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Finances of the Indian Union Since 1947

By

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PREFACE

In this book a study is made of the Tax System of India in the light of socialist finance, which is important not only for the country (which adopted the goal of Socialist Pattern of Society and is striving to attain it through democratic methods), but also for other modern States, particularly those with a developing economy.

Essentially this book is the outcome of my thesis on the 'Tax System in India Since 1947', on which I was awarded D. Phil. degree by the University of Allahabad in January, 1962. Most of the important data presented in the thesis has been brought up-to-date.

I welcome this opportunity to express my heartfelt gratitude to those without whose advice and help this work could not have been completed.

Initially I started the work under the supervision of Dr. R. N. Bhargava. After his joining the Institute of Public Administration in New Delhi, I worked under Professor J. K. Mehta.

I find it difficult to express fully my sense of gratitude to Professor J. K. Mehta, who encouraged and inspired me throughout, besides rendering every possible help to me. I am no less grateful to Dr. R. N. Bhargava, who continued to give me advice whenever needed.

I am also thankful to Dr. M. H. Gopal, Dr. Harbans Lal, Deputy Economic Adviser to the Union Government and Shri Krishnamurty of the Federation of Indian Chambers of Commerce and Industry for giving their valuable time in discussing certain matters. I offer my thanks also to Shri N. K. Chakravarty, Librarian of the Union Ministry of Finance, whose kind attention enabled me to collect most of the important statistical data.

I also got much help from the well equipped libraries of Delhi School of Economics, Federation of Indian Chambers of Commerce and Industry, U. S., U. N. and U. K.—Information Centres,

Council of World Affairs, the Lok Sabha, the Rajya Sabha, and Indian Institute of Public Administration, New Delhi; the Public Library and the Library of the University of Allahabad, and the Public Service Commission Library of Allahabad.

I am obliged to the embassies of U.S.S.R., Britain and Japan for the material (in English) that they so kindly supplied to me.

I wish in the end, to express my gratefulness to Dr. P. S. Lokanathan, Director General, National Council of Applied Economic Research, New Delhi, for sparing some of his valuable time to go through the work and write a foreword to it.

RADHIKA DASS

Department of Post-Graduate
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FOREWORD

I congratulate Dr. Radhika Dass on his valuable book on Indian Tax System. Public finance has ceased to be a study of how to raise revenues to finance a minimum level of governmental functions, and has become a study relating to the uses of fiscal tools to attain given social, economic and other objectives. In the Indian economy, tax policy has been assigned the role of raising revenues to finance developmental outlays, providing incentives for private savings and investment assuring price stability and realizing socialistic pattern of society. Dr. Radhika Das has critically examined the evolution of the tax structure since 1947 to determine whether it is conductive to the attainment of these objectives and to suggest a suitable system. He has exhaustively covered the available material and treated the subject in an objective and analytical way. I am sure that this book will be a valuable addition to the growing volume of literature on taxation in India and will be read by all interested with great profit.

New Delhi
6-4-1966

P. S. LOKANATHAN

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INTRODUCTION

The Tax System in this country must be understood against the background of the goal to which Parliament and the Congress are committed, namely, the establishment of 'socialist pattern of society'.[1] "A great organisation and Parliament do not casually enter into these things—it becomes a decision after years of thought. And for someone without giving too much thought to these difficult economic, industrial and scientific problems to just casually put them aside, seems to me to be rather illogical."[2] National aim is described at other places as also the establishment of 'Welfare State'. In whatever terms it might be described, the ultimate objective appears to be one and the same for all countries. It is maximisation of social welfare, and it is the true objective of State formation. Only the difference lies in the approach to the problem owing to different economic, social, and other conditions of different countries.

Taxes in a modern State,[3] though not entitled to be called taxes in the strict economic sense, are a means of implementing

1. The 60th Session of the Indian National Congress, held in January 1955, resolved that, "in order to realise the object of the Congress as laid down in Article I of the Congress Constitution and to further the objectives stated in the Preamble and Directive Principles of State Policy of the Constitution of India planning should take place with a view to the establishment of a socialistic pattern of society....." At earlier occasions, during the speeches in Lok Sabha and Rajya Sabha the Prime Minister of the Country had declared that Government should pursue the socialistic goal. (See Chapter XI). The Amritsar Session of the Congress held in February 1956, once again stressed the need and importance of the "Socialist Pattern of Society". It is to be noted that the term 'Socialistic' was changed to 'Socialist' in this session, but in terms of Pt. Jawahar Lal Nehru, it was only 'a distinction without a difference'. Further, the recent session of All India Congress Committee at Jaipur (November, 1963) declared that India's political and economic goal is 'democratic socialism'. The subject matter of 'socialist pattern', however, remains unchanged.

2. Prime Minister, Budget Debate in Rajya Sabha, March 11, 1958.

3. By a modern State I particularly mean, a socialist State or the one trying to achieve socialism without resorting to the revolutionary means, because to-day socialistic ideas are gradually gaining ground in almost all countries.

economic, social and other objectives. From this it follows that given the policy objectives, we can reach certain definite conclusions regarding the tax system of a country.

Taxation for the furtherence of any objective other than revenue was never accepted in this country in the early years of the British rule. On various occasions the socialistic doctrines of taxation were expressly refuted.[1] For example James Wilson, the first Finance Member of the Government of India observed, "The lot of men is fixed by thousands of inscrutable causes, and if a government were to attempt to produce an equality by distributing the incidence of taxation, it would undertake a task, the end of which must be confusion and disappointment to all concerned. No, Sir, it is our duty to adjust our taxes upon a clear and general principles of competition and other elements which determine the lot of men."[2] So also Samuel Laing, the successor of Wilson, in the office of Finance Member, when defending his proposal to exclude persons with incomes between Rs 200 and Rs 500 from the operation of the Income-Tax Bill said, "I do not put the case for the exemption of these persons on the ground that they are poor, for I have no sympathy with the socialist legislation which would place taxation exclusively on the rich. On the contrary, I believe the poor, as well as the rich and often even more than the rich, are interested in the support of the State, and the subsistence of social order."[3]

It was after the Second World War that socialistic ideas were given expression to, while framing taxation proposals, particularly when it was described that, "the conditions created by the last war served to accentuate disparities; the rich became richer and the poor poorer."[4] Taxation measures were directed in the pre-partition budget of 1947-48 to mend the existing inequalities. With the advent of independence the framing of the new Constitution, and more so by adopting 'socialist pattern of society' as the ultimate objective to be attained, socialistic ideas began to occupy a prominent place in the framing of governmental policies. However, it cannot be claimed that while framing taxation proposals attainment of the socialistic objectives was always the main idea besides revenue. For, certain more urgent objectives were also to be fulfilled like arresting inflation, increasing production, assisting retention of the market, etc.

The tax system has a great bearing in a market economy as it is a large factor affecting economic decisions. "In a planned economy of the centralized Soviet type, taxes necessarily lose a good deal of importance. But still clearly they have a role to

1. P. Banerjee, *History of Indian Taxation*, P. 3.
2. Proceedings of the Legislative Council of India, 1860.
3. Financial Statement, 1862.
4. Budget Speech, 1947-48 (Pre-partition).

play."[1] The tax system in our country has at the present juncture an important part to play as an instrument of social transformation, which is sought to be carried out in a democratic way. Our problem may thus be described as two-fold. First, we have to decide the shape of the tax pattern necessary for bringing about the socialist pattern of society. Secondly, visualising the shape it is to take in the long run.

'The fiscal reform can never have a clean slate to write upon, hence there lies the need for dealing with the problems histori cally. This fact has been kept in mind throughout this work. While tracing the history of taxes I have tried to be as brief and to the point as possible, leaving out the mass of material that is available. The course of taxation since 1947 has been discussed in detail, but in so doing I had to encounter an insuperable difficulty caused by the fact that the figures for the tax revenue of the Central Government since 1951-52 are not strictly comparable with the figures for the previous years.

The year 1947 saw the partition of the country as a result of which some of the Provinces (Punjab, Bengal and Assam) were reduced in size and their total number brought down from 11 to 9. The integration of the States in 1950 caused a further break so that the accounts since 1950-51 cover not only the finances of the old Provinces but also those of the integrated States. Consolidated position of the finances of the States is also comparable only since 1951-52.[2] However, at several places the tax revenues of the Centre and the States have deen considered for many years even before 1950-51, but in drawing inferences account has been taken of the above mentioned facts. As regards individual States, barring a few, the comparision of the position with respect to years preceeding 1957-58 could not be done due to the reorganisation of States.'

My approach to the subject is macro-economic.[3] It does not mean thereby that it leaves out of consideration the detailed study of some important aspects of the tax system. Central and State taxes have been considered as a whole, while the former

1. Holzman, : *Soviet Taxation*, p. xix.

2. The figures of States for 1955-56 and 1956-57, revised and budget estimates respectively are used, since later figures are not available due to reorganisation of States.

3. Economists like Marshall had developed an economic theory which dealt mainly with individual producers or consumers, while others like Walras and Pareto extended this type of economic theory from the individual to the community as a whole. But this method may lead to errors, since what is true for separate parts may not be true for the whole. For example, there is a difference between individual saving and investment and aggregate saving and investment. Thus the advantage of approaching the question as a whole is evident. Keynes has given us a useful line of approach (macro-economic) for the economic system while dealing with overall problems. It may be criticised on the ground that his theory is over-simplified and the broader concepts conceal various divergent movements in their various parts. But this is not a valid argument when the overall economic system is to be examined.

have been examined in greater details. Regarding local taxation mainly principles have been dealt with (vide Chapter I) and its burden discussed (vide Chapter IX).

Chapter I is wholly theoretical. Other Chapters too consist of necessary theoretical considerations to make the analysis of the individual problems easier and to frame a basis for sound and logical arguments. I have attempted to tackle the problems from the general to the particular.

In Chapter I, I have dealt with the important aspects of the theory of taxation, like the nature of tax, theory of progression, equity vs. ability factor, direct vs. indirect taxation, theory of tax exemptions and incidence of taxation; and have tried to connect them with the theory of socialist finance. The theory of progression based on socialistic grounds has been styled as the 'socialistic theory of progression' as distinguished from the classical theory based on sacrifice considerations. I have also discussed the indicies of ability-to-pay-taxes and the 'efficiency criteria', the correct idea of which is necessary in framing a well-balanced tax system. I have also discussed in the Chapter as to how far taxation can be instrumental in bringing about the ends of socialism even in a capitalist country without bringing all the means of production under State-ownership. I have also given theoretical considerations regarding the use of taxation as an instrument of regulation.

In Chapter II while discussing the problem of tax co-ordination under federal financial system the role of sharing of taxes and grants-in-aid as related to the tax system of the country has been evaluated.

Chapter III has been devoted to the tax policy in our country. First of all the choice of priorities over objectives has been discussed which is a pre-requisite to framing of an appropiate tax policy. Vagueness about objectives to be attained was the cause of a wavering tax policy for many years after independence. Then, while discussing the problem of taxation in relation to mixed economy, I have mentioned the dilemma before the Government suggesting the solution to the problem, leaving the detailed consideration of it for Chapter VIII. Problems of deficit financing and inflation have been discussed in some detail. Lastly, I have studied the changes in the tax policy in the country since independence through budget speeches and debates, resolutions of the Indian National Congress, various reports, speeches and other documents. While doing so I have examined the extent to which socialistic ideas influenced the framing of the tax policy of our country since independence.

In Chapters IV, V and VI, the importance of each Central and State tax in the tax system of this country has been discussed, from historical and theoretical points of view. Wherever possible a comparison has been made of the importance of similar taxes,

if any in existence, in socialistic countries like U.S.S.R. and China with that in our country. In general, each tax has been examined from socialistic point of view. Instrumentality of some of them in bringing about the socialist pattern of society in this country has been discussed in detail.

The administration of direct taxes has also been dealt with. Suggestions have been given after discussing some important principles of tax administration and after examining critically some of the suggestions given by the Direct Tax Administration Enquiry Committee. Matters of technical and procedural details fall outside the scope of this study and have consequently been left out. The problem of tax evasion has been discussed in Chapter X while discussing the tax burden.

The goal of economic development, as 'steadily raising the standard of living of the people', under the 'economic law of socialism' having been discussed, Chapter VII has been devoted to the discussion on the tax effort made in the country since the postwar period for development purposes. Lastly, the revenue prospects of taxation for the Third Five Year Plan has been examined by relating it to the increase in national income and suggestions made for increasing the tax revenue with the increase in national income.

Chapter VIII takes up the question of 'Limits to Taxation'. After considering the previous attempts made to determine the limits to taxation I have discarded the old bases as being inadequate for arriving at correct conclusions. I have evolved the thesis that the objective test lies in considering the effects of taxation on production and distribution through their influence on savings, investment and employment. Effects on production taken in isolation cannot help us in arriving at correct conclusions. In a developing economy the limits to taxation changes rapidly with the rise in national income. I have examined this question in the light of savings, investment, employment, production and distribution as they obtain in our country. It is concluded that the limit regarding direct taxes has been almost reached (There is, however, some scope in the agricultural sector). On the other hand, there is further scope for indirect taxation with the rise in national income and progress towards the socialist pattern of society.

Chapter IX on Public Expenditure Trends has been added as a prelude to the subsequent chapter on Tax Burden.

In Chapter X, I have discussed the tax burden which is next in importance to the limits to taxation. I have calculated the direct money burden of the Central and State taxation on the lower, middle and upper classes in our country basing the calculation on certain assumptions. The burden of local taxation has been discussed showing that village Panchayats and co-operatives could help a lot to get at the resources of the rural sector

for local development schemes without imposing appreciable real burden on the village community.

Chapter XI has been devoted exclusively to the problem of taxation in relation to the socialist pattern of society. I have given my own implications of the socialist pattern of society in the light of the principle of Public Finance *viz.*, maximising social welfare. I have studied the speeches of the Prime Minister, resolutions at various Congress Sessions, proceeedings of the Otty Seminar, the views of many of the socialists and other economists of India and abroad. I have also given a contrast between the Marxian and Gandhian approach to the problem in hand. Then the role of taxation in bringing about the socialistic pattern of society has been discussed in the context of the history of the tax systems of Great Britain, U.S.S.R. and China.

In the end I have explained that maximum social welfare in the real sense can only be attained when we reach the end of wantlessness, wherein lies the solution to all our problems.

I

THEORY OF TAXATION

Nature of Tax

A precipitate idea regarding the nature of tax must be borne in mind before we proceed with any work on taxation. For this purpose we must distinguish 'tax' from 'fee' and 'price'.

'Tax' and 'Price'

Taxation is now widely used as an instrument of achieving various economic, social and political objectives. But in strict economic sense a levy made for fulfilment of any objective or policy other than for collection of revenue cannot be classed as a 'tax'. For example, in communist countries there is no tax in the correct economic sense; there are taxes only in name. Because a communist State has no theoretical need to collect taxes in order to defray its administrative expenses. Since there, the national economy consists of almost entirely the State sector, the State can defray its expenses from surplus profits.

"Prices can and do have elements of taxation, and profits can be so planned as to raise the entire amount needed for financing, construction and development."[1] (Here price has very little connection with the costs of production.) It may be only for psychological reasons[2] that the State may decide to collect levies called taxes and not for revenue purpose. Then the nature and economic function of such a levy is quite different from taxes in liberal and individualistic States. In fact, the tax is used as an administrative means for directing of prices, and equalisation of differences in production costs of several plants in the industry.

When taxation is used as an instrument of policy, the distinction between tax and price or fee becomes blurred. But the fundamental distinction between them cannot be eliminated.

1. Gyan Chand, *The New Economy of China*, p. 333.
2. This has been described as the 'illusion effect'.

The definition of 'tax' which has been widely accepted is as follows :—

"A tax is a compulsory contribution from the person to the Government to defray expenses incurred in common interest of all, without reference to special benefit conferred."[1]

Parallel to this definition, in a socialist economy tax is defined as "the money raised by means other than borrowing to pay for free goods."[2] Free goods (and services)[3] are not free in the sense of involving no cost to the society, but only in the sense of involving no specific or additional cost to any individual. The group as a whole must pay for all goods and services distributed gratutiously to individuals. The goods and services suitable for free distribution may be education, health services, justice, protection of life and property, personal income insurance and public utility services like transportation services, etc.

Government may own and operate industries in order to finance its activities out of the profits. Retained profits are not different from profits taxes from the point of view of the consumer. Both are over and above the costs of production. Thus the total receipts of State enterprises minus their commercial costs are to be counted in the category of taxes on the consumer.[4] Similarly, all indirect taxes are included in the price of all consumer goods.

This price policy may form a part of the general scheme of taxation; and it is so in a socialist economy. There is a planned margin of profit between the costs of production and price. But too much reliance on this method of revenue collection may defeat the end of the enterprise itself. Besides, there will be a distinct feeling in the minds of the people that they are paying taxes through prices. On the other hand, if a country is not completely socialised, it will also affect the cost structure of the private sector and will inflate prices all-round.

There are certain taxes which perform the function of price, and also fulfil the conditions of a tax, but no tax performs the function of a price absolutely perfectly. A gasoline tax, for example, is a tax which varies according to the number of miles the car is driven. Such types of taxes are called 'price taxes'. They are necessary under a socialist economy. A tax to finance compulsory insurance, which varies with the risk involved affords example of it, which is a perfect price tax.

1. Seligman, E. R. A., : *Essays in taxation* (1921), p. 432 (for some other definitions see Robert Jones : *The Nature & First Principle of Taxation*, p. 248).
2. Burnham, P. Beckwith : *The Economic Theory of Socialist Economy* (1952) p. 210.
3. The definition given by Beckwith mentions only goods, but actually he means by it both goods and services.
4. Holzman in *Soviet Taxation*, p. 61, points out "all deviations of price from cost are considered a form of commodity tax."

'Tax' and 'Fee'

'Fee' has the 'special defrayment function' and is applicable '*in personam*', as against the 'general defrayment function' of taxation which is applicable '*in rem*'. "The fee presupposes the production of public services and is merely a method for recovering expenditures already made. . . . The tax, on the other hand, supplies the State in advance with the means necessary for the production of public goods and may, therefore, represent a system of public revenues complete in itself."[1]

The real difference is not the presence of measurable benefits in the case of 'fee'. "The real difference may appear to be that, while in the case of a tax the service is performed for all individuals at once, in the case of a fee it is performed through the medium of a few individuals. These individuals may be said to derive special advantages; but the view that such advantages can be measured or compared in any sense more easily than others, does not appear to be correct."[2]

Besides, the main purpose of taxation is to collect revenue, whereas fees are levied mainly to prevent individuals from indulging in luxuries. In the absence of a fee for administering a statute (for example, court fee) or for supply of service, people might use them recklessly. A fee, however, need not cover the whole cost.

If the amount of fees levied is disproportionate to the cost of administering a statute or supply of service, the taxing element predominates and such fees may become tax. On the other hand, if the benefit by public expenditure becomes increasingly specific, the 'fee' character of a Governmental revenue becomes increasingly pronounced.

Special Purpose Taxes

Duty—Broadly speaking, a 'duty' is other than a direct tax. These charges are not aimed to be levied according to the ability-to-pay taxes, like a direct tax. On the other hand, they are made proportionate to consumption. They are sometimes levied in order to discourage people from consumption of those commodities or services whose unrestricted use is believed to be inimical to social welfare.

Cess—This word was used in item 49 of List II of the Government of India Act, 1935. But the word has been replaced by the word 'taxes' in the corresponding Entry 52 of List II of the Seventh Schedule of the new Constitution. A cess, therefore, generally conveys the sense of a tax, unless it is levied for a specific and defined purpose.

Rate—It is used in two senses. If the levy is for a specific

1. Marco, Antonio De Viti De, : *First Principles of Public Finance*, p. 111.
2. Mehta, J. K., : *Nature, Classification and Principles of Public Revenue and Expenditure*, p. 11.

purpose, it takes the form of a fee such as water rate, and if it is of a general nature and is collected and credited to the general revenue of public authority, it is a tax, like the rates levied by local authorities, for example, rate on lands and buildings.

In India the assumption behind imposition of these rates is that they "are prices for the benefits accruing from the services and have to be charged on the cost of service basis."[1] It must be noted here that local impositions are taxes when they are assessed on the principle of ability-to-pay-taxes. If a local rate assessed according to ability-to-pay is not a payment for benefit received, which is often believed, it is not a tax in its entirety, as Dalton points out—"Local rates are only in part a genuine tax. In part they represent prices paid by rate payers for specific services rendered to them by local authorities."[2]

A tax on lands and buildings, for example, is a general tax imposed either on the owner or on the occupier. But a part of the payment made by tax payer may be considered as price for the benefit he receives in terms of improved roads, or other amenities in the locality where the land or the building is situated. Thus, a tax on unearned increment in the values of land or building contains a large element of price. Thus it is not improper to use the word 'rate' for taxes imposed by local Governments as distinguished from the 'tax' proper imposed by upper layers of Government. The word 'rate' is commonly used in England and elsewhere for such levies.

Since greater emphasis is now laid on the system of decentralised finance in which local bodies should be delegated greater powers to raise revenue for meeting their own needs, the importance of cess and rates is bound to increase.[3]

Use of Taxation for non-fiscal purposes

Now taxation has been widely used as an instrument of public policy,[4] and such a use has been advocated among others by Adolf Wagner, Lloyd George, J. M. Keynes, Hansen, A. P. Lerner and Sir Josiah Stamp. But from strictly theoretical point of view if a State imposes a levy partly for the sake of raising revenue and partly for some ulterior purpose, it is partly a tax and partly not a tax but something else, to which we may assign some name. For example, if the levy of expenditure or wealth tax is partly for raising revenue and partly to rationalise the tax structure or to bring about the socialist pattern of society, it is partly a tax and partly something other than a tax. To the extent it is for revenue it is a tax; and to the extent it is for some other purpose it is not a tax. Nomen-

1. Gyan Chand, : *Local Finance in India*, p. 113.
2. Dalton, H., : *Public Finance*, p. 45, also cf. Bastable : *Public Finance*, p. 397.
3. Vide discussion, Chapter, X.
4. Vide Chapter III.

clature matters much, because correct thinking necessitates correct names.[1]

Besides this, levies with certain objectives or certain policies are usually of temporary nature, inasmuch as their continuance is only justified so long as the object or policy is not fulfilled or is abandoned on its not being found beneficial, when the necessity of the said levy ceases. Whereas in the case of taxation for revenue, it is essentially of a permanent nature attached to a State so long as that State exists; because a State cannot function without revenue. This being the essential difference between a tax and the levies made for fulfilment of any policy, it would be improper to class such levies with a tax, properly so called. Moreover, taxes are the very life blood of a State; whereas such levies for policies are of experimental nature, and may even be found to be unuseful and may have to be given up on gaining experience.

Such temporary levies therefore, should not be classed as a tax of the State. Considering these essential features we would prefer it to be called a 'policy levy' so as to distinguish it from the 'tax' proper.

Principle of Taxation

Taxation in modern States, as has been already said, is widely employed for the achievement of various objectives. This is now a well recognized fact, which cannot be denied. Today the principle of taxation is determined by the objectives which the Government has to fulfil, as against the orthodox classical theories which are independent of any objective other than that of revenue collection. Objectives[2] of taxation may be different with different economic systems—capitalistic, socialistic, communistic or any other.

The most fundamental principle of taxation, which is now-a-days accepted, almost universally emanates from the ultimate (long-run) objective of a State. After all, taxation is a means to the attainment of certain end of a State. The true economic function of taxation is collection of revenue which has just been discussed. But collection of revenue is an immediate objective of a State. So there may be other immediate objectives, too. These immediate objectives may vary with the stage of economic development, time and place. But they are only the stepping stone for the attainment of the ultimate objective. This ultimate objective of a State is only one, and it is the 'maximisation of social welfare'. It is true for all times, for all stages of economic development and for any of the economic systems. It is the objective of the formation of a State itself.

1. Mehta, J.K., Preface to *The Principle and Problems of Inheritance Taxation* by R. N. Bhargava, p. 1.

2. It is only the immediate objective which is meant here, because the ultimate objective is one and the same for all economic systems.

Maximum Social Welfare

'Maximum Social Welfare' is not the principle of taxation, nor, generally speaking, of revenue alone; but this is the principle of the whole corpus of Public Finance, which includes public expenditure as well. Revenue collection alone cannot by itself maximise social welfare. It may only be instrumental in affecting private consumption, saving and/or investment. It is the corresponding public expenditure that increases or maximises social welfare. In the process of revenue collection and public expenditure, there is a net gain in welfare, otherwise there is no sense in collecting and then simply spending it.

Welfare economics is concerned with the welfare of the community and not of the individual. From the individual point of view every addition to income is reckoned as an enhancement of economic welfare, though with progressively diminishing utility. But from the point of view of the community as a whole, every increase in individual income, which means an increase in national income, does not necessarily increase the total welfare to the same extent, but might even decrease the welfare. Welfare may increase to the same extent or even more, only when there is a distribution of resources so as to give more to the poor than to the rich, or there is redistribution of resources from the rich to the poor.

The underlying principle is that a man getting an income of Rs. 50 and another man getting an income of Rs. 50,000 do not get like satisfaction from their incomes. The marginal utility of money is normally greater for the poor than for the rich. Every rupee of the additional income to the poor increases economic welfare or social satisfaction proportionately much more than what it takes away from the rich.

The principle of redistribution has been enunciated by Prof. Vilfredo Pareto, the Italian economist, after a long and detailed investigation of consumption Statistics.[1] Stated broadly it means that every transfer of income from the very rich to the very poor by equalising marginal satisfactions, produce more than proportional increase in the total economic welfare resulting from the redistribution of national income.

Pareto's law has been severely criticised[2] and advocates of the capitalist system have branded it as revolutionary and frankly socialistic. They hold that by depriving the man of large savings of his income, the incentive to accumulate capital would be at an end. But it is not possible to deny Pareto's conclusions. We should, therefore, not be alarmed by a conclusion being revolution-

1. Hutchison, T. W., : *A Review of Economic Doctrines* (1870-1927), p. 219.
2. Vide Pigou, A,C., : *The Economics of Welfare*, Part V, Chapter II, p. 693 ff., and Wealth & Welfare, Part II, Chapter I, p. 71.

ary as "Public Finance preaches no '—isms",[1] the objective of a broad based welfare State being to maximise welfare of the people as a whole. Dr. Pigou contends, and has the authority of Marshall and Keynes behind him, and the greatest of economists also hold, that the country which tends to equalise the incomes, *per se* increases economic welfare of the community in progressive ratio.

In an unequally distributed pattern of incomes or wealth, redistribution can be brought about by the twin effects of taxation and public expenditure. The sacrifice undergone in taxation is more than compensated by the gain due to public expenditure, which has redistributory effect, and this gain over sacrifice is to be maximised to attain 'maximum social welfare'.

Classical economists failed to realise the advantage of public expenditure over taxation and consequently, they advocated that taxation should be minimum. Taxes were regarded as a sort of 'hail that destroys part of the crop' and 'the best of all taxes is that which is least in amount.' Duties of State were also narrowly conceived.

Today with highly increased State activities, taxation has increased considerably and new avenues are to be found for extending the field of taxes to meet the increased State expenditure. Now, the question is not how to minimise the taxes on any individual or a section of society, but the question is how to distribute the burden of taxes on them so as to minimise social sacrifice.

Least Aggregate Sacrifice

The principle of tax distribution is given by A. C. Pigou's 'least aggregate sacrifice'.[2] It states that the tax burden should be allocated in such a way that the total sum of the subjective sacrifice of all individuals affected should be at a minimum. Sacrifices of individuals in their individual capacity may not be equal.

"The actual allocation of the burden of taxation among several individuals is a process which presupposes an objective-measuring and a mutual comparison of the individual sacrifices of several tax payers."[3] The older literature on welfare economics and taxation, for example, the work of Pigou was of course founded on the assumption that personal satisfactions are subject to cardinal measurement and summation. His study on the Economics of Welfare treats that the state of subjective and objective satisfaction derived from the enjoyment of utilities, is capable of being measured in terms of money.[4]

Sacrifice like satisfaction is a sensation of an individual human being. It is the disutility caused to a man by withdrawing from

1. Bhargava, R.N., : *The Theory and Working of Union Finance in India*, p. 17.
2. Pigou, A,C., *Public Finance*, p. 57.
3. Novotny, Jan Maria (McGill University) : *Fiscal Science*, p. 405.
4. Pigou, A.C., : *The Economics of Welfare*, p. 21.

him a portion of his wealth, as preventing him from its potential, immediate or later consumption.

In order to be able to apply all this subjective principle of minimum sacrifice to actual life, it is unavoidable to make some preliminary assumptions. The measure of justice actually resulting from the application of the principle of minimum sacrifice will depend on how closely these assumptions reflect actual facts and actual conviction of tax payers. These assumptions are covered up under the theory of progression.

Theory of Progression

To minimise the aggregate direct burden of taxes on individuals it is necessary that taxes should be progressive, which means that taxes should bear heavily on less important units found at the margin of large incomes and lightly at the margin of small incomes.

The theory of progression is based on the following assumptions—

1. That the law of marginal utility (that the marginal utility of money diminishes as income increases, that is, as individual income rises, the want satisfying value of each additional unit falls) is generally valid.

2. That the subjective valuations of all individuals are equal. Each individual values an equal quantity of income equally.

3. That the relation between income and sacrifice is similar for different people.

These last two assumptions mean the introduction into our considerations of the well known average man 'homo economicus', who is supposed to represent the average citizen of the given time and place. When we are concerned with the community as a whole, such a person is fairly representative; because then we are not concerned with abnormal cases. Such conditions may not apply to a miser, a spend-thrift or a mad man, but may well apply to an average citizen representing the community. We may thus assume the proposition to be true for theoretical discussion.[1]

Proceeding with the assumption that each individual carried equal capacity for pleasure and pain, it can clearly be stated that the aggregate happiness would be increased by taxing at a higher rate as the size of the income increased, and by financing welfare activities for the poor with the tax proceeds. For, as we have stated, to a rich, one additional rupee would yield less satisfaction than it would to the poor.

But there is the practical difficulty that the pleasure experienced by one man cannot be directly compared with that enjoyed by

1. Practically, however, the proposition is not quite true, as every man is in a sense a more or less eccentric, a mad man or a spendthrift, and it would be, therefore, wrong to assume him to be so free from these attributes as to be fairly representative to fulfil the conditions on which the assumption is based.

others. Even if we take money as a measuring rod we have limitations. It is purely a conventional and pragmatic institution. Actual money[1] demands cannot represent the real intensities of human desires behind him. It measures only the intensity of desires which can find a limited expression according to the social evolution of the State, the nature of social institutions, and the relative capacity of the individual to make his real demand efficient under prevailing circumstances. Thus if real intensities of individual satisfactions cannot be compared, if further they are not adequately measured by money demands, then there is no logical argument for taxing one man more heavily than another. Only by some other ground than increase in the sum total of individual satisfactions, can progressive taxation be justified.

Many modern economists are disinclined to accept a theory of progression based on 'sacrifice'. They rest their argument for progression based on the case against inequality of wealth and income, or more precisely on socialistic grounds. The diffusion of socialistic ideas has strengthened the argument.[2] Progressive taxation is one of those agencies that seem likely to facilitate transition from capitalism to socialist regime by readjusting wealth and incomes. In the words of Bastable, "Evil forces have changed the abilities of the tax payer and it is the duty of the State to offset these forces by readjusting wealth through taxation, hence the taxation cannot be equal....a tendency to alter the distribution of taxation in favour of the most powerful class, that is, the numerical majority. This can only be accomplished by putting a heavier burden on the wealthy."[3]

The theory of progression, or in wide terms, the theory of distribution of the burden of taxation based on the arguments stated above, emanates, like the theory of taxation from the socially chosen objective, namely, redistribution of wealth and incomes. We may never succeed in measuring different intensities of sacrifices. But "a decision can always be taken by constitutional or institutional means that a certain transfer of wealth expresses the contemporary view of what is right, what is good for society, and incidentally

1. Here we must remember that money payments represent not satisfactions but desires for satisfactions (Pigou, : *The Economics of Welfare,* Ch. II; Marshall, : *Principles,* p. 16). This does not affect our argument. It is as difficult to measure the intensities of one man's desires against another's, as to measure different people's satisfactions. Desires are even more subjective than pleasure.

2. While supporting his proposals, Dr. C.D. Deshmukh, the Finance Minister, said during Lok Sabha Debates on the General Budget (1955), "I maintain that the proposals that I have placed before the House are the first and very significant step towards the socialistic pattern of society that we are envisaging. In my proposals for direct taxation, I can claim that I have followed the general line indicated by the Taxation Enquiry Commission, and have carried a step further the principle of sharply progressive taxation which is an essential ingredient of what came to be called a socialistic pattern. ..Under these proposals I have made, the taxes in the higher slabs have been raised significantly."

3. Bastable, cf., *Public Finance,* p. 306.

what is the most efficient way of securing that good."[1] This may be called the 'theory of sanction of progressive taxation', to be more correct, rather than the 'theory of progressive taxation'.

The theory of progression ultimately comes out of the ultimate objective of the State, *viz.*, 'maximum social welfare.'

The truth is that social welfare overrides such facts as the loss of satisfaction to individuals. It needs emphasis here that "if more of our citizens secure basic necessities, even at the cost of some esoteric individual satisfactions, then our community will consist of citizens more capable of developing the values we accept. We are trying to use our means more efficiently towards the end..... the claim that individual's view of his own satisfaction should never be infringed implies that he is not a social animal. The refusal to tax progressively, because he may so suffer, is suitable only to solitary individuals. It is, therefore, not suitable to facts. The individual's right to any level of satisfaction is created by, guaranteed by, and developed by the community—a community of social individuals."[2] It is thus a sound amalgamation of individual and the State, where individual liberty is honoured by social objectives and not lost by their attainment. This we may brand as the 'socialistic theory of the distribution of burden of taxation', as distinguished from classical theory based purely on 'sacrifice' consideration.

Ability Theory

That taxes should be progressive, is also supported by ability theory on the ground that "the faculty of increasing production grows in more than arithmetical proportion. The rich man may be said to be subject in some sense to the law of increasing returns."[3] It is not very unreasonable, says Adam Smith, "that the rich should contribute to the public expense not only in proportion to their revenues, but something more than that proportion."[4]

Ability theory states that taxes should be proportionate to the ability of the tax payer. Further, ability has been expressed in terms of 'sacrifice'—equal ability implies equal capacity for bearing sacrifice. The theory is based on the general consideration that, when taxes are made proportionate to the ability of individuals, they are subject to equal sacrifices. But the proper distribution of burden of taxation from social point of view is not that which imposes equal sacrifices. Because, if the law of diminishing utility is true, which for all we know might be a true law, then "according to the principle of equal sacrifice (however interpreted) the taxation would be regressive, the rate of taxation increasing as income decreases."[5]

1. Macfie, Alec L., : *Economic Efficiency & Social Welfare* (1943), p. 28.
2. Macfie, Alec L., op. cit., p. 31.
3. Seligman, E.R.,. : *Essays in Taxation*, p. 15.
4. Adam Smith, : *Wealth of Nations*, Vol. II, Book V, Chapter II, p. 371.
5. Edgeworth, E.Y., : *Papers Relating to Political Economy*, vol. II, p. 234.

According to the theory of distribution of taxation, as we have already shown, the happiness of society will be best attained by so distributing the burden as to inflict the least sacrifice on the whole. This is the least when the marginal sacrifices of individual tax payers are equal or as nearly equal as possible. From this it follows that the ability theory does not aim at equalising the total sacrifices of individuals, but it aims at making their marginal sacrifices equal.[1]

That each should contribute acording to his ability,[2] is illustrated by the history of the English poor law. At first the attempt was made to supply the wants of the poor by voluntary contributions. But it soon became apparent that all were not contributing "as God had prospered them."[3] Legislators felt that fairness demanded that each should contribute according to his ability—ability, however, was interpreted to mean property. Yet the question remained as to what actually constitutes ability.

Indices of Ability-to-Pay-Taxes

Ability expressed in terms of sacrifice, however correct, fails to be of any help to the practical statesman. But the ability theory is the most objective if correct choice is made of the indices on which the abilities should be based. The choice of base has given rise to long discussions.

(1) Income is the only correct measure of the ability to pay taxes. It may be either (1) psychic income, as may be indicated by the value of the capital, irrespective of the revenue it yields, or Money income, from capital or from any other source.

From a long time, however, the best practical test of ability was supposed to be the general property, as mentioned above. Thus all through 'the Middle Ages', when local taxes were levied

1. Seligman, however, holds that sacrifice theory or the sacrifice concept of ability-to-pay is incorrect because it is inadequate, as it refers to the pains involved in parting with wealth and ignores the cost of acquisition. According to him, instead of there being one aspect or test of taxable ability there are two; the privilege side as well as the sacrifice side, the acquisition side as well as disposition side. A man's ability to pay taxes is to be measured not only by the relative burden imposed upon him in parting with his wealth but also by the relative ease with which he has acquired wealth. (Seligman, Essays in Taxation, p. 339 *et seq.*). Accordingly, if sacrifice includes both cost of acquisition and cost of disposition then the theory is correct.

2. When 'ability-to-pay' is considered from point of view of the whole community, not only economic loss resulting from the payment by the individual, but also any indirect loss or gain to others comprising the community as a whole should be taken into account. When we are taking aggregates, we must also look into saving, consumption and investment. In that case even the poor may have to contribute more at present. Sometimes it may be against the ideals of equity, but it may prove beneficial to the society in the long run (vide Chapter VIII).

3. Ashley, W.J., : *An Introduction to English Economic History and Theory*, Part II, p. 356 *et seq.*

at all, they were assessed on general property.[1] Later on ability (or faculty) came to mean income, and Adam Smith explains abilities to mean revenues.[2] Income as an index of ability has been generally accepted.

Capital is a source of money income.[3] But, its value cannot be determined by its revenue yielding power alone, but also by some other advantages which it is capable of giving. It may be psychological satisfaction, or the show of power or vanity to the owner of the capital. The owner of capital who enjoys advantages more than that of money income must pay more than a person who earns money income alone. Hence money income from capital or other source cannot be the only fundamental basis for taxation. Psychic income must also be taken as an additional index of ability along with the money income, and for practical purposes this may be indicated by the value of the capital a person possesses (irrespective of the revenue it yields).

Further, it is argued by J. S. Mill and others that an element of double taxation on savings is involved in an income-tax, when it exists along with taxation of capital. As a matter of fact income breaks into two component parts—*viz.*, expenditure and saving. The latter goes to form capital. In this way 'capital' and 'expenditure' are sometimes argued as the two fundamental measures of ability. Thus income is not taken as the fundamental measure. N. Kaldor too holds that expenditure is the better index of taxable capacity,[4] or, in other words, it is a more fundamental measure of ability. He feels that 'income' can never be a correct measure of taxable capacity of a man because his spending power is not taken into consideration.

This argument is not correct, expenditure cannot be a true measure of ability-to-pay. It is not always true that the greater a person exercises his spending power the greater he may be taken to possess the ability-to-pay. This is due to the reason that people may spend due to multifarious reasons, which may not necessarily be on luxuries. Moreover, it is difficult to define luxury in precise terms. What may be luxury from one point of view may not be so from another point of view.

Thus we come to the conclusion that 'expenditure' cannot be taken to supplement our list of indices for the ability-to-pay, and income (psychic or money) is the only correct measure of the ability-to-pay. However, for other reasons,[5] an expenditure-tax might be justified. Hence a tax system may consist of all the three

1. Seligman, : *Essays in Taxation*, p. 40.

2. Adam Smith's First Maxim, *The Wealth of Nations*, p. 351.

3. Generally, by income we will mean money income, unless otherwise indicated.

4. Kaldor, N., : *Indian Tax Reform*, p. 39.

5. Vide Chapter IV.

types of taxes, namely the taxes on income, expenditure[1] and property. These may be applied according to the administrative feasibility, because it is better to approximate to equity than to be wholly unjust. Richard T. Ely has rightly said "..... however, we strive nothing better than approximate justice, which can ever be secured in taxation. A system that frankly recognises this truth and makes for rough justice, by the imposition of taxes which are simple, stable, convenient, inexpensive and productive, is far better than one which attempts to secure exact justice, through complex and delicate schemes of taxation which cannot be definitely or efficiently administered."[2]

Equity Vs. Efficiency

What consists of equity in taxation (or fairness in the distribution of tax burden) becomes difficult to define, because of the intricacy of the process by which taxes are shifted and the extreme difficulty of tracing their ultimate incidence.

Moreover, the principle of equity is largely a matter of opinion. In words of Dalton, "Equity often seems to say 'No', but hardly ever 'Yes', an elusive mistress, whom perhaps it is only worthwhile of philosophers to pursue ardently and of politicians to watch warily."[3]

Therefore, the radical test of the efficiency of a tax system from social point of view is not equity, but the economic consequences of a tax system, and its instrumentality in bringing about the goal set by a nation. Even the ability-to-pay criterion is of secondary importance. In words of the Taxation Enquiry Commission, "It is inevitable in under-developed countries seeking to accelerate the tempo of their economic development that their tax systems must suffer some departure from the strict basis of ability-to-pay, if the targets of economic development which form the imperatives of their national policies are to be attained within a reasonable period."[4]

It needs mentioning here that equity considerations are not at all important in the Soviet tax policy. The Soviet tax system[5] fails to provide exemptions from taxation for the lower income groups; which means hardship for them. Under the present commodity tax system, the tax paid by the lower income group is of the order of 30 or 50% of the income if not higher. The impact of the tax is only partly offset by the distribution of free social services and subsidies to mothers.[6] "No other nation has ever levied as high a rate of taxation as the Soviet Union, and it may be

1. Under Soviet type of economic system, expenditure tax will have little meaning (vide Chapter IV).
2. Ely, Richard T., : *Outlines of Economics* (1914), p. 613.
3. Dalton, H., : *Principles of Public Finance, Chapter* IX, p. 95.
4. *The Taxation Enquiry Commission Report* (1953-54), Vol. I, p. 148.
5. Vide Appendix I.
6. Holzman, *Soviet Taxation*, p. 307.

that the cause of equity cannot be well served when the financial requirements of the State are so enormous; taxes must reach down into the last person's pocket if the program is to be successful. If this is true, the only way to achieve equity is to reduce the fiscal requirements of the State. But this decision lies in the realm of politics rather than economics."[1]

The efficiency of a tax system must then be judged by some criteria other than equity. The 'efficiency test' involves three such criteria.

First, it may be 'productional criterion'. That is to say, a tax system should be condemned if it reduces incentive to work and invest, thereby reducing the national production.

Secondly, a tax system may also be judged by 'functional criterion', by which taxes make difference in the functioning of the economic system. For example, a commodity tax decreases the incentive to produce the taxed item and the resources thus withdrawn are invested to produce other non-taxed items. Thus the desired allocation of resources may be affected. If a tax system brings about a better distribution of resources then it satisfies the efficiency test. Also, the condition of an economic system at any time may require reduction in private expenditure or private demand. A tax system which may be effective to this end also satisfies the efficiency test. This is another important feature of the functional finance[2] doctrine.

Thirdly, there is the overall criterion of welfare. Whether a tax system increases or decreases the welfare of the community as a whole, can be judged by finding out its redistributory effect.

Here it must be mentioned that indirect taxes may not satisfy the ability-to-pay principle, but they may satisfy the above mentioned three criteria of the efficiency of a tax system. They may not directly affect the incentive to save and invest. But they may go a long way in reducing consumption of the desired commodities. Besides, it is a good revenue collecting device especially from the low-income group. It also conforms to the principle that each should pay to the expenses of the Government. An element of progression may be introduced in indirect taxes by taxing the luxuries more heavily, while taxing lightly the articles of necessity.

The Tax System

From the above discussion it follows that a tax system is to be so adjusted that a balance is struck between the 'ability-to-pay' principle and the 'efficiency criteria'. It can be achieved by a judicious combination of taxes on capital, income, expenditure and commodities, at the same time keeping in view that too great a multiplicity of taxes is dangerous. Instead of examining each tax

1. Holzman, *Soviet Taxation*, p. 307.
2. Vide p. 46.

separately and attempting the futile task of choosing only those taxes which would pass all tests, or trying to evaluate the claim of one kind of taxation against another, we must look at the tax system as a whole, in which the fault of one would be balanced by the virtues of another. But this is not all. Public expenditure must also be taken into account to consider the equity of a tax system. The inequity in a tax system may be offset by the benefits of public expenditure.

The amount of tax paid by different individuals under a tax system will depend first, on what taxes have been imposed, and secondly, on the various attributes of the individuals. For example, in case of a poll tax all will pay the same amount. In case of an income-tax, the amount paid will depend on the amount of taxable income that the individual is able to earn and is willing to earn. The amount of commodity or outlay taxes paid by an individual will depend on his income and his disposition to spend, or the individual preferences.

Principle of Local Taxation

Local authorities which are confined to small areas, must impose such taxes as are paid by the residents of that area, and they are not capable of shifting it to those residing outside the area. This is obviously due to the reason that those who benefit by the local Government must also bear the burden. This is equitably justified.

Besides this, the choice of such a levy necessarily means that the tax base should be localised. This would also make the operation of the tax effective as it would minimise the possibility of tax evasion. Another benefit of localisation of certain levies lies in the fact that where it varies with localities and its assessment requires the detailed knowledge of local conditions, a locally administered tax will be more efficient. Other taxes less local in character or less suited for national assessment due to administrative difficulties are suitable for the State. On the other hand, where national uniformity with effective administration is required, the tax base must be wide and it must be levied on national and not on local or Provincial level.

Secondly, a local tax cannot be raised to high level or made highly progressive without the possibility of driving the tax base to areas with lower or less progressive taxes. Besides, poor localities cannot hope to get enough of revenues if they depend mostly on a levy (like progressive income-tax) on a few moderately wealthy persons residing therein. It is clear that a levy which is proportional or even moderately regressive is more appropriate for local purposes than a progressive tax.

It is evident from the above that neither benefit nor ability alone is the sufficient criterion for local taxes. It is the combination of the two principles which is desirable to be taken as the criterion. Accordingly, some local taxes are levied according to benefit and others according to ability.

Thus the levies suitable for local purposes form an entirely different class. For example, taxes on income and corporations are not at all suitable as local taxes, as their base usually transgress local boundaries and hence it becomes difficult for local authorities to detect concealed income, or check evasion.

For these reasons, in Germany the States were forced to restrict the localities in their levying of income taxes. In Holland, where for generations a local income-tax constituted the backbone of local revenue, yielding approximately three-fourth of all municipal taxation, the Government prohibited local income-taxation in 1929 and in its place established a centrally administered communal fund which is redistributed among the local bodies according to population and other indices, such as assessed wealth and average public expenditure on police, education and public assistance.[1]

For the same reasons, inheritance taxes are also not suited as a local levy. The property inherited (movable and immovable) may be spread over wide area transgressing the limits of the local bodies. Only in case of real estate, a tax may be levied by local authorities in the shape of a tax on transfer of property.

Customs can only be levied on the national level, as they are imposed at the national frontier. Excise duties must also not be levied by local Governments, first, because different rates imposed by different local bodies would prevent free flow of goods. Secondly, because, it is quite improbable that an industry might lie wholly within the jurisdiction of a local body.

Local taxes include mainly—the tax on property (land and buildings), the tax on Trade including the tax on consumption and sale of commodities, and the tax on persons which includes the tax on occupations and professions, *etc.*

Direct Vs. Indirect Taxes

Direct taxes might be defined[2] to include levies on personal income, corporate income, excess profits; death duties and the like. Indirect taxes might be defined[3] to include customs, excises, sales taxes and commodity taxes generally. The direct and indirect taxes differentiate "between those levies which directly affect relative prices and those which do not."[4] This distinction between direct and indirect taxes is rather doubtful in some instances. This

1. *Encyclopedia of Social Sciences*, Vol. V, pp. 570-571.
2. Direct tax has been defined as one, the incidence of which is intended to be on the same man who pays the tax to the Government. The impact and the incidence intended are on the same man. (J.K. Mehta and S. N. Agrawal, *Public Finance, Theory and Practice*, p. 64).
3. "Indirect tax is one in case of which, "incidence is at least partly on some other person or persons than the one who is taxed. The impact and incidence are not wholly on the same man." (Ibid).
4. United Nations : Budgetary Structure and Classification of Government Accounts (February 1951), p. 7.

is due to the reason, that under certain conditions direct taxes can also be shown to be shifted[1] and thus they may also affect prices directly.

Direct taxation in under-developed countries mainly brings about equality, while indirect taxation helps revenues. In a socialist State theoretically, however, any kind of taxes can be equitably justified. Since differences in incomes between individual citizens is relatively small, even general sales tax would bring about nearly equal burden of taxation as income-tax. Thus in a socialist economy, taxes might be used, which would be condemned as inequitable in a capitalistic system owing to high inequalities there. In a capitalist economy discussions are often based on the well known fact that while indirect taxes tend to be regressive, direct taxes may be made progressive without great difficulty. Indirect taxes too can, however, to a certain extent, be made progressive which has been already pointed out. On the other hand, direct taxes cannot be made highly progressive simply on equalitarian objectives because incentive considerations are there, which are used as an argument against the use of highly progressive taxation as a means of redistributing incomes.

Marxist writers have attacked indirect taxation as socially inequitable, because they fall more heavily on the working class. In the early Soviet period there were open controversies over the social character of indirect taxes.[2]

Inspite of ideological difficulties, the Soviets have preferred to rely on commodity taxation, but for different reasons in different periods. In the early 1920's indirect taxes were used, because direct taxes were costly to collect and difficult to administer, and failed to provide a dependable source of revenue. As the average rate of taxation increased in the late twenties and early thirties, and U.S.S.R. developed culturally and economically, it was the illusion effect of indirect taxes which assumed primary importance,[3] The use of 'money illusion'[4] by the Soviets to cushion the political reaction to its economic policies is submitted as the principal reason for the dominance of the commodity tax and relative neglect of income-tax in the Soviet Budget.[5]

In the Soviet tax system,[6] direct taxes have also their own part to play. They are of slight fiscal importance, but they discharge important economic or political functions. For example Soviet income-tax functions as an instrument of Soviet class policy.

1. Vide p. 34, *et seq.*
2. Holzman, : *Soviet Taxation*, p. 46.
3. During war time, however, with patriotism at peak, it was found feasible to pay less attention to the 'money illusion' and to offset a part of the increasing inflationary pressures by higher direct taxes and more bond sales.
4. 'Money illusion' of indirect taxes implies that people are generally more sensitive to changes in direct taxes than to changes in indirect taxes.
5. Holzman, op. cit., p. 64.
6. Vide Appendix I.

Soviets divide tax payers into groups based on the type of occupation or income, and a differential rate structure is applied to the different levels of income. This is done first, to skim off into the budget the "rent" element in the private incomes, for example, the discriminatory tax on incomes of artists and incomes from private practice of doctors. To attract good artists or doctors it might be necessary to allow them high gross salaries. In both the cases, 'money illusion' is operative and income-tax is used to reduce such salaries to a more reasonable net level of income.

Similarly, Soviet agricultural tax resembles the income-tax in the way it discriminates among social and economic classes. In the early Soviet period, the poor and the middle-income peasants were taxed at lower rates than the richer peasants or 'Kulaks'. At present, however, the collective farmer there pays at a lower rate than the private farmer. Thus, direct taxes can be made sufficiently discriminating to serve as an instrument of the Soviet class policy, which commodity taxes cannot do.

Another reason for the use of direct taxes in the Soviet tax system is that commodity taxes are not greatly flexible against declines in the output of consumer goods. For this reason, greater reliance was placed on income taxation during the war, when reduction in output of consumer goods and want of possibility of raising prices of consumer goods caused receipts from commodity taxation to shrink seriously, and new direct taxes were introduced. Receipts from turnover taxes were bound to fall in the absence of a large rise in prices. During war times (1943) direct taxes on income yielded 23% of the total tax revenue, though normally it never provided more than 10% of the tax revenue. Russian Parliament, however, approved the abolition of direct taxes on factory and office workers from 1960.[1]

Thus we find that though direct taxes have been used by the Soviets, they have relied to a much greater extent on indirect taxes.

Prof. Henderson[2] puts up a merely theoretical case against indirect taxation. He points out that indirect taxes cause a loss to consumers by distorting their preferences. He also says that, though a change towards indirect taxation was unusually accompanied by a reduction in the degree of progression in the tax system as a whole, the shift from direct income-tax to indirect commodity tax will not enable us to escape from the burden involved in the former—it will merely add more burden.

Dr. I.M.D. Little[3] refuted the arguments of Professor Henderson in September 1951 issue of the *Economic Journal* and said that the best taxes are those on goods, for which the demand is least elastic.

1. It was reported previously that M. Nikita Krushchev had promised to abolish direct taxation (income-tax etc. on individuals).
2. Henderson, : *Economic Journal*, September 1948.
3. Little, I.M.D., : *Economic Journal*, September 1951.

Among those who strongly advocate indirect taxation is Dr. Baljit Singh. To him, "consumption taxes become more important, as they really are, in activating the economic system."[1] He explains this as follows:

> "A situation which features prominently in contemporary economics, is, however, that of excess savings. It is no more than a myth, for in the real world it cannot exist. To provide for it is futile and dangerous, as man with insatiable and unlimited wants, taken as a whole, cannot have at any time more than what he would like to spend and invest. The main issue is that of the inadequacy of investments rather than any excess of savings. And once this is admitted, much of the glamour woven round progressive taxation thins out."[2]

Prof. Van Phillips, however, says that his proposition is not a universal truth. "The relative significance of direct and indirect taxes within additional government revenues depends—given the ends of economic policy—on : first, the existing burden of both tax groups, and secondly, the net impact of a given increase in one or in the other direction. The latter proposition is closely linked up with the competence of the private sector and government's financial needs. . . . There is not only one form of 'activating finance'—in which consumption taxes must necessarily be strongly emphasised—but there is a wide range of possibilities in which the glamour woven round progresive taxation may still hold good."[3]

Prof. Phillip s' comment does not in any way meet or minimise the force of Dr. Baljit Singh's views. Even what Prof. Phillips says supports the fact, that generally it is true that 'much of the glamour woven round progressive taxation thins out' though he gives some possible exceptions where the glamour still remains. However, excessive reliance on indirect taxation is to be treated with some caution, as the United Nations Department of Economic and Social Affairs points out, "In general, indirect taxes tend to have an adverse effect on industrial development, at least in so far as they are levied on locally produced goods and services, for not only are they likely to raise the price of domestic manufacture but they are usually regressive, bearing relatively more heavily on the lower-income groups and thereby tending to restrict local market."[4]

In a developing country like India, indirect taxes must increase, because the Plans would create additional employment and would increase the incomes of the lower-income groups, a portion of which would have to be ploughed back in the form of additional indirect

1. Baljit Singh : *Federal Finance & Under-developed Economy*, p. 88. (also quoted by Paul A. M. Van Phillips : *Public Finance and Less developed Economy*, p. 122).
2. Ibid.
3. Phillips, Van, A.M., op. cit., p. 123.
4. United Nations Department of Economic and Social Affairs (N.Y): *'Processes and Problems of Industrialisation in Under-developed Countries'*, p. 53.

taxes.[1] Later on as the disparity in incomes are reduced, the proportion of indirect taxation will still have to be increased. In other words, in future the bulk of fresh taxation will have to be in the form of indirect taxation.

Theory of Tax Exemptions[2]

The theory of tax exemptions is a corollary to the theory of taxation.

The origin of tax exemptions dates back with that of taxes itself, and it has developed into a complicated system as the taxes became numerous and the economy became complex.[3] Tax exemptions have become a necessary supplement to various taxes. As soon as a new tax is levied, new exemptions are demanded. There also persists a constant pressure for the revision of the old exemptions.

Tax exemptions have potentialities no less than the tax itself or subsidies. "It can be used to safeguard and to exploit, to subsidize one interest and destroy another, to simplify administration and to confuse it, and to vitiate tax or to give it effectiveness."[4] Thus a tax which might be equitable originally may be rendered inequitable by larger exemptions, while an inequitable tax may be improved by this process. Various ingredients of tax policy may well be achieved through tax exemptions.

If an exemption is really meant to be effective it must be expressly mentioned, otherwise it would depend more on the legal interpretations, and may not be effective. For example, exclusion of cigar from the scope of an excise tax on manufactured tobacco would be an 'exemption', if the tax were levied on tobacco products, while expressly exempting cigar. On the other hand it may not be deemed to be an 'exemption' if exactly the same tax were imposed by enumerating as exempted articles cigarettes, snuff and other tobacco products without expressly mentioning cigar as an exempted article.

Several kinds of exemptions are supported by different considerations. They are used extensively for safeguarding the minimum subsistence level, as well as for encouraging certain economic, social and religious activities. They also form an important factor in facilitating the efficient administration of taxes. They are also employed in adjusting inter-Governmental activities. The need to grant special tax exemptions (or concessions) becomes more apparent within Governmental tax policy in all countries aimed

1. Vide Chapter VIII.
2. 'Tax exemption' refers to the fact that certain items, wholly or in part are being left out of the purview of taxation. The above discussion also applies equally well to 'tax concessions' including lowered down tax rates.
3. Introduction to the Symposium on 'Tax Exemptions' conducted by Tax Policy League, N.Y., (1938), p. v.
4. Ibid.

at attracting foreign private investments, irrespective of their stage of economic development. "Even where tax incentives are found to be necessary and effective, it cannot be readily assumed that the under-developed countries should necessarily be the ones to come forward first with offers of tax concessions, merely because they are most directly interested in the promotion of foreign trade and investment."[1]

One of the most difficult theoretical problems relating to tax exemption arises from the doctrine of reciprocal immunity from Federal and State taxation under the federal system of taxation. This doctrine was originally developed in the opinion of Chief Justice Marshall of the Supreme Court of United States in the case of McCulloch vs. State of Maryland[2] (1818).

The problem of tax exemptions is also complex in connection with the exemption of public property[3] from taxation. It is generally held that as a matter of administrative ease tax will not be collected from the Government itself, it will be a payment to itself, which would involve substantial cost. Further, a number of problems arise in this connection where there are more than one taxing body.

Exemption to Protect the Minimum of subsistence

Perhaps the most important issues in this connection are those involving the exemptions of individual incomes and the small amounts of personal property from taxation. Income and property taxes can be tailored to the personal situation of the tax payer.[4] Prof. Shoup, however, appears to disagree with this interpretation, because he has in view the incidence of the tax system rather than the operation of the particular tax. According to him this class of exemption arises practically from two considerations *viz.*, (1) to offset regressive effects of consumption taxes and (2) to simplify administrative problems. Thus according to him exemptions do not arise on account of the need for exemption of the subsistence minimum. This is, however, true only for those States which maintain the social provision for the subsistence minimum, which is also regarded as simplifying administration.

The problem of tax exemptions is particularly important in a democratic country like India which has for its objective a socialistic pattern, but is not a totally communist country. It is absolutely essential to fix up a minimum for tax exemptions, because a State guarantees and must guarantee, or at least aim at fulfilling

1. United Nations, : *The Effects of Taxation on Foreign Trade and Investment* 1950, p. 5.

2. (1819) 4 Law Ed. 579 (606) : 4 Wheat 316 (425, 426); also vide *The Constitution of India* (A. I. R. Commentaries by V. V. Chitaley, Vol. III, Article 246 Note 13, Pt. 7).

3. There are express provisions in the Constitution regarding the exemption from taxation of Government property (vide Articles 285, 288, 287 and 289).

4. Discussed comprehensively by A.G. Buehler, 'Taxation and the Minimum of Subsistence', *American Economic Review*, June 1933, pp. 234-44.

the essential needs of every individual. In a totally socialist State or rather an ideal communist State, the State provides it to every individual so there exists no importance regarding the question of exemptions on the basis of any minimum. But in this country where the State cannot undertake to provide with the minimum subsistence, lodging or other needs to every citizen, it becomes necessary that any levy must exempt a minimum. Direct taxes must leave a minimum untouched while indirect taxes should not be levied on commodities necessary for subsistence like food items including salt, *etc.*

In framing taxation policies, therefore, it is necessary to keep in view the minimum welfare norm, that is, the minimum standard of living to which every citizen is intended to be brought, consistent with the objectives of a real welfare State. This view may sometimes be lost sight of while using taxation as an equalitarian device, which may reduce the living standard of some people even below the minimum required for their welfare. For example in India, this principle of exempting the minimum is recognised in income-tax, but has been lost sight of in imposing certain taxes like the taxes on property such as estate duty.[1]

Another kind of exemption for this purpose is found in certain excises. The most common illustration is the exemption from sales tax of food, medicine and sometimes other related items. It is based on the theory that taxation on the necessities of life makes the burden of sales tax fall on the very poor and makes it more regressive than it otherwise would be. Exemptions should however be increased with rise in consumer price index.

It is a socially desired objective that if the upper-income level is reduced, the lower level of income must be protected. Thus tax exemption provides a differential treatment[2] towards the lower-income groups. This never means that the lower-income groups be reduced to minimum subsistence level. But the tax exemptions must be so arranged as to leave enough incentive for raising their standard of living.

Exemptions to Provide Incentives To Business Community

In a developing and mixed economy such exemptions are necessary to be provided with a view to give impetus to the national productions.[3]

Success of tax exemptions (or concessions) depend inter alia, upon the level of taxation. High taxation might impede investment seriously despite various exemptions(or concessions). Other restrictions, controls and regulations or frequent changes in them

1. Vide Chapter IV.
2. For example, Soviet system of exemptions is constructed to favour some groups and discriminate against others. It is also done in recognition of the burden of dependents.
3. Vide Chapter IV.

might also be a serious impediment. Meanwhile, aside from the possibility of favouritism, tax exemption (or concessions) tend to involve 'loopholes'. But it cannot be denied that they have virtues of their own.

Incidence of Taxation

Classical theories of shifting the incidence of taxes dealt with the analysis of each tax separately. They did not propound a general theory of shifting an incidence. According to Adam Smith, taxes on profits and necessary articles of subsistence are shifted. On the other hand taxes on land, on houses and on luxuries, are not shifted. Hence according to him, all taxes ultimately fall on the owners of land, houses and consumers of luxuries.[1]

Likewise, Ricardo dealt with the shifting of each tax separately.[2] His conclusions are more or less similar to that of Adam Smith's. The only difference lies in his new concept of rent and wages.

'Shifting' and 'Diffusion'

Canard was the first who tried to give a general theory of shifting. According to him every tax is shifted *ad infinitum*, till it is diffused equally over the whole of the national economy.

But, as De Viti De Marco marks out, shifting cannot continue *ad infinitum* in any case. The process of shifting ends, when it cannot be shifted. Yet it is agreed that taxes are partly or fully diffused over the whole of the national economy though it has been imposed only on a section of it. There is, however, a distinction between 'diffusion' and 'incidence'. "The former transfers the tax and makes it unnecessary for the *de jure* tax payer to reduce his private consumption; the latter imposes a contraction of consumption upon the one on whom the incidence falls, and extends this contraction to all the enterprises from which the latter buys, unless he succeeds in starting a new process of shifting on his own account."[3]

'Incidence' and 'Effect'

There is a fundamental difference between 'incidence' and 'effect'. Effects include both monetary and non-monetary burdens. Monetary burdens may be direct and immediate, or indirect and remote. The immediate or direct money burden is called the incidence of taxation. Though all direct monetary burdens may not come under incidence. For example, a tax on a commodity may reduce the income of the sellers of all other commodities employed in the production of the taxed commodity. All these come under 'effects'.[4]

1. Adam Smith, : *Wealth of Nations,* Book V, Chapter II, Part II, p. 653-723
2. Ricardo, *Principles of Political Economy and Taxation* (1891) vide taxes on raw produce, rent, gold, houses, profits, wages, other commodities than raw produce and tithes, *etc.*, Chapters VIII to XVIII.
3. Marco, Antonio De Viti De, : *First Principles of Public Finance*, p. 142.
4. Vide Mehta, J.K., and Agrawal, S.N., : *Public Finance*, p. 71.

What the term 'incidence of taxation' means, is little disputed. To describe in other words, it is the final setting of the tax burden upon the person who pays the tax, who cannot shift it any further. There is, however, sometimes a confusion as to whether incidence can be taken to include also the 'effects' of taxation ? For example, Bastable holds that "The burden of many taxes is greater than their yield, but it is hardly admissible to cut up this burden into two parts, one measured by state receipts, belonging to the topic of incidence, while the balance is treated as the 'effect' of taxation."[1] While Edgeworth is doubtful, "whether any money loss in excess of the amount of tax can properly be described as the incidence of a tax."[2] On the other hand, Cannan thinks it far better to consider the 'effect' of taxation and eschew the use of the term 'incidence'.[3]

Dalton discusses that it is undesirable and impracticable to maintain the distinction between 'incidence' and 'effects' of taxation,[4] however, while distinguishing between 'direct' and 'indirect' taxes he relies on the distinction between 'incidence' and 'effects' of taxes, but he mentions that "This distinction is less fundamental and useful than is commonly supposed, nor is the distinction always clear in common use."[5] Of course, he did not think the distinction to be completely erroneous.

Thus, Dalton, Shirras and others do attempt to make a distinction between the two by describing 'incidence' as 'direct money burden' and 'effects' as 'indirect money burden'.

The Modern Theory of Incidence

The modern theory of incidence is based on the general theory of value. Nature of shifting of taxes differ under different conditions, in accordance with the theory of value, as given below :—

(1) *Shifting (in the long run) under prefect competition*—

Under perfect competition surplus over costs,[6] will disappear in the long run. If a tax is imposed on a commodity under such conditions it must be regarded as an increase in the cost of production, and the whole of it must be shifted to the consumer in the form of increased price; because under such conditions price is equal to the cost of production. Or, it can also be explained in another way. Because tax can only be paid out of the surplus, the price must rise sufficiently to cover it. According to Richard

1. Bastable, C.F., : *Public Finance*, p. 361.
2. Edgeworth, F.Y., : *Papers relating to Political Economy*, Vol. II, p. 138.
3. Cannan, Edwin, in the Memoranda relating to the: *Classification and Incidence of Imperial and Local Taxation*, by the *Royal Commission on Taxation* (1899), p. 166. (Quoted by Seligman, : *Shifting and Incidence of Taxation*, p. 15 n)
4. Dalton, H., : *Public Finance*, vide Chapter VII.
5. Ibid., p. 51.
6. Vide p. 38.

Goode, "under conditions of pure competition, where free entry of new competitors is possible, there will be no profit or surplus above costs in the long run. Thus in the long run any kind of tax imposed on an industry characterised by conditions of pure competition will be shifted."[1]

But the demand is not perfectly inelastic. With increase in price demand will fall, and consequently supply will fall. Ultimately the price must be determined at the point where the demand for and the supply of the commodity are in equilibrium. How much will the price rise, will depend upon the elasticities of demand and supply. If a commodity is produced under conditions of diminishing returns, the rise in price caused by the tax will be offset to some extent by the lower costs of production as output falls. Conversely, if increasing returns prevail, price will tend to rise by more than the tax, since average costs of production will increase with falling output. Hence, it is not necessary that the price will rise equal to the amount of the tax. It may rise more than the amount of tax imposed or less.[2]

A tax may also be shifted to the factors of production in the shape of lower rewards to them (backward shifting). The extent to which such shifting will be possible, will depend upon the elasticity of supply of the factors of production. The lesser their elasticity of supply the greater amount of shifting to them will be possible.

(2) *Shifting under imperfect competition, or monopolistic conditions or dynamic state*—In real life competition is rarely perfect and changes are constantly occurring, and the influence of competition is impeded by constant friction. Entrepreneurs, therefore, are always able to secure profits. When competition is either absent, or imperfect, there exists surplus over cost.

Under imperfect competition, the price will settle at the point where the marginal cost and the marginal revenue are equal. But the marginal revenue is lower than the price. In order to maximise his profit, each producer will go on producing and selling so long as the extra cost of producing the additional unit is less than the addition to the total receipts made by selling that extra unit. Under such conditions he will be earning the maximum profit. Output will stop before the marginal cost becomes equal to the price. Now, under such conditions, if profits tax is imposed he cannot pass on the tax to the consumer, because then the demand will be reduced (as demand is never perfectly inelastic); and any reduction in demand at the point of equilibrium, when he was earning the maximum profit, will reduce his profit. Hence under imperfect competition or monopolistic conditions, the tax cannot be shifted.

1. Goode, Richard. : *The Corporation Income Tax* (1951), p. 54.
2. Vide Mehta, J.K, and Agrawal, S.N., : *'Public Finance'*, p. 75, *et seq.*

Such an argument is based on the assumption that the entrepreneur is having surplus over 'supply price',[1] out of which the tax can be paid. On the other hand, if the entrepreneur enjoys no surplus over 'supply price' after payment of tax, such a tax is bound to have disincentive effect[2], which will lead to the reduction in supply and consequently rise in price. Thus, ultimately, it will be shifted to the consumer in the form of increased price. How far it will be passed over to the consumer, will depend upon the elasticities of demand and supply.

De Viti De Marco too disagrees[3] with Seligman's conclusion—that a tax on the profits of a monopoly cannot be shifted. Businessmen, trade union leaders and others have again and again pointed out that the incidence of profits tax can and in fact is shifted to consumers.[4]

Shifting of Income Tax

Similarly, basing our argument on the theory of value it can be shown that a general tax on personal incomes also causes shifting. Many modern economists like Dalton, Pigou, Shirras and W. H. Coates hold that some taxes like income-tax cannot be shifted. Pigou,[5] for example, told the Colwyn Committee that income-tax did not directly affect prices, but only indirectly—by its effects on working and saving. Other economist witnesses put the same point of view, and the memorandum of W. H. Coates[6] is a detailed exposition of the same approach. It was perhaps due to the effect of the classical economists like Adam Smith and Ricardo who based their opinion on the shifting and incidence of taxes on their classification of income into three groups according to their source in rents, interests and wages. As we have already pointed out they held that taxes on lands, on houses and on luxuries are not shifted. Further, perhaps it was also due to relative stability of economic life at that time which led to such conclusions.

1. 'Supply price' includes both the 'prime cost' and 'supplementary cost'. The entrepreneur must recover the prime cost and the supplementary cost in the long run, while in the short run he need recover only the prime cost of production.

'Prime cost' is usually defined as that cost which varies with output and is consequently absent or zero when production is nil.

'Supplementary cost' is defined as the cost that is constant—that does not vary with the output—and which is consequently equal to the aggregate cost when the output is nil. (J.K. Mehta, *Advanced Economic Theory*, p. 159).

2. This is based upon the concept of 'rational being' who tries to maximise his profit, or at least aim for 'reasonable' or 'satisfactory' profits. It is generally believed to be a true proposition. "The most plausible hypothesis, supported by both empirical evidence and economic theory is, that some positive rate of rate of return on investment (net of tax) on the average and in the long run, is necessary cost to society of maintaining, improving and increasing its productive facilities." (Don M. Soule, : *The Journal of Finance*, September, 1959, p. 394).

3. Marco, De Viti De, : *First Principles of Public Finance*, p. 149.

4. Goode, R.,: *Corporation income-Tax*, 1951, p. 44-45.

5. Colwyn Committee, Pigou, Evidence-in-Chief, paras 30, 32 and oral evidence, quoted in the *Economic Record* (1937), p. 193.

6. Ibid.

As we have already dealt with, the modern theory of incidence of taxation is based upon the exchange relationship and is an application of the general theory of value. If it can be shown that there exists an exchange relationship, it can also be shown that there are greater possibilities of the tax being shifted. Because a tax can be shifted only through the process of exchange, that is, only if the taxea commodity is bought and sold.

Now, the sellers of income are buyers of commodities and services, and buyers of income are the sellers of these commodities and services. Thus there exists an exchange relationship, and hence personal income-tax can be shifted.[1]

Besides this, income may contain some surplus. Only if a tax is levied on this surplus, it is not shifted. But if the tax exceeds that surplus then that part of it which exceeds surplus is liable to be shifted in the form of increased price of income (or money) and/or decreased price of the commodities or services purchased.[2] As we have taken the case of a general (personal) income-tax, no untaxed field exists, and we cannot escape the tax anywhere by taking up alternative channels available.

Shifting of Corporate Income-tax

Taxation on corporate net income is justified mainly on the ground that it is a means of taxing that part of the income of share-holders which escapes personal income-tax, because of its retention in the corporation. If the corporate income-tax is shifted and is not actually borne by the share-holders, then the very purpose of the levy is not fulfilled. According to the traditional view it was held that corporate income-tax cannot be shifted, either in the long run or in the short run, because of the following reasons :—[3]

(1) it affects neither cost nor demand,

(2) there are few effective ways for profitable investment to avoid paying tax

(3) diversion of funds from investment to consumption would cause economic changes too general to be included in the usual definition of shifting.

Recent empirical studies[4] of corporate earnings tend to support the opinion widely held among businessmen, that corporate

1. Mehta, J.K ., and Agrawal, S.N., : *Public Finance*, p. 82 *et seq.*

2. On the other hand a profits tax or corporate income-tax would generally be shifted in the form of reduced wages and/or increased prices of the commodities sold as we have already discussed.

3. Sould, Don M., : *The Journal of Finance*, 'Shifting of Corporate Income Tax' (September 1959), p. 394.

4. Soule, Don M., op. cit., p. 390; also vide Paul W. Ellis, *Effect of Taxes upon Corporate Policy*, p. 58; Richard Goode, op. cit., p. 44; Committee for Economic development, 'A postwar Federal Tax in 1947 proceedings', *National Tax Association*, p. 123.

income-tax is just another cost, which must be charged from customers in the long run. The traditional argument that firms in perfect competition cannot directly shift an income-tax is, of course, valid for the short run. But such a conclusion is not true in the long run even under imperfect competition as we have already discussed. N. Kaldor[1] also comes to the conclusion that the existing taxes on company profits encourage monopolistic tendencies and are likely in the long run, to be shifted to the general consumer in the form of higher prices and profit margins. Very little information is available about the extent to which firms treat income-tax as expenses for purposes of price setting. But there appears[2] to be some tendency for the firms to treat income-taxes in this manner, and thus the income-tax on corporations may be shifted. Such a shifting is not without serious obstacles.

Complete shifting to the consumer is greatly restricted due to the fact that some firms earn more profit than others, due to the difference in the volume of their sale, particularly when the products are of different variety. Each firm will be more reluctant to shift because of the doubt as to the amount of tax borne by competitors and the price adjustment which they are likely to make. In some cases the uncertainties may be so great that no shifting will at all take place.[3]

On the other hand, there may be shifting of taxes from the successful to unsuccessful firms in the long run. This is due to the reason that corporate income-tax has differential effect on the ability of firms to acquire external funds when retail earnings are reduced on account of the tax. Hence a firm which is not able to acquire the necessary amount to finance improvement in its productive methods or the quality of the products, may reduce its earnings in the long run. As a consequence the demand is bound to decrease relative to other firms who might be able to procure more funds for improving their production and selling the products at lower costs. Because the changes do not occur in the same direction for all firms, a part of the tax burden is, therefore, in effect, shifted from successful to unsuccessful firms in the long run, relative to changes in after-tax earnings.[4]

General Theory of Shifting of Taxes

Taxes on commodities are also shifted through increase in price, and the price will be determined by forces of demand and supply. In actual practice it is not so easy to mark out the effects of taxes on price, as the tax may be only a small factor as compared to other forces determining the shape of demand and supply curve.

Further, we have also to consider the effects of public expen-

1. Kaldor, N., : *'An Expenditure Tax'* Chapter V, pp. 147-8.
2. Due John F., : *Government Finance* (1954), p. 237.
3. Ibid.
4. Soule, Don M., op cit., p. 397.

diture on demand and supply. Here lies an error that classical economists committed. Mr. M. Slade Kendrick holds that the economists have always neglected the effects of public expenditure on demand and incidence. He states that "Studies of the incidence of taxation commonly assume that the incidence of each tax may be examined without reference to the expenditure of the funds exacted by it. The usual discussion proceeds directly from a description of the tax to an analysis of its incidence under the conditions of supply and demand relevant to a consideration of this incidence."[1]

Elmer D.Fagan and Alfred G. Buehler also hold a similar view.[2] According to Fagan "This recognition of the influence of public expenditure rests ultimately upon supply-demand analysis by which the incidence of tax is usually determined."[3]

Despite these various factors affecting demand and supply curves, however, we can give a general statement that it can be shown that a tax, direct or indirect, is shifted, provided we can establish an exchange relationship and can justify the shifting through the general theory of value.

Shifting of Tax and Completely Socialised Economy

There is no shifting in a completely socialised economy. There the law of supply and demand has been replaced by the wages and prices fixed by the State. The free functioning of price system in a free economy working under law of demand and supply is absent there. Thus no question of tax shifting arises there, and the incidence of taxation, or rather, impact of taxation is where it is imposed. The State decides what is to be consumed, and by whom, and for what price. If the State wants to mop up the extra purchasing power due to rise in incomes, it may be done by fixing up high prices. The only limitation there, is the administrative inefficiency, if any. Taxes on commodities are, however, imposed simply for psychological reasons as we have already discussed. But in such a state it is not at all a question as to who bears the burden of a tax. For example, one who purchases a commodity pays the full amount of tax. Unlike this, in a free economy it is very difficult a task to ascertain as to who exactly bears the burden of tax and how much.

A democratic socialist State must, however, give freedom of choice to consumers. As a matter of fact, such a State will be in a position to do so to a much larger extent than is the case of a capitalist society with its inequality of income, its manufacturing and trading monopolies or semi-monopolies, and its huge outlay on advertisements. "There can be no doubt, however, that the price

1. Kendrick, M. Slade,: 'Public Expenditure : a Neglected Consideration in Tax Incidence Theory', : *The American Economic Review* (1930), p. 228.
2. *The American Economic Review* (1941) Comment on Incidence of Taxation, p. 110.
3. Fagan, : *The American Economic Review* (1937), The Incidence and Effects of Taxation, p. 725.

mechanism has to continue in a socialist society not only for the purpose of equating supplies and demands, but also for giving freedom to the consumer to determine the utilisation of his disposable income and giving guidance to the planning organisation in the determination of the pattern of production."[1]

TAXATION AS REGULATORY DEVICE

Introductory

A tax has been generally accepted as an instrument of revenue only, yet it is also used as a major instrument of regulation.

According to the pure theory of taxation, the only valid purpose of taxation is to raise revenue for the support of the Government; while aiming at any other object[2] will only be a trasgression outside the proper field of taxation as we have already referred to on p. 1.

The maxim, 'taxation for revenue' only is the outcome of the 19th century policy of *laissez-faire*. Adam Smith, though a champion of free enterprise, had proposed the employment of taxation to regulate certain activities (towards the end of 18th century). He suggests heavier taxation upon the fines on removal of lease[3] and on certain other kinds of rent in order to discourage such hurtful practices.[4] At another place he says that sometimes it is advantageous to lay some burden upon foreign for the encouragement of domestic industry.[5] He also mentions the use of taxation sometimes as an instrument of monopoly.[6] But his view was lost sight of.

Further, non-fiscal purposes of taxation were discarded also because of the fear that it might weaken its potentiality as an instrument of the revenue; balancing the budget being the aim. For example, a good protective tariff cannot be effectively protective and revenue yielder at the same time. "To mix up with one very important object another different and perhaps incompatible one, is to run the risk of falling in both.... If socialistic regime is the goal to be aimed at, there are more direct and more effective methods open than the manipulation of taxation."[7]

Moreover, because as it was considered difficult to establish quantitatively the relation between the cause and the effect, it was found difficult to formulate taxation to bring about definite ends. "No correlation can be established between the taxation and economic development. Influencing factors are many.....It is difficult to single out the influence of tax system of production."[8]

1. Note on "Implications of Socialist Pattern of Society in India", presented by Dr. V.K.R.V. Rao in OOTY Seminar (1959) *A.I.C.C. Economic Review*, July 22, 1959, p. 37.
2. Objectives of taxation discussed in Chapter III.
3. Adam Smith : *Wealth of Nations*, Vo. II, p. 421, Chapter II, Book V.
4. Ibid., p. 424.
5. Ibid., p. 40.
6. Ibid., p. 478.
7. Bastable C.F., : *Principles of Taxation*, p. 335; also Alfred G. Buehler : *Public Finance*, p. 574.
8. Balakrishna R., : *Commerce*, 15th May, 1958, p. 844.

It is also argued that taxation may work as a palliative and not as a cure. According to Taussig—"Progressive taxation, so far as it aims to correct unjustified inequalities evidently deals with results and not causes."[1] Stamp also says that progressive taxation "does not exist to do this, and it has its justification quite apart from this."[2] Lutz too holds the same view when he says that "Unfortunately the effects of progressive taxation are not dependent upon, nor determined by, the motives of those who believe in its use."[3]

Taxation for Regulation

This is a changed attitude towards taxation. According to this view taxation is not merely a means of raising revenue but also an instrument of regulation. "The basis of fiscal policy rests on the fact that the modern tax is a method of persuading or coercing the community (or a particular section of it) to vary the distribution of its expenditure, or to influence its propensity to earn and to save."[4] Also, "The budget today has become the most important means of attaining the economic and social ends...."[5]

Certain enthusiast economists like A. P. Lerner put the view in an extreme form of 'functional finance'.[6] He goes to the extent of saying that "Taxes should never be imposed for the sake of the tax revenues"[7] and that money can be created by Treasury or banking system. While relating one of the important effects of taxation on the economic behaviour of the public in making them spend less, he says that "it is these effects which should be considered seriously and not the availability of money for the government."[8] He describes his view by saying—"By their fruits shall ye know them."[9]

From the two views given above it is clear that the fundamental difference between them is that in one case the revenue purpose is paramount while other effects—restrictive, regulatory or destructive, are only incidental; but in the other case restrictive regulatory or destructive purposes are paramount, while revenue purpose is of minor importance.[10] In the words of Robert Jones, "It is one thing to choose our taxes and to distribute them so that there may be social and political gains as co-products and by-products. It is another thing to choose taxation mainly or chiefly as a means of reform."[11]

1. Taussing, : *Principles of Economics,* Vol. II, (ed. IV, 1939), p. 543.
2. Stamp, Josiah, : *The Fundamental Principles of Taxation* (1921), p. 177.
3. Lutz, Hakley L., : *Guide-posts to a Free Economy,* p. 73.
4. Illersic A.R., : *Government Finance and Fiscal Policy in Post-War Britain* (1955), Chapter IV, p. 48.
5. Ibid., p. 19.
6. Functional Finance—"The principle of disregarding all the traditional conception of what is 'sound' finance and judging fiscal measures only by their effects or the way they function in society' (Abba p. Lerner,' : *The Economics of Control,* Foot-note, p. 302).
7. Lerner, Abba P.,: *The Economics of Employment,* p. 113.
8. Lerner, Abba P.,: *The Economics of Control,* p. 308.
9. Ibid.
10. Lutz, Hakley Leist, : *Public Finance,* p. 259.
11. Jones R. : *The Nature and First Principles of Taxation,* p. 185.

The effects of taxation have not been denied but they have been ignored, because the aim of taxation was thought to be no other than revenue. According to Seligman "The Government cannot derive any revenue. . .without inevitably effecting social relations."[1] So also Beveridge says—"The state, though in a free society does not seek to control the spending of private citizens, either in amount or in direction, can influence their spending—cannot indeed avoid influencing it by taxation and other forms of fiscal policy."[2] So, in case of taxation when revenue is the only objective, there are always certain effects produced.[3]

The only type of effects taken into account while levying the tax was the negative one, embodied in the principle of 'getting the most feather with the least squawking' or 'crewing the rack to the point where they yell'. But from regulatory point of view we have also to consider the positive principle of taxing with best effects. The two types of effects are complementary to each other. Sometimes the incidental effects and the purposes intended might coincide, and in the words of Lutz—'In consequence, the first group becomes unwittingly, a collaborator with the second group although its members would indignantly deny any affiliation or sympathy of purpose." Robert Jones finds no good reason why such a potent weapon should be neglected.[4]

Taxation Versus Direct Methods of Control

Techniques of taxation and direct methods of control can make it possible to achieve the ends of socialism even in a capitalist economy, without bringing all means of production under State ownership. This is also what the Finance Minister of India (1948) pointed out, "What my own conception of a socialist economy is : socialist economy is judged by the end achieved by a policy, and not necessarily by the means adopted to achieve that end. If by a social economy is meant an economy in which poverty, hunger and disease will not exist, an economy in which every honest man shall be given an honest piece of work, an economy in which undue accumulation of wealth is not allowed in the hands of a few individuals, then. . . . I am all for a socialist economy. In the pursuit of that ideal and for its fulfilment if we find it necessary to have under control and ownership the means of production and distribution let us by all means have it. . . . merely to take under State ownership the means of production, will not by itself bring about a socialist order."[5] As a matter of fact, a community which allowed the possession of wealth,but disallowed its use for production in an uncontrolled way, would justly be called socialistic though not communistic.

1. Seligman,: *Essays in Taxation* VIIIth ed. (1913), p. 317.
2. Lord Beveridge, : *A Report on Full employment in a Free Society*, p. 30.
3. Gadgil, N.V., and Vittal Babu, V., : *Studies in Death Duties*, p. 28.
4. Jones R., : Op. cit., p. 185.
5. Chetty, R. K., Sanmukham, General Discussion on the General Budget (1948), Lok Sabha.

Only in a few countries the State has taken up all economic activities in its hands. Even there, in socialist countries, physical controls, though used to a greater degree are still not all pervasive. The free economy continues to function in some sectors. So long as the free economy survives, or there are loop-holes in it, financial policy remains important. "It is clear that direct controls are heavily relied upon by the Soviets to divert an extraordinarily large portion of the national output into investment. Nevertheless, in most markets a substantial degree of freedom still exists; money prices, and incentives, rather than physical controls are the prime movers. Because of the very high level of government expenditure maintained, taxes are essential to the efficient operation of these markets."[1] In most countries there is mixed economy. Of course, as we have mentioned before, the field of State enterprise may vary in different countries, depending upon the decisions regarding the relative efficiency of private and public enterprise in the achievement of economic ends and also non-economic ends. Yet it is now generally agreed that it is the duty of a State to interfere in some way with the operation of the free economy. Restriction of undesired economic activity through prohibitory taxes rather than by direct legislation, is a well accepted means of control.

Control of Consumption

It is believed that the true benefit (present or future) accruing to the society as a whole, cannot be actually determined from a particular consumption pattern established by ordinary market forces in a free economy. Hence control of consumption is important specially in the case of wage goods, if their supply do not increase with the increase in incomes. A more extensive form of control is affected by manipulation of market prices through taxation (or subsidies[2]). Thus the desired adjustment takes place through the medium of market prices.

The effects of a tax on price will depend upon the conditions of supply and on the elasticities of demand which we have already discussed. If the demand is highly elastic, consumption may be reduced to a greater extent than the increase in the rate of tax. If it is less than unity, the quantity consumed will not decline in as great a proportion as the rise in the rate of tax. On the other hand consumption will be affected to a much smaller extent if its demand is comparatively more inelastic. Thus the knowledge of elasticity of demand can play an important role in the use of taxation as an instrument of control. However, its use is not without limitations.

For example, sales tax on consumption goods has been used in

1. Holzman, : *Soviet Taxation*, p. 21.

2. Subsidy is quite relevant in this connection, as it may be given in the form of exemption and allowances while levying taxes. However, we would drop the word subsidies in further discussion. Converse of what is true for taxes may be taken to be true for subsidies.

many countries, but its effectiveness has been limited because of its application mainly to cities. Furthermore, levying of sales tax tends to increase the price of consumer goods, and a rise in the prices of wage goods tends to cause wages, and therefore, other prices to rise.

There may be direct methods too, besides taxation, for control of consumption. But they are not free from certain serious drawbacks and limitations on account of which we are bound to accept taxation as a better means of control of consumption than the other direct methods. The following are the limitations for the direct methods of control :

Only in countries with an efficient administration (for example Japan), or where there is a fair concentration in the sources of supply of consumption goods (Ceylon), rationing can be effectively applied to check the increase in consumption arising from an increase in incomes. For example, quantitative import control along with rationing, is quite effective in checking consumption in the countries dependent on imports of the consumer goods. Here also price control without rationing might result in poor distribution and black marketing. On the other hand in countries like India, not dependent on import of consumer goods, or where consumer goods are produced by scattered small units rather than by a few large producing units, it is more difficult to restrict private consumption through rationing. Since consumer credit is not important in these countries it is also difficult to restrict consumer demand through credit control. Further, rationing is particularly a war-time measure.[1] "The idea behind price control and rationing in the present circumstances seems indeed to be to provide a breathing space, which will permit ultimate adjustment of the inflated money income to goods, through a gradual expansion in the output of the latter. Even from this point of view the experience of countries where price control is practised is not altogether reassuring, the transition being marked by all kinds of leakages."[2] In normal times rationing has several disadvantages as stated below :

First, a method of direct control is a threat to freedom.[3] The free choice of the people is restricted and they cannot get the most

1. The term rationing is of military origin—meaning, apportionment to each member of a group his due share of supplies, was first applied to the nation-wide distribution of food in World War I. During World War II it was practised not only by belligerent Governments, but also in neutral countries faced with shortages and high prices.

