure trade and industry within the province and may lead to the establishment of these industries in some of the tax-free regions which may be otherwise unsuitable for the purpose.

In framing schemes of provincial taxation, it is of the utmost importance to provide against regional inequality by which the prosperity or the industrial aspirations of a province may easily be

[1] The Madras Stamp Amendment Act, 1943, raised the stamp duty on share transfers above the levels of such duty in Bombay and Calcutta.

wrecked. The attempts of the framers of the Bengal scheme of sales tax in this respect have been explained in the appropriate chapter. But in spite of all care and precaution it is impossible to avoid the danger altogether because the country is, after all, an economic unit.

It may again be said that the remedy lies in the hands of the Finance Minister of a province. It is he who causes the mischief by imposing the taxes in the province and he has only to remove these taxes in order to remove the mischief. But in practice, it may not be so simple as this. His province may be in constant need of money and it may not be practical politics to give up a source of revenue. This is true of most provinces, if not all.

Thirdly, Finance Ministers may be anxious to impose sales taxes on articles of luxury like gramophones, radio sets, etc., but may be frustrated in their attempts to do so, as was the case with the Finance Minister of Assam. Concurrent taxation by all the provinces has certainly a better chance of success in such cases. For all these reasons the Finance Ministers may slowly but steadily realize the need for co-ordinated action. By unco-ordinated action, the Finance Minister of one province creates unequal conditions against one section of traders or manufacturers in his province, while the Finance Minister of the adjoining province creates unequal conditions against another section of traders or manufactures in that province. By co-ordinated action the two Finance Ministers together may create equal conditions for both the lines of trade or manufacture. Further, co-ordinated action brings in more revenue than unco-ordinated action; for, the latter makes avoidance possible while the former closes the gap for avoidance by transfer of business or industry. Under equal conditions in respect of taxation, industries are located in places with the optimum advantages and trade follows the most efficient channels. This is the *raison-d'être* of co-ordination. Co-ordinated action is to the common advantage of all in the long run and it is hoped that the Finance Ministers will have enough foresight and enough forbearance to go in for co-ordinated action. As every Provincial Finance Minister will require all the revenue that he can have under the constitution, co-operation with a view to the co-ordination of taxation is not likely to be difficult in the future. It is not difficult to see that in view of the difficulties of a provincial sales tax, discussed in Part II,

and faced with an urgent need for revenue, all the Provincial Governments may agree to the simultaneous levy of a sales tax of a common pattern.

It is important to remember that some regional inequality must remain in a federation. As already pointed out there may be cases of equitable inequality, harmless inequality and equality which does harm. Need for co-ordination will have to be justified on the merit of each case. No Finance Minister should be asked to or will even agree to give up his freedom to pursue his own taxation policy. But he may be persuaded to agree to a co-ordinated tax policy in respect of such taxes where the need for co-ordination can be established on the merit of the case and by reference to the common interest of the country.

An attempt to forecast the line of development of a co-ordinating machinery in this country will be futile. But certain trends are discernible. Obviously it will not be a machinery with executive power; for, in that case the constitution loses its federal character. Free discussion will remove the danger to a great extent. Finance Ministers of the different Governments will often go in for regional inequality as well as for double or multiple taxation. The trading interests will proclaim aloud the injustice of all regional inequality and of all double taxation. Associations of economists will point out that all double taxation is not bad but that double or multiple taxation becomes bad when it results in an excessive burden on a trade or industry or when it leads to distributive inequality of a harmful type considering the taxation system as a whole. Similarly they will point out that all regional inequality in taxation is not bad but that each case has to be examined on its merit. They will analyse the implications of each measure and examine it on these principles.[1] Finance Ministers will meet in frequent conferences. Their relations will be smoothed out by extra-administrative machinery such as the political party. In this

[1] J. P. Niyogi suggests the formation of an 'Inter-Provincial Commission' which should 'review the activities of different governmental agencies and formulate a "master-plan" of federal, provincial, State and local taxation in the light of resources and taxable capacity of the several territorial units'. See his article on 'Financial Planning and Business enterprise in India' published in *Current Thought*, January–March, 1940. Such a plan is a guarantee against the mistakes of piecemeal consideration.

way, it is believed, a co-ordinated policy which is good for all will emerge in each case in the long run.[1]

The discussion in this chapter does not refer to international double taxation some aspects of which have been discussed in Book IV, Chapter V. The question of an equitable distribution of the tax burden does not arise there and the cases, as pointed out previously, have to be examined by reference to their economic consequences on each nation on the basis of the national self-interest of each.

Secondly, the analysis in this chapter is based on an assumption of normal conditions. It is clear that the pressure for co-ordinated action is not likely to be operative during the period of the war. When goods become scarcer and scarcer and supply ceases to be free, industries boom in spite of some discriminatory taxation. This is bound to make the Finance Ministers as well as the business men forgetful of the discriminatory character of the taxation imposed. The point is, however, sure to be forced on the attention of all as soon as the return of normal times ends such an artificial state for trade and industry. The pressure for co-ordinated action will then appear with full force.[2]

[1] The best example of co-ordinated action as between two Provincial Governments is the formulation and working of the Sugar Factories Control Acts by the Governments of Bihar and the U.P. Consciousness of common interests was certainly the greatest factor in the development of such a certain policy. The actual working was smoothed by the affiliation of the two Governments to the same political party.

[2] See ¶ 17, Chap. X, Part II.

APPENDIX

Except in the case of the Bengal Agricultural Income-tax, the discussion of taxes in this book generally refers to the period ending with the year 1941-2. The subsequent changes are briefly surveyed below.

Tobacco taxes

The changes in the provincial tobacco duties were made at the instance of the Central Government.

With effect from 1st April, 1943, the Government of India imposed an excise duty on cured tobacco and on cigars and cheroots. The rates were substantially increased with effect from 1st April, 1944.

The system of control has been as follows:

Every grower shall in each year before making use of any land for growing tobacco make a true declaration in respect of all land upon which tobacco is to be grown and state whether he intends to cure the whole or part of the tobacco when cut and gathered (Rule 15 of the Central Excise Rules, 1944). No tobacco may be cured except upon land or premises in respect of which a declaration has been made by the curer and which has been approved by the Department (Rule 17). The excise duty becomes chargeable as soon as the tobacco has been cured and is in a fit state for sale or manufacture whichever is earlier (Rule 19). Immediately after the tobacco has been cured, it shall be (*i*) cleared on payment of duty, or (*ii*) deposited in a public bonded warehouse; or (*iii*) deposited in a bonded store-room on the curer's own premises, or (*iv*) sold to a wholesale dealer or manufacturer possessing a private bonded warehouse (Rule 13). When tobacco is deposited in a bonded store-room of the curer himself, it must be disposed of in any of the other three ways before the 30th June next (Rule 24). Transport of tobacco from one grower to another or from a grower to a curer or from a curer to a public or private warehouse is strictly controlled (Rule 31). No tobacco shall be removed from any warehouse except on payment of duty or for removal to another warehouse (Rule 144). All persons engaged in the production, sale, storage and manufacture of cured tobacco are required to be licensed, but no licence is needed for its cultivation.

In explaining the provisions of the Bill on the floor of the Assembly, the Finance Member said:

'The basic principle on which it proceeds is that the tax should be charged on the raw tobacco but that its levy and collection should be postponed until the tobacco is about to go into use and provision is accordingly made for official supervision and control of the commodity from the stage of its production until it is finally marketed. . . . If the curer or the purchaser so desires, the duty may be paid immediately the tobacco has been cured and made fit for sale, but, for the general convenience of the trade and in particular to allow remission of duty to be claimed in respect of losses incurred during storage and of refuse tobacco unsuitable for manufacture and in order also to postpone payment until the tax can be transmitted to the consumer with the least possible delay, the wholesale dealer is permitted to warehouse his goods under bond and to pay the duty when they are ultimately despatched to the manufacturer or retail dealer; and in order to facilitate the disposal of tobacco, the ultimate market for which is situated at a considerable distance from the original place of production, provision is made for transport under bond from one warehouse to another. Abatement of duty will be allowed in respect of evaporation during storage, of waste due to handling within the warehouse, and of refuse such as butts and stems, provided that this is destroyed in the presence of an excise officer or that satisfactory proof is given that it is to be utilized for manure or some other agricultural purpose, and full refund of duty will be allowed in respect of all tobacco exported from India by sea.' (Legislative Assembly Debates, Vol. II, 1943, pp. 1239-40.)

The duty is thus levied on the cured leaf at the stage of wholesale purchase. The Finance Member claimed two distinct merits for the measure. First, it is comprehensive; all forms of tobacco and all consumers of tobacco irrespective of the form in which they may consume it are made to share the burden of the tax. Secondly, the measure produces good revenue.

In the course of the speech the Finance Member made the following statement: 'Where, as for example, in Bombay and Madras, wholesale trade in tobacco is now taxed by Provincial Governments, we are negotiating for the withdrawal of the present taxation measures, subject to reasonable compensation.' (Legislative Assembly Debates, Vol. II, 1943, p. 1239.)

After this statement was made and presumably in pursuance thereof, the following changes were made in the provincial taxes on tobacco in the course of the year 1943-4:

(*i*) The Government of Madras discontinued (*a*) the issue or renewal of licences to wholesale dealers in manufactured tobacco, and (*b*) the levy of the tax under the Madras General Sales Tax Act, 1939, on sales of unmanufactured tobacco.

(*ii*) The Government of Bombay discontinued (*a*) the levy of the maundage tax on tobacco in the city of Bombay, (*b*) the levy of the sales tax of 12½ per cent on wholesale dealers in tobacco in the Bombay Suburban District, Ahmedabad and Sholapur, and (*c*) the issue or renewal of licences to all wholesale dealers in tobacco whether in the city or outside.

(*iii*) The Government of the Central Provinces and Berar exempted the wholesale dealers in tobacco from the provisions of the Central Provinces and Berar Tobacco Act, 1939, and the rules made thereunder.[1]

(*iv*) The Punjab Government amended the Punjab Tobacco Vend Fees Act, 1934, so as to exclude the assessment of fees on wholesale dealers.[2]

In consideration of making these changes, the Provincial Governments concerned received the agreed compensation from the Government of India.

After giving effect to these changes, the Governments of Madras and Bombay were, in the beginning of 1944, considering the question of abolishing their tobacco taxes altogether.

Thus the Government of Madras, in para. 60 of their Press Communique on the Budget Estimates for 1944-5 issued on 17-3-44, stated:

'There is also a proposal to repeal the Madras Tobacco (Taxation and Licensing) Act, 1939, as a result of the levy of excise duty by the Central Government under the Tobacco (Excise Duty) Act, 1943, but the date from which the Madras Act should be repealed has not yet been decided. The budget estimate for 1944-5 takes credit for a revenue of Rs 22,00,000 under that Act. The Government hope that when they repeal the Act, the Government of India will pay adequate compensation so that there will be no appreciable loss of revenue.'

[1] *C.P. and Berar Tobacco (Amendment) Act*, 1943, read with notification No. 1015/546-VIII, dated 20-11-1943.

[2] See *The Punjab Tobacco Vend Fees (Amendment) Act*, 1943 and the Punjab Government notification Nos. 352, 353 and 354-ex., dated 21st January, 1943.

The following table compiled from the Budget Memorandum for 1944-5 of the Government of Bombay shows the position in that province:

Tobacco Duties

(In thousands of Rupees)

	1942-3 (Actual)	1943-4 (Budget estimate)	1943-4 (Revised estimate)	1944-5 (Budget estimate)
Revenue ..	30,23	25,77	6,52	25,00
Expenditure ..	5,55	11,86	1,13	Nil

These figures are explained as follows:

'The decrease in the revised estimate of the current year over the current year's budget estimate is due to the imposition of the Central Excise Duty on Tobacco with effect from 1st April, 1943. Next year's budget estimate represents this Government's share of the net proceeds of the Central Excise Duty on Tobacco.'

As regards expenditure it is said: 'The decrease in the current year's revised estimate is due to the transfer of control over the administration of Tobacco Dept. to the Government of India. No provision is made in the next year's budget for tobacco establishment as it is expected that all provincial taxation will be abolished with effect from 1st April, 1944.'

After the abolition of the maundage tax, the sales tax and the wholesale dealers' licence fee, the Bombay tax has been shorn of most of its content and it is hardly worth while to maintain the residuary portion which must cost a great deal to collect.

The abolition of a provincial tax at the instance of the Centre on the latter's agreement to pay recurring compensation is a new development. The reason why this step was taken by the Central Government is not explained by the Finance Member. But it seems that the Central Government wanted to relieve the wholesale dealer in cured tobacco from concurrent taxation by the Centre and the provinces. In view of this limited objective it has not been necessary for Madras to modify her tobacco duties imposed on manufactured tobacco or on dealers other than wholesale dealers. Similarly it has not been necessary for Bombay to abolish the licence fees on dealers other than wholesale dealers. Bengal also has not relaxed her sales tax in its operation on tobacco because, in effect, the Bengal Sales Tax operates on manufactured tobacco—and mainly on retailers.