2. *Economic Bulletin for Asia and Far East* (1951), 'Inflation and Mobilization of Domestic Capital in Under-developed countries, p. 26.

3. An economy may justifiably claim to be socialistic while yet tolerating free posession, free demand, free employment and a more or less unrestricted use of money. "It is equally true that a socialistic community without the sacrifice of any essential principle may allow perfect freedom of demand to the consumer. Economically the existence of socialistic State is compatible with the toleration of free demand." (D.G. Karve, *Indian Journal of Economics* 1940-41, p. 495.)

satisfaction out of their incomes which they could have done in the absence of rationing. Their demands are suppressed rather than cut down under methods of direct control, as their desire to purchase certain commodities remains unfulfilled due to fixed quotas (assuming the absence of black markets). On the other hand, in case of taxation, the demand is cut down rather than suppressed, because the desire can be fulfilled on paying higher prices, and therefore, cannot be suppressed, though generally it is cut down by consumers themselves as a result of rise in prices due to taxation. It is thus the ultimate choice of the consumer under existing circumstances which makes him cut down his demand for particular commodities, or to change his consumption pattern.

Secondly, rationing restricts the normal forces of business incentives and impedes the natural trends of investment determined by the mechanism of competition, free enterprise and free market.[1] This may go against the spirit of planning, as Meade points out—"If a planner necessarily believes in a quantitative programe of output, employment, and sales for particular industries, occupations and markets, and the exercise of such direct controls by the State are necessary to carry this out, I am certainly no planner. If an antiplanner necessarily desires that the state should so influence the working of the price mechanism that certain major objectives of full employment, stability, equity, freedom and the like are achieved then I am a planner."[2]

Thirdly, the cost of the administrative machinery to be employed for affecting controls is bound to be inefficient, clumsy and wasteful, as compared with a properly functioning price system in a free market.

Lastly, a system of direct controls is a breeding ground for corruption and black marketing.

Thus the methods of direct control to check consumption are not suitable. Hence the use of taxation is to be counted upon largely to restrict consumption despite the various limitations in its use as already mentioned. For doing this, however, an analysis of the consumer pattern is necessary, and the taxes—direct or indirect, may be imposed according to the need of restricting the consumption of desired commodities.

Control of Investment

Discriminate[3] use of taxes may be exercised to affect investment. Taxes[4] may discriminate between industries in the following ways—

1. The greatest restriction of freedom arises from the problem of allocating labour as a factor of production among its various alternative employments necessitated under methods of direct control.
2. Meade, J. Edward, : *Planning and Price Mechanism* p. v.
3. Indiscrimate levy of taxes, if at all employed may be only from revenue point of view, but it will be generally a short sighted policy.
4. Converse of what is true for taxation is true for subsidies or grants.

(1) Taxes may be employed discriminately between the profits paid out in dividends, and the profits retained as reserves in the business. For example, when investment is to be encouraged, distributed profits may be taxed at higher rates. The Royal Commission on Taxation of Profits and Income (1955) has, however, recommended against such discrimination, since it finds no use in promoting the mere retention of profits which might not actually be reinvested, and even if reinvested were likely to be invested in the originating industry with less free choice than the new issues in the market had.[1]

(2) Another method of discrimination is, that allowances for depreciation or for new investments may be raised for the industries which the Government wants to expand, while cutting it down for the industries which the Government wants to discourage.

(3) Control both in volume and in direction over fields of investment, where imported equipment or material is required, can be exercised in the form of differential import duties.

(4) Excise duties and sales tax are levied on certain products to check their purchase, thereby indirectly discouraging investment in the industries producing those articles.

Besides taxation, there are also the methods of direct control of investment. However, such methods are not free from limitations which are mentioned below :

(1) In countries like Ceylon, India and Pakistan funds are made available to the private sector through the development corporations controlled by Government. The Government exercises control over a considerable amount of private investment financed by it, in regard to the amount and direction.

But direct control of private investment, not dependent on Government finance, is limited.

(2) Capital issue authorities also facilitate control over private investment. But in countries like India and Pakistan they are not concerned with restricting the level of private investment from inflationary point of view, but with ensuring that only genuine promoters of private investment are given Government approval. While taxes may well be adjusted to restrict the level of investment from inflationary point of view.

(3) Rationing of the import of raw materials was only a wartime measure, which is now practically abolished in Japan and India at least.

(4) A pre-requisite for investors to enter into a particular enterprise is the prospects in it including the burden of taxation. It is only after they have decided to enter into a particular enterprise that they proceed for licence from the Government which is issued after an examination in the light of the requirements of the

1. *Royal Commission on Taxation of Profits and Income* (1955), p. 159.

development Plans (for example, in India). Even if there be a need to increase investment in particular direction, investors might not find enough incentive to take it up. Hence, licence method of control without corresponding adjustment of taxation to give incentives is only a partial one. On the other hand, a discriminatory tax system may go a long way in fulfilling both the conditions—control in one direction and incentives on the other, without destroying the freedom of private enterprise.[1]

Limitations of Taxation as an Instrument of Regulation

Taxation for non-fiscal purposes can only be justified when this is the only effective way of regulation,[2] otherwise the State may be unnecessarily loading itself with burden.[3] It is also to be judged when loss of revenue is offset by the gain on account of such application to non-fiscal purposes.

No doubt, taxation is a very potent weapon of regulation, yet it must be remembered that taxation cannot be regarded as a very effective general instrument,[4] and not at all a panacea.[5] Though a passive instrument, it is not a full exhaustive instrument.[6] We have also referred to it previously that it deals with results and not causes. Taxation can stimulate consumer demand and investment, or influence the marginal decisions of entrepreneurs; but it cannot change the behaviour of individuals.[7]

In spite of the various limitations of taxation, the use of the tax system as a legitimate instrument of regulation is now among the accepted commonplace of finance.[8] It may certainly provide incentives and correctives to the course of economic development. "It is true that taxes are continually being levied with a view to the regulation or prohibition of certain activities and practices, but it is always difficult to reconcile such operations with the true nature of taxing power."[9]

Conclusions

The principle of taxation for non-fiscal purposes is commonly being accepted. But the weapon, if used at all, should be handled with caution. In the words of Buehler "The effectiveness of regulatory taxation may be increased by the proper observance of economic principles; but it is still in the embryonic stage and requires a perfection of technique in its use and an intelligent

1. *Report of the Working Party* convened by the Economic Commission for Asia and Far East (1953), described the twin purposes of taxation in the countries under reference, that it should 'limit the growth of consumption, while expanding the rate of investent.'
2. Buehler Alfred G., : *Public Finance*, p. 597.
3. Baljit Singh : *Federal Finance and Under-developed Economy*, p. 38.
4. Colm Gerhard : *Essays in Public Finance and Fiscal Policy*, p. 85.
5. *Readings in Fiscal Policy*, p. 362.
6. *View Point on Public Finance*, Edited by Harold M. Groves, p. 712.
7. Colm, G., op. cit., p. 85.
8. Karve, D.G., : *Economic Problems of Modern India*, Edited by Radha Kamal Mukerji and H.L. Dey, p. 451.
9. Lutz. Harley, L., : *Public Finance*, p. 249.

appreciation of its results, if it is to serve mankind more adequately."[1]

The effects of the taxation, whether it is for revenue or non-revenue purpose, are to be studied and such taxes are to be used as fit in the national objectives. In order to estimate the behaviour and inter-relation between consumption, saving and investment, social accounting method is to be applied. Throughout the war period both in U.K. and U.S.A. Public Finance was successfully used as an instrument of policy within the frame work of social accounting. This method would also check mistakes and the indiscriminate use of public means.[2]

Now taxation has become a part of public policy.[3] 'It cannot solve the problem of stabilizing our economy, but the economy probably cannot be stabilized without such a tax policy."[4]

1. Buehler Alfred, G., op. cit, p. 598.
2. (Mrs) Hicks, Ursula, : *Public Finance an Instrument of Policy* (Lecture under the auspices of Delhi School of Economics, February, (1950).
3. Discussed in Chapter III.
4. Colm, G., op. cit., p. 85.

2

TAX CO-ORDINATION

Federal Financial Integration

The history of formation of the present Union of India has an important bearing on the Union-State financial relations. The importance lies in the fact that it is formed by reconciling two kinds of integrating units. First, there were Indian States which had been more or less independent, which numbered about 600 before 1947. Some were as small as a few square miles with revenue of a few lacs of rupees, while others were as large as 80,000 square miles with revenue of millions of rupees. During the British rule they had the tax systems of their own. Secondly, there were Provinces, which prior to 1921 were like local Governments, and later on enjoyed more powers reaching the stage of Provincial autonomy in 1935.

Indian States were merged by four processes. First, some States which were very small were merged in the neighbouring States. Secondly, some were merged into new States or Unions of States. Thirdly, those which were too large to be merged but too small to be separate units, were treated as Part C States, and lastly a few were considered as units in themselves. The number of such Princely States was reduced to 9 Part B States. On the other hand Indian Provinces were called Part A States.

Next, it became necessary to review and redetermine fiscal and financial relationship of Part B States with the Central Government. Accordingly, in October, 1948, Indian States Finances Enquiry Committee was appointed to examine and report *inter alia* the desirability and feasibility of integrating federal finance in Indian States and States-Unions with that of the rest of India, so as to establish a uniform system of federal finance, the manner in which federal financial integration may be best affected and any consequential financial adjustment that may be necessary between the Centre and the States.

As the 'States' and 'Provinces' were equal partners in the Union, the Committee felt that the process of integrating the

federal finances of the States with those of the Union Government should be complete in all essential respects from the outset, but they recommended a gradual process, so that financial integration may involve little disturbance to the finances of the States concerned. The recommendations were accepted by the Government with slight modifications.

Accordingly, the Government of India concluded agreements with each of the seven States[1], and the States subject to Article 278 of the Constitution according to which any such agreement with the Government of a Part B State was to remain in force for a period not exceeding ten years. The agreement might be modified or terminated at the end of five years if it was deemed necessary to do so after considering the report of the Finance Commission. On a 'functional' basis, the items of revenue like customs duties, taxation of income excluding agricultural income, central excises, railways, posts and telegraphs, and the items of expenditure like defence, broadcasting, national highways, currency, coinage and mint, census, aviation, patents, and accounts and audits, were taken over by the Central Government. The allocation of outstanding assets and liabilities of each State between the Centre and the State was also made according to the 'functional' division. Thus all assets and liabilities associated with 'Provincial' functions remained with the newly formed States.

The principles of federal financial integration underlying the agreement with the different Part B States were the same. At the same time as any undue dislocation of a State's budgetary position was necessary to be avoided, and partly in view of certain important differences in the relative tax structure, certain temporary concessions were made to some States. Inland customs duties were to be abolished as they constituted a barrier to the trade, and the loss in revenue was to be borne wholly by the States. But Rajasthan, Madhya Bharat and Hyderabad derived large revenues from this source which they could not immediately give up. Therefore, it was agreed that Madhya Bharat and Rajasthan would abolish the duties in five years and Hyderabad in four years, during which period they would develop alternative sources of revenue.

As for income-tax which is now a Central subject, full Indian rates were applicable from 1950-51 in *Pepsu* and Travancore-Cochin. In Madhya Bharat and Rajasthan, income-tax was introduced at the rates in force in Saurastra. The rates were raised gradually to the Indian level within a period of 2 to 6 years

1. Of the States included in Part B, Schedule I of the Constitution of India, Vindhya Pradesh was administered by the Central Government, and Jammu and Kashmir were not then financially integrated with the Indian Union. Hyderabad, Mysore, Rajasthan, Travancore-Cochin, Saurasthra and Madhya Bharat were financially integrated with the Indian Union as from April 1, 1950, and Patiala and East Punjab States Union as from 13th April 1950. This study therefore deals with the finances of these seven states.

in all the States. No State could participate in the all-India divisible pool of income-tax until two years after the full level of Indian taxation had been reached. Meanwhile, the *ad hoc* arrangement was that a State would receive half the income-tax collections (other than agricultural income-tax) within the State. The Scheme of financial integration thus placed the new States and States Unions in the same position as Part A States vis-a-vis the Centre. As from 1950-51 they were entitled to a share of income-tax (subject to the proviso stated above), food subsidies, development and other grants-in-aid, and loans from the Centre, in the same way as Part A States.

Federal-State-Local Tax Co-Ordination[1]

Federal, State and local Governments all serve people of the same Federation, and are, therefore, correlated. The Federal Government, therefore, cannot disregard the effect of its action. It has responsibility towards other Governments—State and local, in so far as the national policy is to be promoted. Likewise, a State Government also has responsibility towards local Governments. Taxation is an effective instrument, through the use of which the national policy can well be promoted. This can best be achieved by a co-ordinated scheme of taxation for Federal, State and local Governments.

Too much centralisation of taxes would have a tendency towards a unitary system, whereby State revenues are bound to be weakened by dependence,[2] uncertainty and to some extent inelasticity. Centralisation of taxes (as for example in Australia) cannot claim to solve the problem of differences in income and standard of living of different areas. "Fiscal experience indicates that centralisation might solve the formal issues of federalism as in the U.S.S.R., but offers no guarantee to aid economic development

1. Problem of tax co-ordination is only one aspect of the whole problem of 'Integration', which comprises of a number of facets—some are in the field of integration proper, while others are the problems of co-ordination. They are enumerated as :

(1) integration of the different structural detail of any single tax, *e.g.* the scope, rates, exemptions, allowances and so on,

(2) integration of the direct (or indirect) taxes among themselves, *e.g.*, the personal income-tax with the taxes on corporation incomes, bonus shares, dividends, wealth, etc.;

(3) Integration of the direct and indirect tax facets of the system, *e.g.*, taxes on companies with excises and sales taxes affecting them;

(4) integration of the short, intermediate and long-period facets of taxation;

(5) integration of tax policy with the rest of fiscal policy;

(6) co-ordinating fiscal and monetary policies;

(7) co-ordinating the fiscal—tax, expenditure and debt—policies of public bodies at all levels, *i.e.*, Federal, State and local bodies :

(8) co-ordinating fiscal and monetary policies with the other related ones, such as price, wage, trade, and industrial policies, and so on. (M. H. Gopal, Presidential Address to 41st Session of All India Economic Conference 1958).

2. Vide, p. 75.

or reduce poverty."[1] Also, considerations of efficiency and economy suggest that the widening of the administrative base of a number of taxes is necessary. That is achieved by reserving the main taxes for the Federal Government and sharing their proceeds with States. Here arises the problem of co-ordination to bring about fiscal harmony in the various Governmental units. Dr. Baljit Singh points out that, "both economic analysis and fiscal experience of the major countries having federal Constitutions drive home the point that the survival of federalism in the financial field depends on a very large degree of specialisation and co-ordination."[2]

In India successive attempts were made to evolve a co-ordinated scheme of Central, State and local taxation during British administration, particularly in the years 1921, 1928 and 1935. Provisions in the Constitution of 1950 regarding taxation, are to a greater extent based upon the Government of India Act, 1935.

Prior to 1921, the revenues of India were treated as constituting one undivided fund and applied for the purpose of the Government of India as a whole. The Provincial Governments had no inherent legal right to the revenues which they raised. These were assigned more or less on the basis of the estimated needs of the several Provinces, and this involved an apportionment, different for different provinces, of the more important sources of revenue which included land revenue, income-tax, stamps, excise and registration. At times, the Central authorities had to levy benevolences and at others to distribute doles according to the exigencies of finance.

In 1921, a new basis of financial settlement was introduced between the Centre and the Provinces to suit the wide measures of legislative, administrative and financial devolution made under the Montague-Chelmsford Reforms. Subjects in Governor's Provinces were classified as Central and Provincial with reference to the functions of the respective Governments, and there was a clear cut allocation in the matter of heads of revenue and expenditure. The Provinces also obtained a share in the growth of revenue from income-tax so far as that growth was attributable to the increase in the amount of income assessed in that Province, and they were also given powers to impose certain new taxes.

A readjustment of financial resources and obligations between the Centre and Provinces was further attempted to fit in with the machinery set up by the Government of India Act, 1935. The Act introduced a system by which the individual income-tax was shared between the Centre and Provinces. The system is in effect even to-day. In order to determine what part of the tax revenue should be shared between Centre and States, an enquiry was undertaken by Sir Otto Niemeyer in 1936. The Niemeyer award has become the basis on which the present distribution of income-

1. Dr. Baljit Singh, : *Federal Finance and Under-developed Economy*, p. 114.
2. Ibid., p. iv.

tax revenue has been built up by the later enquiries, including that of Finance Commissions of 1952 and 1957.

The present Union-State financial relation is the outcome of its historical tradition, the way in which the present Indian Union is formed, the immediate problems which were to be solved, the economic development schemes and the reorganisation of States.

Inter-Governmental tax relations inevitably have to be revised to accord with the changing conditions, which can best be done through the gradual process of adjustment and readjustment. The record of inter-governmental tax relations in our country during the past twenty years is the record of just that process. In this way the federal system of Government makes use of its flexibility in adapting itself to the changing conditions. This is needed all the more in the developing stage of a country.

Under the existing conditions of our country with varying expenditure levels in different States and varying proportions of social services, no attempt can be made to evolve a general formula applicable for a longer period. The first Finance Commission too said that "in present circumstances, when the country is in the process of carrying through a large development programme... and also due to unforeseeable factors like natural calamities... it is difficult to make a precast for the purpose of determining in advance the assistance that may be required."[1] Thus the Commissions have rightly not attempted to give a permanent solution which would never have been possible. Article 280 (1) of the new Constitution of India, therefore, provides that a Finance Commission be constituted after the expiration of every fifth year.

At present the taxes out of which allocations are made are, income-tax, Union Excise duties, estate duty, tax on railway fares and additional excise duties levied on a few commodities in lieu of sales tax levied by the States.

Income-Tax

Allocation of the proceeds from income-tax among the States began with Niemeyer Award, the main consideration of which was to end 'the chronic state of deficit' in some of the States. According to it 50% of the proceeds was to be distributed among States, and the scale of distribution was fixed partly on residence and partly on population. But it appears that the shares fixed were more or less arbitrary without any exact weightage given to population or residence.

Then on partition of the country in August 1947, Provincial shares were refixed, as was determined by the (Distribution of Revenues) Order of March 1948, passed by the Government of India. The basic scheme of Niemeyer was maintained. As a result, it did not correct the inter-State fiscal disparities. There was some dissatisfaction over the distribution of the Provincial

1. *The Finance Commission Report*, (1952), p. 101.

share of income-tax by the Government of India, and it was decided to have an expert and impartial enquiry to decide this issue, pending the setting up of a Finance Commission, which is provided in the new Constitution.

The Government of India accordingly invited Dr. C.D. Deshmukh (former Governor of Reserve Bank) to enquire into the matter and decide the allocation of States' share among them. His decision took effect from 1950-51 and remained in force till the report of the first Finance Commission. He only attempted to readjust the percentage of allocations on the basis of the basic structure evolved by Niemeyer. The percentages were distributed by him largely on the basis of population, making slight adjustments in favour of the weaker States. The award emphasized the needs of the divided States for a short term, but at the expense of the poorer States, like Assam, Bihar and Orissa. The divided States could have been, however, better financed through grants-in-aid rather than by increasing their share in the divisible pool of income-tax.

The Finance Commission of 1952 raised the divisible share in the net proceeds of income-tax from 50% to 55%. It also departed from the previous financial settlements, in the sense that it laid much greater emphasis on population as the basis, for fixing the scale of distribution. According to its recommendation, out of the divisible pool of income-tax 80% was to be distribued on the basis of population and 20% on the basis of collection. The scheme affected the transference of larger resources to the backward States.

Simultaneously with the recommendation of the first Finance Commission, the share of Part A States except Orissa decreased due to the increase in the number of claimant States from 9 to 16 as a result of the federal financial integration, but at the same time the divisible pool swelled up on account of the proceeds of income-tax, which were raised from the former Princely States.

The Finance Commission of 1957 increased the share in the divisible pool of income-tax from 55% to 60%. With a view to eliminating the factor of collection in stages, it proposed the distribution scheme in terms of 90% on the basis of population and 10% on the basis of collection.

The Finance Commission of 1961, however, considered that it would be fair and equitable to restore the formula of the first Commission for the distribution of income-tax, nearly 80 per cent on the basis of population and 20 per cent on the basis of collection. The Commission also increased the share of divisible pool of income-tax from 60% to 66⅔% (that is one third) of the net proceeds in any financial year of taxes on income other than agricultural income, except in so far as those proceeds represent proceeds attributable to Union territories or to taxes payable in respect of Union emoluments.

Differences Between the Bases Underlying the Schemes of the Finance Commissions of 1952 and 1957 :

The First Finance Commission increased the share of income-

tax assignable to States on various considertions, like the increase in the number of claimant States from 9 to 16, the decrease in the revenue from income-tax, due to the reason that concessions were given to some Part B States during the transitional period, and some increase in the cost of collection was expected.[1]

The Second Finance Commission realised the fact that income-tax in India has ceased to be an expanding source of revenue and its importance is decreasing in the tax structure.[2] Therefore, it cannot now be a major factor in the devolution of further revenues to the States.[3] Therefore, the percentages assigned to the States could not be raised on this basis. The Commission, however, raised the percentage only in view of the unanimous desire of the State.[4]

As regards the fixing of shares in the divisible pool, larger share was allotted by the first Finance Commission to the industrial and commercial States and the principle of collection was given fair weightage. This could be justified on the ground that land revenue was then an expanding source of revenue in agricultural States. Thus they were assigned smaller share of income-tax to allow greater share to the industrial and commercial States.

Now land revenue has declined to be an important source of revenue, while some taxes like sales tax, motor vehicles tax, electricity duty, entertainment and passenger taxes have increased the revenue of more developed and industrialised States. Therefore, the principle of collection cannot help in bringing about equitable basis of distribution. Thus the second Finance Commission came to the conclusion that "collection should be completely anandoned in favour of population as the basis of distribution."[5] Further they noted that this may result in a loss to a few States where collections are concentrated, and their revenue position should be safeguarded by taking it into account in the scheme of distribution.

Under the different financial settlements shares were allotted to States in the divisible part of income-tax as shown in the following Table.

1. *The Finance Commission Report* (1952), pp. 70-71.

2. Vide Chapter IV, p. 144.

3. The share of income-tax payable to the States next year (1961), shows further a decrease of Rs. 27.26 crores as a result of the merger of company Income-Tax in corporation tax, but it is the intention to make good the loss to the states by a specific grant till the next Finance Commission reports on the allocation of income-tax and necessary provision is being made in the expenditure estimates for this purpose. (Budget Speech, 1960-61).

4. *The Finance Commission Report* (1957), p. 39.

5. *The Finance Commission Report* (1957), p. 49.

Table 1

Shares in the Divisible Part of Income-tax under Different Financial Settlements

States	Niemeyer Award	Distribution of Revenues Order 1948	Deshmukh Award	Finance Commission 1952	Finance Commission II (Interim)	Finance Commission (Final Report)	Finance Commission of 1961
Madras	15	18	17.50	15.25	7.95 (reorganised)	8.40 (reorganised)	8.1*a*
Bombay	20	21	21.00	17.50	18.91	15.97	13.41 (Maharastra)
Bengal	20 (undivided)	12 (divided)	13.50	11.25	11.48	10.08	12.09
U.P.	15	19	18.00	15.75	15.59	16.36	14.42
M.P.	5	6	6.00	5.25	5.09	6.72	6.41
Punjab	8 (undivided)	5 (divided)	5.50	3.25	3.96	4.24	4.49
Assam	2	3	3.00	2.25	2.23	2.44	2.44
Orissa	2	3	3.00	3.40	3.46	3.73	3.44
Andhra Pradesh	—	—	—	—	8.01	8.12	7.71
Bihar	10	13	12.05	9.75	9.31	9.94	9.33
Kerala	—	—	—	—	3.60	3.64	3.55
Mysore	—	—	—	2.25	5.93	5.14	5.13
Rajasthan	—	—	—	3.50	3.47	4.09	3.97
Jammu & Kashmir	—	—	—	—	1.01	1.13	0.70
Total	97(a)	100.00	100.00	89.50(b)	100.00	100.00	95.22(c)

(*a*) Shares of North-West Frontier Province (1), and Sindh (2) are not shown in the Table.

(*b*) Shares of Hyderabad (4.50.; Madhya Bharat (1.75;) Patiala and East Punjab States Union (0.75); Saurashtra (1.00), and Travancore-Cochin (2.50) are not shown in the Table. Due to reorganisation of States they underwent territorial changes.

(*c*) Share of the new State of Gujrat (4.78) not shown in the table.

Union Excise Duty

With the decreasing importance of income-tax as a source of revenue, the Finance Commission of 1952, for the first time recommended that 40% of the excise duty on certain articles—matches, tobacco, including cigars and cigarettes, *etc.*, and vegetable products—be distributed among States according to certain fixed proportions based on population. The coverage and yield of excise duty has expanded considerably during recent years as the following Table shows .

Percentage of Central Excise to the Total Tax Revenue of the Central Governmental[1] (before payment to States)

Table 2

Year	Percentage	Year	Percentage
1944-45	10.65	1954-55	23.74
1946-47	12.47	1955-56	29.94
1950-51	12.80	1956-57	33.22
1951-52	16.73	1957-58	39.33
1952-53	18.50	1958-59	43.64
1953-54	22.59	1959-60	44.41
		1960-61	45.80

Therefore, the Finance Commission of 1952 observed that "any further substantial devolution of revenues to the States by sharing of taxes will have to come from union excise."[2]

The Commission justifiably recommended the sharing of only those excises with States which possessed high yield and were stable, being comparatively less affected by fluctuations in customs tariff. This would certainly avoid the elements of uncertainty and large fluctuations in the resource of the States through sharing of excise duties. The recommendation was accepted by the Government and was embodied in the Union Duties of Excise (Distribution) Act in 1953.

The second Finance Commission widened the range by increasing the number of duties to be shared. They added to the list, duties on sugar, tea, coffee, paper and vegetable non-essential oils; but they reduced the percentage of share to be distributed to 25%. With the widening of the range of the duties, the share of States out of this source increased.[3]

As regards the basis of distribution, because the statistics of consumption of important commodities subject to excise is not a ailable,population was taken as the sole basis of allocating shares by the first Commission. This method did not bring about equitable distribution. With this end in view the second Commission decided that 90% of the divisible pool of Union excise duties be

1. Calculated from the Statement I, and figures for 1944-45 and 1946-47 taken from the Budget Memoranda for 1946 and 1948.
2. *The Finance Commission Report* (1957), p. 42.
3. Vide Table 4, p. 84.

distributed on the basis of population and 10% be used for adjustments. The Finance Commission of 1961, for purposes of distribution included all the commodities on which excise duties were collected in 1960-61, excluding those on which the yield was below Rs. 50 Lakhs a year. From this computation the duty on motor spirit was excluded, 20% of which was to be distributed as special-purpose grant to be utilised for maintenance and improvement of communications.

Regarding the distribution of the States share of the divisible excises, the Commission did not think consumption to be the correct criterion to apply for distribution as in the range of the commodities subject to excise duty, producer goods and intermediaries, were left out. Further, the Commission considered that while population should continue to be the major factor for distribution, the relative weakness of the States, the disparity in the levels of development reached, the percentage of scheduled castes and tribes and backward classes in their population, *etc.*, should also be taken into account.

Estate Duty

Under the provisions of the Estate Duty Act, 1953, the entire net proceeds of estate duty on agricultural land were assigned to States. In respect of the duty on property other than agricultural land, the second Finance Commission was asked to recommend the principles which should govern its distribution amongst States, under Article 269 of the Constitution. The recommendations made by the Commission were accepted by the Government and were embodied in the provisions of the 'Estate Duty and Tax on Railway Passenger Fares Contribution Act, 1957.' The Act provided that the net proceeds of the estate duty levied and collected during a financial year, after deducting a sum equal to one percent as being attributable to Union territories, would be distributed among States as follows—(a) The amount attributable to immovable property would be distributed among States in proportion to the gross value of the immovable property situated in these States.[1] (b) The balance would be distributed amongst the States in proportion to their population. These principles were also accepted by the Finance Commission of 1961.

The Centre is not entitled to a share in the Tax. Therefore, the problem of distributing this tax is not difficult. But the contribution out of this source is not substantial.[2]

Tax on Railway Passenger Fares

The Railway Passenger Fares Act of 1957, provided for the levy of a tax on railway fares paid by passengers at the scheduled rates, under Section 5 of the Estate Duty and Taxes on Railway

1. The words of the Committee are not clear, unless they mean the gross value of only that immovable property located in each State, which has been brought into assessment in that year because otherwise it would not be feasible to ascertain the gross value of the entire immovable property located in that State.
2. Vide Table 4, p. 84.

Passenger Fares (Distribution) Act, 1957. As recommended by Second Finance Commission the net proceeds in any financial year, of the tax on railway passenger fares, after deducting a sum equal to $\frac{1}{4}$% of the said proceeds as attributable to Union territories were to be distributed amongst States. The allocation of shares was based on the principle that each State would get as nearly as possible, the share of the proceeds proportionate to the actual passenger travel on railways within its limits. This objective was achieved by working out percentages for distribution, on the basis of passenger earnings in each State. To avoid fluctuations, previous three years' figures were taken as the basis for fixing up the percentages. The Act imposing a tax on railway passenger fares was, however, repealed in April, 1961.

Additional Duties of Excise

Additional Duties of Excise (Goods of Special Importance) Act of 1957, provided for the levy and collection of additional duties on sugar, tobacco, cotton fabrics, rayon or artificial silk fabrics and cotton fabrics produced or manufactured in India. These duties are in addition to the duties payable under the Central Excise and Salt Act 1944 or other law for the time being in force, and they replaced the sales tax levied by the State Governments on these commodities. Out of the net proceeds of the tax 1% was to be retained by the Union, $1\frac{1}{4}$% were to be paid to the State of Jammu and Kashmir and the balance of the net proceeds from these commodities was distributable in accordance with the provisions of Section 4 of the Act read with second Schedule thereto. The Finance Commission (1957) tried to take consumption as a basis for distribution, but as most States were not in a position to supply accurate figures either of collection or of consumption, it used population also as a corrective in arriving at the basis of distribution. The Finance Commission of 1961 considered that, in view of the fact that the additional levy is in lieu of sales tax,it would be equitable to distribute the excess collections partly on the basis of the percentage increase in the collection of sales tax in each State since 1957-58 when the additional excise duties were imposed and partly on the basis of population.

Aid Based Upon Population

As described in the previous discussions the basis of population has been preferred to other methods like collection, need, origin per capita income, *etc.*, because their adequate date were not available. At the same time the Commissions observed that population is the best method of allocating the resources for development putposes. The first Finance Commission remarked, "Whatever the theoretical validity of alternative indices of contribution, a proper scheme of distribution should not overlook the broad purpose of the devolution of revenues to the States, which is to make larger funds available to them to meet their expanding responsibilities in respect of the welfare of their populations."[1]

1. *The Finance Commission Report* (1952) p. 75.

Sharing of Motor Taxes

A Central Road Fund came into being in 1929-30 which was built up out of an additional tax of 2 annas (raised to 2 ½ annas in 1956-57) a gallon on motor spirit. A part of the fund (one fifth in 1956-57)[1] has been reserved for works of special or of all-India importance, the balance being allocated to States for approved works. The basis of allocation has been determined by the ratio of the consumption of motor spirit in each administrative unit.

The Motor Vehicles Taxation Enquiry Committee (1950) had recommended a detailed Scheme for the earmarking of a part of the Central taxes for road development.

The Taxation Enquiry Commission conceded the equity of the claim by States for earmarking a definite share of motor taxes for expenditure on maintenance of roads. But its recommendations suggest drastic reduction of the shares proposed by the Motor Vehicles Enquiry Committee. The Share of 4½ annas per gallon from the Central fuel tax, as suggested by the Committee to be earmarked for credit to the State Road Development Fund, was pruned down by the Commission to 2½ anns per gallon.

Sharing of State Taxes by Local Bodies

The local bodies in India, unlike the U.S.A. and other European local authorities, do not share in the State revenues generally. However, the idea of State-local sharing has originated recently, as the following cases show :

Land Revenue—A recent development in certain States is the sharing of land revenue in addition to the allotment of land cess. The Taxation Enquiry Commission has suggested a higher percentage in case of share in land revenue for local bodies in rural areas. The minimum limit for it has been proposed by them to be kept at 15%. Bombay State subsequently announced its decision to allocate 30% of land revenue to village Panchayats in place of existing 15%, and another 5% to local bodies for the next five years.

State Motor Vehicles Tax—As the result of the recommendation of the Road Development Committee (1927), the States imposed higher taxes on motor vehicles, and wherever feasible abolished the taxes levied by local authorities[2] on motor vehicles. But the local bodies which suffered loss by the abolition of their own taxes receive compensation out of the proceeds of the State Motor Vehicles Tax. The compensation is usually based on the average income derived by them at the time they were deprived of the tax powers. Taxation Enquiry Commission has recommended that not less than a fourth of those proceeds should be earmarked for the purpose of such distribution.

1. Source : *Statistical Abstract*, 1957-58.
2. Vide Chapter VI, p. 326, Foot note.

Entertainment Tax—Entertainment tax is technically transferred to local authorities. But quite an appreciable percentage (about 10% to 12%) is retained as collection charges, so that virtually the State Government shares the proceeds of the tax with local bodies.

These are some cases where sharing of taxes by local bodies with States is involved.

Grants-in-Aid

The first statutory provision for grants-in-aid originated under the Government of India Act 1935, which were prescribed on the basis of Sir Otto Niemeyer's Report. Niemeyer treated grants-in-aid "as a form of residuary assistance for certain Provinces after taking into account the sharing of taxes and adjustment of debt."[1] Grants-in-aid recommended by him were unconditional grants. Later on specific type of grants were also given to the States. Thus at present there are both conditional and unconditional grants.

The first Finance Commission formulated the following principles for regulating grants-in-aid provided under clause (1) of Article 275 of the Constitution.[2]

(1) Budgetary need—The budgets of States should be reduced to a comparable basis by making adjustments in respect of abnormal, unusual and non-recurring items of revenue and expenditure.

(2) Tax effort—Due allowance should be made for 'clear cases' of failure of States to maximise tax effort.

(3) Economy in expenditure—In order not to place a premium upon extravagance, the State's endeavour to secure reasonable economies in expenditure should be taken into consideration.

(4) Standard of social services—Where standard of social services in any State are significantly lower than in others, it should qualify for special assistance.

(5) Special obligations—Special disabilities of States due to abnormal conditions beyond their control, should be provided for.

(6) Broad purposes of national importance—Grants may be made to certain States for the furtherance of broad purposes of national importance, such as primary education, in respect of which they may be specially backward.

So far as the second principle of 'tax effort' is concerned, the Commission held that the assessment of fiscal need requires, "an assessment of the general scope for additional taxation in the States

1. Qouted in the : *Finance Commission Report* (1957), p. 22.
2. *The Finance Commission Report* (1952), pp. 96-98; Also summarised in the *Report of the Finance Commission* (1957), p. 23.

and of their tax effort."[1] It is quite legitimate that States should try to increase their own resources before they should bank upon grants-in-aid. "A State which is prepared to raise the maximum amount of revenue through taxation is better entitled to Central assistance than a State which does not itself act sufficiently in the same direction."[2] This is so, because in a State in which the maximum effort has not been made to utilize its taxable resources, in words of the Finance Commission of 1952, "Assistance to such a State may have the effect of postponing action by the State to increase its own taxation. Such assistance from outside may thus go to relieve those who are comparatively well off, from the necessity of contributing more to State revenues rather than help to increase Public expenditure for the benefit of the general mass of the people."[3]

Thus the principle of 'Tax effort' must be a *sine qua non* of grants-in-aid. The first Finance Commission has admitted that, "it is only in clear cases of inadequate taxation that this should affect the quantum of assistance a State would otherwise be qualified to get."[4] The second Finance Commission, however, comments that "clear cases of inadequate taxation are difficult to determine."[5] The Commission bases its argument on the fact that it is "difficult to decide whether a State is taxing its people adequately in relation to their income and taxable capacity. Some kind of empirical judgment is inevitable."[6] The argument does not seem to be consistent with the postulates of limits to taxable capacity. If the limits to taxable capacity can be studied for the whole country it may be judged for States too. It may be a difficult task, but is not an impossible one.

For practical purposes, however, the Commission assumes that, if a State raised the additional revenue which it promised for the Plan, it would have done its part.

The second Finance Commission recommended the principle of grants-in-aid as follows :

(i) Fiscal needs in a comprehensive sense are to be determined by the priorities and provisions in the Plans itself. "In a Union, in which the Centre and the States co-operate for planned development grants-in-aid should subserve this end."[7]

(ii) The gap between the ordinary revenue of a State and its normal inescapable expenditure, as far as possible be met by sharing of taxes. Grants-in-aid should be "largely a residuary form of assistance given in the form of general and unconditional grants."[8]

1. *The Finance Commission Report* (1952), p. 96.
2. Ibid.
3. Ibid.
4. Ibid.
5. *The Finance Commission Report* (1957), p. 24.
6. Ibid.
7. *The Finance Commission Report* (1957), p. 25.
8. Ibid.

(iii) Grants for broad purposes may also be given. States would be under obligation to spend the whole amount in furtherance of the broad purposes indicated.

Role of Federal Aid

Federal Government, it is argued, commands over the most lucrative revenue sources, and particularly the most progressive taxes. Thus the Federal grants-in-aid would meet a larger share of increasing State and local expenses, at the same time making it possible to increase or even retain the overall progressivity of taxation in the country. Clearly enough, the objective of obtaining certain degree of progressivity in the tax system taken as a whole, does not require that each revenue source at every level of the Government should be progressive.

Grants-in-aid can provide substantial help to the backward States. For example, in our country Part C States which were small in size and population, and were comparatively backward in economic development, had a narrow tax base, and the important tax resource like sales tax were not fully developed by them. The grant from Centre constituted the largest single source to them.[1]

Grants-in-aid offer an immediate solution to the problem of limited taxable capacity of States or local Governments. But it may be inadequate, as the capacity of the Federal Government to give grants-in-aid has its own limitations depending on the overall taxable capacity of a country. No doubt these grants offer a method of spreading tax burden over the whole economy and thus avoiding excessive burden over any part of it. But it implies, on the other hand, an upward shift of the taxing responsibility to the Federal Government, which is in effect a separation of the taxing and spending functions.

Aid to Local Bodies

Grants and contributions from the superior authorities to local bodies form an important part of local revenues. This system of revenue transfer from the upper to the lower authority has assumed increasing importance and significance during recent years, on account of the ever widening gulf that exists between the local requirements and the local resources.

In our country, during recent years adequate measures were taken to finance local bodies. For example, post war reconstruction programme provide loans and subidies to local bodies Examples of the Federal help to local bodies are the grants-in-aid extended to the latter by the Union Government for the following purposes : (i) Development of primary education in the States where it was poorly developed, as recommended by the Finance Commission (1952). (ii) The National Water Supply and

1. In 1953-54 and 1954-55 grants-in-aid to Part C States accounted for about 72% and 64.4% respectively of the total revenue of these States.

Sanitation Programme, on the recommendations of the Committee on Local Bodies, and the second Conference of Local Self-Government. (iii) The rural water supply and drainage scheme of 1954.

As a matter of fact local bodies, whose role in the democratic structure has received due recognition, will fail to fulfil it unless provided with adequate finance. The tendency towards integration of finance is a necessary feature of not only Federal and State Governments but also of local bodies in the modern times. Proper integration of functions, and allocation of resources between the Federal or State Governments and local bodies, is to be suitably considered. It is to be kept in mind that the fiscal activities of local bodies—like levying of taxes, and expending it—have more obvious influence on the social well-being.[1] "As municipal administration increases in complexity and the demand grows for progress in sanitation and for other amenities of civic life, there is no aspect of municipal activities which more intimately affects the mass of citizens than the system of taxation to be adopted for the provision of necessary funds."[2]

States have power to allocate any of the taxes on their list to the local Governments, that is, to municipalities, district boards, village local self-Government units (Panchayats), but there is no general legislation to regulate the discretion of the State in this behalf. Instead of allocating taxes, sometimes tax proceeds are allocated to local bodies. That is, the State Government collects taxes for all units, and then it is transferred to them after retaining an appreciable percentage as collection charges. This method of allocation has some advantages. Since a single unit of Government collects taxes for all units, some saving in collection costs is effected, and a much more efficient machinery is secured. As an example, entertainment tax in certain States like Madras, Andhra and Mysore is transferred to local authorities, but 12% in Mysore and 10% in other States is retained as collection charges.

It is to be kept in view that the power of local Governments to use taxation as source of revenue is quite restricted. This is due to the fact that a local tax, as distinguished from a national tax, has great limitations on account of the smallness of area over which it is assessed. Thus Dalton points out, "Public authorities controlling comparatively small areas must face the possibility that their tax policy may drive persons and capital outside their areas. A small community, instituting a tax system much more progressive than those of its neighbours, might cause such an exodus and suffer by it."[3] Hence lies the importance of aid to local bodies.

Since grants-in-aid constitute a special feature of co-ordination,

1. Vide Chapter X, p. 440.
2. U.P. Government Resolution No. 3463/XI-271E, dated September 19, 1916, as given in : *Municipal Manual* 1933, p. 215.
3. Dalton, H., : *Public Finance*, p. 132.

it is necessary that the policy in regard to it be occasionally reviewed so as to produce the best effective results. Taxation Enquiry Commission has suggested a general purpose grant for all local bodies, except higher municipalities, to discharge their minimum functions. A minimum period of 3 to 5 years is suggested for these grants to ensure availability of funds on a continuous basis. Specific conditional grants stand on a different footing in view of their restricted purpose. Where loans prove inadequate, the case for subsidies would be justified on the test of urgency. The governing principle for the aid to local bodies, under conditions of expanding liabilities, should be sufficient supply of funds, provided that the necessry condition of utilising the funds effectively is satisfied.

Co-ordinated Tax Effort

It was considered by the Planning Commission that raising of resources for the Plan should be the joint responsibility of the Central and State Governments.[1] The Central Government and the Planning Commission have been suggesting to State Governments new measures of taxation[2] and expert enquiries have also been conducted by the Central Government in certain States.[3]

Chief Ministers also undertook a review of the recommendations made by the Taxation Enquiry Commission on State and local finances, and sent memoranda to the Central Government showing the possibilities for raising additional resources. They were also expected to make suggestions regarding the Commission's proposals for Central revenues and also regarding other matters like intensification of savings including schemes for compulsory savings.

Thus a co-ordinated tax effort was made during the Plan periods. Considering the co-ordination activities in the past, and the developing economy which would necessarily involve greater tax efforts to explore new avenues of taxation, and adjustment of the present tax system, it seems extremely desirable that a permanent body be set up for the purpose. It will be able to study constantly the changing conditions and to advise the Central, State and local Governments in the matter of co-ordination.

Inter-State Taxation Council

An inter-State taxation Council might be useful not only in the context of sales tax, as was recommended by the Taxation Enquiry Commission but also as regards other taxes for bringing out the desired co-ordination, and uniformity in methods, rates and procedures. Frinction between States can be avoided to a great extent if the ruling of the Council is accepted by them. Complicated points regarding inter-State taxation can be referred to the Council for its opinion.

1. The Planning Commission, : *First Five Year Plan*, Chapter III, Para 24.
2. Vide Chapter VI.
3. Vide Appendix III.

Co-ordinated levy of a tax will be in the interest of States themselves. The Council can bring about a settlement and fix up the maximum level of rates of a tax on different commodities in different States. It may be left to each State to adjust its own rates within the maximum fixed. This would provide a kind of flexibility according to the different conditions existing in different regions and the requirements of the States. The Council would greatly help the rationalisation of the tax structure of States. This would not only lessen the unpopularity of certain taxes, but is also likely to bring about better returns. Thus there lies a great need for establishing such a Council.

Double Taxation

Problem of double taxation necessarily lies in federations, due to the overlapping of tax jurisdictions, to the extent to which their Constitutions may allow. This would encourage competitive exploitation of the same source of revenue. The Union and State tax lists (as given in the seventh schedule of the Constitution of India, lists I and II) show that in our country the scope for double taxation is minimised. Complete control of the Union Government over the most important items of revenue, while transferring defined shares to States, though involving some amount of difficulties, have clearly established the jurisdiction of the Union Government, over most important fields. Further, the only taxes on the concurrent list, in which both the Union and State Governments formally have powers, are taxes on stamps and advertisements; but in both the cases, jurisdictions have been carefully defined in the Constitution so that there is no direct conflict.

In practice, however, certain taxes are competitive. For example, State sales taxes exploit largely the same field as Union customs and excise duties. So also State taxes on the movement of goods and passengers on railways and in land waterways, local octrois and Union terminal taxes are in conflict. Various inconsistencies have been tried to be removed from time to time. The levy of Central Sales tax has removed much controversy over the levy by State Governments on inter-State trade.[1] In a sense the State prohibition policies also impinge on Federal revenue from customs.[2]

The scope of double taxation by State and local Governments is rather limited. This is due to the reason that the State Government has discretion to impose restrictions on the local bodies in order to safeguard the infringement of its own tax jurisdiction. However, the overlapping of taxes between the State and local bodies may occur due to the misguided policy of the individual states.

Resources Transferred to States

There has been a progressive expansion in the transference of

1. Vide Chapter VI, p. 313 *et seq.*
2. Hicks, U.K., : *Public Finance Surveys* (1951), p. 69.

resources from the Central Government to States, particularly since 1945 as shown below.

Table 3

Resources made available to States (Rs. Crores)

Year	Shared Taxes	Grants	Loans	Total
1938-39	4.0	3.0	...	7.0
1945-46	50.3	9.7	2.8	42.8
1950-51	47.4	26.9	61.5	135.8
1951-52	52.9	33.9	73.3	160.1
1952-53	73.8	36.0	111.8	221.6
1953-54	72.8	45.8	154.7	272.8
1954-55	71.8	51.4	220.7	343.7
1955-56	81.4	48.2	261.9	391.5
1956-57	78.2	38.8	221.9	338.9
1957-58	120.9	114.4	283.6	518.9
1958-59	162.1	141.5	284.1	587.7
1959-60	169.9	181.6	295.0	646.5
1960-61	179.0	224.1	338.6	741.7
1961-62	178.4	216.6	452.4	847.4
1962-63	224.1	222.2	523.5	969.8
1963-64 (R.E.)	259.5	257.2	626.1	1,142.8
1964-65 (B.E.)	253.7	314.1	605.8	1,173.6

Source : Reserve Bank of India Bulletins, May 1958 and May 1964.

Note : (1) Figures for 1951-52 to 1956-57 relate to Part A and Part B States, and those for 1957-58 and 1958-59 to the reorganised States including Jammu and Kashmir.

The devolution of Central revenue has become a significant feature of the system of federal finance in India, the total share

Table 4

Tax Revenue Transferred to States[1] (Rs. Crores)

Year	Union Excise Duties	Taxes on Income	Estate Duty	Tax on Railway Passenger Fares	Total
1953-54	15.5	57.3	...	...	72.8
1954-55	15.1	55.9	0.6	...	71.6
1955-56	16.5	55.2	1.9	...	73.6
1956-57	18.2	58.8	2.4	...	79.4
1957-58	40.2	73.8	2.4	4.4	120.5
1958-59	72.9	75.8	2.4	10.8	1619.
1959-60	74.7	79.3	2.7	13.0	169.7
1960-61	75.1	87.3	2.9	13.7	179.0
1961-62	80.6	93.8	3.8	...	178.2
1962-63 (Revised)	78.9	95.2	3.9	...	178.9
1963-63 (Revised)	92.4	119.3	4.2	...	215.9
1964-65 (Budget)	93.9	108.5	4.3	...	206.7

Source : Memorandum to the Budgets of the Central Government Grant-in-lieu of Tax on Railway Passenger Fares is not shown in the above table which is Rs. 12.5 crores for these years.

1. Part C States were not given a share of divisible Taxes, as the provisions of Part XII of the Constitution did not apply to these States.

of Central taxes going to States is now more than treble since 1953-54, as will be clear from the following table.

The increase in the share of Central taxes received by States is largely due to the fact that the elasticity in Central revenues has affected the State revenues to a large extent. State Governments are also the beneficiaries of the additional efforts by the Central Government in the field of those taxes which are to be shared with the States.

The following table shows how the States were benefited during the second Plan period on account of the additional Central Taxation.

Table 5

Share of Additional Central Taxation (Rs. Crores)

	1956-57 Actuals	1957-58 Likely Actuals	1958-59 Agreed	1956-59 Total	Five Year Estimates 1956-61
	1	2	3	Cols 2 to 3	4
Andhra Pradesh	...	1.6	2.2	3.8	4.8
Assam	...	0.5	0.7	1.2	1.5
Bihar	.4	1.7	2.4	4.5	6.3
Bombay	...	2.6	3.7	6.3	8.9
Kerala	...	0.6	0.7	1.3	1'4
Madhya Pradesh	...	1.4	1.9	3.3	3.7
Madras	...	1.3	1.8	3.1	5.0
Mysore	...	1.0	1.3	2.3	2.4
Orissa	0.1	0.5	0.7	1.3	2.4
Punjab	0.6	1.5	5.1	7.2	23.0
Rajasthan	...	...	...	...	2.4
U.P.	...	3.1	4.3	7.4	10.3
West Bengal	0.2	1.3	1.8	3.3	5.5
Jammu & Kashmir	...	0.1	0.2	0.3	...

Source : The Planning Commission. The Review of the Progress of Second Five Year Plan 1958 (Compiled from the Tables).

The yield of most of the divisible taxes is also likely to improve in response to the growth in domestic output and national income.

In our country the Central Government dominates[1] over States not only by its control over larger resources, but also by the discretion it has in the choice of taxes to be shared, control over sales

1. In all Federations like Canada, Australia and United States there is a tendency towards centralisation. "The tax base has extended and such taxes are more efficiently handled by the federal government." R.N. Bhargava, Public Finance (1954). No. 3, Recent Trends in Federalism, p. 257. However, "In peace times the federal government has expansive sources of revenue, whereas the State Governments are burdened with expansive social services. With the changing conception of the duties and functions of the State, the demand for public services has expanded...The State governments are eminently suited to provide these services, but they do not have the fiscal capacity to finance them." (Ibid).

tax[1] and the emergency powers of the President.[2] This dominance is partly due to the need to build up planned economy with an end in view of maximising social welfare.[3] This is also partly attributable to the tradition of centralised administration. So far as this latter tendency can be assigned, it would limit the independence of the States and it would hinder the free growth of their tax systems.

The Central Government has substantial advantages over State Governments in raising revenue. But this is not a sufficient reason for making the State Governments largely dependent for their finances on Federal devolution of resources or grants. If the functions of the State Governments are to continue as such, the only alternative is that the State Governments should improve their tax systems, if they are to depend less on the Federal resources.

There may be generally three ways in which the State Tax systems can be strengthened. First, the States may act independently, making such changes in its tax structure as it deems best in accordance with its fiscal requirements, economic and political conditions. Secondly, the States may negotiate with Federal Government for its withdrawal from certain fields of Taxation now used by it jointly with them so that they could raise more revenue from these sources. This means the plan of separation of Federal and State tax sources. Thirdly, instead of asking for the separation of their tax sources from those of the Federal Governments, the States may seek a closer co-ordination while using the same tax base as the Federal Government, in order to be able to raise more revenue from the same sources.

In this country the problem of co-ordination in the field of direct taxation, generally does not arise due to the rigid constitutional provisions. There is, however, overlapping in certain cases of direct taxation as well. For example, in case of the tax on residential houses, local bodies charge a tax on the annual rental value, while income-tax is also charged on the same, though on half the rental value.

In the field of commodity taxation, the need for co-ordination is the greatest in India. For example, sales tax does not merely consist of a tax on sales in general, but it also includes special rates on specific commodities, many of which are subject to taxation by the Central Government in the form of excise duties.

1. The Sales tax could directly be influenced by the Centre as the President had extraordinary powers of declaring certain articles as essential, which States could not tax in that case. Now the Central Government has powers to regulate the tax on inter-State trade or Commerce, vide Chapter VI, p. 315.

2. Under Article 360 of the Constitution, when a financial emergency is declared, the State has to take directions from the Centre.

3. Vide R.N. Bhargava, the discussion for inter-regional transfer of resources based upon the maximisation of social utility, : *The Economic Journal*, March 1953, pp. 84-87, also : *The Theory and Working of Union Finance in India*, Chapter III. Also vide B.P. Adarkar, '*The Principles and Problems of Federal Finance*,' Chapter XI.

For any suitable scheme of co-ordination of Central, State and local taxation, it would be necessary first to carefully consider and determine the following issues which are necessary to arrive at proper conclusions.

First, whether the burden of taxation is to be distributed largely through direct taxes, or through indirect taxes. If it is more through the latter, then the State Governments in our country will have a larger role to play, because they command certain important taxes on commodities. Sales tax which is superior to the Central excise duty or customs duties,[1] is the most important example.

Secondly, we have to decide what functions are to be financed through taxes based on ability and what functions through taxes based on benefit. For example, the taxes based on the benefit principle are the most suitable for local bodies.[2]

Thirdly, it is to be determined what kind of functions and services are to be entrusted to Central, State and local Governments respectively. Then it would also be necessary to know, as to which functions are to be financed through State-wide taxes and which one through the nation-wide taxes.

Fourthly, we have to find out what is best in regard to the administrative efficiency, from point of area and the source of taxes.

Consideration of these issues would go a long way in establishing a proper tax co-ordination between the three levels of the Government, and would clear away many of the conflicts.

3

TAX POLICY

Tax policy may be defined, in the words of Robert Blough as "Tax programs that are designed to achieve desired objectives."[1] Thus tax policy is formulated out of the objectives to be achieved. The immediate objective of taxation is revenue. But the effects of taxation are many. And it is these effects which may be positively employed for the fulfilment of various objectives besides the revenue objective.

Objectives of Tax Policy

Choice of appropriate tax policy depends largely upon the correct choice of objectives to be fulfilled during a period. One objective may be postponed till the attainment of another more important objective. Emphasis on the one or the other objective will depend upon the current conditions of economy. As a mattsr of fact, over-emphasis laid on one particular objective will adversely react on the others. Hence the correct choice of priorities over objectives is a pre-requisite to an appropriate tax policy.

Tax policy forms a part of Governmental fiscal policy in particular and economic, social and political policies in general. In other words, it is "a social and political as well as an economic phenomena."[2] In accordance with the resolutions passed by the Indian National Congress, the economic policy which should govern planning in furtherance of the objectives stated in the Preamble and Directive Principles of State Policy in the Indian Constitution, and with a view to establishment of the socialist pattern of society, should be directed towards the following objectives, namely :

(*a*) Bringing the principal means of production under social ownership or control;

(*b*) speeding up production progressively;

1. Blough, R., : *Federal Taxing Process*, p. 3.
2. Galleti, Taxation and Agricultural Policy, : *Indian Journal of Economics*, July 1941, p. 73.

(*c*) securing equitable distribution of the national wealth;[1]

(*d*) leading to progressively fuller employment within a period of ten years; and

(*e*) raising the standard of the people.[2]

In its report presented to the Government of India, a Mission of the International Monetary Fund (I.M.F.) which visited this country during January-March 1953, gave an independent view of the fiscal, monetary and economic policies for India. They regarded 'development with stability' as her basic economic policy.[3] They held that the achievement of the objetives[4] of economic policy requires that the development be carried out in an environment of economic stability. As a matter of fact economic situation changes constantly within a country as well as outside. And it is necessary to take these changes into account from time to time, which means that economic policy has to be constantly reviewed and readjusted and, therefore, it has both a short-term and a long-term objective.

The statement of the long-term and the short-term objectives was given clearly by Dr. Deshmukh in a speech on economic policy at Lok Sabha as follows :—

"The long-term objectives of economic policy in any modern State are an increase of the national income, high and stable levels of employment, provision of certain minimum standards of services to all in matters of education, health and housing, and economic and social justice. These provide the long-range horizon which the planning authority has constantly kept in view."[5]

"But there are also short-term objectives which vary with circumstantances and what is more important, there is often a measure of conflict between short-term and long-term objectives. For instance, the attempt to push up investment rapidly may create an acute scarcity of consumer goods, while a curb on inflation may for a time react adversely on production and employment. Similarly, if any immediate increase in production is desired, higher prices and larger profits may offer promising results. But this might aggravate economic inequalities, besides having other adverse affects. Again, employment in a particular line can be safeguarded or even increased if considerations of productive efficiency are waived, but this may be prejudicial over a period to the growth of aggregate national production. Again there is the question of agricultural prices."[6]

1. a to c—resolutions adopted on Socialistic Pattern of Society at the Avadi Session (1955).
2. d and C—resolutions adopted at the Avadi Session on Economic policy.
3. I.M·F. Mission, op. cit. (Economc Development with Stability), p. 5.
4. The two objectives described by the I.M.F. Mission are—raising the standard of living, and economic and social progress (op. cit. pp. 1 to 7).
5. Deshmukh, C. D., op. cit., December 20, 1954.
6. Ibid.,

Further, John Mathai, the Finance Minister, stated that the short-term objectives are essentially important in transitional period. In his own words, "In a transitional period like this, it is essential to keep the working of the taxation system under constant review and readjust it in the light of chaging circumstances."[1]

The fundamental objective of the national economic policy is set out by the Government of India in its Resolution on Industrial Policy enunciated in April 1948. The resolution says—

"A dynamic national policy must, therefore, be directed to a continuous increase in production by all possible means, side by side, with measures to secure its equitable distribution. In the present state of the nation's economy, when the mass of the people are below the subsistence level, the emphasis should be on the expansion of production both agricultural and industrial."[2]

The Planning Commission supports the resolution in the following words.—

> "While it would be wrong in this sphere to think in static terms and to condone the existence or accentuation of sectional privileges, it is no less important to ensure a continuity of development without which, in fact, whatever measures, fiscal or other, might be adopted for promoting economic equality might only end up in dislocating production and even jeopardizing the prospects of ordered growth."[3]

A substantial and rapid increase in production, as an immediate objective,[4] therefore, takes precedence over the objective of the reduction of economic inequalities or any other objective. Under the present economic conditions of our country it is correct to hold such a view. It is wrongly believed that the argument against the reduction in inequalities is due to the vested interest. The fact is that the quantum of the national income is not so large relatively to the number of people in whose favour redistribution is to be effected.

1. Budget Speech, 1949-50, Para 35.
2. Government of Inda, *Resolution eof Industrial Policy*, April 6,1948, Para 2.
3. *First Five Year Plan* Chapter II, Para 3.
4. As regards priorities over industrial and agricultural production it is to be pointed out that increase in industrial production is a prerequisite in a developing economy. Dr. Baljit Singh too points out in his '*Economic Planning in India*' that the priorities have been wrongly placed in so far as it has been assumed that the agricultural development is a pre-conditon of industrial expansion "Theoretically industrialisation is a pre-condition, although it may not be a sufficient condition, of any agricultural development. Even for stability and sustenance of economic growth the rate of industral development must be higher than that of agricultural expansion. This is so because as our income increases our demand for industrial products increases more rapidly than that for agricultural goods." (op. cit. p. 24). However, he points out that if the private sector of industry rises to the task or is pulled to it, India's economy will be more balanced and dynamic at the end of the Plan period than ever before. (op. cit. p. 26).

The principle that redistribution of national income and wealth contributes to maximise social welfare, holds good only when the national dividend is quite large in relation to the number of people in whose favour distribution is to be made. But such is not the case for this country. U. K. furnishes a good example of it.[1] But even there it seems that the limit to the process of redistribution according to the Chancellor of Exchequer had reached and it was felt that it was desirable to concentrate on increasing the national dividend, as was observed in the 1948-49 issue of the Report on Currency and Finance, by the Reserve Bank of India.[2]

The rise in national income is but an estimate of the average rise in national product,[1]based on the magnitude and pattern of the proposed investment. Hence investment constitutes the main target. Thus the problem is to step up the rate of net investment in the economy, that is, to direct a larger proportion of national income into investment so as to put the resources to the maximum use which might be socially desirable.

Mixed Economy

Three ways have been generally described for diversion of savings, investment and enterprise into socially desirable channels, *viz.*, (1) complete socialisation, (2) leaving large scope for private enterprise in the planned economy, and (3) complete non-intervention with the functioning of private enterprise. With the end of the nineteenth century policy of complete non-intervention[3] Government has to play a larger role in national investment, and it is the second type with which we are concerned in a democratic socialist State, like India. It is usually called mixed economy. It is the term described to denote a "middle ground between complete private and complete public enterprises, in which we can combine civil and political liberties which we cherish, and

1. Vide Chapter XI, p. 471.
2. Reserve Bank of India, op. cit., p. 46.
3. In a modern Welfare State there is no difference of opinion about the needs for State intervention We must emphasise here that it is inevitable in a democratic set up that within the provisions of the Constitution and subject to Parliamentary control and direction, Government must determine what is in the public interest and to secure it in a best possible manner. The days are gone when it was the feeling that public ownership or public control is ,at best an avoidable evil.'

It must be mentioned here the conditions of the central issue of State planning and intervention from the point of view of the 'economies of welfare'—The 'welfare' arguments for extensive State intervention are based on the following grounds—

(i) that the State should intervene to control the total demand for goods and services.

(ii) that there are growing inequalities of income and property which laissez-faire had produced.

(ii) that those competitions result in waste where there is for one reason or other a divergence between the private and the social interest.

But in addition to these old arguments, there is a special argument, for a period through which we are now passing. The whole structure of our economy has to be changed on a scale and with a speed which is quite unprecedented in normal times of peace which cannot be done without State intervention.

the basic economic securities which we aspire..... A mixed economy of this kind means that responsibility for economic welfare of the nation is decentralised."[1]

In words of Harris, "We maintain our attachment to civil and political liberties. We retain our faith in private enterprise as a mainspring of economic activity in many important sectors of our economic life. But, particularly since the Great Depression, we have also come to accept a new responsibility on the part of government for the well-being of the nation. There are certain basic securities, such as protection against unemployment and provision for the aged and the destitute, which are increasingly recognised as a primary concern of government. We can be certain that if mass unemployment should again be with us, it will be to government that people will turn for action."[2]

Keynes, too, though he was an advocate of monetary measures as a chief way of controlling employment, came to look in his General Theory the State action, diverted to control the level of investment for the purpose. He says, "I conceive that a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment; though this need not exclude all manner of compromises and devices by which public authority will co-operate with private investment."[3]

Deshmukh, the Finance Minister of India, says, "The very fact that full employment has been accepted as the goal of policy all over the world, and that governments are expected to follow anticyclical policy, means that they must have at their disposal means for regulating the level of economic activity. In underdeveloped economies, where the resources, financial as well as managerial, at the disposal of the community are limited, the responsibilities which devolve on the State are inevitably greater."[4] Moreover, the problem of unemployment cannot be tackled successfully without significant increase in the rate of investment.

Thus the expansion of investment both in public and private sectors is necessary; each has its own part to play in the national economy.[5] Any discussion for and against the private sector is hardly helpful. In fact we find that today every national economy is a 'mixed economy' in varying proportions. Even the most socialised economy, like China, has a plenty of private enterprise. On the other hand, there are economies which rely mainly on private enterprise. This is true for the advanced capitalist countries. But even such countries have to correct through State action some of the shortcomings of private enterprise. Hence the solution lies not in the two extreme alternatives of State—doing nothing or everything, but in selecting the best out of the endless possible

1. Harris, *'Savings'*, p. 176.
2. Ibid., p. 175.
3. Quoted by A. C. Pigou, in ,Keynes' General Theory' (1956), p. 57.
4. Deshmukh, C. D., Speech at Lok Sabha on December 20, 1954.
5. Vide Chapter XI, p. 451.

variations of the mixtures of private and public sectors. But one thing is essential that, "State-owned industries should lead and determine the course of industrial development and become the basis for the establishment of socialist economy in its fully developed form."[1]

The 'mixed economy' is not one in which the relative proportions in the mixture remains unchanged. What should be the proportion[2] of the two is "a matter to be decided upon by careful weighing of the facts of the case and the overall requirements of any plan for development. . . . It is not correct to assume that any extension of one sector is necessarily an invasion of the other or contraction of opportunities. . . . To my mind there is no basic incompatibility between the public and private sectors."[3] The two sectors must be viewed "as parts of a single plan to be worked in co-ordination with each other and not as two independent sectors of our economy. The public sector has to expand rapidly, but the private sector also has to play an important part within the framework of the plans."[4] The question here is whether the investment seems likely to yield to the private investor a return sufficient to compensate for the risks and costs involved. In these decisions federal tax policy has a large bearing.

A developing economy which depends ultimately on incentives of private entrepreneurs faces a dilemma. It has to adjust taxation policy so as to keep up the incentive of private investment and capital formation, at the same time to derive enough revenue for meeting a plethora of functions. In the opinion of the Bengal Chamber of Commerce and Industry, "a sound taxation policy is one which while yielding adequate returns in the present, gives encouragement to rapid development of enterprise in the future. In the present and foreseeable conditions in India, however, fiscal efficiency does not cover only the yield of taxation, but to an increa-

1. Gyan Chand, : *The New Economy of China*, p. 123.

2. A note in the *Economic Bulletin for Asia and Far East*, Vol. VIII, No. 1, May, 1957, p. 3 clarifies the proposition regarding the proportion of the mixture of the two sectors in the economy in these words—

"Policy regarding the division of investment between the public and the private sector differs widely in the countries of the region. In some countries (India, Burma and Indonesia) the public sector is large and is progressively expanding. In India particularly there has been substantial growth recently, conspicuous examples being nationalization of life insurance and an important part of commercial banking. The new Industrial Policy Resolution of April 1956 redefines the boundary between public and private sectors, widening the public sector considerably. Certain other Governments have also issued statements clarifying the scope of the two sectors. Other things remaining the same, where the general area of the private sector shrinks, the area of foreign investment also automatically tends to shrink.

On the other hand, in Afghanistan, Ceylon, China, Taiwan and Southern Korea there has been an opposite shift from the public to the private sector."

3. Deshmukh, Speech at Lok Sabha on December 20, 1954.

4. Amritsar Session, February 1956, 'Resolutions on Economic Policy.'

sing degree involves considerations of the effect of taxation on the future level of enterprise."[1] Here the question of policy arises when we find that taxes collected in one way may have different economic effects from those levied in another way, because incentives are effected differently.

Usually the question of taxation is considered in view of the negative affects of taxation on incentives—that is to say disincentive effects on incentive to work, to save and to invest. But it should not be forgotten that as against the neutrality[2] approach of taxation, positive approach to the problem of economic incentives provides a rational basis for taxation. Tax instruments when wisely used make a positive contribution to the creation of capital, better climate for investment, balancing overall demand and supply, and above all the creation of wealth.[3]

However, it cannot be denied that considerations of disincentive effects necessarily tends to limit the use of tax policy as an instrument of revenue collection or for any other objective howsoever commendable. This is a specific problem for a mixed enterprise. On the other hand if there is no private enterprise and industries are all State-owned, then a necessary levy would be fixed on the price of the commodity, taking into consideration the need for sufficient capital reserves, replacement of equipment and expansion without any fear of disincentive effects.

The economy, where public ownership extends only over a limited field of business enterprise, presents a different problem for tax policy. So long as there is mixed economy it is reasonable that the industries—whether private, public or nationalised—should not pay or contribute to the treasury in the form of tax beyond what would be a reasonable charge to make upon the profits of industries. Therefore, in a mixed economy taxes have to be levied on the same basis on State as on private enterprise. For example, in Britain taxes on the profits of nationalised industries are levied exactly on the same basis as on the profits of private enterprise.[4]

1. Bengal Chambers of Commerce and Industry, Calcutta, *'Replies to the Questionnaire of the Taxation Enquiry Commission.'* (*Taxation Enquiry Commission Report* (Evidences) Vol. IV, p. 1).

2. As a matter of fact no tax is neutral, the very act of imposition of a tax has some effects.

3. These factors have been discussed in subsequent Chapters.

4. It is an anomaly in the Indian tax system that co-operative societies and industrial and public utility concerns run by a Government department are exempt from taxation. The Tyagi Committee has rightly recommended that since co-operative societies running transport services and factories deal not only with members but with the public and make huge profits, they should be taxed like other business concerns. There was a time when, in order to encourage co-operatives, they were exempted from taxation. But now that stage is past. Some of them are as much business concerns as any others and should pay taxes. It is palpably unfair that business enterprises run by Government department are exempt from taxation while other competing units in private enterprise are subject to taxation. However, the practice in foreign countries in regard to taxability of public enterprise varies. In U. K. the public corporations are not immune from taxation of any kind; in U.S.A. on the other hand, public enterprises are generally exempt from taxation.

In a mixed economy State enterprise also plays a limited role in revenue collection in the form of profits so as to supplement the general scheme of taxation.[1] Yet public sector can have requisite resources through various ways. It can have a share out of social savings, through internal borrowing,[2] or by deficit financing[3] or through heavy taxation.[4] Apart from this, the State may bank upon external loans and free aid. On the other hand, private sector can have a share out of private savings only. Hence it is not only the collective saving which is important for the promotion of the total investment of a country (planned or unplanned), but also the portion of the savings left over for private sector for its development in certain directions. Public savings should therefore, be raised at the expense of socially unproductive and idle resources.[5]

Prof. Nurkse too thinks that taxation is an effective instrument of collective savings,[6] but private enterprise is better suited than public enterprise to perform effectively the function of investment,[7] except in the case of investment in social overhead capital,[8] and in enabling investments in fields where permanent independent bodies organised under State auspices, capable of taking long-term view and pursuing them steadily would be effective.

The Fiscal Commission (1949-50) describes that the process of capital formation takes place under three stages. The first stage consists of the creation of savings. In the second stage, savings are mobilised for investment in trade, industry and agriculture. And in the last stage the funds so invested are converted into capital goods where 'capital formation' in the strict sense takes place.[9] Taxation has a bearing at each one of these stages, and obviously tax policy can play an important part in restricting or stimulating capital formation. Hence the search for additional tax proceeds must not forget to aim at stimulating capital formation in private sector as much as possible. Taxation is to be carried up to the point where our objective tests to the limits to taxation are satisfied, which have been discussed in Chapter VIII

1. In that case, price would include an element of tax.

2. 3. & 4. Briefly stating, a public loan is a protracted form of tax; it is loan in the first instance and tax in the long run. Creating of money is a disguised type of taxation, because instead of reducing the income of the people as in the case of taxation, deficit financing reduces the purchasing power of the income. It has, therefore, more or less the same effect immediately as taxes have. It is to be noted that this similarity between the three ways of obtaining funds—*viz.*, loans, creation of money and taxation hides some vital differences between them. The difference between the three ways, lies in the fact that they do not either take away money from the same set of people nor give it to the same category. Nor is the transfer in all the cases between the people of the same generation.

5. Vide Chapter.

6. Nurkse, Ragner, : *Probleme of Capital Formaton in Under-developed countries* (1953), p. 151.

7. Ibid., Page 152.

8. By Social overhead capital is meant 'public works and services, ranging from roads and railways to telegraph and telephone systems, power plants, water works and last but not least—schools and hospitals'

9. *Fiscal Commission Report* (1949-50) Chapter XV para 206.

The development of organised industries in India till independence was solely on private initiative. Almost all industries which have been established in the country today, owe their existence to the initiative and enterprise of the private sector. They comprise not only consumer goods—industries like cotton textiles, jute textiles, sugar, soap and paper; but also basic industries like steel, hydroelectricity, cement and chemicals, *etc.* After independence the policy of planned economy was adopted. The Prime Minister of India stated the policy as follows—

"It is true that inevitably if we have our way. . . . we go towards a socialistic pattern of society. Inevitably it means building up the public sector. The private sector remains. The private sector always remains. Because the private sector includes cottage industry and so many things. . . . And it may include some big industries too I do not know twenty years later what will happen. But the dominating feature will be the public sector. And the planning will be for the public and private sectors. The private sector will have to function within the ambit of that plan too."[1]

The First Five Year Plan estimated that the total planned and unplanned investment during the five year period would be about Rs. 3,500 crores of which the investment in the public sector was expected to be about Rs. 1,700 crores or about 50% of the total (actual figures are at about Rs. 1,600 crores). The investment of Rs. 1,800 crores in the private sector was made up of about Rs. 550 crores or about 16% of the total as planned investment in large scale industry, the remaining Rs. 1,250 crores or 34% of the total representing unplanned investment in private small scale industry, agriculture and housing, *etc.*

Under the Second Five Year Plan public sector was assigned to undertake larger investment. At the same time no less important place was assigned to the private sector in the development programme. It was estimated that the total investment in the private sector would be Rs. 2,400 crores as against Rs. 3,800 crores in the public sector. Thus the investment in public sector was about 61% of the total investment in the economy.

Table

Break-up of the anticipated investment in the large-scale industries during 1956-61 (In Billions of Rs).

	Public Sector	Private Sector	Total
Industrial machinery and capital goods	0.84	0.72	7.56
Other producer goods	4.63	2.96	7.59
Consumer goods	0.12	1.67	1.79
Total (Investment)	5.59	5.35	10.94

Including new investments of the National Development Corporation
Source : The Planning Commission, Second Five Year Plan (p. 416).

1. Nehru, Jawahar Lal, Speech on the resolution of the 'Socialistic Pattern of Society' at the Avadi Session of the Congress, January 21, 1955.

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The figures of the proposed investment in large-scale industries as given in Table on page 75, indicate that the private sector had an equal share with the public sector and that in public sector investment was confined largely to heavy and basic industries; but even there the private sector was supposed to play no small part. However, a contrast in the trends have been observed. The investments made during the first three years of the Second Plan in organised manufac- turing industries in the public sector amounted to Rs. 426 crores as against Rs. 563 crores in the private sector.[1] The figures show that contrary to what was envisaged in the Plan, the private sector was moving faster than the public sector.

The Third Five Year Plan envisages a total investment of Rs. 10,200 crores in the economy, out of which Rs 6,200 crores is in the public sector and Rs 4,000 crores in the private sector. The investment in public sector again comes to about 61 % of the total investment for the Third Plan also. Thus the private sector has yet to play an important role in the national economy. Dr. Gunnar Myrdal, the well-known economist of Sweden, addressing the members of the Indian Parliament in April 1958, had said, "Your public sector is relatively smaller than it is and—except for Britain, where the nationalisations are more recent—has ever been, in the richer countries in North-Western Europe who are usually not looking upon themselves as very socialistic."[2] His statement still holds good.

Taxation Versus Deficit Financing

A tax system can never be so adjusted in a mixed economy and under developing conditions (without causing some serious effects) as to annually equate federal revenues to total expenditure. This is because, a tax system has certain limitations like the impossibility of having the following conditions—(i) an access to too broad and stable tax bases, (ii) highly reliable prediction at long range of the revenue yield with certain tax rates and (iii) distribution of tax burden according to the will of legislator due to the impossibility of locating the exact incidence of taxation. Moreover, we have already referred to (in Chapter I, p.46) that the budget today has become the most important means of attaining the economic, social and other ends. To attain objectives other than raising revenue, balanced budget, therefore, cannot be helpful. Therefore, a State may resort to deficit financing as an alternative to increased taxation to cover expenses in excess of the Federal budgetary revenues.

The question, as to how far deficit financing[3] can be resorted

1. Deputy Minister of Planning, S. N. Mishra, reported in Rajya Sabha (Feb. 18), *The Leadar*, February 19, 1960.
2. Referred to by Debar, while speaking at the 64th session of the Indian National Congress, on January 9, 1959.
3. There is a difference between 'deficit financing' and 'deficit budgeting'. The latter may be resorted to as a matter of policy by deliberately planning the

to as an alternative to the increase in taxes to provide funds for public sector, keeping in view the effects on private sector in the long run, becomes a matter of policy. The question is closely related to the problem of inflation. How and under what conditions deficit financing causes inflation is to be determined.

Inflationary effects of deficit financing depend upon the conditions of employment and capacity for expansion in consumption goods. There may be three cases—

(1) If there is full employment and only capital investment is to be increased then consumption must be cut down. Under such conditions investment in public sector must be financed through more taxes and not through deficit financing. Because, if it is done through deficit financing, consumption must rise due to rise in incomes. As a result, resources are again employed for the production of more consumption goods to meet the increased demand and the very purpose of the deficit financing, that is, increasing investment in capital goods is defeated. If the supply of consumption goods falls short of the increased demand, prices will rise and persons who are benefited by increase in incomes may resort to more consumption, while persons with fixed incomes may suffer due to rise in prices.

(2) If there is unemployment and much scope lies for invesment in consumption goods, deficit financing may be resorted to, because then there may be more production of consumption goods by employing already unemployed labour and there is no danger of rise in prices. So long as unemployed labour exists there is no danger of inflation[1] and we can rely on deficit financing. This is the Keynsian model, where deficit financing is permissible. The model assumes the surplus capital resources also.

(3) There may be unemployed labour but not sufficient surplus capital resources (for example, in India). Under such conditions it is necessary that first capital resources shoud be increased before increasing further investment in consumption goods to employ more unemployed labour, if we have to avoid inflation. But in practice consumption cannot be cut down, nor kept in abeyance in countries like India, where it is already at low level. Then the only way left is to take resort to deficit financing for investment in capital goods and also consumption goods, if the absorption of the unemployed labour is one of our major objectives. At the same time prices cannot be allowed to rise much, because it would in its turn necessitate rise in wages and the inflation spiral would go up rising high. Thus there must be some limit to deficit financing where wage rises can be kept in check.

budget so as to keep the expenditure higher than the expected revenues. On the other hand, though deficit may be apprehended beforehand, yet the Government is forced to budget deficit on account of the impossibility in cutting down its expenditure according to its revenue, and this is called 'deficit financing.'

1. Vide p. 116, Footnote 2, Prof. J. R. Hicks' amendment to Keyne's Theory of Inflation.

If the effects of deficit financing are inflationary, taxation can be applied as an anti-inflationary device. Windfall profits from inflation must be particularly taxed. To mop up marginal purchasing power, both direct and indirect taxes can be applied. How far and under what circumstances taxation can be used as an anti-inflationary device is dealt with in detail subsequently in this Chapter (pages 112 to 120).

Thus the optimum use of deficit financing and taxation is to be made so that there is neither inflation nor deflation. The Taxation Enquiry Commission points out, that "The tax systems should be adopted so as to meet the dangers of deficit financing if and when they arise."[1] But the question is how to determine the extent to which deficit financing can be safely used. The reply may be given again in words of the Commission, "There is however, no formula by which the amount of deficit financing that may properly be undertaken can be determined, this ultimately is a matter of judgement."[2] As a matter of fact whether deficit financing is desirable or not depends fundamentally on the environment in which it is undertaken and the policies that go along with it.[3]

It is to be pointed out here that budgetary inflation can occur not only through deficits but also if the budget is balanced, or even if surplus is obtained through increased taxation without cutting down total expenditure. Increase in expenditure on consumption goods without increase in investment may promote inflation. Thus a budget surplus may, broadly speaking, produce inflation or deflation according as it increases or reduces total spending.[4]

1. The Taxation Enquiry Commission, Vol. I, p. 153.
2. Ibid.
3. A Mission of International Monetary Fund, Report presented to the Government of India *'Economic Development with Stability'*, (1954), p. 45.
4. Taylor points out that four general possibilities exist:
   (1) If Government were to spend its funds on precisely those things which private individuals (tax payers) would have bought with the funds taxed away from them, no significant anti-inflationary effects will result.
   (2) If Government spends for military materials—materials which private individuals would not have bought—demand pressure upon the prices of civilian goods will be reduced by taxation; though to the extent that military and civilian goods compete for the same material and labour, general inflationary pressure will occur. It is assumed, however, that the effect would be less inflationary than in (i) above.
   (3) If through heavy taxation Government runs surplus and which is used for debt retirement, the chances are that the combination of taxation and debt retirement will be anti-inflationary, on the grounds that propensities to spend from the proceeds of retired bonds are likely to be lower than propensities to spend from current income.
   (4) If the surplus created by high taxation is hoarded, *i.e.*, if Treasury cash and treasury deposits with the Federal Reserve Banks are permitted to pull up, the anti-inflationary effect will be strongest of all. Taylor, *The Economics of Public Finance.*

Deficit Financing in India

Deficit financing is now recognised to be not only permissible up to a point, depending upon the existing conditions of the economy, but is also considered desirable in a developing economy.[1] This was realised in India too in 1954-55 (when the normal conditions had been restored) that the economic climate was then suitable for a moderate amount of deficit financing. The Finance Minister (C. D. Deshmukh) observed in 1954, "It is obvious that every effort should be made to keep the amount raised by taking recourse to it (deficit financing) as low as possible, so that it fills only the unavoidable gap between the available resources and the inescapable requirements for development and is not used to cover any short-fall in resources which could otherwise be currently raised."[2]

There is always a danger of inviting inflation if deficit financing is practised for long. In 1956, the aforesaid Finance Minister remarked while announcing budget proposals, "We are, in fact, taking a measure of risk with the deficit financing proposed for 1956-57 and we shall have to watch its effects carefully and adjust subsequent programmes in the light of these effects."[3]

With Government deficits, would rise greater economic activity in a developing economy. The tax structure, on the other hand, should be so arranged as to mop up a large proportion of the marginal rise in incomes. For example, if deficit financing is applied to the development expenditures on irrigation works, thereby increasing agricultural output and incomes of the agriculturists, then the tax structure should enable the Government to increase its income from this source.

Table 6

Revenue Surpluses (+) and Deficits (−) of Government of India (Rs. crores)

	1951-52	1952-53	1953-55	1954-55
1. Budget Estimate (B.E.)	+25.61	+3.73	+0.45	15.36
2. Revised Estimate (R.E.)	+92.61	— 3.79	—16.96	— 5.00
3. Accounts	+128.09	— 8.93	8.50	+33.51
Margin between B.E. and Accounts (3-1)	102.48	35.20	8.05	48.87

1. The deficits in the war years were wholly due to the high level of defence expenditure, and were met as far as possible by raising additional taxation. The return to peace-time conditions had been slower. Unavoidable expenditure on refugees, payment of subsidies for foodgrains and then the expenditure on development necessitated deficit financing in the later years.
2. Budget Speech, 1954-55.
3. Budget Speech, 1956-57.

The use of different methods in mobilising the revenues of the socialist economy makes it possible to take fuller account of the diverse aspects of factories' activities and ensures a steady flow of funds into the budget. The payments made by the socialist economy are either from the general turnover of the products sold or from the profits received, that is, depending not only on the quantitative but also qualitative indices of the factories' activities. All these payments have at the same time a single economic content, as various forms of pure income of society, and are made in accordance with the results of the production and financial activity of the enterprises. The systematic increase in these revenues is a result of rising production, extension of the turnover of goods, and reduction in production costs.[1]

Taxation and Inflation

Colin Clark writes that, "Taxation attacks the incentive to produce on the one hand and it creates incentives to spend on the other."[2] Thus he believes that the anti-inflationary power of taxation, so often referred to by advocates of compensatory taxation, is subject to strict economic limit. That is to say, taxation is anti-inflationary in its effects, yet it ceases to be effective in controlling inflation when it exceeds a certain percentage of national income.[3]

The percentage of national income which may be taken in taxation, so that inflation may be checked and deflation prevented, may vary from country to country, from time to time and under one condition to another. For this purpose let us examine the inflationary and deflationary effects of taxation.[4] That is to say, under what conditions it is inflationary and under what conditions it is deflationary.

Theory of Inflation

Traditional theory of Public Finance did not clearly describe the effects of taxation on inflationary or deflationary trends. This was due to the fact that the definition of inflation was only one sided. Until the 1930's, inflation was generally defined as an abnormal increase in the volume[5] of money without a corresponding

1. Ibid.
2. Clark, C., in the 'Limits of Taxable Capacity', (Tax Institute, Princeton), p. 143, Quoted from *Government Finance and Fiscal Policy in Post-war Britain* by A. R. Ilersic.
3. Vide Chapter VIII·
4. Here we are not concerned with the effects of individual taxes, their anti-inflationary effects are quite different. We will consider the broader question that heavy taxation in whatever form, leads to inflation.
5. Increase in the volume of money may come about in three ways—(1) The increase in the supply of money, (2) The increase in its velocity of circulation, (3) The restriction of its sphere of employment. Volume of money in the broader sense includes both currency and credit. Currency consists of actual cash in the hands of public and business firms, while credit includes current account balances or deposits with banks. This is most widely quoted as 'too much money chasing too few goods'.

increase in goods and services available for purchases, resulting in a rapid rise in the price level (fall in the purchasing power of monetary unit). Pigou defined inflation in his Economics of Welfare (1920) as "that part of the rise in prices that is consequent upon governmental interference with money and banking."[1] Most of the definitions though differing widely in detail agree that inflation is an 'expansion of currency and credit to finance government spending in excess of tax revenues thereby causing breakdown in the value of the money unit or increase in purchasing power.' All these types of definitions ignore non-monetary causes of inflation.

Following the work of Mr. J. M. Keynes, economists placed less emphasis on the quantity theory of money as the major instrument of influencing total spending (on consumption) and prices. Keynes observed—"The State will have to exercise a guiding influence on the propensity to consume partly through its scheme of taxation, partly by fixing the rate of interest, and partly, perhaps, in other ways. Furthermore, it seems unlikely that the influence of banking system on the rate of interest will be sufficient by itself to determine an optimum rate of investment."[2] Total spending was considered to be largely a function of income received. Changes in the public decisions to invest or consume, quite apart from changes in quantity of money, could result in wide variations in total spending and in prices. Thus they focussed their attention on the rise in price level itself and tried to dissociate monetary expansion from credit and money rise. Inflation is now often used to describe increases in price level.

In case of non-monetary causes of rise in price, the monetary expansion is the effect. In one case the expansion precedes the rise in price level, while in the other it succeeds. As a matter of fact, the difference is invisible in practice. Paul Einzig gives a double edged definition. He says, "Inflation is an expansionary trend of purchasing power that tends to cause or to be the effect of an increase of the price level."[3] He says that the correct definition must be based on the discrimination between monetary inflation and inflation of prices.

From this follows that a correct definition of inflation includes not only a rise in prices caused by monetary expansion, but also the latter caused by a previous rise in price level resulting from non-monetary causes. Such a definition gives that the rise in prices is the effect of increase in purchsing power.

Inflation, in general, arises when purchasing power[4] in the

1. Pigou, A. C., op. cit., p. 666.
2. Keynes, J. M., *The General Theory of Employment, Interest and Money*, p. 378.
3. Einzig, Paul, *'Inflation'* (1952), p. 17.
4. Purchasing power can be created by increase in wages and salaries, increases in social service benefits, subsidies, increase in profits, capital appreciation and monetary expansion itself.

hands of people expands more rapidly than the current output of goods. This does not necessarily mean that the volume of money may increase with the increase in purchasing power. There may be inflation without any increase in the volume of money in circulation. The essential condition for inflation is increased purchasing on the one hand and comparative scarcity of goods on the other. It may thus consist equally well of a decrease in production accompanied by no commensurate decrease in purchasing power, as of the more usual process, stated above, of an increase in purchasing power with no corresponding increase in production. If supply follows apace with the increase in purchasing power there will be no inflation.

As contrasted with mere price fluctuations and adjustments, inflation was described as a dynamic and continuous upward trend of the general price level. (The increases may not be uniform to all prices). Such a condition arises when there are no unemployed resources available, when spending increases and it is impossible for output to increase then the prices rise and they do not fall back to the normal. In other words, increased spending cannot be absorbed by an increase in the supply of goods. This is according to Keynes, who says, "When full employment is reached, any attempt to increase investment still further will set up a tendency in money-prices to rise without limit, irrespective of marginal propensity to consume, that is, we shall have reached a state of true inflation. Up to this point, however, rising prices will be associated with an increasing aggregate real income."[2] Thus full employment is the point at which true inflation sets in and 'inflation in this sense is a phenomenon of full employment.'[3]

1. One thing must be made clear that mere price fluctuations and adjustments do not constitute inflation or deflation. Such movements are going on constantly within the price structure in the absence of control. They may relate to large body of commodities or with respect to specific commodities on account of changes in relationship between demand and supply. So long as changes are mere fluctuations and do not denote a definitive trend in the whole price structure, they are regarded only as minor adjustments that bring about equilibrium between demand and supply.