It is also clear that though the contact between the Central Government and the Provincial Governments was established with a very limited objective, negotiations are developing towards a total abolition of provincial taxation on tobacco. This development, it appears, has taken place at the initiative of the Provincial Governments. After the Bombay tax, for instance, was shorn of most of its content it was hardly worth while for the Government of Bombay to maintain an establishment for collecting the small residue. This line of development of the negotiations was therefore very natural. Further, if the Provincial Governments can get the revenue without taking the responsibility and trouble of raising it, it is certainly an advantage to them.

It thus appears that very limited objectives lay behind these negotiations. The more fundamental questions of equity or hindrance to trade were not taken into consideration before starting these negotiations.

Now there is clearly no point in seeking to relieve the wholesale dealer in unmanufactured tobacco from the trouble of submitting returns, etc., to two authorities. Dealers in quite a large number of articles have to submit such returns to two Governments and there is no reason why on that ground only, the tobacco dealer should be singled out or a portion of the tax on tobacco should be removed.

On the ground of equity, again, it is doubtful whether the consumers of tobacco, at least of certain types, e.g. cigarettes, cigars, etc., can claim any relief at all. Constructive double taxation exists on such articles as salt, matches, kerosene, sugar, etc.;[1] and if relief is to be granted to consumers on the ground of equity by the removal of such double taxation, it is these articles which should have a higher order of priority.

It has already been pointed out that the Madrās tax on tobacco requires to be reformed both on the ground of equity as well as on the ground of undue hindrances to trade which it creates. But it is clear that the abolition of the tax has not been urged on that ground. Further on the ground of reforming such a measure, it may not be necessary to abolish it altogether; for, in that case persons who may not deserve relief will also get it. A particular tax is only part of a taxation system and the question of equity

[1] See Part V, Chap. III, ¶ 8.

involved in it cannot be dealt with without at the same time considering the system as a whole.

Fourthly, the device of compensation is a novel one. The Constitution Act of course contemplates levy of excise duties by the Centre and the distribution of the proceeds thereof to the provinces according to certain approved principles of distribution (Sec. 140). There the proceeds should go to all provinces and the principle of distribution is not compensation for loss of revenue but should be some such principle as operates in respect of the income-tax, jute export duty or the centrally levied stamp duties. The device adopted in respect of the tobacco duties can hardly succeed. For, a province which has not been levying a tobacco duty can always proceed to levy it and claim compensation if it is to be persuaded not to levy it. Compensation in such cases will have to depend on hypothetical figures and this will make negotiation very difficult. Secondly, the provinces which now agree to give up the levy in return for a fixed compensation, may at any time demand a revision of the agreement either on the ground that they wanted to levy the tax at a higher rate or on the ground that the trade itself had increased substantially in volume. Similarly, when the Centre puts up the rate of taxation, provinces may claim a higher share. In that case, the Centre may feel inclined not to agree, which may mean the end of the existing agreement; and if it is willing to agree there will be no basis available for determining the compensation to be paid.

In view of these difficulties it is likely that the new experiment will be a shortlived one and will not be extended by the Centre to other similar measures. This does not and should not mean the end of co-ordinated action as between the Centre and the provinces. It only means that co-ordination should proceed on different lines. Co-ordination should have for its objective, first, the question of equity in the distribution of the tax burden and secondly, the question of hindrances to or excessive burden on a particular line of trade. Subject to these two considerations, the respective constitutional rights of the Centre and of the provinces should not be restricted. It must be recognized that double taxation is impossible to avoid in a federation and that double taxation is not objectionable either, if the two considerations mentioned above are adequately attended to and co-ordinated action is taken on the basis of these two considerations. Central excises are bound to increase

in number. So also are provincial sales taxes. Hence cases of double taxation of the same commodity will also increase in number, if co-existence of an excise and a sales tax are considered to be double taxation. It must be recognized that there is nothing inherently wrong in such double taxation; only they should be co-ordinated on the basis of the two considerations stated above. The correct scope of negotiation for such purposes should be strictly drawn up in order that negotiation may prove successful as well as beneficial to the community.

The Comprehensive Sales Tax

Madras.—With effect from the 1st October, 1943, the rate for flat rate assessees (i.e. those having a turn-over of ten thousand to twenty thousand rupees a year) was increased from four to five rupees a month, and the rate for other assessees (having a turn-over exceeding twenty thousand rupees a year) from a quarter per cent to one per cent. (*The Madras Finance* (No. 2) *Act* (No. XVII) *of* 1943.) The exemption limit was retained at a turn-over of ten thousand rupees a year. The transactions in fair price grain shops [1] which did not make any profit were exempt from the tax.

Again in March, 1944, the Government of Madras published a Bill to amend the Madras General Sales Tax Act, 1939. The Bill embodied the following proposals:

'(1) An increase in the slab rate of tax from a uniform rate of Rs 5 per month on dealers with a turn-over exceeding Rs 10,000 and not exceeding Rs 20,000 per annum to Rs 8 per month on dealers with a turn-over between Rs 10,000 and Rs 15,000 and Rs 12 per month on those with a turn-over between Rs 15,000 and Rs 20,000 and

(2) the withdrawal of the exemption from liability to sales tax of sales of bullion and specie.'

After considering the objections received against the Bill, the Government of Madras passed the Bill into law in April, 1944. The objections and suggestions received, together with the views of the Government of Madras thereon, were published in the Government of Madras, Revenue Department Press Communiqué, No.9, dated 28-4-44. The communiqué ran as follows:

2. The main objection in respect of the proposal is that the increase in the rate will affect small business men and the poorer

[1] Started at the instance of Government during the difficult times of 1943.

section of the community who cannot purchase from wholesale dealers. The Government consider that the existing exemption of dealers with a turn-over of less than Rs 10,000, sufficiently protects the poor and that the enhancement in the rates proposed for dealers with a turn-over between Rs 10,000 and Rs 20,000 is so small that it will not affect the consumer or the small dealer to any appreciable extent.

3. The proposal to levy sales tax on sales of bullion and specie has been the principal target of attack. It has been argued that the levy of the tax will drive the business in bullion and specie to the adjoining Indian States and the French establishments, and further that large buyers will prefer to buy direct from the Reserve Bank as sales by that Bank are free of sales tax. The sale of gold by the Reserve Bank is limited to the Madras city and the bulk of such sales will presumably be absorbed by the wholesale dealers in bullion. Business may, to a certain extent, be diverted to the adjoining States, etc., but it is not considered that there will be any material diversion. The ordinary customer will prefer to buy bullion locally and pay the tax rather than go outside the province to escape it.

4. It has also been contended that the sales of bullion and specie should not be regarded as sales of goods, but should be regarded as a banking transaction and that the taxation of the sale of bullion and specie is tantamount to taxing the currency itself. The Government cannot accept this contention. Bullion and specie are not currency. The purchases of bullion and specie are mostly for speculative purposes and usually by persons who have made large profits under the existing war conditions.

5. It has also been suggested that instead of levying a sales tax on the sales of bullion and specie the Government might consider the question of enhancing the existing rates of licence fees. Licence fees are levied only where the sales tax would seriously interfere with the trade. The Government consider that the levy of sales tax on sales of bullion and specie will not, in present circumstances, seriously interfere with the trade in the province. With the present high price of gold and the speculation and hoarding that is going on, the sales tax of one per cent will make no appreciable difference.

The Government have therefore decided to pass the Bill into Law.'

The upward revision of the lump rates is after all a small matter and the Government's view on the point is justifiable. As regards the imposition of the tax on bullion and specie the following comments are called for:

(*i*) The Government of Madras are correct when they say that the tax on bullion and specie is not a tax on currency

because the currency of the country has no relation to gold or silver.

(*ii*) It is admitted that 'business may, to a certain extent, be diverted to the adjoining States', etc., but in the opinion of the Government the diversion will not be material, for, they believe that 'the ordinary customers will prefer to buy bullion locally and pay the tax rather than go outside the province to escape it.' The foundation of the belief is rather weak. The belief may be justified in the case of small buyers but any man buying gold worth, say, Rs 10,000 can avoid the payment of a tax of Rs 100 by buying it outside the province while the cost of a journey for going outside the province may be only a quarter of the sum. The payment of tax can be thus avoided.

Secondly, in ¶ 4 the Government contend that 'the purchase of bullion and specie is mostly for speculative purposes and usually by persons who have made large profits under the existing war conditions'. It will obviously not be possible to confine these large purchases within the province; and if these purchases form the bulk of the transaction in bullion and specie, the amendment will have a serious discriminatory effect against the poorer buyers who would not be able to buy outside.

Bihar.—Bihar passed a sales tax law in 1944. It follows the Bengal model. The levy of the tax has not yet been made but is likely to be made very soon.[1] It is a single-point comprehensive sales tax operating through the registration of dealers, sales to registered dealers being exempt. Raw materials and things required in the manufacturing process, exports and specified necessities of life are not taxed. The rate of the tax is three pies in the rupee. The minimum registrable turn-over is five thousand rupees only as against fifty thousand rupees in Bengal.

On account of this low limit of registrable turn-over it has not been necessary to provide for voluntary registration or for a lower minimum registrable turn-over for manufacturers and importers, as in Bengal.

[1] The tax is being levied with effect from 1st October, 1944.

The lower minimum

(*i*) restricts the exemption of articles which do not come up to a registrable dealer in the whole course of the transactions connected with them;[1]

(*ii*) reduces the number of small producers who suffer a disadvantage in obtaining their raw materials;[2] and

(*iii*) magnifies the administrative problem by increasing the number of dealers with whom the administration has to deal.[3]

On the whole, the general lowering of the registrable minimum to such a low figure has probably been unwise. One of the distinct advantages of the Bengal scheme of sales taxation is that in it the minimum registrable turn-over can be kept high and thereby (*a*) the cost of collection can be kept low, and (*b*) the rural trade in articles which are never dealt with except by very small traders is left undisturbed. To fix a low limit for registrable turn-over is therefore to throw away this advantage in the hope of a little additional revenue which cannot obviously be commensurate with the additional friction and the additional cost involved in the process. The disadvantage to small manufactures, as explained in ¶ 29, Chap. IX, Part II, can be removed by providing for voluntary registration for any manufacturer.

Bengal.—With effect from the 17th April, 1944, the rate of the Bengal tax was increased from three pies in the rupee to six pies in the rupee. The exemption of hand-loom cloth, if sold by a dealer dealing exclusively in such cloth, was removed and in its place was substituted the much more substantial exemption of dhutis, lungis and sarees, whether millmade or hand-loom woven, the price of which does not exceed the amount fixed by Government in respect of each from time to time. The price-limits fixed by Government and now in force are:

Goods	Description	Price-limit
Dhuti	A. Millmade	
	(i) Each piece not exceeding 4½ yd. in length	Rs 7-0-0 per pair.
	(ii) Each piece exceeding 4½ yd. in length	,, 7-8-0 ,, ,,

[1] See ¶ 27, Chap. IX, Part II.
[2] See ¶ 29, Chap. IX, Part II.
[3] See ¶ 6, Chap. IX, Part II.

Goods	Description	Price-limit
Dhuti	B. Hand-loom woven	
	Any size ..	.. Rs 10-0-0 per pair.
Lungi	A. Millmade	
	Any size ..	.. ,, 3-0-0 per piece.
	B. Hand-loom woven	.. ,, 4-0-0 ,, ,,
Saree	A. Millmade	
	(i) Each piece not exceeding 4½ yd. in length ..	.. ,, 8-0-0 per pair.
	(ii) Each piece exceeding 4½ yd. in length ..	.. ,, 9-0-0 ,, ,,
	B. Hand-loom woven	
	Any size ..	.. ,, 15-0-0 ,, ,,

As the bulk of the people wear millmade cloth, this extended exemption will bring them much relief. Hand-loom cloth still receives some preference, as will be evident from the price limits fixed. The former preference for hand-loom cloth of higher prices is, however, discontinued by this amendment.

The following trends are noticeable in recent years:

(*i*) The comprehensive sales tax tends to extend from one province to another slowly but surely.

(*ii*) The provinces in which the tax is in force are inclined to place increased reliance on it.

(*iii*) The poor man receives greater consideration as the rate of the tax is increased. In Madras the exemption of food-grains is a recognition of this principle, though the exemption is restricted to sales from certain shops. In Bengal the price limit as a basis of exemption in respect of certain items of cloth is a new experiment.

If a forecast is permissible, it may be stated:

(*i*) that along with the necessities of life, raw materials and exports also will receive increased consideration. As explained in ¶ 17, Chap. X, Part II, the pressure for such consideration will increase as soon as the abnormal conditions created by the war come to an end;

(*ii*) that price as a basis of exemption as well as of graduation will be increasingly adopted; as the provinces come to adopt a

co-ordinated scheme of sales taxation, the demand for differential rates on luxuries will become irresistible;

(*iii*) that as the first and the second points gain ground, the Bengal model will gradually oust the Madras model. For, raw materials and exports can be dealt with more efficiently under the Bengal model with its single-point tax than under the Madras model with its turn-over tax. This tendency will gather increased momentum on account of the lower cost of collection of the Bengal tax.