2. Keynes, J. M., op. cit., p. 118.
Keynes' theory of inflation is an important contribution to the theory of prices under full employment, though his most important contribution is in relation to circumstances less than full employment. He is sometimes called 'inflationist', though it is misleading. (Dillard, Dudley, '*Economics of J.M. Keynes*', p. 238).

3. Application of the Keynesian idea is limited in the case of an under-developed country and more so in a developing country. By an under-developed economy in this reference is meant the one which suffered from chronic unemployment, which was not associated with unsold surpluses but with shortages and scarcities. It was important to keep investment up to the mark to see that there was enough investment to absorb such saving as was available, yet this would not be sufficient to absorb the unemployed resources. Further, there lies a danger of rapidly increasing population, more rapidly than the demand for labour expands. Thus the chronic unemployment may continue to mount.

However, Prof. J. R. Hicks gives a slight amendment to Keynes' theory. According to Keynes an increase in investment (with unchanged propensity to

Inflation does not rest upto the point of full employment only. Although there are no employment-resources available, manufacturers try to increase their output to take advantage of unduly high profits. In doing so they offer high wages and prices for non-wage factors. (Thus there is increase in 'cost-unit'). This raises the purchasing power of the labour and the owner of materials, and a further increase in spending takes place. A 'vicious spiral' is created in this way and wages and prices chase each other in upward direction.

It might be realised that an increase in the purchasing power or in the demand for goods and services might have two types of effects. It might increase production or it might raise prices. According to Keynes, as quoted above, the first effect (that is, increasing the output) would last so long as there was unmployed labour to be absorbed. After that when full employment has reached wages and prices rise faster and faster, and inflation in a true sense[1] sets in.

This theory does not apply to the Soviet type of economy, because prices of non-wage factors are successfully controlled. Moreover, in capitalist countries, particularly those with strong labour movements, wages tend to follow final output prices. In periods of rising prices, workers and unions are in a position to exert all their efforts to keep wages rising commensurately. In some industries, and in some countries, wages are actually tied to a cost-of living index and are adjusted regularly to changes in the index.

In U.S.S.R. though wages have tended to rise concurrently with retail prices, the movement in wages cannot in any sense be considered functionally related to the price rise. Soviet workers do belong to unions, but wage determination is not a function of Soviet trade Unions. Workers have no means of arguing for a

save) would raise income and employment, until the full employment level was reached. Until that level was reached, employment was increased by an increase in investment, or by fall in saving (with increased consumption). Increases in consumption and increases in investment, would both increase the effective demand for labour. There was no danger of inflation until there was so great a labour shortage that wages started rising. Prof. Hicks suggested that this construction would fit perfectly with a purely manufacturing economy; for the prices of manufacturing goods were stabilised to a considerable extent by manufacturers, who were reluctant to raise prices until their costs changed. The expansion, so long as it proceeded at constant money wages would also proceed at constant real wages. But in an economy of which agriculture was a large part, increased demand(of food articles) would raise prices, even before wage rate rose, and therefore, the real wages would fall. It must be expected that workers would resist a fall in real wages below a certain point. When that point is reached, inflation would set in, even though full employment had not been attained.

(Prof. J. R. Hicks of Oxford University said this, during his three lectures delivered in Delhi School of Economics as a visiting Professor. (Feb. 2 to Feb 4, 1950) with the object of putting together lessons that could be learnt from the expereience of many countries in the last ten years on the problem of inflation. (The Eastern Economist, gist of the lectures, Feb. 10, 1950, p. 210).

1. Keynes—op. cit., p. 303.

wage increase, even if there is rapid increase in prices. "The key to Soviet wage inflation lies not in rising retail prices, but in the scarcity of Soviet workers relatively to demand."[1] It is thus clear that Soviets can rely almost solely on indirect taxes which tend to increase prices without fear of wage-price spiral reactions taking place.

Taxation as Anti-inflationary Device

The broader principle governing the anti-inflationary effect of taxation follows from the definition of inflation discussed above. Taxes are anti-inflationary so long as they narrow down the gap between total demand and supply. The extent to which taxation would be anti-inflationary in its effects depends upon the extent to which it reduces spending and increases the supply of goods and services (valued at stable price). In other words, the more the tax reduces spending and the less it cuts production the more anti-inflationary it is. Rationing is an attempt to achieve a similar end by regulating the demand at any given price; difference between the two being that taxation cuts down the excess demand, while rationing suppresses[2] it.

The obvious way to prevent inflation is to reduce the total volume of spending. In so far as individuals and businessmen tend to spend too much money, the Government may take the excess away from them in the form of increased taxation, or by increasing higher the ratio of savings to income.[3] If the Government feels the need to spend more, as in times of war, inflation can only be avoided by withdrawing some of the potential private expenditure. Taxation intended to reduce aggregate consumption will be effective to the extent that it falls upon income which would otherwise be spent for consumption.

Savings have also a bearing upon inflation. Taxation is one such method which can increase the volume of aggregate savings, yet it can avoid inflation, which an individual cannot do. If instead of taxation the Government depends on voluntary savings, there will always be a risk of inflation because sufficient savings may not be forthcoming, as people may spend more and save less.

Keynes describes how dependence on voluntary savings tends to be inflationary in these words, "The government needs money. But this is a free country. Someone, therefore, must save it voluntarily. If you and your friends do not do so, the necessary amount will be taken compulsorily from the real value of your earnings through the action of higher prices and handed to the profiteer, and he will save it voluntarily such part as he does not pay in com-

1. Holzman, *Soviet Taxation.*
2. Vide Chapter I.
3. Vide Chapter VIII.

pulsory taxes. In this way we shall avoid any departure which would be anathema to the city from the voluntary system."[1]

Keynes points out that "the danger of depending on voluntary savings lies in the fact that we are liable to step insensibly into voluntary savings by inflation." He quotes, "We shall depend on the voluntary system", and says that it is another way of saying "We shall depend on inflation to the extent that is necessary."[2] Further he says, "An individual cannot by saving protect himself from the consequences of inflation if others do not follow his example, just as he cannot protect himself from accidents by obeying the rule of the road if others disregard it. We have here the perfect opportunity for social action, where everyone can be protected in making a certain rule of behaviour universal."[3]

However, the difficulty is that there are so many factors, besides taxation, effecting inflation that it would be erroneous to trace out the effect of only one factor in isolation from the other. They are so interrelated that sometimes it becomes difficult, rather impossible, to differentiate between the cause and the effect. The extent to which any one factor or a set of factors contribute towards the inflationary trend is all the more difficult to point out. Therefore, while considering the inflationary effects of taxation we must either assume other factors which might effect inflation to be absent, if they contribute very little to the inflationary trend, or if any one or more of them considerably contribute towards it we must take them into account for arriving at correct conclusions.

Factors in inflation during an expansionary phase have been described as "lack of employable resources, high propensity to consume, low taxable capacity, and a certain behaviour of balance of payments.'[4] All have been held to combine together in an under-developed country to cause inflation at an early stage.

Inflation in India

Since World War II the progress in the return to peace-time conditions was not rapid and smooth. The deflationary tendencies, which were expected to manifest themselves soon after the end of the war, did not materialise, and restoration to peace-time economy was slow and halting. Inflationary trends were generated after 1946. Index number of wholesale prices rose from 266.7 in 1946, to 381.1 in 1949 and 400.7 in 1950.

Up to 1950, budget deficits were the major source of post-war inflationary pressures. An important factor in the deficits has been expenditure (over 20% of total expenditure) for rehabilitation and for development. Emergency conditions arising from the separation of India and Pakistan and natural calamities like partial

1. Keynes, J. M., *How to Pay for War*, p. 68.
2. Ibid.,
3. Ibid.,
4. Baljit Singh, "*Federal Finance and Under-developed Economy*" p. 26.

failure of the monsoon, drought, or floods over large parts of the country particularly every year after the end of the war also burdened the budget. Another contributory factor was the devaluation of rupee with the inevitable fillip it gave to inflationary trends.

Then the export boom arising from the Korean conflict substantially accelerated the current generation of inflation which had proceeded at a moderate rate from 1946 to June 1950. In 1950-51, India had for the first time since war, sizable export surpluses. Exchange reserves increased during 1950-51, not only in India, but also in all the seven countries of Asia and Far East.[1] In all these countries budget deficits were still the rule in post-Korean months, as investment programme and increased defence appropriations continued.[2] The combined effect of all these factors was increased inflationary pressure.[3] Index number of wholesale prices rose from 400.7 in 1950 to 439.3 in 1951.

In India, as in most countries, the major problem has been that of keeping the inflationary trends under control. The shortage of essential commodities particularly food and clothing aggravated the situation owing to the rise in the money incomes and hence the increase in the purchasing power of some sections in the community, who competed for food and consumer goods on a higher scale.

As regards the measures necessary to fight against inflation, it was not possible to arrive at complete unanimity of opinion. But it was clear as was said in the budget speech that "immediate action should be taken to prevent as far as possible the further creation of purchasing power in the hands of the community, and to take all steps possible to stimulate production and instil a spirit of confidence in industry."[4]

Anti-inflationary measures were taken towards the end of 1948, particularly in October, 1948. In the field of taxation additional duties on certain articles of luxury such as liquor, tobacco, motor cars, silk and art-silk fabrics were imposed, and an excise duty on superfine cloth was levied. Power was given to make provisional assessments of income-tax on the basis of returns submitted by the assessees. A system of interest bearing deposits of income-tax

1. *The Economic Bulletin for Asia and Far East*, Vol. II, Nos. 3, 1951, pp. pp. 25 to 27; vide Statement No. XVII.

2. A comparison of investment expenditures with budget deficits conveys in percentage terms the impact of these expenditures on budgets. In several cases, investment expenditure exceeded deficits, *i.e.*, the expenditures were met out of revenue receipts as well as by deficit financing. In these cases the deficit may be considered to have arisen entirely from the Government's expenditures. (Vide Statement No. XIX, showing Central Government's investment as per cent of deficit of aforesaid countries from 1947-51).

3. The increase of prices in India after the outbreak of war in Korea was relatively much smaller than in a large number of other countries. Compared with the level of prices in June 1950, the increase in India was only a little over 10% while in other countries in certain cases it was well over 30% (*The Economic Bulletin for Asia and Far East*, Vol. II, 1951, p. 25).

4. Budget Speech, 1949-50.

which was introduced in 1943, was also revived. It was decided to postpone for a further period of three years the refund of deposits of excess profits tax except for approved purposes. A temporary limit was also placed on the amount that may be distributed as dividend by public companies, by an Ordinance. Now industrial undertakings commencing production in the next three years were given exemption from income-tax for the first five years upto a limit of 6% per annum on their capital. The rules regulating depreciation allowances were also liberalised.

Reduction in import duty on machinery and certain raw materials and the abolition of the import duty on cotton yarn in 1948 were also efforts in this direction, because restrictions on foreign trade, though they might be necessary for other economic considerations were also apt to produce inflationary effect. Any interference with this free flow of international trade leads to higher cost of production and higher cost of living. In the first seven months of 1948 there had been a steep rise in prices, the index number of wholesale prices rising to 389.6 in July 1948. After that with the various measures adopted, steady downward trend continued till March 1949. After it the trend of prices was upwards as the following table shows :—

Table 9

Index Number of Wholesale Prices

(Month-wise, 1948 to 1955)
(Base-1939=100)

Months	1948	1949	1950	1951	1952	1953	1954	1955
January	329.2	376.2	384.7	414.3	430.3	377.5	398.5	363.9
February	342.3	372.0	392.3	423.4	415.8	381.5	395.0	361.4
March	340.7	370.2	392.4	438.6	377.5	385.2	394.0	353.8
April	347.9	376.1	391.3	457.5	377.8	384.9	402.6	345.4
May	367.2	377.1	393.3	456.8	367.1	393.4	396.1	342.0
June	382.2	378.3	395.6	456.5	374.8	405.4	381.6	342.5
July	389.6	380.6	405.2	447.0	383.8	407.7	381.3	355.6
August	382.9	389.0	409.2	437.6	387.4	410.4	382.3	357.3
September	382.3	389.8	412.5	435.1	389.0	403.8	384.4	353.2
October	38.17	393.3	411.2	438.0	387.5	393.6	381.6	357.2
November	382.2	390.2	410.9	435.6	382.7	390.6	376.1	365.0
December	383.6	381.3	412.6	433.1	386.9	389.4	367.8	368.4

Source : Office of the Economic Adviser, Ministry of Commerce and Industry, Explanatory Memoranda on the Budgets of the Central Government from 1949 to 1956.

Soon after devaluation[1] of rupee in September 1949, price cuts in certain essential commodities were made to counter the

1. Devaluation is a factor closely related to inflation. It may be the cause or the result of inflation depending upon the then prevailing conditions. If devaluation is to confirm an already existing internal depreciation of currency it is the result rather than the cause. Devaluation is followed by a gradual adjustment of prices and wages to the new level of currency. It also affects the prices of imports from countries who have not themselves devalued their currency.

possible effects of devaluation. This assisted in holding price level for some time, but the upward pressure could not be checked for long, and the price index reached to 395.6 by June 1950. The outbreak of Korean war gave a further impetus to rise in prices as pointed out previously, and by September 1950 the index rose to 412.5. During first four months of 1951 it reached to the peak figure of 457.5. Then the increase halted.

From July 1951 there was a downward trend. In January 1952, there was a drop of 27.2 points (430.3) compared to 1951 peak-figure. There was a further drop of about 12°/₀(377.5) by March 1952. It was mainly assisted by two factors—

(1) Substantial reduction in purchasing power by transfer of money from the hands of the public to the exchequer. Substantial revenue surplus estimated at Rs. 92.62 crores was realised against Rs 26.1 crores which was provided for in the budget. This could be made possible by the use of powers given to the Government by Parliament for increasing the export duties and levying new ones. Export duty on medium and coarse cotton cloth was raised from 10°/₀to 25°/₀ *ad valorem* and on groundnuts from Rs. 80 per ton to Rs. 150 per ton. New duties were levied on exports of oil-seeds and vegetable oils. Secondly, the sale proceeds of the wheat obtained from American loan had also the effect of reducing the supply in the businessmen's hands.

(2) Another step taken in 1952 was to secure a restriction of credit. Bank rate was raised from 3°/₀ to 3½°/₀. During 1951 there had been a sizable degree of credit inflation and the advances made by commercial banks had shown an increase of over 25°/₀.

It may be mentioned that the fall in prices was due to the measures deliberately adopted to curb inflation,[1] and it was premature to talk of recession. So far as taxation is concerned, it exerted deflationary effects. Direct taxes are claimed as disinflationary. Taxation of commodities other than articles of necessity has the effect on the whole of keeping the pressure on consumption goods checked, and has thus a dis-inflationary effect. The increase of duty on items like tobacco, would have the effect of reduction of consumption in other items, to the extent to which the consumers of tobacco maintain their existing levels of consumption. Export duties are also disinflationary.

However, under Indian conditions there are various limitations for use of taxation as a weapon for controlling inflation. In india, the proportion which public revenue and expenditure bear to the aggregate national income and expenditure is extremely low as

1. Mr. H. Borges De Fonseca, economic adviser to the President of Brazil, told a Press Conference in New Delhi (March 11, 1960) that among under-developed countries India has been most successful in controlling inflation. He believed that one of the reasons for this was the high level of competence of the people at the top 'who know what to do'.

compared to other countries.[1] Also, the public expenditure is of limited variety and relatively inelastic. The per capita income of Rs. 239 is among the lowest in the world.[2] The coverage of direct taxes constituting about 36 per cent[3] of the total tax revenue is limited to about 1/5% of the entire population,[4] and the yield of other taxes is too small in relation to the size of population numbering about 361 millions.

Return to normal conditions commenced in 1952 and continued during 1953. However, throughout the earlier months of 1953, and until August 1953, there was a continuous but moderate rise in prices, largely caused by temporary factors. Supply position was slightly difficult—there was expectation of lower output of certain important commodities like pepper, sugar, cotton and groundnuts. Demand for certain commodities like sugar and cotton also rose due to increased internal consumption. Measures to improve supply position were taken. Imposition of ban on export of sugar and 'gur'; restriction on export of groundnut oil; liberalisation of imports of coconut oil and copra, reduction of import duties on palm oil, copra, sugar and cotton,seed oil; opening of fair price shops; issue of large quantity of foodgrains; reduction in price of imported wheat supplied by centre, were the steps taken. Since August 1953 there was a continuous decline in wholesale price index till May, 1955, after which there was again a rise.

Rising price trend during the recent few years is attributed largely to rise in food prices. It is true for an underdeveloped country like India that rise in food prices causes inflation which has already been discussed.[5] There is insufficiency of food production in relation to the demand.

Taking for example the figures for 1957-58 we can find some relation between the index of production of food grains and the wholesale price index of all commodities. The index of production of foodgrains fell from 120.5 in 1956-57 to 108.0 in 1957-58. The price index of cereals rose from 96 to 101. While the price index of industrial raw materials and manufactures remained almost steady, still the wholesale price index of all commodities rose from 105.3 to 108.4 in 1957-58. Obviously, the rise in prices in foodgrains had appreciable effect on general price index. It is clear from the following tables :

1. Vide Chapter VII, and Chapter IX.
2. Vide Chapter VII.
3. Vide Chapter IX.
4. Number of Income-tax assessees in 1958-59 was 7,04,775 and the population in that year was 361,329,485 (calculated on the basis of 1951 figures). Thus the percentage of income-tax assessees comes to about 1/5%. But the percentage of assessees in the high income groups is very low (vide Chapter X) and the assessees subject to other direct taxes is also very low. In 1958-59 the number of assessees for estate duty were 7,999; for wealth tax they were 37,951 and for expenditure tax and gift tax they were ony 5,513. (Tyagi Committee, Report Paras 2.3, 2.5, 2.6 and 2.7).
5. Vide p. 84, foot-note.

Table 10
Index Number of Production of Foodgrains
(Crop year ending June 1950=100)

	1954-55	1955-56	1956-57	1957-58	1958-59
Food grains	115.0	115.3	120.5	108.0	128.2
(a) Cereals	114.5	114.9	119.9	108.6	127.3
(b) Pulses	118.5	118.4	124.5	104.2	134.1

Table 11
Index Number of Wholesale Prices
(1952-53=100)

	1954-55	1955-56	1956-57	1957-58	1958-59
Food grains	94.6	86.6	102.3	106.4	115.2
(a) Cereals	80.0	76.0	96.0	101.0	107.0
(b) Pulses	59.0	62.0	81.0	82.0	104.0
Industrial raw materials	101.9	99.0	116.0	116.5	115.6
Manufactures	100.6	99.7	106.3	108.1	108.4

Table 12
Index Number of Wholesale Prices—All Commodities
(1952-53=100)

1954-55	55-56	56-57	57-58	57-58
97.4	92.5	105.3	108.4	112.9

Source : Government of India, Economic Survey, 1959-60, and Reserve Bank of India Bulletin, May, 1960.

Further, the movement of food prices is reflected in the cost of living. All India cost of living index moved down from 101 in 1954 to 96 in 1955, due to fall of about 12% in food index. By October 1955 the general index again moved up to 97. Later on the cost of living continued to move up as is clear from the Table 15. The Index rose from 113 in November 1957 to 122 in November 1958 but declined to 119 in December 1958 with the index of food prices coming down from 118 to 113 as shown in table 17. Thus by comparing Tables 15 and 17 a connection between the cost of food indices through the various years, and the trends in the cost of living may be noted.

Table 13
Working Class Cost of Living Index (All India) (Year-wise)
(1949 = 100)

Year	1949	1950	1951	1952	1953	1954
Index No.	100	101	105	103	106	101

Year	1955	1956	1957	1958	1959*
Index No.	96	105	111	116	122

*Provisional

Table 14

Working Class Cost of Living Index (All India) (Month-wise)
(1949=100)

Month	1953	1954	1955	1956	1957	1958	1959
January	102	104	97	97	107		117
February	103	102	95	97	107		118
March	104	101	94	100	107	110	117
April	104	102	93	103	108	111	117
May	105	102	92	104	110	113	117
June	109	101	94	106	112	116	122
July	111	101	96	107	112	119	124
August	111	101	97	107	119	120	125+
September	110	101	96	108	114	121	125+
October	108	101	97	108	114	123	126+
November	106	98	98	110	113	122	126+
December	193	97	98	109	114	119	124+

+Provisional.
Source—Indian Labour Gazette, 1960.

Table 15

Index Number of Wholesale Prices of Food Articles (All India)
(year-wise) (1952-53=100)

Year	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59	1960(Jan)
Index No.	108.9	98.2	86.6	102.3	106.4	115.2	117.7

Table 16

Index Number of Wholesale Prices of Food Articles (month-wise 1956 to 1959)
(1952-53=100)

Months	1956	1957	1958	1959
January	89.4	103.6	102.5	114.3
February	88.8	104.1	100.8	115.7
March	92.8	102.3	102.3	113.8
April	95.7	104.3	105.2	112.1
May	96.6	107.0	107.2	116.1
June	99.0	109.3	113.4	118.7
July	101.0	111.3	118.4	121.0
August	105.0	112.1	120.2	121.7
September	103.6	108.5	121.2	120.5
October	104.0	107.3	121.2	124.0
November	106.9	107.7	118.0	121.4
December	105.1	104.0	113.3	118.2

Source : Explanatory Memoranda of the Budgets of the Central Government 1956 to 1959.

As we have already discussed,[1] taxation is dis-inflationary in its effect so long as it balances overall supply and demand. It is

1. Vide, p. 84.

not dis-inflationary, but positively inflationary, if it reduces the supply and thereby widens the gap between the supply and the demand.

Thus taxation must be so planned as to balance the demand and the supply not only of non-food items, but also of food items. Because food items cannot replace non-food items, and vice versa. Thus the separate schemes for taxation of the two items is needed. To illustrate the fact, the reduction in the burden of taxes on excise duties would not help lowering the price of wheat or rice. The real point is that the prices of food articles have to depend on the law of demand and supply. If the crop is good, prices come down unless consumption keeps pace with supplies.[1] If consumption rises, then prices go up. Thus taxation must aid not only to check the rise in consumption, but also to regulate the production of crops and to help to increase production.[2]

Tax Policy in India Since 1947[3]

Since 1947 to 1955 tax policy in this country may be said to be wavering. This was perhaps due to disturbed conditions during that period and lack of clearness in the objectives of tax policy itself.

The taxation measures in the 1946-47 budget were designed to suit the transition from war to peace economy. That budget was framed with the main idea of providing influences which would counter the inevitable deflation which was expected to arise after the war. When war expenditure had ceased, it was feared widely that there might be a lessening of demand for things and, therefore, it was necessary to pump more and more money into circulation to stimulate demand. So the Finance Minister tried to remove the taxes which he could possibly eliminate from the tax structure of the country.

Then in February, 1947, came the budget of the Coalition Government for 1947-48. That budget was framed against an inflationary prospect, while the 1946 budget had been framed against a disinflationary prospect. The budget of 1947 was based on the assumption that there was far too much money in the country.

1. High prices in food-grains are also attributed sometimes to the fact that in certain localities there is enough money to hoard food-grains and to wait for better times.

2. Vide Chapter VI, and Chapter XI.

3. Tax policy in India has found different expression with different Finance Ministers who have so often changed from year to year. As many as seven Finance Ministers have held the portfolio since independence. Starting with Liaquat Ali Khan who presented the pre and post partition budget of 1947-48, R. K. Shanmukham Chetty in 1948-49, John Mathai during 1949-51 and C. D. Deshmukh who enjoyed the longest tenure of 6 years from 1951-52 to 1956-57. Then in 1957-58 T.T. Krishnamachari came with a strong hand whose policy was carried on by the next holder of the Finance Portfolio, Pt. Jawahar Lal Nehru, and since 1958-59 Morarji Desai was there. Now again from October, 1963, T. T. Krishnamachari holds the Finance Portfolio for the second time.

the prices of commodities were going up, the inflationary position was worse than ever, the share markets were experiencing an unwholesome boom, and it was thought necessary that the process be reversed. Therefore, new taxes and heavy taxes were imposed, the very reverse of the process which was considered expedient in the budget of 1946.

The 1947-48 pre-partition budget was a step towards socialist economy and the problem of reducing inequalities of income and wealth was sought for, and the increases in direct taxation were made. The Finance Minister said that the taxation proposals, "are related not to purely financial purposes, but to certain social objectives. The conditions created by the last war served to accentuate these disparities; the rich became richer and the poor poorer. . . . . A set of conditions in which the few are able to wield such vast power over the many can hardly be regarded as anything but a negation of the principles of social justice."[1] This was stated to be the background of his budget proposals.

In the post-partition budget of 1947 little changes were made on taxation proposals of the pre-partition budget, but the taxation proposals were criticised as seriously affecting the incentive for investment. The Finance Minister promised so as to create confidence in the business community,[2] to examine the consequences of the tax policy before putting up the next budget.

Taxation proposals in 1948-49 were made, first, to meet the inflationary conditions and secondly, to foster incentives. Consumption taxes were increased so as to cut down expenditure on consumption. Re-adjustment was made in direct taxation by concessions, especially in taxes on business. The Finance Minister pointed out, "the aim of our policy should be to secure that, while the level of taxation is resonably high so that the wealthier sections of the community are placed under an equitable contribution for the common needs of the State, a genuine margin is left for savings which would flow back into investment and thereby add to the productive wealth of the community, which the State itself could subsequently tap. It is also necessary so to adjust our taxation as to provide a real incentive to the ploughing back of profits into fresh business."[3]

The equalitarian policy of highly progressive taxation was abandoned for the time being as a need to stimulate production. But it was really a step towards socialist objective, as an increase in production is a prerequisite to the establishment of a socialistic society.[4] Although, for formulating the taxation proposals only short term objectives, like control of inflation, were stated.

1. Legislative Assembly Debates, 28th Feb. 1947, Vol. II, No. 8, page L33, and Budget Speech, para 38.
2. Constituent Assembly Debates, 26th Nov. 1947, Vol. I, p. 760.
3. Budget Speech, 1949-50.
4. Vide, Chapter XI.

In the budget of 1950-51 greater emphasis on production was laid and the anti-inflationary objective was still the main preoccupation, while the equalitarian aspect was lost sight of. The Finance Minister mentioned the objectives to be "to prevent, as far as possible, the further creation of purchasing power in the hands of the community, and to take all possible steps to stimulate production and instil a spirit of confidence in industry."[1] It was, therefore, decided to hold up temporarily even the various schemes of development, "the execution of which was necessary for the well-being of the country."[2]

Tax reliefs were mostly concerned with direct taxes on companies. Capital gains tax was abolished, relief was given in super and corporation taxes and depreciation provisions were liberalised. As an anti-inflationary device, custom duties, excises and postal rates were increased.

To carry out the policy of the Government of India announced under eight-point programme, which was a reaction against the inflationary tendencies caused by devaluation of money in September, 1949, several steps were taken. These were the levy of customs duties on exports to hard currency areas, voluntary settlements of taxes on hidden war profits, and economy in public expenditure. Also export duties on hassian, raw cotton, mustard oil, *etc.*, were increased and excise duties on cloth and other corresponding goods were reduced.

In 1951-52, anti-inflationary objective continued to occupy the foremost position, but the approach to the problem was different from that in the previous year. In 1950-51 it was sought to be implemented through economy in Government expenditure, reduction of direct taxes, and increase in indirect taxes. On the other hand in 1951-52, the method adopted was aimed at a surplus budget through increased taxation and increase in Government expenditure for utilising the country's development.

The additional burden was sought to be spread 'widely' and 'equitably'.[3] It was done through increase in corporation tax by 10% and income and super taxes by a surcharge of 5%, also by raising Union excises and custom duties. An export duty on groundnuts was levied for the first time, while that on cotton textiles which had been abolished two years back was reimposed. Central excise on motor spirit and kerosene was raised by 5%, and excise duty on tobacco was also raised. The Finance Minister remarked —"The scope for raising money by direct taxation is somewhat limited and a fair amount of the tax burden has necessarily to be laid on the community by means of indirect taxes. . . .it will not, therefore, be correct to say that the raising of additional taxation by the enhancement of indirect taxes is inequitable. . . . . it is true

1. Budget speech 1991-51.
2. Ibid.
3. Budget Speech, 1951-52.

that the net of taxation has been cast fairly wide. . . . in the burde of building up the new India every section of the community should take its legitimate share "[1]

The budget of (March) 1952-53, was framed against the background of various problems to be faced. The main problems continued to be those of arresting inflation, increasing production and meeting the large deficit in the country's food resources.[3] During the previous year there had been a partial failure of rains over many parts of the country. Another problem was of raising necessary funds to finance schemes under the First Five Year Plan. However, no fresh taxation measures were adopted that year, as it was a 'care-taker' budget.

In May 1952-53 the fresh budget was presented which contained only a few changes. In light of the fact that prices were regarded to have reached 'a more stable level' in the country, it was feared that this would effect export earnings. Therefore, reduction of export duties was affected along with other measures, like relieving controls over the distribution of textiles and granting of special credits, *etc.*

The 1953-54 budget was prepared against the background of the First Five Year Plan. Thus the Plan dominated over the budgetary policy. Anti-inflationary objective was no longer there, economic conditions had eased, *viz.*, prices were steady at lower rates, production had improved, balance of payment was more favourable and food position was better, leading to relaxation of controls. Thus the long term problems regarding unemployment and implementation of the Plans remained to be considered. As the Taxation Enquiry Commission was already at work then, only readjustments in taxation were done rather than exploring avenues for additional taxation.[3] Therefore, the implementation of long-term objectives was postponed till the report of the Commission. The changes in taxes were of the following type. To assist retention of world markets, duty on jute was reduced. To give relief to tax administration, personal income-tax exemptions were raised. To make up consequent loss in revenue, import duties on luxuries like toilet requisites, betelnuts, *etc.* were raised. Also, for these reasons—giving relief to tax administration and to avoid loss in revenue—Union excise duty on textiles was changed from the ad valorem to a specific basis. A few modifications were also made in income-tax and corporation tax.

In 1954-55 no large-scale change was made, pending the report of the Taxation Enquiry Commission, which was expected to be out by the end of 1954.

1. Ibid.
2. White Paper on the Budget, 1952-53 (page 2)
3. Budget Speech, 1953-54.

In the year 1955-56 the Report of the Commission was available which has indicated the future policy. But as the Finance Minister indicated, "They are more an indication of the possibilities in these directions than in the nature of actual budget proposals. . . . Steps that we take each year from time to time must necessarily be considered from the light of economy and budgetary considerations of the time."[1] Broadly speaking, the recommendations are in the direction of widening the base and range of taxation, both direct and indirect, and involve readjustment of the rate structure.

In the budget of 1955-56 a number of recommendations of the Commission were given effect to. However, a number of difficulties in the implementation of most of their proposals were indicated, *viz.*, (1) a detailed study and further thought was necessary, (2) a very important problem of gearing the administration to take up the new and additional responsibilities was there, (3) procedural changes which do not impinge directly on the tax liability were left out of the Finance Bills to be implemented through amending bills to the various Acts.

The budget proposals for 1956-57 were enunciated as the first step towards the implementation of the Second Five Year Plan. It was also the first deliberate step towards establishing a democratic socialist economy. Though the Finance Minister did not expressly say so, but what he said clearly meant it. He said, "the objective we have set to ourselves is that primary and ineluctable duty of every modern Government, namely to raise the living standards of the people and to create in the process a progressive and equitable economic and social order. This objective, moreover, is to be attained by democratic means."[2]

Report on Indian Tax Reform (1956) submitted by Mr. Nicholas Kaldor, has important bearing in the formation of tax policy in India during the past few years. Mr. Kaldor considered the possibility of substantially augmenting tax revenues during the next five years, consistent with the twin objectives of reducing inequalities of incomes, and maintaining incentive to save and invest in risky enterprises.[3] Capital gains tax, one of the new taxes which Mr. Kaldor recommended was included in the Finance Act (3) of 1956. In 1957-58 his favourite expenditure-tax was imposed along with wealth-tax.

However, these measures were not strictly according to the scheme suggested by Mr. Kaldor, and were also the outcome of the Finance Minister's own working. This would be clear from the remarks of the Finance Minister, Sri T. T. Krishnamachari, who said, ". . . . I am doing so not because that I want to exhibit any cleverness, not because I borrow freely from Mr. Kaldor or

1. Budget Speech, 1956-57, para 73.
2. Budget Speech, 1956-57, para 73.
3. Kaldor, N., Indian Tax Reform, Introduction & Summary, pp. 1 to 17.

from Mr. 'X' or from somebody else, or I ignore Mr. Pigou, who, I suppose, deserves to be ignored in the economic field, or I take certain portions from the Taxation Enquiry Commission's Report or that I discard some of them. I have come before the House with these proposals, because these are the minimum proposals that I can at the present moment put forward before the House, which will help us to sustain this Plan, to carry it to the next stage forward."[1]

It was only in 1957 that an elaborate statement regarding taxation policy in our country, was given by the Finance Minister, when he said :

"Taxation policy and proposals at this juncture have to be shaped in the light of the following criteria—

(*a*) They must produce a sizeable addition to public revenues;

(*b*) They must provide incentives for larger earnings and more savings;

(*c*) They must restrain consumption over a fairly wide field so as to keep in check domestic inflationary pressures, and to release the resources required for investment; and

(*d*) They must initiate such changes in the tax structure as would make tax yields progressively more responsive to increased incomes, and facilitate an orderly development of the economy with due regard to the social objectives we have adopted."[2]

Finance Minister's Statement of objectives is too exhaustive to be all fulfilled simultaneously. It is definite that a few of the objectives must be sacrificed at the instance of the others. To some extent the three objectives—revenue, incentives and equality, are contradictory. The more revenue we try to raise the greater will be the adverse effect on incentives. If it is possible to raise larger revenue without dis-incentive effects by more reliance on indirect taxes, the equalitarian objective cannot be attained. On the other hand, more proceeds from direct taxes would require larger incomes and wealth to be taxed at higher rates, it would cause disincentive effects.

However, the Finance Minister had all these objectives in his mind while making taxation proposals for 1957-58. Tax concessions and a standard rate of tax on earned incomes, and a differential rate for taxation of unearned incomes, tax on wealth, tax on expenditure, bringing down exemption limit for tax liability—all these were supported on the background of the above stated objectives. Proposals in respect of company taxation were made to encourage the ploughing back of profits through a check on

1. Krishnamachari, T. T, Rajya Sabha Debates on General Budget, 1957-58.
2. Budget Speech, 1957-58 (15th May), Para 42.

dividend distribution, and to retain the bias in the tax structure in favour of corporate investment. Readjustment was also made in the tax rates to encourage foreign investment. The Finance Minister's proposals regarding indirect taxes were mainly designed to check inflationary pressures and to stimulate exports.

The emphasis of the Finance Minister's tax proposals was, in his words, "to initiate structural changes in the tax system so as to make it more progressive in term of tax problem."[1]

Steps taken by the Finance Minister in 1957-58 were of high magnitude. Additional taxation in that year was estimated to yield a revenue of Rs. 99.50 crores(say Rs. 100 crores) in a full year. Out of which Rs. 76.75 crores were estimated for additional indirect taxation (import duties to yield Rs. 6 crores, excise duties to yield Rs. 57.35 crores and Railway Passenger Fare Taxation Rs. 13.40 crores); Rs. 21.30 crores were estimated for additional direct taxation (changes in income-tax and corporation tax to yield Rs.8.80 crores, and wealth tax to yield Rs. 12.50 crores); and Rs. 1.45 crores were estimated for Postal Rate changes. It was for the first time in the financial history of this country that additional taxation of this magnitude was imposed.

After making changes with a heavy hand in 1957-58 budget, the Finance Minister was confident that, "there will, undoubtedly, have to be some adjustments in this structure from year to year. But I expect that these adjustments will be relatively small and of a marginal character. For the rest of the Plan period, our aim will be to watch how the changes I have initiated this year work in practice and how the system can be improved upon, to the benefit of the taxpayer no less than in the interest of the tax-receiver. Within this broad framework, I believe, all concerned can proceed with their plans with confidence and assurance of sympathetic consideration by Government of any genuine difficulties."[2]

During later years changes in direct taxation were confined to such improvements as were necessary to make the taxation pattern as integrated one and to plug the loopholes in taxation. In 1958-59 gift-tax was imposed.

In the year 1959-60 the changes made were largely in the field of indirect taxes which were estimated to yield Rs. 20.85 crores. The increase due to the changes in wealth-tax was estimated to yield Rs 2.5 crores. In the light of the large changes made during the previous three years the Finance Minister proposed to cover only about a fourth of the anticipated deficit of Rs. 80 crores in 1959-60.

In the budget of 1960-61 the Finance Minister said that "The proposals for the coming year, particularly those widening the base of taxation, have been formulated with the needs of the Third

1. Budget Speech, 1957-58, para 71.
2. Ibid.

Plan in view. While direct taxation will be kept under constant and continuous review so as to make it yield the maximum resources, the bulk of the expansion will have to come from indirect taxation."[1] In pursuance of this policy additional indirect taxation of Rs. 23.53 crores were imposed and only certain minor changes were made in the direct taxes like expenditure tax and estate duty. The proposals were hailed by the business community. It was in fact, a step in the right direction.

The first budget for the Third Plan Period was put up in 1961-62. The tax net was cast wide. The excise duties were raised on fifteen commodities and new ones imposed on eighteen commodities, while existing import duties were raised on fifteen articles by name and also on other ones not otherwise specified. In addition, countervailing import duties were imposed on ten commodities. Through indirect taxation an addition of about 10% of the total revenue was estimated. An increase of only Rs. 3 crores in revenue from direct taxation was expected by way of some marginal adjustment in the tax structure. The main source of additional revenue was contemplated to be indirect taxation. The tax policy was aimed at doing nothing that would reduce the accumulation of capital in the private sector. The emphasis was on the promotion of production.

In 1962-63 budget, besides levying excise duties on a variety of articles and increasing rates on many others, the Finance Minister announced an increase in corporation tax on Indian companies, an increase in Wealth Tax at higher slabs, increase in personal rates of income-tax, while reducing surcharge on salary income. Expendure tax, one of the integrated controversial taxes introduced by Shri T.T. Krishnamachari, five years ago, was abolished.

The Finance Minister said, "Taxation policy in a planned economy serves the wider objectives of augmenting savings, promoting exports, of bringing about a better balance between the supply and demand for individual commodities and indeed of social justice in distributing the rewards and sacrifices in planned progress. The budget proposals for that year were framed with these ends in view.

The net effect of the changes in direct taxes was expected to bring about an increase of Rs. 27.2 crores and an increase of Rs. 44.5 crores by way of changes in indirect taxes (the estimate was for a full year). A part of additional levies must, however, necessarily be hoped to have passed to the consumer. In case of most commodities there is a sellers' market in India. As a result, the producers and sellers are able to raise the prices of commodities.

The concessions in income-tax, import duties and excise duties which were announced in case of export commodities were, no doubt, favourable to encourage exports, thereby to some extent

1. Budget Speech, 1960-61.

helping the country in reducing the foreign exchange gap.

The new taxation proposals for 1963-64 were expected to yield a revenue Rs 275.5 crores, an all-time record of taxation by any Finance minister in this country. This was due to the reason that Chinese aggression necessitated an increase in defence expenditure. Financial outlay on defence for that year was estimated to be of the order of Rs.867 crores and Plan outlay Rs.1,226 crores.

That year corporate taxation was supplemented by super-Profit Tax. A progressive surcharge was levied on incomes after tax. There were included a number of changes in direct taxes, which were intended to expedite tax collection and to rationalise some of the deductions which were allowed in corporate taxation as well as wealth tax.

In the budget several proposals were also made to vary excise duties and customs duties to provide a measure of flexibility in them in response to the changing circumstances.

A new feature for this country in the budget for 1963-64 was the introduction of Compulsory Deposit Scheme. The salaried workers who do not pay income-tax were later on exempted from this Scheme. Withdrawal of the scheme in respect of income tax payers was not contemplated to be feasible as Shri T.T. Krishnamachari pointed out, "a withdrawal of compulsory deposit in respect of income-tax payers might mean a great hardship to them because in lieu of refundable deposit they would have to make an outright payment in shape of a tax."

In the budget for 1964-65, the Compulsory Deposit Scheme was replaced by a new Annuity Deposit Scheme. This would operate at the income level above Rs. 15,000 per annum. The current year's budget was intended to serve as far as possible the various ends which were explained by finance minister in these words : "Taxation has to be used as a sensitive and multipurpose tool, to encourage production, to keep a measure of restraint on rising levels of consumptions, to ensure that people get the fruits of their labour, to induce savings and to prevent profiteering so that the inherent ills of a scarcity economy are not multiplied." Further the finance minister put up two criteria to be kept in view while imposing indirect taxes. One of the essential conditions to be fulfilled by indirect taxes was that the revenue from the items on which such taxes were imposed was sizable and secondly, that the incidence of these taxes should be identifiable. Applying these conditions, it was proposed to remove the duty completely on a number of items. For example, excise duty was removed on gramphone records, all gases other than carbon dioxide used for the manufacture of aerated waters, low voltage electric motors and all acids other than sulphuric acid. Excise duty was withdrawn on soap manufactured without the aid of power.

We find that rationalisation of the tax structure rather than

revenue has been the motivating force behind the extensive changes in the tax laws that have been announced this year with a surplus in the revenue account even at the then existing rates of taxation, the aid of fresh taxation was sought only to the tune of Rs. 40 crores —Rs. 15 crores in direct taxes and Rs. 25 crores in indirect taxes.

4

CENTRAL TAXES (DIRECT)

(1) *TAXES ON INCOME*

Introductory

Taxes on income[1] occupy a prominent place in the tax systems of all capitalist countries[2] because of the large inequalities in incomes and the important role they have to play there. They can be made fairly progressive so as to distribute the burden of taxation equitably among different sections of the society according to the ability or capacity to pay, because, as we have already discussed,[3] income is the best measure of ability to pay taxes, where they are largely unequal. Besides this, the taxes on income are also employed there for bringing about redistribution of income.[4] On the other hand, in a fully socialised economy redistribution of income is mainly brought about by direct methods and not through taxation. For these reasons, taxes on income or direct taxation in general is not so important in a socialist economy. In China there is no income-tax at all, and in Soviet Russia[5] the bulk of revenue comes from turnover taxes. Direct taxes, however, have also some part to play even in Soviet type of economy as we have already discussed.[6]

1. Income liable to tax generally fall into five categories (i) wages and salaries (ii) interest on securities and dividends (iii) profits of business, profession or vocation (iv) Income from property and (v) income from other sources, which also includes income from dividends, computed after making certain allowances for expenditure incurred solely for earning the income. Many countries distinguish certain categories of income for special reasons *e.g.*, earned and unearned income. Some countries like France and South Africa exempt the income of residents which is earned abroad. Australia also exempts income earned abroad except income from dividends.
2. For example, in U.S.A., the receipts from the personal income-tax in 1957 was 46.7% of the Federal budget revenues. Receipts in 1948 amounted to almost half of the Federal budget revenues and to 37% of the combined revenues of the Federal, State and local budgets.
3. Vide Chapter I.
4. Vide Chapter XI.
5. InU.S.S.R., direct taxes on income, generally did not provide more than 10% of total tax revenue except during war (1943) when it was 23% (Vide Chapter I.
6. Chapter I.

In our country too as the economy becomes more and more socialised and the top brackets are removed from existence in course of time, and "there are a very large number of people—shop-keepers and people who are not salaried classes, whose income cannot be deducted at source, and escaping taxation—who are likely to grow in the future,"[1] we will have increasingly to depend on this class for our tax revenue, or "alternatively give up direct taxation and go to indirect taxation."[2] Therefore, direct taxes,[3] including taxes on income, are bound to be the decreasing source of revenue in our country. The decreasing importance of income-tax in the tax system of India will be clear from the following table :

Table 17

Percentage of personal Income-tax to total Tax Revenue of the Central Government (before payment to States):

1644-1947

Year	1944-45	1946-47	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57
Percentage	29.02	25.35	29.88	28.53	31.30	29.22	26.80	27.08	26.61

1958-1966

Year	1957-58	1958-59	1959-50	1960-61	1961-62	1962-63	1963-64	1964-65 (R.E.)	66 (B.E.)
Percentage	23.51	23.98	18.33	18.41	16.85	14.48	14.91	14.71	

Calculated from Statement No. 1 and the Explanatory Memoranda of the Budgets of the Central Government for 1947-48 and 1948-49.

(A) INCOME-TAX

Earlier History

Income-tax in India was first introduced in the year 1860 under the British rule as an emergency measure to remove financial difficulties. The importance of the tax began to increase gradually. By the end of nineteenth century it became a permanent feature of the system of India for supplementing the revenues. Such was the case for income-tax in most countries of the world also.

When it was first introduced it was imposed on agricultural income also. In the Act of 1886, when it was re-introduced, agricultural income was exempted from the tax. A form of cess was introduced in its place which too later on ceased to exist. Even now agricultural income is exempted from the income-tax levied by the Union Government, as agriculture is a State's subject

1. T. T. Krishnamachari, Rajya Sabha Debate, 1957.
2. Vide Table 429, showing percentage of direct to indirect taxes In India.
3. Ibid.

according to the Constitution, and the Union Government has no power to legislate on it.

Up to the year 1914, income-tax was levied at a flat rate at all levels of income, and in the following years some progression was introduced, but the rates were fixed on the basis of 'step system'. In 1916 the 'slab system' was introduced for incomes above Rs. 50,000. In 1918 the practice of taxing incomes from different sources was discontinued, and the total world income of the individual was made the basis of assessment. Various amendments were made from year to year. Ultimately the Income-tax Act of 1922 came in force, which still remains in existence today. The present shape of Income-tax Act is a result of additions and modifications made in the structure of the Act of 1922. The Government of India appointed an expert Committee in 1935 to investigate the defects of the Act in all its aspects to ascertain the scope of the tax and efficiency in its administration. On receiving the report of the Committee radical changes were introduced in 1939. In 1940, the slab system was made applicable to all levels. Further changes were made particularly due to World War II. The rates of the tax were raised, and during the following seven years they were stepped up till they reached the peak in 1947-1948.

In order to reduce the incidence on lower incomes, certain reliefs were introduced from time to time. The limit of the minimum income exempt from tax, which was Rs. 2,000 in 1939 was reduced in 1942 to Rs. 1,000, but was again restored to its original level of Rs. 2,000 in 1943. The provision for earned income relief was introduced in 1945. The relief was given at the rate of 10% of earned income subject to a maximum of Rs. 2,000. In 1946, the rate of earned income relief was raised to 20% subject to a maximum of Rs. 4,000.

Income-Tax Since 1947

Exemption Limit (1947 to 1955)—The minimum exemption limit was raised from Rs. 2,000 to Rs. 2,500 in 1947, Rs. 3,000 in 1948, Rs. 3,600 in 1951 and Rs, 4,200 in 1953. The Taxation Enquiry Commission recommended that the exemption limit should be Rs.3,000. As against the consideration that lowering of the exemption limit would impose considerable administrative strain and would involve disproportionately large cost of collection, the Commission was of opinion that "it will become more and more important for effective administration at all levels that considerably larger number of persons should be on the list of a assessees."[1] The minimum limit had been raised during the past few years mainly for administrative reasons. In 1957 the limit was lowered to Rs. 3,000 for individuals and Rs. 6,000 for Hindu undivided families as recommended by the Commission. The justification for it was given by the Finance Minister in the follo-

1. The Taxation Enquiry Commission, Vol. II, p. 136.

wing words, "An income of Rs. 4,200, modest though it is in absolute terms, is quite a large multiple of the average level of incomes in the country. It is reasonable to expect that those with an income over Rs. 3,000 should also make their contribution, however small, to the public exchequer, and should come within the range of direct taxation. As development proceeds, there will, I expect, be a large and progressive increase in the number of incomes within this range and I think it is essential if the Exchequer is to benefit proportionately from the expansion of incomes consequent on development, that these incomes are brought within the income-tax range."[1]

The exemption limit (and the rates of the tax) for Hindu Undivided Families, unregistered firms and other associations of persons were the same as for individuals from 1939-40 to 1948-49. For 1949-50 the exemption limit for Hindu Undivided Families with two or more members was fixed at Rs. 5,000. From 1950-51 the exemption limit for Hindu Undivided family had been double of that for an individual, changing along with the change in the latter. The Taxation Enquiry Commission recommended that for families with four or more such members, the exemption limit for income-tax may be fixed at three times the general exemption limit. It did not recommend any relief in respect of super-tax. In 1955-56 such a concession was made for such families entitled to claim partition. They were exempted from tax so long as their income did not exceed three times the exemption limit allowed to an individual.

Rates (1947 *to* 1955)—The rates of income-tax like the limit of non-taxable minimum have also changed from time to time. Rates[2] of income-tax from 1946 to 1955 were as follows :

Table 18

Rates of income-tax in case of every individual who is married and every Hindu Undivided Family.

(1946-47 to 1954-55)

Grades of Income	1946-47 to 1948-49	1949-50 to 1954-55
1. First Rs 1,500 of total income	Nil	Nil
2. On the next Rs 3,000 of total income	1 Anna	9 pies
3. On the next Rs 5,000 of total income	2 Annas	1 Anna & 9 pies
4. On the next Rs 5,000 of total income	3 Annas & 6 pies	3 Annas
5. On the Balance	5 Annas	4 Annas

Changes in Income-Tax Since 1955—In 1955 a number of changes

1. Krishnamachari, T. T., Budget Speech, 1957-58.
2. Vide Statement No. III (A) for comparative chart of the rates of income-tax, from 1946 upto-date.

affecting tax liability were included in the amendments to the Income-tax Act in accordance with the recommendations of the Taxation Enquiry Commission.

Among the large number of the Commission's recommendations, some deal with the broad structure of taxation and others with matters of detail, such as the inclusion or exclusion of certain categories of income from taxation, grant of incentives and other concessions, and so on. So far as the basic structure of personal taxation is concerned they had suggested a graded diversification of the existing slabs particularly in the slabs of super-tax, and the readjustment of rates within these slabs. They had also recommended the withdrawal of the concession relating to earned incomes beyond a certain limit which they had suggested to be Rs.24,000. In the case of super-tax they had also suggested a lowering of the limit at which super-tax is attracted from Rs. 25,000 to Rs. 20,000.

The broad pattern of adjustments suggested by the Commission were accepted by the Government and various changes were made in the year 1955 to implement the scheme with such modifications as were found necessary and desirable by the Finance Minister. Only such of the recommendations were put to actual implementation as were found immediately practicable and feasible. Some of these involved, bringing in to net certain incomes which were not being taxed before. Others were regarding the concessions recommended by the Commission. The most important among the former were that—(1) the value of any perquisite or benefit, whether convertable into money or not received by salary earners drawing over Rs. 18,000 per annum and by directors of companies, and entertainment allowances of all kinds were subjected to tax. (2) Unclaimed balance out of expenses allowed as deduction, compensation received for loss of managing agency or other agencies, and compensation received for termination of employment were similarly subjected to tax.

A first step towards reducing by stages the allowance on earned income was taken, *viz.*, on higher-income brackets, that is, on incomes in excess of Rs. 25,000, the concession was to cease when the level of Rs. 45,000 was reached. The relief of Rs. 4,000 then allowed between Rs. 25,000 and Rs. 45,000 was reduced by Rs.200 for each Rs. 1,000 of income.

The then existing slab of Rs. 5,000 to Rs. 10,000 was broken into two equal slabs—one Rs.5,000 to Rs.7,500 and the other Rs. 7,500 to Rs. 10,000. On the slab of Rs. 7,500 to Rs. 10,000 the tax was raised by six pies from 1 anna nine pies to 2 annas 3 pies. On the next slab of income from Rs. 10,000 to Rs. 15,000 the rate was raised from 3 annas to 3 annas and three pies, as shown below.

Thus in accordance with the recommendations of the Commission the tax exempt slab of Rs. 1,500 was raised to Rs. 2,000 for married persons. This was the first move in the direction of

evolving a suitable scheme of family allowances which the Commission had suggested for implementation.

Table 19

Rates of income-tax in case of every individual who is married and every Hindu Undivided Family (1955-56 and 1956-57).

Grade of Income	Rate
1. On the first Rs. 2000 of total income	Nil
2. On the next Rs 3,000 of total income	9 pies.
3. On the next Rs 25,000 of total income	1 anna & 9 pies.
4. On the next Rs 25,000 of total income	2 annas & 3 pies.
5. On the next Rs 5,000 of total income	3 annas & 3 pies.
6. On the balance of total income	4 annas

Vide Statement No. III (A)

The Select Committee, however, made certain modifications to liberalise the original proposals of the budget. They provided for (1) the exemption from tax of certain benefits, *viz.*, free passage of foreign employees for home leave, liberal treatment of certain entertainment allowances and (2) a less strict definition of S. 23 A-Companies.

In 1956-57 the only change made in the personal taxation was a slight adjustment upwards of the super-tax payable on incomes above Rs 70,000, which has been discussed under super-tax.

In 1957-58 a fundamental change in the income-tax system was made. Till then these changes had followed a standard pattern. The Finance Minister explained the principle underlying the change saying that, "it is necessary to recognise that the basic rates should apply to the person who earns his income, that is, sweats and toils for it, and that others who derive their income from property and investment, that is, without making any direct effort should be made to pay more by surcharge."[1] This marks the introduction of socialistic principles in the tax policy in India and its practical application. Under the system existing then there was no provision for earned income allowance for super-tax. For income-tax there was an allowance of 20°/₀ subject to a maximum of Rs. 4,000 for earned income not exceeding Rs. 25,000. For incomes in excess of this amount, the allowance of Rs.4,000 was reduced at the rate of 20°/₀ of the excess over Rs.25,000, so that for an earned income of Rs. 45,000 the allowance was reduced to nil. To change this system altogether, a standard schedule of rates for all earned incomes and a higher surcharge on unearned incomes was applied. When a person's income was partly earned and partly unearned, the unearned income would be considered to belong to the slab in which the earned income ends, and to higher slabs where necessary. The Finance Minister remarked that "I have come to the conclusion that our existing rates of direct tax at top levels deprive the tax structure of all flexibility. It is said that they tend to diminish the incentive for work but I am sure

1. Budget Speech, 1957-58.

that they encourage large scale evasion. It is now recognised that the very high rates of direct taxation in the top-income brackets in many countries of the world are in practice tolerated or tolerable only because of considerable evasion that takes place. In other words, the high rates tend to be applied to a corroded tax base."[1]

Accordingly, a revised schedule of these rates was introduced and a new scheme of surcharge levy was made as follows :

Table 20

Rates of Income-tax in case of every individual who is married and every Hindu Undivided Family (1957-58 to 1961-62)

Grade of Income	Rate
1. On the first Rs 3,000 of total income	Nil
2. On the next Rs 2,000 of total income	3 percent
3. On the next Rs 2,000 of total income	6 ,,
4. On the next Rs 2,500 of total income	9 ,,
5. On the next Rs 2,500 of total income	11 ,,
6. On the next Rs 2,500 of total income	14 ,,
7. On the next Rs 5,000 of total income	18 ,,
8. On the balance of total income	25 ,,

On earned incomes a surcharge of 5% and an additional surcharge of 5% on incomes exceeding Rs.1,00,000, and a total surcharge of 20% on unearned incomes is chargeable.

A married man with children is to get a child allowance of Rs.300 per child upto a maximum of Rs. 600. The married allowance and the child allowance are not available to persons with incomes exceeding Rs. 20,000.

In subsequent years no changes were made in the income-tax structure except that in 1960-61, the exemptions to certain special categores of assessees were modified.

Exemptions to Certain Special Categories of Assessees

(1) *Religious and charitable trust, and institutions*—The exemption from taxation of income derived by the religious and charitable trusts and institutions from the property held under trust or under other legal obligation, and from voluntary contributions, is among the oldest exemptions in the Indian tax system. The business income of such organisations is also exempt if certain conditions are fulfilled.

The Taxation Enquiry Commission, however, felt that the exemption from taxation of the income of charitable trusts and institutions provides opportunities for tax avoidance, the scope for which becomes wider with the levy of the estate duty. In its view a more permanent machinery than the occasional scrutiny by the income-tax department was necessary for the control and supervision of charitable trusts and institutions.

1. Budget Speech, 1957-58, para 51.

In 1953-54 it was decided that the requirements in regard to the approval of the charity or charitable institutions by the Central Government be waived and the benefit be given to any fund or charitable institutions registered or under a trust, or run by the Central or State Governments or local authority. This modification would lead to a freer flow of assistance to deserving institutions. Along with this modification the minimum exemption limit was reduced from Rs. 2½ lakhs to Rs. 1 lakh and from 10% of the income to 5%. In the 1960-61 budget this limit up to which donations for charitable purposes qualify for exemption from tax was, however, increased to 7½% or Rs. 1,50,000 whichever is less.

(2) *Local authorities*—The entire income of local authorities was being treated as exempt even from 1886, and the Income-tax Acts of 1918 and 1922 placed the exemption on a statutory footing. As a result of the recommendation of Income-Tax Enquiry Committee, 1936 the scope of exemption was restricted. Now, income arising to a local authority from business is liable to tax except where the business consists of the supply of a service or commodity within its jurisdictional area. On its taxable income, a local authority pays income-tax at a flat rate of 4 annas in the rupee plus 5% surcharge, and super-tax at 2½ annas in the rupee plus 3 pies surcharge without any exemption limit.

(3) *Political exemptions*—Until 1953 the rulers of the former Indian States enjoyed exemption under the Income-tax Act from income-tax and super-tax on interest on Government Securities held by them or on their behalf as their private property. Article 291 (1) (b) of the Constitution of India has exempted the taxation of privy purse granted to ex-rulers of Indian States only where the privy purse has been guaranteed or assured under an agreement entered into before the commencement of the Constitution.

Exemptions have also been granted to diplomatic and consular representatives and to members of their staff and to employees of international organisations.

(B) Super-Tax

By super-tax we mean super-tax on personal incomes only. Super-tax on companies is called corporation tax. Super-tax and income-tax are levied on the same income and neither is allowed a rebate in assessing the other.

Super-tax was first levied in 1917-18 as an emergency measure to meet the increased revenue requirements during war-time. It is ever since levied on the slab system. The exemption limit from 1917-18 to 1954-55 was Rs.25,000, then it was lowered to Rs.20,000 in 1955-56. During the war the rates were progressively raised. The maximum rate was raised from 7 annas to 10½ annas in the rupee in 1942. This maximum rate was reached at Rs. 3 lakhs for unearned income and Rs. 5 lakhs for earned income.

In the year 1946-47 the distinction between earned and un-

earned income was introduced for super-tax[1] purposes. In 1947-48 a new scale was devised in which the maximum rate of 10½ annas was reached at a point much lower than it was previously, *viz.*, at Rs. 1.2 lakhs for unearned income and Rs. 1.5 lakhs for earned income. This, in effect means, that the total of income-tax and super-tax taken together amounted to 15½ annas in a rupee. This meant that it would take away from any person with an income of Rs. 1,20,000 nearly the whole of income beyond this amount. It was felt that it hardly left any incentive to save, and hence would retard industrial development.

As a result, in the year 1948-49 the limit at which the maximum rate of tax would be attracted was put at Rs. 3½ lakhs both for earned and unearned incomes. The rates were also changed. The differentiation between earned and unearned income was ignored above Rs. 1½ lakhs.

In 1949-50 the rates were again changed and the different rates for the earned and the unearned incomes were fixed. For earned income the maximum rate of income-tax and super-tax together amounted to 14 annas. For unearned income it came to 15 annas.

In 1950-51 the distinction between earned and unearned income, so far as super-tax was concerned, was abolished. When after Rs.20,000 no distinction remained between earned and unearned income for the purposes of income-tax, it was absurd to make distinction between them for super-tax purposes, which is chargeable only above Rs. 25,000. Therefore, in that year this distinction was removed.

The second change made in that year was that the maximum rate of super-tax, was reduced from 9 annas for earned income and 10 annas for unearned income to 8½ annas in a rupee. The rates for the various slabs were also changed.[2] The maximum rate of personal taxation (income-tax plus super-tax and surcharge) came to 88.6.%

Further in 1955-56, the readjustments in slabs were made in accordance with the recommendations[3] of the Taxation Enquiry Commission. In 1956-57 there was an upward adjustment of the super-tax rates payable on incomes above Rs.70,000. The maximum marginal rate of tax on the topmost income was thus raised to 14 annas.

With this adjustment, the rate of tax on the highest slab of income, that is above Rs.1,50,000 was raised to 91.8% against the then existing figure of 88.6%. The Taxation Enquiry Commission had recommended that the tax on the highest slab of income should

1. The distinction in the matter of Super-tax is not generally recognised in other countries mainly due to administrative difficulties in applying it.
2. Vide Statement No. III B, for the rates of super-tax from 1950 up-to-date.
3. *Taxation Enquiry Commission, Report.*, Volume IV, (Evidences).

not be more than about 86%. They had, however, recommended that in addition to this rate of tax there should be a surcharge cum compulsory deposit at a graduated rate on income above Rs.25,000 —the maximum being 5.6% as surcharge, and the same amount as deposit. Their scheme envisaged that against the surcharge a long-term loan, say for 45 years, might be given by the tax payer at a nominal rate of interest under certain conditions, and that the deposit should be payable with interest after 45 years. Considered purely as a tax burden, the effect of the Commission's recommendation was thus a tax of 86% plus 5.6%, that is to say, about 92°/₀ on the highest slab of income. Thus the scheme of taxation for year 1956-57 came to almost the same as recommended by the Commission.

In 1957-58 the free slab for super-tax was lowered down from Rs 25,000 to Rs. 20,000 and the new schedule of rates was introduced in that year.[1]

(C) Surcharge

A surcharge of 5°/₀ was levied since 1951-52 on all income-tax and super-tax rates (excluding corporation tax) exclusively for the purposes of the Centre. Its burden comes like this. On a person with an income of Rs.5,000 a year, this meant about 8 annas a month. On a person with an income of Rs. 12,000 a year it was Rs.3 a month, and on a person with an income of Rs. 24,000 it was Rs.12 a month. Exemption from surcharge was allowed up to Rs. 7,200 in case of a person other than a company, and Rs. 14,400 in the case of Hindu Undivided Family.

In the year 1957-58 a new scheme of surcharge levy was evolved. A standard schedule of rates to all earned incomes was applied and higher surcharge was imposed on unearned incomes. The surcharge was 5°/₀ on the tax calculated at the standard schedule rates for earned incomes upto Rs.1,00,000, and 10°/₀ on incomes in excess of that sum. For unearned incomes there was a uniform surcharge of 20% over the standard schedule rates. No surcharge on unearned income was to be levied, where total income did not exceed Rs, 7,500.

Through revised schedule of rates and the new scheme of surcharge, the levy brought down the total of the income-tax, super-tax and surcharge for the highest slab from the existing level of 91.8°/₀ to 84°/₀ for unearned and 77°/₀ for earned incomes. But there was an increase in the incidence of tax on unearned incomes between certain high ranges (that is, between Rs. 36,000 to Rs. 1,00,000).

Changes in Income-tax, Super-tax and Surcharge Since 1961-62

Changes in 1961-62

In the year 1961-62 the only change in the rate structure of

1. Vide Statement No. III B.

personal income-tax related to the raising of the special surcharge on earned income over Rs.1 lakh from 5°/₀ of the basic tax to 12°/₀. This proposal was intended to bring down the rate differential obtaining between earned income over Rs. 1 lakh and unearned income. The changes in personal income-tax were expected to bring about Rs. 2.0 crores.

Changes in 1963-64

The schedule of rates of income-tax and super-tax on individuals, Hindu Undivided Families and unregistered firms was revised. The rate at the highest slab is calculated to be 72.5% exclusive of surcharges, while the rate on incomes below Rs.5,000 was to remain unchanged. The intermediate slabs were suitably adjusted to secure an even increase in rates as given below :

Table 20 (a)

Rates of Income-tax in case of every individual who is married and every Hindu Undivided Family (1962-63 to 1963-64).

Grade of Income	Rate
1. On the first Rs 3,000 of total Income	Nil
2. On the next Rs 2,000 „ „	3 per cent
3. On the next Rs 2,500 „ „	7 „
4. On the next Rs 2,500 „ „	10 „
5. On the next Rs 2,500 „ „	12 „
6. On the next Rs 2,500 „ „	15 „
7. On the next Rs 2,500 „ „	20 „
8. On the next Rs 2,500 „ „	23 „
9. On the balance „ „	25 „

A married man with children was to get a child allowance of Rs. 300 per child upto a maximum of Rs. 600 as before.

A reduction was also made in the surcharge on income-tax on salaries including pensions, from 5°/₀ to 2.5°/₀. The other surcharges were to remain uncharged. The rate at the highest slab inclusive of surcharges was 87°/₀.

The structure of rates of tax on registered firms was also revised by reducing the limit for exemption, revising the number of slabs and the rates of tax and having higher rates for firms with five or more partners.

All these measures were expected to yield an annual revenue of a little over Rs. 15 crores.

Changes in 1963-64

An additional surcharge was levied for the purpose of the union rising progressively from 4°/₀ to 10°/₀ on incomes after tax, of individuals, Hindu Undivided Families, unregistered firms and associations of persons. A part of this additional liability could be discharged through a compulsory deposit. A surcharge for the purpose of the union, of 20% on the income-tax payable by registered

firms was also levied. Additional yield of Rs. 45 crores was expected from these measures.

The structure of the existing surcharges was simplified by removing the complicated system of marginal relief involved in the higher limits. Briefly, the existing higher exemption limits of Rs. 15,000 for certain Hindu Undivided families and Rs. 7,500 for individuals, unregistered firms, *etc.* was abolished. The revenue effect of this measure was, however, small.

Changes in 1964-65

This year the structure of income slabs has been simplified and the revised rates of income-tax and super-tax have been introduced.

Also, various surcharges on income-tax and super-tax (including the additional surcharge on income-tax) have been abolished and a single surcharge has been imposed each on income-tax and super-tax for purposes of the Union. No surcharge will be leviable is respect of earned income where such income does not exceed Rs.1 lakh. Where the earned income exceeds Rs. 1 lakh, surcharge will be leviable on income-tax and super-tax chargeable on the excess amount at the rate of 10%. In respect of unearned income, surcharge will be leviable only if such income exceeds Rs.10,000. For unearned income between Rs. 10,000-25,000 the rate of this surcharge will be 12.5% of the income-tax and super-tax payable by the assessee in respect of the whole unearned income (subject to marginal relief); between Rs. 25,001-Rs.75,000 the rate will be 15% and above Rs. 75,000, it will be 17.5%.

The effect of the revision of the rate structure of income-tax and surcharges applicable for the assessment year 1963-64 by a single surcharge on income-tax and super-tax and the introduction of annuity deposit scheme[1] will be that there will be a reduction in the amount of tax payable at most of levels of income.

A single revised rate schedule of income-tax has been prescribed for all registered firms irrespective of the number of partners in such a firm. The rate of Union surcharge (20% of the amount of income-tax payable by the firm on its income from any business carried on by it) and 10% of the amount of income-tax payable by it on its income from all sources other than from any business carried on by it) on income-tax payable by registered firms, however, remains the same as for the previous year. The rate of income-tax in case of companies (25% on the whole of total income) remains the same as for the assessment year 1963-64. However, companies which declare and pay their dividends outside India, *i.e.* foreign companies, will be entilted to a rate of income-tax of 10% of the amount of dividends received by them from an Indian company in which the public are not substantially

1. See Appendix.

interested and carrying on some specified manufacture or production.

The present rates of income-tax are given below—

Table 21

Rates of Income-tax (1964-65)

(i) *In the case of every individual who is married and every Hindu undivided family.*

(1)	On the First Rs. 3,200 of total income	Nil
(2)	On the next Rs. 1,800 ,, ,, ,,	6 Per cent
(3)	On the next Rs. 2,500 ,, ,, ,,	10 ,,
(4)	On the next Rs. 5,000 ,, ,, ,,	15 ,,
(5)	On the next Rs. 7,500 ,, ,, ,,	20 ,,
(6)	On the balance	25 ,,

A married man with children to get a child allowance of Rs 400 per child up to a maximum of Rs 800.

(ii) In the case of every individual who is not married and every individual or Hindu undivided family and in the case of every unregistered firm or other association of persons or body of individuals, whether incorporated or not,or every artificial juridical person referred to in sub-clause viii of Clause (31) of section 2 of the Income-tax Act.

(1)	On the first Rs 1,000 of total income	Nil
(2)	On the next Rs 4,000 ,, ,,	6%
(3)	,, ,, ,, Rs 2,500 ,, ,,	10%
(4)	,, ,, ,, Rs 5,000 ,, ,,	15%
(5)	,, ,, ,, Rs 7,500 ,, ,,	20%
(6)	On the balance of total income	25%

(D) COMPANY TAXATION

Introductory

Corporation tax[1] has become an important source of revenue in most countries, not only because of its revenue aspect but also the tax collected. However, it has become a matter of considerable concern not only to the businessmen who are directly concerned with it, but also to the economists who are concerned with the effects of taxation on corporate earnings on the level of production and employment, or in other words, on the national economy as a whole.

It is held that corporate income-tax is not a tax on stockholders, rather it is a tax on a complex organisation which has a tax paying

1. Corporation tax is a super-tax levied on the profits of companies, which is levied and collected by the Union wholly for its own purposes. It is to be distinguished from the super-tax, which is shared between the Union and the States.

It is to be noted here that in the revenue statements, under the head Corporation tax, the surcharge is also included in so far as it is payable by companies. The business profit tax and excess profits tax, payable by companies were also included under this head when they were levied.

ability distinct from the tax paying ability of shareholders. A corporation, due to larger resources in its possession, is in a better position to earn larger incomes than individuals. Thus, it has a taxable ability more than that of the stockholders. Hence, there lies justification in levying a distinct tax on corporations.

Federal corporate income-tax has been subject of heavy criticism by various groups. The principal arguments against the tax are—(1) it discourages risky investment, (2) distorts business judgment (3) deprives industry of needed funds and (4) imposes an inequitable form of double taxation. The measures which have been proposed to meet some of these arguments may be classified into three groups—(1) those which would better co-ordinate the corporation and individual income-taxes, (2) those which would limit the scope of corporation tax in terms of the number of corporations to which it would apply and (3) those which would improve the structure of the tax itself. In the light of these arguments we shall proceed to study the corporation income-tax in our country.

As regards the argument, that it constitutes double taxation of the same income, the courts in India[1] as well as in the U.K.[2] had held that the corporation tax paid by the company was paid by it as a separate entity and not as an agent of the shareholders. Apart from the legal aspect, the company was also a separate economic entity, the shareholder "resembling less an entrepreneur and more a lender of money."[3]

The productive enterprise in India has been sought to be encouraged during recent years at the corporate rather than individual level. The basic assumption of the policy has been, that while reduction in inequality should be secured by a steeply progressive system of personal taxation, its adverse effects on private capital formation should be counteracted by providing incentives to ploughing back of profits in the corporate sector.

The more recent policy has been to provide special facilities to corporations through initial and additional depreciation allowances, rebate on undistributed profits, development rebate, taxation of bonus share at a progressive rate and increase in the rate of the tax on dividends.

Corporation Tax in India

The corporation tax (formerly called super-tax on companies) was levied in this country after World War I. Till 1939 the companies whose income was Rs 50,000 or above had to pay the super-tax in addition to the income-tax on its entire income. The same was the exemption limit in case of super-tax charged from indi-

1. *The Taxation Enquiry Commission, Report,*, Vol. II, p. 151.
2. Keith, E. Gordon, *Proceedings of National Tax Association,* 1946, p. 388, Also vide *The Taxation Enquiry Commission Report,* Vol. II, p. 151.
3. *The Taxation Enquiry Commission, Report,*, Vol. II, p. 152.

viduals. But the two levies were not to be identified, as the Indian Taxation Enquiry Committee (1925) clarified the position that, "the super-tax which is levied on profits of companies is in fact not a super-tax, but a corporation profits tax."[1]

In accordance with the recommendation of the Taxation Enquiry Committee, the exemption limit in case of super-tax on companies was removed and all the companies had to pay this tax irrespective of their incomes. The rate of tax was also made the same for all the companies irrespective of their profits. The rate was one anna in a rupee.

In 1944, the principle of preferential treatment to corporate savings was introduced. A rebate of one anna in the rupee was allowed on so much of company's total income as was not distributed in dividends, other than dividends payable at a fixed rate. In 1946 this rebate was discontinued and a super-tax (dividend tax) at steepening rates varying from 2 to 7 annas in the rupee was imposed on dividends other than dividends payable at fixed rate in excess of 5 per cent of the capital of a company (other than private companies) including reserves, or 30% of total income, whichever was higher.

This dividend tax was not imposed for the purpose of raising revenue, but in order to discourage the distribution of company's resources in excessive dividends. It would encourage the ploughing back of profits for industrial expansion. The idea underlying the scheme was that a company should be penalised if it distributed roughly more than half of its profits left after taxation. It was ascertained from the completed assessments that the policy which this tax sought to enforce was followed in a great majority of cases. But in order to further discourage those who still persisted in distributing excessive profits, the rates of the tax were tightened in subsequent years.

In 1947 the rate of corporation tax was raised from one anna to 2 annas. In 1948-49 the following three important changes were made in company taxation :

(1) The rate of corporation tax was raised from 2 annas to 3 annas and a rebate of one anna was allowed to the companies, which declare and distribute their dividends in India. The reason given for this was that under the law as it was super-tax on dividends was paid by companies incorporated outside this country to their shareholders abroad in respect of their Indian business. For this purpose it was necessary to ascertain from the companies, particulars about their shareholders abroad and the dividends distributed to them. This information was rarely available in full, with the result that very little of the tax due was collected. To protect from the loss of revenue against this leakage it was thought best to raise the general rate of corporation tax, and to give an

1. *Indian Taxation Enquiry Committee Report*, page 203.

appropriate rebate on their incomes to those companies which declare and pay their dividends in India.

(2) The income-tax on companies with an income of Rs. 25,000 and below was reduced to half the usual rates. This was done to encourage the growth of smaller companies, because in the rapid industrialisation of this country danger lies in concentrating too many businesses in the hands of large companies. The Finance Minister said, "This will broadbase our economy and will also be in line with our general pattern of industrial development with its constant emphasis on the development of cottage industries and a fair distribution of industry over the various Provinces. My contribution towards such a development is to allow this concession in favour of small companies with moderate incomes."[1]

(3) It was also found then that owing to the complicated system of levying the tax at steeply graded rates on dividends above a datum line, very little revenue was collected from this source, and the purpose with which it was introduced did not appear to have been realised. It was felt that something more positive was required to induce industrialists to return more of their profits into investment than taxing those who distribute large dividends. As a measure in this direction the tax on undistributed profits of companies was reduced by one anna. The effect of this was that the tax on undistributed profits was at 4 annas, while that on distributed profits remained at 5 annas.

In the year 1949-50 instead of attempting to tax each privately controlled company incorporated outside India[2] on different basis, the principle of applying an average rate was adopted. As a result, all corporations whether Indian or non-Indian continued to be treated as companies, but a further corporation tax of 1 anna was imposed on those privately controlled companies that did not distribute their profits in India.

In the previous year the concession made to small companies gave rise to considerable administrative difficulties. To meet this, while continuing the concession, it was given the form of a rebate of half the corporation tax, and was limited to public-controlled small companies which were not branches or subsidiaries of bigger companies. As a result of this change, the entire cost

1. Budget Speech, 1948-49.

2. As a part of the scheme proposed in 1948-49 in respect of the dividends paid out of Indian profits by companies incorporated outside this country, an amendment was made in the Income Tax Act so as to confer personal immunity from further taxation upon the shareholders of such companies. The amendment, however, had the effect of conferring immunity from super-tax not only upon the dividends actually received, but also upon the dividends which under the operation of S23-A, of Income-Tax Act could be deemed to have been received from privately-controlled companies. This point was met by applying to this category of companies the rates of income-tax and super-tax prescribed for individuals or associations, and the definition of "company" was altered to permit this being done by executive action.

of the concession fell upon the Centre, and the Provinces had not to share it.

In 1950-51, there was a reduction in the income-tax paid by companies (from 5 annas to 4 annas) with a concurrent adjustment in the rate of corporation tax (raising it by ½ anna). This was designed to assist in the development of industries and to help companies to plough back more of their profits into their business. Even with this reduction the general rate applicable to a company, taking income-tax and corporation tax together, amounted to 6½ annas *i.e.* ½ anna more than the rate during 1946-47.

In 1951-52, the rate of corporation tax was raised by ½ of an anna, from 2½ annas to 2½ annas. Since 1922 it had always been the practice to fix the rate of corporation tax at the lowest rate of super-tax applicable to an individual. This was departed from twice in years 1945 and 1946. It was pointed out by the Finance Minister that he did not consider it appropriate "at the present juncture to do something towards re-establishing the conventional-parity between the two rates."

No changes were made in 1952-53. In 1953-54 companies, which invested their surplus funds in another company were exempted from corporation tax on such dividends, which they had to pay formerly.

Then after a gap of five years in the year 1956-57 three important changes were made in the company taxation. It was said by the Finance Minister, "In view of the large development expenditure that has taken place in the First Plan period, and the even larger expenditure contemplated in the next Plan, I think there is adequate justification for putting a small extra burden on companies."[1] The changes were as follows:

(1) The rebate of one anna of income-tax then given to non-Section 23-A Companies,[2] in respect of undistributed profits were withdrawn.

(2) While the rate of the corporation tax payable by Indian companies remained unchanged, there was levied in addition a tax at a graduated rate on the dividends declared by them above a certain limit, namely, 6%. This rate was fixed at 2 annas in the rupee on the amount distributed in excess of 6%, but upto 10% of the paid-up capital. On distribution above 10% of such capital,

1. Budget Speech, 1956-57.
2. Section 23-A Companies: Section 23-A applies particularly to two kinds of companies (1) private limited companies where number of shareholders are 5 or less, (2) where 60% of the total shares is owned by 5 or lesser number of persons. Such companies are required to distribute certain percentage of their profits as dividends, so that the big shareholders are not in a position to evade super-tax thereon. However, it is necessary to encourage industrial companies to plough back their profits into their business for purposes of maintenance and employment. With these considerations, the percentage of profits to be declared as dividends was reduced (in 1958-59) particularly in the case of industrial companies.

the extra tax was fixed at 3 annas in the rupee.[1]

(3) Another change was that an increase was made in the penal corporation tax payable by a section 23-A Company which dealt wholly or mainly in investments. It was raised from 4 annas in the rupee to 8 annas in the rupee on the amount of undistributed profits, the rate applicable to other Section 23-A Companies remaining unchanged. The reason for such a change was explained to be that in order to avoid super-tax by the shareholders of the S.23-A Companies, it did not declare full dividends. If they did not declare full dividends, it was held that they should pay certain penal tax.

(4) A tax of 2 annas on bonus issues was imposed. The Taxation Enquiry Commission had, on the other hand, recommended that there should not be any tax on bonus shares. The Finance Minister, however, said, that "there is adequate justification for imposing such a tax,. . . ., such tax is an integral part of the scheme I have proposed."[2] It was also said in justificaton of the corporate taxation proposed and specially in regard to the tax on bonus shares that "you cannot have a tax on dividends without a tax on bonus shares and you cannot have a tax on bonus shares without a tax on dividends."[3]

The process which was started in 1953, of equating the tax payable by a foreign company operating through a branch, and that payable by another company operating through a subsidiary Indian company which remits the whole of its profits as dividend to the foreign parent company, was also completed this year. The net effect was that the tax payable by a foreign company operating through a branch went up from 53°/₀ to 62°/₀.

In 1957-58, the following changes were made :—

(1) The income-tax payable by companies was raised from 4 annas in the rupee to 30°/₀ and the corporation tax from 2 annas 9 pies in the rupee to 20°/₀. The reasons for increasing company taxation were given as follows : First, corporate taxation is not high in India in comparison with its level in other countries. This will be evident from the following comparison of the rates of incidence of corporate taxation in some other countries, on the basis of distribution of 30°/₀ of the taxable profits.

Secondly, it was necessary to help the checking up of the tax evasion. If the rate of income-tax paid by companies is low,

1. Certain changes were made by the Select Committee to meet the needs of certain special types of cases. As regards excess dividend, share premia were to be included in the capital base while computing dividends. In the case of companies having taxable and non-taxable income, only that portion of the dividends, bonus issues and capital employed, which related to the taxable income, was to be taken into account for purposes of the extra corporation tax.
2. Deshmukh, Lok Sabha Debates, 1956.
3. Budget Speech, 1956-57.
4. The changes in company taxation in 1959-60 (vide p. 125) were made in such a way as to leave the incidence on companies unchanged.

bigger shareholders do not tend to declare their dividend incomes, because they would then be subjected to super-tax.

Table 22

International Comparison of the Incidence of Corporate Taxation (1956)

Country	Normal tax	Super-tax profits tax social security tax	Total taxes	Credit to share-holders	Net incidence
(1)	(2)	(3)	(4)	(5)	(6)
United States of America[1]	30.00	22.00	52.00	1.50	50.50
United Kingdom	42.50	11.10	53.60	12.75	40.85
Canada[2]	44.00	2.00	46.00	6.00	40.00
Australia	40.00	...	40.00	...	40.00
Sweden (Communal)	12.00	...	56.00	...	56.00
(State)	44.00				
West Germany	31.50	9.00	40.50	...	40.50
Japan	40.00	...	40.00	6.00	34.00
India[3] 1956-57	26.25a	17.18	43.43	10.67	32.76
1957-58	31.50b	20.00	51.50	13.80	37.70

1. If Provincial taxes are also taken into account, the net incidence will be much higher.

a. Income tax (25 per cent) plus surcharge (1.25 per cent).
b. Income tax (30 per cent) plus surcharge (1.50 per cent).

(Source : Brochure : 'Taxation Measures Explained' circulated by the Finance Minister, 1957).

3. (Given as footnote on previous page).

As we know, income-tax was paid on behalf of the shareholders and credit for such tax was given to the shareholder, in his personal assessment in respect of the dividends received by him.[1] If, therefore, the income of the shareholder was such that the ncome-tax payable on his income was less than the tax credit to which he was entitled in respect of his dividend income, a refund was given to him out of the income-tax paid by the company. Persons with incomes below the taxable minimum thus got a full refund[2] of the income-tax so collected originally from the company in respect of the dividends. If, however, the amount already collected from the companies on their behalf was large, the loss accruing to Government by the concealment practised by the bigger shareholders would be considerably reduced. The smaller shareholder, however, would still be entitled to his refund.

(2) Another change made was to reduce slightly the rate of excess dividend tax payable by companies. This was done in view of the fact that the basic tax payable by them was increased

1. The process was known as 'grossing' : *The Taxation Enquiry Commission Report*, Vol. II, Chapter X, para 13.
2. Total credit given every year in respect of income-tax paid by companies in the personal assessments of shareholders amounted to about Rs. 10 crores.

and the amount of money left after the payment of basic taxes would be less than before. The changes made were as follows :—

Table 23

Rates of Excess Dividend Tax, 1956-57 and 1957-58

Rates	1956-57
1. On dividends in excess of 6 °/₀ but not more than 10 °/₀ of the Paid up capital	2 As. 10 per cent
2. On dividends in excess of 10 °/₀ but not more than 18 °/₀ of Paid up Capital	3 As. 20 per cent
3. On dividends in excess of 18 °/₀ of the Paid up Capital	3 As. 30 per cent

(1) Total credit given every year in respect of income-tax paid by companies in the personal assessments of shareholders amounted to about Rs. 10 crores.

(2) Besides this the tax on bonus issues was raised steeply from 12½°/₀ to 30°/₀ in view of the imposition of excess dividend tax and capital gains tax.

(3) Further, the inter-corporate dividend tax was reduced from 17.18°/₀ to 10°/₀ with two objectives in view. First, to compensate the foreign companies for the increase in the basic rates of corporate income-tax, and secondly, to encourage Indian companies to make investments in other companies. The rate of corporation tax on other incomes of foreign companies was reduced from 36°/₀ to 30°/₀ to balance the increase made in the income-tax rate of companies.[1]

So as to balance the need to prevent the tax avoidance, and the needs of companies for funds required for expanding industrial activities, the minimum amount required to be distributed was reduced from the existing level of 60°/₀ to 45°/₀.

(4) A wealth tax on companies was also imposed. Wealth tax was intended primarily as a measure of personal taxation, but in the peculiar economic structure of India it was considered advisable not to exclude companies from the purview of this tax. However, the rate of tax was kept low in the case of companies. There was no tax on assets up to a value of Rs. 5 lakhs and on values beyond that, the rate was 1½°/₀.

(5) Certain other changes were also proposed, like the increase in the percentage of the income that would qualify for rebate of income-tax saved in the provident fund or insurance; exemption from income-tax of employer's contribution to a recognised provident fund, limitation on the 'carry-forward' of losses, *etc.*

1. It is to be noted that shareholders of foreign companies did not get a refund of income-tax paid on their behalf by the companies.

In 1959-60 the following changes were made—

(1) The legal fiction of deeming the income-tax paid by the company as having been paid by the shareholder, and the complicated process of 'grossing' the dividends received by the latter, were abolished; and thus the scheme of company taxation was simplified.

(2) Wealth-tax on companies and excess dividends tax were abolished.

(3) A rate of 20°/₀ for income-tax and 25°/₀ for super-tax, that is to say, a total of 45°/₀ was provisionally fixed for purposes of advance payment of tax by companies. The final rate of tax was to be fixed by the Finance Act of 1960 which adopted these very figures as the final one. This rate was estimated to secure the same revenue as was derived from the taxes on the wealth and profits of companies, that is to say, the yield would be equal to the then annual gross yield, less the annual credit then given to the shareholders.

(4) The tax liability of the shareholders was no longer to be related to the tax borne by the companies. So far as the shareholders are concerned, companies would deduct the tax at the prescribed flat rate and credit it to Government. This tax would be re-imbursed to the shareholders at the time of their assessment. A scheme was also devised for issuing exemption certificates for small shareholders, so that the question of reimbursement might not arise in their case.

(5) Foreign companies were, however, not subject to the scheme. Therefore, to make an adjustment on account of the withdrawal of the wealth-tax on companies the rate applicable to them was raised from 61.5°/₀ to 63°/₀.

(6) Another change was that Bonus issues made out of share premium accounts were also made subject to the tax.

No changes in company taxation were made in the budget of 1960-61.

Comments

Mr. Kaldor had severely criticised[1] (in 1956, in his report on Indian Tax Reform) the complex provisions of company taxation in this country in the following words: "The company taxation provisions of India (perhaps even more than that of other countries) are apt to strike a detached observer as a perfect maze of unnecessary complications, the accretion of years of futile endeavour to reconcile fundamentally contradictory objectives."[2]

1. Kaldor has dealt with in detail how various taxes and provisions relating to company taxation had created unnecessary complexity, uncertainty, penal effect in some cases and resulted in disincentive effect, and hindered the progress of industries and were bound to act as a serious drag on administration. He also severely criticised the provision of section 23A (discussed on p. 121).

2. Kaldor, N., op. cit., p. 84.

So far as the taxation provisions for companies stood till the year 1958-59, they were as a matter of fact, complex and innumerable. There were—(1) the income-tax and corporation tax, (2) the tax on excess dividend distribution while withdrawing the rebate provided for undistributed profits, (3) a tax on bonus issues, (4) capital gains tax, (5) wealth-tax on companies and (6) a compulsory deposit scheme. Mr. Kaldor had suggested simplification of the whole system of company taxation.

In the year 1959-60 an attempt towards simplification and rationalisation of company taxation was made. The abolition of wealth-tax on companies and of the tax on excess dividends were welcome to the business community. The abolition of excess dividend tax was a move in the right direction. Mr. Kaldor too had remarked regarding the discriminatory nature of the tax on dividend distribution, that they operate to penalise companies which earn a high rate of profit and in consequence distribute relatively a high rate of dividend.