Provincial Excise

The experiment of prohibition was ended in most of the provinces in which it was undertaken. The most outstanding case in this respect was the suspension of prohibition in the four districts of Madras (Salem, Chittoor, Cuddapah and North Arcot) in which it had been in force for several years and was reported to have been a success during the initial years. The suspension was announced by the Government of Madras in their Press Communiqué, No. 40, dated 16th November, 1943. The suspension was justified on the following grounds:

(*i*) The increase in the cases of illicit distillation and kindred offences. The figures of illicit distillation cases in Salem were:

1938-9	..	..	144
1939-40	..	..	296
1940-1	..	..	434
1941-2	..	..	978
1942-3	..	..	1133

'These figures', the communiqué says, 'establish that prohibition has not been a success and that a substantial proportion of the population of the districts in which the Act is in force has been securing illicit supplies of alcohol and that too of a very injurious quality.'

(*ii*) 'The public enthusiasm which greeted the enactment of the Prohibition Act has waned. Although the figures of offences have been published periodically, there has in recent years been no non-official propaganda and the officers of the Government get little or no co-operation from the public in the enforcement of its provisions. Without such co-operation, the Act cannot be enforced and its continuance on the Statute Book has the effect of increasing contempt for law.

(*iii*) 'It has become urgently necessary to utilize all sources of revenue to a fuller extent as one method of combating inflation. The profits now being made from illicit sales are escaping taxation. The additional revenue that will result from the suspension of prohibition and the consequent taxation of liquor will go some way towards meeting the heavy extra expenditure which the Government are obliged to incur under several heads, for example, famine, repair of flood damages, procurement, distribution and rationing of foodstuffs and increased dearness allowance.

(*iv*) 'In the present food shortage, it is also desirable that a licit supply of toddy, which in its fresh state has a distinct food value, should not be denied to labouring classes.'

On these grounds, the Government of Madras decided to reopen toddy and foreign liquor shops in the four districts with effect from 1st January, 1944. Arrack shops were, however, not reopened in these districts 'partly because arrack cannot now be supplied, as the existing stocks of molasses are required for essential war purposes, and partly in the hope that the re-introduction of toddy may have some effect in reducing illicit distillation and other excise offences'.

The suspension of prohibition in these districts where it started with a good promise is undoubtedly unfortunate. It is, however, difficult to enforce prohibition in four districts only when in all the other districts there is no prohibition. It is clearly a state of unstable equilibrium which cannot be maintained for long. Prohibition must either march onward till all the districts are conquered or it must retreat. It cannot rule peacefully in a small area of four districts. Hence the suspension became inevitable as soon as the policy of extending it was abandoned. The arguments on which the suspension was based have, however, a temporary force only. The main argument is that with the resignation of the popular Ministry the Government receive no non-official support without which it is impossible to continue a policy of prohibition. It is hoped that this is a temporary phase. The other two reasons, namely inflation and food-shortage, are obviously temporary phenomena. There is therefore good ground for hoping that with the return of better days and with the return of a popular Ministry, the policy of prohibition will be re-introduced and extended.

Several provinces increased the rates of the excise tax on some of the articles during the year 1943.

In the United Provinces the duty on Indiamade foreign liquor was, in 1943, increased from twenty-one rupees fourteen annas to thirty rupees per gallon.

During the same year, the rate of still-head duty on ordinary country spirit was raised by ten per cent and that on spiced spirit by fifteen per cent. Besides, prohibition was abolished in the six districts, in which it was in force, with effect from 1st April, 1944. The issue price of opium was increased from a hundred and forty to a hundred and eighty rupees a seer, that of ganja from a hundred and twenty to a hundred and sixty rupees a seer, the duty on ordinary country liquor by fifteen per cent and that on spiced liquor by ten per cent.

The Government of Madras made substantial increases of duty on country spirit, wines, opium and hemp. The Government of the North-West Frontier Province also increased the rates of excise duty on certain articles subject to provincial excise.

The Government of the Punjab raised the duty on Indiamade foreign liquor from twenty-one rupees fourteen annas to thirty rupees per London Proof Gallon, with effect from 1st September, 1943. It also raised the issue price of excise opium from seventy to eighty rupees per seer.

As regards country spirit, the retail price was decontrolled and the duty was raised so as to absorb as far as possible the difference between the retail price and the effective market rate.

The following table[1] shows the rates of duty in force in Bengal from time to time in the year 1943:

	Duty on 31st March			Duty on 1st May			Duty on 1st August			Duty on 1st December		
	Rs	a	p	Rs	a	p	Rs	a	p	Rs	a	p
1. Indiamade foreign liquor (per L.P. gallon) ..	30	0	0	30	0	0	40	0	0	42	8	0
2. Country spirit (per L.P. gallon)	7	1	6	17	0	0	17	0	0	22	0	0
3. Ganja (per seer)	41	15	0	51	7	0	80	0	0	109	14	0
4. Opium (per seer)	87	4	0	101	12	0	101	12	0	145	4	0

[1] The table is taken from the Explanatory Memorandum on the Budget of the Government of Bengal for the year 1944-5, p. 14.

The increased burden placed on the consumers of these articles clearly heightens the injustice of the tax. Its effect on consumption is not considerable; and even when there is reduction, it cannot be correlated to the financial position of the consumers. The increases are also very uneven. Take the case of Bengal, for instance. In the case of country spirit the increase is more than two hundred per cent. In the case of ganja it is more than a hundred and fifty per cent. In the case of Indiamade foreign liquor, it is less than a hundred and fifty per cent. In the case of imported foreign liquor, the increase of taxation has been lower still. The increase is thus inversely proportionate to the financial position of the consumers because it is the richest class which consumes foreign liquor while it is the poorest class which consumes ganja.

Entertainment and Betting Taxes

These taxes were considerably increased in several provinces. In Bombay and Bengal, the betting tax was raised to eight and ten per cent. respectively and the entertainment tax was about doubled.[1] In the United Provinces both the taxes were doubled. Bihar increased them by about fifty per cent. In Madras the betting tax was raised from one and a quarter per cent to three and one-eighth per cent in Ootacamund and to six and a quarter per cent in Madras city (Guindy). In the Central Provinces and Berar the entertainment tax was increased considerably. In the North-West Frontier Province the rates of entertainment tax were doubled with effect from 1st April, 1944.

Stamp Duties, Registration Fees and Court Fees

These were substantially increased in several provinces.

As from August 1943, the Government of the United Provinces levied a surcharge of twenty-five per cent on Stamp duties, Registration fees and Court fees.