But the new scheme of company taxation introduced in 1959-60 under which dividends were subjected to a tax deduction at source of 45% to 20% for income-tax, and 25% for corporation tax—with no credit being given for income-tax paid by the company distributing the dividends, increased greatly the burden on corporate dividends. The rates were fixed with the intention of the Government to maintain the status quo in regard to revenue, after abolition of wealth-tax and excess profits tax. Moreover, it is to be noted that a large number of companies failling under Section 45 of the Wealth-Tax Act, which were exempted from the wealth-tax would be generally more affected, because in applying the same new rate of tax to them as to other companies no account was taken of the exemption from wealth-tax to which they had been entitled.

Abolition of rebate (by grossing) on dividend income received by the share-holders irrespective of the tax paid by the companies on their behalf, was also not justifiable. Mr. Kaldor had suggested that no rebate be given, on the ground that there is no justification for such a rebate as a company is an entity different from the shareholders constituting it. The Taxation Enquiry Commission did recognise that the company is distinct and separate from its shareholders, but it did not recommend the withdrawal of the rebate given to shareholders. Their reasons for doing so, were mainly based on considerations of practical policy in regard to the promotion of equity investment in corporate undertakings.[1]

Even if a company is treated as a different entity, it should pay tax on its profits only. Dividends distributed to the shareholders constitute the expenditure on the profits of the company and must be treated as such. Therefore, only after deducting the

1. *The Taxation Enquiry Commission Report*, Part II, p. 153.

dividends distributed out of the profits, the company should be subjected to the tax. As a practical proposition, no fiction can justify double taxation.[1] Even if we are inclined to resort to the fiction of a separate entity, we should take a realistic and rational view as regards the rights and liabilities of the two distinct entities, namely, the company on the one hand and shareholders on the other hand. If the dividends are taxed in the hands of both the company and share-holders, it would amount to double taxation. Therefore, it is justifiable that if the dividends are taxed in the hands of shareholders they should be deducted from company's profits.

The suggestion of Mr. Kaldor for the merger of the income-tax and corporation tax into a single levy at a reduced rate (of 7 annas in a rupee) was reasonable, but the proposal that no rebate be given to the shareholders, seems to be inequitable and cannot be justified at all.

The tax on bonus issues could justifiably be withdrawn, for there seems no justification for its retention after the abolition of the wealth tax was justified by the Government on the ground that it would prevent the avoidance of the dividend tax. This argument does not avail with the removal of the dividend tax. The yield from the tax also does not justify its existence. It was only Rs. 26.5 lakh in 1956-57, Rs 164.4 lakhs in 1957-58 and the estimated yield for the year 1958-59 was Rs. 150 lakhs. On the other hand, its retention will have a disincentive effect on investment and capital formation. Kaldor had also criticised the tax on bonus issues saying, that it has been introduced more as a measure to prevent avoidance of the new dividend tax than a new tax justified on its own grounds. Instead of abolishing the tax on bonus issues, bonus issues which were made out of share premium were also made subject to the tax in the year 1959-60.

Further, the principle on which the tax on undistributed profits of companies is based is that individuals having income in the higher brackets should not be allowed to avoid payment of super-tax by forming close corporation and not distributing their profits in such corporations. But Mr. Kaldor had said that Section 23-A would considerably limit the growth of corporate enterprise in the country. He had referred to the history of other countries in which industrialisation had depended upon the growth and multiplication of undertakings, which almost invariably started as private businesses and became Public companies later on. He said that, "the penal provisions concerning non-distribution by private companies impose, on the face of it, the most undesirable handicaps on industrial growth."[2]

Some Special Categories of Assessees

Cooperative Societies—The business profits of co-operative societies are exempt from income-tax, but are to be taken into

1. Ibid., p. 151.
2. Kaldor, op. cit., p. 86.

account for determining the rate of income-tax on their other incomes. The rates of super-tax on co-operative societies are also substantially lower than those on personal incomes. The grant of exemption appears to have been based partly on the principle of mutuality and partly on the policy of promoting thrift and self-help.

At present, co-operative societies are charged super-tax at a flat rate of 16% on that portion of their income which is in excess of Rs 25,000 plus a surcharge of 12½% of the amount of super-tax. Dividends distributed by co-operative societies out of exempt profits are not taxable in the hands of their members but are to be included for determining the rate of tax on their incomes.

Partnership Firms—The Income-tax Act recognises two kinds of partnership firsms (1) those which are registered, (2) those which are not registered. In the case of the former no tax was imposed on the firm as such, but its profits were taxed in the hands of the partners according to their respective shares and at rates applicable to them individually. In the case of the unregistered firms, the tax was imposed on the firms as such, at rates applicable to personal incomes. The registered partnership firms, therefore, enjoyed an advantage over the unregistered ones, and they did not also pay any corporation tax which was payable by companies. Hence a tax was levied in the year 1956-57 on registered firms also with an exemption limit upto Rs. 40,000. Now the exemption limit is Rs. 25,000 only.

Insurance Business—The profits[1] of the life insurance business are also taxed. The rates of tax for life insurance business have been lower than for other businesses, as fixed since 1943.

In 1951-52 the Government accepted the proposal of the Income-Tax Investigation Commission that the rebate on super-tax hitherto given to the life insurance companies was not justified in respect of that portion of the profits of the business, which went into the pockets of the shareholders, and did not accrue to the benefit of the policy holder. Thus the rebate was reduced from 2 annas to 1½ annas. For mutual life insurance companies which do not distribute any dividend, the rebate at the old rate of 2 annas in a rupee was continued.

The Taxation Enquiry Commission has remarked that the position as regards differentials in insurance business compares favourably with that in other countries, and the "pitch of taxation does not appear to have exercised any distinct restraining effect in relation to the growth of life insurance business."[2] They, however, recommended a reduction of tax in the first slab of profits (of Rs.

1. The profits are calculated on the basis of the company's accounts, and allowance is made for a reserve for unexpired risks and for additional reserves made by the company.

2. *The Taxation Enquiry Commission Report*, Vol. II, p. 108.

25,000) of insurance companies just as they suggested for all companies.

Till 1939, the profits of the mutual insurance business[1] were exempt from taxation on the basis of judicial decisions. Owing to the need to increase the sources of taxation during the war, mutual companies and co-operative insurance societies were also brought under the purview of taxation. Later on as a result of judicial decisions, business profits of co-operative insurance societies were exempted[2] from taxation. The Taxation Enquiry Commission did not recommend further tax concessions for mutual insurance companies.

Concessions to New Industries

Depreciation Allowances—The need for rehabilitation of industry in the post-war period led to the discovery of a new regulator of the rates of investment, in the form of initial and double depreciation allowances.[3] Following the U.K. practice such allowances on machinery and buildings were instituted in 1946 and 1949 respectively.

In October 1948, as part of the Government's anti-inflationary programme, concessions were granted to industry for encouraging private enterprise to expand production. The normal depreciation allowance was to be allowed at double the ordinary rates on all new plants and machinery installed during five years commencing April 1, 1948.

An additional depreciation allowance was also to be allowed in case there was a drop in the general level of prices which was available only by April 1, 1953, to cover the difference between the written down value of assets on the date and their corresponding value at the reduced prices. For existing plant and machinery extra depreciation allowance for increased wear and tear up to a maximum of 100% of the normal depreciation allowance was to be granted if triple shifts were worked.

Development Rebate—A novel feature introduced in the Indian income-tax Act in 1955 was the granting of an outright development rebate of 25% of the cost of all new plant and machinery installed after March 31, 1954 for business purposes. In the last

1. In mutual insurance associations, the policy holder members join together to help one another mutually for the purpose of insurance. The directors are all elected by the members and the constitution is democratic.

2. Vide Part II of exemptions notified under Section 60 of the Indian Income-tax Act 1952 by the Central Government.

3. The most common method as was initiated by Sir Stafford Cripps is to grant to companies, which instal new plant, an initial and extra allowance, in the first year, in addition to normal depreciation on such plant, and thus provide depreciation on the accelerated basis. It enables a company to write off its assets in a shorter period. India, Pakistan, Ceylon and New Zealand are some of the countries where initial allowances are granted at various rates. The initial allowance in New Zealand is given for five years at diminishing rates. In other countries the inital allowance is given for one year only. India also gives for five years an additional allowance as discussed above.

few years, there had been a demand for an increase in the amount of depreciation allowances so as to take into account increased costs of replacement. The Taxation Enquiry Commission examined this matter in considerable detail and has come to the conclusion that the principle of 'revalorisation' or continuous revaluation of an asset for purposes of depreciation is not merely defective in theory, but certainly unworkable in practice. Instead, they have suggested that while the existing system of intial and double depreciation allowances may be retained with certain modifications for all industries, certain other new industries might be given this 'development rebate'.

Accordingly, the Finance Act of 1955, allowed in place of the initial depreciation allowance of 20% the development rebate of 25%.

Provisions for deposit—In order to ensure that these liberal provisions for depreciation are not abused and the funds are not frittered away in doubtful or speculative ventures, but are either conserved for development of the business itself, or used for other development purposes according to the National Plan, a scheme of deposits was introduced with effect from the financial year 1957. It was, however, much opposed and was branded as a forced loan.

Under this scheme, the company is required to deposit with the Central Government, before the 30th June of the relevant assessment year (or six months after the end of previous year, whichever is later), a prescribed amount depending on its undistributed profits or reserves. The deposit will carry interest at the rate prescribed by the Central Government and will be refundable whenever it is required for 'approved purposes'.[1]

If the company does not make the statutory deposit, the depreciation or development rebate admissible will not be allowed in its assessment.

Tax Holidays—One of the distinct features introduced in 1955 in the Indian Income-tax Act, was the tax holiday given to the new industrial undertakings, which had begun to produce or manufacture goods in any part of India before April 1, 1961. Profits of such undertakings are exempt from both income-tax and super-tax up to 6% of the capital employed, if the following conditions are satisfied :

(i) The industrial undertaking is not formed by splitting up or by reconstruction of any business already in existence or by transfer of assets used in any business which was being carried on before April 1, 1948, and

1. 'Approved purposes', mean, capital expenditure on building, machinery and other fixed assets required for the existing business of the company, repayment of money borrowed by the company on the security of its fixed assets and include any other business purpose approved by the Commissioner of Income-tax or the Board of Referees appointed for the purpose.

(ii) It employs ten or more workers in a manufacturing process carried on with the aid of power or employs twenty or more workers in a manufacturing process carried on without the aid of power.

This concession is applicable for five assessment years immediately following the year in which the assessee begins to manufacture the goods. Dividends declared by such new industrial undertakings, out of its income exempt from tax, in the above manner, are also exempt from income-tax and super-tax in the hands of the shareholders, which would otherwise have been liable to tax in their hands. This benefit is also available to non-residents who invest in the shares of newly established industrial undertakings of the type mentioned above.

Changes in 1961-62

The changes made this year were to rationalise the tax structure. These changes were expected to yield Rs. 1 crore. The main changes were as follows :

(i) The super-tax on dividend on inter-corporate investments was designed mainly to discourage the formation of subsidiary companies in India. In respect of dividends received from an Indian company, whether a subsidiary or not, formed after April 1, 1961, the rate on dividend received by all companies (Indian or foreign) was fixed uniformly at 20%. The rate on dividend received by an Indian company in which the public are substantially interested and which has total income not exceeding Rs.25,000 was 15%. Thus, dividends from subsidiary companies henceforth attracted higher super-tax(20%)than hitherto (10%). Dividends from non-subsidiary companies was to pay a lower tax, the reduction being particularly in respect of dividend received by foreign companies.

(ii) With a view to encouraging companies to widen the equity base, the effective rate at which super-tax is payable at bonus issues was reduced from 30% to 12%.

(iii) A reduction was made in the effective rate of super-tax on royalties received by a foreign company (which does not declare dividend in India) from an Indian concern, in pursuance of an agreement made with the Indian concern on or after April 1, 1961 and which was approved by the central government, from 45% to 30%; the total tax was thus reduced from 63% to 50%.

(iv) The development rebate in case of machinery or plant installed after March 31, 1961 was reduced from 25% to 2%.

(v) The benefit of five years tax-holiday were extended to newly started hotels which satisfy certain conditions. This was intended to promote tourist traffic in India.

(vi) The Schedule of admissible entertainment expenses was tightened mainly as a measure of restraint.

Changes in 1962-63

The rate of corporation tax on Indian companies was increased from 45°/₀ to 50°/₀ while the rate of tax on foreign companies was to continue at 63°/₀ generally. For this purpose the rate of income-tax applicable to all companies was raised from 20 to 25°/₀, the rates of super-tax being suitably adjusted. Earnings from exports were to be excluded from this increase.

With the increase in the level of corporation tax, it was necessary to make some reduction in inter-corporate taxation because when one company pays a dividend to another, the same profit is liable to corporation tax twice. In the case of Indian Companies, the rate including super-tax applicable to dividends received from Indian subsidiaries registered before April 1961 was to continue at 30°/₀ while that on dividends received from all other companies was to be reduced to 35°/₀. Indian Companies in which the public are substantially interested and whose income does not exceed Rs.25,000 will continue to get a further concession of five per cent. On dividends received from a non-subsidiary Indian company registered before April 1959, it was to be reduced from 63°/₀ to 50°/₀ while on dividends received from other Indian Companies, it was reduced from 40°/₀ to 35°/₀.

As a result of these changes, corporation tax was expected to yield an additioned revenue of Rs. 10,25 crores.

Changes in 1963-64

The corporate taxation was supplemented by a Super-Profits tax. It was realised by the Finance minister that in the existing system of corporate taxation there was no correlation between the rate of tax and the percentage of profits. Instead of revising the existing system, it was proposed to super-impose on it a super profits-tax. This tax was scheduled to operate when the income of a company after deducting the income-tax and super-tax payable by it exceeds six per cent of its capital and reserves except for such amounts of reserves which have been allowed as deduction in computing the total income for income-tax. The rate of tax was 50°/₀ when that income is above 6% but not above 10% of the capital, and 60% on incomes above 10%. It was hoped that this tax would act as a disincentive to excessive profits and will help to keep down the prices.

The super profits-tax was expected to yield a revenue of about Rs. 25 crores in 1963-64. Other changes in taxation on corporations provided for a measure of incentive to exports.

Changes in 1964-65

(i) A sur-tax on companies profits has been introduced to replace the Super-Profits tax which was introduced the previous year. This tax would be attracted only at comparatively high levels of profits and the incidence would also be generally lower

than that of the super-profits tax. The finance minister explained that the replacement of super profits tax by the sur tax has three-fold objectives—first, generation of greater savings in the corporate sector and to increasing ploughing back of it for the purposes of industrial expansion and growth. Secondly, flow of adequate investment in high priority industries and thirdly, encouragement of smaller units in order to diversify the ownership of industries and attraction of more foreign private investment to improve the balance of payments position.

Sur-tax is a new tax on all companies other than companies having no share capital. It is to be charged at the rate of 40% of the amount by which the chargeable profits of a company for the relevant previous year exceed the amount of the statutory deduction admissible to it. It is also provided that an Indian company or a company which has made the prescribed arrangements for the declaration and payment of dividends within India shall be entitled to a rebate calculated at 20% of that part of the sur tax which is attributable to any profits derived by it from the business of generation and distribution of electricity or of the manufacture or production of any one or more of the articles specified in the list contained in the schedule.

Other important changes in corporate taxation :—

(i) Companies were exempted to pay super-tax on any income by way of dividends received by them from an Indian Company or company which has made the prescribed arrangements for the declaration or payment of dividends within India.

(ii) Super-tax rate in the case of non-resident companies has been raised from 38% to 40% in respect of their income other than dividends.

(iii) Rates of super-tax have been raised from 25% to 35% in the case of companies other than those in which the public are substantially interested or are wholly subsidiary of public companies.

(E) Capital Gains Tax

Capital gains tax is leviable only when the capital gains are realised by sale or transfer for some consideration. So long as a person continues to hold his property, there is no liability for the tax.

The justification for taxing capital gains lies in the fact that it represents income, and therefore, tax payer's ability-to-pay.[1] Moreover, capital gains constitute the source of inequalities of income.[2]

Some writers on public finance have been advocating for a long time a comprehensive definition of 'taxable income' so as to include all forms of casual gains and receipts along with the con-

1. Vide Chapter I.
2. Vide Chapter XI.

ventional forms of income. Such a definition would give the term 'taxable income' a wider connotation and bring within its scope also capital gains.[1]

In this country the capital gains tax was imposed for the first time by Section 6 of the Indian Income-Tax Act and Excess Profits Tax (Amendment) Act, 1947. By virtue of it capital gains arising from 1-4-1946 and upto 31-3-1948, that is for the assessment years 1947-48 and 1948-49 were taxed. Capital losses were to be set off only against capital gains to make secure the position that losses claimed might not exceed the profits declared. Further, profits and losses not exceeding Rs 15,000[2] were to be ignored, so as to avoid investigating petty capital transactions and to exclude the great majority of cases in which assessees dispose of personal possessions. In this levy there was slab system. The rate was one anna in the rupee on the whole of capital gains upto Rs. 5,000, rising by one anna by stages upto a rate of 5 annas in the rupee on the whole amount of capital gains where that amount exceeded Rs. 10 lakhs. Between 5 lakhs to 10 lakhs it was 4 annas in the rupee.

The levy was abolished in 1949 for the following reasons :

(1) the actual yield was small,[3]

(2) the psychological effect of the tax on investment was bad,

(3) the tax operated to hinder the free movement of securities in the capital market, which is a necessary prerequisite for industrial development.

During the two years of its operation only Rs. 6 crores were collected.

As a result of the experience of the capital gains tax levied in 1947, the Taxation Enquiry Commission observed (in 1954) that normally it should not be levied. But they added that if a situation arose when profits were continuously increasing and prices generally were continuously rising, the State may be justified in approaching a part of the unearned surplus for the State. Mr. N. Kaldor suggested capital gains tax as one of the measures to meet the revenue requirement for the development schemes. Mr. Kaldor pointed out that, "it is essential that the additional burden

1. Since Entry 82 of the VIIth Schedule of the Indian Constitution viz., 'Taxes on Income other than Agricultural Income' corresponds to Entry 54 of the VIIth Schedule of the Government of India Act 1935, in view of the decision of Supreme Court the word 'income' is to be given the widest connotation so as to include 'capital gains' Navinchandra Mafat Lal Vs. C.I.T. (AIR 1955, S.C. 58). It was also held in Traders & Miners Ltd.Vs. C.I.T. that the levy of capital gains tax was intra vires of the Constitution.

2. It was on recommendation of a 'select Committee' that the exemption limit was raised from Rs 5,000 to Rs 15,000, and the rates were fixed on a slab system. It was appointed to investigate the accumulations made during war time, which presented its report on March 19, 1947.

3. In U.S.A. also where realised capital gains are taxed, the practical experience is that a large part of it never comes in the tax net.

that will inevitably be imposed through taxation or through inflationary price rises on the broad masses of population, should be complemented by an efficient system of progressive taxation on the small minority of the well-to-do."[1] However, Kaldor remarked that revenue potential of the tax can be apparent only after it had been in operation for 10 to 20 years.[2]

As a result, capital gains tax was revived in 1956 to fill up the loop-hole in the scheme of income taxation.

Under the Act the tax was leviable on capital gains arising from sale, exchange, transfer, or, relinquishment of capital assets after 31-3-1956. The basis of tax was the capital gains represented by the excess of the sale price over the original purchase price or its estimated price on January 1, 1954. The rate of capital gains tax was the income-tax rate applicable to the person, by adding to his other income one third of the capital gains. The maximum rate was 4 annas in the rupee. No super-tax was applicable on capital gains then. The following were exempted from capital gains tax :—

1. Capital gains below Rs. 5,000, and also capital gains made in a year plus the other taxable income earned by him not exceeding Rs. 10,000.

2. Capital gains arising from the sale of agricultural land, personal effects or household goods, or in partitions of Hindu undivided Families.

3. Capital assets transferred by a present company to another company which it owned 100%.

4. On selling one's residential property which had been occupied by him or his parents for a period of at least two years, and investing the gains included in the proceeds of this sale for acquiring residential property within a period of one year from the first sale.

5. Total house property of a person not exceeding Rs. 50,000 and on selling one of his properties for a sum not exceeding Rs. 25,000.

The capital gains tax forms a part of the income-tax. Therefore, it is assessed and collected along with the tax on other incomes.

Capital losses are allowed to be carried forward, without any time limit. The only limitaton is that capital losses of less than Rs. 5,000 are not allowed to be carried forward.

The most radical change made in the fresh levy was to abolish the system of taxing capital gains on the basis of a slab system. The new formula of amalgamation of capital gains and other taxable incomes, and a uniform rate as that of income-tax meant to follow

1. Kaldor, N., *Indian Tax Reform*, p. 1.
2. Ibid., p. 36.

Mr. Kaldor's recommendations. Besides this, the minimum limit of taxable capital gains was reduced drastically to cast the net wide to catch the large mass of people.

The imposition of the tax in our country for the second time, was a deliberate attempt in the direction of the socialist pattern of society. It is one of the methods of reducing inequalities. While recommending the capital gains tax, however, it seems that Mr. Kaldor had no such objective in his mind. The purpose of the impost was not purely a fiscal one.[1] According to him, the long term yield would be Rs 25 to 40 crores per annum. He based his calculation on the assumption that the value of privately-owned property will increase at the same rate as national income measured at current prices.[2] On the other hand, the accumulation of capital through private savings would not be so large, or rather will tend to decline as more and more the objective of the socialist pattern of society is realised. However, capital formation in the future socialist pattern of society in India would be expected from the common man and, therefore, cannot be expected to be large enough so as to yield appreciable taxable capital gains.

The Changes in Capital Gains Tax

1962-63—To secure broad equity in the treatment of different categories of capital gains tax payers, the following basis of assessment was adopted :

The gains which result from disposal of capital assets within a period of one year from the date of acquisition (that is, short-term capital assets) were made subject to average rate of income-tax and also average rate of super-tax respectively, which would have been applicable to the total income if the amount of the net capital gains, if any, relating to the capital assets *other than* the short term capital assets had not formed part of it.

Capital gains for assessees other than companies from assets held over a period longer than one year (that is, long-term assets) were subjected to income-tax at the rate of 25% or at the average rates of income-tax and super-tax respectively, whichever was less. The average rates being those which would have been applicable to the total income, if the net capital gains, if any, relating to *short-term capital assets* had not formed part of it. Long term capital gains of companies were continued to be taxed at 3%. These changes were expected to yield a revenue of Rs. 50 lakhs. Half of the revenue was expected to be realised from Companies.

1. Vide Chapter X.
2. Ibid.
3. 'Average rate of income-tax' means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.
4. 'Average rate of Super-tax' means the rate arrived at by dividing the amount of Super-tax calculated on the total income by such total income clauses 10 and 11 of Sec. 2 of Income-Tax Act, 1961. (Amended)

Changes in 1964-65

In respect of long-term capital gains relating to buildings or lands or rights in buildings and lands, tax shall now be payable by assesses other than companies at 75% of the average rates of income-tax and super-tax applicable to their total income and at 50% of such average rates in respect of other long-term capital gains. The average rates of income-tax and super-tax are to be computed in the same manner as given before in case of long term assets.

Provided that if capital gains are below Rs 5,000, and also if capital gains made in a year plus other taxable income earned by him does not exceed Rs. 10,000, no capital gains tax is payable.

In case of companies no change was proposed to be made in regard to the income-tax chargeable on long-term capital gains. In regard to super-tax on long term capital gains relating to buildings or lands or rights in buildings and lands, the super-tax will be chargeable at 15% (existing rate was 5%) and on other long-term capital gains at 5% as before.

(F) Excess Profits Tax

It is generally considered to be essentially a war-time measure, because during war times artificial scarcities arise and artificial war-time demands are created, and the abnormally large profits are earned in the form of windfall gains. As an anti-inflationary measure and to meet the vast Governmental expenditure during war time the excess profits tax becomes necessary to be imposed.

The Taxation Enquiry Commission has recommended its use during highly inflationary period when excessive profits are made even in peace time.[1] There are, however, a number of difficulties and factors which may go against its imposition in peace times. First, in peace times and under competitive conditions, private enterprise can earn high profits only for a short time. Secondly, considerable difficulty lies in ascertaining what consists of reasonable and normal profit and what is to be decided as excess over it. Thirdly, cases of excess profit over reasonable profit are only few and imposition of the tax under such conditions might kill the incentives.

If, however, the abnormally high profits exist due to monopolistic conditions, it is better to exert direct controls on it rather than impose excess profits tax for a few cases. If, on the other hand, people are generally earning exeess profits then a tax on it is quite justifiable, because from a socialistic point of view, the excess profits mean unearned income, and it must be curbed down. Under such conditions the levy would be justified even in peace time.

In U.S.A. this tax was practised during World War I and

1. *The Taxation Enquiry Commission Report*, Vol. I, p. 165.

World War II but on expiry of the war emergency, the tax was abolished. After the Korean War the tax was re-imposed in 1950.

In India too it was first levied during World War I in the years 1919 and then during World War II from 1940 to 1946. It was imposed at the rate of 50% of the excess profits[1] and then it was raised to 66% in March 1942. The excess profits tax was to be deducted in computing the assessee's income liable to income-tax and super-tax in case of individuals, and corporation tax in case of companies. A post-war credit provision was adopted in 1942 in the excess profits tax legislation. The main idea was that a portion of the excess 'taxed' away would be returned to the taxpayer after the war. It yielded a total revenue of about Rs 408 crores. The Taxation Enquiry Commission discussed[2] the case for its levy in India again, but did not approve of it. To repeat the words of the Commission "Experience of U.S.A., and other countries in regard to excess profits tax in normal time has shown no particular advantage for it over customary forms of income-tax."[3]

(G) Business Profits Tax

The reasons described above which make an excess profits tax harmful and inequitable in peace-time conditions, apply to the business profits tax too.

The business profits tax was imposed as a temporary measure in India in 1947 at the rate of 16⅔% of the business profits exceeding one lakh of rupees. The abatement for companies was 6% on the working capital. The withdrawal of excess profits tax and the need for additional funds for reconstruction and rehabilitation of refugees gave this tax a considerable measure of justification.

In 1948-49 the exemption limit for the tax was raised to Rs. 2 lakhs, and the rate of tax was reduced to 10% of the amount of the excess profits. Thus while it was decided to retain the tax, the burden was reduced by an estimated amount of Rs. 2 crores on the whole.

In 1950 the tax was abolished, as it was felt that it was bearing hard upon industrial concerns. Its burden was directly upon equity capital, (that is, capital which bears risk, rather than the fixed interest bearing capital). Besides this, it applied even when there was no excess profit. For example, it applied to a partnership the capital of which was Rs.40 lakhs, even if the profits were as low as 6%. While, if each of the partners had decided to do business independently and had made profits as much as 10%, there was no liability to pay the tax. It was also found that the receipts from the business profits tax had been steadily falling. It yielded a total revenue of about Rs.31 crores during the three years of its working. In the Finance Minister's own words, "the

1. Rs 1 lakh corresponds to 'standard profit' under Excess Profits Tax Act.
2. *The Taxation Enquiry Commission*, Questionnaire, Question No. 100.
3. *The Taxation Enquiry Commission Report*, Vol. I, p. 165.

business profits tax was the most important single factor affecting capital formation and the development of existing industries."[1]

(II) TAXES ON PROPERTY

(A) Estate Duty

A tax on property from the dead to the living, forms an important part of the tax systems of most of the countries of the world. In India it came to be levied only since 1953. The only duty which was hitherto charged at the time of succession to property was the probate duty. But its scope was very limited.

Before the passig of the Estate Duty Act some of the States like Saurashtra and Madhya Bharat, had proposals pending to impose it as a State levy. After the Central Act was passed they were dropped. Receipts from estate duty, however, devolved on the States. The principle of distribution of shares among States[2] under article 269 of the Constitution, was to be decided by the Finance Commission. Even though the proceeds of this duty will go to the benefit of the States, this augmentation of the revenues of the States would, to some extent, reduce the strain on Central finances. Apart from this it was pointed out during the budget speech of 1948-49, that it was possible to levy a surcharge for purely Central purposes. But it has not been done yet.

The Estate Duty Bill was criticised in the House of the People on two main points of principle.

(1) Its cumulative effect would be to discourage productive effort and retard much-needed capital formation.

(2) It would disarrange rural economy because of the break-up of the large estates[3] involved and the upsetting of established social usages.

The Finance Minister answered the first objection by the argument that he expected capital formation in the future not from the wealthy but from the common man. This view is definitely socialistic. It has been explained in Chapter VIII, how the savings of the common man would help capital formation. As rgards the second point, the Finance Minister accepted wholeheartedly the possibility and desirability of the large estates breaking up. It was also the socialistic objective. Thus the role and the effect of the duty is not so much a fiscal one as a socialistic one,[4] although

1. Budget Speech, 1950-51.
2. Vide Chapter II.
3. Dalton pointed out that in Britain, though Harcourt in 1894 disclaimed any "ulterior aim" in his reform of Death Duties, "the ulterior effects of his policy were readily visible to all intelligent observers, who approved or disapproved of his policy according as they approved or disapproved of its tendency towards the gradual break-up of Large Landed estates (Dalton, *Public Finance*, p. 15).
4. Vide Chapter XI. Also, my article, 'Taxation on Wealth Transfers in India', published in *Estate Duty Journal* (New Delhi), Quarter No. IV, December 1958, pp. 14 to 20.

ita ppears that the imposition of estate duty in our country has been prompted largely by revenue considerations. It was then believed that something between Rs.5 crores to Rs.15 crores would be collected in a year. The actual collections of estate duty have fallen short of even the modest expectation at the time of imposing it, as the following table shows :

Table 24 (A)

Revenue From Estate Duty

Year	1954-55	1955-56	1956-57	1958-59	1961-62	1963-64 (R-E.)	1964-65 (B.E.)
Revenue	0.81	1.81	2.11	2.70	3.09	4.35	7.40

Source : Statement I; and the Explanatory Memorandum to the Budget of the Central Government 1964-65, Annexure II.

The small yield from the duty was partly due to the practice of making large gifts *inter vivos*, which were subsequently expected to be checked by the levy of gift tax. It was also partly due to several concessions provided in the Act itself. The concessions were, therefore, reduced in 1958-59 as follows :

(a) The exemption limit was reduced from Rs. 1,00,000 to Rs. 50,000.

(b) Only half of the probate duty or court fee paid on succession certificates was allowed as a deduction from estate duty, instead of the full amount as it was previously.

(c) Gifts, other than those for charitable purposes, made within a period of two years prior to death were subjected to estate duty. This period was increased to five years as was recommended by the Taxation Enquiry Commission. Gifts on which gift tax had been paid, would not be taken into account for purposes of estate duty.

The effects of these changes were expected to increase the revenue by Rs. 50 lakhs.

The Estate Duty (Amendment) Act of 1958 came into force with effect from July 1, 1960.[1] The rates of duty were also slightly reduced in respect of the lower slabs. The assessment and appellate procedures were generally brought into line with those under the other direct taxes Acts.

The Estate Duty (Amendment) Act of 1960 also came into force with effect from the above noted date. This was passed in order to give effect to the resolutions of the State legislatures (under Article 252 of the Constitution) regarding application of the provisions of the Estate Duty Act, 1953, as amended, to agricultural lands in the States concerned. The Act clarified that the provisions will apply to the levy of estate duty on agricultural lands situated in all States except the States of Jammu and Kashmir, Orissa and West Bengal.

1. Press note issued by the Ministry of Finance, *The Leader*, July 2, 1960.

With the above mentioned amendments the assessment work was bound to increase. It was estimated that with the reduction of the exemption limit another 10,000 estates would become liable to estate duty in a year, and the increase in the administrative staff, along with incidental expenses of administration including payment of remuneration of valuers would cost Rs 5 lakhs.[1]

The number of estate duty assessments in 1958-59 were 7,899.[2]

In the budget for 1964-65 the rate schedule of estate duty was substituted by a new rate schedule. Under the revised rate schedule, the rate of estate duty applicable to the principal value of an estate in the slab over Rs. 20 lakhs has been increased from the existing rate of 40% to 85% as given below :

Table 24 (B)

In the case of a property which passes or is deemed to pass on the death of the deceased (1964–65).

		Rate of duty
1.	On the first Rs 50,000 of the principel value of the estate	Nil
2.	On the next Rs 50,000 " " " " " "	4 Per cent
3.	On the next Rs 1,00,000 " " " " " "	15 "
4.	On the next Rs 3,00,000 " " " " " "	15 "
5.	On the next Rs 5,00,000 " " " " " "	25 "
6.	On the next Rs 5,00,000 " " " " " "	40 "
7.	On the next Rs 5,00,000 " " " " " "	50 "
8.	On the balance of the principal value of the estate	85 "

In the beginning the exemption limit was kept high in order to ensure the volume of assessment and collection work, as the staff was relatively small and inexperienced in handling the new tax. In future, however, the limit should not be fixed very low. "If the exemption limit is reduced drastically"—said the Central Board of Revenue, (which the Taxation Enquiry Commission also approved), "the cost of collection will become disproportionately high."[3]

Estate duty as it stands in India is levied on 'the interest which ceased by reason of death'. The duty is levied irrespective of the fact as to who and how many persons are inheriting it and what will be their individual shares. It is unlike the inheritance tax which is imposed on 'the interest to which somebody succeeds on death,' that is to say on individual inheritance. Inheritance tax which is based on the separate inherited share of each recipient rather than on the whole estate was not considered possible for India due to the peculiar features of the Hindu joint-family system governed by the Mitakshara School of Law.[4] It was, therefore, decided to impose estate duty (on the English model) which bases

1. Budget Speech, 1958-59.
2. *Direct Tax Administration Enquiry Committee Report*, para 2.7.
3. Quoted in the Taxation Enquiry Commission Report, Vol. II, p. 244.
4. The Mitakshara law is in force outside Bengal. According to this law each son upon his birth takes an interest equal to that of his father in ancestral property, whether it is movable or immovable.

liability on the total value of the estate left by the deceased.

Under the model of the estate duty in our country, therefore, the application of the principle of progression based on the windfall element arising out of the degree of relationship of the heir to the deceased, could not be applied in taxing the estate. Also, the discrimination in taxation of an estate according to the age of the estate was not possible. It is often suggested that the older the estate the higher should be the rate of the tax on that portion, that is, taxation should be according to the number of times the estate has already changed hands (Rignano Plan). Since inheritance under Mitakshara law is by survivorship, discrimination in taxation according to the age of the estate was ruled out.

On the other hand social justice requires that lesser attention be paid to the total size of the estate left by the deceased than to the amounts received by individual beneficiaries, because otherwise it would lead to inequality. For example, if a man possessing property worth a lac leaves only one heir, the heir is at a much greater advantage than the heir of one who leaves ten heirs. Each of these ten heirs would get very small shares yet he will have to pay tax at the same high rate. We should not be entirely indifferent to the fact whether a large estate passes wholly to a single individual or in small portions to many persons, or to the rich or the poor. If the inheritance goes to a single rich individual he should not be taxed lightly.

Mr. Kaldor also remarked, "from the point of view of equity, the rate of progression should vary with the amount received by a particular person...and not with the total amount of property left by a man."[1] It is said that this differentiation cannot be practicable in India with its peculiar joint-family system, and is dilemma to be solved. But it is not a porblem which cannot be solved if the limit is made to depend on the number of heirs to inherit, prescribing a maximum exemption limit for each heir.

The next point is that, as the exemption limit has been reduced, the question of excluding certain items must also be considered; for example, the exclusion of residential houses in computing the principal value of the estate. During the second reading of the Estate Duty Bill in the Parliament the proposal of exempting residential houses was raised, but was not then passed on the ground that the exemption limit was high. Now when the exemption limit has been reduced the time has come for its being considered. Another proposal is that investments in certain new industrial under-

"On the death of the father the son takes the property not as his heir, but by survivorship" (Mulla, *Principles of Hindu Law*). The result of this is that the interest of the coparceners under Mitakshara law fluctuates with the birth or death of other coparceners. Hence the imposition of death duties is a matter of difficulty in the case of Hindu joint families governed by the Mitakshara school of law.

Under Dayabhaga law, sons do not take interest in ancestral property in the life time of their father. Their rights arise only on the father's death.

1. Kaldor, *Indian Tax Reform*, p. 50.

takings also deserve to be exempted from the principal value of the estate.

(B) Gift-Tax

Gift-tax is the necessary adjunct to estate duty. Gift-tax exists along with death duties in various countries of the World, like Australia, West Germany, Greece, Iran, Italy, Mexico, New Zealand, Spain, Sweden, Argentina, Japan, Canada and United States, *etc.* In Greece, gift-tax was levied as early as 1641. The Gift-tax Act as amended and supplemented still exists there.[1]

Gift-tax in India, introduced in 1958, is a tax on gifts made by individuals, Hindu undivided families, companies, firms and associations of persons on the value of the taxable gifts made by them during the previous year, which would be the same as for income-tax assessment. Gifts from one person to another provide the convenient means of avoiding or reducing liability to estate duty, income-tax, wealth-tax and expenditure-tax. The only effective method of checking such attempts of evasion or reduction of tax liability is the levying of a tax on gifts. With the introduction of this tax, the integrated tax structure which the Government had been aiming at is complete.

It is difficult to determine what proportion of gifts *inter vivos* is made solely to evade the aforesaid levies, particularly estate duty (apart from genuine needs of dependents). So also it cannot be said how far the proportion increases with the successive increase in the rates of estate duty, because it is said that steepening the rate of the duty does not necessarily increase the volume of gifts. "Anyone who studies day by day the habits of wealthy men, as their will reveals, will realise that they do not,in general, desire to distribute their possessions in their life time."[2]

Thus in the absence of any data regarding gifts made in a year,the volume of tax yield and the number of persons who might be called upon to pay gifts-tax could not be estimated correctly when it was passed. However, it was estimated that about 10,000 assessees might be subject to this tax in one year, and it was estimated to yield Rs.3 crores. Actually in 1958-59 the number of assessees were 7,039 and Rs.1.2 crores was the revised estimate of revenue in that year. It was estimated to yield the same revenue in 1959-60.

The tax as enforced in India is of the simplest type. No aggregation is to be made of gifts made during the preceding years of the assessment, other than the previous year alone, for the purpose of determining the rate of the duty. In the Gift-tax Bill the proposal was made that the gifts made during the five preceding years be aggregated. But the Select Committee deleted the provision

1. Commerce Clearing House, Chicago, : *The Tax Systems of the World.*
2. Laski, H., : *Oxford Economic Papers,* Vol. II, 1950,p. 193.

and opined that after getting experience of the working of the Act for a year or two, this matter might be reconsidered. This proposition, however, does not seem to be appealing from administrative point of view.

The following items are exempt from gift tax :[1]

(1) Gift of immovable property situated outside the territories to which this Act extends; and of movable property situated outside the said territories, unless the individual making gift is a citizen of India and is ordinarily resident in the said territories;

(2) Gift in the form of savings certificates issued by the Central Government, and notified to be exempt from gift-tax;

(3) Gift to the Government or a local authority;

(4) Gift to an institution or fund established for a charitable purpose;

(5) Gift for any charitable purpose not fallng under clause 4, made before April 1, 1958, or after that date subject to the maximum of Rs. 100 in respect of each such gift, and subject to a maximum of rupees five hundred in value to the same donee, in any one previous year;

(6) Gift to the relative, dependent upon him for support and maintenance up to Rs. 10,000 at the time of the marriage; and gift to him or her spouse up to Rs. fifty thousand.[2]

(7) Gift of policies of insurance or annuities upto Rs. 10,000;

(8) Gift under a Will;

(9) Gift in contemplation of death;

(10)* Gift for education of his children;

(11)* Gift by way of bonus, gratuity or pension;

(12)* Gift in the course of carrying on business profession or vocation;

(13) Bhoodan and Sampattidan;

(14) Gift for approved purposes out of sums guaranteed or assured by the Central Government as one's privy purse.

Taxable gifts can be calculated by deducting the above mentioned exempted items from the total value of gifts made during a previous year. If the balance exceeded Rs.5,000[3] in one previous year, the excess constitutes the value of taxable gifts on which the donor was to pay the tax at the rates mentioned in the Schedule to the Act. The rates are the same as in the case of estate duty. The only difference being that the first slab of Rs. 50,000 will not

1. Gift-Tax Act, 1958, Section 5 (1).

*. The extent to which the gifts will be exempt in these cases has been left to the satisfaction of the Gift-tax Officer as being reasonable having regard to the circumstances of the case.

2. Changed by Finance Act, 1964, formerly it was Rs. 1 lakh.

3. Changed by Finance Act, 1964, formerly it was Rs 10,000.

be exempt from the tax. The rates of the tax ranged from 4% on the first slab to 40% on gifts over Rs. 50 lakhs. In the budget for 1964-65, existing exemption of Rs.10,000 limit has been reduced by half. The existing rate schedule of gift-tax has been substituted by a new rate schedule. Under the new rate schedule the highest rate of gift-tax will be 50% which will be altered on the slab over Rs. 3,45,000 as given below.

Table 24 (C)

Rates of Gift-tax

1.	On the first Rs 5,000 of the value of all taxable gifts	4 per cent
2.	On the next Rs 15,000 " " " " "	8 "
3.	On the next Rs 25,000 " " " " "	15 "
4.	On the next Rs 1,00,000 " " " " "	25 "
5.	On the next Rs 2,00,000 " " " " "	40 "
6.	On the balance of the value of all taxable gifts	50 "

Gift-tax is defended on the same ground as estate duty. But there lies a difference. Gifts are made during the life time, while the estate duty is levied after the death of the person who leaves a property. There is greater amount of sacrifice to part with one's property during one's life time; because there is natural "reluctance of the property owners to pass with their own, even to their dearest and nearest."[1] Also, persons discount future taxes precisely as they discount all future events, and since the event is known to fall when they themselves are no longer alive, their concern in the event is largely diminished.[2] Hence the rates of gift-tax must be lower than those of estate duty.

Another reason for lowering the rates of tax on gifts is that the tendency to divide one's property during one's life time needs encouragement. It brings about more equitable distribution of wealth. It also brings wealth to the heirs at an earlier age when they need it more and can use it better, while the donors need for it becomes less. On the other hand, inheritance comes to recipients of the property in the advanced age, when they are settled in life and then it may be described as a luxury for them. Thus there is a strong case for lowering the rates of gift-tax.

Under the Act, gift-tax is payable by the donor. It may be recovered from the donee only when in the opinion of the Gift-tax Officer the tax cannot be recovered from the donor. This is, however, inequitable that the person making the gift should pay the tax. The donee acquires the ability-to-pay tax on receiving the gift and he should be subjected to tax and not the donor. Further, the rates of the tax should depend on the wealth possessed by the person receiving the gift or legacy. Thus, if a poor person receives a gift or legacy he should pay tax on it at a much lower rate than if the same gift is received by a very rich man. This was also

1. Taussig, : *Principles of Economics*, Volume II, p. 581.
2. Pigou, A.C., : *Economics of Welfare*, p. 718.

recommended by Kaldor. He said, "The ideal method appears to be to make the rate of taxation dependent neither on the size of the gift, nor on wealth of the donor, but on the total wealth of the recipient, that is, his net worth including the gift."[1] In this way the tax would be related to the ability-to-pay and would bring about a better distribution of wealth when the total wealth of the recipient is taken into consideration while calculating the rate of tax.

The aim of a gift-tax should be to check evasion and not genuine and desirable gifts, and it must not hinder in any way the Indian practice continued from times immemorial of giving donations for the attainment of their spiritual happiness during life or thereafter, nor should it be levied where it is meant to provide the poor and the destitute or needy dependants, because then it will militate against the aim of social welfare and the socialist pattern.

(C) Wealth-Tax

Hugh Dalton was the champion of this property tax in England where it was tried in 1919, but was abandoned subsequently. Wealth-tax is now prevalent in European countries, for example, Denmark, West Germany, Netherlands, Sweden and Norway.[2] It is also levied in U.S.A. In Japan, a net wealth-tax was imposed in 1950, but was discontinued in 1953 after successive reduction in the rates.

In our country the annual tax on wealth came into effect from April 1, 1957. It is a measure which is "egalitarian in intent, but which does not have a disincentive effect."[3] This is due to the reason that the relief in income-tax of top levels of income would give encouragement to larger effort and greater incentive, while at the same time the levy of wealth-tax would prevent large concentration of wealth in the hands of a few. Thus the progressive tax was intended towards a more effective taxation of the richer class without diminishing by it the incentives to earn.

As we have already discussed,[4] income is the best measure of ability-to-pay taxes. Kaldor, on the other hand, holds that "only a combination of income and property taxes can give an approximation to taxation in accordance with ability-to-pay."[5] This is too much in favour of wealth as a measure of ability-to-pay taxes, because the amount of wealth, that is, the assets are not the infallible criterion for it. However, it cannot be denied that wealth-tax is quite commendable from point of view of establishment of an equalitarian society.

Further, from the administrative point of view, it checks the

1. Kaldor, op. cit., p. 51.
2. Commerce Clearing House, Chicago, op. cit.,
3. Finance Minister, Budget Speech 1957-58; Also objects of wealth tax and expenditure tax in the *Gazette of India*, Extraordinary, Part II, May 15, 1957, p. 132.
4. Vide Chapter I.
5. Kaldor, op. cit., p. 20.

evasion of income-tax also, because, "the examination of a man's property ownership is bound to lead to the discovery of his concealed income, and similarly the examination of his income receipts is bound to lead to the discovery of concealed property."[1] It was estimated in the budget of 1957-58 that Rs. 5 crores would be saved by way of reduction of tax evasion.

The following are some of the main arguments which were put up against the imposition of wealth-tax, during the discussion of the Bill in Lok Sabha :

(a) Wealth-tax makes no difference between productive and unproductive wealth. Not all properties yield an income and therefore, they could not all be taxed equitably on a uniform basis and at the same rate.

(b) Wealth-tax on business would be payable even when there are losses.

(c) Wealth-tax would discourage savings and productive enterprise, and business would be starved of funds.

(d) In the case of wealth-tax on business and companies, the burden of the tax might sometimes be shifted wholly or partly to the consumer, according to circumstances.

(e) Wealth-tax would compel forced sales to the detriment of property values.

(f) There would be various administrative difficulties involved, namely, (i) difficulty of discovering true owners of property (ii) difficulties of valuation and (iii) considerable scope for corruption.

(The present municipal records of urban property are admittedly defective and incomplete; and ownership is often difficult to ascertain owing to formidable difficulties created by benami transactions).

Main Provisions of Wealth-tax Act

'Net wealth' is defined as the aggregate value of all the assets belonging to an assessee, less the aggregate value of the debts owned by him (leaving certain specified debts).[2] Assets do not include agricultural property and the right to annuity or any interest in property, where such annuity or interest is available to an assessee for a period not exceeding five years. In computing net wealth, the value of the assets held by an assessee's wife, minor child or association of persons to whom such assets have been transferred, otherwise than for adequate consideration, is to be included. Wealth-tax is not payable in respect of property held in trust, coparcenary interest, works of art, handlooms, etc.; right to pension or life annuity; interest in any insurance policy or provident fund; personal effects such as furniture and jewellery (upto Rs.

1. Ibid., p. 21.
2. Wealth-tax Act, Section 1, sub-clauses (m) (i) and (ii), also sub-clauses (iii) as added by Act 12 of 1959.

25,000), etc. Further, national savings certificates, post office deposits or investments in Government or local authority securities as will be notified by the Government are exempt.

The value of an asset will be estimated to be the price which, in the opinion of the Wealth-tax Officer, it would fetch if sold in the open market. Where, however, the assessee is carrying on a business for which correct accounts are maintained, the Wealth-tax Officer may determine the net value of the assets having regard to the balance sheet of such business.

Table 25 (A)

Rates of Wealth-tax (1957-58 to 1963-64)

	1957-58	1959-60	1962-63 to 1963-64
(a) **In case of every individual**			
1. On the first Rs. 2 lakhs	nil	nil	nil
2. On the next Rs. 10 lakhs	.5 per cent	1 per cent	1 per cent
3. On the next Rs. 10 lakhs	1 ,,	1.5 ,,	1.75 ,,
4. On the balance	1.5 ,,	2 ,,	2.5 ,,
(b) **In case of every Hindu Undivided family**			
1. On the first Rs. 4 lakhs	nil	nil	nil
2. On the next Rs. 9 lakhs	.5 per cent	1 per cent	1 per cent
3. On the next Rs. 10 lakhs	1 ,,	1 ,,	1.75 ,,
4. On the balance	1.5 ,,	2 ,,	2.5 ,,
(c) **In the case of every company**			
1. On the first Rs. 5 lakhs	nil	nil	nil
2. On the balance (flat rate)	.5 per cent	...	...

Where the net wealth of an assessee includes the value of an asset on which wealth-tax is not payable, a proportionate rebate is given. In the case of an assessee having shares in private companies, a provision is made according to which the combined incidence of the tax on his share in the company and on him, does not exceed 1.5%. (Subsequently in 1959-60 it was raised to 2%). In 1958-59 the only change made was to exempt the foreign citizen from payment of the tax on his foreign wealth, even though he might be resident, or ordinarily resident in India.

The procedure for assessment, revision, appeals, etc., is more or less the same as for income-tax.

The provisions of the Wealth-Tax Act, varied considerably from the scheme envisaged by Kaldor. He had suggested a tax on wealth and on personal expenditures in substitution of the high marginal rates of income-tax. The highest rate of income-tax envisaged by him was 45% (including surcharge), whereas it was 77% and 84% on earned and unearned incomes in 1959-60.

In the scheme of wealth-tax envisaged by Kaldor, the tax was conceived as a progressive one, and to be levied at rates (i) which might be well within the total accrual from property, whether in the form of money income, expected appreciation, or psychic

income, and (ii) which took into account the other taxes on accruals, in particular, the income-tax.[1] Accordingly, Kaldor had suggested that the tax should be levied at the rate of 0.3% per annum on the lowest slab (that is, from Rs. 1 lakh to Rs.4 lakhs) rising to 1.5% per annum on the highest slab (that is, in excess of Rs. 15 lakhs). But he was in favour of a lower exemption limit in the long run, in order to cover up those sections of the community which are not touched by the existing tax on income. The exemption limit of Rs. 1 lakh at initial stage was suggested by him entirely for administrative convenience.

Wealth-tax applied to individuals who had wealth of more than Rs.2 lakhs and to Hindu Undivided Families who had wealth of more than Rs 4 lakhs.[2] Although a liberal exemption limit was set up, a large number of exemptions were provided for, which were bound to complicate administrative problems. For example, Kaldor had suggested the uniform exemption limit for individuals, Hindu Undivided Families and companies. While different exemption limits were provided for them. All these provisions also increased administrative difficulties. Also, he had suggested from considerations of equity and administrative efficiency that the tax should be comprehensive, that is, extending to all forms of property. According to him, property in the form of bank balances, jewels and valuables above an exemption limit of Rs. 5,000, also real estate of all kinds, assignable rights with a market value, the ownership of stocks and shares, etc., should all be comprised in it.

Moreover, Kaldor had not recommended the levy of wealth-tax on companies. It was intended by him to be a measure of personal taxation. The Finance Minister in support of his own proposal said, that in the peculiar economic structure of India he considered it advisable not to exclude companies from the purview of this tax. It was also pointed out that the wealth-tax on companies is not something new as it is levied in the following countries (rates quoted against it) : West Germany ¾%; Norway 3/5%; Switzerland ¾%; Finland 4/5%; Italy ¾%. In U.S.A. the rate goes in several States to as much as 2%. It was calculated that about 6,000 companies would come within the net of wealth-tax.[3]

The imposition of wealth-tax on companies was criticized from all quarters on the grounds that investment in companies would become unattractive, it would hinder capital formation and will be injurious to new companies particularly. It would lead to hardship to older companies running at loss, and to the properties with low income yield. It was also objected that it would involve double or even triple taxation. This is because a company may have its subsidiary or may be holding shares in another company.

1. Kaldor, N., : *Indian Tax Reform*, p. 19.
2. It was also applicable to companies which had wealth of more than 5 lakhs.
3. Finance Minister's speech in Rajya Sabha, 1957-58.

The subsidiary company would be taxed on its assets. Then the main company would be taxed on its assets including assets of its subsidiary, and again the shareholder would be taxed on his shares which had already been taxed in the hands of the company. Finance Minister gave an assurance during the discussions in the Parliament that some concessions would be given in case of inter-corporate investments and in the case of industrial undertakings of new company[1] for the first five years. However, wealth-tax on companies was abolished in 1958-59.

In the budget for 1964-65 the rate Schedule was changed. Under the new rate schedule the initial slab of net wealth not chargeable to wealth-tax has been reduced in the case of individuals from Rs.2 lakhs to Rs. 1 lakh and in the case of Hindu Undivided families from Rs. 4 lakhs to Rs. 2 lakhs. The rate of wealth-tax applicable to net wealth falling in the slab above Rs. 20 lakhs has been retained, both for individuals and Hindu Undivided Familes, at 2.5% as shown in the following table :

Table 25 (B)

Rates of Wealth Tax (1964-65)

(a)	**In the case of every individual**	
(i)	On the first rupees one lakh of net wealth	Nil
(ii)	On the next rupees 4 lakhs of net wealth	0.5 per cent
(iii)	On the next rupees 5 lakhs of net wealth	1.0 ,,
(iv)	On the next rupees 10 lakhs of net wealth	2.0 ,,
(v)	On the balance of the wealth	2.5 ,,
(b)	**In the case of every Hindu Undivided Family**	
(i)	On the first rupees 2 lakhs of net wealth	Nil
(ii)	On the next rupees 3 lakhs of net wealth	0.5 ,,
(iii)	On the next rupees 5 lakhs of net wealth	1.0 ,,
(iv)	On the next rupees 10 lakhs of net wealth	2.0 ,,
(v)	On the balance of net wealth	2.5 ,,

Revenue from wealth-tax is as follows :[2]

Year	1957-58 (account)	1958-59	1961-62	1962-63	1963-64 (R.E.)	1964-65 (B.E.)
Amount	7.04	9.67	8.26	9.54	10.00	10.20

(III) EXPENDITURE-TAX

We have already discussed in Chapter I that income is the best measure of taxable capacity. However, tax on expenditure beyond a certain point of income is best from point of view of

1. With the recommendation of the Select Committee exemption from wealth-tax was to be given for first five years on the value of the assets pertaining to an industrial undertaking of a new company.
2. Source : Statement No. 1.

increasing private savings, avoiding disincentive effects of highly progressive income-tax and ultimately advancing towards "an egalitarian society whilst improving the efficiency of operation and rate of progress of economy."[1]

In a mixed economy the incentives in the private sector are to be preserved. An expenditure-tax would necessarily reduce the standard of living of high-income groups without effecting incentives. It is because a person would prefer to have his earnings in the form of savings even if he has to cut down his expenditure, rather than to part with it in the form of taxation.

Thus an expenditure-tax, while preserving the ability and willingness to save and invest, and thus contributing to the national production, will be in consonance with the redistributive objective; because proceeding towards an equalitarian society by raising standard of living at lower level of incomes, is a better method than dropping off a few productive heads by applying highly progressive income-tax.

Kaldor proposed the levy of an expenditure-tax in combination with a tax on wealth and a lower marginal rate of tax on incomes. Wealth-tax would discourage the accumulation of large property, while an expenditure-tax would reduce the standard of living of high-income groups thus making it possible "to restrict effectively the living standards of the rich without sacrificing the long-run egalitarian objective of a more even distribution of property."[2]

Besides this, curtailing down non-functional consumption and promoting savings is an equally important aspect of expenditure-tax.

An expenditure-tax would also help to check tax evasion, because of the fact that an assessee will have to submit a comprehensive return of all his receipts and expenditures. Together with wealth-tax and gift-tax it would be an effective method to check tax evasion. In words of the Finance Minister "By and large we should check evasion, because we are attacking people who have property from various angles, and it is not a question of expediture-tax yielding more."[3]

A proposal for a tax on expenditure was first put up for discussion in the U.S.A. during the last World War in September 1942, but was summarily dismissed by the Senate Finance Committee in view of considerable administrative difficulties. It was perhaps the only effort ever made to introduce expenditure-tax in a practical way. Theoretically, however, the idea was put up

1. Kaldor, N. : *An Expenditure Tax*, p. 15. "The main thesis of his book is that there is no need to look upon the egalitarian or redistributive objectives of progressive taxation as being necessarily in conflict with considerations of economic efficiency and progress. This conflict undoubtedly exists with progressive income-tax." (Ibid, p. 15). But according to him, if progressive taxation were levied on an expenditure base instead of an income base, the difficulty would be over.

2. Ibid.

3. Krishnamachari, T. T. Lok Sabha Debates on the General Budget, 1957.

by some political economists like Fisher, J.S. Mill and Thomas Hobbes. The idea was to tax people on what they consume rather than what they earn; on what they take out of the pool rather than on what they put in.

A spendings tax was also suggested for the Soviet Union by the United States Treasury in 1942.[1] But the tax might have little useful purpose to serve in that country. This is due to the reason that the problem of savings is not so serious there as it may be found in U.S.A. In the Soviet Union the level of liquid asset holdings is quite low, while the main purpose of expenditure-tax is to penalise spendings and to encourage savings. Besides this, it would also be hard to administer there because of existence of collective farm market, unless a system could be devised for recording income from sales of these markets.

The champion of this tax is Nicholas Kaldor who has written a separate volume on this tax and who prescribed it for India too in his report on 'Indian Tax Reform'.

The expenditure-tax was introduced in the Indian Parliament on May 15, 1957. It came into force with effect from April 1, 1958 and was to be assessed on expenditure incurred in 1958. It was not designed primarily with an intention of mobilising resources for the public sector. But it was done more to increase savings and to prevent non-functional consumption. The Finance Minister remarked : "It is, however, a tax which, given effective administrative arrangements, can be a potent instrument for restraining ostentatious expenditure and for promoting savings."[2] On another occasion he said, "If the expenditure-tax does not yield more it is good, because people do not spend. The money goes into savings. If the expenditure-tax yields more it is good."[3]

It was also with the intention of checking evasion, as was remarked by the Finance Minister—". . . . the evader sometimes uses the instrument of law for purposes of avoiding payment, we have to see that the tax structure itself is changed so that we catch these people at many points."[4]

The tax as imposed in India did not conform strictly to the form in which Kaldor had proposed it.[5] We shall refer to the

1. Holzman, : *Soviet Taxation*, p. 92.
2. Budget Speech, 1957-58.
3. Lok Sabha Debates on the 'General Budget', 1959.
4. Ibid.
5. The Finance Minister explained the origin of the taxes levied by him during 1957-58 as follows :

"I do not say that I have borrowed it entirely from Mr. Kaldor. I had the benefit of a number of discussions with Mr. Kaldor. I had the benefit of reading some of his notes which ultimately formed the booklet which we have given to this honourable house. I had to tell Mr. Kaldor that no Government will go as far as he wants. . . All that I have done now is to give a turn to the taxes." (Lok Sabha, Debates on the General Budget, 1957-58). However, it cannot be denied that Kaldor's report forms the basis of this tax.

points of deviation while discussing the provisions of the Act as follows :

Main Provisions of Expenditure-Tax Act, 1957

It is an annual tax on personal expenditure levied only on individuals and Hindu Undivided Families. A company either private or public will not be an assessee for the purpose of expenditure-tax.

A basic allowance was provided as follows :[1]

(i) For an individual, Rs. 30,000 for himself and all his dependants; and

(ii) For a Hindu undivided family, of Rs. 30,000 in respect of the karta and his wife and children, and a further allowance of Rs. 3,000 for every additional coparcener.

Provided that the basic allowance for the Hindu undivided family as a whole was not to exceed Rs. 60,000 in any case.

Provided further that the allowance of Rs.3,000 for any additional coparcener was not to be allowed where the the coparcener was separately assessed under this Act and was entitled to the allowance of Rs. 30,000.

Kaldor in his report had not said anything about the minimum income necessary for attracting this tax, though he had suggested that the tax should apply to a few upper-income brackets. He had suggested a basic expenditure allowance of Rs 10,000 for every adult dependant, and Rs. 5,000 for every child per annum. His system involved the quotient system. He suggested that the rates of taxation in case of expenditure ought to vary with the scale of expenditure per head rather than the total expenditure of the whole family unit. According to this, the expenditure of all members of the family is to be aggregated and then divided into a number of parts depending on the number of persons in each family, and the tax is charged separately on each part.

Most of the provisions in the Expenditure-tax Act were based on the corresponding provisions in the Income-tax Act. Administrative set up, assessment and the appellate procedure were the same as in the case of income-tax. Some of the important provisions are considered below.

'Expenditure' has been defined as the aggregate of all sums in money or money's worth spent or disbursed by an assessee and includes any amount which is required to be included by the Act in the taxable expenditure.

The rates prescribed were based on the slab system ranging from 10% on the lowest slab to 100% on the highest. The rate structure was as follows :

1. As amended by Act XII of 1959.

On that portion of the taxable expenditure	Rate of Tax
(i) which does not exceed Rs. 10,000	10%
(ii) which exceeds Rs. 10,000 but does not exceed Rs. 20,000	20%
(iii) which exceeds Rs. 20,000 but does not exceed Rs. 30,000	40%
(iv) which exceeds Rs. 30,000 but does not exceed Rs. 40,000	60%
(v) which exceeds Rs. 40,000 but does not exceed Rs. 50,000	80%
(vi) which exceeds Rs. 50,000	100%

The rate of taxation proposed was lower than that in Kaldor's scheme, in which the lowest slab of expenditure between Rs.10,000 and Rs.20,000 started from 25% rising gradually upto a maximum of 300% on expenditures in excess of Rs. 50,000 per head. Thus it appears as was also referred to in the budget speech, that a small beginning had been made and it was of an experimental nature. Anyhow, it was not likely to achieve the objective for which it had been levied. The purpose of discouraging high level of spending could be achieved, as was also suggested by Kaldor, by steeply raising the marginal rates.

The list of some important items specified, upon which exemption were allowed for the purposes of expenditure-tax were briefly as under—

(a) Expenditure, current or capital, incurred by the assessee in the ordinary course of his business, profession or occupation.

(b) Expenditure on purchase or construction of buildings or any immovable property.[1]

(c) Investments in bank accounts, deposit loans, shares and securities.

(d) Capital distributed to a partnership or association.

(e) Repayments of loans borrowed.

(f) Gifts and donations.

(g) Premia paid for life insurance, accident, health and disability insurance of the assessee or his dependant, and

(h) Contributions to a provident fund, thrift or superannuation, fund, etc.

The list of exemptions do not follow the one given by Kaldor. There are various subtractions and additions in it. The following important exemptions suggested by Kaldor have been excluded from this list.

1. In place of 'immovable property', the words 'building or part thereof not in the occupation of the assessee or any of his dependants, were substituted by Act 12 of 1959.

Funeral and birth expenses, medical expenses up to a certain amount per head, any additional expenses incurred as a result of severe physical disabilities upto a certain amount per year, fines imposed by courts, and expenses incurred as a result of burglary, theft, flood-damage, etc.

The Act provided a list of deductions and exclusions that were to be made while computing the taxable expenditure *inter alia*, as follows :

(i) All taxes paid to the Government including expenditure-tax [but excluding (a) taxes and fees in respect of any conveyances or other movable asset intended for the personal use of the assessee or any of his dependants. (b) customs duties on articles imported for personal use].

(ii) Expenses on marriage of a dependant subject to a maximum of Rs. 5,000 for each dependant.

(iii) Any capital expenditure on motor cars, jewellery, furniture, etc., spread over a period of five years. (These are the items which are not immediately consumed). That is to say, only one-fifth to be treated as expenditure of the year in which it is actually incurred, and the remaining four-fifth to be included in the expenditure of the four succeeding years.

(iv) Expenditure incurred on leave travel in India as well as education of children in India.[1]

(v) The taxes paid by an assessee to a foreign Government.[2]

While levying the tax it was realised that persons accustomed to high standard of living in the past would need some time to gradually cut down their expenditure. A provision has, therefore, been made which gives them an option that instead of the basic allowance and other deductions which they might be entitled to under the law, the deductions in their case will be equal to 75% of the average expenditure for the last three years, or Rs 75,000, whichever is less. This limit of Rs. 75,000 will be progressively reduced by Rs 5,000 every year.

Changes in 1959-60

Because of being a new levy, first tried in this country only, it was first imposed, with liberal rates and large exemptions. However, in the year 1950-60 some of the exemptions were withdrawn so as to tighten the existing law. Husband, wife and minor children were to be regarded as one unit for the exemption limit of Rs. 30,000 of non-taxable expenditure and not as separate assessees even if they have income in their individual rights.

The definition of dependants was changed that year so as to include any person wholly or mainly dependent on the assessee for support and maintenance.[3] Formerly it included only spouse

1. & 2. Concessions provided in the Budget of 1960-61.
3. Added by Act XII of 1959.

or minor child, who was dependent on the assessee for support and maintenance, while it excluded even near relatives like brother, sister, parents, etc., which was a harsh provision.

The definition of expenditure also needed modification. It must be defined as expenditure other than an outgoing which brings into existence an asset, so that expenditure for capital asset should not be treated as an expenditure liable to tax.

Kaldor had recommended a drastic scaling down of the maximum marginal income-tax rate on earned as well as unearned income which has also been referred to previously. Kaldor says, "A progressive tax on personal expenditure (with a relatively high exemption limit) should be imposed along with other suggested reforms, and the maximum rate of income-tax should at the same time, be lowered to 7 as. in a rupee (or 45% including surcharge)".[1] He thought that "It would not be practicable to impose expenditure-tax on the top of present taxes on income since this would make taxes on income altogether too severe."[2] Therefore, it is alleged that the incentive to personal effort under the present scheme is not so potent as Kaldor had suggested.

As against this argument it may be mentioned that the total of the income-tax, super-tax and surcharge for the highest slab was brought down from the level of 91.9% to 84% for unearned incomes and 77% for earned incomes (in 1959-60), at the same time the rates for expenditure-tax were not so severe as Kaldor had proposed. However, it was hoped that in future when the expenditure-tax is tightened corresponding reduction would be made in the rates of income-tax on the higher slabs.

In 1962-63 the expenditure tax was abolished which was reimposed from the assessment year 1964-65. The rates of schedule

Table 26

Rates of Expenditure Tax (1964-65)

In the case of every individual and Hindu undivided family, on that portion of the taxable expenditure—

(i)	Which does not exceed Rs. 36,000	Nil
(ii)	Which exceeds Rs. 36,000 but does not exceed Rs. 48,000	5 per cent
(iii)	Which exceeds Rs. 48,000 but does not exceed Rs. 60,000	7·5 ,,
(iv)	Which exceeds Rs. 60,000 but does not exceed Rs. 72,000	10 ,,
(v)	Which exceeds Rs. 72,000 but does not exceed Rs. 84,000	15 ,,
(vi)	Which exceeds Rs. 84,000	20 ,,

Amendments have also been made to the Expenditure Act, 1957 to abolish the exemptions and/or the deductions of certain items of expenditure allowed under Sections 5 & 6 of the Act. A yield of Rs. 1.5 crores has been estimated in the budget.

1. Kaldor, N., : *Indian Tax Reform*, p. 39.
2. Ibid.

under the Expenditure-Tax Act, 1957, applicable to individuals and Hindu undivided families have been substituted by a new rate schedule. The rates under the new rate schedules are considerably lower than the rates under existing schedule. The first slab of Rs. 36,000 of taxable expenditure has been exempted from expenditure-tax. Under the revised rate schedule, the highest rate for the assessment year 1964-65 and 1965-66 which will be attracted on expenditure over the slab of Rs. 72,000 will be 15% and from the assessment year 1966-67 onwards, the highest rate which will be attracted on taxable expenditure over the slab of Rs. 84,000 will be 20%, as given in table 26.

Expenditure-tax has been criticised from various quarters. But it cannot be denied that it would go a long way in establishing the socialist pattern of society in the country, though the yield from the tax is too low as given below :[1]

Year	1958-59 (Ac.)	1959-61 (Ac.)	1960-61 (Ac.)	1961-62 (Ac.)
Amount (Rs. crores)	0.64	0.79	0.91	0.84

DIRECT TAXES ADMINISTRATION[2]

Income-tax, expenditure-tax with wealth-tax on one side and estate duty and gift-tax on the other side—form a complementary set of direct taxes. Despite the fact that income is the best measure of ability-to-pay taxes, the expenditure and property taxes are also justified for the reasons given, while discussing these taxes. Thus all the five taxes enumerated above constitute an integrated direct-tax-structure. They constitute, on the whole, an efficient and sufficiently broad based system of direct taxes.

But this is not all. In order that the beneficient aims of the enactments are not frustrated, the administrative machinery is to be so arranged as to make them workable in the most efficient and effective manner. It is to this work that the Government has now turned itself.

The Direct Taxes Administration Enquiry Committee was set up under the chairmanship of Sri Mahabir Tyagi, to advise the Government on this matter. They submitted the report on November 30, 1959.[3]

1. Source : Statement No. I.

2. The Questionnaire issued by the Direct Taxes Administration Enquiry Committee was divided into six sub-heads. I have discussed the problem here under the same sub-heads. I had also kept these sub-heads in my article, 'Direct Tax Administration'—published in '*Civic Affairs*' (June 1959, pp. 59 to 63), which was written before the report of the Committee was out and just after the issue of the Questionnaires).

3. Sri G. P. Kapadia, a member of the Committee submitted a note of dissent in which he discussed such topics as the abolition of expenditure-tax, rates and incidence of taxation, and the raising of the minimum taxable limit. He has also made reconmendations thereon.

Administration

The Central Board of Revenue is responsible for administration of the various direct (and indirect)[1] Central revenue laws in the country. It exercises an over-all supervision, and control over the several administrative and subordinate authorities functioning under various statutes. The Tyagi Committee has recommended that the Central Board of Revenue should continue to function as a Department of Revenue, because it is neither practicable nor desirable to divorce administration entirely from policy making.

Every branch of administrative machinery relating to taxation has today become a matter for experts from the point of view of not only Government revenue, justice to tax payer or his consequent contentment or discontentment, but also for the continuance of the taxes themselves. Professor Seligman considered that the question of administration is nearly as important as the question of justice.[2] The new taxes imposed recently are still in the experimental stage. We must not forget that expenditure-tax has been imposed nowhere in the world due to administrative difficulties except in India, while wealth-tax and gift-tax are being levied only in a few other countries.

The burden of administration of these taxes has come under the income-tax department. The tax administration of the leading countries of today has a similar tendency to combine the staff that deal with cognate subjects.[3] It is obviously wasteful to have two men operating in the same area collecting different taxes when one can do the work of both. One person can deal more efficiently with the income, expenditure, estate and gift of a person. It will also function as a check-up of any evasion or concealment.

To do away with duplication of work and facilitate direct-tax proceedings, an integrated tax Code for all the direct taxes is desirable. Tyagi Committee in its report has, however, postponed the framing of a common code, until such time as the department and the tax paying public gain sufficient experience of the working of the existing statutes and has advised that the present position of administering the various taxes should continue.[4] But there does not seem sufficient justification for delay in this matter.

Income-tax Department was expanded on partition of the country. On integration of Part B States it was expanded further to undertake the new work. Yet the expansion has fallen short of the incumbent burden now imposed on it. A permanent increase in the staff has been found to be desirable, otherwise the collection

1. Tyagi Committee recommended that for the present there should be two distinct wings of direct and indirect taxes in the Central Board of Revenue with a common chairman. After examining the working of the two separate wings, it has been suggested that the Government may consider the feasibility of constituting separate Boards for direct and indirect taxes.
2. Seligman, E.R.A., : *Essays in Taxation*, p. 332.
3. *The Taxation Enquiry Committee Report* (1922-25), Volume 1, p. 395.
4. *Tyagi Committee Report*, Chapter I, Para 4.

of revenue would suffer.[1] But what should be the optimum point for such an increase? For this, various considerations are to be made. The additional cost of collection should not only be low as compared to the high financial advantage to the Government, but it should also contribute immensely to the advantage to the public by providing them with more efficient, considerate and prompt service.

The whole staff need not be of highest qualifications. Highly qualified persons dealing directly with important matters will lay proper standards of high principles for others. Difficulty is not so much of securing and training men, as of retaining the best men. This is an important matter to be considered. Some increase in salaries and early promotions to honest and sincere officers is a method for preventing such tendency in India. It would also tend to stop some malpractices in the subordinate departments.

Assessments

The criteria for fixing the taxable amount should be uniform and simple so that people may know beforehand the exact amount they are liable to pay. This is embodied in Adam Smith's well-known canon of 'certainty'. At the same time administrative importance lies in the attribute of flexibility in the system, as Sir Josiah Stamp points out, "When the real problem is having to discharge legal functions executively, through a large number of agents, how on earth you are going to make those agents act with one mind ?"[2] Then, how are we going to draw a line between flexibility and no flexibility ? It will, of course, depend upon the ability of a good administrator. But as far as possible the element of arbitrariness should be minimised and more equality in assessment brought about by substituting the known for the unknown. Certain mathematical rules to guide the assessor may have to be evolved. But considerable amount of discretion is necessary to be invested, in the assessors even in that case.

The assessment of small incomes presents an entirely different problem. Assessment at source, as has been suggested, is not a very good method for small incomes; because other sources of income cannot be taken into account by this method. Besides, it may go against the good relations between the employer and the employee. Some of the employers may even charge a good amount for the cost of collection. It also reduces tax consciousness.

Tyagi Committee points out that the amount of time and labour devoted to cases of different categories should bear relation to their revenue potential.[3] The time and energy being spent on

1. Ibid., Chapter 8, para 67.
2. Stamp, Josiah, : *The Principles of Taxation.*
3. *Tyagi Committee Report,* Chapter II, para 26.

small cases appear to be totally disproportionate to the revenue yield, which is clear from the following analysis of income-tax revenue statistics.

The total number of effective assessments completed during 1957-58 were nearly 6,73,000. Out of which those (excluding companies) having assessed income of Rs. 7,500 and below were nearly 3,60,000 in number. Of these nearly 12,200 were pure salary earners. Excluding the pure salary earners (whose incomes are assessed at source) and adding to it 2,50,000 'no assessment cases',[1] figure of nearly 4,88,000 is arrived at, which is about 50% of the total number of assessments made in 1957-58, *viz.*, about 9,68,308 (including 'no assessment cases'). The demand raised in all these small income assessments (excluding purely salary cases) amounted to Rs.2.40 crores which is over one per cent only of the total demand of Rs. 222 crores raised during the year from all assessees.[2]

It would be wrong to say that small assessees keep their account irregularly to avoid taxes, but the difficulty is inherent with them. More tax information and tax teaching is required for them. Simplified form of return for small incomes is to be formed.

Then the delay in completing assessment not only causes inconvenience to assessees but also makes investigation of facts difficult and creates a bad impression on assessees of the departmental inefficiency. All this results in loss of revenue. Besides this, the assessment which does not involve any substantial revenue should be examined quickly. Above all, the honest and judicious discretion of the assessor in several other cases also may save a good amount of infructuous investigation and the consequent delay and expense.

Table 27

Disposal of Direct Taxes 1958-59

	Income-tax	Extate Duty	Wealth tax	Gift-tax	Expenditure tax
1. No. of Assessments for disposal	15,87,228	10,779	56,667	7,039	7,774
2. No. of Assessments Completed	11.31,365	7,664	44,077	4,778	5,768
3. No. of Assessments pending at the end of the year	4,55,872	3,115	12,590	3,261	2,006
4. Arrear assessments in terms of number of month's workload	6	5	3	6	5

Source : Direct Taxes Administration Enquiry Committee Report, Tables 1, 3, 4 and 5.

1. These are the cases in which the income computed is below the taxable limit but in respect of which regular assessment proceedings were taken.
2. *The Taxation Enquiry Commission Report*, Chapter II, para 26.

The disposal of assessment of direct taxes has not been unsatisfactory, still the number of arrear assessments was very large, for example, the number of arrear assessments for income-tax represented six months' work-load in 1958-59 at the current rate of disposal. Table 27 shows the arrear assessments which were reduced in terms of number of months' work-load at the current rate of disposal.

In the coming years a continuous increase in the work-load of the income-tax department has been visualised due to various factors such as increasing level of development expenditure, the lowering of taxable limits both for income-tax and estate-duty and intensification of the survey work. According to the rough estimate given by the Central Board of Revenue, the number of income-tax assessees was likely to increase from 9,83,277 as on 1-4-1959 to about 12 lakhs in a period of five years from the above date.[1] Hence there lies a matter of urgency regarding the question of disposal of assessments.

Refunds

Refunds are necessitated under pay-as-you-earn scheme, deduction at source method or when double income-tax relief is sought for. The major defect in making refunds, is the considerable amount of delay made in doing so. It is due to the extra amount of burden placed on the staff and also due to the postponing habit of the officials in this matter. Due to these reasons, even when the refund orders have been made by Income-tax Officer, considerable delay is caused in getting the voucher ready.

Much improvement has been made in making refunds since the Income-tax Investigation Commission gave its reports. Yet much is left to be done in this direction. The Taxation Enquiry Commission has suggested that the progress report of the Income-tax Officer should be amended to indicate also the pending cases of over one year. The Commissioner of Income-tax should also carry out surprise inspection of some of the selected cases in order to satisfy himself that everything possible was being done to expendite the disposal of refund claims.

There is a strong case for the grant of interest at a prescribed rate on the refunds delayed beyond a specific period. The Income-Tax Investigation Commission and also the Taxation Enquiry Commission were convinced of the considerable amount of delay in refunds, and had rightly suggested for the grant of such interest.[2] Tyagi Committee has recommended the rate of interest at 6% per annum to be granted on refunds. But the rate seems to be too high particularly at this stage when the new taxes are still in the experimental stage and the staff is meagre and inefficient. It would add to the cost of administration.

1. Ibid., para 8.
2. *The Taxation Enquiry Commission Report*, p. 213.

Appeals

Delay in disposal of appeals is injurious to the tax-payer as well as to the Government. Tax payers are prevented from making the best use of their funds. On the other hand, it withholds badly needed revenues which may sometimes involve considerable amount. The Government may suffer also, because after a number of years the tax payer may no longer have funds to pay their taxes. The cause of delay is the shortage of the officers of the status of Appellate Assistant Commissioners.[1] More appointments of officials from Income tax practitioners of considerable standing, or giving early promotions to experienced officers of the department is desirable.

Further, it is very important for the Government to be well represented before the Appellate tribunals or law courts. Pleading has an important bearing on the tax and above all on the principle involved in such cases. Whether an issue is resolved one way or the other depends upon the manner in which the cases are presented by the opposing attorneys. Therefore, it is necessary that persons representing the Government should be either specially trained and posted with up-to-date law or should be selected from legal practitioners.

Lastly, a decision should not be kept pending for years simply because it is complicated or is likely to result in a refund to the assessee. Overhearing, suspicious and arbitrary behaviour towards assessees should give place to an attitude which is sympathetic, reasonable and judicious. Tyagi Committee does not favour the time limit within which the appeals should be disposed of.[2] This is, however, to be criticized. A normal time-limit must be fixed which might be waived for good reasons under certain special circumstances. This would make the authorities dispose of cases quickly.

Collection and Recovery of Taxes

On tracing the history of taxes, it seems that the contributions for the support of the society were originally voluntary. Imposition of a tax was considered a disgrace. It was imposed only on the conquered.[3] Next, the taxes came to be imposed in the guise of fees and charges levied for the specific services rendered by the State. Lastly, came the era of taxes when they came to be levied openly and compulsorily. The benefit theory took the place of the ability theory, whereby every citizen should pay not only for the individual benefit received from the services of the Government, but also according to his ability-to-pay (for the benefit of the community as a whole).

To-day co-operation of the taxpayer plays an important part in prompt payment of dues. But co-operation cannot be entirely

1. Ibid., Chapter 4, para 40.
2. Ibid., Chapter 4, para 37.
3. Seligman, E.R.A., *Essays in Taxation*, pp. 1 to 3.

voluntary, and the compulsion of law and threat of penalty in some form is necessary. Incorporation of the proposed grant of rebate on advance payment in all Direct Tax Acts, and likewise payment of interest on the delayed payment of tax, is also desirable.

Co-operative attitude of tax-payers is no doubt, of inestimable value to the Government. Attempts should be made to preserve and develop it, if some of the direct taxes at least are to be self assessed taxes and if the Government has to depend mainly on the returns made by the tax payer.[1] The British system, despite the strain caused by heavy taxation, still depends mainly on the willing co-operation of tax payers through the method of self-assessment. The American system has, however, tended to rely on penalties.[2]

General

In general, the problems bearing on the entire field of public administration are the achievement of high levels of integrity, efficiency, economy and public co-operation. These aims are interrelated and inter-dependent too.

It seems that one thing is very necessary to be infused in the minds of the officers dealing with taxation, namely that they should not be guided by a spirit of somehow making increased assesment to show creditable work, but should try to preserve justice and fair play as the guiding principle, above all other considerations. They will thereby beget confidence and co-operation. Mixed motives beget distrust and breed devices for evasion even more.

In the words of the Planning-Commission, "If at the level at which the citizen meets the administration he encounters corruption, delay and inefficiency, and if he finds no sign of effective steps against the anti-social elements who exploit the community and benefit themselves at its expense, it will become difficult to evoke enthusiasm and active support from the people. . . . There is yet insufficient realization of the identity of aims between the people and administration. . . By approaching people as comrades in the same cause, disdaining privilege and status, eager to learn and help those engaged in administration, can make an immense contribution towards creating the conditions in which public co-operation grows. . . . Where the administration and the people feel and act together, the programme gains in vitality and significance."[3]

1. Though Tyagi Committee does not favour the introduction of a system of self-assessment under the Income-tax Act, it recommends its introduction under wealth-tax, and expenditure-tax, under which assessees would pay tax along with the returns as per their wealth or expenditure declared by them in the returns. (*Tyagi Committee Report*, Chapter 5, para 42).

2. Tyagi Committee has also recommended that tax evasion should be made punishable under the Indian Penal Code (vide Chapter X). But instead of relying on penalties, attempt must be made to develop the co-operative attitude of the assessee which is a *sine qua non* for a socialistic society (Vide Chapter, XI.).

3. The Planning Commission, : *Administration and Public Co-operation*, (1955), p. 145.

5

CENTRAL TAXES (INDIRECT)

SALT AND EXCISE

Salt Duty

Salt taxes or State monopolies of salt had almost universal prevalence through various ages.

In India, for more than 2,000 years salt has been considered an important item for revenue purposes, and it was the monopoly of various rulers. During Mohammadan rule there were transit duties on its transportation from the place of manufacture to other parts of the country. During the British rule also a duty on salt, produced in this country or imported, was introduced from 1765. But it was only from 1870 that a uniform rate of duty was fixed throughout India. In the beginning the rate was Rs.2 and 8 annas per maund. Thereafter the rates varied from year to year, and lastly, from 1931 to 1947 it was Re. 1 and 9 annas per maund. An additional duty on imported salt at 4 annas 6 pies per maund was imposed in 1931 which was subsequently abolished in 1938-39, after successive reduction in its rates. Thereafter the imported salt was subject to the same excise duty as the Indian salt.

Salt duty was abolished with effect from April 1, 1947. This was mainly due to the reason that the Indian struggle for independence was closely connected with the tax on salt, as Gandhiji had started the civil disobedience movement in 1930 against the tax on salt.

As a result of the abolition of salt duty there was considerable loss of revenue to the exchequer. As a part of the scheme to make up the loss, a 'Cess' was imposed[1] on all salt at the rate of -/2/- per maund on salt manufactured by private factories, and -/3/6 per maund on salt from Government factory. This course was adopted to spread the expenditure on salt administration over the

1. Finance Department, Central Board of Revenue Notification No. 3, dated March 29, 1947 issued under Section 37 of the Central Excise and Salt Act, 1944.

whole of salt produced in India. The higher charge from Government factory was due to the reason that the selling price from this source was much lower. The idea behind the cess was that it should be considered as a part of the cost price of salt. Certain exemptions were granted, for example, salt exported to Japan from India was exempted from the levy of the cess.[1]

The incidence of taxation in the country when salt duty was levied was calculated to be 4 annas per capita per annum, and the incidence on account of the levy of the cess was about 4 pies per capita per annum. Salt duty brought revenue ranging from about 7 to 11 crores of rupees as shown below :

Table 28

Salt Revenue in Selected Years

Year	Total Tax Revenue of Central Govt. Rs. Crores	Revenue from Salt Rs. Crores	Percentage of (2) to (1)
	(1)	(2)	(3)
1920-21	60.85	6.76	11.1
1925-26	72.86	7.86	10.6
1928-29	76.58	6.68	9.2
1938-39	81.87	8.41	10.3
1940-41	81.87	8.06	9.3
1941-42	112.11	10.37	9.3
1942-43	151.66	11.25	7.4
1943-44	229.22	8.81	3.8
1944-45	357.90	9.71	2.7
1945-46	387.27	10.48	2.7
1946-47	344.85	9.34	2.7
1947-48	332.19	2.57	0.8

Source : The Taxation Enquiry Commission Report Vol. II p. 399 and the Explanatory memorandum to the Budget of the Central Government for 1947-48.

As is evident from the table it was an inelastic source of revenue hence its importance as compared to the total tax revenue was declining.

It has been sometimes proposed[2] that salt duty should be reintroduced in this country because it could bring about a good amount of revenue to the Government. But from the view point of the 'minimum welfare norm',[3] salt should be exempted from tax. Salt tax does not present a case for revival. Salt duty is a levy on bare necessity, the demand for which is inelastic and the levy would not spare even the poorest. There lies a difference between a tax on necessity like the excise duty on cloth and the

1. Finance Department, C.B.R., Notification No. 17, dated July 18, 1950.

2. For example, by Dr. M. H. Gopal, Presidential Address, 41st session of the Indian Economic Conference, December, 1958.

3. Vide Chapter I.

tax on salt. People may use more cloth with the fall in prices, while salt cannot be used in larger quantity with the fall in price, nor can its use be curtailed with rise in prices.

CENTRAL EXCISE

Introductory

Central excise duties has formed an important and expanding source of revenue to the Government of India, as the following table shows. This is due to growing indigenous production and availability of commodities in India.

Table 29

Customs, Income-tax and Central Excise Revenue (Comparative Chart)

Year	Total Revenue	Revenue from customs	Percentage of customs to total Revenue	Taxes on income	Percentage of Income-tax to total Revenue	Revenue from Central Excise	Percentage of Central Excise to total Revenue
	Rs. crores	Rs. crores		Rs. crores		Rs. crores	
1921-22	80.0	31.61	39.5	18.74	23.4	2.8	3.5
1938-39	82.9	40.51	48.9	13.74	16.6	8.66	10.5
1944-45	334.40	39.77	11.9	80.52	24.1	38.14	11.4
1953-54	394.34	160.00	40.6	69.31	17.6	78.0	19.8
1957-58	615.53	179.99	29.2	146.40	23.7	273.62	44.4
1958-59	745.82	134.86	18.0	150.54	20.1	312.94	41.8
1961-62	1036-79	212.25	20.4	228.84	22.0	489.31	47.2
1962-63	1427-53	245.96	17.2	312.39	21.8	598.83	41.9
1963-64[1]	1753.28	320.00	18.2	390.89	22.3	703.47	40.4
1964-65[2]	1970.84	336.37	17.0	449.10	22.8	769.93	39.0

Source—The Taxation Enquiry Commission Report, Vol. I. p. 23, and Explanatory Memoranda to the Budgets of the Central Government.

Thus, Central Excise which was a comparatively minor source of revenue in 1921-22 has grown to be the largest source of revenue in 1958-59. This is mainly due to the widening of the scope of excise duties to cover new commodities and the increase in the rates of the existing ones.

Prior to 1934 excise duties were levied only on—(1) motor spirit (introduced in 1917), (2) Kerosene (introduced in 1922) and (3) Silver (introduced in 1930). In the year 1934 excise duties were imposed on sugar, matches and steel ingots. In 1943 the duty was imposed on tobacco. In 1944, coffee, tea and betelnuts were subject to excise as further sources of revenue. (Duty on betelnut was, however, abolished on March 1, 1948). In 1949 it

1. Revised Estimate.
2. Budget Estimate

was extended to mill made cloth and in 1954 to art silk, cement, soap and foot-wear. In the budgets of 1954-55 and 1955-56, excise duties were levied on a number of new items, such as art-silk fabrics woollen fabrics, electric fans, electric bulbs and fluorescent tubes, electric batteries, paper, paints and varnishes, vegetable non-essential oils, refined diesel oil, vaporising oil, and industrial fuel oil, *etc.*[1] It was largely due to the recommendations of the Taxation Enquiry Commission. Further, eight new excise duties were imposed in the 1960-61 budget, eighteen in 1961-62 and nine in 1962-63. In 1964-65 budget excise on some items were, however, withdrawn as given ahead.

Excise Policy

Excise duty was first levied in various countries including India during periods of stress to augment revenues. The Fiscal Commission (1921-22) considered the question of excise duty in India and indicated in its report as to when and on what objects the excise duty should be imposed. The following were the general suggestions made[2] by it :

(1) Excise duty should ordinarily be confined to industries which are centred in large factories or in small areas.

(2) They may properly be imposed for the purpose of checking consumption of injurious articles and specially on luxuries coming under this category.

(3) They should be imposed for revenue purpose only.

(4) While permissible on commodities of general consumption, they should not press too heavily on poorer classes.

(5) When an industry requires protection, any further necessary taxation on its products may take the form of an excise duty while imposing an additional import duty on competing foreign goods. The latter should fully countervail the former, and may be pitched at a higher rate.

The Taxation Enquiry Committee (1924-25) accepted the suggestions numbered 1 to 4. As regards the fifth suggestions it held that, "when an industry requires protection and a computation tax is also required from the produce of that industry in the interest of the revenues, the necessary amount of excise is unobjectionable, provided that it is accompanied by an import duty equal to the excise duty, together with the necessary protective duty, plus a small extra duty to compensate for the administrative inconveniences to the manufacturer caused by the excise duty."[3]

The structure of excise duty is to be viewed in the context of (1) the revenue requirements and (2) the pattern of industrial deve-

1. Vide Statement No. IV.
2. The Fiscal Commission Report (1921-22).
3. The Taxation Enquiry Committee (1924-25), p. 133.

lopment,[1] in the country. It is quite appropriate that in a developing economy, those industries, which have in past developed with the assistance of protectionist policies, should when they have reached the stage of full development, pay their fair contribution to the Government for two reasons : (1) bringing in additional revenues[2] and (2) replacing the loss of customs resulting from the replacement of imported manufactured goods by indigenous production.[3] However, excise duties should be broadbased without affecting the economy of the industries taxed, or placing an undue burden on the consumers. Excise duties are also legitimately levied for (1) restraining consumption and (2) giving fillip to exports. These are the principles underlying the extension of excises from time to time.

Thus the policy adopted by the Government of India as regards excise has been continuously changing to adapt to the changing needs of the economy. It was dictated not only by revenue considerations, but also by the need for providing a suitable climate for the establishment and growth of new industries. The impact of excise duties is upon the industries or the trade, although the incidence lies on the consumer in the long run. While expanding thc scope of excise duty it should be kept in mind that it does not unduly restrict consumption. This aspect is important more so in India, where most of the consumption consists of articles of necessities. Thus the choice of items and determination of rates is to be very judicious.

Excise duty is a proportional tax, as its rate is constant irrespective of the fact that its base is large or small. No system of

1. The Finance Minister (John Mathai) remarked in Lok Sabha (1949) "If you are at all interested in safeguarding the position of the industry in the country's economy, I suggest that it would not be possible for you to give any assistance apart from the device of an excise duty. . . .We are in for a time when, whatever rates of duty you adopt with regard to income-tax, whatever rates of duty you adopt with regard to customs duty, these two sources of revenue will begin to decline. We are a democratic society trying to function as an independent Government. . . while democracy is a priceless blessing, it is a very expensive blessing. The more democratic our society becomes, the more it becomes a positive organ of social and economic development, the more the financing of it is going to strain your resources. I have not the slightest doubt in my mind that, if not to-day, at some time in the near future, you would be seriously faced with the question of accepting excise duties, as an inevitable source of revenue for financing the fundamental function of a democratic Government."

2. As stated by the Finance Minister in 1949-50—"While some adjustments may be found possible in respect of import duties, and export duties could be utilised to some extent, we can no longer rely on customs duties for raising substantial additional revenue and we shall have to depend largely on developing excise duties.". (Budget Speech).

3. In words of the Finance Minister, (1953-54), ,'With the progress of industrialisation, revenue from Custom Duties is bound to be progressively less stable source of revenue. Even otherwise, the revenue from customs is inevitably subject to vicissitudes of trade policies, and the availability of foreign exchange. It is, therefore, necessary to turn increasingly to indigenous industries producing consumer goods for the replacement of a part of the revenue which in the past we used to derive from customs duties on such goods." (Budget Speech).

graduation of rates on producers or merchants, thus far discovered, could in practice achieve progression in excise related to the size of the consumer income. On the other hand, it is regressive in its effect when the amount of tax paid is related to the buyer's income. For example, two persons of different incomes purchasing the same quantity of a taxed item feel different burdens of the tax. This is so whether the rate is 'ad valorem'[1] or 'specific'.[2]

Excise Rates

Ad Valorem and Specific Rates—The choice of the two methods of fixing rates of excise duty (or sales tax) depends upon the relative ease in their administration and their relative regressive character as discussed below. However, there is a theoretical distinction between the two. Ad Valorem duties are varying additions to variable cost per unit. While specific duties are constant additions to the variable cost per unit. In the former case the amount of tax varies with the price of the product. The larger the quantity sold the lower the price per unit (assuming increasing returns), and as a result the smaller will be the tax addition to the variable cost. In the latter case the tax is independent of price and depends upon the quantity of commodity sold. The larger the amount sold the larger the tax collected.

At present excise duties on most of the items are at specific rates, with an admixture of ad valorem basis in the case of matches and tobacco. The only exciseable commodity on a purely ad valorem basis is 'tyres and tubes'. The rates of excise duties on cloth were originally on ad valorem basis on fine and super fine, and on specific basis on medium and coarse cloth. Subsequently, the basis of excise on fine and super-fine cloth was changed and specific rates were prescribed with the option to the mills to pay the duty at the rate of 5% ad valorem. From the beginning of 1953-54 this alternative basis was also changed to the specific one.[3]

In general, the ad valorem tax is preferable to the specific tax. A specific tax falls more heavily upon the cheaper brand of taxed article. On the other hand, ad valorem taxes being in proportion to the prices fall more heavily on the expensive brand. Sometimes they are applied in a mixed form. Commodities are graded according to their quality, and different specific tax rates are levied on them. Best grades are subject to higher specific tax rates, while other grades are subject to gradually lowering down ones. This method also eases the administrative difficulties in case of ad valorem duties, because the declaration of correct value of commodities depends much upon the honesty of its dealers. This

1. In case of ad valorem taxes the tax base is measured in terms of value, and the rate as per cent.
2. Specific taxes measure the tax base as physical quantity (number, weight or volume), while the rate is measured as an absolute number of rupees or annas per physical unit of base.
3. Vide Table 29.

difficulty is, however, not experienced in case published price lists can be offered,which can provide with a reliable basis to the assessing officer. The difficulty lies largely in case of small dealers who can escape assessment. There is one more difficulty that under the forces of demand and supply the declared price may differ from the market price.

Structure of Excise duties—The structure of excise duties is relatively simple. Many issues which are important in case of income and profits taxation, *e.g.*, rate progression, are absent in case of excise duties. While excise duties are very numerous, the issues arising in all of them are more or less similar. They have also some resemblance to import duties.

The use of 'slab system' in excise duties is a development of comparatively recent origin. At present such a system is in use in respect of certain commodities like matches and paints. In respect of consolidated levies also, a slab system exists. But these are designed to help smaller units than as part of a scheme to charge excise duty on the slab system.

Details of Excise

Excise on Tobacco—It is only in recent years that tobacco excise has been developed in India. Every country in the world depends upon Tobacco for revenue purposes.

Prior to the Government of India Act 1935, taxation of tobacco was not a Central subject. The Provinces (now States) were, therefore, "encouraged to derive what revenue they could from the control of taxation of retail vend and gradually to develop this field of taxation in the hope that experience of the various schemes suggested might lead to the evolution of a practicable general excise system."[1] The Taxation Enquiry Committee (1924-25) observed that "the absence of any internal taxation on tobacco is a feature which distinguishes the fiscal system of India from that of almost every other civilised country in the world."[2] Under the Government of India Act, 1935, the power to levy a tobacco excise was allocated to the Central Government.

The pressure of War led to the imposition of an excise duty on tobacco from April 1, 1943.[3] The rates of duty were designed on the progressive scale. In subsequent years there was a gradual increase in rates, with the building up of the organisation necessary for tobacco excise.

1. Budget Speech, 1943.

2. The Taxation Enquiry Committee Report, Vol. I, p.

3. Tobacco (Excise Duty) Act, 1943 was subsequently merged in the Central Excise and Salt Act 1944. In consequence of the imposition of this duty, measures of taxation on tobacco had to be suspended by some States (formerly Provinces). The loss thus accruing to those States is compensated by the Central Government. The payments on this account being debited in the Central Accounts to 'Union Excise Duties' and credited in the State Accounts.

For flue-cured-tobacco the rates were raised in 1944. They ranged between 8 annas to Rs.1/12/- per lb. in 1943, which were doubled in 1944 ranging between Rs. 1 to 3/8/- per lb. For non-flue cured tobacco used in manufacture of cigarettes, biris and snuff, rates were raised from 6 annas (in 1943) to 9 annas per lb; for Cigar and Cheroot tobacco, it was changed from 2 annas (in 1943) to 3 annas per lb; for 'hookah' and chewing tobacco, stalks, and cigarettes also it was fixed at 3 annas instead of 1 anna (in 1943) per lb.

In 1945, the rates of duty on flue-cured tobacco used in the manufacture of cigarettes in admixture with imported tobacco were raised; and on the classes of cigarettes containing over 60% and between 40% and 60% of imported tobacco, rates were imposed at Rs. 7/8 and Rs.5/- per lb. respectively. As a result of these changes the revenue, realised from tobacco in 1943-44 which was Rs.9.65 corres, rose to Rs.17.28 crores in 1944-45 and to Rs.20.82 crores in 1945-46.

In the year 1948-49, however, it was realised that taxation on tobacco could be raised so as to increase the revenue from this source. An excise duty on cigarettes amounting to about 25% on exfactory prices was levied and an addition to revenue of about Rs.7 crores was estimated. Rates of duties for biri and snuff tobacco were raised to 12 annas, and for cigar and cheroot, 'hookah' and chewing tobacco they were raised to 4 annas. As an effect of these changes the revenue was raised to Rs. 25.46 crores in that year.

The existing system of taxing tobacco on the basis of its intended use was not only criticised as being contrary to the normal principle that an article should be taxed according to its specific character, but had also proved cumbersome and difficult both to the administration and the trade. In order to safeguard the evasion of taxation by diversion after clearance of tobacco, capable of multipurpose use from a low-rated use to a high-rated use, a widespread scheme of departmental restrictions had to be designed. This created discontent in the trade and was difficult to administer.[1]

A scheme to rationalise the system was set up in 1951-52. It had these important features—(1) In respect of the various categories of tobacco(other than the one which is used in manufacture of cigarettes) the basis of taxation with reference to intended use was abandoned and the duty was levied as a 'leaf duty' at flat rates, separately for flue-cured and for other tobacco. (2) A further duty of 8 as. per lb. was levied on certain tobacco manufactures, like biris and snuff, with the intention of raising revenue and that every section of consumer might contribute their share of additional revenue (3) a temporary surcharge of 3 pies and 6 pies per ten cigarettes according to their retail price was imposed.

The substantial decline in prices in 1953-54 necessitated the

1. Budget Speech, 1951-52.

grant of temporary relief in rates of excise duty which was announced on Aprl 10, 1954.

The Taxation Enquiry Commission recommended (in 1954) that surcharges be removed from the category of cigarettes of the value of Rs. 10 to Rs.15 per thousand, which were according to them relatively over-taxed and that the revenue loss be recouped by a suitable increase in the duty on the category of cigarettes of the value of Rs.40 to Rs.50 per thousand. They further recomended that alongwith this adjustment the surcharge on categories other than the Rs.10 to 15 per thousand be merged with the basic excise duty. In 1955-56 these recommendations were implemented with certain necessary changes and modifications. No revenue loss occurred due to these changes, on the other hand, there was some gain.

In January, 1956, the Tobacco Expert Committee was appointed to review the procedure adopted in applying the criterion for assessment of unmanufactured tobacco. The Committee after careful consideration of the problem, recommended that the criterion of 'capability' of use for manufacture of 'bidis' should be revised by the criterion of 'physical form' of tobacco, other than flue cured, for purposes of assessment.

Accordingly, in 1957-58 such tobacco was reclassified on the basis suggested by the Committee for revenue purpose. The rates of duties on such tobacco were also somewhat enhanced. With the increase in the rate of duty on the two types of tobacco the rate of excise duty on unmanufactured tobacco for use in manufacture of cigarettes was also proportionately raised.

The duty for unmanufactured tabacoo was raised as under :

(a) for other than flue-cured and used for the manufacture of cigarettes or smoking mixtures for pipes and cigarettes, duty was raised from 56 nP per lb. to 75 nP per lb.

(b) for not flue-cured and not actually used for the manufac ture of cigarettes or smoking mixtures for pipes and such tobacco cured in whole leaf form and packed or tied in bundles or bunches or in the from of twists or coils, duty was raised from 37 nP per lb. to 50 nP per lb.

(c) for other than flue-cured and not otherwise specified, duty was raised from 87 nP per lb. to 100 nP per lb.

As a result of these changes the yield increased from Rs.36.46 crores in 1955-56 to Rs.45.49 crores in 1957-58.

The duty on tobacco thus continued to increase from 1944 till 1951-52 after which it gave more or less constant returns, but it took a high jump in 1957-58,[1] as given above.

Excise on Cloth

The following factors had large bearing on the history of excise duty on cloth in this country since independence.

1. Vide Statement No. IV.

First, the circumstances in which the levy was made in the present form were quite different from those in which it was levied by a foreign Government in the interest of a foreign industry. Secondly, it was necessary to replace the loss in revenue resulting from the abolition of salt duty by developing some equally stable source of revenue. Cloth, with a large industrial production and as an article of universal consumption, offered itself as most obvious commodity for taxation. Thirdly, it was necessary to help the handloom industry, because the excise duty on mill product would and to some extent to the cost of the mill product. If, however, the import duty on cloth is high enough, the excise duty is not likely to affect the indigenous industry.

Rates of excise duty on cloth have been altered from time to time since 1949, as shown in Table 29 (p. 246). The duties have been specific, except for early short periods before 1953 and that too, with regard to fine and super-fine cloth. There are difficulties of administration in levying duties on an ad valorem basis because of the difficulties in arriving a proper valuation of cloth, and delays consequent on disagreement between mills and excise authorities regarding the valuation. It is also detrimental to the interest of the industry.[1]

In 1949-50, a duty of 25% ad valorem was levied on super-fine cloth as one of the measures against inflation, 6¼% ad valorem on fine cloth and 1/4 anna per yard on coarse and medium cloth. The duty was confined only to mill made cloth, and was not applicable to cloth woven on handlooms.

With effect from February 1, 1950, the rates of duty on super-fine and fine varieties were reduced to 20% ad valorem and 5% ad valorem respectively. These rates continued till May 1952. Heavy fall in the price of cloth of these categories during 1952 made the assessment of the duty onerous and it was decided to prescribe certain specific duties per yard as maximum duties, the duty being levied at these rates or at the ad valorem rates, whichever was less.[2] The rates of specific duties were fixed at a level which, it was believed at the time, would eliminate ad valorem rates, in most cases. The subsequent fall in prices led to the preponderance of ad valorem assessments, and the expectations were falsified. This gave rise to administrative difficulties and continuous friction between the mills and the assessing staff on the question of the adequacy of declared prices.

In 1953-54 it was decided, in order to overcome these difficulties, to prescribe specific duties. Duties on super-fine cloth was to be charged at the rate of 3 annas 3 pies a yard and on fine cloth a duty of 1 anna 3 pies a yard. From October 25, 1953 the rate of duty on super-fine cloth was reduced from 3 annas 3 pies to 2 annas per yard. In 1954-55 the rate of duty on super-fine

1. *The Textile Enquiry Committee Report* (1958), p. 13.
2. Vide Table 29, p. 246.

cloth was again raised to 2 annas 6 pies per yard, that on fine cloth to 1 anna 6 pies per yard, and on medium and coarse cloth to 6 pies per yard.

To enforce the restriction on the output of dhoties by mills, graduated additional excise duties were levied on mill made dhoties at rates ranging from 2 annas to 8 annas per yard from October 26, 1953.'

Till February 1955, cotton cloth was graded for purposes of the duty into 4 categories—super-fine, fine, medium and coarse. (This classification as a basis for tax differentiation and as indicating the broad sections of the community using the cloth had become somewhat unrealistic. As a result, it was proposed to reclassify it in 1955-56 into two categories—super-fine and others. Also, the rates of the duty on all cotton cloth (except fine cloth) were proposed to be enhanced, taking into account the view of the Taxation Enquiry Commission that there was a case for enhancement of the rate of duties on all varieties of cloth.

However, the Select Committee did not approve of the above proposals, which were withdrawn, as it was represented that prices of agricultural commodities were falling and purchasing power of the rural population was low. The offtake from the mills had also declined at the time and mills were carrying large unsold stocks.

Originally the excise duties on coarse and medium cloth were uniform. The position continued till March 1956. From March 1, 1956 a distinction was introduced between coarse Dhoties and Sarees and other coarse varieties, and all medium varieties. The reduction in the duty on Dhoties and Sarees was intended to benefit the poorer class of consumers. This distinction between Dhoties and Sarees and other varieties was extended to the medium categories of cloth in March 1958.

The Report of the Textile Enquiry Committee (1958) arrived at the conclusion in this respect that the distinction between Dhoties and Sarees and other varieties had led to somewhat unhealthy changes in the pattern of production. Prior to March 1956, the quantities of coarse Dhoties and Sarees produced by mills were negligible. With the differentiation in excise duties, production of coarse Dhoties and Sarees naturally went up. In September 1956, a rebate on extra production was announced. Since the duty on Coarse Dhoties and Sarees was revised and the production of these varieties being the easiest, the low duties coupled with the rebate on extra production led to a phenomenal increase in production of these categories of cloth. The Commission suggested that there was no need of distinction in favour of Dhoties and Sarees as there was abnormal shift in the production of these varieties, while poorer sections of the community wear not only Dhoties and Sarees, but also other varieties of cloth.[1]

1. *The Textile Enquiry Committee Report* (1958), p. 16.

The Committee also found on investigation that the existing structure of duties weighed more heavily on plain cloth and unprocessed cloth compared to the processed cloth of various descriptions, as a result the demand for processed varieties was on the increase. This had increased the difficulties of mills, mostly located in the interior, which were not equipped with processing equipment. Therefore, the Committee recommended that both on the grounds of equity and on the grounds of fairness to the mills without processing equipment, it was essential that the pattern of excise duties be changed to provide for a closer approximation to ad valorem duties.[1]

The Committee recommended[2] *inter alia* that the following proposition be adopted in changing the pattern of excise duties.

(1) The distinction between Dhoties and Sarees, and other varieties should be abolished.

(2) The difference in the levels of duties of coarse and medium cloth should be small.

(3) Medium cloth should be divided into two categories—'Medium A' up to average count of 25's and 'Medium B' above the average count of 25's and up 35's.

(4) Surcharges should be levied for the processes of (i) bleaching (ii) dyeing, printing, mercerising or any other chemical processes, and (iii) shrink resisting process such as sanforizing and organdie processing.

The Committee also recommended that the assistance available to the handloom sector by way of rebate, should be placed on a fairly stable basis. It should not be changed during the middle of the finanical year or at short notice. They also emphasised the importance of the handloom rebate in providing incentives to the handloom sector.

In line with the recommendations of the Committee, several changes were affected in 1958-59. Excise Duty on all varieties of cotton textiles was reduced from 3.125 np to 3 np. per square yard on coarse dhoties and saries; from 9.375 np to 6 np. on coarse cloth of other sorts; from 9.375 np. to 7 np. on medium dhoties and saries, and 9 np. on medium cloth of other sorts; from 18.75 np to 17 np. on fine cloth; and from 25 np to 22 np. on superfine textiles. The revised rate became effective from March 19, 1958. In line with the revision, rates for power loom, producing cotton fabrics were also reduced. On July 3, 1958 the Government announced further reduction in excise duties on coarse and medium varieties of cotton cloth, while those on fine and super-fine were increased slightly. The rates were split into a basic rate, and a surcharge was levied at differential rates on the processed varieties to ensure a fair and equitable incidence of the levy on different

1. Ibid., p. 17.
2. Ibid., p. 16.

varieties of cloth, bringing it as close as possible to an ad volorem levy.

Excise revenue from cloth which amounted to Rs.12.33 crores in 1949-50 fell to Rs.9.26 crores in 1950-51 due to the substantial drop in the clearance of super-fine and to a lesser extent of fine and medium varieties. The revenue rose to Rs. 16.36 crores in 1951-52 but again there was a sharp fall in clearance of super-fine and fine cloth (although the quantity of medium cloth cleared was on increase) and the revenue fell to Rs.13.46 crores in 1952-53. In 1953-54 there was a recovery under all varieties except 'fine', and the revenue rose to Rs.21.67 crores including the additional levy. In 1954-55 it rose to Rs.27.59 crores and to Rs. 28.18 crores (in 1955-56) due to rise in the rates of excise duties. Subsequently it rose to Rs.51.86 crores in 1956-57, to Rs.64-60 crores in 1957-58.

Sugar

With the development of indigenous sugar industry the import duty from this source declined. In order to recoup the consequent loss of revenue, excise duty on sugar was imposed in 1934 at the rate of Rs. 1/5/- per cwt. Excise revenue from sugar has risen steadily with the increase in production and enhancement of the rate of the duty. Examining the existing conditions, the Taxation Enquiry Commission came to the conclusion that the rates of excise duty had not affected consumption adversely. On the other hand they recommended its further enhancement. As a result of the recommendation of the Taxation Enquiry Commission in 1955-56 the rate was increased to Rs. 5/10/- per cwt.

The consumption of crystal sugar had expanded considerably in the last few years and the larger quantities had to be imported at considerable expenditure of foreign exchange. The increase in duty, it was believed, would also have the effect of discouraging consumption to some extent.

The excise rate was further increased to Rs.11.25 per cwt. in 1957-58. The rates were changed in the various years as follows :

Table 30

Changes in the Rates of Excise on Sugar

Year	1935	1937	1940	1949	1955	1957	1959
Rates Rs. (per cwt)	1/5/-	2/-/-	3/-/-	3/12/-	5/10/-	11.25	11.25

Revenue from excise on sugar was only Rs.1.53 crores in 1935. It rose to Rs.7.34 crores in 1949, Rs. 18.58 crores in 1955-56 and was estimated at Rs. 47.82 crores for 1959-60 (budget).

Khandsari

The excise on Khandsari sugar was also imposed in 1934 at the rate of 10 annas per cwt. In 1937 it was raised to Rs.1/5/- per cwt, later on it was reduced to Re 1 per cwt. and then to 8 annas per cwt. In 1952 it was discontinued, since then it was exempt from excise duty, but had to pay usual sales tax. With the substantial increases in the duty on crystal sugar, there has been shift in production to this form of sugar, as the difference between the price of the two is wide. In case of sugar, cane cess has also to be paid which Khandsari people have not to pay.

In 1959-60 a basic duty of Rs.5.60 per cwt. was re-imposed on Khandsari with an additional duty of 70 nP. in replacement of sales taxes. The yield from it was estimated (in the Budget) at Rs. 1.85 crores, besides Rs.25 lakhs from the additional duty which would accrue entirely to States.

Motor Spirit

The excise duty on motor spirit was introduced in 1917. Since 1929 the duty on motor-spirit was linked with the development of roads in India. A resolution was adopted in that year, according to which 15% of the increase in the excise duty, due to increase in rates from 4 to 6 annas per gallon was to be earmarked[1] for research and administration of roads, and the rest was to be distributed among the Provinces on the basis of petrol consumed. Due to the pressure of War the duty was enhanced to 10 annas per gallon in 1938-39 then to 12 annas per gallon in 1940-41 and to 15 annas per gallon in 1942-43. It was again reduced to 12 annas per gallon in 1946-47, but in 1948 the rate of 15 annas per gallon was restored. In 1951-52 the surcharge of 5% was applied so as to equalise the duties of customs and excise, consequent to the general surcharge of 5% on import duties. Thus the duty came to 15 annas 9 pies per gallon or 98 np. In the year 1957-58 it was raised to 125 nP per gallon (inclusive of surcharge) and the revenue collected amounted to Rs. 30.85 crores.

Table 31

Excise Revenue from Motor Spirit

1917-18 1948-49 Rs. crores

Year	1917-18	1924-25	1928-29	1929-30	1936-37	1937-38	1948-49
Amount	0.24	0.79	1.55	2.81	5.59	1.36	1.41

1950-51 1959-60

Year	1950-51	1953-54	1954-55	1955-56	1957-58	1958-59 (R.E.)	1959-60 (B.E.)
Amount	2.08	2.47	9.87	23.05	30.85	32.29	33.25

Source : Statement No. IV and the Taxation Enquiry Commission Report, Vol. II, pp. 422-24.

1. Vide Chapter II.

The increase in the yield of excise duty from motor spirit is worth noting.

In 1936-37 the yield from excise on motor spirit reached a high level, but in 1937-38 the separation of Burma resulted in the reduction of this source of revenue and thereafter customs on it became more important than excise revenue as Table 32 shows. However, when the new refineries go into full production, the indigenous output is expected to rise substantially. As a result, the Central excise revenue from motor spirit will be derived mainly in the form of excise duty instead of customs duty. As indicated by the Taxation Enquiry Commission the question of the appropriate rate of duty for motor spirit will be investigated in detail after refineries in India are firmly established.

The following table shows the decline in the revenue from import duty on Motor spirit, as against the rise in excise duty as shown above.

Table 32

Import Duty on Motor Spirit

1931-32 to 1952-53

Rs crores

Year	1931-32	1938-39	1948-49	1949-50	1950-51	1951-52	1952-53
Amount	0.67	5.15	9.72	14.01	19.93	26.04	27.59

1953-54 to 1959-60

Year	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59 (R.E.)	1959-60 (B.E.)
Amount	27.53	20.01	7.52	2.96	4.62	2.50	2.50

Source : Statement No. IV and The Taxation Enquiry Commission Report, Vol. II, p. 406.

Diesel oil

In the year 1956-57, the loss in import duty on diesel oil was replaced by an excise duty, due to the reason that production of diesel oil and other fuel oils at the new Refineries at Bombay was soon expected to outstrip the internal requirements for such oils. The duty was levied at the following rates—4 annas per gallon on High Speed Diesel oil and Vaporising Oil used primarily in driving heavy motor vehicles, and Rs. 30 per ton and Rs. 15 per ton respectively on other Diesel Oils and Furnace oils. It was estimated to yield Rs.4.5 crores. It was proposed that countervailing customs duties would be imposed whenever necessary.

In the year 1957-58, the rates were raised as follows :—

(i) Diesel oil not otherwise specified—raised from Rs.30 per ton to Rs. 40 per ton.

(ii) Refined Diesel oil raised from 25 nP. per Imperial gallon to 40 nP. per Imperial Gallon.

Total increase in revenue was estimated at Rs. 2.25 crores.

The duty on diesel oil is not merely a question of revenue. The question also is one of economic balance between the production of diesel oil and petroleum. Petroleum is produced more and diesel oil is produced less. It was indicated during the budget proposals of 1959-60 that there was price advantage in favour of diesel oil of which India has to import substantial quantities. It is also to be noted that the consumption of diesel oil has been increasing considerably as compared to the consumption of motor spirit as the following table shows :

Table 33

Consumption of Motor Spirit and Kerosene ('000 tons)

	1950	1954	1955	1956	1958
Motor Spirit	596	770	806	819	760
Diesel Oil—Light	329	409	422	433	498
High Speed	179	346	424	532	920

Source : Quarterly Economic Report of the Indian Institute of Public Opinion (New Delhi), Vol. VI, No. 3, January 1960, p. 43.

Therefore, both as a measure of increasing revenue and conserving foreign exchange, the duty on refined diesel oils and vaporising oils was raised in 1959-60 from 40 nP. per Imperial Gallon to 80 nP. It was estimated that the increase came to 0.34 np. per ton mile which was not a great burden on Transport.

In view of the increasing consumption of diesel oil the basic rate of duty was further increased by 25 np. per imperial gallon in 1960-61.

Kerosene

The duty on Kerosene oil was first imposed in the year 1938-39 at the rate of 2 annas 9¾ pies per gallon. It was raised to 3½ annas 9 pies per gallon in 1942 and to 4 annas 6 pies in 1944. In 1946-47 it was reduced to 3 as. per gallon. In 1951-52 a surcharge of 5% was imposed to equalise the duties of customs and excise. In 1957-58 the duty was further proposed to be increased but it was later on restored to its previous level. Thus the rates continue to be the same.

As a result of the separation of Burma and then the partition which led to the loss of Attock oil fields, the major part of the revenue from this source is derived from customs duty. The revenue from excise duty will go up in future as a result of establishment of refineries. In 1959-60 (budget) the revenue from this source was estimated at Rs.5.08 crores.

Vegetable Non-essential oils

A new excise duty on vegetable non-essential oils of 3 pies per lb. (only on factories operated by power) was imposed in 1956-57. Exemption for first 125 tons per year cleared for home consumption was granted. In 1957-58 the duty was raised to 5 nP. The revenue from it was Rs.5.30 crores in 1956-57 and Rs. 9.80 crores in 1957-58.

Matches

There was high import duty on matches. As a result of which match industry in India had developed. The Taxation Enquiry Committee of 1924-25 considered that under these circumstances there was a case for the levy of an excise duty on this article. Accordingly, the excise duty on matches was imposed in 1934. The rates of duty fixed in 1934 remained in force up to 1941 when they were doubled for raising additional revenue as given below :

Boxes	1934 to 1940	1940 onwards
40's	Rs 1/- per gross	Rs 2/- per gross
50's	... ...	Rs 2/- per gross
60's	Rs 1/8 per gross	Rs 3/- per gross
80's	Rs 2/- per gross	Rs 4/- per gross

In 1940 a new category of match boxes of 50's was introduced and it was attempted that it could be sold at 2 pice. The rate on it was reduced to Rs. 1/12/- per gross in 1946 but was restored to Rs. 2/8/- in 1948, as the attempt to sell it at 2 pice could not be materialised. In 1948-49 the question of standardisation of match production was examined and it was decided that there should be only two classes—that of 40's and 60's. A rebate was also granted to low output factories which was further liberalised in 1950, and then in 1955-56.

The Taxation Enquiry Commission observed that there was further scope for raising the rates. In 1957-58 the existing duties were raised, so as to permit the sale of match boxes at 6 nP. and 4 nP. per match box of 60's and 40's respectively. As a result of the change the revenue from the duty was raised from Rs. 10.05 crores in 1956-57 to Rs.15.08 crores in 1957-58.

Cement

Excise duty on cement was imposed for the first time in 1954-55 at the rate of Rs.5 per ton which was raised to Rs.20 per ton in 1957-58; then it was increased to Rs. 24 per ton in 1958-59, but the surcharge levied by the State Trading Corporation was withdrawn at the same time. The revenue yielded by this duty was as follows :[1]

1. Source : Vide Statement No. III

Rs crores

1954-55	1955-56	1955-57	1957-58	1958-59 (R.E.)	1959-60 (B.E.)
2.11	2.22	2.55	11.17	13.83	14.03

Being one of the investment goods, the burden of these would hardly fall on the common man. However, it is rightly objected that the increases in the rates would largely affect the industrial projects both public and private and to a limited extent the middle class building activity. It would also affect the slum clearance and housing programme.

Tea, Coffee and betel-nuts

Excise duties on tea, coffee and betel-nuts were imposed for the first time in India in 1944 at the rate of 2 annas per lb. In 1946-47 the duty on betel-nuts was reduced from 2 annas to 1 anna per lb., while that on tea and coffee remained at the same rate of 2 annas. In 1948-49 the duty on betel nuts was withdrawn as the administration of this excise had always been difficult and it was a prolific source of complaint from the Provinces where betel-nuts were grown. The loss of revenue was estimated at Rs.30 lakhs. The duty on tea and coffee was increased from 2 annas to 3 annas per lb.

In 1957-58 the excise duties on tea and coffee were proposed to be increased. However the proposals were withdrawn on May 31, the same year. So the rates remained the same as given below:

For tea the rates were as follows :

(a) loose tea—13.75 nP. per Kg.

(b) package tea converted from duty paid loose tea—41.25 nP. per Kg.

(c) Package tea—55 nP. per Kg.

Rate for Coffee—41.25 nP. per Kg.

It was represented that the excise duties on coffee be reduced. But the Taxation Enquiry Commission observed that the duty on Coffee bears about the same percentage to wholesale price as the duty on package tea, hence they did not consider that there was a case for reduction of the rate of duty on coffee.

The revenue from coffee was estimated at Rs.1.20 crores and from tea Rs.7.38 crores in 1959-60 (Budget).

Steel Ingots

The excise duty on steel ingots was introduced in 1934 with a view to recouping the loss of custom duties with the reduction in the level of import duties on them (due to recommendation by the

Tariff Board). The duty was imposed at Rs. 4 per ton. As against the recommendation of the Taxation Enquiry Commission which was against any increase in the duty, the duty was raised to Rs.40 per ton in 1956-57. However, this does not seem to be a wise act, as the increased costs of steel ingots are bound to reflect in the increase in the cost of implementing the plans both in the public and the private sector.

The yield from the duty was Rs.35 lakhs in 1935-36 which rose to Rs.55 lakhs in 1952-53 and as a result of the increase in the duty it rose to Rs.6.25 crores in 1957-58 and was estimated to yield Rs.8 crores in 1959-60 (Budget).

Tyres

The excise duty on it was introduced in 1941 in order to recoup the loss of customs revenue as a result of the growth of the industry in India. The duty was at flat rate of 10% ad valorem from 1941 to 1948 and then it was raised to 15% ad valorem. From 1949 a higher rate of 30% ad valorem was fixed for motor tyres. Neither Motor Vechicles Enquiry Committee suggested any change in rates, nor the Taxation Enquiry Commission. Hence, there was no change since then.

Yield from this duty was Rs.1.98 crores in 1948-49, Rs. 3.57 crores in 1949-50, Rs 4.95 crores in 1953-54, Rs. 3.87 crores in 1957-58 and it was estimated to yield Rs.8.55 crores in 1959-60 (Budget).

Paper

The Taxation Enquiry Commission recommended the levy of a moderate rate of duty on paper with exemption for hand-made paper, in view of the fact that the industry has developed as result of tariff protection. The excise duty on paper was levied in 1954-55 which yielded substantial revenue as given below.[1]

Rs crores

1954-55	1955-56	1956-57	1957-58	1958-59 (R.E.)	1959-60 (B.E.)
0.21	2.68	3.27	5.39	6.50	6.80

Artificial Silk Fabrics

The use of artificial silk fabrics had become very widespread and they competed to some extent with cotton cloth which had to bear an excise duty. For this reason a duty was imposed on it in 1954-55. The duty was 6 pies per yard with an additional levy of 3 pies per yard for the benefit of Khadi and other handloom industries. The duty was not to be levied on the manufactures of handlooms and small units which had less than 25 power looms.

1. Statement No. IV.

It yielded Rs. 49 lakhs in 1954-55, Rs.1.03 crores in 1956-57, Rs.1.69 crores in 1957-58. In the budget for 1959-60 it was estimated to yield Rs. 1.08 crores.

Vegetable Product

The duty was imposed in 1943 for revenue purpose. The rate of duty was Rs.5 per cwt. till 1948, then it was raised to Rs. 7 per cwt. in 1949. In 1958-59 a relief was granted to small producers by reduction in the duty for the first 3,000 tons cleared by each factory.

The excise revenue from this source has steadily risen from Rs. 94 lakhs in 1943-44 to Rs.3.92 crores in 1957-58and was estimated to yield Rs. 4.91 crores in 1959-60 (Budget).

Soap

In the year 1954-55, for the first time a duty on soap was levied at the following rates :

Rs. 5/4-per cwt. on washing soap in soap bars of one pound and more in weight,

Rs.6/2/- per cwt. on other washing soaps,

Rs.14/- per cwt. on toilet and other soaps.

The incidence of taxation on soap was calculated not to exceed 10% of the value. Non-power operated units were exempt from duty. Factories manufacturing not more than 100 tons of household and laundry soaps and 50 tons of toilet soap or other kinds of soap were also exempted from duty. First 120 tons of household and laundry soap and first 25 tons of toilet soap cleared for home consumption during each financial year were also exempt from duty.

In 1956-57 new excise duties for non-power operated units at lower rates than the existing ones for power operated units were levied, as it was found that non-power operated units were producing substantial quantities of soap and were offering appreciable competition to the smaller power operated units.

The yield from excise on soap was Rs.1.40 crores in 1954-55, Rs.1.55 crores in 1955-56, Rs.1.76 crores in 1957-58 and Rs.2.46 crores in 1961-62.

Footwear

In 1954-55 excise duty on footwear at 10% ad valorem was levied on factories not operated by power and employing less than 49 workers per day. Power operated footwear factories not employing more than 49 workers per day and using not more than 2 horse-power of energy were also exempted from the levy. It yielded a revenue of Rs.82 lakhs in that year. Subsequently it rose to Rs. 97 lakhs in 1957-58 and was estimated to yield Rs.1.05 crores in 1959-60 (Budget).

In 1960-61 budget, excise duty was levied on machine-made soles and heels made of materials other than leather or wood. The rate of duty will be 15% ad valorem and has been estimated to yield a revenue of Rs.20 lakhs a year. This was done with a view to avoid evasion of the duty on footwear.

Mechanical lighters

The duty on mechanical lighters was introduced in 1934 as it was considerably used then. As there is no indigeneous manufactures of it there is no revenue yield. The Taxation Enquiry Commission suggested that the duty on it should be lowered so as to encourage its production.

Other Excises and Cesses[1]

Besides the excise described above, there are other commodities too on which excise duties are levied. The duties on them, however, do not yield large revenue and are of recent origin. These are—(1) woollen fabrics, electric bulbs, electric batteries, paints and varnishes. The duties were imposed on them in 1954-55. (2) excise duty on industrial fuel oils was imposed in 1955-56, and (3) on Rayon (synthetic fibres and yarn) in 1956-57.

There are also some cesses imposed by the Central Government. A cess is a supplementary or additional charge levied for a more or less defined purpose. These are—cesses on oils and oil seeds (levied from 1956-57); coal cess and cess on copra (levied from 1957-58).

Additional duties of Excise

The Additional Duties of Excise (Goods of Special Importance) Act of 1957, provides for the levy and collection of additional duties on sugar, tobacco, cotton fabrics, rayon or artificial silk fabrics, and woollen fabrics produced or manufactured in India. These duties are in addition to the duties payable under the Central Excise and Salt Act of 1944 or other law for the time being in force, and replaced the sales-tax levied by the State Governments on these commodities. Revenue collected from these duties was as follows :[2]

(Rs. Crores)

	1958-59 (Revised)	1959-60 (Budget)
Sugar	12.86	12.86
Textiles	21.19	21.19
Tobacco	7.10	7.10
Total	41.15	41.15

1. Vide Statement No. IV, showing the yield from these duties and cesses.
2. Source : Vide Statement No. IV.

The net proceeds from these commodities are distributable among the States in accordance with the provisions of Section 4 of the Act, read with the Second Schedule thereto.[1]

Higher Yield of Excise Revenue

The account figures for 1958-59 show that the revenue realised in that year exceeded the revenue realised during any of the previous years. The gross revenue (including State's share) was Rs. 312.94 crores being 14% higher than the amount realized in the previous year, which was Rs.274.51 crores. (Out of which additional duties of excise had yielded Rs. 2.61 crores in 1957-58 and Rs.16.12 crores in 1958-59). The increase was contributed by almost all excisable commodities except cigars and cheroots, cotton fabrics, vegetable non-essential oils and motor spirits.

Cotton fabrics yielded the highest excise revenue in 1958-59, amounting to Rs. 62.09 crores, followed among others by sugar, which yielded Rs.59.71 crores, unmanufactured tobacco Rs.34.47 crores motor spirit Rs.33.48 crores, matches Rs.19.11 crores, cement Rs.14.1 crores and refined diesel oils and vaporising oil Rs.11.27 crores. In all these cases, except for cotton fabrics, revenue was higher than the previous year.[2]

New Excise and other Changes Since 1960-61

In the budget for 1960-61 eight new excise duties on—Aluminium, cycle parts, internal combustion engines, electric motors, exposed cinematograph films, tin plate, pig iron and silk fabrics, were announced. These new excises were estimated to yield Rs. 13.37 crores, while other changes in the existing excises were expected to yield an additional amount of Rs.8.36 crores. Thus the total Union excise duties were expected to bring in an additional revenue of Rs 71.73 crores in 1960-61 of which Rs.70 lakhs was to accrue to the States.

In 1961-62, the excise net was spread over as many as eighteen new items, including caustic soda, soda ash, glycerine, cotton and woollen yarn, glass and glass ware, china and porcelain, copper, zinc, wireless receiving sets, *etc.*

The existing rates were stepped up in respect of fourteen items, the more important among them being cotton fabrics, rayon, paper and paper boards, kerosene, diesel oil, tobacco, cigarettes and tea.

The additional yield from the above measures were expected to be Rs. 30.9 crores.

In the budget for 1962-63 excise duty was levied on nine new items. These were jute manufactures, certain iron and steel products, electric cables and wires, certain specific acids and gases, plywood, asbestos cement products, tread rubber and latex from

1. Vide Chapter II.

2. Source : Explanatory Memorandum on the Budget of the Central Government for 1960-61.

sponge, gramophones, gramophone parts and accessories and gramophone records and mineral oils and mineral products not otherwise mentioned. The total revenue from the fresh levies were estimated to be Rs. 15.42 crores in a full year.

The other changes in the existing excise duties were expected to bring in a revenue of Rs.20.74 crores in a full year. Some of the important changes are mentioned below :

(1) The rates of excise on unmanufactured tobacco and cigarettes were revised. This was expected to yield an additional revenue of Rs.5.28 crores in a full year.

(2) The general structure of duty on cotton cloth and yarn was revised so as to introduce a slight progression in the incidence of tax according to the quality of cloth, maintaining the existing duty on coarse yarn. It was also proposed to step up the duty on processing of cloth, keeping in view the improvement in quality and price of cloth as a result of processing. Also, the units with 50 or more powerlooms were placed on the same footing as powerlooms.

As a result of these changes the revenue from cotton cloth and yarn was expected to increase by Rs. 12.1 crores a year.

(3) The duty on loose tea was increased by 10 np. per kilogram. A rebate of 15 np. per kilogram was given for its export. This was a measure to encourage the export of tea.

No new excise duties were levied in 1963-64 budget. But in addition to the changes in rates for the few items (like motor spirit, refined diesel oil, kerosene and vaporising oil) a selective surcharge on the central excise duty on several articles were levied with a view to raising revenue. The surcharges were so arranged as to bear lightly on selected intermediate goods and rather heavily on luxury items consumed by the more well-to-do classes. As for articles which enter into common consumption, such as sugar, cotton fabrics, footwear, matches and cycle parts as well as patent and proprietary medicines, there was no change in excise duty.

Changes in Excise in 1964-65

Excise duties on several items were withdrawn. The duty was removed on gramophone records, all gases other than carbon dioxide used for the manufacture of aerated waters, low voltage electric motors and all acids other than sulphuric acid. Excise duty was also withdrawn on soap manufacture without aid of power. Besides these there were some minor adjustmens in the excise duties. Taken all together these changes, there was estimated a net gain in revenue of Rs. 1.954 lakhs from excise.

IMPORT DUTIES

Introductory

Import duties have formed an important part of the tax system of a country though they have been imposed mostly to protect home

industries against foreign competition or as an anti-inflationary device, they have also been used simply for revenue purposes. When it is used for revenue only, it means that it imposes no price disadvantage upon the imported goods.

If the goods are not produced at home the duty must be low, particularly so, if its demand is highly elastic. However, the duty can be raised high if its demand is highly inelastic. If the goods are produced both at home and abroad, a tax must be levied upon the sale of home-produced goods equal in amount to the import duty imposed so as to balance price differential of the commodity.

A tariff has, however, been imposed on various occasions only with the objective of revenue collection. The general revenues may, however, be sacrificed in the interest of the development of trade and economy of the country, if it is found necessary.

Fixing up import quotas is also a method of restraining imports. But as we have already discussed[1] taxation as a method of control has several advantages over direct methods of control. One of them is that one should not abolish free choice, and if the importer inspite of a heavy duty desires to import, he should be allowed to do so. It is now Government of India's general policy of gradually replacing, wherever possible, at least partly, quantitative restrictions by higher import duties.[2]

Earlier History

In this country, the system of levying duties on imports originated in 1875. Between the years 1882 and 1894 no customs duties were levied. It was free-trade period. The duties were re-imposed in 1894 due to financial requirements. The general rate of import duty from 1894 upto the period of first World war was 5%. Items like liquor and tobacco were subject to higher rates, while certain items like railway materials and machinery were free of duty. After the outbreak of the First World War the rates were revised. In 1916 the general rate was increased from 5% to 7½% and the items free of duty were no longer free. Additions were made to the list of items, bearing higher rates. In 1921 the general rate of import duty was further raised to 11%. A schedule of luxury goods like motor cars, silk goods, watches, *etc.*, was also introduced upon which a high duty was imposed. Again in 1922 the general rate was increased to 15%.

So far, revenue objective was the main consideration. In 1921 the first Fiscal Commission recommended a policy of discriminating protection. They also recommended the introduction of the scheme of exemption from duty of raw materials used in industries, and low rates of duty on semi-manufactured goods. As a result of these recommendations, two types of duties—revenue and protective—were levied. Duties levied for revenue purposes were only incidentally protective. During inter-war periods

1. Chapter I.
2. Budget Speech, 1955-56.

there was a decline in revenue, due to the fact that the country had not to depend much on the foreign supply of certain articles, like cotton textiles, matches, soaps, sugar, iron and steel and a few chemicals. Further, during the Second World War the imports declined owing to two reasons—(1) non-availability of supplies and (2) restrictions imposed, due to currency considerations. As a result of these there was drastic fall in revenues.

During the Second World War the rates were increased to meet increased revenue requirements. In 1941 the rates were increased on certain specified items. In 1942 a general surcharge of one-fifth of the rates in force was imposed. Due to these measures there was some gain in revenue. Since 1944-45 there was substantial increase in revenue due to the more free import supplies.

The following Table shows the trends of revenue from import duty from 1920-21 to 1947-48.

Table 34

Revenue from Import Duty (1920-21 to 1947-48)

Rs. Crores

1920-21	1928-29	1930-31	1931-32	1933-34	1938-39	1940-41	1942-43	1944-45	1945-46
23.08	40.92	37.29	36.08	35.68	39.80	37.51	31.63	91.07	123.40

Source : Statement No. V and the Taxation Enquiry Commission Report, Vol. II, pp. 396-397

After War II relief in respect of raw materials required for industry, and on plant and machinery, was given. On the latter it was reduced from 10% to 5%, except in certain cases on protection grounds.

Import Duty Since 1947[1]

In 1947-48 the yield from import duty was unusually high amounting to Rs. 103.60 crores. In the following year (1948-49) there was a fall (to Rs.98.23 crores) due to the import restrictions to conserve foreign exchange, and also due to the fact that the revenue which was collected at ports in Pakistan accrued to that dominion. Adjustments in the rates of customs duties in 1948-49 were made mainly as an anti-inflationary policy, announced in October 1943.[2] Accordingly, import duty on machinery and certain raw materials were reduced, but subsequently the rates of import duties on certain luxury items were increased.

In 1949-50 there was increase in the duty mainly due to re-

1. Source : Explanatory Memoranda on the Budgets of the Central Government, Budget Speeches, Reports on Currency and Finance (Reserve Bank of India) and Finance Acts.

2. Vide Chapter III.

laxation in import control. There was a phenomenal increase in imports during the earlier months of that year. The increase was, however, partly set off by a reduction in revenue in closing months of the year, as a result of re-imposition of import controls. In 1950-51 there was further rise due to liberalisation of import allocations in respect of certain articles. It reached a high level of Rs. 141.59 crores in 1951-52.[1] This was mainly due to larger imports and rise in import prices which yielded greater revenue due to ad valorem duty. In 1952-53 the receipts came down to Rs. 118.07 crores. In 1953-54 the collections improved a little mainly due to raising of the duty on certain items mostly of semi-luxury nature.

During the year 1954-55 receipts amounted to Rs. 141.06 crores. The increase over the previous year was mainly due to the additional yield from large imports of sugar necessitated by decline in indigenous production, and relaxation of restrictions on commodities carrying high duties. The increase was partly set off by decrease under motor spirit due to reduced imports, as a result of increased production within the country, and the abolition of import duty on raw cotton and some varieties of steel.

In 1955-56 the yield was Rs. 127.98 crores. The decline in revenue was due to the decreased imports of motor spirit, kerosene and lubricants, and smaller receipts under import duty on sugar. In pursuance of the general policy of a gradual remission or reduction of duties on essential raw materials, duty on certain articles, for example, dyeing and tanning substances, gums, resins, plumbago and graphite, *etc.*, were also abolished subject to the margin of preference being maintained wherever it was bound by agreement.

The revenue from import duty again rose to Rs. 140.52 crores in 1956-57 due to higher imports during the year, and the increase in import duties on a number of articles—wines and spirits, clocks and watches, motor cycles and scooters, coal tar, dyes and certain type of machinery and staple fibre and staple fibre yarn.

In the year 1957-58 tariff rates were given a simpler form and the surcharges were merged into the basic rates as shown in Table 35 (page 190). Revenue collection from import duties again reached a peak level (of Rs. 150.94 crores) even greater than that in 1951-52. This was due to the reason that rates of duties of about 90 items were raised by small amounts and the general rate of import duty was raised to 35% (while the surcharge was merged in it). Thus an effort to rationalise the rates was made. The increase proposed were, however, mostly in respect of items consumed by the upper-income groups. On the other hand, tariff rates were given a simpler form, as the diversity in rates was administratively cumbrous.

For the year 1958-59 the revised estimate showed a fall in revenue to Rs. 112.57 cores, and the budget estimate for 1959-60

1. The actual yield was much larger than the Budget Estimate.

shows a further fall to Rs.110.62 crores. This is due to the reason that cuts were made in the import programme to conserve foreign exchange, affecting a large variety of consumer goods.

In the budget for 1960-61 following the changes in excise duties, provision was made, where necessary, for the levy of a countervailing import duty on wines and spirits and other alcoholic liquors so that the indigenous product is not placed at a disadvantage (estimated yield, Rs.25 crores).

In the year 1961-62 the existing rates of duty on as many as 41 items were raised including machinery and component parts of machinery, iron and steel manufactures, newsprint, tobacco, betel nuts, instruments and appliances, *etc.*

In 1962-63 budget the import duty was increased on six items, *viz.*, certain iron and steel items, art silk yarn, stainless steel plates, sheets, rods and bars, copra, certain types of tools excluding machine tools and agricultural implements.

In the year 1964-65, however, the rate of customs duty on motor cars, which had gone up to 150% was reduced to 60%. (Estimated yield, Rs 2.5 crores).

Revenue from import duty since 1946-47 has changed as follows :[1]

1946-47 to 1952-53 — Rs. crores

Year	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52	1952-53
Amount	89.3	103.6	98.23	100.30	107.70	141.59	118.07

1953-54 to 1959-60

Year	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59	1959-60
Amount	119.60	141.06	127.98	140.52	150.94	116.53	135.82

1960-61 to 1964-65

Year	1960-61	1961-62	1962-64	1963-64 (R.E.)	1964-65 (B.E.)
Amount	154.61	198.22	238.42	318.82	335-79

The Pattern of Import Duties

Import duties in India are levied in accordance with the rates of the duty prescribed under Schedules I and II to the Indian Tariff Act (1934) which are subject to changes from time to time. The import tariff is cast in the form of a commodity schedule with broad distinctions indicating the treatment to be accorded to various classes of articles. Articles are listed according to their stage of manufacture (for example, raw materials, finished goods, *etc.*) or according to their derivations (for example animal, vegetable or mineral products, *etc.*) or in the line with some other technical description or use.

1. Source : Vide Statement V.

The general rate[1] of import duty have been changed from time to time as follows :

Table 35

General Rates of Import Duties*

1951-52 to 1952-53	1953-54 to 1955-56 and 1956-57	1957-58	1958-59	1959-60
25% + a temporary surcharge of 1/5th	25% + a temporary surcharge of 1/4th	35%	40%	40%

*The surcharges were merged into the basic rates in 1957-58.

On certain non-essential items, where it was felt that the consumer could well pay a higher rate, or where there was sufficient indigenous production to meet the needs, higher rates of duty were imposed. Accordingly, certain items have been subject to protective duties, while certain others have been declared duty free, or have been subject to lower rates of duty, in the interest of the indigenous industry or of the country's economy as a whole. It would be clear from the present provisions, which are as follows :

(1) Some of the protected goods are—automobiles, electric conductors, some chemicals, certain coal tar dyes, matches, silk and art-silk fabrics, aluminium, cycles, certain items of machinery and parts, ball bearings, titanium dioxide, power and distribution transformers. The rates of duty are fixed for them at such amounts and for such periods as are found necessary, having regard to the recommendations of the Tariff Commission.[2]

(2) Grains and pulses and a number of raw materials for industry (of which raw cotton[3] and raw jute are most important) are on the free list.

(3) Specially low but varying rates of duty cover a large number of essential items like fuel oils, batching oils, lubricants, raw films, machinery, *etc.*

(4) Some of the items which carry the heaviest rates of duty (ranging from 75 to over 200%) are the following :

Tobacco manufactures, wines and spirits, artificial silk goods, gold plated articles, fabrics containing gold or silver thread, socks and stocking of silk or art silk, boots and shoes, parasols and sunshades, gold and silver-thread manufactures, silver thread and wire, motor cars, clocks and watches, *etc.*[4]

Ad valorem duties used singly or in combination with specific duties, occupy a larger part in the Indian customs tariff. There has been a gradual shift from specific duties to ad valorem duties.

1. The general rate of import duty applies to all articles other than those specially listed.
2. Explanatory Memorandum on the Budget of the Central Government for 1958-59, Statement II.
3. Import duty on raw cotton was abolished in 1954-55.
4. Explanatory Memorandum of the Budget for the Central Government, 1959-60, Statement II.

In case of customs, ad valorem basis is easier to understand and to compare relative burdens. In the case of price fluctuations the burden of the duty remains the same and there is automatic increase in revenue when prices rise. However, great difficulty lies in the assessment of value. On the other hand, specific duties are easier to administer but they fall more heavily on certain articles of lower grade, as we have already discussed previously. Keeping in view the various objectives to be achieved by customs tariff on various occasions the use of both the systems in combination is necessary.

Customs duties cover a very wide variety of goods and the level and incidence of these duties are under constant review so that re-adjustments could be made from time to time. The annual budget provides the most suitable occasion for making these changes, except when during the course of the year it is found desirable in public interest to make such changes without waiting for the annual Finance Bill.

Increases in the rates of the duty was limited by the General Agreement on Trade and Tariff (G.A.T.T.) for maintaining duty in respect of certain items at the existing levels. Government of India's power to alter the rates of import duty in certain cases, however, was incorporated in the Indian Tariff (Amendment) Act of 1951. This power was subsequently acquired on a permanent basis under the Indian Tariff (Amendment) Act of 1953. This was done largely due to the reason that the rates of import duty have to be altered with a view to promoting the process of industrialisation. Even now the Government's power to bring about changes in import duties is limited.

Revenue collections from import duties have declined, largely owing to the changes in the composition of imports, as has been discussed before. With larger production of goods in India, the dependence on foreign goods is decreasing. Machinery and raw cotton were low duty items (the latter is now duty free). Their share in imports went up from 7.4% in 1925-26 to 24.4% in 1953-54, while that of finished goods, which bear higher import duties, is decreasing. On the whole the customs on import is on the decrease. For these reasons the revenue from import duties may be expected to decline or even disappear on certain commodities. On the other hand, receipts from Central excise would go up as has been already discussed.

EXPORT DUTIES

Introductory

The Fiscal Commission of 1921-22 did not disapprove of export duty as a source of revenue, nor does the Taxation Enquiry Commission deny its value, provided it is used judiciously and with caution. The Government has to be cautious to see its effects on the country's industry and trade in the changing circumstances of international trade. The test laid down by the Fiscal Commission was, that the export duties for revenue purposes would be justified,

if they would fall mainly on foreigners, and in the circumstances in which there was little danger of the production of the commodity in this country being affected. In other words, an export duty should be imposed primarily on articles in which India had a monopoly or semi-monopoly, and the level of the duty should be moderate.

The Taxation Enquiry Commission agrees with the general statement that in normal circumstances only moderate duty should be levied, and that these should be restricted to monopoly and semi-monopoly exports. As regards the proposition that a duty should not be imposed when the burden might fall on the Indian producer the Commission accepts it only with a little modification. They hold that in a competitive market, an export duty could not ordinarily be shifted to foreigners. "The question is one primarily to be decided on the facts of each individual case including the type of product, the nature and extent of competition in the export markets, the relative importance of domestic and foreign demand for the product and other factors."[1] It is, however, recognised that the levy of an export duty may create specially difficult problems in uncertain conditions of international trade and the psychological reactions, of the importers in other countries to such duties.

It has also been suggested by the Commission that the Indian producers who export their goods might be made liable to pay other taxes lightly, so that the export duty might ensure a suitable total tax burden on them. For example, producers of commercial crops might be entitled to lighter land revenue in relation to income than producers of food crops, so that the burden of the incidence of customs duty combined with that of land revenue on the former, would not be greater than the burden of land revenue alone on the latter.[2]

The Taxation Enquiry Commission while considering the possibility of imposing import duty in place of export duty, further points out that export duty can play an important function which import duty cannot, namely that "Export duties may merely be a device to transfer resources from Indian producers of the raw material to Indian manufactures of exportable goods. Export will take the form of the finished article rather than the raw material."[3]

But export duties on raw materials cause more resentment to foreigners than protective import duties on the manufactured articles. This is due to the fact that such duties would place all foreign output of the finished article at a disadvantage,and not merely that part of the foreign output which was exported to India. The first Fiscal Commission expressed itself particularly against the levy of export duties of this type.[4]

Besides revenue considerations, the use of export duty has

1. *The Taxation Enquiry Commission Report*, Vol. II, p. 278.
2. Ibid., p. 272.
3. Ibid., p. 278.
4. *The Indian Fiscal Commission Report* (1921-22), p. 102.

also been made as an anti-inflationary measure or for protective purposes, in order to retain essential materials in the country or to stabilise prices of several commodities. However, the use of export duty for such purposes is also not free from difficulties. Even if the exporting country has a monopoly, the recourse to export duties causes resentment on the part of the foreign consumer and a search by them for substitutes. If, on the other hand, the goods concerned are not a complete monopoly but represent a very large portion of the total world supply, the export duty can still probably be passed on to the consumer, but the rise in prices may go against the trade of the exporting country in the long run. It may also go against the goodwill, and may stimulate cheaper substitutes to be found out. In case of considerable world competition the export duty will have to be borne by the exporter otherwise it may adversely affect the exports in the long run. For these reasons, export duty is considered to be a menace to the country's existing export trade. Nothing is calculated to annoy foreign customers or to disrupt the course of export trade more than the levy of export duty.[1] United States constitution, however, bans export duty.[2]

Further, export duty has necessarily restrospective effect, which violates the sanctity of a contract. The duty imposed is either a loss to the exporter or to a foreign buyer. An example of the retrospective effect and flagrant disregard of the sanctity of contracts by the executive is provided by the action taken by the Indian Customs in 1952, when the method of assessing the duty on manganese ore was summarily altered, setting aside contract prices, and substituting an arbitrary value at the time of shipment. Buyers were naturally troubled. Search for alternative sources of manganese ore was reported to have been in progress in Brazil and Africa, as was pointed out by the Bombay Chamber of Commerce.[3]

Time lag in case of export duties in making the necessary adjustments in rates has meant hardship for industries and trades concerned in times of difficulties. The difficulty is inherent with the administration in not making adjustments at the proper time and in not taking adequate measures. Thus it becomes difficult to sufficiently adjust export duties with changing conditions. Though the duties are levied as a temporary measure they continue to stick for long.

For these reasons in India, for example, the instance of export duty on jute, coal and cloth, *etc.*, were quoted by the Employers' Association of Calcutta to illustrate the ill effects of the duty.[4]

1. Bengal Chamber of Commerce, Calcutta, : *The Taxation Enquiry Committee Report* (Evidences), p. 110, Vol. IV, part II.
2. Levy of Export duty is banned under U. S. Constitution (Art. 1 Section 9).
3. Bombay Chamber of Commerce, : *The Texation Enquiry Committee Report*, Vol. IV, Part II (Evidences), p. 110.
4. Employer's Association, Calcutta, : *The Taxation Enquiry Commission Report*, Vol. IV, Part II (Evidences), p. 456.

When the price of jute manufactures went up as a result of the Korean boom, the duty was raised to as high as Rs. 1,500 per ton, but when prices came down, the duties were not lowered down simultaneously. As a result, the country lost the markets by encouraging the rival manufacturing countries and due to the use of alternative substitutes. In case of cotton textiles the duty was imposed in November 1948 at 10% ad valorem but was abolished only in June 1949, while the export of cloth was affected adversely as a result of the duty in the very early part of 1949.

Thus only when the Government is more vigilant and the administrative set up is improved, the levy of export duty might be justified. As regards this the Taxation Enquiry Commission recommended that the Ministry of Commerce and Industry should have a thorough investigation made of the existing organisation with a view to making it fully effective.

In this country although the levy was mainly justified in early periods of its levy on grounds of revenue, the principle was regarded as unsound. Export duties were then levied generally at small ad valorem rates on most of the exports. A consistent policy of abolition of export duties was pursued from 1867 upto 1916. Just a few years before World War I, export duty was levied only on one item, *viz.*, rice. Financial pressure of World War I again led to the imposition of export duties on a number of items. In 1916, jute and tea were subjected to the duty and in 1919 the duty was imposed on exports of hides and skins. The duty on hides and skins was levied as a measure of protection to the tanning industry to check exports, in raw form.

When the Indian Tariff Act of 1934, was first enacted, export duties were enforced only on a few commodities. Prior to World War II export duties were levied only on raw jute and jute goods. In the post-war period the Government imposed duties on a number of articles with a view to bringing about an equilibrium between internal prices and the export prices, and thus bring some revenue to the Government. Since then, considerable additions have been made in the list and a number of modifications have been made in the rates of the duties as given ahead.[1]

1. Some of these duties have been imposed by the Amendment of the Indian Tariff Act of 1934, while others have been imposed as a result of the power exercised by the Government, under Section 4A inserted into the Indian Tariff Act by the amendment in December, 1950, which we have already mentioned, and which has conferred the powers on the Government to levy or increase export duty. While this amendment provided that any notification issued thereunder would cease to have effect on 1st March 1952, a subsequent amendment was made in July 1952, which has removed this time-limit and any notification made under Section 4A, which may be approved by Parliament may now be rescinded by the Central Government at any time by notification in the Official Gazette. Also, Section 23 of the Sea Customs Act 1878, empowers the Central Government to exempt by notification in the Official Gazette, any goods imported into or exported from India or from any specific part therein, from the whole or any part of the customs duties leviable on such goods.

Export Duties Since 1947[1]

Since 1947, export duties acquired a new importance in this country. Duties were imposed on a number of new articles and old duties were raised. Export duties covered a number of items of which jute, tea and raw cotton were most important.

During the year 1950-51, new duties were levied on black-pepper, also on cotton waste and raw wool at 50% and 30% respectively ad valorem, and export duties on raw cotton and jute manufactures were enhanced. It was due to Korean War boom that export duties were used to counter inflation and to obtain for the Exchequer the benefit of the large disparities between the internal and external prices of the country's principal exports. The total yield from export duty amounted to Rs.47 36 crores in that year.

In 1951-52, the export duties covered jute, cotton, cotton waste, tobacco, cloth, yarn, manganese, tea, black pepper, mica, iron and steel, oil and oil seeds, and raw wool. During that year export duties on certain types of cotton cloth were raised from 10% ad valorem to 25% ad valorem, and duty on groundnuts was raised from Rs.80 per ton to Rs.150 per ton. New duties were also levied on exports of oil seeds and vegetable oils. As a result of these changes the duties showed an increase to Rs. 90.74 crores.

During 1952-53, export duties on coarse and medium cloth were again reduced from 25% ad valorem to 10% ad valorem, and for certain other varieties also it was reduced, while abolished on others. A new duty was levied on mercury flasks.

In 1953-54, export duties on the following items were abolished—(a) jute manufactures other than cloth and bags, both of hessian and sacking variety, (b) certain iron and steel manufactures, (c) medium cloth, (d) tobacco, and (e) certain seed oils. Also, duties on linseed, linseed oil and hessian cloth and bags were reduced. A new duty was levid on coffee at the rate of Rs. 62½ per cwt. There was a drop in the revenue collected during this year to Rs. 38.53 crores, due to the reduction in the duties particularly that on jute and also due to the duty on medium cloth being abolished.

In 1954-55, export duties on cigar and cheroots, mustard oil, linseed oil, Kardiseed oil, Nigerseed oil, cotton seed oil, Rapeseed oil and manganese ore were abolished. Also, duties on castor oil, black pepper and raw cotton excluding certain varieties were reduced. New duties were levied on de-oiled groundnut meal, and certain oil cakes. Duty on tea was enhanced. There was increase in revenue in that year to Rs.41.37 crores.

During 1955-56, export duties on the following items were abolished—Jute, black pepper, iron and steel and manufactures

1. Source : Same as for import duties.
Also Statement No. VI.

thereof and cotton-seed oil. Duties on seasamum oil, certain oil cakes and certain varieties of raw cotton were reduced. The average rate of export duty on tea was also less than 10 annas per pound as was assumed in the previous year's budget. Thus there was a reduction in the collections from the duty which came down to Rs.37.76 crores.

During 1956-57, duty on coarse cloth was abolished. Appropriate relief was also allowed in the rate of export duty on tea. A slab system for export duty on tea was introduced in lieu of the then existing flat rates. It was due to the fact that as prices were rising the incidence of tax in terms of value became progressively higher. On account of the numerous qualities, it was not possible to devise a system of ad valorem assessment.

The revenue that year further declined to Rs. 28.67 crores. It was due to the short-fall in the revenue from export duties on raw cotton, oils and oilseeds, oilcakes, etc.

In 1957-58, duties on certain vegetable oils, oilcakes and certain varieties of raw cotton were abolished. Appropriate relief was also allowed in the rates of export duties on cotton waste and manganese ore. There was short-fall in revenue from export duties on tea, raw cotton and cottonwaste.

In the year 1957-58, the items on which export duties were leviable were cotton, cotton waste, mangnese ore, some oils, oilseeds, oilcakes, and tea.

During 1958-59, in order to improve the competitive position of Indian produce in foreign markets, export duties on manganese ore, oil-seeds, vegetable oils and oil-cakes were abolished (thus leaving very few items subject to export duty), and the duties on certain varieties of raw cotton were reduced. The export duty on tea was revised in conjunction with necessary changes in the excise duty so as to give a measured relief to common teas. The revised estimate for that year shows a further decline to Rs 21.73 crores, and in the budget for 1959-60 it was estimated to yield Rs.17.88 crores only.

Tea is the most important item amongst the commodities now subject to export duty. It yielded Rs.19.09 crores in 1957-58 and the revised estimate for 1958-59 shows a yield of Rs. 17.00 crores. Fall in revenue in the latter year is, however, due to the concessions provided in that year, as mentioned above. Next in importance are raw cotton and cotton waste, but they were expected to yield only Rs.1.50 crores and Rs.1 crore respectively in 1959-60 (Budget)

Export duties do not form a dependable source of revenue due to their instability because they are subject to changes from time to time due to indispensable conditions. This is evident from the history of export duties in our country as given above in brief. The changes in custom duties from exports are at once clear from the following Table.

Table 36

Yield From Export Duty (Selected years from 1919-20 to 1964-65)

1919.20 to 1951-52 Rs. Crores

Year	1919-20	1938-39	1946-47	1948-49	1949-50	1950-51	1951-52
Amount	0.60	4.10	7.14	26.44	25.19	47.32	90.7

1952-53 to 1958-59

Year	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59
Amount	55.38	38.51	41.37	37.76	28.67	26.83	20.84

1959-60 to 1964-65

Year	1959-60	1960-61	1961-62	1962-63	1963-43 (R.E)	1964-65 (B.E.)
Amount	14.89	13.12	12.69	9.60	3.46	2.96

Source : Statement No. VI and the Taxation Enquiry Commission Report, Part II, p. 396.

Pattern of Export Duties

While discussing the choice of suitable commodities for the levy of export duties, chiefly for revenue purpose the Taxation Enquiry Commission suggested on the basis of the conclusion of the Official Team on the Tea Industry that tea is appropriate as a commodity for revenue duty. Its burden falls primarily on foreign buyers. The duties on manganese ore, cigarettes, cigars and cheroots were also considered as the commodities on which export duties could be levied for revenue purpose alone. The latter are the commodities which are not monopolies, but are the products of industries with good markets abroad.

Commodities considered most significant from point of view of anti-inflationary duties were jute manufactures, cotton textiles and black pepper.

Commodities on which export duties were levied to stabilise price of essential commodities were iron and steel, vegetable oils and coffee.

Export duties for protective purposes were levied on raw wool, oil seeds, raw cotton, cotton waste and raw jute.[1]

'Anti-inflationary' duties were found to be most important revenue yielding items till 1953-54 which yielded Rs. 16.1 crores in that year. 'Revenue duties' came next, which yielded Rs.15.1 crores in the same year. The 'protective duties' were less important, (yielded Rs. 5 crores in 1953-54), while other duties were negligible from point of view of revenue. Later on, 'revenue duties' became most important and protective duties occupied the second place, while anti-inflatilonary duties were altogether nil during last few years. The following table shows the position :

1. Export duty on jute has been abolished in 1964-65.

Table 37

Revenue from Export Duties levied for Different Purposes

(Rs. Crores)

Year	Duties primarily for revenue purpose (a)	Duties for protective purposes (b)	Duties to remove price disparities (c)	Anti-inflationary duties (d)	Total (1+2+3+4) (e)
	(1)	(2)	(3)	(4)	(5)
1948-49	11.2	3.6	0.9	10.4	26.1
1949-50	11.4	3.5	nil	9.8	24.7
1950-51	12.5	5.4	0.2	28.5	46.6
1951-52	12.3	9.8	0.7	67.2	90.0
1952-53	13.3	11.5	0.9	28.9	54.6
1953-54	15.1	6.6	0.9	16.1	37.7
1954-55	20.5	16.1	1.3	2.5	40.4
1955-56	17.9	15.0	0.1	1.1	34.1
1956-57	22.3	4.9	0.5	0.1	27.8
1957-58	22.5	3.3	0.1	...	25.9
1958-59RE	18.6	3.3	0.1	...	21.4
1959-60BE	14.5	2.5	0.1	...	17.1

Source : The Taxation Enquiry Commission Report, Vol. II, p. 279, Table 4; and the Explanatory Memoranda on the Budgets of the Central Government, from 1953-54 to 1959-60.

(a) Duties on tea, manganese and cigarettes.
(b) Duties on raw wool, oil seeds, raw cotton, cotton waste and raw jute.
(c) Duties on iron and Steel, vegetable oils and coffee.
(d) Duties on jute manufactures, cotton textiles and black pepper.
(e) The totals in this column are less than the figures for gross revenue from export duties given in Statement No. VI as the latter includes some miscellaneous receipts also.

Cesses on Exports

Cesses are levied on the exports of tea, jute, cotton, lac, coffee, bones, raw hides, wool oil seeds, *etc.* These cesses have been imposed in some cases at the request of the trades concerned and the proceeds are devoted to the purposes calculated to help these traders. The incidence is too small to have any effect on the volume of exports and the fact that proceeds therefrom are to be utilised for specific purposes differentiates them from ordinary taxes.

The procedure in respect of levy of cess on different commodities is not uniform. For instance, in the case of lac, the entire proceeds (minus collection charges) go to the Lac Cess Committee which administers the fund. The procedure is similar under the Coal Mines Safety (Stowing) Act 1939, and the Indian Soft Coke Cess (Reconstruction and Incorporation) Act, 1939. The Mica Mines Labour Welfare Fund Act of 1946 also makes a provision for a cess to be levied and collected by Government which is credited

on the last date of each month to the Mica Mines Labour Welfare Fund. In the case of commodities referred to above, the entire net collection of cess is credited to a statutory body which administers the funds for the purposes sanctioned in its own Constitution. In these cases, therefore, the resources available to the statutory body correspond to the realisations from the cess.

A different procedure is followed in the case of cesses on agricultural products like bones, bristles, butter, raw hides, oilcakes, *etc.* Under the Agricultural Produce Cess Act, 1940, a duty at the rate of ½% ad valorem is levied on all articles included in the Schedule, which are exported, unless these articles are proved to the satisfaction of the Collector not to have been produced in India. The proceeds of the duty levied under this Act less the cost of realisation are paid to the Indian Council of Agricultural Research which in turn utilises the funds for research, *etc.*, in connection with the agricultural produce. However, in this case there is no connection beween the amount collected from a certain article and the amount spent on research thereon.

Yet another procedure is followed in the case of other commodities such as jute or tobacco. In these cases a cess is levied and collected by the Central Government and is credited to the general revenues. On the expenditure side the Central Budget makes annually specific provisions for the Indian Central Jute Committee and the Indian Central Tobacco Committee. These grants are lump sum provisions and do not correspond to the collections from the particular cesses.

Tax on Railway Passenger Fares

A tax on railway passenger fares was imposed in 1957. The rate of the tax was fixed at 5%for distances up to 30 miles, 15%for distances between 31 miles and 500 miles and 10% for longer-distances. No tax was to be levied on season tickets. The proceeds of it less the amount attributable to Union Territories were to be distributed entirely to States.[1]

The tax yielded substantial amount of revenue, as shown below:

Table 38

Tax on Railway Passenger Fares

	1957-58 Accounts	1958-59 Accounts	1959-60 Accounts	1960-61 Accounts
	3.68	12.24	12.81	15.89
	3.68	12.24	12.81	15.89
Less State's share	4.41	10.89	13.07	13.79
Net Receipt	—0.73	1.35	—0.26	2.10

Source : Explanatory Memoranda on the Budgets of the Central Government (Statements No. III).

The Act imposing a tax on railway passenger fares was, however, repealed in April 1961.

1. Vide Chapter II.

6

STATE TAXES

(I) TAXES ON LAND

At present, taxes on land comprise of land revenue, betterment levy and service charges[1] (*viz.* irrigation and power charges). Much greater reliance was placed in the past on land revenue.

(A) Land Revenue

Introductory

A tax on land exists from the earliest times, and as a matter of fact, land revenue was the only tax along with poll tax which existed then. Even upto nineteenth century it contributed a major share of the total tax revenues of most countries.[2] In our country, land revenue contributed as much as 73.1% of the total revenue in 1818, 66.5% in 1850-51 and 46.77% in 1894-95. Later on the figure declined to 35.42% in 1914-15. With the introduction of other taxes, namely, taxes on personal incomes and commodities, now land revenue holds a less important place. The latter constitutes generally a small percentage of the total revenues of the countries today.[3] In India the decreasing importance of land revenue in the total revenue is evident from Table 39.

It is to be noted, however, that following the Zamindari abolition and other land reforms in several states, land revenue increased substantially from 1952-53 onwards. The bulk of this

1. Though service charges do not wholly fall within the ambit of taxes, yet in most cases they may have an element of tax in them.

2. For example, in Japan land tax yielded as much as 93.3% of the total national taxes in 1873 and 51.8% in 1895 (Vide Chapter VII).

3. Again in Japan, for example, land tax, which stood at the top for the national tax revenue until 1908, declined in importance for Government finance with the end of the last century. In the budget of recent years annual yield from income-tax (personal and corporate) has amounted to more than 55% of the total national tax revenue. At present in that country the major sources of revenue for the national Government are personal income-tax and corporate income-tax, liquor tax and monopoly profits from tobacco. (vide Chapter VII).

Table 39

Percentage of Land Revenue to the Total Revenue of India (Centre and States (1937-38 to 1963-64).

1937-38*	1944-45*	1946-47*	1950-51	1951-52	1952-53	1953-54
16.2	5.9	5.5	4.3	5.2	6.6	8.6

1954 to 1964

1954-55	1955-56+ (Revised)	1956-57+ (Budget)	1957-58	1958-59	1961-62	1963-64 (R.E.)
7.6	7.7	8.1	6.3	6.5	6.2	5.4

* Figures are for the undivided India.

\+ Due to reorganisation of States account figures for these years were not available.

Source : Statement No. VIII and the Finance Commission Report (1952) p. 39.

increase was, however, counterbalanced by the expenditure incurred on Zamindari abolition including compensation payment and consolidation of holdings, *etc.*

Land revenue has, from the point of view of the agriculturist, great disadvantages. First, it is regressive and secondly, it is harsh as it does not vary with the product. At times when crop fails or prices are very low, there is no reduction in land revenue. However, these disadvantages can be rectified, first, by making it progressive and, secondly, by making it flexible.

One of the reasons for under-taxation of land as given by some of the studies made by U.N.O. and F.A.O. is that land taxation is regressive and inflexible. "The land tax which until recently has been the major tax in a number of countries, has proved inflexible and non-progressive and has failed to keep pace with increases in production and prices. The only exceptions are in those countries where this tax is collected in kind, for example, in China (Taiwan and Main land). Although some States in India and Pakistan have introduced an income-tax in the agricultural sector as a complement to the land tax, its yield has been too small to cause any significant change in land taxation. One of the major fields of tax reform would, therefore, be to introduce flexibility and progressivity in the taxation of land and its income."[1]

It can be made progressive if the assessment of the value of holdings are made up-to-date from time to time[2] and then progressive rates are fixed on it. It can be made flexible by allowing

1. *Economic Bulletin for Asia and Far East*, Vol. VIII, No. 3, 1957, p. 27.
2. This has only recently drawn the attention of the land reforms panel of the Planning Commission which has proposed for land settlements every five or three years period. (A two days discussion, held on August 5 and 6, 1960 in a meeting of the panel).

remissions or postponement of payments when it is established that there have been unfavourable monsoon or other vagaries. There is one great advantage of land revenue that farmers will have a tendency to strive to produce more if taxed heavily, as the tax is assessed on land rather than on production.

Co-operative Farming, Ceilings and Taxation on Land

The Indian National Congress Party passed a resolution regarding co-operative joint farming[1] in our country, in which they stated, "The future agrarian pattern should be that of Co-operative Joint Farming in which the land shall be pooled for joint cultivation, the farmers continuing to retain their property rights and getting a share from the common produce in proportion to their land. Further, those who actually work on the land, whether they own the land or not, will get a share in proportion to the work put in by them on Joint Farming. "As a first step, prior to the introduction of Joint Farming, Service Co-operatives should be completed within a period of three years. Even within this period, however, wherever possible and when generally agreed to by the farmers, joint cultivation may be started."[2]

Past experience and the present conditions do not lead us to believe that co-operative farming in our country could be immediately taken up successfully. Although more than 1,000 Co-operative Farming Societies were then in existence in this country, most of them had been established on Government land with Government capital for the settlement of refugees or landless people. Very few societies in India have demonstrated that the farmers willingly take to co-operative farming. The trouble lies with the love of land so deeply rooted in the minds of the Indian peasant that they do not like to be deprived of the farmer's right of cultivation and growing crop. Co-operative farming, if introduced by compulsory methods, would go against the very concept of co-operation.

Other difficulties lie where the management is democratic and elected, discipline is poor and efficiency suffers. Where the management is authoritative, the co-operatives lose their co-operative character and expenditure increases as the discontented members resort to go-slow policy.

1. Under Co-operative joint farming the significant feature is that the individual ownership of land is retained even though land is jointly cultivated. As distinguished from it under co-operative collective farming, the co-operative society holds land in free-hold or lease-hold and arranges for joint cultivation by the members. Each member receives wages for the work done by him. Net profits are divided in proportion to the wages for the work done by each member.

In U.S.S.R. collective farms are called co-operatives, but are actually managed by the Government. It is to be noted here, that in China farming is done by 'Communes' which consist of labourers who are assured of three meals a day besides clothing, housing, medical aid, education, etc.

2. *The Hindu*, March 19, 1959.

Andhra Land Reforms Committee summarised the theoretical and practical difficulties which lie with co-operative farming in general, as follows :

"1. The average farmer is fanatically attached to his land and is unwilling to pool his land along with lands belonging to others. He is individualistic in outlook and prefers to cultivate his holding himself. Joint farming is alien to his feeling and traditions.

"2. The harmonious working together of a large number of persons is extremely difficult to achieve, especially where such persons happen to enjoy unequal status and hail from different communities. The position would be greatly aggravated if factions exist in groups from which these persons are drawn and unfortunately factions do exist in most villages today.

"3. The organised and efficient working of such societies would call for honest, capable and disinterested leadership on the one hand, and a high degree of industry and discipline on the other, qualities which are not likely to be sufficiently available in an average village.

"4. Administrative and technical difficulties will arise, in particular the assessment of the work turned out by each member will not be easy, especially work of a supervisory nature.

"5. No co-operative Joint Farming Societies exist at present to demonstrate the tangible benefits that accrue to farmers as a result of Joint Farming."[1]

Co-operative farming is an attempt to tackle the problem of inadequate holdings and to expand the size of holding to the economic one. The fundamental assumption is that increased production can be obtained only under large-scale farming. But even under small-scale farming under intensive cultivation, production can be increased. For example, in Japan production was increased by this method. Large scale co-operative farming does not seem to provide a solution to the problems of our country. It would mean mechanism, which in its turn is bound to throw some labour out of employment. This would lead to an increase in unemployment in the rural areas.

For the reasons stated above, co-operative joint farming in this country, under existing conditions does not seem to be advisable. On the other hand, the peasant should be allowed to continue to independently cultivate his land and harvest his crop with the assistance of Service Co-operatives, which may be called Co-operative Individual Farming or Co-operative Peasant Farming. (Co-operative collective farming, on the other hand, may be confined for the present to the lands which do not involve rights of ownership like—reclaimed lands, or lands owned by Gaon Sabha or State, and lands obtained under Bhoodan.) Further, it has

1. *Andhra Land Reform Committee Report*, p. 70.

been discussed on page 293 how in this country taxation can be instrumental in bringing about the ends of Co-operative joint farming in a better way.

Next, regarding the problem of large holdings, Nagpur resolution stated that "Ceilings should be fixed on existing and future holdings and legislation to this effect should be completed in all States by the end of 1959. Such surplus lands should vest in Panchayats managed through village co-operatives."[1] But it may be seen that there does not appear to be land enough for distribution among the landless.[2] Moreover, it would result in vast increase in the administrative work, waste of money and inefficiency.

On the other hand taxation can provide with a better solution to the problem of land holdings as related to the increase in production on the one side and Government revenue on the other, while at some time trying to mitigate inequalities in income and property. If land revenue is made progressive in accordance with the value or 'standard acreage', it would take the place of ceilings on land holdings. Because the highest marginal rates may be fixed as high as to make it unattractive to hold land beyond a certain limit. At the same time the rates at the lower levels may be low, while the poorest farmers should be exempt from it. Thus the maximum marginal rate should be operative at 30 acres. This would tend towards splitting up larger holdings without legislative measures. This would be quite consistent with the democratic set up also, while at the same time would be equalitarian in its effect. This would also help to achieve the aim of ceiling without the necessity of paying any compensation or incurring extra administrative expenditure.

Uttar Pradesh large land holdings tax introduced in 1957 affords a good illustration of the proposition. It is described below in short.

U. P. Large Land Holdings Tax—It was designed to liquidate large holdings in the State through the easier and better process of taxation instead of the more difficult one of land redistribution. This was intended to give the finishing touch to the process, which Zamindari abolition had already carried out far. Before Zamindari abolition, the number of farmers holding more than 25 acres each, totalled 1,14,700. The 1957 estimate of such holdings was only about 30,000, and land holders having more than 50 acres each were more than 10,000 including 2,200 mechanised farms.

The object and reasons of the large land Holdings Tax Bill were stated as follows :

"For securing successful implementation of the Second Five

1. *The Hindu*, March 19, 1958.
2. It has, however, not yet been possible to estimate surplus land that will be available for distribution after fixation of ceilings. That will depend not only on the limits fixed but also on provisions disregarding transfers.

Year Plan it has become necessary to augment the revenues to the State.

The Agricultural Income-tax which was enacted at a time when Zamindari system was in force has become out of date in the context of post-zamindari era. The principle of social justice enshrined in our Constitution also demands that disparities between agricultural incomes be reduced. More efficient exploitation of agricultural lands is essential for increasing the food production in the State. Those big holders who do not fulfil this duty towards society will have to sell up as they should, if they fail in making increased contribution to the exchequer in the form of Holdings tax under this legislation. With these objects in view the Agricultural Income-Tax Act, 1948 was repealed and this Bill was introduced."[1]

Main Provisions—U. P. Large Land Holdings Tax was enforced as a property tax sought to levy graduated tax for each agricultural year, on agricultural holdings of bigger than 30 acres in size on their annual value.[2] The Rates are as follows :

Table 40

Rate of U.P. Holding Tax (1957 up-to-date)

	Rate
1. On the first Rs 1,800 of annual valuation	Nil
2. On the next Rs 3,200 of annual valuation	5 np. in a rupee
3. On the next Rs 5,000 of annual valuation	10 np. in a rupee
4. On the next Rs 10,000 of annual valuation	25 np. in a rupee
5. On the next Rs 10,000 of annual valuation	40 np. in a rupee
6. On the balance of annual valuation	60 np. in a rupee

The Rates are subject to the condition that :

(a) no holding tax shall be payable where the annual valuation does not exceed Rs. 3,600, and

(b) where the annual valuation does not exceed Rs. 5,000, the holding tax payable shall not exceed half the amount by which the annual valuation exceeds Rs. 3,600.

In Uttar Pradesh there was no ceiling on existing lands, but there was a ceiling on future acquisitions.[3] The large land holding

1. U. P. Gazette, Extraordinary, dated November 1, 1957.

2. Annual Value—"For the purposes of this Act, annual value of a land holding shall be deemed to be an amount equal to the rent payable for the land or lands included therein multiplied by such multiple not exceeding twelve and a half as may be prescribed and different multiples may be prescribed for different districts or portions of districts or for different classes of lands included in a land holding." (U.P. Large Land Holdings Tax Act, 1957, Section 5(a).

3. The ceiling on land fixed by the U.P. Zamindari Abolition and Law Reforms Act of 1950 for future acquisitions was 30 acres, but by the U.P. Law Reforms (Amendment) Act 37 of 1958, the ceiling on land was reduced to 12.5 acres for future acquisitions and secs. 154 and 165 of the Z. A. and L. R. Act were amended accordingly. The object of reducing the ceiling as stated in the objects

tax could be expected to attain the objective of ceilings quite well, or rather in a better way as discussed above. In Uttar Pradesh also the 'Imposition of Ceiling on Land Holdings Bill of 1959' is however, shortly going to be enacted like many other States where the legislation on ceilings of land is under consideration.[1]

In the absence of a ceiling, people would be free to keep large farms but will have to pay high taxes. In that case they will have to strive for greater production to pay up taxes, which they might well afford to do. This will mean greater effort for more production. It may be added that joint-family system in our country also provides a good type of co-operative system, where they work together for their common benefit out of the ties of affection and trust so necessary for the work of this kind. It can contribute towards greater production and may not be, therefore, discouraged. On the other hand, ceiling on agricultural lands imposed by legislature and the joint co-operative system would take away the incentive for higher and better production. It should be replaced by progressive taxation on the lines indicated above. Thus the policy of imposing ceilings by legislature is contradictory to the objective of stimulating production in our country.