In Madras, Registration fees were increased generally by fifty per cent with effect from 1st April, 1943. With effect from 1st October, 1943, the rates of Stamp duties were increased under most heads—in some cases by one hundred per cent and in other cases by fifty per cent.[2]

[1] *The Bombay Betting Tax (Amendment) Act, XI of* 1943. *The Bombay Entertainment Duty Amendment Act, XIII of* 1943. *The Bengal Finance Act, V of* 1943.

[2] For details, see the *Madras Stamp (Increase of Duties) Act*, 1943.

In Bihar, a war surcharge of twenty-five per cent was levied on all Court fees and Stamp duties. The surcharge is intended to remain in force during the war and is to cease on such dates as may be fixed by the Provincial Government.[1]

In Bombay there was levied with effect from 1st January, 1944, a surcharge of fifty per cent on most non-judicial Stamp duties[2] and of twenty-five per cent on judicial Stamps[3] and Registration fees.

In the Central Provinces and Berar a surcharge of 33⅓ per cent was levied on Stamp duties, Registration fees and Court fees.

Agricultural Income Tax

The Bengal Agricultural Income-tax Bill, which was dropped in 1941, was revived and passed into law in 1944. Its provisions have already been discussed at some length. In Bihar and Assam, there has been no change in the rates of taxation since the measures were introduced in these two provinces.

The Bombay Urban Immovable Properties Tax

This was the only tax of which the rate was reduced during the period under study.[4]

It was for the express purpose of financing prohibition that the tax was levied in Bombay. When, in accordance with a decision of the Bombay High Court, prohibition had to be relaxed in the province in respect of foreign liquor, the Provincial Government announced that the gain in revenue on account of this relaxation, instead of being appropriated by Government would be utilized in effecting a reduction in the rates of the urban immovable properties tax. Since then revenue from foreign liquor consumed in the prohibition area has steadily increased and the Government effected successive reductions in the rates of the tax.

[1] See the *Bihar Court Fees (War Surcharge Amendment) Act*, 1943 and the *Bihar Stamp (War Surcharge Amendment) Act*, 1943.

[2] Bombay Increase of Stamp Duties Act, XIV of 1943.

[3] Bombay Increase of Court Fees Act, XV of 1943.

[4] In the Punjab it was provided by Law that the Provincial Government may by notification direct that during the period of the war and for twelve months thereafter a surcharge not exceeding 50 per cent shall be levied on the urban immovable property tax.

The progressive reduction in the rates is shown in the table below:

Year	*The prevailing rate*
1940-1	10 per cent
1941-2	8 ,, ,,
1942-3	$7\frac{2}{3}$,, ,,
1944-5	7 ,, ,,

The lower rate operative on properties valued at not more than two thousand rupees in Bombay and not more than one thousand rupees in other towns has always been half of the rates given above.

The tax has yielded revenue as follows:

(In thousands of rupees)

1939-40	1940-1	1941-2	1942-3	1943-4 (Revised Estimate)
1,00,98	1,33,38	1,07,76	96,22	1,00,00

It will appear from the foregoing survey that there was considerable increase of provincial taxation during the year 1943-44. The wave of enthusiasm for taxation that started on the introduction of Provincial Autonomy had practically died down. A fresh wave of almost equal force started in the year 1943-44. Though up to the end of the year, the wave was confined mainly to the deficit province of Bengal and those provinces in which the Constitution was under suspension, it does not appear to have spent its force yet.

The causes from which the pressure for taxation arose in 1942-3 were quite different from the causes from which the pressure arose on the introduction of Provincial Autonomy. During the first period, the pressure was due to the abundant enthusiasm released by the introduction of Autonomy for national uplift and tax reform. During 1942-3 the pressure arose out of the conditions created by the war.

The causes that generated the pressure for taxation in 1943-4 are discussed below.

In Bengal, the financial position of the Government deteriorated. The food-shortage of 1943 created a wide gap between the revenue and expenditure of the province so that the budget for 1944-5

showed a negative closing balance of about ten and a half crores of rupees. It was impossible to bridge this huge gap by provincial taxation within the limited field of taxation open to the Provincial Government. But the Government of Bengal tried to raise as much revenue as possible by taxation.

The other provinces, except the North-West Frontier Province, were not faced with budget deficits. Prosperity prevailed in most of them and their budgets showed substantial surpluses. But they also adopted a policy of non-expansion of expenditure during the war except in inescapable cases. In their case, therefore, the motive for taxation was different. The statement of objects and reasons given by the Government of Bihar in the various measures of taxation introduced in 1943 included the following:

'The anticipated increased revenue from these measures will, however, be large enough to serve as an effective brake on inflationary tendencies. These enactments are not designed as ordinary revenue-producing measures and their proceeds will increase the fund which is being created to provide money for post-war reconstruction. It is proposed to form a Revenue Reserve Fund for this purpose to which the main portion of the annual surpluses which are expected to result from Government's rigid policy of economy during the war will be credited.'[1]

The Press Communiqué, No. 32, dated the 30th September, 1943, issued by the Government of Madras explaining the various measures of increased taxation, contained the following:

'The Government also consider it necessary to build up a reserve fund for use in financing post-war reconstruction schemes and to co-operate with the anti-inflationary measures of the Government of India by withdrawing some of the excess purchasing power in the hands of the public from use for the present as one means of keeping down prices. In order to cover additional expenditure and also, if possible, to build up a reserve for use after the war and at the same time to check unnecessary spending by the public whilst there is a shortage of goods, the Government consider it essential to raise substantial additional revenue by taxation in the current year.'

Similarly, in their Budget Memorandum for 1944-5, the Government of Bombay justified the additional taxation as follows:

'Two reasons weighed with Government in imposing this additional taxation: the need to combat inflation and the need to build

[1] *The Bihar Gazette* (Extraordinary), November 11, 1943.

up reserves for post-war reconstruction.' (Introductory Note, ¶ 7.)

This is a new motive in provincial taxation. To understand it, it is necessary to understand contemporary conditions.

As India became the base of operations against Japan, increased purchases had to be made in India on behalf of the united nations. The task of finding rupee finance for all these purchases fell on the Government of India. For effecting these purchases, the Government of India agreed to receive sterling securities in London and to find the equivalent rupee finance in India. The total rupee receipts of the Government of India, including revenue and loans, proved inadequate for the purpose. The Government of India had, therefore, to issue increased quantities of notes against sterling securities received in London. These financial operations were not included in the budget estimates. The expenditure of the Government of India, including their war expenditure, was fully met out of revenue and loans. The result was that though the budget was apparently balanced, there was, in fact, a big gap between the rupee receipts and the rupee disbursements of the Government of India, and this gap had to be bridged by note issue. Though a large quantity of notes was thus put on the market, the production or the supply of goods did not increase correspondingly. The result was a high degree of inflation. The process started in 1942, became very marked after September of the year and the position was acute in 1943, when food-shortage aggravated the process. The various control measures of Government proved ineffective. Though from the end of 1943, the situation came gradually under control, during the greater part of the year there was food-shortage, scarcity of consumption goods, soaring prices, black markets and plenty of money in the hands of certain sections of the community. It was against this background that taxation was adopted as a means of mopping up currency and of reducing the gap between the rupee receipts and rupee disbursements of the Government of India.