The Taxation Enquiry Commission examined in detail the question of changing the structure of land revenue. The Commission after considering all the alternatives submitted before it, arrived at the conclusion that any other alternative like the agricultural income-tax could not prove a good substitute for land revenue in State finances. It is only a comprehensive tax policy which could solve the problem.[2]

In this connection it is to be noted that land tax in India is akin to the taxation in kind in Soviet Union in so far as it is based on the number of acres owned rather than on actual output. They must deliver a fixed amount of the produce to the State regardless of the success of the crop. They have preferred it over other alternatives[3] of taxing the agricultural sector, for simplifying their task against unpredictables like bad harvests.

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nd reasons published in the U.P. Gazettee Extraordinary dated September 11, 1958 was that "A change in the definition of the family necessarily calls for a reduction in the ceiling for future acquisitions."

1. Legislation on fixation of ceilings on land has been enacted only in seven States, while it is in various stages of consideration in others according to a note by the Planning Commission. (The 'Pioneer', August 7, 1960).

2. *The Taxation Enquiry Commission Report*, Vol. III, p. 207.

3. A State has several alternatives in taxing agricultural Sector, as pointed out by Holzman which are as follows: (1) compelling collective farms and peasants to deliver a specified part of their output either for no remuneration or for a very small one; (2) compelling collective farms and peasants to deliver a specified part of their output for a remuneration which at least covers costs of production; (3) doing away with collective farms (Kolkhozy) and replacing them by State farms (Sovkhozy); (4) levying a very high money income-tax on peasants and collective farms for the purpose of forcing them to sell a sufficient portion of their output to pay the taxes. (Holzman, Soviet Taxation).

Soviets have preferred to rely on the first method as mentioned above.

(B) Betterment Levies and Service Charges

Betterment levies, irrigation charges and power charges have been recognised among the most desirable means of capturing for the Government a part of the additional income attributable to the developments made in the Five Year Plans.

Betterment Levies

Betterment levies are intended to absorb a part of 'unearned increment' in the value of land served by the new irrigation projects. State Governments have accepted the principle of imposing betterment levies in the areas benefited by new irrigation projects. The Taxation Enquiry Commission considered the taxation of unearned increment of land values as 'a sound principle',[1] and were also of the view that betterment levies would fulfil the desired objectives like stabilisation of land values besides providing to the Government a part of the capital cost of the irrigation projects.

Betterment Levy is like a tax on capital gains. It is desirable to secure through such betterment levies some portion of the capital expenditure incurred on a particular project. For example, in the States benefited by the multi-purpose Bhakra-Nangal project, the levy was proposed to be utilised for repayment of the capital cost. (Capital costs inculde the interest on the loan for investment and necessary depreciation allowances). However, the burden should be spread over a number of years, because all lands do not react immediately to irrigation to an equal extent and some period has to lapse before they reach full development. Moreover, they have to make additional investments to prepare the lands, for construction of water-courses, *etc.* Thus the entire capital cost of any development project cannot and should not be expected immediately from the beneficiaries. The general tax payer has to bear the burden for the time being.

It may be considered quite reasonable to fix the maximum rate of betterment levy at 50% of the increased value in land as the Taxation Enquiry Commission has suggested.[2] As a matter of fact, appropriate levies and charges would not absorb away the entire benefit of the projects to cultivators and users of services. They would still have a net gain from the more efficient use of their own labour, land and capital. Thus there seems to be no need for any subsidy in the form of lower levies (or charges). Instead, a betterment levy at a suitable rate is to be charged from them over and above the service charges. In case of minor irrigation works like tubewells and storage tanks, however, the Taxation Enquiry Commission considers it more appropriate to make a small addition to water rates than to levy a betterment charge.

In India several State Governments have taken power to impose betterment levy on new projects. Bombay, Hyderabad, Punjab,

1. *The Taxation Enquiry Commission Report,* Vol. III, p. 251.
2. Ibid., p. 258.

Pepsu and Rajasthan were among the first to impose it. Other States in which betterment levy was imposed subsequently in 1954-55 were—Orissa, Madras, Mysore and Hyderabad. Later on Madhya Pradesh, Rajasthan and Saurashtra imposed the levy.

How far measures like betterment levies would be helpful in raising the required resources, would depend to a considerable extent on the level of agricultural prices. In times of high prices it might yield good results while with the lowering of agricultural prices it might not prove an effective device for raising revenue.

Irrigation rates[1]

Irrigation rates realise some profits and there is an element of tax in it. There is more likelihood that an element of tax would be present, as in no progressive system of taxation can receipts be directly linked with expenditure for specified purposes. Hence there is likelihood that the rates may exceed the actual cost of service. In some older works (for example, in Hyderabad, Punjab and Uttar Pradesh) irrigation rates realised some profits. The Taxation Enquiry Commission recommended that a policy of no profit and some loss would be justified only in case of an irrigation work for scarcity area which is being economically developed.[2]

Although on several occasions it might be reasonable to provide some services by public enterprises at prices below their full cost, the general policy should be to attempt to cover in the price all expenses and capital costs. Departures from the full-cost pricing must be adequately justified. Full cost pricing would also promote economical use of the services. On the other hand, charges below full costs would mean subsidies for the user of the service which must be paid by the general tax payer.

The Principles and rates of assessment of irrigation charges are likely to be different in different States and sometimes even to be contrary to the scientific principles. It forms sometimes an extremely inequitable system favourable to some areas and burdensome to others. The Taxation Enquiry Commission, therefore, recommends the reduction of "as far as possible the present differences in the cost of water supply within the same class of irrigation works in a State and between different States."[3] In case of 'protective works' where the water charges might initially have been fixed with a view to help the cultivators, the Commission recommends, "a periodic enquiry into the maintenance costs and the benefits derived by the cultivators in the area, since this would provide a proper basis for adjustment of water rates to changing conditions."[4]

1. The principle for levy of power charges is the same as for irrigation charges.

2. *The Taxation Enquiry Commission Report,* Vol. III, p. 256.

3. Ibid., p. 254.

4. Ibid., p. 255.

(II) AGRICULTURAL INCOME-TAX

Introductory

The nature of income from agriculture is different from non-agricultural occupation. The former is received after hard manual labour[1] and natural risks, while the latter is received from profit, interest or high salary. Moreover, there is no uniformity either in the systems of agriculture and agricultural produce or in prices and disposals of agricultural produce all over India. On the other hand, agricultural income-tax in respect of its assessment and collection is nearer to land revenue than to the Central taxes on income. For these reasons it is justifiable to assess it separately from the Central income-tax.

Under the Indian Income-tax Act [Section 4 (3) viii] agricultural income is exempt from income-tax. The Indian constitution empowers State Governments to levy a tax on agricultural incomes.[2] This provision continues since the passing of Government of India Act, 1935.

In all Western countries there is aggregation of incomes from agricultural and non-agricultural sources. There are two distinct reasons for it. First, the activities of the Western farmer are more akin to that of a trader than the activities of a farmer in India. For instance, in England a farmer devotes more of his time to husbandry, poultry farming, dairying and so on. Secondly, there is no system like the land revenue in India, where the land revenue is considered to be rent rather than a tax. Thirdly, people are educated and more advanced in those countries. Thus there is no obstacle in those countries in treating agricultural income as a part of the total income of an assessee for taxing income. On the other hand, in India in early stages of income-tax during a short period of nine years (1860-1865 and 1869-1873) an aggregation of the two incomes was tried, but it proved a failure mainly due to administrative difficulties and the low standard of education; which is a prerequisite for correct valuation of agricultural income.

Both the Indian Taxation Enquiry Committee (1924-25) and the Income-tax Enquiry Committee (1936), however, observed that, on grounds of equity there was no reason why agricultural income should not be included in income-tax. For the justification of their argument the Income-tax Enquiry Committee said that a tax-payer's ability-to-pay could be determined only with reference to his entire total income including agricultural income, and so there was no justification to exclude agricultural income, while fixing the amount of tax payable on the assessee's other incomes. Thus according to them, there was no theoretical justification for

1. Agricultural income had, until recently, been construed to mean income from land as a result of human labour on that land. However, recently in the case of Mulji Sicka & Co. (1946 I.T.R. 92), the High Court held that actual tilling of soil is not a *sine qua non* of an agricultural operation.

2. The Constitution of India, Seventh Schedule, List II, Item 46.

the exemption from income-tax of incomes derived from agriculture.[1]

There were administrative and political objections to the change, of which the Committee was no doubt aware and which were necessary to be primarily considered apart from justice or other considerations.

But the levy of agricultural income-tax is not free from difficulties. (1) In some cases the decision, whether the income is agricultural or non-agricultural, becomes difficult to make, (2) while in other cases, where the income is partly agricultural and partly non-agricultural, it becomes difficult to point out with exactitude what part is agricultural and what not.

For the above reasons, in some cases it might also lead to double taxation.

Brief History

Bihar was the first State to introduce agricultural income-tax in this country in 1938, Assam followed in 1939. Bengal Agricultural Income-tax Act was passed in 1944. In Orissa the tax is effective since April 1, 1948. On the suggestion of the Central Government the tax was introduced in Uttar Pradesh in 1948-49, but was repealed in July 1957 with the coming into force of the U. P. Large Land Holdings Tax Act of 1957, which has been already discussed. In Madras, a Bill for levying the agricultural income-tax was under consideration in 1946-47 and was expected to yield an estimated annual revenue of about Rs. 1 crore. However, the proposal was given up and has not been revived since then. Mysore Agricultural Income-tax Act was passsed in April 1955 for the levy of income-tax from lands used for growing commercial crops.

Pattern of Agricultural Income-tax

Agricultural Income-tax is in addition to the prevailing land revenue assessment. In all Provinces where the tax is levied the rates applicable to different income ranges are much lower than the income-tax rates (including surcharge) on non-agricultural incomes. For example, the rates for agricultural income-tax in Uttar Pradesh upto 1957 were as given in Tabe 41.

(When the Act was introduced in 1948 there were only two slabs of income of Rs. 5,000 each over Rs.5,000. The rates for these slabs were 2 annas and 3 annas 6 pies in the rupee respectively while the balance was charged at the rate of 5 annas in the rupee).

Agricultural income-tax in Uttar Pradesh was payable by a person whose total agricultural income of the previous year exceeded

1. *The Income-Tax Enquiry Report* (1936), p. 7, and *The Taxation Enquiry Committee Report* (1924-25), p. 217.

Table 41

Rates of Uttar Pradesh Agricultural Income-tax from 1954 to 1957.[1]

Agricultural Income-tax		Rate
1. On the first Rs. 1,500 of the total Agricultural income		Nil
2. On the next Rs 3,500	do	1 anna in the rupee
3. On the next Rs 10, 000	do	2 annas in the rupee
4. On the next Rs 10,000	do	4 annas in the rupee
5. On the next Rs 10,000	do	8 annas in the rupee
6. On the balance	do	10 annas in the rupee

Rs.4,200[2] and in the case of any society, trust or other association of individuals, higher figures were prescribed. The tax was subject to the following conditions :

(a) The tax was not payable by a person who cultivated not more than 30 acres of land.[3].

(b) In case of assessees with income up to Rs 5,000 the agricultural income-tax payable was not to exceed half the amount by which the total agricultural income exceeded Rs 4,200.

Persons getting an income of Rs.30,000 and above had also to pay super-tax on graduated scale at rates varying between 1½ annas and 5½ annas in the rupee.

The levy of a graduated direct tax on agricultural incomes with an exemption limit placed a justifiably large tax amount on the high-income groups. It was justifiable for two reasons. First, it would provide some revenue to the States for development and reconstruction. Secondly, it would curb down inflation. Land owners had been making large profits during past few years due to rising agricultural prices, and States were not able to appropriate sufficient portion of it, as the amount of land revenue was not related to prices. Though land revenue meant the surrender of an appreciable portion of their incomes to the State in the case of small holders, its incidence on the larger land holders was considerably light.[4] As a result of this tax the bigger land-owners would pay commensurately larger sums.

There are, however, no greater prospects of yielding greater revenue from this source in the States where it is levied. This is due to the following reasons—(1) Larger number of agriculturists

1. Rates as substituted by Section (9) (1) of U. P. Agricultural Income-tax (Amendment) Act of 1954.
2. The exemption limit was raised by the Agricultural income-tax (Amendment) Act of 1954. Prior to it, it was Rs. 3,000.
3. In the proviso, '30 acres' were substituted by Section 4 of the U.P. Agricultural Income-tax (Amendment) Act of 1953 for '50 acres'.
4. Vide Chapter X,.

would fall under the minimum exemption limit. (2) Even the income of those who are liable to pay the tax are not calculated to be very big nor there are prospects of increase in future as noted ahead. (3) It becomes difficult to calculate the net income after making allowance for the various expenses in agriculture. (4) The large amount of illiteracy in low-income groups is not going to be removed so early. They are not able to keep the account of their incomes properly.

After the abolition of Zamindari, the importance of agricultural income-tax dwindled to a large extent and only big farmers would be liable to pay it. Lately as a result of agrarian reforms in States, larger holdings are being prevented and compulsory distribution of holdings is being attempted. As a result of this, large agricultural land-holders will be no longer there. The Taxation Enquiry Commission remarked—"It is only necessary to recall that in most States the proportions of the number of holdings under 5 acres to the total holdings is more than 50% while those under 10 acres account for 75%, in order to realise how inadequate agricultural income-tax would be, as the substitute for land revenues from the stand point of the revenue of the State Governments. To this consideration would have to be added important developments implied in recent land reform policies; those policies will have the effect of further reducing the number of large holdings and consequently of large incomes from agriculture."[1]

As the revenue from agricultural income-tax is low as given below, there has been little inclination in many States to levy it.

Table 42

(2) Agricultural Income-tax—(State-wise)

Lakhs of Rs.

States	1957-58 (Acct.)	1958-59 (Acct.)	1959-60 (Acct.)	1962-63 (Acct.)	1964-65 (B.E.)
Andhra Pradesh	—	—	4	349	421
Assam	224	299	230	349	421
Bihar	14	17	18	46	40
Kerala	183	181	161	242	225
Madhya Pradesh	—	1	2	—	—
Madras	130	86	147	116	116
Mysore	54	103	105	76	70
Orissa	3	3	3	11	5
Rajasthan	2	2	3	4	4
Maharashtra	—	—	—	—	15
West Bengal	117	89	68	84	75
Uttar Pradesh	—	—	—	28	49
Total	780	842	818	957	1020

Source : Statement No. IX and Reserve Bank of India Bulletin May 1960.

1. *The Taxation Enquiry Commission Report*, Vol. III, p. 208.

No large scale prospects of yielding more revenue from agricultural income-tax have been indicated due to the reasons already stated. However, other States like Punjab where this tax is not levied, should also impose this tax not only to augment their resources to some extent but also to achieve the socialistic objective of reducing inequalities in incomes in the agricultural sector also. A large land holdings tax in the absence of ceilings on land would, rather, be a better method for achieving the aforesaid objectives as has been already discussed. It will also eliminate uneven distribution of property.

(III) COMMODITY TAXES

(A) State Excise Duties

Excise duties levied by Indian States are mainly for restricting consumption of certain articles. These include the excise duty on consumption of (a) alcoholic liquors (b) opium,[1] Indian hemp and other narcotic drugs and narcotics, non-narcotic drugs and (c) medical and toilet preparations containing alcohol, or any substance included in (b). Some excise revenue is also derived from the sale of Vend licences for sale of imported liquor and licences for bottling it, and other similar operations. The duty on the importation of liquor from abroad is regulated in accordance with the customs tariff in force and credited as a receipt under 'Customs'.

The bulk of the State excise revenue is realised from duties on liquors and intoxicants. Therefore, the revenue from this source is directly linked up with the policy of prohibition. The policy of prohibition, from revenue point of view, has been a subject of controversy since about half a century. The Planning Commission appointed a Prohibition Enquiry Committee in December 1954 with the object of formulating a national programme of prohibition in pursuance of the Directive Principle of State Policy (Article 47) of Indian Constitution. The committee gave their report in October, 1955.

The primary emphasis of the Report was on the feasibility of having a nation-wide prohibition programme, and on various beneficial economic and social effects that resulted from the policy of prohibition in those States where it had been operative. The Committee considered that prohibition was both a sound policy as well as a practicable proposition and recommended that it should be regarded as an integral part of the Second Five Year Plan with April 1, 1958 as the target date for bringing about complete pro-

1. The production of opium is a monopoly of the Government of India who, in pursuance of this policy, regulates the allotments of the quota of opium to States, since 1960 opium is not to be sold except for medical and scientific purposes.

hibition. In the opinion of the Committee, the fiscal aspect of the problem should be considered secondary. Inasmuch as prohibition is one of the Directive Principles of State Policy and forms an integral aspect of social welfare and national development, any revenue loss or expenditure incurred should be viewed in the light of social gains.

As regards the incidence of excise duties, the Commission considered excise duties on intoxicants as highly inequitous, regressive and anti-social, because the major portion of excise revenue is collected from the consumers of toddy and country spirit, who are among the poorest sections of the community. According to an estimate,[1] per capita expenditure of the consumer on intoxicants amongst the poorer sections worked out as high as Rs. 100 per year; further, for every rupee of excise duty collected, the consumer was calculated to spend about Rs. 3 on drink. In non-prohibition States, 12 to 28% of total revenue was in this manner realised from 5 to 15% of the population.

The excise duty was considered by the Committee as also inherently inelastic in character, as raising the duty beyond a point is fraught with the risk of increased illicit distillation. The deleterious effects of expenditure on drink and the fact that the excise duty is unrelated to the ability-to-pay, alike impair the efficiency of the tax payer. Besides, the middlemen (contractor class) appropriate the largest amount of profit at the cost of the poor and of the State treasury. Thus, from the point of view of fiscal justice, and in view of the adverse effects on the efficiency of the tax payers and their saving capacity, the Committee emphatically recommended the abolition of the excise duty, which according to them has no place in a progressive tax system.

Dealing with the problem of financial loss arising from the policy of prohibition, the Committee stated that prohibition should be regarded as an integral aspect of national development. The progressive fall in excise revenue should be taken into account in the general financial proposals of each State, and no additional taxation should be directly linked with prohibition. The Committee underlines the more important proposals of the Taxation Enquiry Commission and of some other Commissions mentioned below, for raising additional resources, and said that some States unduly depended on excise revenue.

The Taxation Enquiry Commission pointed out (as was also pointed out by Madhya Pradesh Prohibition Enquiry Committee) that while the aim of the official excise policy in India for the last fifty years had been one of reducing consumption by the levy of high duties, the State Governments had unusually been steadily increasing excise duties 'in pursuit of revenue, though professing to

1. Reserve Bank of India Bulletin, January, 1956, p. 34.

reduce consumption."[1] In the Andhra Prohibition Enquiry Committee Report also, it has been observed that, "the objective of minimum consumption was not helped but vitiated by the objective of maximum revenue in which revenue was sought to be obtained from the poorest classes for being spent on society in general."[2] The Committee was of the opinion that the policy of maximising excise revenue and minimising consumption was self-contradictory.

With the policy of prohibition, revenue from State excises are expected to fall progressively. In particular, the effect of prohibition on receipts from excise is most noticeable in case of Bombay. The receipt from excise in Bombay declined from Rs.6.17 crores in 1948-49 to Rs. 91 lakhs in 1951-52. There was a slight rise in subsequent years. In 1957-58 it amounted to Rs. 1.75 crores, but was estimated at Rs 90 lakhs, again for 1959-60 (Budget) In Madras, from Rs. 3.72 crores in 1948-49 it was reduced to merely 40 lakhs in 1951-52 and was estimated at Rs. 26 lakhs for 1959-60. (Budget)

Bombay, Madras, Andhra and Saurashtra were the States of complete prohibition. Uttar Pradesh, Madhya Pradesh, Mysore, Orissa, Travancore-Cochin and Coorg were the States of partial prohibition. Among others a few States (Assam and Punjab) were the States with some dry areas; while others (Bihar, West Bengal and Madhya Bharat) were pursuing a temperance policy. Rest of the States (Hyderabad, *Pepsu*, Rajasthan, Himachal Pradesh, Ajmer, Bhopal, Delhi and Vindhya Pradesh) were non-prohibition States.

Collections in British India increased from Rs. 13 crores in 1912-13 to Rs.17 crores in 1930-31, declined to Rs.13.00 crores in 1938-39, with the assumption of office by the Congress which had enforced prohibition as its avowed policy, but registered a considerable rise to about Rs. 49 crores by 1946-47 with the relinquishment of the office by the Congress, and the stimulus of war-time conditions. This increased the importance of excise duties in the provincial tax systems. The excise revenue again declined by 1950-51, following the resumption of the prohibition programme by Congress Ministeries in 1946 and the partition of the country in August 1947, but subsequently it has increased particularly in the non-prohibition States as Table 43 shows. It now froms about 7% of the total tax revenue of the States.

In any case excise duty must not be abolished at present as was recommended by the Prohibition Enquiry Committee, on grounds of being an inequitous levy. In due course of time as the prohibition policy is extended the revenue would dwindle down considerably and then it may be abolished altogether.

1. *Madhya Pradesh Prohibition Enquiry Committee Report,* Quoted from *The Taxation Enquiry Commission Report,* Vol. III, p. 138.
2. *Andhra Prohibition Enquiry Committee Report,* Quoted from *The Taxation Enquiry Commission Report,* Vol, III, p. 138.

Table 43

Collections from State Excise (1938-39 to 1959-60 selected years).

Rs. Crores

	1938-39 to 1951-52						
Year	1938-39*	1946-47*	1947-48	1948-49	1949-50	1950-51	1951-52
Amount	13.08	48.79	39.68	34.32	28-95	24-92	49·41
	1952-53 to 1958-59						
Year	1952-53	1954-54	1954-55	1955-56 Revised	1956-57 Budget	1957 58 Revised	1958-59 Budget
Amount	46.30	44.66	44.56	43·49	42.76	45·73	45·37
	1959-60 to 1964-65						
Year	1959-60 Budget	1960-6	1961-62	1962-63	1963-64 (B.E.)	1964-65 (R.E.)	1964-65 (B.E.)
Amount	43.82	53·1	58.6	62.8	63·1	67.5	71.0

* Figures for undivided India.

Source : Statement No. VIII and Reserve Bank of India Bulletin December 1949.

Some have suggested the scrapping away of prohibition policy. They admit that what they advocated was 'definitely against the current trend of opinion.' But they were thinking mainly in terms of augmenting revenues to the Government and slowing down in practice of the socialist pattern of society. But there seems no need for scrapping away prohibition policy when other avenues like sales tax have been explored and are available to augment the resources. On the other hand, health and efficiency of the people are to be improved besides the fact that moral values are no less important than economic development for advancement of the country towards the socialist pattern of society of our concept.[1]

(B) SALES TAX

Introductory

General Sales tax and its other version, turnover tax, have never received universal acceptance. They have been extensively criticized by non-socialist writers. In a sense they have merely been tolerated "as an evil necessary to meet heavy revenue needs, rather than being regarded as a desirable permanent element in the tax structure.[2] They are considered discriminatory and oppressive, because the highest rate of tax is on commonly consumed commodities, for example, in Russia turnover tax has been imposed on such an essential commodity as salt, raising its wholesale price of 95 roubles to the retail price of 980 roubles per ton.[3]

1. Vide Chapter XI.
2. John E. Due, *Canadian Tax Papers*, No. 3 (1951), p. 151.
3. Vide *The Tax System in U.S.S.R.* Appendix I.

However, sales tax (and turnover tax) are one of the devices to regulate consumption according to available supplies of commodities (other than those whose demand is perfectly elastic). Above all they are one of the most effective instruments to mop up people's surplus purchasing power.[1] They are also difficult to evade, and easier to administer.

In favour of sales tax (and turnover tax) it is also maintained that they have less adverse effect upon incentives to work and to save. On the other hand, they provide an incentive to save more and consume less.

Sales tax is levied mainly either at a single point or at multiple points.[2]

Under the single-point system of sales tax, it is generally levied and collected at the retail stage, that is, when the goods are sold either to unregistered dealers or to consumers directly. The previous transactions, that is, sale between one registered dealer and another registered dealer is free from sales tax. While under the multi-point system of sales tax, the tax is levied at each and every stage through which the commodity changes hands.[3] However, the rates are substantially lower in this case. A low rate extending to all commodities without exception, would no doubt make the accounts much simpler and to that extent be of great advantage to small dealers. Revenue and administrative considerations, however, make this suggestion unacceptable.[4]

Purchase tax also ensures the tax being levied only at one point, that is, the last point where the goods pass on to the consumer. In most of the Western countries, generally purchase tax is in vogue and not sales tax. Purchase tax is more convenient than sales tax, when the number of producers is large and there is low turnover. The tax levied on a commodity is to be collected from the purchaser instead of being collected from the seller. Theoretically, as far as the incidence of sales tax and purchase tax is concerned there is no material difference between a sales tax and a purchase tax.

The significance of purchase tax lies on the fact that, when a dealer or a consumer buys goods from dealers in other States such a buyer who is within the territorial jurisdiction of the consuming State is liable to pay the tax to his State and it is not the seller who has to pay in a different State. It appears to be quite

1. Dobb, *Soviet Economic Development Since* 1917, pp. 370-73.

2. The question regarding advantages and disadvantages of the two system of taxes was investigated first in 1946 by the Bombay Sales Tax Enquiry Committee (also referred to as Gadgil Committee) and subsequently by the Finance Minister's Conference in 1948.

3. The Indian experience was said to indicate that the collection at the wholesale level was more effective. Experience of other countries pointed to the better public understanding of the sales tax when imposed at the retail level. (*U.N. Taxes and Fiscal Policy in Under-developed countries*, p. 39)

4. *The Taxation Enquiry Commission Report*, Vol. III, p. 40.

justifiable a proposition. But this is not free from serious limitations. This is due to the reason that it is levied at the point where the article is bought for the first time by a registered dealer from an unregistered dealer or from a person who is not a dealer at all. On the other hand, every registered dealer would be exempt from tax on those transactions which he shows to be purchases from other registered dealers. Now, in case of transactions between two States, purchase tax is leviable on the resident registered dealers and not on unregistered dealers as in case of single point sales tax. Hence, a purchase tax on resident registered dealer or consumer is much less attractive from the point of view of the importing State than an extra-territorial sales tax on the non-resident dealer.[1]

If the tax net is to be cast wider, sales tax is the best means, because it has certain advantages over other commodity taxes, like excise, customs and octroi. There is, however, not much difference between sales tax and the other levies mentioned above, as far as their incidence on the consumer is concerned.

Sales tax has an advantage over excise in the fact that it is comprehensive in its application, while excise duties are selective. Thus sales tax avoids the undesirable effect of shifting the consumption pattern from highly taxed commodities to low taxed ones. Sales tax and excise are, however, theoretically separate and distinct imposts. The Central Government becomes entitled to impose excise duty as soon as a commodity comes into existence, and it is not concerned at all with what is done to it afterwards, whether it is sold, consumed or thrown away. In case of sales tax it is to be paid only at the time of sale. There may be overlapping in practice only when the sales tax payer happens to be a manufacturer.

Octroi and customs are also similar in their incidence like sales tax. But the occasion of the levy of the three are quite different. The first tax is levied at the point of entry of a commodity into a specialised area, while the second is levied when it is imported from outside. Thus these two levies have only limited application. On the other hand, sales tax can be extended to all commodities whether produced within or without the country.

Sales tax has an advantage over expenditure-tax also, in the fact that the former is the most effective way of reaching the low-income groups as well while the latter is applicable only to the high-income groups. So long as the articles of bare necessity are kept exempt from sales tax, it is quite equitable to serve the social purpose.

Sales tax in this country has become a mainstay of State revenue, and is regarded as a permanent element in the tax structure,

1. *The Taxation Enquiry Commission Report*, Vol. III, p. 42.

though unlike most countries of the world,[1] it has not been employed at the national level. The Union has power to levy a tax only on sale of newspapers or on advertisements. But the power has not so far been exercised. Now it has also the power to regulate the tax on inter-State sales.

When the general sales tax was first introduced, it was not recognised as a very desirable form of taxation. Still it was considered to be 'the only alternative' to make up the loss caused due to the prohibition policy. Thus at the time of the introduction of sales tax it was not intended as an additional impost, but as a substitute for Provincial excise, which was also considered as an undesirable form of taxation. However, in the initial stages, as the Finance Minister Sir Jeremy Raisman observed (in 1945), care was necessary to prevent the incidence from being too regressive.[2] For this reason several exemptions were carefully enumerated. All exports outside a Province, industrial raw materials, foodgrains and other necessaries of life, bullion and specie were generally free from the levy.

Later on, in their quest for additional revenues, the Provincial Governments found in the sales tax a convenient source. Additions were made to the list of special articles subject to the higher rate or duty. The ordinary rates of tax were generally raised. Exemptions for Bullion and specie were generally curtailed. In some Provinces like Bihar even food grains are liable to the tax.[3] With the pressure of revenue requirements, the scope of sales tax was extended indiscriminately to such an extent that it encroached upon the subjects of the levy of Central Government, namely, inter-State trade, export and import trade and various items of excise duty (for example, industrial raw materials). This was due to the reason that sales tax did not remain confined to retail sales only. This was a constant source of conflict between the Central Government and State Governments.

With the framing of the new Constitution of India several restrictions were placed on the power of States to levy sales tax under Article 286 of the Constitution. In short, the restrictions were as follows—(a) no State shall levy a sale or purchase tax where such transactions take place outside the State, (b) no sales tax or purchase tax should be imposed on transactions taking place in the course of the import into or export from the country, (c) no State shall impose a sale or purchase tax where such transactions take place in the course of inter-State trade or commerce, (d) no State shall impose a sale or purchase tax on goods which have

1. United States is the only major power of the Western World which does not employ the tax at the national level, although sales tax is the most important source of State revenue. In Canada Sales tax is most important at both federal and Provincial level.

2. Budget Speech, 1945-46.

3. In April 1949, Foodgrains were made liable to sales tax at 3 pies per Rupee (*The Taxation Enquiry Commission Report*, Vol. III, p. 20).

been declared by Parliament to be essential for the life of the community unless such State enactment receives the assent of the President of India.[1] The inclusion of Article 286 in the Constitution was at the time hailed by the commercial community as a great concession who had naturally been disappointed at the rejection of their basic demand of centralisation of sales tax.[2]

In practice, however, these restrictions have been nullified to a large extent by means of interpretations made in the decisions by various courts. Later on, as the result of Constitution of India (Sixth Amendment) Act 1956 and passing of the Central Sales Tax Act, State Governments were authorised to levy sales tax or purchase tax on inter-state transactions which were till then immune from tax under their respective sales tax laws. This has been further discussed under Central Sales Tax.

Conclusion

From the above discussion we find an increasing importance of Sales tax in India. Revenue from sales tax which yielded Rs. 14.48 crores in 1946-47 rose to Rs. 54.40 crores in 1951-52, Rs. 142.5 crores in 1960-61 and has been estimated to yield Rs.253 crores in 1964-65 (Budgets).[3]

The greater the extent to which we proceed towards a socialistic economy, the more we will have to rely on sales tax (and excise duties); because the more socialised economy we have, the lesser the inequality in incomes will exist and the lesser will be the role of direct taxation.[4] On the other hand, indirect taxation will play a greater role. In Soviet Russia, for example, the percentage of turnover tax in relation to gross national product increased from 41% in 1937 to 57% in 1948 and was 54% in 1952. It is worth while noting that though the ratio of turnover tax to national product has fallen between 1948 and 1952, it still accounts for more than half of the Soviet national product.

(C) CENTRAL SALES TAX

Historical

Before the coming into force of the Constitution of India in 1950, apart from taxing the sales which took place within the

1. Clause (3) of Article 286 relating to the essential articles was omitted by the Constitution of India (Sixth Amendment) Act of 1956 and the following clause was substituted—

"Any law of a State shall, in so far as it imposes, or authorises the imposition of a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or Commerce, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidence of the tax as Parliament may by law specify."

2. *The Taxation Enquiry Commission Report*, Vol. IV, Part II. (Evidences) Bengal National Chamber of Commerce, p. 48.
3. Vide Statement VIII.
4. Vide Chapter IV.

territories of Provinces (under Entry No. 48 of List II of the Seventh Schedule), sales tax laws of nearly all the Provinces contained provisions which authorised the imposition of tax on sales or purchases not actually taking place within Provincial territories, but outside thereof on the principle of territorial 'nexus'.[1] They picked out one or more of the ingredients constituting a sale, and made them the basis of their sales tax legislation. For example, Assam and Bengal made, inter alia, the actual existence of the goods within the Province at the time of the contract of sale the test of taxability. In Bihar, Madras and Uttar Pradesh the production and manufacture of goods was made an additional ground. A net of the widest range was laid in Central Provinces and Berar, where it was sufficient if the goods were actually found in the Provinces at any time after the contract of sale or purchase was made.

The validity of these enactments authorising the levy of tax on sales or purchase actually taking place outside the Province was challenged in many High Courts. The High Courts, with one or two exceptions, held that it was not necessary for the purpose of sales tax jurisdiction that all the legal ingredients of sale or even the transfer of title should have taken place within the Province. It was sufficient if there was some territorial 'nexus' between the sale and the taxing State. The Supreme Court also confirmed their view. This provided further impetus for States to levy sales tax on the 'nexus' theory.

Clauses (1) and (2) of Article 286 of the new Constitution (which came into force on January 26, 1950), seek to restrict the powers of State Governments to levy tax on sale or purchase of goods, where such sale or purchase takes place outside the State concerned or in the course of import of goods into or their export outside the country. The Article also seeks to prohibit State Governments from levying purchase or sales tax on transactions in the course of inter-State trade and commerce (as we have already given. The provisions are so worded that they have lent themselves to varying interpretations with the result that different State Governments interpreted them in such a manner that the levy of sales tax on inter-State transactions continued in some form or other.

This led to unnecessary controversy and litigation causing inconveniences and hardship to merchants and traders. In view of these difficulties, the Government of India proposed that in the

1. The principle applicable for determining the question of territorial jurisdiction of a legislation in relation to taxation laws is that of sufficient territorial 'nexus', as laid down by the Privy Council in Wallace Brother & Co.Ltd.vs. Commissioner of Income-tax Bombay (A.I.R. 1948 P.C. 118). According to this principle, the existence of sufficient territorial connection between the taxing State and what it seeks to tax is the test of jurisdiction in such cases. This principle was applicable in cases under the Government of India Act 1935 and the same principle applied under the present Constitution also. [State of Bombay Vs. United Motors (India) Ltd., 1953, S.C. 252]. As there is no hard and fast test as to what constituted sufficient territorial connection, Article 286 of the New Constitution was enacted to remove the defect.

wider interests of trade and commerce and harmonious administration of sales tax, States should adopt a uniform interpretation of clauses (1) and (2) of Article 286. It was thought to be the best solution of the problem if the Centre and the States could arrive at some agreed formula.

The Finance Ministers Conference held in October 1952 considered this point, and arrived at an agreement relating to inter-State Commerce, among other things. Further details as to how the principles thus agreed upon could be applied in practice were examined and worked out by a 'Committee of Officials.'

Subsequently, the Supreme Court finally decided[1] the legal position of inter-State transactions by giving an interpretation to clauses (1) and (2) of Article 286. The Supreme Court opined that only the State, in which goods were actually delivered for the purpose of consumption therein, was competent to levy sales tax on such transactions to the exclusion of all other States. Thus a State could collect taxes from non-resident dealers in other States. Although this Supreme Court decision had clarified the position of sales tax in regard to inter-state transactions, it created a number of difficulties of practical nature. Traders were harrassed by notices served by several States demanding sales tax, by appearance in persons, production of account books, *etc.*, in respect of such transactions.[2]

The Government of India recognised these difficulties of the traders and referred the matter to State Governments which was put up in a meeting of Officials Committee held on 16th and 17th November, 1953. In the meeting certain proposals were recommended to all the States for acceptance. It was also considered that, where a State insisted upon taxing the inter-State point of transaction, a solution could be achieved only by means of a purchase tax at the points involving inter-State trade, because this tax could avoid the exercise of extraterritorial jurisdiction as we have discussed before.

When the Constitution was framed, the possibility of the provisions of Article 286 leading to the exercise of such extraterritorial jurisdiction by State administration was never intended.

1. State of Bombay Vs. United Motors Co. India, Ltd., AIR 1953, S.C. (252).

2. In the light of finding of the Supreme Court, the Bihar Government called upon parties in Bombay State to pay tax on their sales to parties in Bihar. The U P. Government similarly called upon parties in Bombay to pay tax on their sales to parties in U.P., though the delivery by the sale of goods had been completed in every sense of that term in the State of Bombay. Bihar Government served notices on U.P. dealers, who had supplied goods to Bihar parties, to get themselves registered under the Bihar Sales Tax Act if the parties desired exemption of their sales on dealer to dealer basis from sales tax under the single point tax mechanism in vogue there. Similarly, any dealer in any part of India having the off-chance or prospect of supplying goods even once to any U.P. party, had, therefore, to get himself registered under the U.P. Act if he chose to pass the incidence of U.P. Sales tax to his purchaser. Complications were thus found to arise.

It also opened a source of evasion. The tax-payer could avoid the payment of tax in either State (importing and exporting) by taking delivery elsewhere than where the commodity was to be consumed.

Recommendation of the Taxation Enquiry Commission

The problem was examined thoroughly by the Taxation Enquiry Commission. It held that "in essence, the sales tax must continue to be a State tax, as a source of revenue... it must wholly belong to the States; and as a tax to be levied and administered it must substantially pertain to State Governments.... The sphere of power and responsibility of the State may be said to end, and that of the Union to begin, when the sales tax of one state impinges, administratively on the dealers, and fiscally on the consumers of another State.... inter-State sales should be the concern of the Union... But the responsibilities pertaining to the Union could be exercised through the State Governments and the revenue in any case be devolved appropriately on them."[1]

The Commission further recommended the following modifications in respect of inter-State sales tax.[2]

(a) Amendment of the Constitution to provide for the inclusion of the sales tax on inter-state sales in the Union List and also to empower Parliament to formulate principles to determine transactions in course of inter-States sales and import and export trades.

(b) Substitution of the power of the President to consider and give assent on law made by a State regarding the tax on essential articles, by giving power to the Parliament to regulate taxation of commodities of importance in inter-State trade and commerce.

(c) Permitting the exporting State to levy a tax on inter-State transactions at 1½% in the case of specified goods and 1% on other goods.

After the Commission's Report another important development took place as a result of the judgment of the Supreme Court in the case of Bengal Immunity Company Ltd. Vs. The State of Bihar.[3] The Commission had examined the whole problem of taxation of inter State trade in the light of the interpretation of the Supreme Court in the Bombay Sales Tax case, which virtually had given power to the State Governments to tax non-resident dealers. In the Bengal Immunity case, the Supreme Court reversed its earlier decision and stated that no such power existed.

Besides this, the inclusion of sales tax on inter-State sales in the Union List and the provision for the distribution of proceeds among the States would go against the scheme envisaged in Article 286. The fundamental idea behind Article 286 is that import and

1. The *Taxation Enquiry Commission* Vol. III, p. 54.
2. Ibid., pp. 5-57.
3. A.I.R., 1955, S.C. 661.

export trade and inter-State trade should be free from sales tax. In exceptional cases, however, Parliament may by law provide for taxation of inter-State Sales.

Some of the recommendations of the Taxation Enquiry Commission have been accepted by the Government of India. The Constitution has since been amended (as has been mentioned previously)[1], vesting in the Centre exclusive power to levy tax on inter-State transactions.

The Central Sales Tax Act was also passed in 1956 for levying a tax on inter-State sales.[2] It came into force with effect from January 5, 1957.

Main Provisions of the Act

In practice, the exporting State initially levied a tax at 1% on all exports on behalf of the Centre and retained the proceeds. The rate of 1% was reasonably small. It could hardly have been less. It was in keeping with the recommendations of the Taxation Enquiry Commission. In 1963 the rate was enhanced to 2%.

The Act requires the dealers who are liable to pay such tax to register themselves with the authorities named by the Central Government in an order separately published. The dealers who are not so liable, but are liable to pay tax under any sales tax law of the State in which they carry on the business of selling goods, may also, if they so like, obtain registration. Thus, subject to the conditions imposed under the Act, inter-State sales to dealers who are registered are liable to be taxed generally at the preferential rate of 1% of the sale price of the goods, whereas inter-State sale to other dealers is liable to be taxed in the same manner and to the same extent as it would be under the sales tax law of the State as if the sale had, in fact, been made inside such State.

The Act also formulates the principle for determining whether a sale or purchase of goods takes place outside a State, or in the course of inter-State trade or commerce, or in the course of import of the goods into and export of goods out of India. It also declares certain goods to be of special importance in inter-State trade or commerce. The goods so declared are coal, including coke in all its forms, cotton, hides and skins, iron and steel, jute oil seeds, rayon or artificial silk, sugar, tobacco and woollen fabarics. The Act also lays down that no State is authorised to levy tax on the inter-State sale or purchase of such goods at a rate exceeding 2% and at more than one point in the series of successive sales.

Suggestions

It is, however, quite probable that the current tax practices

1. *Constitution of India* (Sixth Amendment) Act of 1956, vide the change in Article 286 clause 3, page 315 Footnote.
2. The Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, 1952, was thereby repealed.

may lead to inter-State tax being levied at a number of stages. Remedies can, however, be found for these difficulties. Although the Supreme Court decided that sales outside the State are exempt from Sales-tax, some of the State Governments have tried to circumvent this restriction by the imposition of purchase tax. It is, therefore, necessary that Central Sales Tax Act should provide that no purchase tax be levied by State Government on purchases outside the State.

Complications arising out of the levy of Sales tax on inter-State transactions by the State Governments under Article 286 were meant to be simplified by Central Sales Tax Act. The Act is, however, not clear on many points. The Sales Tax Conference, convened by the Federation of Indian Chambers of Commerce and Industry in Bombay on 24th and 25th July 1957 in which over four hundred Trade and Industrial Associations and Chambers of Commerce participated, adopted various resolutions in this connection, of which some important ones are mentioned as under,[1] These would also throw light on certain shortcomings of the Act.

(1) That inter-State sales tax should be levied only in the State from which the goods are originally dispatched. In other words, re-exports should not be subject to Central Sales Tax.

(2) Although a number of transactions may take place whlie the goods are in transit, by endorsement on the Railway Receipt or otherwise, the transactions should be subject to inter-State sales tax only at the point where there is a sale by a dealer in one State to a dealer in another State.

(3) The position in regard to inter-branch movement of goods, or movement from the principal to the agent should be clarified.

(4) The position of inter-State transactions, where declared goods are bought for use in manufacture, or in the execution of a contract, is not clear.

(5) The words 'for use in the manufacture of goods for sale' should be clarified so as to cover not only raw materials and other materials consumed for manufacture, but also machinery, machinery parts, stores, building materials, *etc.*, which are used for purposes of the manufacture of goods for sale.

The other resolutions adopted by the Conference were largely in respect of administrative expedience and ease to the dealers.

(D) MOTOR VEHICLES TAXATION

Taxes on road Transport in this country can be divided gene rally into the following categories :

Central Taxes — (1) Customs duties on motor vehicles, accessories and spare parts, and motor spirit.

1. The Federation of Indian Chambers of Commerce and Industry, Bombay, Proceedings of the above mentioned Conference.

(2) Excise duties on motor spirit, power alcohol, tyres and tubes manufactured in India.

State Taxes[1] —(3) (a) Motor Vehicles taxes (b) Sales tax on motor vehicles and accessories, (c) registration and other fees.

and Local Taxes[2]—(4) Wheel taxes and tolls.

First comprehensive enquiry into road transport problems, after the road Development Committee of 1927, was taken up by the Motor Vehicle Enquiry Committee in 1950. The main questions to be settled were (1) how co-ordination in motor vehicle taxation was to be obtained (2) how to assess the nature of the unrequited contribution which motor vehicles users could equitably be called upon to pay to the general revenues and (3) how to assess the level of import duties on motor vehicles.

They recommended the abolition of all taxes relating to motor transport and their merger into two taxes—petrol tax and motor vehicles tax, the ceiling for the former was fixed by the Committee below the rate then prevailing in Madras (6 annas per gallon) which was the second highest. They recommended freedom and relief for the road transport industry in India. They pointed out that the motor vehicles taxation in this country was the highest in the world.[3]

After the report of the Taxation Enquiry Commission, these suggestions have, however, lost their weight. The Commission disapproved the Motor Vehicle Enquiry Committee's scheme of the two-tax structure on various grounds. They have clarified why special taxes on motor vehicles, parts, passengers and goods cannot be abolished, and have pointed out that the multiplicity of taxes on motor vehicles is not peculiar to India.[3] As regards the ceiling on the rates of motor vehicles tax, the Commission has cast the

1. (a) These taxes are levied under various State taxation Acts, and the bases and incidence of taxation vary. (b) Fees are levied under the Motor Vehicles Act, 1939, which is a Central Act, and Motor Vehicles Rules are framed by the State Governments thereunder. These include (i) fees for issue and renewal of driving licences, issue of duplicate licences, tests of competence to drive, and (ii) others which include fees for issue of registration, certificates and duplicates thereof and issue of permits for operation of transport vehicles.

2. In accordance with the recommendations of the Road Development Committee (1927), the States abolished these taxes levied by local authorities. In some cases, municipalities were allowed to continue to levy wheel taxes.

The Taxation Enquiry Commission recommended that municipal corporations should be permitted to levy separate wheel taxes, that is, no attempt should be made to consolidate it into motor vehicles tax. (*The Taxation Enquiry Commission Report*, Volume III, p. 86).

3. High cost of road transport as compared to railway transport is evident from the following figures—The cost of carrying by rail in 1957 was 11 pies per ton mile including freight and all charges. As against this, just the tax (not the entire cost) on road transpert was 15 pies per ton per mile, being thus 4 pies more than the entire cost of carrying goods by train. Two more pies were added to this burden in 1957 as a result of the additional taxation measures.

4. *The Taxation Enquiry Commission Report*, Part III, pp. 87-88.

responsibility an burden on the Inter-State Taxation Council as was proposed by it to be constituted.

Motor Vehicles Taxes

Direct taxation on motor vehicles in India is a State subject, and forms lucrative source of revenue, which has increased progressively from 1951-52 onwards as given below :

Revenue from Motor Vehicles Tax[1]

Crores of Rs.

1951-52	1952-53	1953-54	1955-56	1957-58	1959-60	1960-61	1962-63	1963-64 (R.E)
10.09	11.76	13.67	14.39	21.08	24.55	34.1	46.3	54.1

The increase in revenue is partly due to the measure of additional taxation adopted since 1951. There was also intensive growth of motor transport, the beginning of which is to be traced to the period immediately following the termination of World War II. Passenger and goods traffic may be assumed to increase further at the same rate at which the national income increases.

(State) Road Fund

The Motor Vehicles Taxation Enquiry Committee while recommending a detailed scheme for the earmarking of a part of the Central and State Taxes for road development have recommended the creation of road funds not merely for the Central Government[2] but also for States. The Taxation Enquiry Commission along with other variations in the scheme suggested by the Committee, have, however, watered down the recommendation of the Committee as regards earmarking of the State fuel taxes (like sales tax on motor spirit) and motor vehicles taxes, and have placed it at 25% of their receipts from taxes on motor spirit to their Road funds, as the minimum amount.

Outlay on road repair and upkeep is bound to increase progressively in future. It is realised that unless it is adequately provided for, the damage and financial loss to motor transport services cannot be brought within reasonable limits of normal operating costs.

(III) OTHER TAXES

(A) STAMP DUTIES

Stamp duties are in the nature of taxation, though for the most part they perform the function of fees, for either they relate to the conferment of legal rights on the documents duly stamped,

1. Source : Vide Statement VIII.
2. Vide Chapter II, and Chapter IV, for Central Road Fund.

or they are charged in lieu of performance of a specific service.[1]

Stamp duties have been criticised on the ground that they cannot be graduated to conform to the capacity of the tax payer. Further, it is held that it retards business activities. The Taxation Enquiry Committee (1924-25) points out :

"The system of levying duties on documents relating to transfers of property and commercial and other transactions is theoretically not one of the best methods of taxation, and has been criticised by many economists as unsound and subserving no principle."[2] The Committee refers to Hobson in his 'Taxation in the New State' who regards stamp duties generally as "a restraint on trade or other forms of presumable personal and social utility."[3]

However, Stamp duties also have an important place in the tax system of India (as in other countries) as a substantial source of revenue. For example, in Uttar Pradesh alone, net yield from 'Stamp' was Rs.23.70 lakhs in 1955-56, Rs.26.01 lakhs in 1957-58 and Rs. 28.68 lakhs in 1958-59.

The Taxation Enquiry Committee suggested several points regarding fixing the rates of stamp duties, which related to, first, the value of the convenience or utility attaching to a particular kind of transaction, secondly, the diminishing returns and thirdly, hardship to any class of community.[4] These refer to the limits of stamp duty, which cannot be raised beyond a certain point without loss to the business community. This has also been referred to by U. K. Hicks in 'Public Finance Surveys'—"The rates of these (stamp) duties have been substantially raised from time to time. Over 50 per cent more additional revenue is now collected from the States of the Indian Union than was available from undivided India in 1938. There is a strict limit, however, to the amount of additional revenue which can be raised from this source without interfering with business habits."[5]

The Taxation Enquiry Commission, on the other hand, gave the following recommendations—(1) State Governments should carefully examine the list of exemptions and withdraw such of them

1. Judicial stamps are used to denote the payment of the duties imposed on judicial instruments by the Court-fees Act of 1870. All other stamps used to denote the payment of duty, e.g., on leases and mortages, bills of lading and bills of exchange, are governed by the Indian Stamp Act, 1899 and are termed 'Non-Judicial' Stamps.

In India, the stamp duty is ordinarily a tax on documents which constitute evidence of legal right, however, certain taxes, such as the entertainment tax, are sometimes collected in the form of stamps. For example, in West Bengal entertainment tax and various licence fees are collected in the form of non-judicial stamps.

2. *Indian Taxation Enquiry Committee Report*, 1924-25, ch. X, Para 278.

3. Ibid.

4. Ibid., Para 282.

5. Hicks, U. K., *U. N. Public Finance Surveys (India)*, 1951, Chapter IV p. 48.

as were not connected with some important policy of the Government. (2) In view of the considerable leeway which banking in general and the cheque habit in particular had yet to make in this country, no stamp duties should be levied on cheques. (3) Stamp duties could be extended to instruments relating to transactions in the Stock Exchange markets.[1]

As regards court fees, the Commission suggested that court fees should be levied to cover expenses of justice. However, some additional revenue could be realised by curtailing numerous exemptions. Evasion should be minimised by strict observance of the payment of court fees and periodical checks by special investigators. Enhancement of court fees in certain States has been severely criticised on the ground that it implies denial of Justice to the poor.[2] However, it has been justified on the ground that, "it seeks to try to close the door for those litigants who go to the courts with a speculative or gambling spirit."[3]

There is a strong case for uniformity of the rates of stamp duty throughout the country. In regard to documents enumerated in Item 91 of the Union List, rates of stamp duty are to be fixed by the Centre.[4] The intention for this provision is clear enough, *viz.*, to bring about uniformity in the rates. In regard to other documents covered by Item 63 of the States List, uniformity is also necessary. With this end in view there is a strong case for centralisation of these duties.

By their very nature, duties like stamps (and registration) are inelastic sources of revenue. In our country stamp revenue was also affected by Zamindari abolition during past several years. The percentage of revenue under the head 'Stamps and Registration' to the total tax revenue of all States has declined from 9.9% in 1951-52 to 6.5% in 1962-63 as shown in the following table.

Table 44

Percentage of Yield from stamps and Registration to Total Tax Revenue of all States. 1951-52 to 1956-57

1951-52	1952-53	1953-54	1954-55	1955-56 Revised	1956-57 Budget
9.9	8.5	8.3	8.0	8.0	8.

1957-58 to 1963-64

1957-58	1958-59	1959-60	1961-62	1962-63	1963-64
7.0	6.5	6.5	7,0	6.5	6.4

1. *The Taxation Enquiry Commission Report*, Vol. III, pp. 101-104.
2. For example, when in U.P. Court fees were enhanced in 1958, there was much criticism over it.
3. Finance Minister of Uttar Pradesh, in Vidhan Sabha, December 1958.
4. The Union Government is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory rates, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.
5. Calculated from Statement No. VIII.

(B) ENTERTAINMENT TAX AND TAXATION ON FILM INDUSTRY

Entry 62 in List II of the Seventh Schedule to Constitution of India confers on the States the authority to levy 'taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.' Almost all the States have passed local Acts authorising the levy of a tax on entertainments or amusements which is payable also by Cinemas,[1] which provides a bulk of revenue.

Entertainment Tax

Methods of Collection—A tax is fixed on each ticket sold. In some cases cinemas are assessed at a fixed sum per week. In a few cases the exhibitor has to fix on each ticket a stamp for the amount of the tax, while in most cases the amount is shown in print.

Scheme of the levy—Except in Bihar the tax was levied on a slab system when the Cinematograph Industry Enquiry Committee (1951) recommended that the tax should be levied on a flat percentage basis. It was also demanded by the cinema owners that the tax be realised on percentage basis. The Committee also suggested a uniformity in the rates of the levy which differ from State to State.

In Uttar Pradesh, entertainment tax has been levied with effect from February 1, 1959 on percentage basis, at the rate of 50% in cinema shows. Before this the tax was on a slab system, and the rates varied from 50 to about 100% of the admission charges. For cultural shows, amateur theatrical companies, musical performances, *etc.*, entertainment tax is levied at lower rates, that is, at 12½% of the admission charges. This was intended to give impetus to cultural shows and the revival of Indian theatre and Indian circuses which do need encouragement.

The Taxation Enquiry Commission suggested that the whole scheme of entertainment tax would be rendered simpler and better if entertainments were divided into professional and non-professional, and the latter wholly exempted. It also recommended that small non-official advisory Committees consisting principally of social workers should be set up to assist Government in deciding exemptions. In the professional sector, exemptions should be granted only where the proceeds of an entertainment were devoted to a philanthropic or charitable purpose.

Revenue—Entertainment tax in India showed a decrease from Rs.6.39 crores in 1951-52 to Rs.6.14 crores in 1952-53 and Rs. 5.85 crores in 1953-54. Thereafter there was a slight increase to Rs. 6.22 crores in 1954-55. After that it remained nearly constant

1. The powers of taxation delegated to local bodies have been so worded in most cases, that Municipalities and Panchayat Boards levy taxes on Cinemas. For example, in Bombay, Municipalities and Cantonments levied tax on cinemas under section 72 of the Bombay Municipal Boroughs Act 1925. However, it meant double taxation.

in subsequent two years. There is, however, a considerable increase since 1957-58 as the following table shows :

Table 45

Receipts from Entertainment Tax (All States)

1951-52 to 1957-58 Crores of Rs.

Year	1951-52	1952-53	1953-5	1954-55	1955-56 (R.E.)	1956-57 (B.E.)	1957-58
Revenue	6.39	6.14	5.88	6.22	6.50	6.53	8.56

1958-59 to 1964-65

Year	1958-59	1959-60	1961-62	1962-63	1963-64	1964-65
Revenue	10.65	10.42	15.1	18.2	21.4	22.2

Source : Statement VIII and Reserve Bank of India Bulletin May 1960, Table 4.

It was pointed out by the Indian Merchants' Chamber, Bombay that the burden of the tax on the industry was leading to adverse results, which had reflected in the collections from entertainment tax in the three major States during 1950-53.

Table 46

Collections of Entertainment Tax[1] (Bombay, Madras, Bengal, 1950-53)

Lakhs of Rupees

Year	Bombay	Madras	West Bengal
1950-51	172.85	123.89	105.02
1951-52	177.00	126-39	109.77
1952-53	156.88	119.28	104.33

It is evident that the rates of entertainment tax must not be raised high. However, with the increase in the picture-going habit of the general mass and due to the fact that it provides with the main source of entertainment, it has now become a dependable source of revenue to the States.

Taxation on Film Industry

Besides entertainment tax other taxes on the film industry are as follows :

(1) Central levies—(a) Import duty on raw film, (b) excise on exposed cinematograph films, which was imposed in 1960-61 budget, (c) fee for release certificate (Rs. 5 per one thousand feet in 1951);

1. Source : The Indian Merchants' Chamber, Bombay, *The Taxation Enquiry Commission Report*, Vol. IV, Part II (Evidences), p. 163.

(2) State Levies—Sales tax on raw film, equipment, carbons and make-up materials;

(3) Local Levies—(a) Octroi duties and terminal taxes paid by the distributors; (b) licence fees charged by authorities for special godowns for storage, *etc.*

The Cinematograph Industry Enquiry Committee considered the incidence of taxes on the industry too heavy. It was contended by the Committee that film artists have short 'screen' life, while the sale of their capital assets—voice, feature and form was taxed like normal income. The Committee further said that on the other hand, "we realise that in present conditions the share of revenue that goes to exhibitors is out of proportion to their role in the industrial structure, and an insufficient proportion of this money if at all returns to the industry. We have found from many an experience that an insignificant part of this revenue is spent on the improvement of a provision for additional amenities in existing cenemas."[1]

It is worth mentioning here that even in the Soviet economy, artists are allowed high salaries to attract them. A heavy income-rax is levied on them later on.[2] In India, too, if the industries are not allowed to earn good profits, they will not be able to attract good artists which is necessary for a film industry to prosper. The case for film industry thus presents a different problem from other industries. First, they must be allowed to earn initially good profits, which might be taxed later on. Therefore, all taxes levied at initial stages should be reduced. Secondly, the income of artists should not be treated at par with income of other persons, but the former should be treated lightly due to the reason already stated.

(C) DUTIES ON CONSUMPTION OF ELECTRICITY

They bear the characteristics of an excise duty and have similar incidence as the latter. The duty is levied for and paid to Sate Governments on the electricity consumed by certain specified types of consumers. The rates of duty, the categories of exemption, as also the manner in which the duty is assessed vary from one State to another, depending upon the specific provisions of the Electricity Duty Acts in force in different States.

The taxation of electrical consumption has been supported on the ground that electricity was generally cheaper than other sources of light and power subject to tax. A small tax might bring revenue to the Government without imposing undue burden on the consumer. Even a tax on power used for industrial purposes was justified by the Taxation Enquiry Commission, in case the cost of electricity constituted a small part of production. If power costs considerably, in that case the Commission recommends a very

1. *The Cinemetograph Industry Enquiry Committee Report*, 1951, p. 126.
2. Holzman—*Soviet Taxation*, p. 261.

low rate. For cottage and small scale industries also only very small rates were justified.

Only a few States levy the tax. The rates of duty vary considerably, being 60% in Bombay city and the lowest being 6.3% in Madras. Other States levying the tax are Uttar Pradesh, West Bengal and Bihar. Total revenue from electricity duties accounted for Rs.7.15 crores in 1957-58 and was estimated at Rs. 9.39 crores in 1959-60 (Budget).

Miscellaneous Taxes and Cesses

There are some levies which are aggregated under miscellaneous head in the budget accounts of the States. These are tobacco duties, tax on passengers and goods, taxes on prize competitions and betting, *etc.* The tobacco duties levied by States are not treated under excise duties in the budget account but are aggregated with the miscellaneous levies. Some cesses, like cesses on sugar cane and raw jute cess, are also levied by some States.

7

TAXATION AND ECONOMIC DEVELOPMENT

Introductory

The definition of socialism describes one of its objectives as 'steady raising of the standard of living of the people'. In his 'Economic Problems of Socialism', Stalin raised this goal to the status of 'economic law of socialism', as opposed to the 'economic law of capitalism' which is essentially the pursuit of maximum profit.[1] Still the goal of every economic system is the satisfaction of most needs of the society.[2] In capitalistic system, free play of economic forces, unrestricted competition, and bold initiative and enterprise, are the means used to attain this goal; while the socialistic system employs State control of the economic processes for this purpose.

Our country's attempt towards raising the standard of living of the people is through organised planning in a democratic socialist way, which is a biggest instance of its kind.[3] It has accepted mixed economy as the means of economic development, and is attempting to harmonise the objectives of rapid economic development with social welfare and democratic control.

Taxation has, therefore, a double role to play in the process of economic development in this country, first, as an instrument of State control and secondly, as revenue raising device. Both the aspects of taxation are to be related with the need[4] of economic

1 Glowinsky, E., *'Soviet Socialism'* (Studies on the Soviet Union, September 1959, Vol. II, No. 3).

2. By this statement we do not, of course, mean that the capitalistic or any other system satisfies social needs to an equal extent. We have discussed at other places also that a socialistic system is in a position to satisfy social needs to a much greater extent than a capitalistic one.

3. The original idea that planning could only be done by a strong centralised authoritarian State has proved to be incorrect. Democratic countries like England and France have done efficient planning.

4. The Economic Conference for Asia and Far East convened a Working Party of Experts (in 1953) to consider the questions concerning taxation in relation to economic development. The whole question of taxation was discussed by the working party under the following heads and sub-heads—

development, namely pushing up investment—both in public and private sector. Public Sector has to take up increasingly larger investment. But the objective of maximum practicable rate of investment in the public sector should be attained so far as it is consistent with maintaining and strengthening necessary incentives in the private sector.[1]

At the present low level of economic standard in India, development and increase in production is the topmost priority. With this end in view, too much insistence on achieving redistributive justice through taxation is to be held in abeyance for the present, otherwise necessary incentives might be lost, besides the fact that no material benefit would arise out of such transfer of wealth. On the other hand, the increase in the standard of living should flow towards the low-income groups. The increase in mass purchasing power is, however, also to be kept in check for the present, and the increase in incomes is to be diverted towards development.

With these facts in view, an estimate of possible resources available by way of taxation should be made, vis-a-vis the development programmes—The State must definitely have an idea, as to how far a plan can be financed out of the tax proceeds. Therefore, it is necessary to investigate while drafting a plan, the possibilities of stepping up taxation further within practicable limits.

Taxation for Post-War Development Schemes

The Finance Member of the Government of India in 1944, did not conceive of any difficulty in securing finances for development and expansion through taxation, according to the experience of war-time expenditure. He remarked, "in the light of our experience of war-time finance, there is no reason, given the will to find money for peace on the scale on which it has been found for war, wey resources should not be forthcoming to an extent, which could not possibly have been envisaged in pre-war days."[2]

But we must note, that there lies a difference between the war-time effort and the peace-time effort in a developing economy. The former is made for a short time while the latter is a continuous process, extending over, say, fifteen or twenty years. As against war conditions, in peace times as development efforts are made, real national income expands and there is subsequently rise in consumption. The problem then arises of diverting a significant and increasing proportion of addition in incomes to investment. At the same time, control measures for the restriction of consumption become necessary. The volume of private consumption is, however, automatically limited to a greater extent by taxation.

(1) Taxation and related measures as instruments of development policies (a) public and private investments (b) trade (c) income distribution, (2) variability in tax yields in relation to economic development, (3) taxation in relation to individual development projects.

1. Vide Chapter II.
2. Finance Member, Legislative Assembly Debates, 1944-45, p. 715

To-day, an experience of about two decades in our country shows, that the war-time levies—like business profits tax and excess profits tax—were of no avail in peace-time and had to be abolished, and an entirely different taxation policy had to be followed in the light of the peace-time conditions. On the other hand, as the long term planning in this country aims at the broad picture of socialistic structure, the disparity of incomes will be successively reduced and the proportion of indirect taxes will have to be increased. In this connection it would be useful to study how the socialist countries got their resources for development through taxation.[1]

For Post-War Development Schemes, it was estimated that during 1946-51 for Centre and the State Rs.500 crores and Rs. 192.94 crores respectively would be available in the form of surplus from current revenues, by means of an all-out taxation policy.[2] But the target for the Central Government could not be realised. During that period, Central Government could mobilise only Rs. 132.92 crores[3] out of the above stated target of Rs.500 crores for development, This was due to various factors. Partly it was due to increase in non-development expenditure like defence, relief and rehabilitation of displaced persons and on food subsidies. Expenditure outside the plan has an obvious significance to the realistic appraisal of financing for development. Shortfall in the resources for development was also due to the lack of planned taxation policy.

On the other hand, the performance of States was quite satisfactory. The States in the Indian Union were able to mobilise Rs.94.01 crores of resources from the surplus in current revenues for financing of their post-war schemes, as against the target of Rs.116.37 crores for all States of the undivided India.[4] But it was largely due to the Korean boom during 1950-51 and not to any special tax effort.

Taxation for the First Five Year Plan

From 1951-52, that is, with the First Five Year Plan, the revenue and expenditure of the Central Government and States began to rise. Planning reversed the traditional role of taxation in India. The outlay of Rs. 2,069 crores (subsequently raised to Rs.2,377.7 crores) during the First Plan was to be financed by internal budgetary resources to the extent of Rs.1,258 crores, by the Centre and States together, Rs.521 crores by external assistance and the balance of Rs.290 crores was to be covered by definite financing. It was recognised from the very beginning that the aim of

1. Vide Appendix I, *'The Tax System in U.S.S.R.'*, and Appendix II, *'Taxation in China.'*.
2. *The Advisory Planning Board Report*, pp. 65-66.
3. Calculated from the Explanatory Memoranda for the Budgets, and the Budgets of the Central Government from 1946-47 to 1952-53.
4. Reserve Bank of India, *Report on Currency and Finance* 1951-52, pp. 81 and 87.

fiscal policy both at the centre and of States should be to provide from current revenues, as much as possible, for the development expenditure.

Actually the plan was financed as given in Table 47.

Out of the total budgetary resources of Rs. 1,258 crores as estimated in the plan, Rs 740 crores (that is 58% of the total budgetary resources) was assumed to be financed out of current revenues (of the Centre and States) including fresh taxation and receipts of railways. As against it Rs. 690 crores was available over the Plan period from the savings of public authorities—Rs. 420 crores at the Centre and Rs.270 crores by the States. The Centre was able to find Rs.305 crores out of current revenues, which was Rs. 145 crores more than the plan target required, while in the States there was a short-fall of about 34% (initial estimate being Rs.410 crores). This short-fall in the States occurred inspite of the transfer of about Rs. 80 crores to them under the Finance Commission's award.

The Tax Effort

The Central Government adopted various measures of taxation during the period. In 1951-52, the first year of the plan, as a measure of revenue collection and to generate disinflationary climate, taxes were increased so as to give an additional revenue of Rs 32 crores. The main measures were the increases in export duties on a number of commodities, a surcharge on income-tax, an increase in corporation tax, additional excise duties and import duties. In the two subsequent years, inflationary pressures had abated and no substantial changes were made, except for some reductions made in export duties. In 1954-55 substantial increases were made in excise duties. The additional taxation imposed in 1954-55 was estimated to raise the yield by Rs.11 crores. In 1955-56, changes were made both in direct and indirect taxes, the major increases being under income-tax and excise duties. The total increase in revenue was estimated at Rs 17 crores in that year. Over the five years, additional taxation at the Centre, excluding export duties, which are variable in their nature, were estimated to yield about Rs. 175 crores, which was not very significant.

Among the States, Bombay fulfilled the target of additional taxation to the full amount, or rather a little more than that. Rs. 24.0 crores were raised by it as against the target of Rs.23.5 crores. Assam and Punjab nearly reached the target and raised Rs. 3.3 crores and Rs.4.5 crores, out of the targets of Rs. 3.5 crores and Rs. 5.0 crores respectively. Their achievements were thus 94.2% and 81.0% of the target figures respectively. In other States, the actual tax efforts were much below the respective targets.[1] The

1. Vide Appendix IX, showing State-wise break up of additional taxation during the First Plan as compared to the target figures.

Table 47

Financing of the Plan (1951-56)

(Financial resources for the Plan—Centre and States combined)

	1951-52	1952-53	1953-54	1954-55	Total for 4 years 1951-55	1955-56 (Revised estimate)	Total for 5 years 1951-56	Plan 1951-56 Original
	(Accounts)							
1. Outlay on the Plan	259.4	267.6	343.0	475.9	1345.9	666.5	2012.4	2069.0
								(2377.7)*
2. Budgetary resources	204.8	141.3	246.1	368.6	960.8	316.5	1277.3	1258.0
3. External assistance	64.8	45.6	18.5	16.0	145.0	58.2	203.2	521.0
4. Deficit	10.3	80.7	78.6	91.3	240.1	291.8	531.9	290.0

* Revised

Source : Planning Commission, Review of the First Five Year Plan, Page 23.

Planning Commission has estimated in the Review of the First Five Year Plan that the aggregate resources from additional taxation mobilised by Part A and Part B States over the Plan Period was Rs. 80.4 crores.

Thus the progress in the matter of additional taxation in States was not commensurate with the requirements of the Plan. It was not wholly due to the fact that these targets were not based on any close study of the taxable capacity of the States. But it was mainly the tax system of the States which needed improvement, which we have discussed later on under 'Taxation for the Third Five Year Plan'. No doubt, in a federal form of Government the responsibility of laying down policy and limits to taxation in the States devolves mainly on the Central Government, although adaptation by the State and local Governments was also necessary.

The Planning Commission has from time to time been suggesting to the State Governments new measures of taxation for raising additional funds required for meeting their increasing expenditure on development activities. Some of these are :

(i) Raising of water rates to economic levels,

(ii) Betterment levies,

(iii) Special cesses on commercial crops,

(iv) Taxes on land—including land revenue resettlements, surcharge on land revenue, agricultural income-tax, *etc.*

(v) Special assessment of ground rents in urban areas. The scope for (iii) and (iv) above has to be reviewed in the light of the latest trends in prices and incomes, but (i), (ii) and (v) offer considerable scope, as was pointed out by the Planning Commission.[1]

The Taxation Enquiry Commission has made some concrete suggestions for raising more funds in view of the expected increases in development outlays of the State Governments. The recommendations of the Commission are more or less on the lines suggested by the Planning Commission, except that they are not in favour of imposing special cess on commercial crops. It has also recommended that taxes on properties and assessments of rents, *etc.*, should exclusively be transferred to the jurisdiction of local bodies. In addition to it the Commission has made various other recommendations also.[2]

Taxation for the Second Five Year Plan

During the Second Five Year Plan, out of the target of additional taxation of Rs. 450 crores, the State Governments were expected to raise a total of Rs.225 crores, and the Centre was to raise a like amount. This was supposed to be the minimum that

1. The Economic Division of Planning 'Formulation Papers', Second Five Year Plan.

2. Many of the important recommendations have been already discussed while dealing with the respective State Taxes in Chapter VI.

had to be attempted. While making estimates, the recommendations of the Taxation Enquiry Commission were also taken into account. The Commission had suggested increase in both direct and indirect taxes. They had recommended no new direct taxes, but only changes in the existing ones.

In 1956-57, a number of tax changes were made at the Centre along the lines suggested by the Taxation Enquiry Commission. Further measures of taxation were announced in September and November 1956. The total yield from the tax measures of 1956-57 was estimated at Rs.55 crores for the year and Rs.81 crores for a full year thereafter. The budget of (May) 1957-58 aimed at a further 'widening and deepening of the tax base.'[1] The changes were more or less due to the suggestions of Mr. Kaldor, who wanted new direct taxes to be imposed. The yield from the additional taxation imposed was estimated at about Rs.78 crores for the remaining year and about Rs. 100 crores in a full year. However, due to the subsequent concessions granted and the smaller yield of wealth-tax and of railway passenger fares tax, the tax receipts for the year on account of the additional measures were about Rs. 73 crores and might be placed at about Rs.85 crores for a full year. The tax changes in 1958-59 were not expected to make any further addition to the effort. Additional yield from Gift-tax, the adjustment in estate duty and the higher excise on cement, *etc.* were, however, estimated to be offset by the reduction in excise on cotton taxtiles.

For the year 1959-60, the Finance Minister remarked, "Taking the three years of the Plan together the additional taxation has been quite substantial. Having this in mind, I proposed to cover only about a fourth of the anticipated deficit of Rs. 80 crores in the coming year."[2] During the year the total additional revenue from various measures was expected to amount to Rs.25.62 crores (Rs. 20.35 crores from the changes in Union excise, R.2.77 crores from the changes in customs and Rs. 2.5 crores from the increase in wealth tax).

The aggregate yield over the five-year period from the measures of additional taxation adopted by the Centre upto 1958-59, was estimated by the Planning Commission at Rs. 725 crores.[3] This is an improvement of Rs. 500 crores over the tax target suggested originally in the Plan (that is, of Rs. 225 crores). The measures adopted in 1959-60 and 1960-61, expected to yield an extra income of Rs.25.62 crores and Rs.23.53 crores respectively, would mean a further addition to the above noted figure of Rs. 725 crores.

In States, the additional measures of taxation in 1956-57 were estimated to yield Rs 8.7 crores in the remaining part of that year

1 Krishnamachari, T. T., Rajya Sabha Debates on the Budget for 1957-58.

2. Budget Speech, 1959-60.

3. The Planning Commission '*Appraisal and Prospects of Second Five Year Plan*' (May 1958), p. 11.

and Rs. 12.4 crores in a full year. For 1957-58, the corresponding estimates were Rs. 11.9 crores and Rs.20.2 crores. For 1958-59, the measures proposed in their budgets were expected to yield Rs. 14 crores. For the first three years of the Plan, the yield from additional taxation in the States was about Rs. 79 crores. The yield of these measures over the five year period was expected to be around Rs. 173 crores. This is Rs. 52 crores below the target of Rs.225 crores in the Plan.

Taking the Centre and States together, the five-year yield of additional tax measures adopted in the first three years of the second Plan thus worked out at Rs.900 crores. This would have fully met the target of Rs. 450 crores in the plan, plus the uncovered gap of Rs. 400 crores, which was to be covered up by additional measures to raise domestic resources. But it was not specifically mentioned by which measure it was to be filled up. However, the only possible source for filling up this gap was supposed to be taxation and to the possible extent, from profits of public enterprises.

But all this tax effort was not expected to be available for the plan. A large part of it was likely to be absorbed by other demands like defence, non-development expenditure and development expenditure outside the plan. Rs. 160 crores were to be allotted for extra transfer of resources to States under the Finance Commission's award, and Rs. 225 crores for increase in defence outlays, on the assumption that the defence expenditure would remain at about the same level for the rest of the Plan period. Thus Rs.385 crores of the new taxation at the Centre may be taken to be absorbed by these two additional demands on the Centre only, besides the increases in other non-developmental expenditures like food subsidies and grants for raising emoluments of low-paid employees, *etc.*

Therefore, in spite of the vigorous tax effort made during the past few years, on account of the above demands on expenditure, the original gap of Rs. 400 was left uncovered.

During the first three years of the Second Plan, the overall position of resources remained unchanged due to increased transfer of resources from the Centre to the States. But a large amount of expenditure by States also were incurred on items which did not enter into the plan. The gain to the States from the Finance Commission's award plus a part of the additional taxation which they had adopted was also absorbed in non-development expenditure, which was due to administrative difficulties connected with the reorganisation of States, and also in part due to inadequacy of other resources available. Expenditure under development heads other than the plan had also been rising and a considerable porportion of this rise appears to be in respect of items not included in the plan. States were yet to raise another Rs. 52 crores in the last two years of the Plan to reach the original plan target of additional taxation during the plan period.

Conclusions

It is clear from the actual performance of the States during the First and the Second Five Year Plans that the hope for further expansion of revenues is bound to be futile under the existing tax systems of the States.

In the First Plan period, while irrigation rates were put up in some States, these increases yielded only Rs.6 crores as compared to the plan estimate of Rs. 29.5 crores. The additional revenue from taxation of land; which the plan had placed at Rs. 34 crores turned out to be only Rs. 5.4 crores.

Table 48

Yield from the Measures of Additional Taxation in States in the First and the Second Five Year Plans (Part A and Part B)[1]

Rs. Crores

	Yield from additional measures in the First Five Year Plan (1951-56)	Additional measures in the first three years of the Second Five Year Plan		Targets set out for the Second Five Year Plan
		Yield from 1956-57 to (1958-59)	Estimate of Five year yield (1956-60)	
1. General Sales Tax	31.8	39.6	83.2	
2. Tax on Motor Spirit & Diesel oil	6.0	2.9	7.0	112.0
3. Betterment levy		0.8	2.2	16.0
4. Agricultural Income-Tax	5·4	3·3	7·5	12.0
5. Land Revenue				37.0
6. Irrigation Rates	6.0	4.0	9.6	11.0
7. Electricity rates & duties	3.0	3.4	8.4	6.0
8. Tax on Motor Vehicles (including tax on passengers and goods	14.6	5·3	13.1	10.0
9. Stamp duties and registration etc.	3.1	1.2	3.0	4.0
10. State Excise Duties	1.4	1.8	3.6	...
11. Miscellaneous	9.1	17.0	35·3	17.0
Total	80.4	79·3	172.9	225.0

Source : The Planning Commission, Review of the First Five Year Plan p. 28, and 'The Appraisal and Prospects of the Second Five Year Plan', Table 6.

1. In the majority of Part C States no fresh taxes were imposed. Only in some States like Himachal Pradesh and Vindhya Pradesh, tax charges were effected to bridge the gap between revenue and expenditure and to bring their tax levels and pattern into conformity with those of neighbouring Part A and Part B States. Many of them did not exploit even the important sources of revenue like sales tax, tax on motor spirit, agricultural income-tax, registration and stamp duties.

In the Second Plan, betterment levies which were expected to yield Rs.47 crores in five years, (including Rs.31 crores to be made available to the Centre for repayment of loans) are estimated to yield only Rs.2,2 crores in this period. Land revenue and irrigation rates, which were expected to yield Rs. 48.0 crores, are estimated to yield Rs.9.6 crores only, as Table 48 shows.

The tax efforts made by respective States during the First Five Year Plan and the Second Five Year Plan have been discussed in detail in Appendix III. Most of the taxation measures taken by the States took the form of increases in the rates of existing taxes or their extension to newly irrigated areas or to hitherto uncovered items.

In the sphere of State taxation, as we find from the above data, the tapping of revenue from agricultural properties and incomes was inadequate.

Taxation and the Third Five Year Plan

In our country, as the Finance Minister has recently pointed out, "the attention needs at this stage to be concentrated on how to raise effectively the internal resources required for the Plan... the success of our Third Plan, and indeed of all our plans depends on the extent to which we can develop and mobilise our internal resources."[1]

As against this we may find that the Third Five Year Plan depends heavily on external assistance. Receipts corresponding to external assistance in the Second Five Year Plan was envisaged at Rs.1,038 crores[2] (that is, 22.6% of the total estimated plan outlay of Rs.4,600 crores in the public sector) while for the Third Plan it has been estimated to be Rs.3,200 crores[3] which is about 44.1% of the estimated plan outlay of Rs.7,250 crores in the public sector.

As a matter of fact, development in under-developed countries is to be largely a self-generating process. In the words of the United Nations Organisation, "a country in which the share of the Government sector in the gross national product is 12 per cent may be taken to be fairly typical of low-income countries. If one assumes that not more than one-third of the government share is devoted to economic development, an increase of only 2% points in the ratio of taxes to national income (that is, to 14%)

1. This is what Morarji Desai, Finance Minister, said in Lok Sabha (November 19, 1959), after his visit abroad. He reported that, no matter how much foreign aid we get, we cannot get enough to finance our economic development which has to be on a big scale to show the desired effect." (*Leader* November 20, 1959). Also vide discussion on '*Domestic Savings*' Chapter VIII.

2. The Planning Commission, *Appraisal and Prospects of the Second Five Year Plan*, May 1958. Table 7, p. 22.

3. The Planning Commission, *Third Five Year Plan, A Draft Outline*, p. 48.

would enable the government to increase its contribution to development expenditures by 50%."[1] The need for relating the prospects of further resources with the increase in national income was also stressed recently by the American Ambassador to India, Mr. Ellsworth Bunker, who said that in his opinion the target of 5 or 6% annual increase in gross national product (which the Third Plan evisages) was "an attainable goal whose achievement should put India well on the way to the point of 'take-off' to a self-generating economy."[2]

National Income and Taxation

"National income estimates or accounts are. . . . measures of total net product of a country's economy, with distinctions among significant operating sectors and several economic functions, all gauged in a consistent basis permitting quantitative measurement. These measures tell us how much various sectors have produced, distributed and consumed and they tell it for the economy as a whole, without omission, without duplication."[3] Thus it provides with a wide view of a country's entire economy and of various groups in the population, who participate as producers and income receivers; and if available over a substantial period they reveal clearly the basic changes in the country's economy in the past, and suggest, at least, the trends for the future. It also reveals the various lines of interconnection existing among the sectors.[4]

Such statistics are of wide importance for both analysis and policy formation. "The crux of the matter lies in the fact that these various groups will respond differently to various policy measures, and the effect of one and the same measure will differ as it is applied to several groups."[5] In estimating the magnitude of the possible collection from a tax if the components in national product and measures of distribution and consumption are known, it would be possible to estimate as to what the different rates of taxes with different coverage would yield, when national income undergoes a change (for example, when it increases). Besides, it would also be possible to try to evaluate the effects of such a tax on consumption or expenditure. This is the importance of studying the problem of taxation in relation to the national income of a country.[6]

The Finance Minister of India in 1951 remarked, "If we had national income figures, I think our taxation structure would have been much more scientific. The trouble is that we have not got

1. United Nations, *Fiscal Policy in Under-developed Countries*, p. 6.
2. Reported in *The Leader*, June 15, 1960.
3. *The National Income Committee* (*First Report*, 1951), p. 9.
4. Ibid., p. 6.
5. Ibid., p. 7.
6. However, this is a complicated problem. To assume that the tax revenue increases or decreases proportionally to changes in national income would lead to serious errors, due to various reasons discussed subsequently. Only a rough calculation for the purposes of forecast, may be made, by observing the ratio between the change in national income and corresponding change in tax yield of the past years, keeping in view the various factors affecting the ratio.

them yet."[1] But now we have got the figures, it is scientific to avail it for our purpose.

In the Third Five Year Plan a target of Rs. 1,650 crores of additional taxation over the five year period was considered vital for the successful implementation of the Plan. It was envisaged, that with the normal increases in tax yields and with additional taxation proposed for the Third Plan, the proportion of tax revenue to the national income should go to about 11 percent by the end of the plan period. But it must be noted down that, the major problem for a developing economy is to get progressively larger proportion of national income to the public exchequer, and a beginning can be said to have been made in this direction as will be clear from the following table.

Table 49

Tax Revenue, National Income and Tax Revenue as Percentage of National Income (India)

(Rs. Crores)

Year	Total Tax Revenue (Central & State)	National Income at (1948-49) Prices	Percentage of tax revenue to National Income
1951-52	741.04	9,100	7·11
1952-53	691.98	9,460	7.31
1953-54	693.58	10,030	6.93
1954-55	736.48	10,280	7·17
1955-56	761.00	10,480	7·25
1956-57	860.49	11,000	7.82
1957-58	844.84	10,890	7·75
1958-59	1044.27	11,650	9·05
1959-60	1230.83	11,860	10.38
1960-61	1354.94	12,750	10.62
1961-62	1537-97	13,020	11.81
1962-63	1854-98	13,370	13.87
1963-64	2226.26 (B.E.)	13,940 (Provisional)	15·97

Up-to 1957-58 the national income and tax revenues can be said to have kept pace with each other. This was made possible largely by the substantial measures of additional taxation adopted during this period.[2] The increase in the percentage of tax revenue

1. Deshmukh, C.D., Lok Sabha, Debates on the Budget, 1951.
2. Experience shows, first, that the less advanced economy of a country generally the lower is the ratio of tax payments to national income. It shows secondly, that through intensive administrative and legislative efforts (and in some cases, aided by favourable international market conditions or by foreign aid), quite a few less advanced countries have considerably increased their ratios in post-war years". (United Nations, Taxes and Fiscal Policy in Under-developed Countries, p. 6).

to the national income during recent years was also largely due to the vigorous tax effort made, rather than by normal increases in the actual tax collections. The proportion of 11.8% of the national income to be taken away by taxation at the end of the Second Plan (1960-61) and 13.9% by 1962-63 or even about 16o by 1963-64, should not be taken to be a satisfactory achievement, because it does not indicate the automatic increase in the yield of the taxes with developmental activities of the Government being rapidly accelerated. On the other hand, it also includes an additional tax effort by the Centre and the States.

The functioning of automatic flexibility of tax revenues with changes in the national income has been described by the United Nations Committee for Economic Development in these words, "set the tax to balance the budget and provide a surplus for debt retirement at an agreed high level of employment and national income. Having set these rates, leave them alone unless there is some major change in national policy or condition of national life."[1] As national income rises, tax collections should rise, taking more and more from the available income of the public. Similarly, when income drops, tax collection should fall too.[2]

Besides the fact that our tax system lacks such flexibility,

Table 50

International Comparison of Tax Revenue as Percentage of National Income (1954-55)

	Tax Revenue as a percentage of National Income
India	7.1
Burma	15.0
Japan	15.3
Germany	19.5
Italy	19.2
Canada	17.3
Ceylon	17.7
U.S.A.	20.7
Sweden	19.2
Australia	21.3
France	23.4
Netherlands	28.4
U.K.	31.0

Note : India includes the Centre and States, while in the case of other countries, tax revenue refers only to the revenue of the Central Government.

Source : (1) U.N. Statistical Year Book, 1956.
(2) U.N. National Income and Expenditure, January 1957.
(3) Report on Currency and Finance 1958-59.

1. U.N. : *A Programme For Prosperity in a Free Economy*, (Taxes and Budget), p. 22.

2. Automatic changes in tax collections with fluctuations in national income are sometimes sought for aiding the economic stability. ('Federal Expenditure and Revenue Policy for Economic Stability', *American Economic* Review, Vol. 39, 1949, p. 1268). However, sole reliance cannot be placed on automatic flexibility of taxation, as a means to economic stability. More must be done to cope with serious economic fluctuations.

tax revenue as the percentage of national income had also been low as compared to other countries as the table above shows.

Prof. Kaldor at the very outset of his report on 'Indian Tax Reform' points out :

"At present the total revenue raised in taxation by the Centre and the States is a little over 7% of national income, and on the record of last five or six years, the tax revenue does not exhibit that natural buoyancy—*i.e.*,the automatic rise in yields with the increase in national production and income which is a common feature of the tax systems of Western Countries."[1] He further suggests that a thorough and comprehensive reform of tax system is desirable.

The question here is—whether the defect lies only with the tax system or it is due to some other factors determining the automatic rate of growth of tax revenue with the increase in national income.

We shall first discuss the proposition under two heads—(1) The factors pertaining to the tax system itself which determine the rate of growth of tax revenue with changes in national income; (2) Factors outside the tax system, yet affecting the yield.

(1) *Factors Pertaining to the Tax System*—(a) Automatic response of yield from taxation with changes in national income, is less efficient where direct taxes are less important in a tax system. This is more so in poorer countries than in advanced fiscal systems. "An extension of the significance of direct taxes with total tax proceeds brings a closer positive correlation between the development of national income and government revenues."[2]

In case where most of the taxes (*viz.* commodity taxes) are on the low-income groups, the tax system is less progressive than otherwise. This means that an increase in national income is siphoned of to a smaller extent than in the case of the countries where great stress is laid on steeply progressive direct taxation. Yield from taxes like individual income taxes, increased relatively much more than the rise in national income. Corporation taxes are, however, generally limited due to incentive considerations.

(b) The ratio of earned income upto which no income-tax is payable, to the national per capita income is too small in under-developed countries.[3] Thus a larger number of incomes fall outside the tax net itself. Therefore, the coverage of income-tax is very small in under-developed countries.

(c) Inelastic taxes like land revenue do not respond to the changes in national income unless some element of progression is

1. Kaldor, N., op. cit., p. 1.
2. Wallich and Adlar, : *Public Finance in a Developing Country*, p. 17.
3. Vide, p. 253, footnote 1.

introduced in it. So also, the yield from commodities like tobacco, increases relatively less than the rise in national income.

(d) Tax holidays and concessions in a developing economy may also account for a slower rise in tax collections than the profits accruing to the business community.

(e) Inefficient tax administration may lead to the collection of lesser revenue than the expected one, due to no fault in the tax structure.

(2) *Factors Outside the Tax System*—We shall now discuss the factors, other than those mentioned above which are related to the tax system itself, affecting the rate of growth of revenues with changes in national income.

(a) The way in which an additional national income is distributed is of great importance. It might go to swell the incomes of the lower-income group, the middle-income group or the upper-income group. For example, if an increase is in the wages of workers (lower-income groups) consequent upon an increase in employment in public works, construction and various development schemes, a large part of the increase in national income (in the form of wages) would be spent in mass consumption, and cannot be transferred to the coffers of the State, if most of the necessities are subject to exemption from taxation.

(b) If the largest part of the increase in production occurs in small holdings and small enterprises, it would not expand the base of the existing direct or indirect taxes.