On 12th April, 1943, twenty economists of the country issued a manifesto on the position. In this manifesto one of the remedies they suggested was as follows:

'We earnestly feel that immediate and drastic measures to check inflation are called for. In this connexion we urge on the

Government of India the primary necessity of closing the "gap" by increased taxation and borrowing. Taxation, in our opinion, should be raised to the highest practicable pitch, adjusted to shoulders that can best bear it.'

They ended by saying, 'We would also emphasize that the total liabilities undertaken by the Government of India, whether on their own account or on account of the British and allied Governments, should not exceed the resources that they find possible to raise in pursuance of the policy outlined by us.'

The requirement of rupees for financing the Indian purchases of the united nations is exactly of the same financial significance as the requirement of rupees for financing the expenditure of the Government of India. This was well pointed out by the economists in the manifesto as follows:

'The Government seems to act as if it is enough for it to take care of its own budget deficit while meeting the needs of the British Government by printing more notes. This is a grave misreading of the whole situation and has resulted in an ever-increasing expansion of currency unrelated to the needs of internal production and trade. As a result, the inflationary spiral is already at work in India.

The net inflationary gap in India's finances, counting in the finance made on behalf of His Majesty's Government, is thus being wholly filled by the creation of more currency. The inflation in India is, therefore, a deficit-induced fiat money inflation. It is the most disastrous type of inflation.'

Though these huge operations were kept out of the budget, money was required as much for financing them as for financing the expenditure of the Government of India shown in the budget. If money was required, it could be raised either by taxation or borrowing, if inflation was to be avoided. Hence taxation was perfectly in order as one of the means to close the gap between the rupee receipts and rupee disbursements of the Government of India.

Now the Provincial Governments were called upon to co-operate in these anti-inflationary efforts of the Government of India. They, therefore, increased provincial taxation not for meeting expenditure, but in response to the anti-inflation call. They created reserve funds for future expenditure out of the proceeds of these increased taxes. The funds were invested in Government of India loans and thereby the Government of India got a good supply of rupees through the taxation policy of the Provincial

Governments. This helped them in their efforts to bridge the gap between their rupee receipts and rupee disbursements—a gap which if it could not be so bridged, would have to be covered by inflation. It was in this sense that the provincial taxation was anti-inflationary in character.

There was no idea of tax-reform present behind this new drive for taxation. The additional taxation was generally effected not by the imposition of any new tax but by increases of the rates of the existing taxes or by the withdrawal of the land revenue concession granted previously. The extent to which the different provinces made transfers of their respective revenues to such funds will appear from the following table compiled from their civil budget estimates for 1944-5:

In thousands of rupees

Name of Province	Name of fund	Opening balance on 1-4-43	Credited in 1943-4 (*vide* revised estimates)	To be credited in 1944-5 (*vide* budget estimates)	TOTAL
Madras	Revenue Reserve Fund	38,50	7,00	5,55,75	6,01,25
Bombay	Special Development Fund ..	2,02,03	73,53	—35,61	2,39,95
	Post-war Reconstruction Fund ..	22,40	1,10,53	4,50,00	5,82,93
U.P. ..	Revenue Reserve Fund	1,78,71	1,78,99	1,91,00	5,48,70
Punjab	Peasants' Welfare Fund ..	90,00	60,00	Nil	1,50,00
	Special Development Fund ..	55,57	24,28	—10,52	69,33
Bihar	Post-war Reconstruction Fund ..	Nil	3,17,27	Nil	3,17,27
C.P. ..	Post-war Development Fund ..	28,08	1,21,01	1,41,24	2,90,33
Bengal..	Nil	Nil	Nil	Nil	Nil
	TOTAL ..	..	..	..	27,99,76

As already explained, anti-inflationary provincial taxation in this sense is perfectly in order. But it is necessary to guard against a few possible misconceptions.

First, inflation is not an arithmetical concept. It is explained by the quantity theory of money which can be and usually is expressed arithmetically. But if inflation is bad, it is so because of its very harmful economic consequences. When, therefore, it is intended to combat inflation, it must be combated as an economic concept. There is a danger that in the enthusiasm for counter-inflation, this

aspect of the question may be forgotten. It has been suggested, not infrequently, that as inflation means injecting money into circulation, so mopping up money by any means will cure the malady, provided there is equality between the money injected and the money withdrawn. But it is obvious that unless this mopping up takes place in the correct way having full regard to the economic consequences of inflation, the counter-inflation may, instead of remedying the economic ills of inflation, even intensify them. Inflation has a very bad effect on distribution. It involves large transfers of wealth from the poorer and the middle classes to the richer classes. It puts a certain amount of purchasing power in the hands of Government but the sacrifice inflicted on the people is out of all proportion to the purchasing power obtained by Government. While a few grow rich quickly, the masses get poorer and poorer. If a policy of taxation is to be adopted to counteract inflation, the taxation must be adjusted to these conditions. Taxation should not be directed towards those who are the victims of inflation for that will only intensify the effects of inflation. Anti-inflationary taxation should be ruthlessly directed against the beneficiaries of inflation and in its application to this class, justice need not be tempered by mercy. Suppose in a country there are only two men, and a regular flow of goods and a regular flow of money, the quantity being equally divided between them. The two men will therefore buy equal quantities of goods over a period. If a third party, without increasing the flow of goods, disturbs the flow of the money in such a way that one of them gets ten times as much money as the other, the fortunate man will buy up ten-elevenths of the goods, leaving only about one-eleventh for the unfortunate man who may thereby have just enough for subsistence. If again in the name of anti-inflation the third party removes from the unfortunate man a portion of that one-eleventh also, the result will be that he will die. Anti-inflationary taxation must, therefore, operate against the fortunate man. It must be constantly borne in mind that the purpose of anti-inflationary taxation is not merely to mop up currency in the arithmetical sense but to combat the economic consequences of inflation.

Secondly, the canons of taxation do not cease to be valid in respect of anti-inflationary taxation. In fact the canons apply with added force in cases of such taxation. When inflation and taxation go on side by side, taxation has got to be very sharply

progressive in order to mitigate the seriously regressive character of the inflationary burden. Secondly, inflation and the consequent rising price level must affect the faculty of various classes of men differently. Some people will have large windfalls while others with fixed income will find the purchasing power of this income drastically cut. Anti-inflationary taxation must take full note of such facts. Taxes on things—particularly on goods of general consumption—become particularly objectionable under such circumstances.