(c) When increase in production occurs in the sector where the larger part of transactions are unmonetised, the difficulty lies in bringing it under the purview of taxation. The Planning Commission points out, "Much depends on the importance of money transactions in the economy, when a large part of the production is raised by the labour of peasant families and directly consumed by them, the scope for organising taxation would be obviously smaller than if the operation were being conducted through markets and result in monetary transactions."[1]

(d) When there is a rapid increase in population, the increase in national income is distributed over a larger number, and is too little per head. This is more so in a developing country where the increase in production is small and is distributed over corresponding increased consumption,[2] thus leaving the margin for taxation small. Taxation of small incomes, however, involves considerable difficulty and cost of collection.

(e) The rapidity with which changes in national income itself take place also affects tax yields during the period of change.

1. *First Five Year Plan*, Chapter III, Para 10.

2. The Statistical Office of the United Nations Organisation shows (vide Statement No. XVI) that there is relationship between the stage of economic development and the composition of its national expenditure. In under-developed countries, much of the resources are devoted to consumption than in advanced countries. The data indicate that one-fourth of the product is devoted on personal consumption in under-developed countries, leaving little margin for taxation.

(f) If the increase in incomes is due to change in prices, it does not affect tax revenues from commodities taxed at specific rates.

(g) Public expenditure also determines how far revenues can be increased with increase in national income, which determines to a large extent the burden of taxation on the community. The more the public expenditure for the benefit of the community, the less the burden will be felt by the tax-payer consequent upon taxes. The less the burden of taxation the people feel, the more willing they will be, to pay taxes, and there will be less evasion and avoidance.

(h) The process of prohibition may cut down the increased desire for consumption of alcoholic liquors with the increase in their incomes. State excise revenues, derived mainly from this source (*e. g.* in our country) may not increase or may rather decrease.

(i) Insufficient sense of responsibility of the tax-paying public may also be one of the causes for the low yield.

Due to the factors mentioned above, there is greater possibility that national income may not automatically lead to a corresponding increase in the Government revenues. Because of this reason, "underdeveloped countries are under no illusion that they can or should push their tax ratios of 10 to 15 per cent of national income to 30 to 40 per cent levels reached in such advanced countries as Austria, Belgium, France, Germany, the Netherlands, Norway, the United Kingdom, and the United States. But they are aware that even modest increase in taxation may be able to finance a large percentage increase in a government's contribution to the development programme."[1]

These factors have, however, to be kept in mind while making suggestions for improving the tax system.

We now proceed to examine as to how far the tax system in our country itself is responsible for the lack in automatic response to the changes in national income, which we have previously stated.

At the very outset of the problem, it is to be noted that in India the overall coverage of taxation is low. A large part of private income goes untaxed, and only a small proportion is taken out of private incomes by way of taxation. In 1954-55 it was 8.9% and in 1956-57 it was 9.5%.

The reasons for low coverage of taxation in our country are mainly the following :

(a) The income is spread in thin layers over a larger number of population and it is neither feasible nor just to tax them.

1. Phillips Paul, A.M. Van, '*Public Finance and Less Developed Economy*,' p. 136.

Table 51

Government Draft on Private Incomes

	Rs. Crores (at current prices)		Percentage distribution	
	1954-55	1956-57	1954-55	1956-57
1. Direct Taxes	240	290	2.4	2.5
2. Indirect Taxes	520	650	5.3	5.7
3. Miscellaneous fees	110	150	1.2	1.3
Total	870	1090	8.9	9.5
4. Private Income	9,740	11,460	100.0	100.0

Source: Central Statistical Organisation 'Estimates of National Income' (April 1959), Table 3.

(b) A major portion of the income from agriculture goes untaxed.

(c) Non-agricultural sector also largely escapes from taxation.

(a) *Per Capita Income*—The following Table shows an international comparison of the income per capita. The income per capita for India was about $ 50 (or about Rs.239)[1] in 1955 which was the lowest as compared to other countries given here.

Table 52

Income per Capita (1955)

(U.S. Dollar at 1955-56 prices)

Country	Income
India	50
U.S.A.	1,953
U.K.[1]	1,298
Canada	832
Germany	601
France	821
Italy	353
Switzerland	1,078
Japan	212
Netherlands	580
Egypt	111
Thailand	71

1. 1954 Figures

Source : (1) U.N. Statistics of National Income and Expenditure, January, 1957.
(2) U.N. Statistical Year Book, 1956.
(3) International Financial Statistics, July 1957.
(4) Central Statistical Organisation, 'Estimates of National Income' (1948-49 to 1955-56).

1. Per Capita Income (All India) in Rupees, at 1955-56 prices.

1955-56	239.38
1960-61 (Estimated)	264.86
1965-66 „	311.13

(b) *Income From Agriculture*—On the average, farmers in India are lightly taxed than the rest of the community. It is true that they constitute a poorer section of the community. But it cannot be refuted that there are quite a large number of well-off and wealthy individuals whose income is derived largely from land, who are not taxed equally heavily as those who derive the same amount of income from other sources. Thus, better-off farmers[1] must be taxed more heavily than hitherto.

Income from agriculture in India forms about 50% of the aggregate national income as the Table below shows :

Table 53

National Income By Industrial Origin (At current prices) —Agriculture.

Rs. Crores

	1949-1950	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-1957
Aggregate	9010	9330	9970	9820	10480	9610	9990	11410
Agriculture	4490	4890	5020	4810	5310	4350	4530	5690
Others	253	4640	4950	5010	5170	5260	5460	5720

Source : Estimates of National Income, C.S.O.

Land revenue was estimated (in budgets) to yield only about 9.2% of total tax revenue[2] of this country in 1959-60, while other levies on land and agricultural income-tax have not been fully exploited.[3] Greater taxation on land (and not on production) would stimulate effort to greater production of food. This would also help in lowering the food prices. Besides this, agriculturists are the greatest consumers of food. If agriculturists are earning higher profits and getting richer due to increase in food prices, they must not be allowed to grow richer and a higher tax on them is justified.

In this connection if we refer to the histories of several industrialised countries, we find that their early development was stimulated by rise in agricultural productivity and by siphoning off the increase in agricultural income, mainly through taxation. From 1885 to 1915, for instance, when Japan was developing rapidly, the productivity of the farm worker was more than doubled owing to the liberal use of fertilizer, better seeds, improved techniques, and so on. There appears, however, to have been only a limited improvement in the living standards of the farm population bacause of the heavy land tax. Agriculture being the basic industry of

1. We have discussed in Chapter VI that big farms should be allowed instead of imposing very low ceiling on lands, but they should be taxed at progressive rates. This would not only bring about more production but also more revenue to the Government.
2. Vide Table 71, Chapter X.
3. Vide Chapter VI.

national economy in Japan, land tax occupied the main part of the national tax system. In the early years of modernisation, land tax yielded more than 90% of the Central Government's tax revenue (93.3% in 1873). Only a relatively small share of funds was invested in irrigation, flood control, land improvement and reclamation. The greater part was channelled by the Government into industry.[1]

Later on land tax declined in importance as a source of Government revenue. Still in 1895 it was 51.8% of the total tax revenue and it stood at the top for national tax revenue until 1908. From that time on, liquor tax became first on the list of tax receipts. Income-tax was enforced as a national tax in 1887, but at the start, revenue from this tax was very insignificant. It was after World War I, when Japanese economy made such rapid progress, that personal and corporate income-tax acquired greater importance in Japanese tax system. This tax began to compete against the liquor tax for the top place in national revenue and at last, in 1935 it won that position. From then until now, the yield from personal income-tax and corporate income-tax has remained the greatest. In the budget of recent years, annual yields from this tax have amounted to more than 55% of the national tax revenue.[2]

U.S.S.R. is another case where farm incomes per head were kept down because of the world wars, inspite of farm mechanism and the considerable release of labour to the towns.[3] The primary objective of the collectivisation of agriculture in the U.S.S.R. was to tax the primary sector for the benefit of industrialisation, and heavy land tax was levied.

In mainland of China too, a land tax collected in kind accounted for 41.4% of the total estimated State revenue in 1950. In England and Germany also the early development was stimulated by the rise in agricultural productivity and then diverting the increase in agricultural incomes to the industrial development.

(c) *Income in the Non-Agricultural Sector*—Income in non-agricultural sector also largely escapes from taxation as is clear from the low percentage of income assessed for the purposes of income-tax and corporation tax which are exclusively paid by the urban sector.

Enhancing the built-in-flexibility of the tax system requires the strengthening the individual and corporate income-taxes where incomes are largely unequal. In view of the U.N. Joint-Committee on Economic Development, "The stabilising capacity of income

1. Bruce, F. Johnston, "*Agricultural Productivity and Economic Development in Japan*", Journal of Political Economy. (December 1, 1951).

2. 'Public Finance' (1958) '*Direct Taxes in Japan and the Shoup Report* by Hanya Ito, p. 357; and the '*Tax System in Japan*,' supplied by the Japanese Embassy in India.

3. *Economic Bulletin for Asia and Far East*, 'Allocation of Resources for Investment in Agricultural and Non-agricultural Sector.' Vol. VIII, No. 3, November 1957.

Table 54

Rs. Crores

	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57
1. Assessed Income	577.2	803.9	729.6	781.2	760.0	784.9	936.0
2. National Income (at current prices)	9,530	9,970	7,820	10,480	9,610	9,990	11,410
3. Percentage of (1) to (2)	6.0	8.0	7.4	7.4	8.0	7.9	8.2

Source : (a) Central Board of Revenue—Income-tax Revenue Statistics, 1958-59.
(b) Central Statistical Organisation—Estimates of National Income 1948-49 to 1957-58.

taxes primarily depends on (1) the size of the tax base relative to the actual income of individual and corporate tax payers, (2) the responsiveness of the items of income which comprise the tax bases to changes in levels of economic activity and (3) the degree of effective progression in the rate structure applied to the tax base."[1]

A large amount of exemptions, higher exemption limit, evasion and avoidance—are accountable for the low coverage of taxation under income and corporation taxes in our country. However there is no reason to hold that the exemption limit be lowered to have a wider coverage like that in Japanese tax-scale (1953-54), tax liability beginning at the bottom from Rs.100 a month for an unmarried person and at Rs.210 a month for a married person with two children.

The per capita income in more developed countries being higher, the exemption limit can be a lower multiple of the per capita income,[2] but in countries where the per capita income is very low this is not possible. Therefore, the less developed countries cannot lower tax exemption limits in relation to per capita incomes to the level of the more developed countries. Besides, cost of collecting taxes on small incomes would probably be larger than the receipts. Only with further social and economic development including improved administration, accounting knowledge,

1. Quoted by Lewis H. Kimmel in *'Federal Budget and Fiscal Policy'*, p. 278.

2. The ratio of earned income to national per capita income upto which no income-tax is payable had been much larger in many countries of Asia and Far East, than in the more developed countries. In Burma (in 1953) a man with wife and three children had to earn 20 times the national per capita income before he paid any tax on income. In India (in 1953) the exemption limit for a similarly placed person was about 11 times the per capita national income, while in Ceylon and the Philipines (in 1953) it was 14 times. Only in Japan, where the exemption limit for a similar person was 2.6 times the national per capita income, was the ratio only comparatively slightly above the same as in the United States (1.4), the U.K. (1.6), Australia (1.0) and Canada (1.9) in 1953. (*Economic Bulletin for Asia and Far East*, Vol. II, No. 3, p. 30, 1956).

etc. can thos be attempted. Further, improvement in the tax collecting machinery would yield better results, but a permanent increase can only occur with very significant increase of real incomes.

Therefore, it is better to collect taxes from incomes below Rs. 250 per month through indirect taxes instead of through direct taxes.

An attempt to move the country out of the 'settled groove' was made in the budget proposals for 1957-58. Making the proposals for taxation the Finance Minister said, "Indeed I feel confident that over a period they (indirect taxes) will help in getting out of the stagnancy of public revenue relatively to national income which is a bottleneck from the point of view of further development."[1] He added that "the propriety of change I have suggested, should be judged in this light rather than in terms of their immediate yield."[2]

The direct taxes newly imposed in the last few years are not of much significance from revenue point of view. Expenditure-tax, estate duty, gifts-tax and wealth-tax are not going to yield large revenues. However, they would check tax evasion besides fulfilling the socialist objectives, discussed in Chapter X.

Indirect taxes cannot, however, wholly replace direct taxes particularly those on companies. The reason is that first, one cannot tax all consumption goods, and there may be a shift of demand for non-taxed items. Secondly, indirect taxes cannot be made highly progressive. On the other hand, profits of companies can easily be taxed with desired amount of progression. Indirect taxes and taxes on companies are similar as regards their incidence on consumers. Taxes on profits of companies are also passed on to the consumer in the long run as already discussed in Chapter I, because entrepreneurs must earn profits. In actual practice, however, the profits are reduced, because the demand of commodities are neither inelastic nor generally there are monopolistic conditions. But that amount of reduction in profit might be beneficial if it does not hamper incentives, and entrepreneurs are equally willing to make investments.

Despite the advantages of direct taxes, the role of indirect taxes must be increased in our country. Customs duties are the declining source of revenue. Central excises and general sales tax, on the other hand, show great promise. The only thing to be searched out is the choice of items to be taxed, because all commodities cannot be taxed.

Kaldor did comment on the poor elasticity of the Indian tax system but it is strange that he made no recommendations about indirect taxes. It was perhaps due to the lack of consciousness on his part, of the growing equalities and the advancement towards socialist pattern of society. But from the brief reference that he

1. Budget Speech, 1957-58.
2. Ibid.

made about excise duties, it was clear that he did not put much reliance on at least one form of indirect tax. He was of the opinion that excise duties "should be regarded as the 'marginal source' of taxation to be resorted to, only when and to the extent the total yield from direct taxes falls short of requirements."[1] The Taxation Enquiry Commission, however, recommended increases in both direct and indirect Taxes.

National sample survey (No. 13, 1952)[2] shows that about a little more than half of the consumption is on food items, which are generally outside the purview of taxation.[3] From welfare point of view it is not desirable to tax these items. Then remain non-food consumption items, which constitute the other half of the total consumption goods. The Taxation Enquiry commission had recommended that Article 286 (3) of the Constitution may be amended to remove the exemption of articles essential to the life of the community from the scope of State Sales Tax and 'it was amended like-wise in 1956. There seems to be no way out to escape from such taxation but the health and efficiency of the people must not be allowed to suffer in any case.

Conclusion

Thus we may conclude that the greater coverage under taxation on land (which includes progressive land revenue, betterment levies and agricultural income-tax or the large land holdings tax in the absence of ceilings), and the coverage of indirect taxation in non-agricultural sector is desirable to increase the built-in-flexibility of the tax system in India, thereby helping a self-sustaining growth.[4]

1. Kaldor, *Indian Tax Reform*, p. 4.
2. Vide Statement No. XV.
3. New estimates based on 1961 census, however, does not alter this proportion.
4. One of the principal objectives of the Third Plan has been described as securing a marked advance towards self-sustaining growth'. In fact, it is to be the objective of all future plans.

8

LIMITS TO TAXATION

In a developing economy it is highly inconsistent to talk of limits to taxation, because limits go on rapidly changing as economic development proceeds on. Tax proceeds are constantly utilised for development purposes, adding progressively to the size of the national income. So long as the process continues there are no fixed limits. However, we must have an idea about the limits to taxation in a particular economy, necessary at any particular time, because taxation beyond limits might do injury to the national economy. But where the limits lie and how to judge them is a highly controversial proposition, which has drawn the attention of Political Economists and Financiers from time to time.

Historical

In this connection economists tried to define and interpret a vague and confused concept which they termed as—'Taxable Capacity.' In their attempts to do so they failed to give a precise and scientific definition of the term.

Josiah Stamp defined taxable capacity, as the amount which the citizen of a country can contribute towards the expenses of public authorities, 'without having a really unhappy and downtrodden existence and without dislocating the economic organisation too much."[1] What is unhappy and downtrodden existence, and what is dislocation, is difficult to interpret or demarcate. Dalton uses similar words 'unpleasant effects', while discussing taxable capacity, and he likewise arrives at the conclusion that it is difficult to interpret what are unpleasant effects.[2] Shirras says "Taxable capacity is the total surplus of production over the minimum of consumption required to produce that volume of production, the standard of living remaining unchanged."[3] By providing minimum of consumption Shirras means that the citizens of a

1. Stamp, Josiah, *Wealth and Taxable Capacity*, p. 134.
2. Dalton, H., *Public Finance*, p. 164.
3. Shirras, G. Findlay, *Journal of Royal Statistical Society*, (Vol. 88, 1925) '*Taxable Capacity and Burden of Taxation and Public Debt*,' p. 516.

country will not have an unhappy and downtrodden existence. Thus the statement comes to be not very different from that of Josiah Stamp, and is equally vague. Besides this, he assumes the standard of living remaining unchanged which is against the object of Public Finance. The object of Public Finance is to maximise social welfare which implies that there should be a rise in the standard of living. It is obvious that this definition also is not at all scientific and practical. Let us examine one more definition by Mr. Mason. He thought that the limit of taxation is passed over when it "affects production unduly".[1] Again the question arises as to what is 'unduly'.

In their attempts to define and interpret taxable capacity they have also tried to distinguish between 'absolute taxable capacity' and 'relative taxable capacity'. Dalton holds relative taxable capacity as reality and absolute taxable capacity as a myth.[2] Professor Adarkar while criticising this statement of Dalton says, "True relatives are often regarded as unimpeachable where absolutes are dubious, but if the latter themselves are non-existent, the former become a dubiety."[3] As a matter of fact, "both the terms (relative taxable capacity and absolute taxable capacity) are superfluous as they express a common concept in unfamiliar language."[4]

Some of the economists have outright denied the possibility of ascertaining the taxable capacity of a nation. Edwin Cannan (1921) answered, 'No how', when the British Association asked as to how the taxable capacity of a nation could be ascertained.[5] Dalton said, it was quite impossible to fix any definite sum which could be said to represent the limit of its (community's) taxable capacity at any particular time, "for any such estimate would necessarily leave out of account almost every factor relevant to a practical decision on policy."[6] But one cannot afford to be too pessimistic in this respect, as it is the most practical problem. The defect lies with the very concept of taxable capacity. "It is likely to create confusion and misunderstanding and it is, therefore, desirable to eschew the use of both the terms."[7]

The main defects with the explanations and interpretations given for the concept of taxable capacity is, that only one sided view of public finance is taken, *viz.*, taxation alone, leaving aside the corresponding benefits of public expenditures. According to their view, taxation should be at the lowest possible level, and that level should be determined by the current needs of the Government including debt reduction. Simon Kuznets proceeds to describe the problem of taxable capacity as that of 'diversion

1. Quoted by Dalton, op. cit., p. 167.
2. Ibid., p. 164.
3. Adarkar, B.P. *The Principles and Problems of Federal Finance*, pp. 206-7.
4. Bhargava, R.N., *The Theory and Working of Union Finance in India* p. 29.
5. Quoted by Dalton, op. cit., p. 166.
6. Ibid.
7. Bhargava, R.N., op. cit., p. 29.

of scarce real resources to governmental use."[1] We may repeat here what Josiah Stamp said about taxable capacity "as the amount which the citizen of a country can contribute towards the expenses of public authorities. . ."[2] Dalton rightly points out that "it is fertile to look only at taxation and to ignore the corresponding public expenditure, or to assume that this expenditure brings no benefit to anyone, but represents simply a subtraction from wealth which is destroyed or thrown into a sea."[3] Absolute taxable capacity is a problem of Public Finance and not of taxation alone.

Taxation means sacrifice on the part of taxpayer, whereas expenditure of the money raised by taxation means gain in satisfaction. Limits to taxation lie at the point where the marginal social sacrifice in giving taxes is just equal to the marginal gain in social satisfaction from these expenditures. In words of Pigou, "If a community were literally a unitary being with the government as its brain, expenditure should be pushed in all directions up to the point at which the satisfaction obtained from the last shilling expended is equal to the satisfaction lost in respect of the last shilling called up on government service."[4] While dealing with any problem of Public Finance we have to take a view of the whole community in aggregate (an addition to the welfare of any part of it should be regarded as an equal addition to the welfare of the whole), and the guiding principle is maximum social welfare or the principle of least aggregate sacrifice, the two principles being one and the same. Thus, the limits to taxation are governed by this one principle of taxation.

Taxation as Percentage of National Incomes

Having discussed the defects in the classical thought on the limits to taxation (which were given in terms of taxable capacity),

1. Simon Kuznets, *American Economic Review*, 1942, p. 42. "*National Income and Taxable Capacity*.."

The analysis by Kuznets involves the establishment of the minuend *i.e.* the total real product of the economy, and the subtrahend *i.e.* the amount necessary for the satisfaction of basic needs at a proper level, excluding those satisfied by Governments. The difference represents the amount of real goods or the proportion of total real product, that can be withdrawn by Governments without injury to the basic function of economy; and he calls it the 'diversion capacity'. He assumes that the minuend is measured by the country's national income. As regards subtrahend, he makes four assumptions. First, he assumes that each consuming unit be allowed the minimum of subsistence standard and no more. Secondly, he assumes that some differentials in levels of consumption expenditures be retained to assure incentives to greater efficiency and to a greater national product. Thirdly, that no private capital formation be provided for. Fourthly, some limited percentage of consumer's outlay be permitted to assure the proper rise in the secular level of the national product. These various assumptions will give different estimates of absolute or relative 'diversion capacity'. He prefers the last assumption. His definition of taxable capacity, besides being a one-sided view of Public Finance, is too rigid.

2. Stamp, Josiah, op. cit., p. 134.
3. Dalton, op. cit., p. 165.
4. Pigou, A.C., *Public Finance*, p. 31.

we now turn to the recent approaches to the problem of limits to taxation.

These approaches have dealt with the problem of limits to taxation in terms of national income. It was with Keynes, that the theory of income was developed, and a new importance was thus given to the estimates of national income. From Keynes' analysis it followed, that the total of incomes formed an index of economic activity. It, therefore, became clear that a systematic economic policy could be based on the estimates of national income. Before Keynes this theory was not known. Relation between tax revenue and national income, though estimated in various countries, was not put to any practical use, except that it showed the comparative tax burden and was only a matter of social interest.

Several eighteenth and nineteenth century writers expressed the taxable amount as percentage of national income, but their estimates were arbitrary and were not based on systematic analysis. For example, Leroy-Beaulieu arranges the charge on national income for State-ends, in grades: 5% he thinks light, between 5% and 10% moderate, over the latter figure heavy, and when 15 or 16% is reached, almost impossible to increase. Bastable, while giving the general agreement of Justi, Hock and Beaulieu that 15% of the national income is too large an amount to appropriate for State objects unless in very exceptional cases, believes that a trial is to be taken to ascertain this amount.[1]

The relationship between tax revenue and national income has been used recently in determining the limits to taxation, above which it would impair consumption, saving and investment, and would have an inflationary effect. This was the brilliant application of Colin Clark, the well known Australian economist, who formulated the thesis that once taxation has absorbed 25% or more of the national income, it does not check inflation, but promotes it. In his own words, "the critical level of taxation, beyond which inflationary forces come into play (and deflationary forces suffer a political check) is around 25% of the national income."[2]

Colin Clark supported his thesis by giving evidence of various countries. He claims that the origin of this idea was due to Lord Keynes.[3]

Clark's thesis appears to be giving a very comfortable and easy method for fixing the upper limits for taxation, but it is not

1. Bastable C.F., *Public Finance*, p. 135.
2. Clark, C. 'Danger Point in Taxes' in *Harper's Magazine*.
3. C. Clark, writes in his book '*Welfare & Taxation*' that his thesis of 25% as the limit of taxation, was supported by Keynes. He writes "Lord Keynes, whose name is so often taken in vain by the advocates of limitless taxation, was Editor of the *Economic Journal* at the time of my article and arranged for its publication shortly before his death. In a personal letter to me, dated May 1, 1944, he agreed with my conclusion that for post-war Britain as he foresaw it, 25% of the national income would be just about the safe limit for taxation. Op cit Footnote 5.

free from some serious shortcomings, though he supports it on various pieces of evidence. No doubt, it has been, or may be the just limit for proper taxation in certain cases, but it is not a universal law. His conclusions are based purely on induction. An inductive method has no doubt surer foundation than the deductive one. But the danger lies in the fact that the conclusions might be drawn from insufficient number of facts or ignoring some important facts. Further, on checking it in light of the other aspects of the situation it may not hold good. His thesis may not hold true on further examination. As a matter of fact, the idea underlying Clark's thesis is useful only in determining the limits of taxation to check inflation as we have discussed in Chapter III, and not the overall limits to taxation.[1]

The judgment of technical assistance experts of United Nations in Public Finance as reflected in their mission reports and other writings, appears to be that "most under-developed countries could increase the proportion of their national income taken by taxation without unduly disturbing the economy, and perhaps even with positive gains in the face of inflationary pressures. Yet where the optimum level lies permits of no doctrinaire answer."[2]

We find one obvious defect in Clark's thesis of 25%, namely that he omits several important considerations while fixing one universal percentage of taxation to indicate the limit for all countries. He solely concentrates on inflationary or deflationary effects of taxes as we have already pointed out. But there are other factors too affecting the limits to taxation.

Factors Affecting the Limits to Taxation

Various factors affecting the limits to taxation may be economic, political or social. But we are concerned with economic factors only. Some of the important factors have been discussed here.

(a) Ability-to-pay-taxes does not depend upon the total amount of income alone, but also upon the quality of income.[3] 'Taxable ability' takes into account family obligations, and corresponding allowances for wives, children and dependant relatives. It also distinguishes the class of income—whether from investment or from personal toil.

(b) How the income is distributed is also an important consi-

1. C. Clark, however, mentions one other method also besides the inflationary test, for confirming the percentage of 25%, which may be taken as the limit to taxation. It consists in a careful study of the potentialities of each tax in turn (*Economic Journal*, December, 1945, 'Public Finance and Changes in the Value of Money', p. 381).

Sir Josiah Stamp also points out this method for finding out the limits to taxation, describing it as the point at which the revenue shows an actual diminition on an increase in rates of tax (op. cit., p. 117).

2. United Nations—*Taxes and Fiscal Policy in Under-developed Countries*, pp. 6-7.

3. "The Taxable Capacity of Ireland", by J. Stamp, *The Economic Journal* (1921), p. 336.

deration. C. Clark does realise that in a country where the distribution of income is comparatively equal, the limit to taxation is lower than in a country where inequality is greater,[1] although he does not explain it further while dealing with his thesis.

(c) Per capita income has also a bearing on the level of taxation. Percentage of taxation to national income is not enough while comparing limits to taxation of different countries or in the same country over different periods. Poor countries may have lower limits to taxation than the rich ones. Bastable said, "Expenditure requiring 10% of the national income of India would be much more burdensome than if 30% were to be required in England or United States."[2]

(d) Both the quality and quantity of Government expenditures affect the limits to taxation. Moreover the qualitative aspect is more important. We have already pointed out before, that expenditure and revenue deserve equal attention. One cannot be studied in isolation from the other. Harold M. Groves says, "Most taxpayers have a selfish as well as a philanthropic interest in governmental outlays that help to maintain a progressive community. But they are demoralized by 'pork-barrel' outlays, handouts to pressure groups, and a philosophy that government expenditures, unlike those of individuals, need not be paid for. Reckless disregard for the value of money by the government is not compatible with maintenance of the economic virtues among individuals.[3]

Public expenditure which increases productive efficiency raises the limit to taxation. If the Government is going to bear greater responsibilities in the field of production and there is better return of investment-proceeds than in the case of private investment, the limits to taxation can be raised higher without fear of retarding production though in this case it will be taxing its own industries. Thus the distribution of function between public and private sectors of economy is quite relevant while determining the limits to taxation.

Expenditure for social uplift is likewise an important consideration in this respect. Transfer payments like interest (on internal loans) and social security benefit, and expenditures for goods and services by the Government definitely expand the limits to taxation, provided the benefits are obvious and clearly appreciated. A. R. Ilersic imagines a case where the Government takes 50% of national income, but returns it back as social cash benefits.[4]

1. C. Clark says, "It is inevitable that as the distribution of incomes be become more equal, the amount of revenue which can be obtained by applying a given progressive tax scale to a given national income should fall."—*The Economic Journal*, December 1945, "Public Finance and Changes in the Value of Money', p. 381).
2. Bastable C. F., op. cit., p. 137
3. Groves Harold M., *Post-War Taxation and Economic Progress*, p. 14.
4. Ilersic A.R., *Government Finance and Fiscal Policy in Post-war Britain*, p.142.

In this case there is negligible absorption of resources by the Government except the cost of administration. Even in this case there will be appreciable psychological effect if there is redistribution of wealth. In social services provided by the State, taxpayer's views on his tax burden[1] will be influenced by the benefits he receives.

(e) Not only the fact of taxing and spending, but also the manner and 'timing' of taxing and spending is significant. This involves the doctrine of compensatory finance. Compensatory spending by the Government affects the level of employment and production by creating effective demand, while compensatory taxation may regulate private expenditure, savings and or investment (discussed in the later part of the Chapter). Such fiscal operations affect the level of economic operations and consequently upon the limits to taxation.

(f) Limits to taxation are also affected by the psychology of the people. "The point of psychological reaction is far more important than the actual subsistence level."[2] Adverse psychology of the people towards the payment of taxes may lower down the limits to taxation. This is wholly a subjective factor. "These taxpayer reactions and their repercussions constitute the chief subject matter of the economics of taxation."[3] Psychology of the people may be affected by the education of the people, ability of Finance Minister to convince them about the necessity and the wisdom of his plans. One thing must be mentioned here that there is difference between the attitude of the people and their psychology. Attitude of the people towards their Government depends upon political considerations, which is also of no less importance in a democratic country. Reserves of a nation are difficult to get without the assent of the person who possesses them.

(g) Existence of a large scale of non-monetised sector in the economy, also makes it difficult to increase tax receipt through usual forms of taxation.

(h) Efficiency of tax administration is another factor to affect the limits to taxation. Adam Smith's canon of economy, convenience and certainty originate from this idea which we have discussed in Chapter IV.

(i) The type of the tax system itself, affects the limits to taxation. A regressive tax system has lower limits to taxation than a progressive one, because the former consists more of indirect taxes which fall on lower-income groups, while the latter consists more of direct taxes which fall progressively on higher-income groups. The higher the income on which taxes fall, the greater the limits to taxation.

1. Vide Chapter IX.
2. Stamp, op. cit., p. 117.
3. Blough, R., *Federal Taxing Process*..

(j) Limits to taxation also depend upon the number of revenue sources. The greater the number of revenue sources that are both productive and acceptable, the higher are the limits to taxation. There are at least three reasons for it. First, one source of revenue can be utilised only up to a certain limit due to the principle of diminishing returns. After that point has been reached, further increases in tax rates tend to yield less than proportionate revenues. Secondly, a tax cannot be perfect. Imperfections in its application will require other taxes to close the loopholes. Thirdly, taxes imposed at high rates accentuate administrative and enforcement problems, because inequities that are bearable at low rate may become magnified at much higher rates.

(k) The goal of establishing a pattern of economic system will also determine the level of taxation. If the goal is the establishment of a socialist pattern, we must set higher limits to taxation, and taxes of confiscatory type will have to be levied. On the other hand, if the goal is the capitalistic or free enterprise system, naturally the limits will be lower.

Objective tests for Limits to Taxation

These limitations enumerated above, or any other limitations not herein mentioned, besides the Constitutional ones, may broadly be divided into—'economic-law limitations' and 'human-nature limitations.' Both work more effectively to limit the taxing power than do the Constitutional ones. Practical statesmen and financiers are not directly concerned with 'human-nature limitations', as they provide only a subjective test. There can be a crisis due to human nature, more particularly described as 'psychological crisis', but this cannot be studied to indicate the danger point in taxation. Taxpayer's grouses are many and multifarious. These do not provide at all with any reliable test.

On the other hand, the problem of incentives involves an examination of human-nature. Here lies a difficult task for an economist or a financier to arrive at correct generalisations. The objectives of investors are diverse,[1] but some form of prospective economic gain is necessary to justify the risks and the effort of investment.[2] Taxation may so limit incentives to work, to save and to invest, as to directly or indirectly lead to the curtailment of production, either from an existing level or from prospective or otherwise attainable future level. Any result of this kind will mean that the country's income would be reduced below the level to which it would have otherwise reached.

Thus any repressive effect of taxation or incentives would be reflected in productivity, which might work no doubt, as a good touch-stone for arriving at concrete results regarding the limits to

1. Vide Chapter XI.
2. Ibid.

taxation. As the Taxation Enquiry Commission points out, "taxable capacity of different sections of the community may be said to refer to the degree of taxation, broadly speaking, beyond which productive effort and efficiency as a whole begin to suffer."[1] Also, in words of James A. Arnold, "Taxable capacity becomes that portion of the national output which the electorate is willing to devote to group activities, as contrasted with personal activities, and still continue to produce."[2]

But the effect of taxation on production alone, is not the true test for arriving at the correct conclusion regarding the limits to taxation. On the other hand, it must also be considered in the light of effects of taxation on savings, investment and employment distinctly, as here-in-after discussed.

(A) Taxation, Savings and Investment

Introductory—According to the classical view, "Taxation must spare entrepreneur's savings as much as possible,"[3] because private savings were supposed to be the major way to investment. This implied low taxation instead of high one. They would encourage thrift on the part of the people and avoid greater equalisation of wealth. Further, they were sure that all individual savings will find their way to investment.

This is of little current interest, as taxes cannot be *prima facie* abandoned on the traditional assumption that they are at the expense of private savings. This is due to the reasons that we are concerned with, first, the aggregate domestic saving,[4] and investment and, secondly, with the nature of the investment. In other words, it is not only the total domestic savings and capital flow which are important, but also the way in which these financial resources are invested.

Taking into consideration the private sector alone, we find that a wide gap between savings and investment exists,[5] and a still wider gap between savings and socially desirable investment. It means that, first, large amount of savings in the private sector are not put to investment and secondly, all investment is not in public interest. Thus, on one hand additional taxation suitably imposed on the private sector will not hamper its capital formation

1. *The Taxation Enquiry Commission Report*, Part I, p. 150.
2. Arnold, James A., Symposium on '*The Limits of Taxable Capacity*', Tax Institute, Princeton (1953), p. 113.
3. Smith, Adam, *Inquiry into the Nature and Causes of Wealth of Nations*, Part II, pp. 210-11.
4. Domestic savings mean public savings plus private savings. Public savings comprise of the excess of Government tax receipts over current expenditure (development or non-development) and the profits of Govnernment enterprises, principally the share of railway profits assigned to the Government in this country. The private savings absorbed by the Government, consist of loans from the public, small savings, and various special funds.
5. According to Keynes, savings necessarily need not be equal to investment where a tendency to chronic unemployment exists.

as it will absorb private over-savings. On the other hand, even if it curtails some savings, increase in socially desirable investments made possible by additional tax proceeds would add to the national welfare.

Keynes gives the effects of taxation in the two cases. First, when the people are over-saving,[1] and secondly, when they are saving less.[2] In either case there is canalising of the savings to the Government, either through reduction in savings of individuals or through reduction in their consumption expenditures. Hence, even when the individual savings are cut down, the savings for the whole society are not reduced; on the other hand they are increased. Thus taxation creates high aggregate savings from a given national income unless it reduces the national income itself.

The extent to which private investment may reasonably be reduced by the tax system, should be determined by the social utility pattern of Government expenditure, aiming at the maximisation of the well being of the people. State action is necessary to ensure adequate investment both public and private. Keynes says, "It is not the ownership of the instrument of production which is important for the state to assume."[3] What is needed is "an adjustment between propensity to consume and inducement to invest."[4] Keynes was keenly aware of the advantages of individualism and free enterprise, yet he thought the functions of the Government as "the only practical means of avoiding the destruction of existing forms and promoting the successful functioning of individual initiative."[5] What is needed is a 'right analysis. . . to cure the disease while preserving efficiency and freedom."[6] In this direction a Government will spend or invest according to what the needs of the society or the compensatory fiscal policy require over a period of time.

A memorandum submitted by the International Bank for Reconstruction and Development lays greater emphasis on the proper use of savings than on their increase, stating that "In low-income countries it is difficult to increase the volume of current domestic saving. Much can be done, however, to institutionalize saving and to encourage its investment in the fields of greatest urgency and productivity for economy."[7]

In the socialist economy, public investment is the major source of capital formation. This necessitates an increase in public savings. In a fully socialised economy, savings may be made to vary within fair limits by restricting consumption by direct methods

1. Keynes—*'General Theory,'* p. 131.
2. Keynes—*'How to Pay For War,'* pp. 9-10.
3. Keynes—*'General Theory,'* p. 378.
4. Ibid., p. 379.
5. Ibid., p. 380.
6. Ibid., p. 381.
7. United Nations, Department of Economic Affairs, *Methods of Financing Economic Development in Under-developed Countries* (1949) Part II B, p. 92.

of control. Thus under such an economy expenditure can be determined first and then requisite resources can be found out. In a democratic socialistic State like India, on the other hand, the scope for affecting variations in savings, which is largely the result of individual choices, is comparatively limited.

The difficulties in increasing voluntary savings in under-developed countries in view of their low incomes has been stressed in the various economic reports of international agencies. Some of their views are given below.[1]

First, the Food and Agricultural Organisation mentions that voluntary savings by individuals in under-developed countries is small since agriculture is the main source of both employment and output. The low per capita income in Agriculture[2] and the desire for increased consumption is an obstacle to the effort to increase voluntary savings. The volume of per capita savings is small and is lower than in other sectors. Further, where economic activity is carried on, not so much on the basis of money, but in kind, monetary savings become rare. Also, a tendency to hoard makes the savings immobile.

Secondly, the amount of savings available are also affected by the distribution of incomes in under-developed countries. There is no full agreement in the reports on the way in which existing inequalities of income distribution in under-developed countries affect methods of financing economic development. In the view of the U. N. Sub-commission on Economic Development, internal inequalities of distribution are deterimental to economic development in so far as they reduce the nutritional health and general living standards of the people, and create an excessive demand for imported consumption goods of luxury, transfer excessive funds abroad and prevent the growth of internal markets. The Food and Agricultural Organisation, on the other hand, sounds a warning note in its report that measures to share national income more equally, though socially desirable for other reasons, may tend to reduce the amount of capital which can be created by voluntary domestic savings.

It is widely believed, that although per capita incomes of under-developed countries are low, income distribution is very uneven,[3]

1. Observations of international agencies regarding domestic financing of economic development as summarised by United Nations Department of Economic Affairs in the publication, '*Methods of Financing Economic Development in Under-developed Countries*' (1949), pp. 118-120; and *Economic Bulletin for Asia and Far East* Far, Vol. III, No. 3, 1957 'Allocation of Resources for Investment in Agricultural and non-agricultural Development, p. 60.

2. Per capita income in agriculture in India was Rs. 105.26 in 1955-56 and is estimated to be Rs 113.39 in 1960-61 at 1955-56 prices.

3. Reliable data on the inequality of income are lacking for most under-developed countries. A study made by Kuznets on the distribution of family income in India (1940-50) and Ceylon (1950) shows that the shares received by the richest were 55% and 50% respectively as against 44% in the U.K. (Economic Growth and Income inequality. *American Economic Review*, March 1955, pp. 20-21).

and that substantial savings could be affected by the upper-income groups. Landlords, for example, could have been substantial savers in our country. As a matter of fact the aim of the land reforms and abolition of Zamindari in India to affect more equitable distribution of wealth, has been contrary to the aim of promotion of savings, even though the reform may be justifiable by other socially desired objectives.

With our country's adoption of the goal of the socialist pattern of society, and the consequent gradual dispersal of national wealth among the largest numbers, much greater reliance must necessarily be placed now on the small savers. This is particularly so when our economy is a developing one and the increase in incomes will be mainly affected in the lower-income groups which will be naturally applied in consumption or raising their sub-marginal living standard, rather than in augmenting their domestic savings.

In this context three measures are necessary to be taken to augment domestic savings with increase in incomes :

(a) Small savings drive; (b) Compulsory savings scheme; and (c) Taxation. We will discuss them here in short to evaluate the relative importance of the three methods for promoting domestic savings.

(a) *Small Savings Drive*—The Small Savings Movement in India can be traced to the starting of the Postal Savings Bank in 1882. This was followed in 1917 by the Post Office Cash certificates. The movement slowed down after the First World War, till it was revived during Second World War (in the early forties). After the war, the movement continued to receive attention primarily as a dis-inflationary measure to mop up the surplus purchasing power that had accrued during the war. The first two years after independence, saw a declining trend in the Small Savings Movement which reached the lowest level in 1948, then it was reorganised in 1948 to arrest the trend. Since then the movement has been gathering momentum. On the whole there has been a steady growth in small savings in our country since 1950-51 as the following table shows :

Table 55

Small Savings 1947-48 to 1958-59

	1947-48 to 1952-53					Rs. Crores
Year	1947-48	1948-49	1949-50	1950-51	1951-52	1952-53
Amount	14.2	29.7	25.6	33.8	38.7	39.8
	1953-54 to 1958-59					
Year	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59[1]
Amount	39.7	55.5	67.9	61.52	69.56	78.00

Source : Report on Currency and Finance 1957-58 and 1958-59.

1. Provisional.

A total net collection of Rs. 241.6 crores was made during the First Plan against the target of Rs.225 crores. The target for the Second Plan was put at Rs.500 crores. The actual collection during the first two years of the Second Plan (1956-58) was Rs. 131.08 crores. The annual targets of Rs.100 crores laid down by Second Plan was fulfilled only to the extent of 65%. Also, it is worth noting that collections during 1955-56 to 1957-58 were more or less steady in spite of substantial increase in staff and expenditure over it. Net receipts from small savings for 1958-59 were provisionally placed higher at Rs. 78 crores as compared to Rs. 69 crores in 1957-58.

The Estimates Committee of the Government of India felt the necessity of more effective steps, not only to work up to the targets laid down for small savings in the Second Plan but to improve them, The Committee also recommended (in 1957) that attention should be given to those States (like Assam, Bihar, Orissa, Madhya Pradesh and Rajasthan) which offer savings potentials and also where the performance had been poor.

The Small Savings Movement is intended to appeal primarily to the common man, who saves little out of his earnings. The movement has so far made itself felt mostly in urban and semi-urban areas. It has not yet been able to make a sufficient impact in the rural areas primarily, due to lack of suitable communications, dearth of trained workers, absence of adequate publicity and illiteracy or ignorance on the part of most of the rural folk in appreciating the benefits of the movement. The situation has changed a little in Community Project and National Extension areas. The Community Project Administration has also been entrusted with the task of mobilising savings in these areas. Also certain Rural Agency Schemes on easy security terms have been introduced as an experimental measure in several States to suit the particular needs of the rural areas.

A National Savings Movement to be really successful cannot, however, depend on State direction and control, but must develop into a people's movement. Educating people in the habit to save is a social service of the highest value to the nation. In encouraging small savings, the private sector will be encouraging a national habit of thrift in the masses which will ultimately benefit investors in the private industrial field also. In U. S. A. much the larger part of the publicity and propaganda for small savings is done among the private sector gratis. There "the publicity and propaganda for small savings by the private sector exceeds the publicity and propaganda for all other national causes put together."[1]

The largest measure of support to the Government has to come from voluntary loans and small savings; and to the extent that

1. Chavan, Y. B., Inaugural Address at the Conference of Federation of Indian Chambers of Commerce and Industry on 'Saving and Investment', February 1958.

these sources yield increased returns, there will be a corresponding reduction in the burdens on the tax payer and what is more important is the satisfaction in the knowledge that the nation is shaping its future through its own voluntary efforts.

(b) *Compulsory Swings*—Below the income level of Rs.300 a month it is more feasible and cheaper to have a scheme of compulsory savings than to obtain contributions through taxation. As a matter of fact, from the point of view of aggregate savings, such compuslory savings are very closely analogous to taxation. It would be more equitable as well as a popular method of contribution. The employee would be willing to undergo compulsory deduction without demanding higher wages. A compulsory savings scheme for economic and psychological reasons will have a greater appeal to the community and will have none of the adverse effects on incentives associated with heavy taxation. Compulsory savings may be levied in the same way as taxes, or surcharges on them, with the difference that it is to be interest bearing and refundable.

Compulsory saving already exists in India in the form of provident funds affecting 3 million employees. Net contributions after deducting benefits paid out from all provident funds in 1958 were about Rs. 27 crores. The question is first, as to whether this kind of compulsory saving can be extended to all employees except only agricultural labourers who do not receive money payments. Secondly, whether the present rates of employees contributions can be raised further.

At present under industrial employee's provident fund scheme, which applies to factories employing 50 men or more, in 38 specified industries. The rate of employer's contribution is $6\frac{1}{4}\%$. In addition, the employer has to pay contributions to the other State schemes for medical benefits. Further increasing the rates would be most undesirable, as it is like a tax on employment of labour, in a country where labour is insufficiently employed. Thus there seems no further scope for extending the present scheme.

Further, the employee's contribution of $6\frac{1}{4}\%$ is already high and it would be more so if the scheme is extended to include many of the lowest paid workers. Also, because the benefit of employer's contribution is dependent on long service, it cannot be feasible for domestic servants, casual labour, or employees in small establishments.

For the above reasons, only a few suggestions can be made to increase compulsory savings. One of them is that the employees contribution may be made progressive. The other suggestion may be that some sort of light contributory scheme be introduced to cover up many of the low-income employees as well.

Employers contribution cannot be increased without any disincentive effect on employmet. However, companies can be relied upon for larger contributions to the State in other ways.

They can be taxed heavily to economically desirable limits or they can largely contribute towards voluntary savings.

Corporate savings play a far more important role in capital formation than personal savings (voluntary or compulsory). In advanced countries like U.K. and U.S.A. very large proportion of saving is made by corporations. In U.K., corporate saving accounts for more than half of the total savings. It should also be encouraged in India.

A Government can and in some cases does force their citizens to save much more out of low incomes than they would if left to voluntary choice. The Food and Agricultural Organisation, while dealing briefly with taxation together with other non-voluntary methods under the heading forced savings for investment, stressed in a report the dangers from the agricultural point of view of too severe programmes.[1] The report points out that involuntary savings can be affected by severe controls on consumption, large public investments financed by heavy taxation, large profits from publicly owned industries, or even more coercive measures such as forced labour at low wages. Such measures were widely used during the war. The use of even mild measures of this sort in time of peace is likely to require repressive action, unless there is high level of enthusiasm and strong support by the population for the investment or development programme undertaken.

F.A.O. remarks, "From agricultural point of view, such programmes, if too severe have the danger of unduly depressing the consuming power of the public. If consumption of food is kept too long below minimum nutritional levels, gain in real capital may be obtained at the sacrifice of health and strength of the people, and may lower the working power and productivity of the nation."[2]

Anyhow, direct methods of savings by taxation and compulsory savings have greater certainty and precision than through price control and rationing. The great defect of the latter methods is, that they are not fool-proof, but they leave excess purchasing power in the hands of the community which may be put to illegitimate use by developing black market, causing disturbance to the cost-price structure and the saving programme itself. Thus reasonable restriction of consumption and collection of revenue simultaneously through taxation is a better device than rationing.[3]

Nevertheless, fiscal measures are to be employed in such a way as to avoid adverse affects on incentive to work, earn and save voluntarily and without affecting the health and physical strength

1. United Nations, : *Methods of Financing Economic Development in Under-developed Countries* (1949), p. 83.
2. Quoted from United Nations Department of Economic Affairs in the Publication : *'Methods of Financing Economic Development in Under-developed Countries'* (1949), p. 84.
3. The problem of rationing vs. taxation has already been discussed in detail in Chapter I.

of the people. Thus a judicious combination of taxation and compulsory saving is to be worked out.

(c) *Taxation*—Progressive taxation particularly on income, can, no doubt lead to larger Government saving and productive investment, although most probably there will be a simultaneous drop in private savings, because in case of progressive income-tax, it will be paid largely by reducing private savings of tax-payers. In the lower groups, however, a greater proportion of tax will be paid by reducing consumption. This was shown by Richard Goode after a study of the tax paid by various groups of income-tax payers in America.[1]

Thus in our country for example, lower-income groups (that is below Rs.15,000) paid only Rs. 11.841 crores as income-tax in 1957-58 which were mostly paid out of consumption. While the remaining Rs. 77.76 crores were mostly paid out of savings as the following data show.

Table 56

Yield of income-tax from different income groups in India (1957-58)

Range of Total Income		No. of assessees	Total income assessed Rs. crores	Tax Receipts Rs. crores
Below	5,000	1,61,251	66.24	00.959
5,001	15,000	3,23,824	261.95	10.882
10,001	50,000	7,58,21	184.18	29.499
50,001	1,00,000	6,992	46.58	18.671
1,00,001	over	2,274	46.10	29.594
Total		5,70,162	605.05	89.605

Source : Central Board of Revenue, Income-tax Revenue Statistics—All India, Statement No. 5.

Company taxation would partly fall on consumption and partly on saving. Richard Goode has shown that about 60 to 70% of the tax came from income that would otherwise have been saved by corporations and only about 15 to 20% by reducing individual consumption. It is assumed that a large part of the tax is borne out of retained profits and it would reduce corporate savings.

Death duties, however, it is believed, do not make an addition to the aggregate savings, because larger part of the tax is paid out of private savings. Very little of the inherited wealth goes to consumption. On the other hand it might be used in capital formation. The tax realised may be used by the Government on current

1. Goode, Richard., *Corporation Income-tax* (N.Y.) 1951, p. 233.

expenditure. But if it is utilised by the Government for capital formation, while the assessee also would have utilised the inherited wealth in capital formation, there is no addition to aggregate capital formation. The same argument applies to wealth-tax.

Expenditure-tax serves a good purpose in making addition to the savings as we have already discussed in Chapter IV.

Betterment levies would no doubt help a lot in this direction. Improving agricultural taxes would also provide a major source of Government revenue for financing development.

Indirect taxes which are mostly paid by the lower-income groups are largely to be depended upon. "A savings-oriented tax policy should not favour low-income groups."[1] This is due to the reason that the larger flow of national income would be to this class who have low propensity to save.

But this does not suggest that the Government should denude this class of their savings. Because, despite the low volume of per capita savings, a substantial part of the investment in the unorganised sector like agricultural trade,[2] construction and small scale industries is financed by direct savings, that is, the savings of persons undertaking the investment, or by the savings of their friends and relatives. According to the All India Rural Credit Survey (1951-52) the loans from relatives accounted for 14% of the reported borrowings by cultivators.

Savings and Investment during the Plan Periods—The total net investment during the First Plan was Rs. 3,100 crores and was put at Rs.6,200 crores for the Second Plan period, Rs.9,900 crores for the Third Plan, Rs. 14,800 crores for the Fourth Plan and Rs 20.700 crores for the Fifth Plan. This means that investment in the Fifth Plan will be about seven times greater than that in the First Plan period, while the rate of investment as percentage of national income would progressively rise from 7.3% at the end of the First Plan to 17.0% at the end of the Fifth Plan as table 57 on p. 273 shows .

Whether investment envisaged during successive plan periods can be undertaken without giving rise to severe inflationary pressures will depend upon the adequacy of resources. If the total planned investment exceeds the available resources, either actual investment will fall short of the planned investment or inflationary pressures will develop. Apparently, inadequacy of resources for any sector will be a problem. Investment through deficit financing is permissible so long as it does not go to inflate the prices of food or other commodities.[3]

1. Baljit Singh : *Federal Finance and Under-developed Economy*, p. 387.

2. Of course, a large part of investment in agriculture is outside the scope of taxation being non-monetised. The data obtained in the second round of the National Sample Survey led the Taxation Enquiry Commission to estimate rural investment of a predominantly non-monetised type at more than one-fifth of the net aggregate investment in the economy, or roughly 1.5% of the national income (op. cit. Vol. I, p. 138)

3. Vide Chapter III.

Table 57

Growth in Income and Investment 1951-76 (At 1952-53 Prices)

Item (1)	1st Plan (1951-56) (2)	2nd Plan (1956-61) (3)	3rd Plan (1961-66) (4)	4th Plan (1966-71) (5)	5th Plan (1971-76) (6)
1. National income at the end of the period (Rs. crores)	10,800	13,480	17,260	21,680	27,270
2. Total net investment (Rs crores)	3,100	6,200 (6,750)*	9,900 (10,200)**	14,800	20,700
3. Investment as percentage of national income at the end of the Period	7.3	10.7	13.7	16.0	17.0

*Revised Estimate
**Provided in the Draft Third Five Year Plan.
Source : Planning Commission, Second Five Year Plan, p. 11.

The aggregate investment expected in the Plans is inferred from estimates of savings and a target of foreign resources.

A larger part of net investment is assumed to accrue out of domestic savings. The following table shows that Rs. 7.56 billions out of Rs. 7.90 billions of net investment in 1955-56, and Rs 13.10 billions out of Rs. 14.40 billions in 1960-61 were estimated to be financed by domestic savings, while in 1950-51 domestic savings exceeded by Rs. .07 billions over the net investment.

Table 58

Actual and Projected National Income, Investment and Consumption in India, at 1952-53 Prices

National income, investment, savings and consumption	1950-51	1955-56 (billion rupees)	1960-61
National income	91.10	108.00	134.80
Net investment	4.48	7.90	14.40
Net inflow of foreign resources	—0.07	0.34	1.30
Net Domestic Savings	4.55	7.56	13.10
Consumption expenditure	85.65	100.44	121.70
Investment as percentage of national income	4.94	7.31	10.68
Domestic savings as percentage of national income	4.98	7.00	9.70

Source : The Planning Commission, Second Five Year Plan, p. 74.

The estimate was based on the assumption that about 20% of the increase in income during the period of the Second Plan would be devoted to extra savings. If allowance is made for the increase in population during the period, the estimate implies that

nearly one-half of the increase in per capita output would be devoted to additional savings and the other half to increased consumption. The programme of investment of Rs.6,200 crores envisaged for the Second plan period required a step-up in the rate of domestic savings from the level of 7% in 1955-56 of national income to about 10% of national income in 1960-61. As against it the Planning Commission estimated the savings-income ratio at 8% at the beginning of the Third Plan. This can be said to be due to the low rise in per capita income (10.64% over the Second Plan period), increase in consumption expenditure, increase in population, and the pattern of saving in our country. (A major portion of saving has been estimated to be contributed by individuals, that is, about 83%, 6% by the corporate sector and 11% by the Government).

For these reasons the postulate that as income rises at a certain rate, savings will rise faster[1] has been proved untrue in this country.

In the Third Five Year Plan it was estimated that the savings-income ratio would rise to 11% by the end of the plan period. The estimate was based on the assumption that national income woud increase from Rs. 13,480 crores at the beginning to Rs.17,000 crores at the end of the plan, But as we have stated above the rate of increase in savings with the increase in income has not been satisfactory, nor there is any likelihood of its improvement during the Third Plan, in face of the fact that while per capita income has been estimated by the Planning Commission to rise by 13% only in five years, an increase in consumption has been envisaged at more than 4% per annum.

(B) Taxation and Production

Introductory—An increase in production increases human well-being, other things being equal. But other things may not be equal. First, production gains at the expense of worker's leisure and his preferred way of life, though his contribution to total real output provides an added source of well-being to others. Secondly, taxation, which increases inequality in income (*e.g.* regressive tax) may worsen the distribution of output among consumers. Thus the assumption that a gain in production is a gain in welfare is to be modified.

Socialist economists put the optimum condition of economy with reference to productiviy as well as distribution. Bergson, for example, lays down the following conditions in this connection[2]

(a) The ratio of the marginal utilities for each pair of con-

1. According to the well-known theory of economic growth, savings are largely determined by the level of national income. It also depends on consumption; savings and consumption being interdependent variables. As the economy progresses with increasing incomes, savings tend to increase at a greater rate than incomes. Consumption is not supposed to increase at a greater rate than increase in incomes. Thus the ratio of saving to income tends to increase. '*The Theory of Economic Growth*' by W. Arthur Lewis, p. 397.

2. Bergson's article on 'Socialist Economics' Published in *A Survey of Contemporary Economics*, Vol. I, pp. 422-448.

sumer goods sould be the same for all households, (b) In every industry, factors must be combined in a technologically optimum manner, (c) The marginal value productivity of each factor must be the same in every industry, (d) In the optimum there must be no possibility of shifting a worker from one occupation to another to increase the value of output by more than what would be required to compensate the worker for the change, (e) Occupational wage differentials must at the same time correspond to differenees in marginal value productivity. (f) The Social dividend or tax must be determined independently of the workers occupational earnings.

The growth of productivity has, therefore, been defined as "the increase in quantity and quality, of all goods and services available to the consumer accompanied by a corresponding decrease in the total effort necessary to produce them."[1] In other words, development of productivity increases the economic and social progress, which seeks maximum well-being for the minimum necessary effort.

A progressive tax will decrease the command over goods and services of the high-income groups. On the other hand public expenditure would result in better standards for the low-income groups (for example, nutrition, health, housing, *etc.*). This will have net favourable effect on the productive potential. A regressive tax may also sometimes, more than offset loss of productive potential via decreased private consumption through increase in work capacity of the low-income groups. In this way, by imposing through collective choice, a pattern of consumption quite different from that which individual choices would have created, a considerablenet increase in work capacity and thus in the real productivity might be achieved.

Dr.V.K.R.V. Rao while writing on 'Implications of Socialist Pattern of Society' says that "A socialist society must by definition be more efficient in the sense that it leads to more production per head and a higher increase in productivity than a system based on private enterprise. It is necessary, therefore, to apply the principles of maximisation of output with minimisation of cost of economic decisions in a socialist community. It must be made clear, however, that the minimisation of cost referred to here, is social cost and not just private cost. A socialist society is not just a give-away society, nor is it only concerned with the redistribution of income. It must lead to an increase in efficiency . . . . . The keynote of the socialist system is, from the economic point of view, efficiency."[2]

The tax system, therefore, should not impair the most precious assets—the competence, character, and productivity of human re-

1. European Productivity Agency of the Organisation for European Economic Co-operation. *'The Influence of Sales Tax on Productivity,'*, (1951).
2. Rao, V.K.R.V., *A.I.C.C. Economic Review*, July 22, 1959, p. 35.

sources. On the other hand, these should be survived, expanded and multiplied. The public interest today places top priority upon a new canon of taxation. "Do not impair future national health, future national income and potential national strength."[1]

Productivity criteria of taxation, may thus be taken to include three things, first, that there is maximum output per unit, secondly, that products are distributed in optimum manner and thirdly, that minimum of effort is necessary to produce them, which implies minimum social sacrifice.

Trends of Production in India—There has been a continuous rise in industrial production particularly from 1951 onwards as shown below :—

Industrial output (General Index) (1951=100)

1951	1952	1953	1954	1955	1956	1957	1958	1959 Jan-Oct
100.0	103.6	105.6	112.9	122.4	133.6	137.3	138.8	136.1

Since 1956 there has been a decline in the rate of growth of industrial production.[2] As against a rise of 8% in 1956, the rise in 1957 was 3.5% and in 1958 1.1%. This slowing down of the rate of growth was mainly attributable to the fall in out-put of cotton textile including yarn which had a weightage of 36% in the index of industrial production. The jute industry also was passing through a difficult phase because of lower demand and competition in external markets. However, the rise in 1958 in production of chemicals and chemical products, machinery (other than electrical) and electricity generated was greater than in 1957. Although there was a decline in the rate of growth, the level of production in cement, electrical machines, *etc.*, and coal mining recorded an increase of 8.3, 8.9 and 4.2 per cent respectively in 1958.

Most of the existing industries have been no doubt working on ambitious expansion programmes, and a number of new industries (like the production of heavy electrical equipment) have been established with the result that there has been considerable diversion of production as well. There has also been increase in consumer goods like sugar, bicycles and automobiles.

It is not only that industrial production has gone up in volume but the quality of the products has also improved to such an extent as to be acceptable to local as well as foreign consumers. Consumer prejudice against indigenous products which existed particularly for some of the engineering and chemical items is gradually disappearing. Various industries have received testimony from the Tariff Commission, as also from visiting foreign teams regarding

1. Proceedings of the Annual Conference of the National Tax Association (U.S.A.), 1956, p. 23.

2. No direct relationship can, however, be established between investment and the rise in output for any particular period or year, because the results of some of the investments made are likely to accrue in later years, because of time lag between investments and realisation of output.

the quality of their products. Our exports of manufactured goods have risen from Rs.190 crores in 1947-48 to Rs. 265 crores in 1957-58 and withstood increased competition in foreign markets. The country has been able to export some of the engineering goods not only to the countries of the Middle East and Far East, but also to the more developed countries of the West. No doubt, the exports of such commodities to these countries have been only token exports, but the trend itself is quite encouraging, for example, during January-August, 1958, U.S.A. was the leading purchaser of Indian household sewing machines valued at Rs.1.2 lakhs. U.S.A. and U.K. were the two leading importers of sewing machine parts; their imports valued at Rs 92,000 and Rs. 70,000 respectively. U.S.A. was also the leading importer of glassware from India with import of the value of Rs. 85,000. Some other exported items were—bolts and nuts to U.K., hand tools to U.S.A. Germany and U.K. metal containers to U.K., boot and shoe manufacturing machinery to U.S.A., electric motors to U.K., metal lamps and glass lamps to U.S.A. and electrical accessories to U.K. and Germany, etc.

Satisfactory as the broad picture is, it is necessary to draw attention to the decline in production in certain industries. The most important of these, as already referred to above, is the cotton textile industry. The output in 1958 was 4,927 million yards against 5317 million yards in 1957, the main reason for which was a fall in consumer off-take resulting in the accumulation of stock with the mills. A substantial reduction in the excise duty on all categories of cloth was, therefore, made to give relief to the industry. An Enquiry Committee under the Chairmanship of the Textile Commissioner was also set up to look into the difficulties confronting the textile industry.

The case of cotton textile industry in India affords an exemplary situation to illustrate the effect of taxation in a precipitate form. Excise duties on cloth have been altered from time to time details of which we have already given in Chapter v. In September 1956, Government departed from the usual pattern, and the duties were sharply raised in the middle of the financial year. The reason stated for this was that the industry was making very large profits which required to be mopped up. As a counter-balance to the rise in duties, however, a rebate on production in excess of the average of the first eight months of 1956 was also announced. The effects of the duty is evident from the following table.

With the increase in excise duty, unsold stocks of cloth with the mills began to rise continuously and rose from 201, 431 yds. of bales in September, 1956 to 274, 596 yds. in January 1957 and to 395,759 yds in November, 1957, rising continuously every month without exception.

Factors other than the increase in excise duty were also cited by the Textile Enquiry Committee contributing to the difficulties of the industry. These are—decline in purchasing power, increase

Table 59

Month-end unsold stocks of cloth with the Mills (January 1951 to June 1958)

Figures in Bales of 1500 yds. each

	1956	1957	1958
January	144,366	274,596	372,500
February	113,154	287,486	362,600
March	145,511	300,238	344,800
April	126,830	292,154	324,100
May	112,312	261,308	308,000
June	132,460	297,277	341,000
July	138,367	319,062	
August	154,328	338,585	
September	201,431	356,114	
October	257,788	391,005	
November	255,647	395,759	
December	271,098	450,699	

Source : Textile Enquiry Committee Report, p. 70.

in cost structure of the industry, over production of certain varieties of coarse cloth, additional measures for controlling the prices by wide publication of fair prices for certain varietis and the credit squeeze imposed by Banks under instructions from the Reserve Bank of India.[1]

In view of the difficult conditions through which the industry was passing, Goverment thought it necessary to reduce the rates in December, 1957. The duties were further reduced in March 1958.

It is interesting to note here that notwithstanding the other factors cited by the committee contributing to the difficulties of the industry, the accumulated stock declined simultaneously with the reduction in excise duty. The accumulated stock was reduced from 450,699 yds. of bales in the month-end of December 1957 to 372, 500 yds. of bales in the month-end of 1958, and then to 324,-100 yds. in the month-end of April, 1958. This shows that high excise duty had a large effect on the accumulation of the stock.

Further, the Committee came to the conclusion after their examination of the facts that the uncertainty created by the modifications in excise duties in the middle of the financial year, unsettled the cloth market to a considerable extent. It is this uncertainty which had been responsible for the trade holding quantities less than hitherto held by them. This led in its turn to the mills having to finance a much larger holding of stock of cloth. In addition, as conditions worsened, the mills had even to give credit

1. *The Textile Enquiry Committee Report,* (1958) Chapter II, p. 3, et seq.

to the traders usually to the extent of one month. The Commission held that there is no doubt that uncertainties consequent on the practice of introducing changes in the excise duties in the middle of the financial year should normally be avoided.[1]

The Committee also commented on the structure of excise duties on cloth. It held that it weighed more heavily on plain cloth and unprocessed cloth compared to the processed cloth of various descriptions. While on the one hand, the demand for processed varieties was on the increase, the weight of excise duties on the other hand fell proportionately more heavily on the unprocessed cloth. This had increased the difficulties of mills, mostly located in the interior which were not equipped with processing equipment.

The Committee held that, "since the pattern and weight of excise duties have been a significant factor in the working of mills and since the condition of the industry was such that to maintain desirable levels of production, some incentive should be immediately made available."[2]

Under these circumstances excise duty on all varieties of cotton textiles had to be further reduced in July 1958 as discussed in Chapter V. Subsequently the position of the industry further improved, showing thereby that the limit of taxation for this particular industry had reached under the above mentioned conditions.

Incentive to Industry—As we have discussed in Chapter I, when the volume of taxation rises beyond a limit, general price level tend to rise. While an increase in taxation encourages rise in prices, a decrease in taxation does not necessarily help in bringing the prices down. In case of perfect monopoly there is no tendency of prices coming down at all. However, in a free competition the prices may respond to the reduced taxation to a great extent and rapidly.

Once the volume of taxation continues for some time, the economy adjusts itself to it at the appropriate price level and people get accustomed to the tax. They continue to earn normal profits. Normal profit is purely subjective, that is, it depends upon the prevailing psychology of investors. Once a volume of taxation remains in operation for some time and it is realised that it has come to stay, investors are bound to get adjusted to a lower rate of marginal profit. At this stage tax concessions provide an impetus to the fall in prices and consequently to industrial expansion. A new position of equilibrium is attained after the tax remains in operation for some time. Thus taxation, though considered to exert only negative effects on industrial expansion, also provides an impetus through tax exemptions or reduction in tax rates.

This is true not only for the general volume of taxation but also

1. Ibid., p. 14.
2. Ibid., p. 17.

for particular taxes. For example, if income-tax rates continue to exist for certain length of time, wages, like prices would be adjusted at a certain level. Any decrease or increase in income-tax would lead to an increase or decrease in effort. This is, however, possible only where the amount of effort can be varied.

Taxes on profits of companies have likewise, a great bearing on industrial expansion. Tax concessions on the undistributed profits, which are ploughed back into the business give incentive to the industrial expansion. Tax concessions on distributed profits, on the other hand, encourage the process of lending to the company.

Reduction of import duties on industrial raw materials and machinery, provides a substantial incentive to production. Tax concessions have been provided to business in our country from year to year as we have discussed under tax policy and while discussing each of the direct taxes separately in Chapter IV.

After studying the tax concessions and the new capital issues in each year (which are fairly indicative of business incentives), we may conclude that the tax concessions offered by the Government have failed to provide any incentive to industry. On the other hand, taxation measures in recent years seem to have exerted disincentive effect. Taking, for example, the budgets for the years 1948-49 and 1950-51, various tax concessions to business were given, but the new capital issues declined in those years. Again, we find that the capital issues in private sector which amounted to Rs.170.75 crores in 1956 came down to Rs. 135.35 crores in 1957 and Rs.89.45 crores in 1958, though there was an increase in 1959 to Rs 149.58 crores.

Table 60

New Capital Issues in India

1948 to 1955

Year	1948	1949	1950	1951	1955
Total Amount of consents (Rs. Crores)	111.93	34.66	74.75	59.55	125.39

1956 to 1959

Year	1956	1957	1958	1959
Total Amount of consents (Rs. Crores)	230.15 (59.40)	153.32 (17.95)	422.97 (333.52)	203.46 (53.88)

Source : Reserve Bank of India, *Report on Currency and Finance* 1958-1959 Statement No. 45 and 1959-60 Statement No. 42

Data in respect of Government Companies, available separately for 1956, 1957, 1958 and 1959 are shown in the brackets below the totals. During 1958, the unusually high figure is due to the consent given for a single share issue of Rs. 300 crores in the Government sector.

Decline in capital issues from 1956 to 1958 may be attributed largely to the taxation measures taken in those years. But no direct inter-relation can be established at once between the measures taken and incentive to industry, since cognizance needs be taken of factors which affect the business outlook beyond the framework of taxation.

To the extent that there is a relationship between price trends and the business outlook, there is no reason to suppose that this has been unfavourable for investments. The index number of wholesale prices have shown a continuous rise during the period under consideration, which is shown below :

Index No. of Wholesale Prices (1952-53=100) All commodities

1955-56	1956-57	1957-58	1958-59
92.5	105.3	108.4	112.9

Further, this period had been one of rising economic activity, and no general international slump can be said to be in operation.

If the index of industrial profits is supposed to indicate the incentive for investment we find that the incentive had declined as the profits had declined, as the following table shows :

Table 61

Index Number of Industrial Profits (1950=100)—All Industries

Year	1951	1952	1953	1954	1955	1956	1957
Profits Before Tax	132.4	86.6	100.9	121.6	150.1	167.2	133.7
Profits After Tax	131.6	78.6	98.1	115.2	149.8	158.3	116.4

Source : Quarterly Economic Report of the Indian Institute of Public Opinion, Table VII, Vol. VII No. 1, July 1960.

It is evident from the table that the investor had not received corresponding benefits. The index of industrial profits (before tax) with 1950 as the base which stood at 13.24 in 1951 declined to 8.6 in 1957, but rose subsequently to only 167.2 in 1956, in spite of all the expansion that took place in the various industries which we have already discussed. Again in 1957 the index of profits fell dwn. It came to only a little above 1951 level, before tax, (that is, 133.7 in 1957 and 132.4 in 1951), but was lower than the level after tax (that is, 116.4 in 1957 and 131.6 in 1951).

Trends in the profits of corporate enterprise indicate that some indices had gone below 1948 level. For example, the profits of a company like the Tata Iron and Steel Company Ltd., which increased its gross receipts from Rs. 41.9 crores in 1955-56 to

48.0 crores in 1957-58, declined from Rs. 11.7 crores to Rs. 9.5 crores.[1]

The fall in the margin of profits might be attributed to rise in the cost of production, which was partly due to rise in the prices of factors of production and partly due to taxation. Thus we might infer that further taxation on industry would affect their margin of net profits and would result in decrease in incentives.

The Report of the Central Board of Directors of the Reserve Bank of India, for the period ending June 30, 1958 observed that, "Private investment and industrial production appear to have touched a plateau after the sustained and substantial increases recorded in the preceding few years. . . . . Prices and cost continue to move upwards, and profit margins have begun to decline in some sectors, thus accounting for the comparative stagnation in investment and production."

Therefore, we might say that there did not seem to be further scope for taxation on private industries in our country during the period under consideration, if they were expected to play the proper role assigned to them, and if necessary capital was expected to be forthcoming from this sector.

(C) Taxation and Employment

In a country where capital is owned both by the State and private persons, employment is the outcome of decisions taken by both, public and private sectors. The Government decides how much should be set aside for the increase of socially owned capital, including nationalised industries. On the other hand, private businessmen decide how much they would add to their capital. The decisions of the latter concerning investment are, however, mainly guided by profit motive.

The decisions of the two sectors in an economy play a crucial role in determining the overall level of employment. How far taxation affects incentive to work, to save and to invest has, therefore, direct bearing on employment. Taxation has large effect on the private investment decisions as we have already discussed, and its adverse effects lead to an appreciable fall in the volume of employment in a country like India, where private sector continues to play an important role in the national economy. At the same time investment in public-sector must also increase if full employment is aimed at.

The following routes to full employment have received consideration of various authors[2]—(i) Tax remission to stimulate private investment, (ii) deficit spending by the Government, (iii)

1. Report of the Central Board of Directors of the Reserve Bank of India for the period ending June 30, 1958.

2. Among others, Beveridge, Kaldor, Lerner, Hansen, Wallich and Musgrave have thoroughly explored these ways to full employment.

expansion of both Government revenue and expenditure. The idea, that stimulative action is limited not only to tax remission or deficit public spending but may also be effected through increase in Government expenditure financed from consumption taxes, is an evolution only of recent origin. Lewis H. Kimmel points out that first reference to this idea in the modern literature appears to be that of Jorgen Gelting, a Danish economist, who wrote in 1941—"When the public sector collects more taxes from the private sector and uses the revenue for increased outlay, total employment will be increased exactly by an amount corresponding to the increase in outlays. This, at least, holds true when the marginal propensity to consume as well as productivity in the private sector are unaffected."[1]

Later on Hansen and Perloff pointed out, that "an increase in useful governmental expenditure (the initial expenditure being financed by borrowing) will tend to raise the national income and employment even though subsequently financed from consumption taxes."[2] In a developing economy, consumption taxes chop off the increased purchasing power which is due to the rise in incomes. Thus while private expenditure on consumption is cut down there is increase in Government spending. This results in an increase in net investment and hence employment also increases.

Kaldor[3] also held that full employment can be achieved through increased public spending even though financed fully by taxation.[4]

On the other hand, Keynes' theory explains unemployment primarily in terms of deficiency of effective demand, and to get over it he stresses a series of measures pertaining to consumption as well as investment.[5]

1. Quoted by Lewis H. Kimmel, *Economic Journal*, 'Federal Budget and Fiscal Policy', Vol. 68, March, 1958, p. 155. P. N. Rassmussen further states that Jorgen Gelting did not claim his idea as original and that it perhaps stems from Ricardo (Ibid).

2. Hansen, Alvin, H., and S. Perloff Harvey, *State and local Finance in the National Economy*, pp. 244-45. A similar conclusion was reached by Wallich.

3. Kaldor, N., Quoted from '*Full Employment For a Free Society*,' by Beveridge, Appendix C, 'The Quantitative Aspect of Full Employment', pp. 346-47.

4. Among others whose conclusions are comparable, are Trygve Haavelmo "Multiplier Effects of Balanced Budget", *Econometrica*, Vol. 13 (1945) pp. 314-15; G. Haberler, "Multiplier Effects of a Balanced Budget," *Econometrica*, Vol. 14 (1946) p. 149; Ralph Turvey, "Some Notes on Multiplier Theory", *American Economic Review*, Vol. 43 (1953) pp 275, 284-86; Hansen, "More on Multiplier Effects of Balanced Budget : Comment", *American Economic Review* Vol. 46 (1956) p. 157; Millian J. Baumol and Maurice H. Peston, "More on the Multiplier Effects of a Balanced Budget." *American Economic Review* Vol. 45 (1955) pp. 140.

5. Keynes recommends State intervention also to compensate for the slackness in the private investment at the time of depression. He urged public works to provide employment. To finance public works, he went to the extent of advocating deficit financing on the part of the State.

As a matter of fact, in an under-developed country the problem of increase in employment does not depend on increasing the effective demand through redistribution of wealth by progressive taxation or by any other method, nor by increasing public spending, but it depends on increase in economic development. In our country there is unemployment today because her resources have not been fully explored for the benefit of her people.

But the factor of inadequacy of demand should not be lightly dismissed. If demand is deficient, then socialisation of demand may well be required. Such condition necessarily arises in a developing country. An essential condition for high employment and stable prices is reasonable stability of total demand at an adequate level—which means a steadily rising level of demand as our productive capacity grows.

Unemployment in India—Though no reliable data regarding the extent of unemployment in this country is available, the figures supplied by the Employment Exchanges show that the number of applicants on the registers of Employment Exchange was 7.58 millions at the end of 1956. It rose to 9.22 millions in 1957 and 11.8 millions in 1958. An steady increase in numbers is shown in the following table.

Table 62

Number of Applicants on Registers of Employment Exchanges at the End of the Period.

1948 to 1954

Year	1948	1949	1950	1951	1952	1953	1954
Number (Millions)	2.39	2.74	3.30	3.28	4.37	5.22	6.06

1955 to 1960

Year	1955	1956	1957	1958	1959	1960
Number (Millions)	6.91	7.58	9.22	11.83	14.2	14.3

Source : Indian Labour Gazette, July 1960.

The magnitude of urban unemployment was estimated by the National Sample Survey (1952) at 2.5 millions, after making deductions for fractional employment. The Agricultural Labour Enquiry Committee put the amount of rural unemployment in 1950-51 at 2.8 millions. Taking into account the increase in the labour force both in urban and rural areas, it was estimated by the Planning Commission that during the Second Plan Period employment opportunities were to be created for 9.0 million people in the

rural areas and 6.3 million people ip the urban areas. That is to say, it was necessary to provide job opportunities to 15.3 million persons.

Though it is true that a part of unemployment was due to the fall in effective demand for manufactured articles as a result of a substantial rise in food prices and consequent accumulation of the stocks of manufactured articles, yet it cannot be denied that taxation policy had also affected it, as the experience of some large scale industries shows.

For example, textile industry provides with a concrete example of the fact. A few mills had to be closed down because of the difficulties of obtaining money to finance their business and because of accumulation of stocks consequent upon the imposition of excise duties. At the end of May 1958, altogether 28 mills remained closed out of which 11 mills were spinning and 17 composite units. As a result of this the number of labour actually engaged in Textile Mill industry fell to 7.72 lakhs in April 1958 from 8.23 lakhs in April 1957.[1]

The Textile Commissioner's Organisation took steps to study the problem of closure of mills.[2] The reasons for the closure, according to the findings of a specialised Wing of the Textile Commissioner's Organisation seems to be the bad condition of the machinery in many cases neglected continuously without proper attendance and repairs and replacements. Inefficient management had also been one of the reasons for this state of affairs. Despite various other reasons the Textile Enquiry Committee stressed that the pattern and weight of excise duties had been a significant factor in the working of mills which we have already referred to, which resulted in the fall in employment as well.

Conclusion

After discussing the problem of taxation in relation to savings, investment, production and employment in our country, we may conclude, first, that there were indications to show that the limit to direct taxes[3] had almost reached in our country for the period studied because these largely affected industries. Any disincentive effect of taxation on private sector must be avoided so that necessary capital in that sector might be forthcoming, and thus contributing to the increase in national production. It is to be kept in mind that the private sector still occupies an important place in our national economy as a producer and employer.[4]

For the above reasons it appears that under present conditions in our country, too much insistence on equalitarian principle would

1. *Textile Enquiry Committee Report*, 1958, Statement VI.
2. Ibid, p. 27.
3. There lies, however, some scope regarding direct taxes in agricultural sector like agricultural income-tax and betterment levies, which we have discussed in Chapter VI.
4. Private sector also includes village and small scale industries.

be harmful to the national economy in so far as it would retard the growth of production in the private sector by reduction in ability and willingness to save and invest, with a consequent fall in employment.

Secondly, a savings oriented tax policy requires at this stage of national economy that larger taxation should come from the lower-income groups whose incomes are bound to rise largely with rise in national income but who have little propensity to save. Their consumption must be cut down and this is possible mainly through taxes on commodities,[1] excepting food items which might affect national health and efficiency. Hence a further scope for taxation lies mostly in the field of indirect taxes as the national income rises.

9

PUBLIC EXPENDITURE TRENDS

The well known law of Adolph Wagner says that public activities grow faster than private activities. This is corroborated by the experience in the developed and developing countries. Government expenditure tends to increase with expanding industrialisation, urbanisation and consequently with higher standards of living. John R. Common points out, "Government must have revenues in increasing amounts, not because they are corrupt and inefficient, which can be remedied, but because the social needs of education, ethics, morality, art, liberty, protection of the weak, highways, health, recreation grow faster in an improving civilisation than do private needs of food, luxury, ostentation.[1]

Besides the above mentioned factors, no doubt, one of the important causes of mounting government expenditure has been war. Particular mention may be made in this context of World Wars I and II.

About two hundred years back the duties of the sovereign were given clearly by Adam Smith under three heads. Even today we do not claim to have a better classification than this, *viz* (1) Defending the society from violence and injustice of other independent societies (2) Securing internal justice between citizens (3) Erecting and maintaining those public institutions and works, which though they may be in the highest degree advantageous to a great society, could never repay the expense to any individual. Chief among such works he considers those 'facilitating the commerce of the society, and for promoting the instructoin of the people'.

The first two duties are essentially fundamental. The third duty, though not fundamental, assumes much importance, as the income of a community rises. In a modern State it has larger part to play to achieve various economic and social ends. In the days of Adam Smith, expenditure for social and economic ends, however, were confined only to the Poor Law and the bounties.

We do not find today the supporters of J.B. Say's golden maxim.

1. Op. cit., *Institutional Economics*, (New York), 1934, p. 831.

"The very best of all plans of public finance is to spend little'. Nor can we lay too much stress on what the German writer Lorenz Von Stein has said, 'One State may be good because of great expenditures and another bad because of small expenditures.' It would, however, be wise to strike a balance between the two maxims, rather than to be guided wholly by any one of them. More truly we should follow the principle of public expenditure or the principle of equi-marginal utility. The principle has been stated by Prof. A. C. Pigou in these words, "resources should be so distributed between different uses that the marginal return of satisfaction is the same for all of them."[1]

A balance of equi-marginal satisfaction has been explained by Prof. Pigou to be possible when 'a community were literally a unitary being, with the government as its brain.' This type of unitary being is, however, different from an average individual. Private expenditure by an individual is to be decided by comparing marginal utilities dervied from a unit of money spent on various commodities. This is done under normal market mechanism. But the public expenditure policy is governed by various considerations and may be that sometimes it is primarily the political one.

Decision makings are sometimes the results of accident rather than deliberate choice. It should then be called an outcome rather than a decision making. Expenditure decisions should be made explicitly keeping in view all the objectives of the national economy—the immediate objective, as well as the ultimate one,[2] the latter being the attainment of maximum social benefit. It needs repetition here that according to the theory of Public Finance, the twin effects of Government revenue and expenditure must lead to maximum social benefit rather than to any loss to the society considered as whole.

The above fact is important not only for expenditure decisions but also for considering the real burden of taxation in a country. The impact of taxes causes hardship immediately, by reducing the monetary income of the people in the first instance, even if in the end the beneficial affects of Government expenditure counter-balance or more than counter-balance such hardships. But to yield best results, taxation must not reduce the average real income of the people. Government schemes of revenue and expenditure, alter the distribution pattern of the community. In simple words, it increases the real income of some people and decreases that of others. Such a distortion of the distribution pattern need not be a hardship for it might transfer real income from those who need it less to those who need it more.

In many countries of the world public revenues have shown noticeable increase. But this increase was accompanied by the expansion in social services and the payment of internal debts.

1. Op. cit. '*A Study of Public Finance*'. p. 31.
2. Vide Chapter III.

For example, in U. K. public revenues as percentage of national income increased from 20% in 1938-39 to 41% in 1951-52.[1] The expenditure on social services as percentage of national income also rose from 2% in 1900 to 13% in 1950.[2] Besides this, a very large proportion of revenue raised in England was utilised for the payment of interest on the war loans raised in the covntry itself; in other words, the amount was only transferred from one set of of people to the other. "The apparently heavy incidence of taxation per head of the population in the Western countries, where on account of the War the internal debt is very large, is not comparable with the burden calculated on the same lines in a country where the internal debt is small."[3]

Lastly, those countries have normally not to spend much on defence except in periods of national emergency. Taking the example of U. K., the defence expenditure as percentage of total

Table 63

Expenditure on Nation-building Development and Social Services by the Central Government as Percentage of its Total Expenditure 1950-51 to 1956-57

1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57
11.3	13.8	16.2	16.2	18.1	27.0	27.4
1957-58 to 1964-65						
1957-58	1959-60	1960-61	1961-62	1962-63	1963-64 (R.E.)	1964-65 (B.E.)
27.7	28.5	28.6	19.3	14.1	10.7	10.6

Source : Calculated from the Explanatory Memoranda for the Budgets of the Central Government from 1951-52 to 1964-65.

Table 64

Expenditure on Development and Social services by State Governments as Percentage of their Total Expenditure 1951-52 to 1956-51

1951-52	1952-53	1953-54	1954-55	1955-56 (R.E.)	1956-57 (B.E.)
48.7	50.0	50.0	52.8	56.4	58.4
1957-58 to 1964-65					
1957-58	1960-61	1961-62	1962-63	1963-64 (R.E.)	1964-65 (B.E.)
56.7	57.7	58.7	57.9	55.9	58.4

Source : Calculated from the Explanatory Memoranda for the budgets of the Central Government from 1951-52 to 1964-65.

1. Reserve Bank of India, *Report on Currency and Finance* (1951-52), Statement 6, p. 134.
2. U.K. Annual Abstract of Statistics, 1952, Table 49, p. 47.
3. *The Indian Taxation Enquiry Committee Report*, Ch. XIV, para 478.

national expenditure was 29% in 1938-39, 81% in 1945-46, 22% in 1949-50 and 27% in 1951-52.

In our country also the expenditure on nation-building, development and social services by the Central and State Governments has increased in absolute terms (vide Statement), but the percentages of expenditure under this head have come down for Central Government since 1961-62, as shown in the above table, owing to social services being given lower priority in the Second and Third Plans.

There has been rapid increase in the expenditure on development and social services by the Central Government from 11.3%of the total Central expenditure in 1950-51 to 27.7% in 1957-58 and 28.5% in 1959-60. In States also, the corresponding expenditure increased from 48.7% in 1951-52 of the total expenditure of State Governments to 56.7% in 1957-58 and 58.7% in 1960-61.

As regards the percentage expenditure on defence, it has on the other hand, continued to decline after the war period but again increased in the years 1962-63 and 1963-64 owing to Chinese aggresson as the following table shows.

Table 65

Defence Expenditure as Percentage of Total Expenditure of the Central Government

1938-39 to 1957-58

1938-39	1945-46	1949-50	1951-52	1953-54	1954-55	1956-57	1957-58
50	74	47	45	42.6	41.1	37.6	38.2

1958-59 to 1964-65

1958-59	1959-60	1960-61	1961-62	1962-63	1963-64 (R.E.)	1964-65 (B.E.)
38.6	32.0	29.9	21.7	32.5	41.7	38.3

Source : Calculated from the Explanatory Memoranda for the Budgets of the Central Government from 1951-52 to 1964-65.

It may be hoped that a decrease in the expenditure on defence and the simultaneous increase in nation-building, development and social services in our country in future would countribute towards a further increase in the average real income of the people in the long run. This is due to the reason that the expenditure on armament and armed forces make no direct contribution to economic welfare.[1] "It is often said that such expenditure is economic waste. For men cannot eat guns or high explosives. And the multiplication of battleships is not an economic solution of the housing problem."[2] On the other hand, "public expenditure on education and health, for example, is often productive of greater

1. During war times, defence expenditure would only indirectly contribute towards economic welfare in so far as it would diminish the economic loss which invasion or defeat would otherwise have caused.

2. Dalton, *Public Finance*, p. 213.

economic welfare than private expenditure on luxuries, or even on new capital goods."[1]

It must be mentioned here that our country should not depend much on foreign loans which would mean the drain of our resources to other countries. We find that borrowings from abroad during 1963-64 has been estimated at Rs. 502.5, as against Rs.452.3 crores of borrowings in India. The following table shows the position of borrowings in India and abroad.

Table 66

Loans Raised in India and Abroad

Rs. Crores

1953-54 to 1958-59

Year	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59
Borrowings in India*	75.3	158.1	103.7	157.7	136.2	202.6
Borrowings abroad	1.5	0.7	2.6	10.8	32.5	238.4

1959-60 to 1963-64

Year	1959-60	1960-61	1961-62	1962-63	1963-64 (R.E.)
Borrowings in India	379.6	247.0	256.5	337.0	452.3
Borrowings abroad	299.8	264.71	316.3	365.5	502.5

Source : Ministry of Finance, Explanatory Memoranda to the Budgets of the Central Government.

* Including Annuity Certificates, Prize Bonds and Premium Prize Bonds.

Table 67

Administrative Expenditure as Percentage of total Revenue of the Central Government

1950-51 to 1957-58

1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58
5.5	5.6	6.5	6.6	7.0	7.2	6.9	6.7

1958-59 to 1964-65

1958-59	1959-60	1960-61	1961-62	1962-63	1963-64 (R.E.)	1964-65 (B.E.)
7.5	7.8	7.1	6.4	5.7	4.8	4.3

Source : Calculated from the Explanatory Memoranda to the Budgets of the Central Government.