Thirdly, the success of a policy of taxation is strictly limited by the real income of the people. It must leave in the hands of the people a minimum of real income adequate for maintaining them in health and strength. A policy of inflation fails earlier because on account of its severely regressive character, it begins very soon to cause suffering and death to the poor. A policy of taxation, which can be deliberately designed to be progressive in character can go much further; but even then the minimum real income necessary to maintain the people in health and strength is the inexorable limit. This is what the Finance Member of India must have meant when he stated in his budget speech delivered in February 1944 that a further substantial increase in the demands on India's resources 'would impose a severe burden on her economy which has already shown distinct signs of overstrain and might even lead to a serious breakdown'. When, therefore, it is necessary to raise taxation to a high pitch, it is essential to speed up production and to control distribution. After a point, taxation can be raised only as production increases and distribution is made more equitable. It is essential under such circumstances to keep a strict watch on the realities behind the financial screen and to follow up the financial policy by a suitable industrial policy.[1]

On account of the economic considerations given above and in view of the limits set by the Constitution it appears that there was no great scope for anti-inflationary taxation by the provinces. The increases in the betting and entertainment taxes were fully justified and they could have been increased still further. The increase in the stamp duties in so far as their incidence was on

[1] An article on 'Budget and its effect on prices' by G. D. Birla in the *Eastern Economist*, dated March 31, 1944, gives a good analysis of the point, though it is somewhat propagandist in tone and outlook.

business, which was booming at the time, was also justifiable in spite of the unequal incidence of such duties. Increase of Registration fees stands more or less on the same footing as increase in Stamp duties. The Agricultural Income-tax is also good as an anti-inflationary measure, provided, in fixing rates of taxation, the effect of the rising price level on the fixed income of landlords is kept fully in view. Increase of Court fees is hard to justify as an anti-inflationary measure. Excise duties and sales taxes being of regressive character will ordinarily further intensify the regression of the inflationary burden but, under certain circumstances explained in the next paragraph, they may be quite good as anti-inflationary measures.

Though taxes on things, being regressive, are generally objectionable as anti-inflationary measures, selective sales taxes directed towards the wealthy section of the people would have been quite justifiable as anti-inflationary measures. Again, it is likely that in the abnormal conditions of the year 1943, taxes on things had a different incidence. There was a shortage of goods and their supply was not free. When the supply is not free, cost ceases to function as a regulator of prices. A tax on things enters into the price through cost. When, therefore, cost no longer influences price, the tax also ceases to have any influence on price. Price begins to be determined by demand alone as the marginal demand price, however high, cannot react on supply which is not free. The tax, under such circumstances, is merely a deduction from the marginal demand price which becomes the market price and moves without producing any reaction on supply. It is, therefore, very likely that in 1943 the incidence of the sales taxes was on the dealers who were enjoying a windfall. This aspect of the question was kept in view at least in one province, Madras. The Government of Madras in their press communique, No. 32, dated the 30th September, 1943, state in regard to the sales tax:

'The Government hope, however, that under present conditions it will be borne largely by business profits, at least where they have become abnormally high.'

Under such abnormal circumstances a general sales tax also becomes good as an anti-inflationary measure.

But such conditions are absolutely abnormal and must be ended as quickly as possible if an economic and social catastrophe is to be avoided. No taxation can therefore be based on such conditions.

Such conditions should be ended quickly either by the restoration of free competition or by the introduction of rigid measures of price control correlating market prices to costs.

Apart from the additional taxation imposed as an anti-inflation measure, the yield of most of the existing taxes went up automatically on account of the economic condition induced by inflation and other causes connected with a rising price level. Phenomenal increases were obtained under the heads provincial excise, the betting tax, and the entertainment tax.

Consumption of country spirit and wines increased remarkably.[1] The duties on their consumption were also increased in most provinces. The result was an almost doubling of the revenue under provincial excise in every province. The following are some of the figures:

Name of the Province	(In thousands of rupees) 1938-9 (Actuals)	1943-4 (Revised estimate)
Bombay	2,89,77	4,49,17
Madras	3,72,23	6,62,59
Bengal	1,59,35	3,65,47
United Provinces	1,33,16	3,72,37

The receipts under the betting tax and the entertainment tax showed greater increases. The following are the figures for Bombay where the increase was the most marked:

	(In thousands of rupees) 1941-2	1942-3	1943-4 (Revised estimate)	1944-5 (Budget estimate)
Entertainment Tax ..	12,18	21,32	36,00	55,00
Betting Tax ..	15,95	24,23	36,00	65,00

The proceeds of the stamp duty after showing a steady decrease from year to year since the early thirties registered an increase in 1942-3 and 1943-4 and the increasing trend still persists. The

[1] Assam was an exception. As the Finance Minister said in his Budget Speech for 1944-45:

'The deterioration in receipts from country spirit continues mainly due to difficulties of transport but this is more than counterbalanced by increasing receipts from ganja and Indiamade foreign liquor.'

following are the figures for the Punjab and Bengal where there was no increase in the rates in the period under review, i.e. since 1st April, 1942.

(In lakhs of rupees)

	1932-3	1933-4	1934-5	1935-6	1936-7	1937-8	1938-9	1939-40	1940-1	1941-2	1942-3	1943-4 Revised	1944-5 Budget
Punjab ..	114	108	103	92	90	90	78	75	66	66	90	114	115
Bengal ..	313	287	286	296	302	287	258	256	252	256	250	340	315

The increase in the yield of the taxes mentioned above was directly due to the contemporary economic conditions and in fact reflects the tendencies of the times. The new money that a section of the people was earning in plenty was freely spent on drink, betting, amusement, etc. These people also bought land on a fairly large scale which another section, who were the victims of inflation and famine, were compelled to sell by the stress of circumstances. Such transfers of land became a serious problem in Bengal and the Government of Bengal passed an Ordinance for the restoration of lands to sellers, sold by them during 1943, for a consideration of two hundred and fifty rupees and below. This increased activity in sales and other transactions led to an increase of stamp revenue for the first time after several years. The revenues of the Governments are thus a good index of the economic tendencies of the time. The Government of the Central Provinces and Berar very correctly stated: 'the present unprecedented revenue is entirely abnormal and ephemeral and is due to factors arising out of the war which will cease to operate with the termination of hostilities.' [1]

[1] Budget communique, published in the *C.P. and Berar Gazette* (Extraordinary), dated March 25, 1944.

END.