As regards expenditure on Administrative Services, it has risen from Rs.22.0 crores in 1950-51 to Rs.52.0 crores in 1958-59.

1. Ibid., p. 8.

It is not negligible, but the amount may be justified on the ground that when the Governmental activities are widened such expenditure is bound to increase correspondingly. On calculating the percentage of expenditure on the administrative services to the revenue, we find that it remained constant at about 7%[1] throughout during many years as the table No. 67 shows. There has been, however, a decline in the percentage since 1961-62, though the absolute amount of expenditure under this head is on increase (vide Statement).

1. Likewise, the cost of collection in relation to tax revenues has remained constant that is about 2%. It was 2.19% in 1954-55, 2.08% in 1956-57 and 2.16% in 1958-59.

10

BURDEN OF TAXATION

Classes in a Society

Introductory—Before proceeding to find out as to how the different classes in our country are hit by the present system of taxation as compared to that of earlier years, we will discuss the classes in which our society may be divided.

In a capitalist economy there is a fundamental division of society between the capitalist and the working classes. This class division is, however, not clear cut and there are various sub-division into grades.[1] / The question is as to what should be the criterion for determination of a particular class. The subjective criteria—the class to which a person says he belongs—cannot be taken as necessarily identical with the class to which he actually belongs. In a capitalist State, the wealth a person possesses or the income he receives are the criteria for division into classes. / Under socialism it is personal ability and qualities which are the criteria for division into classes. However, there should be some working criterion for determining the classes of a society. /

According to Cole, ". . . . if a single criterion is to be used, occupation is likely to be better than any other, where the purpose is to arrive at a rough estimate of the number to be included in the various social classes."[2] / Thus according to him, it is the relation to the means of production which determines classes and not income alone.[3] He also emphasised the changing nature of classes.

1. ".....in contrast to the classical Marxist picture of two tightly knit homogeneous social classes ranged clearly against each other, we find a complicated class structure with an increasing proliferation of middle groups." Crosland, *New Fabian Essays* (1952), p. 44.

2. Cole, G. D. H., '*Studies in Class Structure*', Quoted by Andrew Grant in 'Socialism and the Middle Class' (1958), p. 18.

3. We may compare well this view with the Marxist definition of classes as was expressed by Lenin in 'A Great Beginning', (1919). "Classes are large groups of people which differ from each other by the place they occupy in a historically definite system of social production by their relation (in most cases fixed and formulated in laws) to the means of production, by their role in the social organisation of labour, and, consequently, by the dimensions of the social wealth that they obtain and their method of acquiring their share of it. Classes are groups of people, one of which may appropriate the labour of another' owing to the different places they occupy in the definite system of social economy." (Quoted by Andrew Grant, op. cit. p. 14).

Classes in India

The Taxation Enquiry Commission does not particularly mention the middle class, but observes that expenditure group above Rs. 300 a month is in a "somewhat different category from the other expenditure groups."[1] And it supposes that all income below Rs 300 is spent up, and Rs.300 is sufficient for minimum living. Above this, either less will be spent or will be spent in comforts, or on commodities other than necessities. Accordingy, we may fix middle class standards at Rs.300 per month for minimum living.

As a matter of fact, a class is not distinguished entirely by income, and the distinction between upper, middle and lower classes is not altogether based on income. Within middle classes there may be persons with low incomes, whereas in the lower or working class there may be some having high incomes. The concept of class in our country is largely based on status or social esteem. Thus income cannot be said to be a unique attribute of a class in our country, though occupation and income are the two most important determinants of status. Of course, education may also be taken to be one of the most significant factors in the determination of standard.

However, for our purpose of studying the incidence of taxation in our country, we shall divide the society into two groups—Group A, comprising of the lower class (mainly residing in villages), and Group B, comprising of the middle and upper classes (mainly residing in urban areas), who pay taxes on incomes and profits. They constitute less than 1/5% of the total population.[2]

Distribution of Tax Burden

An effort to determine the distribution of burden of taxation is largely a matter of guess work, because the data available is extremely fragmentary. It is only the direct money burden (or the impact of taxation) that can be calculated with some ease, and inferences can be drawn in broad terms.

On the other hand, tracing of indirect money burden is not without insurmountable difficulties. It is due to the reason that this includes not only the incidence but also effects of taxation. For example, the rise in prices is not only on account of the tax but also because of consequent restriction of output, as will be clear from the following illustrations—

(1) Import duties raise the internal price level of the taxed commodity not only equal to the amount of tax but also to the rise due to restriction in the quantity of import; (2) Export duties imposed with the idea of increasing home market might lead to fall

1. *The Taxation Enquiry Commission Report*, Vol. I, p. 49.
2. Vide Chapter III.

in internal price of export commodity, which imposes a further burden to the seller in addition to the collection of export duty. (3) Excise duty might lead to restriction of output which means extra burden on the consumer in the same way as would the burden imposed by equal amount of tax in the form of income-tax. (4) Sales tax affects the price first and as a result reduces the demand which in turn leads to restriction of output, or if the output is not restricted the incidence might be shifted to producers or dealers.

Burden is also caused by fall in demand due to reduction in disposable income as a result of income-tax. Thus the fall in demand and the fall in output both are factors which contribute to the rise in prices and hence to indirect money burden.

Direct money burden can be calculated to the first approximation, by basing our calculations on the total tax collections, the consumption pattern of the different classes in the country, the population figures and on some of our assumptions.

Burden of Central and State Taxes

Taxes on income (other than agricultural incomes) and profits, expenditure-tax, wealth-tax, gift-tax and estate duty are wholly paid by the middle and upper classes. These classes also pay a large proportion of Central customs duty, mostly on industrial goods and raw materials, like– raw cotton, raw silk, silk yarn, oils, motor spirit, metal and machinery, and on articles which may be classed as luxuries or semi-luxuries, like foreign spirits, and liquors, foreign tobacco, textile fabrics, motor cars, *etc.*

The lower class pays customs duties only on a small number of items like spices, betelnuts, pneumatic rubber tyres, tubes, kerosine, and cycles. The proportion of the customs paid by the middle and upper classes on one hand, and the lower class on the other hand may be divided on rural urban basis, because as we have already said, middle and upper classes mainly reside in urban areas and the lower class mainly resides in villages. In 1951 the population in rural sector was 82.7% and in urban sector 17.3%,[1] which comes, say, roughly in the ratio of about 4:1. On the population basis we have calculated that the lower class pays customs as per table (68) overleaf :

Even a lesser amount of customs than 13.6% of total customs may be assumed to be paid by the lower class becuase a tendency towards using indigenous products like cycles, *etc.*, is found more in this class. Hence we assume that 10% of the customs is paid by the lower class and 90% by the middle and upper classes.

The lower class pays Central excise duty as per table 69.

As regards the burden of State taxes, burden of land revenue

1. While taking proportions into consideration we may ignore the growth of population in subsequent years.

Table 68

Customs Paid by the Lower Class

Commodities consumed by the lower class	Revenue from Import duty 1957-58 (Accounts) (a) Rs. lakhs	Import duty paid by the lower class = 4/5th of the total import duty on commodities consumed by them [col. (2)] Rs. lakhs
(1)	(2)	(3)
Spices	119	
Betelnuts	688	
Peneumatic rubber tyres and tubes	71	
Kerosene	984	
Cycles, lorries, etc.	1,292	
Total	3,154	2,523

(a) Amount shows the revenue from import duties on respective items noted in Col. 1 as taken from the Memorandum for the Budget of the Central Government (1959-60).
Customs paid by the lower class=Rs. 2,523 lakhs
Total customs (export and import) in India, 1957-58 (from all commodities) =Rs. 18,505 lakhs.[1]
Therefore, customs paid by the lower class as percentage of total customs in India comes to 13.6%.

Table 69

Central Excise Paid by the Lower class

Commodities consumed by the lower class	Revenue from Excise 1957-58 (Accounts) (a) Rs. Lakhs	Excise paid by lower class=4/5th of the total excise on commodities consumed by them [Col. (2)] Rs.lakhs.
(1)	(2)	(3)
Kerosene	306	
Sugar	4,275	
Matches	1,508	
Tobacco	4,549	
Vegetable Products	392	
Tea	386	
Cotton Cloth	6,460	
Total	17,876	14,301

(a) As taken from the Memorandum for the Budget of the Central Government for 1959-60.
Central excise paid by the lower class=Rs. 14,301 lakhs
Total Central excise in India, 1957-58 (from all commodities) = Rs. 27,362 lakhs[2]

Therefore, excise paid by the lower class as percentage of total excise in India, comes to about 52%.

Thus half of Central excise duty may be assumed to be paid by the lower class, and the other half by the upper and middle classes.

1, 2. Figures taken from the Memorandum for the Budget of the Central Government, 1959-60.

lies mainly on the lower class. Payment of about three-fourth of it may be attributed to this class. This has been assumed on the basis that "in most States the proportions of the number of holdings under 5 acres to the total holdings is more than 50% while those under 10 acres account for 75%."[1] In addition to this, the results of the developments due to the recent land reform policies will also have to be taken into account. Those policies had the effect of further reducing the number of large holdings, and consequently, a larger number of the lower class now pay land revenue. Thus, we may safely assume that about three-fourth of the land revenue is paid by the lower class.

Regarding other State taxes (State excise, sales tax, stamp and others), the following table gives the percentage of the revenue collected from these taxes in the cities of Bombay, Calcutta and Madras to the total taxes collected in the entire States of Bombay, Calcutta and Madras.

Table 70

Collection of Taxes (under major heads) in the cities of Bombay, Calcutta and Madras

Revenue	Bombay City			Calcutta City			Madras City		
	1948-49	1949-50	1950-51	1948-49	1949-50	1950-51	1948-49	1949-50	1950-51
State Excise	30	26	50	50	50	50	20	20	20
Sales Tax (General)	66	63	59	80	80	81	26	23	23
Stamp Revenue	61	57	57	57	56	53	16	14	14
Other Taxes	73	55	47	65	80	74	22	16	14

Source : Report of the Finance Commission, 1952 Appendix IX, Table 11, pp. 194-95.

Average of State Excise	...	35	Per cent
Average of Sales Tax	...	56	,,
Average of Stamp Revenue	...	46	,,
Average of other Taxes	...	49	,,

On the basis of these data we may presume that the people of the middle and upper classes who mainly reside in urban areas, roughly pay 40% of State excise, 60% of sales tax and 50% of stamps and other taxes, *viz.*, electricity duty, entertainment tax, receipts under Motor Vehicles Act, *etc.*

Though the percentages of Central and State taxes assumed by us to be paid by the different classes, are only rough approximations, still they may serve our purpose to ascertain whether the burden of taxation on the respective classes have increased or decreased over the last few years with the changes in the structure of taxation.

1. *The Taxation Enquiry Commission Report*, Vol. III, p. 208.

Table 71

Percentage of Taxes (Under Major Heads) to Total (Central and State) Tax Revenues

Heads of Revenue	1937-38	1944-45	1946-47	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1959-57	1957-58	1958-59	1959-60
Taxes on Income	11.8	48.0	36.6	28.2	24.6	24.6	25.0	22.9	22.6	22.6	21.8	20.9	21.7
Customs Duty	34.1	10.2	20.8	25.0	31.7	25.5	22.1	23.7	21.6	18.5	16.5	13.2	12.2
Central Excise	5.7	9.5	9.7	10.7	11.5	13.3	14.1	15.1	18.8	26.9	29.5	32.7	34.8
Land Revenue	19.8	7.9	70.0	8.2	7.3	9.5	10.7	10.1	10.5	8.9	9.4	8.9	9.2
State Excise	10.9	11.4	11.9	7.8	7.0	7.4	6.7	6.2	5.7	4.3	4.1	4.3	4.2
Sales Tax	...	2.2	3.0	8.8	7.2	8.2	9.2	10.1	9.9	9.7	7.3	9.2	9.2
Stamps	8.2	4.1	4.6	3.8	3.3	3.7	4.1	3.9	3.8	3.1	3.0	3.2	3.1
Other Taxes	9.5	6.7	6.4	7.5	7.4	7.8	8.1	8.0	7.1	6.0	8.4	7.6	5.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : Calculated from the Combined Finance and Revenue Accounts, up to 1950-51; and Statements Nos. I and VIII.

Table 72[1]

Burden of Taxation on the Lower Class—1937-38 to 1959-60 (Percentage of Tax Revenue).

Heads of Revenue	Percentage of Tax paid by the Lower Class	1937-38	1944-45	1946-47	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59	1959-60
Taxes on Income	Nil	...	...	...	...	...	...	...	...	...	...	...	...	...
Customs Duty	10 per cent	3.4	1.0	2.1	2.5	3.2	2.6	2.2	2.3	2.2	1.9	1.7	1.3	1.3
Central Excise	50 „	2.9	4.7	4.8	5.3	5.7	6.6	7.0	7.6	9.4	13.4	14.8	16.3	17.4
Land Revenue	75 „	14.9	5.9	5.3	6.2	5.5	7.1	8.0	7.6	7.9	6.7	7.0	6.7	6.9
State Excise	60 „	6.5	6.8	7.1	4.7	4.2	4.4	4.0	3.7	3.4	2.6	2.5	2.6	2.5
Sales Tax	40 „	...	0.9	1.2	3.5	2.9	3.3	3.7	4.0	4.9	3.9	3.1	3.7	3.7
Stamps	50 „	4.1	2.1	2.3	1.9	1.7	1.9	2.0	1.9	1.9	1.5	1.5	1.6	1.5
Other taxes	50 „	4.8	3.4	3.2	3.8	3.7	3.9	4.1	4.0	3.5	3.0	4.2	3.8	2.7
Total (Burden)	—	37.6	22.8	24.5	27.9	27.3	27.6	31.0	31.1	32.2	35.0	34.8	37.0	36.1

1. Calculated from Table 67.

Table 73[1]

Burden of Taxation on the Middle and Upper Classes 1937-38 to 1959-60 (Percentage of Tax Revenue)

Head of Revenue	Percentage of Tax Paid by the middle & Upper classes	1937-38	1944-45	1946-47	1950-51	1951-52	1952-53	1953-54	1954-55	1955 56	1956-57	1957-58	1958-59	1959-60
Taxes on Income	100 per cent	11.8	48.0	36.6	28.2	24.6	24.6	25.0	22.9	22.6	22.6	21.8	20.9	21.7
Customs Duty	90 ,,	30.7	9.2	18.7	22.5	28.5	22.9	19.9	21.4	19.4	16.6	14.8	11.9	10.9
Central Excise	50 ,,	2.8	4.7	4.8	5.3	5.7	6.6	7.1	7.5	7.4	13.5	14.7	16.4	17.4
Land Revenue	25 ,,	4.9	1.9	1.7	2.0	1.8	2.4	2.7	2.5	2.6	2.2	2.4	2.2	2.3
State Excise	40 ,,	4.4	4.6	4.8	3.1	2.8	3.0	2.7	2.5	2.3	1.7	1.6	1.7	1.7
Sales Tax	60 ,,	...	1.3	1.8	5.3	4.3	4.9	5.5	6.1	5.9	5.8	4.2	5.5	5.5
Stamps	50 ,,	4.1	2.1	2.3	1.9	1.7	1.9	2.1	1.9	1.9	1.6	1.5	1.6	1.6
Other Taxes	50 ,,	4.7	3.4	3.2	3.8	3.7	3.9	4.0	4.0	3.5	3.0	4.2	3.8	2.8
Total (Burden)		62.4	78.2	75.4	72.1	73.7	72.4	69.0	68.8	67.6	67.0	65.2	63.0	63.9

1. Calculated from Table 67.

Table 67 gives the percentage of taxes to the total tax revenue of the Central and State (formerly Provincial) Governments in this country since 1837-38 (in selected years).

Table 68 has been calculated from Table 67 on the basis of the percentages of taxes paid by the lower class. The total of the taxes paid by this class in each year shows the monetary burden of taxation on them for the respective years.

Similarly, Table 69 has been calculated from Table 67 on the basis of the percentages of taxes paid by the middle and upper classes. The totals show the monetary burden on them for the respective years.

From Tables 68 and 69 the following conclusions may be drawn :

(1) That the lower class which constitutes the large majority of population as mentioned before contributed about 22.8% of the total Central and State Tax revenues in 1944-45, 31% in 1952-53 and 37% in 1958-59.

(2) That there has been an increase in the percentage of taxes paid by the lower class since the post-war period. This has been mainly due to the increase in the percentage of indirect taxes paid by them, like Central excise and Sales tax. Percentage of Central excise paid by this class has increased from about 4.7% in 1944-45 to 6.6% in 1952-53 and 16.3% in 1958-59. Percentage of sales tax has also increased from about 0.9% in 1944-45 to 2.9% in 1951-52 and 3.7% in 1958-59. Customs paid by this class increased from about 1.0% in 1944-45 to about 3.2% in 1951-52, but subsequently declined to 1.3% in 1958-59. State excise paid by this class has, however, declined from 6.8% in 1944-45 to 2.6% in 1958-59.

(3) That there has been a decrease in the percentage of taxes paid by the middle and upper classes which is mainly due to the decrease in the percentage of taxes on income paid by these classes. It was about 48% in 1944-45, 25% in 1953-54 and 21% in 1958-59.

We may also note that during pre-war years, the percentage of taxes paid by the middle and upper classes was lower than in post-war years. It was 62.4% in 1937-38 and 78.2% in 1944-45. This was due to the fact that the percentage of taxes on income in the former year was only 11.8%, while in the latter year it was as much as 48.0%.

Thus broadly speaking we may say that the increase in the percentage of indirect taxes since post-war years has hit the lower class, while the decrease in the percentage of direct taxes has relieved the middle and upper classes.

Percentage of indirect taxes to the total tax revenue, which was 60.03% in 1952-53 rose to 65.33% in 1957-58 as the following table shows—

Table 74

Direct[1] and Indirect Taxes[2] (Centre and States)

1951-52 to 1955-56

Taxes (Centre & States)	1951-52	1952-53	1953-54	1954-55	1955-56
Total Direct Taxes (Rs. Crores)	272.00	276.52	270.40	268.74	289.29
Total Indirect taxes (Rs. Crores)	469.04	415.46	423.18	467.74	471.71
Total Tax Revenue (Rs. Crores)	741.04	691.98	693.58	736.48	761.00
Percentage of Indirect Taxes to Total Tax Revenue	63.29	60.03	61.01	63.12	61.98

1956-57 to 1959-60

Taxes (Centre & States)	1956-57	1957-58	1958-59 (R.E)	1959-60 (B.E.)
Total Direct Taxes (Rs. Crores)	332.79	362.46	373.25	381.45
Total Indirect taxes (Rs. Crores)	527.70	682.38	671.02	697.96
Total Tax Revenue (Rs. Crores)	860.49	1044.84	1044.27	1079.41
Percentage of Indirect Taxes of Total Tax Revenue	61.33	65.33	64.25	64.66

(Calculated from Statements I and VIII)

(1) Direct taxes include 'Taxes on Income and Expenditure' and Property and Capital Transactions'.

(2) Indirect Taxes include 'Taxes on Commodities and Services'.

Increase in the percentage of tax paid by the lower class could not be affected much because a large sector residing in villages goes untaxed. The National Income Committee points out that about 48% or half of the national income of India for 1948-49 (Rs.8710 crores) represented the product of agriculture covering 70% of the working force.[1] "When it is remembered that a large part of the commodity production does not enter into trade at all—being retained by the producer for his own consumption—the relative importance of this sector is clear."[2] For the sake of comparison we may note that household enterprises and hand trades contribute about 10% of the income, and professions and Government services contribute another 9%. Industry, commerce, transport and communications contribute 28.6% or about one-fourth of the national income.[3]

The Planning Commission, therefore, emphasises that "Unless

1. *National Income Committee Report*, Chapter V, Tables 2, 3 and 4, also vide Chapter VII.
2. Ibid.
3. Ibid.

fiscal policy and the machinery of taxation are assimilated so as to obtain a significantly wider coverage, the tendency will be not only for tax revenues to fall as a proportion of further additions to national income, but also to make the sharing of the burden of development increasingly inequitous."[1] This problem has been already discussed in Chapter VIII.

Hence the increase in percentage of total tax revenue paid by the lower class should not necessarily mean the increase in per capita tax burden, because, first, it would mean the increase in the coverage of taxation as the tax base is broadened. Secondly, it would mean the taking away by the Government of the increase in incomes of this class, which economic development is supposed to bring about, to aid the financing of the plans. Thirdly, the expenditure by the Government on social services and other welfare activities would augment the real incomes of this class, as has already been discussed in Chapter IX.

Good tax administration would not only increase the net revenue collection but also would mitigate a lot of harassment and trouble to the tax payer, thereby decreasing their burden of taxation.[2]

As far as possible, economy should be made in Government expenditure so that the public money may be properly utilised.

Tax Evasion

Problem of tax evasion is also important while studying the burden of taxation. Evasion, besides doing loss to the revenue, disturbs the burdens which are intended to be imposed with due regard to equity; inequitable burden being placed on the honest tax payer.[3]

Tyagi Committee investigated the problem of tax evasion and avoidance in the country, and observed that the problem is not peculiar to India. The problem exists in U. K., U. S. A. and more so in France. The Committee pointed out that the quantum of tax-evasion, though undoubtedly high in India, is not of the magnitude indicated by Prof. Kaldor in his report. The Committee further said that the magnitude of tax evasion in this country was indicated by the following facts—

First, Income-tax Investigation Commission detected concealed income of the order of Rs.48 crores. Secondly, concealed income amounting to Rs.70 crores was disclosed by the assessees themselves under 'voluntary disclosure scheme' of 1951. Thirdly, by efforts of Income-tax Department during 1958-59, concealed income amounting to Rs. 1.10 crores was assessed.

1. First Five Year Plan, Chapter III, para 17.
2. Vide 'Direct Tax Administration', Chapter IV.
3. Avoidance of tax is also likewise injurious. It does not come under the scope of tax administration because it has a colour of legality in it. Various amendments in the enactments itself might be required to prevent tax avoidance.

On the other hand, according to Kaldor, the amount of income-tax lost through evasion amounted to between Rs.200 crores and Rs. 300 crores for the assessment year 1953-54. As against this, the Central Board of Revenue was of the opinion that the tax evaded in that year would not have exceeded Rs. 20 crores to Rs. 30 crores. The difference was largely due to the fact that Kaldor included in his estimate of evasion also the loss due to avoidance. Further, his estimate was based on certain tentative figures relating to national income, supplied to him by the Central Statistical Organisation. It is also to be noted that the concept of 'income' in the national income statistics is much wider than that under the Income-Tax Act. Besides this, Kaldor himself declared his estimate to be only tentative. There are obviously inherent difficulties in any attempt at estimating the extent of evasion.

Tyagi Committee held that, while it cannot be denied that the higher the rate of tax the greater will be the temptation for evasion and avoidance, the tax rates by themselves are not to be blamed for the large extent of evasion in this country. "Even if the rates of tax are reduced, evasion will still continue, because it exists at all levels of income."[1]

Similar was the opinion of the Taxation Committee of New Zealand, in connection with tax avoidance, which is equally true for evasion. According to it, "Legal avoidance takes many forms and is encouraged by high taxation. Tax laws are complex and in some directions inequitable..... As the taxing authority insists on payment according to the law, the tax-payer cannot be condemned for following the form of the law to avoid liability for taxation. Tax avoidance does not occur only with large taxpayers. The spirit of avoidance is evident in those who will not work longer or try harder, because too much goes in taxes."[2]

The Income-Tax Investigation Commission (of 1948-49), on the other hand, after considering the various evidences put up before it held that "It has been strongly pressed on us that the present rates of income-tax and super-tax are so high as to defeat their purpose by discouraging enterprise and by increasing the temptation to conceal business income. It has been added that there is more likelihood of a larger tax on income being realised at a moderate rate of tax, than at a higher rate. We do not belittle the force of this argument... so far as the temptation to evade is attributable to high rates of taxation, it must be met in the same manner as every other attempt to evade tax."[3] However, as we have quoted already, Tyagi Committee did not consider at all the reduction of tax rates as the remedy to tax evasion.

Among other causes of evasion Tyagi Committee pointed out the complicated provisions of the direct taxes Acts, inadequacy of

1. *Tyagi Committee Report*, Chapter 7, para 8.
2. *Taxation Committee* (New Zealand), *Report* (1951), p. 30.
3. Income-Tax Investigation Commission, (1948-49), Part I, Sec. II. para 15.

the powers vested in the personnel of the Department, shortage of experienced personnel, absence of deterrrent punishment, suppression of sales in the case of retail trades in an attempt to evade sales tax, morality of tax payers, mutual distrust between officers and tax payers and even dishonesty of some departmental officials, which are the main causes of tax evasion and avoidance.

Thus after examining Tyagi Committee's Report we come to the conclusion that evasion and avoidance in India is still quite substantial. However, we may have a consolation that similar problem exists in other countries too. But such consolation would not do. Earnest efforts must be made to check it by efficient tax administration.

The following are some of the important ways to check evasion:

1. Deduction at source may avoid some evasion, but such a method has various drawbacks as discussed in Chapter IV.

2. Steps should be taken to develop greater sources of information, which may be safe and reliable.

3. An organisation like the Income-Tax Investigation Commission should be constituted as a permanent feature of tax administration, to investigate cases of substantial concealment of tax liability.

4. The highest important point for consideration in connection with the question of evasion of taxes is, that the public mind should be educated to a sense of duty to the State—without which genuine co-operation and effective stoppage of evasion can never be possible.

5. It is also equally important that a sense of confidence in the public should be created of the following facts—

(i) that taxes are to serve some useful purpose.

(ii) that the taxes are not excessive and that the assessee will not be deprived of the amenities of life; and lastly,

(iii) that justice will be done at the hands of assessors in fixing the amount of tax.

Of course, points (i) and (ii) do not come under the purview of tax administration and constitute a budgetary problem; but they do affect the feelings of the people, and in case of dissatisfaction they create a revolt in the minds of tax payers, leading them to evade or avoid taxes.

In the end, we must say that some evasion is inevitable, and we should not hope for perfect results by any method whatever it might be, owing to the ingenuity of the brains of tax evaders and the abettors. Tyagi Committee has suggested that tax evasion should be made punishable under the taxing statute itself and should be made an offence under the Indian Penal Code. According to the Committee not only tax evasion but also the abetment of tax

evasion should be made punishable. Even increase in penalty would also not stop evasion completely, as the evaders would always evade. The penalty already provided is, however, quite sufficient if it is properly enforced with due discrimination.

Burden of Local Taxation

As we have mentioned in Chapter I, taxation for local purposes in general, corresponds to the cost of service or the benefit principle of taxation. This accounts for a difference between the burden of local and Central or State taxes. For example, even though a section of a community, say, villagers might be bearing higher burden of taxation than the other section, say, the people in the town, yet imposing new local taxes or increasing the rates of the existing ones for the purpose of their own development, might not be felt cumbersome by the former. This is due to the irrationality on the part of the taxpayer. Thus the real burden of a local tax would be different from a Central or State tax of equal amount levied for general purposes.[1]

Hence there lies much scope for raising fund through local taxes without imposing appreciable real tax burden.

The essence of the question of mobilisation of resources is, how best to get at the resources of the rural sector. This sector has accounted for the production of as much as 45% to 49% of the total national income during the last decade. Despite the large share of agricultural production in national income, it had not been possible to raise much by way of savings from this sector as we have already referred to in Chapter VII. In this connection it would be better to think in terms of local bodies, like village Panchayats and Cooperatives. Panchayats should not only be delegated greater powers to levy local taxes,[2] but the existing taxes should also

1. Thus local taxation also affords an illustration of the fact that formal incidence or direct money burden is an inadequate measure of tax burden.

2. Since the Decentralisation Commission (1909) had expressed its fears of Panchayats becoming unpopular and the Phelps Musanna Committee (1916), also held the same view, Panchayats established under the Act of 1920 were given no power of taxation whatsoever. Later on, it was felt that this was a serious defect of the Act. So the Local Self-Government Committee, known as the Kher Committee appointed by the Government of U.P. in 1939, with a view to strengthening the financial position of Panchayats and other local bodies, proposed that all public property within the respective jurisdiction of a Gaon Panchayat or town area should be vested in that body. It was based on the analogy of Section 116 of the Municipalities Act. The Committee also proposed contribution in the form of compulsory labour by all male adults in the community. The other taxes proposed were optional. The list of optional taxes referred particularly to the taxes on profession, trades, callings and employment. These taxes were mainly intended for non-agriculturists and it was recommended that every Gaon Panchayat and Town Area Committee would be well advised to levy it. (Report of Kher Committee, 1939, Chapter IV, page 15). U.P. Village Panchayat Act of 1947 is mainly based on the report and the recommendations of the Kher Committee. The Act vests in the Gaon Sabha all the property situated within the jurisdiction of a Gaon Sabha which is required to directly manage and control it. Panchayats are nevertheless vested with the discriminatory power to levy taxes and fees for which the maximum rates have been prescribed in the Act and Rules made thereunder.

be effectively levied. This would lighten the financial burden of the State or Central Governments, because local bodies would depend less on State or Central Grants if they could themselves raise more revenue. Another advantage would be, as we have mentioned above, the community would be enabled to see clearly for itself the tangible results which its own contributions were able to produce in its own locality. This would cause less or no psychic pain in paying local taxes then it would have been otherwise.

Further, Gaon Sabhas and Panchayats in the village have the advantage of having the system of direct democracy. The members of these bodies, in fact, tax nobody else, but each member gives his consent to contribute his share to the general pool.[1] The underlying idea is that the Gaon Sabhas should raise a small fund for the common benefit of its members, which is very different from a tax imposed by a remote body. The sanctity and force of their own will is bound to transform taxation into a voluntary and sacred contribution for the common cause. Neither Municipal Boards and corporations, nor the State Government can create love and faith required for raising such contributions howsoever small they may be.

The responsibility for meeting all local requirements like elementary education, improvement of roads and the like, could be transferred to the local authorities. By giving appropriate matching grants, the community could be given an inducement to make efforts to meet its own immediate needs. It would, however, be worthwhile to examine the types of development programmes which could be beneficially entrusted to local authorities. Social service programmes must be undertaken on a large scale by local bodies, because the progress lies in the State Governments using the agency of local bodies to carry out as far as practicable their own social service programmes. "This is the way in which social services have been expounded in the democratic and industrial countries of the West."[2] Hence instead of the State Governments taking over from local bodies such functions, the financial position of the latter must be strengthened by proper development of local rates and adequate grants-in-aid.[3]

Madras affords an example in regard to elementary education. Responsibility of running schools and providing elementary education has been delegated to panchayat unions at the block level. The present grants due to each block, on account of elementary education was being handed over to the Panchayat Union concerned as a basic grant. If the local authorities raised extra resources for elementary education, the State Government would advance them an equal amount. In backward areas, the local contribution need be only 40% or even less for the Government to make up the balance.

1. Vide U.P. Panchayat Raj Act Section 37.
2. Baljit Singh, 'Economic Planning in India', p. 130.
3. Ibid.

The Local Finances Enquiry Committee[1] and the Taxation Enquiry Commission[2] in their reports have recommended a number of taxes to be levied by Panchayats. However, it has been pointed out that the scope of Panchayat taxation is limited. The sources of income assigned to Gaon Panchayats are inelastic.[3] The Zamindari abolition deprived them of the income from taxes or rents realised by zamindars. Wherever taxes were levied they could hardly be realised for want of adequate arrangement for collection. For example, in Uttar Pradesh it has been pointed out that though most of the local taxes recommended by the Local Finances Enquiry Committee and the Taxation Enquiry Commission are levied by the Panchayats in U.P., they were not taken up seriously. All over the State faulty lists of nearly all Panchayats show huge arrears. This has been attributed mainly to easy-going policy of the Secretaries. During the seven years intervening since their establishment and until the end of the financial year 1955-56, the Panchayats of the State imposed a total sum of Rs.655,13,893 as taxes and fees. Out of this a total number of Rs. 294,44,856 only was collected. This shows the need for strengthening the measures for the levy of taxes assigned to local bodies.

A sound system of local taxation and tax administration alone can provide a solid basis for sound local finance. It is the power of taxation which is supposed to provide the 'Open sesame for the local bodies to make up their financial leeway'.[4] Because among the various sources of incomes, rates and taxes constitute the major source of income of most local authorities. They contributed about 45% of their total receipts in 1957-58.[5]

State Governments should, however, not hesitate to accept an

1. The Local Finances Enquiry Committee (1951) suggested many items of taxation. However, it has recommended that "Every Panchayat should levy two taxes compulsorily (i) house tax or Chulla tax or circumstance and property tax and (ii) general sanitary cess. Other taxes may be levied by Panchayats according to their needs and local conditions." Both these items of taxation though not compulsory, have nevertheless been provided under clauses (i) and (j) of Section 27. (Report, para 729).

2. Taxation Enquiry Commission has suggested that in respect of Panchayats, the general property tax, service tax, land cess and duty on transfer of property are the main taxes suitable. In addition, the power to levy the tax on vehicles, the profession tax and the theatre or show tax may be given to individual Panchayats which may be found suitable by the State Governments (Report Vol. III, page 370).

3. Vide Appendix IV, p. 27. It is shown that despite the tax resources of local authorities being inelastic, there has been an increase in tax revenue between 1951-52 and 1956-57.

4. Local Self-Government, Uttar Pradesh Activities (1953-54), p. 52. In his presidential address to the Provincial Local Bodies Conference at Surat in 1935, late Sardar Vallabh Bhai Patel (who was the Chairman of the Ahmedabad Municipality said, "It is being said that the franchise of the electorate has been enlarged and the local bodies have been given vast powers. True, I accept it. But what good would come out of it unless and until the question of local finance is settled first. The extension of franchise and widening of the scope of the duties would be like dressing a dead women."

5. Vide Appendix IV and Statement XIV (b).

increasing measure of decentralisation of taxation and to transfer[1] suitable financial powers and responsibilities to local bodies where it is necessary. This would not only increase the self-dependency of local bodies, but the burden of local taxation will also be felt to a lesser extent than in cases where tax is imposed by State or Central Government and then a portion of the latter is later on transferred to local bodies.

'Labour Tax'

One of the important resources available in rural areas, in employment of which local bodies like Panchayats can play an important part, is the utilisation of the idle-man power which is free in seasons of unemployment and inactivity, to development programmes of the area for the direct benefit of the local community itself. With this object, suggestions have been often made that Panchayats could be delegated power to levy a labour tax of ten or fifteen days work in the year, taking the family as a unit. The All India Congress Committee on Panchayats was not against the view that legislative measures might provide for enforcing labour contributions.[2]

As against this view the Taxation Enquiry Commission expressly advised against the levy of labour tax in these words. "In no case, however, should manual labour be demanded or accepted in lieu of payment of tax; a labour tax should be ruled out altogether as a possible feature of local or other taxation."[3]

The Local Finance Enquiry Committee (1951) held that as regards labour tax there should be no compulsion.[4]

Uttar Pradesh Panchayat Raj (Amendment) Bill of 1950 did contain the provision to impose a labour tax, which was finally dropped by the Joint Select Committee of the two houses of the U. P. Legislature after much discussion.

No doubt, no one should be forced to do labour, but when there are specific programmes of development which are considered necessary for the welfare and benefit of the local community itself, Panchayats can usefully employ the idle-labour in villages, during times of inactivity and unemployment, by organising and encouraging voluntary contributions of labour or Shramdan from the people of the community itself in their own common interest.

The spirit of Shramdan is worthy of being pursued and is bound to sustain the dignity of labour. Shramdan can be a powerful resource of the village community and Panchayats, which can be suitably employed. Cases are not few where Shramdan by all men and women has been organised for long and sustained periods,

1. States have power to allocate any of the taxes on their list to local Governments.

2. Report of the Congress Village Committee, New Delhi, pp. 48-49.

3. The Taxation Enquiry Commission, Volume III, p. 367.

4. The Local Finance Enquiry Committee (1951) Report, Para 729.

not during a prescribed week or fortnight, but during other periods of comparative inactivity.

The noble character of Shramdan is now well recognised and accepted. Therefore, every one or at least some persons per unit of the family are expected as a matter of duty to the community to offer it for the common cause. But there may still be persons who might be unwilling to contribute or may even be obstacles in it; and would yet enjoy the benefits of the development in common with the community which has worked for it.

Therefore, taxation in the shape of labour would be a useful weapon in successfully organising Shramdan, and making it not only a successful means of utilising the manpower while removing all elements of forced or compulsory labour, but also equalising the burden on all persons of the locality who would ultimately be benefitted by the development schemes.

This can be done not by imposing any regular labour tax. This can be done by giving powers to Panchayats to first decide, with the consent of the majority of the Community represented by Gaon Sahba,[1] as to the projects to be taken up by Shramdan which are really necessary and useful to be undertaken for the benefit of the locality, to create enthusiasm for it, and then to invite Shramdan from every family unit. Those who are unwilling to offer Shramdan should be made to pay a 'Shramdan tax', so to call, to compsenate for their share of contribution, (of course, providing for reasonable exemptions). The details can be easily settled. This would be justified morally, as there is no reason why, when others are offering Shramdan for the benefit of all persons of the locality, everyone should not contribute to the well-being of the locality. It is justified economically as well, because all who will get the ultimate benefit must share the burden of fulfilling those schemes of development by contributing their share in the form of labour tax. No forced labour is imposed as its equivalent can be paid in money. Thus the scheme would take away the character of forced labour. Moreover, forced labour is the one taken for the benefit of others, while Shramdan being for his own benefit along with the benefit of the community. Hence it cannot be deemed to be forced labour, it is in fact self-help.

Taxation in the form of labour will thus not only equalise the burden, but will give a systematic form and workable shape to the organisation of Shramdan for development schemes agreed to be carried out for the community's benefit. It would also make them realise and feel that they are taking direct part themselves in the working up and development of India.

We would, therefore, suggest imposing of 'labour tax' or a 'Shramdan tax' for definite schemes undertaken to be carried out.

1. Gaon Sabha consists of all adult residents of the area.

II

TAXATION AND SOCIALIST PATTERN OF SOCIETY

Socialist Pattern

The establishment of the socialist pattern of society in India has not been claimed as a doctrinaire approach, yet it may be emphasised, it is essentially an economic doctrine, evolved to find a solution to the economic problems with which India is faced today. It has been held that it is not to be achieved for the sake of any socialist doctrine,[1] but for the sake of economic expansion. It does not, however, consist in merely increasing the number of factories or securing greater production by any means. It is something more with a deeper significance. As was pointed out by the Prime Minister of our country, "we want to raise our country's standard, and yet to bring about equalisation and try to go towards an equalitarian society."[2]

Socialism means an approach to the establishment of an equalitarian society with equality of opportunity and the like. But it would be too simple to think of socialism as—'chopping off the heads of some tall persons and cutting at the pockets of some persons who have money.' There can really be no socialism without there being a Welfare State. It matters little whether the Welfare State is identified with a socialist or any other kind of State, or is held to be different from either. But one thing is certain, that there can be no economic system commendable without there being a Welfare State. Every country accepts the ideal of a Wel-

1. "What I wish the House to consider is this, that the kind of problems we have to face here are *mutatis mutandis* common problems in many countries in the world today. Whether you call those countries capitalist, socialist, or communist, the problem is the same; the world has to face difficulties due to certain basic causes. There are different ways of approach and finding a solution. It is not enough for this house or for this Government to dispose of the solution of the problem by saying that we shall follow the capitalist way, or the way of private enterprise, or the socialist or communist way. You say that, all that you mean is that you shall adopt a certain approach in understanding and in trying to find out a solution to that problem, which may be socialist or any other. This is all that it means." (Prime Minister's Speech in Lok Sabha, March 14, 1951).

2. Prime Minister's speech in Lok Sabha, December 15, 1952.

fare State, whether it follows the capitalist, socialist or communist way.

Now, to bring about a Welfare State, the essential prerequisite is an advanced society having good means of production—many factories, satisfactory yield from land and technical apparatus for economic growth. This is the basis for all, may it be Russia or America.

In an under-developed country like India, it is all the more necessary to achieve, first, sufficient increase in national income, or in other words in the production of goods and thereby the production of money, before it can be equitably distributed. In other countries too, with the advent of industrial revolution, first production increased rapidly, and then people could think of measures of equality, which were expressed in terms of utopian socialism and then scientific socialism. As Dr. Gyan Chand points out, "Industrialisation is.... essential, because it is in line with historical economic evolution, and without it socialism cannot be realised."[1]

To the consumer the means of ownership of production (whether it is public or private) is immaterial, for him importance lies in distribution of the resources. Any means or method (whether capitalist or socialist) therefore, would be socially justified if it leads to the end of maximum social welfare.

Ours is not the pursuit of any dogma or the slogan, like 'tax the rich' or, 'nationalise the industries', but the problem is to be solved in the most practical way. Definite and constructive steps suitable to the conditions of our country are to be planned, so as to produce necessary wealth to apply our resources to maximum social advantage.

No doubt, there exist wide inequalities in India, and a wide gap between the rich and the poor. Such inequalities must be and have been rightly condemned by various authors. Nevertheless, it has been pointed out that, in the act of removal of disparities if we do something which prevents our going ahead then we have not served the people or the cause of socialism.[2] The socialist pattern of society as conceived at present, may be described as an economic system in-between a fully socialist[3] economy and a capitalist one, as we have discussed subsequently. Because of this, not only has a

1. Gyan Chand, The New Economy of China, p. 132.
2. Prime Ministers' speech in Rajya Sabha, September 7, 1956.
3. Socialist economy has been described by Ralph H. Blodgett in these words—"A socialist economy is not one in which private individuals and firms perform most economic functions and produce most commodities and services, while only a few functions are delegated to Government. Rather, in a socialist economy, the citizens receive almost all their incomes collectively and the Government, operating in the name of the people as a whole, is the only enterprise of any great significance". (Blodgett, R.H., Comparative Economic Systems p. 558).

For other definitions of socialism, vide A.C. Pigou, Socialism Vs. Capitalism pp. 2-3; Economics of Socialism by H.D. Dickinson, pp. 3, 10-11; G.D.H. Cole, 'The Simple Case for Socialism', P. 7, etc.

field to be left for private sector to function, it is also considered necessary to encourage it to function in wider fields in particular directions to help greater production instead of crushing its incentives altogether by too rigid application of the equalitarian principle.

By stages, however, it is hoped that public sector would become bigger and bigger occupying all strategic points to enable the equalitarian principle to be carried out more thoroughly. As Professor Pigou had said, it is better, "to follow the path of gradualness—to mould and transform and not violently to uproot. Further, gradualness implies action, and is not a polite name for standing still."[1]

But, while providing a field for private sector, the forces of capitalism are to be kept in check by taxation[2] (while the direct methods of control remaining postponed), otherwise the rich would grow richer and the poor poorer, thus increasing the gap between the two.

It is to be marked that even the capitalist system has developed certain socialistic checks. For example, death duties and other sharply progressive taxes are the methods to this end. As we know, a large part of the income of the wealthiest groups in the United States is derived from business profits. The combination of corporate and personal income taxes and death duties have limited the rise in incomes and fortunes at the disposal of the wealthiest Americans.

Johnson and Kross point out that in the twentieth century the combination of a progressive tax structure and greater expenditure for the benefit of the low-income groups, resulted in a considerable shift of income from the upper to the lower-income groups, "rather paradoxically it was capitalistic society that was giving practical application to the Marxian dictum—from each according to his ability to each according to his need, proving once more that social solicitude is not the monopoly of an ideology, and that consideration of welfare may be best implemented in societies which emphasise production and business vitality."[3]

However, as Pigou has pointed out, much of the waste can to a certain extent be removed by a proper system of bounties, taxes and legislation within the framework of the capitalist system itself, but a socialist economy can do it more thoroughly than the capitalist one.[4] Capitalism with its queer institutions has failed in realising maximum social welfare. It aims at promoting the

1. Pigou, A.C., Socialism Versus Capitalism, p. 130.

2. One automatic method of bringing about rational allocation of resources is the competition for profit, brought about only under conditions of perfect competitive equilibrium. In practice, however, due to existence of monopoly among producers and inequality of incomes among consumers, allocation of resources under capitalism is far from perfect.

3. Johnson and Kross, The Origin and Development of American Economy, p. 356.

4. Pigou, A.C. Socialism Vs. Capitalism, Chapter II.

individual interests of a few rich persons at the cost of the entire society. On the other hand, socialism aims at realising social welfare as well as individual welfare.

Since the aim of socialists is to abolish the cause of exploitation, it is proposed to abolish private property[1] so far as it leads to exploitation.[2]

But in his note on 'Implications of Socialist pattern of Society' presented at the Otty Seminar, Dr. V.K.R.V. Rao explains his views on our mixed economy based on socialist pattern and how there would be a large scope for the private sector with little scope for exploitation, and how the latter would be prevented. He says,

"In our conception of the socialist society...there is room for private property in means of production, provided, however, this is limited to small units of production and not extended to individual firms or corporations engaged in large scale enterprise in the private sector. As far as large scale units are concerned, they should be in the public sector. . . . During the transitional period, however, private property will be permitted in existing large scale concerns in industry, while the question of their expansion will be decided on individual merits and in accordance with the production requirements of the plan."[3]

Thus, when private property in the means of production would be limited to that needed for small scale production as in the case of agriculture or small industries, there would be little scope for exploitation. It is not the absence of profit that characterises co-operatives and collectivist societies, but it is the surplus over profit which has been eliminated there; whereas the driving force of capitalist production is the desire for maximisation of surplus over profit.

Dr. Rao further says, that as regards public versus private

1. This is theoretically true. But unless moral values are elevated, public ownership may be worse than the private one. Here lies the difference between Gandhian thought and Marxism. Gandhiji's insistence on change of heart (moral values)not only elevates socialism to a higher plane but also requires a revision of Marxism. Thus there is need of a cautious movement towards the change-over from the private to public ownership of large-scale production. What is needed is a great deal of moral education, both on the national scale and on individual basis, without which even institutional changes would not help much in this direction.

2. Marxist theory of exploitation is well known. Labour is ,forced' to work for longer hours than would be needed merely to produce the goods required for its own remuneration at the existing standards of living. That is, labour produces a total value greater than its current wages. This surplus value, which would have accrued to the workers themselves had they owned the means of production, now accrues to capitalists. It is the appropriation of this urplus value, which constitutes exploitation. (This surplus value must not be confused with 'Prime cost' or 'Supplementary cost'. Vide Chapter I).

3. Rao, V.K.R.V., Op.cit., A.I.C.C. Economic Review, July 22, 1959, p. 36.

2. Because profit is one of the cost items, it does not normally consist of surplus (vide p. 457).

sector, there seems to be a large scope for the private sector in a socialist society in India, and even in public sector there would be ample scope for decentralised management and a ceriain measure of dispersal of flexibility and initiative even in the planning of economic decisions.[1] What a socialist society requires is, that no private individual or interest is able to influence significantly either output or price in any given field, and also that no private individual or corporation continues as a large employer, nor has the opportunity to have economic power.[2]

In so far as private property is earned by one's own efforts (mental or physical exertion), it is to be permitted in the 'socialist pattern' of our concept. Inherited property is a source of exploitation, idleness and inequality. It is the source of exploitation, because it consists of surplus. The inheritor does no physical or mental exertion to inherit the property. On the other hand, it might be the result of waiting on the part of the inheritor till his or her ancestor dies. Waiting does not cause a damage to be recouped. Hence inherited property does not constitute 'cost-income' but wholly 'surplus-income.'[3]

Further, inheritance fosters idleness, because it confers differential advantage relating solely to the accident of birth, and not in any way the 'fruits of man's own labour.' It goes against the principle that every citizen should have an equal opportunity of attaining the highest rewards. Differences in opportunities are the natural result of large inequalities of unearned incomes. (The inherited property is unearned income for the inheritor, even though the earned income of his fore-fathers). Besides this, the inheritors receive a dividend of national income without substantially contributing to its production.

Even large inequalities of earned income may be considered unjust, if they reflect differences in opportunity and not only differences in ability.

Socialism provides with the dictum "to each according to his capacity and to each according to his work."[4] This principle involves a fair treatment to every body and does not require any sacrifice on the part of any member of society.[5] At the stage of

1. Ibid.
2. Ibid.
3. Vide p.
4. Crosland, however, remarks that this is not a very sensihle phrase even when applied to incomes from work. Most work-incomes are not the fruit of a man's individual effort, but of joint production to which many different individuals have contributed. How this joint output should be, and will be imputed to individuals, is a matter of personal judgment, the market structure of relative prices and incomes, relative bargaining power, and historical convention. (Crosland, C. A. R. Future of Socialism, p. 296).
5. ". . . a socialist society has as its root a moral and social philosophy significantly diffrent from what lies at the base of a capitalist society. . . . . fraternity, equality, solidarity, dignity, individual worth and co-operation are all specific concepts, that not only have intellectual acceptance in a socialist society but form the actual content of the motivations and incentives that lie behind action and behaviour in that society" (V.K.R.V. Rao, Op.cit, Economic Review, July 22, 1959 p. 35).

communism the central theme is "To each according to his capacity and to each according to his needs." This would involve a sacrifice on the part of those who produce more than their needs, but they would willingly help those unfortunate members of the society who cannot earn enough to satisfy their primary needs. When human nature is changed up to this standard, it would tend to grow up to a state wherein each would act virtuously and altruistically helping all and everybody to the best of his capacity. This would be the stage of Anarchism where the State would wither away. However, as Laider points out, "no philosopher however wise, could decide in detail the exact kind of industrial regime which a future social group would accept. In the utopian stage of socialism, numerous philosophers and humanitarians pictured an ideal commonwealth which needed but to be perceived to be accepted.... they were troubled not at all by the fear that society was not ready for the leap from private to common ownership of industry, that a privileged class could not, as a class, be depended upon to give up its privileges without pressure from below."[1]

It is wrong to hold that socialism sacrifices the individual for the society. It will only transfer the ownership of the means of exploitation from private persons to the State. "It is not possible to do away altogether with employee status in the private sector. That will be permitted in the socialist society of our conception."[2] But the means of production owned by any one individual will not be such as to give him opportunity to employ a large number of workers onhire. Moreover, imposing a ceiling on a number of persons that can be employed, and instituting adequate safeguards—legislative or otherwise, will prevent these employees from being exploited. There will not be many employees in the private sector. Either they will be self-employed or work in co-operatives or be employed in the public sector.

An industry or trade that leaves no room for surplus over wage, salary, profit, or interest must be considered socialistic. Wage, salary, interest and profit do not contain an element of surplus. They merely cover the cost of production.[3] Further, professor J.K. Mehta has explained as to what is surplus and what is non-surplus part of income (the former being called 'surplus income' and the latter 'cost income'). In his own words, "Only that part of income is, in most cases, of the nature of necessary remuneration which goes to repair the damage done to the body and mind of the producer."[4] All productive functions cause damage to body and mind which must be reimbursed. On the other hand, "the damage caused by waiting and uncertainty-

1. Laidler, Harry W., A History of Socialist Thought, p. 678.
2. Rao, V.K.R.V., Op.cit., Economic Review, July 22, 1959, p. 36.
3. Vide Chapter I.
4. Mehta, J. K., 'Functions of Production and the True Nature of Incomes'. Published in "*Rivista Internazionale di Scienze Economiche Commercial*" (1959) No. 10 (Italy), p. 8.

bearing is registered only on the psychological plane, and, consequently, its repair needs merely the anticipation of future results."[1]

Socialism involves the collective ownership only of those things which are socially used. Social ownership is looked upon not as an end in itself, but as a means of abolishing exploitation. Where no exploitation is involved, private ownership will, probably, remain unchanged even under socialism.

Nationalisation of all industries will mean greater approach to communism and more or less departure from socialistic pattern envisaged in India. Therefore, a well-graded via media has to be found, and we have to proceed gradually with cautious steps to attain our objective, and the rigorous methods of direct control of purely socialist or communist States are not to be employed, and the goal is to be achieved in a democratic way.

Role of Taxation

Taxation can be employed to cut off surplus values as an aid to the establishment of socialistic order. Taxation is sometimes the favourite weapon of intervention. It no longer aims under such situation, exclusively or predominantly at increasing State revenues.[2] They begin to fulfil an entirely different function, and their relation to Public Finance vanishes. Most taxes are employed for this purpose to alter the social order.

Adolft Wagner taught such a use in Germany which was later on generally accepted. He gave 'politico-social', conception of taxation against the 'pure fiscal' one. Lloyd George was the first to use taxation as an instrument of social reform in Britain. Mr. J. M. Keynes also approaches this method and argues for progressive taxes, like income-tax, surtax and death duties, as a means of correcting inequitable distribution of wealth and incomes. But he did not work it out in detail and it was done by Alvin Hansen and Keynesians.

Marx has, however, spoken unfavourably of the efforts to alter the social order by measures of taxation. He emphasised that taxation reform alone cannot replace socialism. His views on the effects of taxes within the capitalist order were also different from those of the ordinary run of socialists. He said, that to hold that corporate income-tax does not affect the workers, was truly absurd. In the present social order where entrepreneurs and workers stand opposed, the bourgeiose generally compensates itself for higher taxation by reducing wages or raising prices. This we have dealt with while discussing incidence,[3] that corporate income-tax, or profits tax can most probably be partly shifted. Thus it may appear that the role of taxation as an instrument of changing social order is limited.

1. Ibid., p. 4.
2. Under capitalism, however, the most important long-run source of funds is taxation, and taxes are levied for this purpose.
3. Vide Chapter I

But we have discussed in Chapter I, that so long as the tax is levied on surplus, it will not be shifted. Now, the essence of socialism consists in the theory of surplus value. It is through this surplus that exploitation is carried on, and this surplus is over and above the normal wage, salary, profit and interest. Thus taxation can be employed to cut off surplus without affecting prices.

Taxation as an Instrument of Achieving Equalities of Income and Wealth

Inequalities of income and wealth go against the character of a socialist State.[1] A socialist State may have certain amount of inequalities, only if it does not involve exploitation. The essence of socialism is the abolition of class and providing equal opportunities to every body,rather than the achievement of perfect equality of income or wealth. A society in which the means of production are socially appropriated and income from ownership had disappeared would be a socialist State, even though it tolerated a considerable personal inequality.[2]

As a matter of fact, differences could not vanish; as, according to the differences in the capacities of individuals, differences in their earnings and economic status are bound to exist. It is wrong to say, as it is some-times asserted, that socialist views are to make every body equally rich or equally poor. It is a digression from truth and reality. Socialist views definitely recognise that individuals differ in their capacities and abilities.

The amount of inequality which will be permitted would be personal inequality, and not class inequality. It would not involve exploitation which the capitalist system involves. However, a limit is to be laid down to check individual inequalities of incomes and wealth if they are very large, which would tend to destroy the character of a socialist society and lead to re-emergence of a capitalistic one.

A country like ours which is not completely socialised requires only a maximum limit on the amount of inheritance permitted to large inherited fortunes, rather than complete disappearance of the right of inheritance. Then the question arises, what should be the maximum limit for the amount of inheritance permitted. In

1. Keynes also advocated redistribution of national wealth in favour of the poor, aiming at a certain amount of equality. But his ground of supporting equality is quite different from equity considerations. According to him if wealth is transferred to the poor, who have a greater 'propensity to consume' than the rich, it shall raise total consumption and hence effective demand.

In his earlier works *e.g.* 'The Economic Consequences of Peace', Keynes was opposed to re-distribution of national wealth and even tried to justify inequality on the ground that it was conducive to accumulation of capital. Later on in his 'General Theory' he opposed unequal distribution of wealth on account of adverse effect on consumption function and as a result on the effective demand.

2. Dickinson, H.D., Economics of Socialism (1939), p. 132.

Chinese leaders have repeatedly stressed their disapproval of equalitarianism on grounds of incentives' though they are followers of Marxism.

answer, it is difficult to say exactly where this would be set. But certain broad principles may be laid down for this purpose. For example, the amount of inheritance permitted should be such that no widow would be left without minimum means of subsistence[1] so long as she lives. Young married couples in middle class society would be able to start their lives together comfortably. One must not be deprived of their residence provided by their ancestors as it is the fundamental right of every one to have a roof and get square meals. And some such other considerations should be made while fixing the maximum amount of inheritance which provide for a kind of security to the dependant members of a joint-family, and which is the main characteristic of the Indian life.

But as a principle, no individual inheritor should be allowed to inherit sufficient to permit a prolonged luxurious existence on the unearned income. These are definitely socialistic views. They are not against all thrift and saving or the continuity of family life or the living standards of life, as it is thought of by certain critics. It needs emphasis once more that the socialist aim is the removal of large inequalities, and not the reduction of all to the lowest common standard. It aims at social justice and genuine equality of opportunity.

Redistribution of Wealth

If at all private property is allowed, inequality is bound to exist which must be corrected adequately through taxation and public expenditure.[2] Even in socialist States progressive taxation is employed to redistribute some persisting inequality. In the ages of transition from the capitalist to the socialistic society the need for redistribution is the greatest. Voluntary flow of wealth from the rich to the poor would simply be an utopian idea, and some kind of compulsory methods[3] are to be employed. Taxation is one such method necessary for bringing about redistribution.

Property is the major source of inequality. Death duty[4] (along with gift-tax to avoid evasion) is one of the methods to correct inequalities of wealth. Redistributive effects of death duty are rather slow, since the estate passes on the average only once in, say, 30 years. At the same time the forces of accumulation tend to swell up the inherited property again. There is thus the

1. Vide Chapter I.

2. The principle of redistribution needs no separate treatment. The principle of least aggregate sacrifice or the more comprehensive principle of maximum social welfare (which we have already discussed in Chapter I), leads to it.

3. According to the philosophy of Mahatma Gandhi, taxation is, however, an act of application of force (violence). He believed in the advocated trusteeship of the rich. He said that the money that belongs to the rich should not be taken from them by force. It is desirable that wealth should flow from the rich to the poor. He said that the rich should willingly give their money to the poor. As a matter of fact, Gandhiji rightly said that redistribution of wealth must be affected by the process of giving rather than by that of taking.

4. Also vide, Chapter IV, p. 187.

contention that the levy must be sweeping and largely eliminate, instead of merely reducing, the larger estates. A large capital levy may bring about this end, but such a levy would increase resentment and discontent, and would not be suitable. Rather, it is desirable to reach the objective by steady and evolutionary stages.

An annual tax on capital is suitable to supplement death duty. The former has been little discussed by socialists. Only a few authors[1] have discussed it. The tax would have a continuing influence on the redistribution of property without having the disadvantages of a once-for-all large scale capital levy. With high rates of tax and surcharge on incomes, there is every possibility that capital tax might raise the burden of tax over 100% and will be paid out of capital. Thus, it would be no doubt a useful weapon in attacking inequalities of capital wealth.

Evils inherent in the maldistribution of private capital are magnified by the gains, which arise out of the capital. Capital gains cause inequality in the purchasing power and are,therefore, to be condemned on socialist grounds. The property owner who makes gains during an inflation or fall in interest rates, receives a relative increase in spending power as compared with those who possess fixed interest securities, or whose incomes are fixed in money terms. Capital gains also arise due to rising profits and dividend payments of private industry.[2] Thus there lies a need for the levy of capital gains tax.[3]

But merely eliminating capital gains without eliminating or reducing large capital wealth itself, would not serve the cause of 'socialist pattern.' The central and most indefensible cause of inequality, the uneven distribution of property, is to be eliminated and then, "it will become possible both to more actively encourage growth of small property, and to take a more favourable attitude towards the taxation of incomes from work. . . . the more so, if other measures designed to remove the rent element in gross work-incomes are also successful."[4] Further, "socialists have no desire to penalise small savings or enterprise or initiative; their aims are social justice and genuine equality of opportunity. Once these are achieved, and the dead hand of inheritance removed, we shall more easily be able to lighten the load of taxation on incomes from work, and restore to individual effort and enterprise some of the rewards which the unequal distribution of property 'now forces us to tax away."[5]

1. For example J.R. Hicks, U.K. Hicks and L. Rostas, in the Taxation of War Wealth, (p. 190) and N. Kaldor—'Expenditure Tax' (p. 33).

2. The Radcliffe Commission examined in detail for and against this aspect of the tax.

3. Also vide Wealth-tax, Chapter IV.

4. Crosland, C.A.R., Op. cit., p. 331.

5. Ibid., p. 332.

Redistribution of Income

Redistribution of Income in India—Reduction of inequalities of income in an under-developed country like India is to be sought for by raising incomes at the lower end rather than by cutting it down from the upper end as we have already stated. However, gross inequalities are to be corrected. Besides, measures are to be taken to prevent emergence of inequalities, rather than taking palliative measures to reduce them. In China, for example, taxation is not preoccupied as a measure of reducing and redressing economic inequalities or ending other social inequalities. Direct measures for realising this objective are being mainly relied upon.[1]

For the community as a whole, a widely used method of studying income distribution is the device of drawing a Lorenz curve[2].

Table 75

Distribution of Income of Individuals Before and After Tax (1948-49)

Grade of Income	Number of Assessees	Total Income Assessed Rs. Crores	Tax Payable Rs. Crores	Income after Tax Rs. Crores
Below — 5,000	81,202	25.74	0.89	24.85
5,001 — 7,500	25,358	15.56	0.89	14.67
7,501 — 15,000	29,030	30.37	2.79	27.58
15,001 — 25,000	10,770	20.63	3.14	17.49
25,001 — 50,000	7,290	24.94	4.91	20.03
50,001 — 90,000	2,463	16.10	3.42	12.68
90,001 — 100,000	285	2.72	0 60	2 12
100,001 — 200,000	952	13.03	2 74	10 29
200,001 — Over	467	19.04	3.98	15 06
Total	157.817	168.13	23.36	144.77

Source : Central Board of Revenue, Income-Tax Revenue Statistics (1949-50), All India Statement No. 5

1. Gyan Chand, The New Economy of China, p. 328.

2. There are two other methods also found to be appropriate in most countries, but they have certain drawbacks. For example : Vilfred Pareto's famous law of distribution of income (which shows that the larger the fortune, the smaller the number of those who possess it), is only applicable to the higher ranges of income, but is totally inapplicable to the lower ranges.

Colin Clark rejects the applicability of the law in India on the ground that Pareto's straight line is curved in case of India, and Shirras does so on the ground that the distribution indicated by it does not conform to experience. Another method of describing the income distribution is the log-normal curve which is good for the lower ranges of income but is quite unsatisfactory for the higher ranges. Thus Lorenz curve provides a convenient method for measuring the inequality of incomes.

to the income distribution data.[3] In such a curve the cumulative percentage of income receivers at each succeeding income level is plotted along the horizontal axis and cumulative percentage of total income at each level along the vertical axis. The diagonal which makes an angle of 45° is the line of equal distribution. The further the curve is away from this line, the more unequal is the distribution of income.

The Lorenz curves to the following data for the years 1948-49 and 1957-58 have been drawn. (page 324)

Table 76

Cumulative Percentages*

(1948-49)

Grades of Income	Number of Assessees	Total incomes Assessed Rs Crores	Income after Tax Rs Crores
Below — 5,000	51.45	15.42	17.16
5,001 — 7,500	67.52	24.56	27.36
7,501 — 15,000	85.93	42.62	46.41
15,001 — 25,000	92.78	54.33	58.42
25,001 — 50,000	97.40	63.78	72.26
50,001 — 90,000	98.92	73.34	80.01
90,001 — 100,000	99.11	75.33	82.48
100,000 — 200,000	99.74	82.14	89.06
200,001 — Over	100.00	100.00	100.00

* Calculated from Table 75

Table 77

Distribution of Income of Individuals Before and After Tax (1957-58)

Grades of Income	Number of Total Income Assessees Assessed	Rs. Crores	Tax Payable Rs. Crores	Income after Tax Rs. Crores
Below — 5,000	1,61,251	66.24	0.95	65.29
5,001 — 7,500	1,96,026	102.06	2.43	99.29
7,501 — 15,000	1,54,798	159.89	8.45	151.44
15,001 — 25,000	48,602	92.43	9.04	83.39
25,001 — 50,000	27,219	91.75	20.45	71.30
50,001 — 90,000	6,441	41.34	16.09	25.25
90,001 — 100,000	551	5,24	2.57	2.67
100,001 — 200,000	1,663	22.2	11.82	9.41
200,001 — Over	611	23.87	16.76	7.11
Total	5.70.162	605.05	89 56	515.49

Source : Central Board of Revenue, op. cit., All India Statement No. 5.

1. Income-tax Revenue Statistics prepared by the Central Board of Revenue gives data regarding assessments, income and tax assessed every year. This statistics has certain deficiencies, which was pointed out by the First Finance Commission and the Taxation Enquiry Commission in their Reports (op. cit. p. 5 and op. cit. Vol. I, p. 19 respectively). Since no better data are available, it has to be depended upon. However, it may still serve well the purpose of giving an idea of the broad trends and magnitudes.

Table 78

Cumulative Percentages*

(1957-58)

Grades of Income	Number of Assessees	Total Income Assessed Rs. Crores	Income after Tax Rs. Crores
Below — 5,000	28.24	10.94	12.62
5,001 — 7,500	57.89	27.81	31.84
7,501 — 15,000	85.09	54.24	61.36
15,001 — 25,000	93.33	69.53	77.49
25,001 — 50,000	98.24	84.68	91.65
50,001 — 90,000	99.47	91.34	96.50
90,001 — 100,000	99.61	92.38	96.69
100,001 — 200,000	99.91	96.54	98.83
200,001 — Over	100.00	100.00	100.00

* Calculated from Table 77.

The adjoining graph gives the Lorenz curves, showing degree of inequality in the distribution of income in our country in 1948-49 and 1957-58, 'before' and 'after' income-tax.

The area enclosed between the line of equal distribution and the Lorenz curve gives the measure of inequality. It is evident from the graph that the aforesaid area for 1948-49 was larger than that for 1957-58 (both before and after tax), which shows that there has been a reduction in inequalities in income since 1948-49. Further, if we look at the point on the vertical scale marked 20, we find the corresponding reading on the horizontal scale of 60.5 on the curve for 1948-49 and 46 on the curve for 1957-58, both before tax, which means that 20% of the income was received by 60.5% of assessees in 1948-49 and the same percentage of income was received by 46% of assessees in 1957-58. In this way readings have been taken to form Table 79. Table 80 has been derived from Table 79 which gives figures complementary to those in Table 79. For example, if Table 79 shows that 20% of income was received by 60.5% of assessees, then Table 80 shows that the remaining 80% of the income was received by remaining 39.5% of assessees, and so on.

Table 79 shows that in 1948-49, 5% of the income was received by 21.5% of the aseessees in the lower-income group, while in 1957-58 the same percentage of income was received by only 12.5% of assessees in that group.

Table 80 shows that in 1948-49, 20% of the income was received by 0.5% of assessees in the upper-income group, while in 1957-58 the same percentage of income was received by 3% of assessees in that group.

Lorenz Graph Showing Distribution of Income

Before and After Tax

(1948-49 and 1957-58)

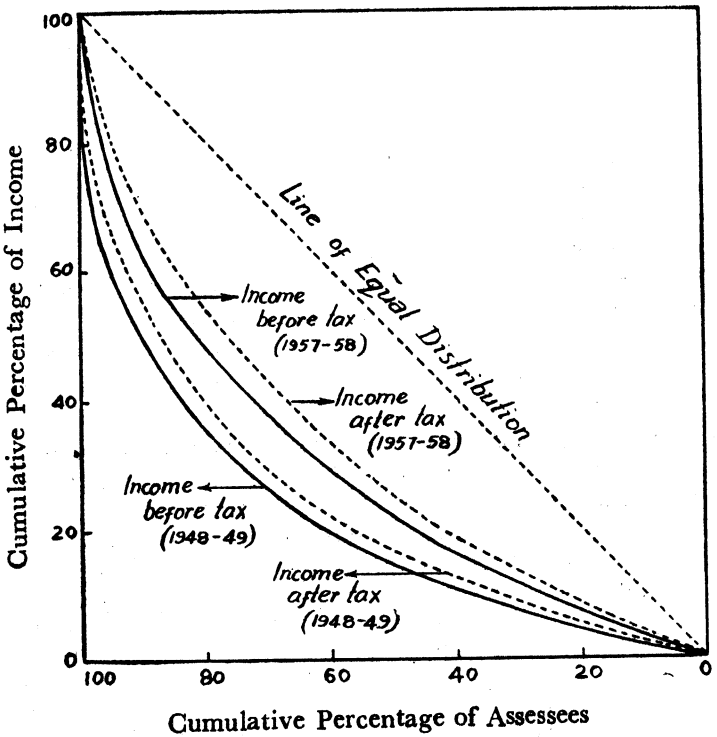


Table 79

Recipients of Income Before Tax (Ascending)

Percentage of Income	Percentage of Assessees 1948-49	1957-58
5	21.5	12.5
10	38.0	26.0
20	60.5	46.0
40	84.0	72.0
60	95.0	89.0
80	99.5	97.0

Table 80

Recipients of Income Before Tax (descending)

Percentage of Income	Percentage of Assessees	
	1948-49	1957-58
5	78.5	87.5
90	62.0	74.0
80	39.5	54.0
60	16.0	28.0
40	5.0	11.0
20	0.5	3.0

The proportions in which the incomes were distributed in different income-groups are given by the following Tables. Figures for Table 81 have been read from the graph. Table 82 has been derived from Table 81 in the same manner as Table 80 was derived from Table 79.

Table 81

Percentage Distribution of Income Before Tax (ascending)

Percentage of Assessees	Percentage of income	
	1948-49	1957-58
20	5.0	8.0
40	11.0	16.5
60	19.5	29.0
80	35.5	48.0

Table 82

Percentage Distribution of Income Before Tax (descending)

Percentage of Assessees	Percentage of income	
	1948-49	1957-58
80	95.0	92.0
60	89.0	83.5
40	80.5	71.0
20	64.5	52.0

From Table 81 we find that in the lower-income group 20% of the assessees held 5% of income in 1948-49 and the same number of assessees held 8% of income in 1957-58, meaning thereby that the assessees in that group enjoyed relatively about 3% more of income in 1957-58 than in 1948-49.

From Table 82 we find that in the upper-income group 20% of the assessees enjoyed 64.5%of income in 1948-49 while the same percentage of assessees in that group enjoyed only 52% of income in 1957-58, thereby showing that 20% of assessees in that group possessed in relative terms about 12.5% of income less in 1957-58 than in 1948-49.

Similarly, we can find out for other groups.

Next, as regards the impact of income-tax on distribution of incomes, we find from the graph that the redistributory effect of the tax in 1957-58 was greater than that in 1948-49, as the degree of inequality after tax in 1957-58 was reduced to a greater extent than it was in 1948-49, which is shown by the fact that the area enclosed betwen the curves 'before' and 'after' tax was greater in 1957-58 than in 1948-49. The redistrributory effect of income-tax in 1957-58 is clear from Tables, 83 and 84.

Figures for Table 83 have been read from the graph. Table 84 has been derived from Table 85 in the same manner as Table 80 was derived from Table 79.

(The proportion in which the incomes in different income-groups were affected is given by the following Tables, 83 and 84.)

Table 83

Distribution of Income Before and After Tax (Ascending) 1957-58.

Percentage of Assessees	Percentage of Income	
	Before Tax	After Tax
20	8.0	9.0
40	16.5	18.5
60	28.5	34.0
80	48.0	54.0

Table 84

Distribution of Income Before and After Tax (Descending) 1957-58

Percentage of Assessees	Percentage of Income	
	Before Tax	After Tax
80	92.0	91.0
60	83.5	81.5
40	71.5	66.0
20	52.0	46.0

From Table 83 we find that 20% of assessees in the lower group held 8% of income before tax and 9% after tax, thereby enjoying in relative terms 1% incomee more after tax than before tax.

According to table 84, 20% of assessees in the Upper-income group held 52% of income before tax. After tax, the same percentage of assessees in that group held in relative terms 6% less of income than before tax.

This illustrates the redistributory effect of income-tax.

Redistribution of Income in Some other Countries

In Great Britain the process of redistribution of income by means of the taxing power affords an outstanding example. The objective of the labour party is said not to be complete socialisation (about 80% is to be left to private ownership).[1] However, the socialist philosophy of the labour Government may be indicated by some of the changes which were made in the tax structure, particularly in the year 1948. The Government in its equalitarian policy took much of the incomes of those in the higher brackets, while it raised the exemption limit so as to relieve the lower-income groups. In 1948, the total exemption limit was raised from £ 120 to £ 135, and the earned-income credit was increased from 1/6th of earned income (up to £ 250) to 1/5th (up to £ 400). In 1947, the first £ 50 of taxable income was taxed at 15%, the next £75 at 30% and the rest at the standard rate of 45%. In 1948, the first £50 was to continue to be taxed at 15% but the 30% rate was to apply to the following £200 before the standard rate of 45% applied. It was estimated that these changes would relieve some 500,000 low-paid workers, of all income-tax payments, and lower the payments considerably for others. While, sur-tax rates were to continue as before, running from 10% to 52.5%, any income affected by the maximum rate would be paying total income-tax and sur-tax of 97.5%.[2]

Another tax development in 1948, was the imposition of a special levy on investment income. This tax was to be paid once for all, and applied only when the tax payer's total income from all sources exceeded £2,000 and his investment income exceeded £250. The rate of tax rose from 10% on the investment income between £250 and £500, to 50% on income exceeding £5,000. Thus the combination of the special levy and income-tax were almost confiscatory in character, in some instances produced rates well over 100%. Tax revenue as the percentage of national income was about 40% in that year.[3]

1. British Information Services, Labour and Industry in Britain, Sept. Oct., 1947, p. 162.

2. Data taken from Blodgett, Ralph H., Comparative Economic Systems, p. 567.

3. Ibid.

In France wealthy classes suffered less, where taxation continued to be lenient towards the well-to-do.

In America the picture is totally different. Despite the tremendous national debt, and despite the heavy taxation that continued after war, all classes enjoyed a degree of prosperity.The rich became more numerous and the poor virtually ceased to exist due to high degree of prosperity.

In Italy and Germany there was no question of redistribution as they were impoverished due to War.[1]

The Taxation applied to U.S.S.R. aimed from the very beginning the objective of redistribution of national income, besides other objectives (vide Appendix V).

Incentives in The Socialist Economy

The extent to which a reduction in income through direct or indirect taxation will lead to increased effort to maintain real income, would depend upon various factors. Among other factors, the rigidity of the standard of living of various income groups and the degree of social and economic mobility into higher levels—are the leading ones. For the persons who are accustomed to a fixed standard, a reduction in income by taxation may be offset by increased effort, if it is possible. But a tax increase that coincides with expanding incomes which would be expended on luxury goods or other things, which do not go to form an integral part of a standard of living, would be much less likely to be balanced by extra effort. On the other hand, if there is a move towards a desired and attainable different standard of living, a tax increase coinciding with an income increase may still lead to additional effort.

It is wrong to think that normal economic incentives have no place in a socialist society, the difference being in their operation and incidence, which is planned in the light of the social objectives. For instance, the Soviet economic system is oriented towards incentives at the expense of equity.

The preservation of incentives is probably the most important and the only objective of tax policy of the Soviet Union. Wages and salaries are sharply differentiated for incentive purposes.[2] In addition to incentive payments paid from the regular wage

1. J. Salwyn Schapiro, The World in Crisis, pp. 122-123.

2. In China also there are wage and income differentials. Chinese leaders have, however, a strong disapproval of equalitarianism. Mr. Chou En Lai clearly pointed out in his report submitted to the National People's Congress that "Equalitarianism is a type of petty bourgeois outlook which encourages backwardness and obstructs progress; it has nothing in common with a socialist system and marxism. Equalitarianism damps down the enthusiasms of workers and employees in acquiring technique and raising labour productivity and is, therefore, harmful to the development of economic construction. We must, therefore, resolutely oppose equalitarianism." (Quoted in Dr. Gyan Chand's, The New Economy of China, p. 221).

fund, there are bonuses paid to workers and managers from the Director's fund, Stalin prizes for outstanding accomplishments in all fields, and a host of non-monetary rewards. This system of rewards and differentiated wages and salaries, however, does not remain undisturbed by some direct taxes, though, of course, not much.

The significance of taxes in the Soviet economy for managerial incentives is probably small, because the progression of direct taxes is too small to make them work higher for compensating the reduction in their real profits. It is in this era particularly that other motivations are likely to be dominant. Among these, the more important may be premiums for fulfilling and over fulfilling the output plan, premiums for lowering costs, benefits from Director's fund.

The Soviets rely primarily on commodity taxation to exploit 'money illusion',[1] and it is on the whole roughly proportional. Therefore, the Soviet tax system is neutral towards work incentives. Incentives are, however, provided in other ways as men tioned above.

From this we may conclude that socialistic steps in a country should not be supposed to do away with any socially desirable incentive,[2] but "it would add to the strength of the incentives, which inspire mankind."[3] Prestige and power are often sought for, by earning a large income and accumulating wealth. But under a socialist economy this kind of incentive is not so important as the noble incentives such as altruism, enthusiasm for economic planning and socialist competition, or the effort of the workers of various enterprises to out do each other in the matter of increasing production. Public honours might be given for unusual accomplishments in production. Besides this, the need for security against unemployment, old age and other economic misfortunes would also serve as good incentives Underlying every thing else would be an ultimate requirement that every able man must work if he wishes to get enough to eat.

1. Money illusion has a bearing upon incentives. It was to minimise the negative impact on incentives of its huge tax programme that the State ceased to depend on direct taxation for meeting its increasing financial requirements. The importance of direct taxes in budgetary receipts declined by almost 2/3rd from 1928-29 to 1935. (Also vide Chapter I).

2. Adjustment of socially desirable incentives, on the other hand, must be achieved to a great extent by the use of indirect controls. Taxation is one such method which serves this purpose. Discriminatory tax policy is employed, because it is necessary to adjust incentives in accordance with the overall plan. This is particularly so in the agricultural sector of the Soviet Union, which is not State-owned. Taking, for example, the case where the increase in the out-put of a particular crop is desired at the expense of another. Then the tax on the former might be removed, while that on the latter raised.

3. Spargo and Arner, Elements of Socialism, p. 369.

Conclusion

The principle of maximum social welfare, which is recognised as the ultimate objective by all countries of the world, is essentially a principle of socialism. Whatever '-ism' or ideology a country may follow, it is bound to adopt socialist principles to some extent at least, according to its requirements for the achievement of the the objective of maximum social welfare. We have seen how even America, an essentially capitalistic country, has adopted the socialistic principle of checking the accumulation of wealth in the hands of the very rich through highly progressive taxes. We have also seen that the same principle was adopted in Great Britain and other countries. It is, therefore, evident that in a country in which there is wide disparity between the rich and the poor socialist principles had to be borrowed and adopted as an economic doctrine and not as a matter of mere ideology.

In an under-developed country like India, however, maximum social welfare cannot be attained without industrial advancement and sufficient increase in production of goods and the rise in national income. In a socialist country like Russia or China, mostly public sector takes up production. But in a country like India which is trying to pursue a democratic socialist way, it is not possible to do away with private sector completely. It is necessary to preserve both public and private sectors, and in fact, the latter has to be encouraged to work over wider fields in certain directions. Both public and private sectors are to be so regulated as to work together for national welfare. In other words, the only economy suited to India is a mixed economy, or as Dr. Gruchy points out, it is a 'public-private enterprise' economy.[1] Private sector has thus to be harnessed to help in the economic cause of the country. All that is needed is so to regulate the functioning of the economy as to eliminate from it the chances of exploitation. This, we have shown, can be suitably eliminated or regulated through the instrumentality of a progressive tax system.

We have pointed out that the essence of socialism consists in the elimination of surplus. It is through surplus that exploitation it carried on. An industry or commerce that leaves no surplus over wage, salary, profit, rent and interest, must, therefore, be considered socialistic. In socialism State-ownership is looked upon as a means of abolishing exploitation. If there is no exploitation private ownership would not require to be changed necessarily in our socialist pattern. Thus, where the function of taxation is to cut off surplus it comes forward as an aid to the establishment of the socialistic order.

If, therefore, the exploitation by private sector could be eliminated or reduced to a negligible minimum, by an appropriate tax system, it would be as acceptable a device for the estab-

1. Gruchy, Quoted from Dr. Baljit Singh's Economic Planning in India, p. 9.

lishment of socialistic order, as State ownership. In the public sector too, what is needed is the change of hearts and the change in the moral values so much insisted on by Gandhiji. This has to be brought about because without it public ownership might well be worse than private ownership. Gandhiji's concept would, in fact, raise Marx's socialism to a higher plane.

Thus maximum social welfare can be achieved by properly harnessing the private sector for the benefit of society, rather than by eliminating it altogether from our economy. Therefore, the socialist pattern as envisaged in our country, which has the mixed economy as its pivot, is the best form of economic doctrine for our country which is under-developed and poor.

Moreover, our country has its own heritage of ideology, culture and principles. It is a country which has shown the world, the noble ideals based on high moral values, the ideals of co-existence, tolerance and Ahimsa. It would have to depart more or less from those ideals and from moral values it has preached if it were blindly to adopt the ideology of any of the '-isms'. We should be prepared to take all that is good from socialism and capitalism, without being a slave to their complete ideologies. We should take the best from all, and evolve an economic system best suited to the conditions of our country, to our needs, and to our spirit. This is, what should be conceived as the aim of our ultimate objective—the socialist pattern, based on mixed economy.

It is once again to be pointed out that in doing so our country is not going to be a slave of one ideology or the other, but will independently shape its own destiny by following a doctrine based on a homogeneous combination of all that is good and consistent with human values. This type of economic doctrine lies midway between the socialist and capitalist economy.

In fact, modern economists have begun to realise that the modern economic system which is growing is really neither capitalism nor full socialism. Gruchy, a foremost contemporary among the institutional economists whom we have referred to previously, points out that the merging economic system throughout the world "exemplifies the principles of neither laissezfaire capitalism nor full socialism."[1] We have already discussed, how even America had to adopt socialist measures. We know that even China has adopted mixed economy and is encouraging private enterprise and has pleaded that the equalitarian principle is dangerous and is likely to take away incentives. All that is needed is, as we have said, the removal of surplus and thereby the prevention of exploitation.

Therefore, (with the exception of some factors which might be specially suited to the requirements of India) this new doctrine

1. Gruchy, Quoted from Dr. Baljit Singh's Economic Planning in India, p. 9.

evolved for our country is in fact the one to which the world seems to be unconsciously drifting. The economic system embodied in the 'socialist pattern' of our conception is a pleasant mixture of socialism and capitalism. It will bring about an increase in national production and wealth with the joint efforts of both the sectors. The national wealth so produced will have to be employed and distributed in a well thought-out and planned way on socialistic lines. But this is not all. A well planned system of taxation will also have to be used to reduce the high disparities in the income and wealth arising in the future and to eliminate exploitation (besides the various other functions which taxation has been described to perform).

I feel confident that the aforesaid policy would help us to reach our goal of maximum social welfare and deserves to be pursued with such modifications as the circumstances may require. It is unwise to be carried away merely by sentiments, and it is unwise to attempt to reach our ultimate goal by blindly pursuing the ideology of a fully socialist of a fully communist State, none of which is suited in its entirety to the conditions of India. What is important for our country is not the ideology of any 'isms.' Economics in fact preaches no 'isms'. It is the end of maximum social welfare which is the goal, and the aforesaid via media course seems to be suited to the condition of this country which is also in harmony with the latest experience of economists.

But maximum social welfare in the real sense of the word can only be attained when we reach the end of wantlessness. And this end can be attained only by total elimination of wants, both present and future. Wantlessness does not mean actionlessness. One has not to renounce action. Action is to be performed, the only difference being that one should not be driven by the desire for satisfaction of wants of 'individual self' but by the sense of duty and the dictates of sublime conscience which emanate out of the invisible directive forces of God, the supreme power. Actions are to be directed towards the welfare of the 'universal self,' with no desire for selfish gain.

When the end of wantlessness has been attained the work of the State would be greatly reduced. "It would not be necessary then to tax the rich for the benefit of the poor."[1] Mahatma Gandhi's trusteeship of the rich would then be a reality. As Professor J. K. Mehta says, Gandhiji actually "wanted people to be wantless.[2]

Economics, according to Professor Mehta "is a science that studies human behaviour as a means to the end of wantlessness."[3]

1. Mehta, J.K., Advanced Economic Theory, p. 21.
2. Mehta, J.K., op. cit., p. 21. Here Professor Mehta's views are in accord with that of Gandhiji. But Professor Mehta's theory of wantlessness is an original contribution to the economic science which is worthy of being universally realised and followed.
3. Mehta, J.K., op. cit., p. 10.

Human behaviour is related to the condition of mind. The mind loses its equilibrium when there is a desire for the satisfaction of a want which causes pain. Thus pain is associated with the phenomenon of "want". When the pain is removed one gets pleasure. On the other hand, if there are no wants there is no pain. When one selflessly performs one's duty or follows the dictates of conscience one feels happiness as distinct from the pleasure which is obtained from satisfaction of a want. When we reach the stage of happiness we are "conscious of the fact that our mental self is in equilibrium."[1] We are concerned here with conscious wants. Unconscious wants do not cause pain.

When such wantlessness has been achieved one would not only attain his own happiness and poise of mind, but would also work for universal welfare. "The welfare of an individual would be identified with that of the society."[2] Herein lies the true solution to all our problems rather than in merely depending on the State or pursuing our own endless wants which can never be satisfied.

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Statements I

TAX REVENUE OF THE GOVERNMENT OF INDIA (*a*)1950-51 to 1955-56

Rs. Crores

	1950-51 Accounts	1951-52 Accounts	1952-53 Accounts	1953-54 Accounts	1954-55 Accounts	1955-56 Accounts
I. Taxes on Income & Expenditure (1+2+3)	125.70	134.74	128.25	107.09	103.64	113.23
Taxes on Income other than Corporation Tax	132.73	146.19	141.43	122.84	122.26	131.35
Less States' Share	47.52	52.86	56.98	57.29	55.95	55.16
1. Net receipts from I.Tax	85.21	93.33	84.45	65.55	66.31	76.19
2. Corporation Tax	40.49	41.41	43.80	41.54	37.33	37.04
3. Expenditure Tax	...	...	...	...	...	...
II. Taxes on Property and Capital Transactions (1+2+3+4+5)	3.81	4.81	1.76	2.26	2.31	2.55
Estate Duty	...	...	...	...	0.81	1.81
Less States' Share	...	...	...	...	0.57	1.86
1. Net receipts from Estate Duty	...	...	...	...	0.24	0.05
2. Tax on Wealth	...	...	...	...	...	...
3. Gift Tax	...	...	...	...	...	...
4. Stamps & Registration	1.81	1.93	1.33	1.50	1.62	1.72
5. Land Revenue	2.00	2.88	0.43	0.76	0.45	0.88
III. Taxes On Commodities and Services (Total Indirect Tax) (1+2+3+4)	227.49	320.44	257.05	253.93	293.31	295.69
Custom:						
Imports	107.70	141.59	118.07	119.60	141.60	127.98
Exports	47.36	90.74	55.97	38.53	41.37	37.76

Other Revenue (Land customs, Air customs & Miscellaneous)	6.37	4.76	4.59	3.55	4.76	4.22
Less refunds	4.28	5.40	4.88	2.97	2.33	3.26
(1) Net receipts from customs	157.15	231.69	173.75	158.71	184.86	166.70
Union Excise Duties—	67.54	85.78	83.03	94.98	108.22	145.25
(of which additional Excise)	...	...	...	...	...	...
Less State's Share	...	...	...	...	...	16.57
(2) Net receipts from Excise—	67.54	85.78	83.03	94.98	108.22	128.68
Tax on Railway Passenger Fares	...	...	...	...	...	...
Less State's share	...	...	...	...	...	...
(3) Net receipts from Tax on Railway Passenger Fares	...	...	...	...	...	...
(4) Other Taxes & Duties	2.80	2.97	0.27	0.24	0.23	0.31
IV. Total Tax Revenue (I+II+III)	357.00	459.99	387.06	363.28	399.26	411.47
V. Total Revenue (IV+VI+VII+VIII)	405.86	509.49	429.60	409.80	449.86	481.19
VI. Administrative Receipts	12.53	14.35	13.10	12.09	12.96	17.08
VII. Net Contributions of Public Undertakings	23.16	20.98	16.61	21.63	26.92	28.92
VIII. Other Revenue	13.17	14.17	12.83	12.80	10.72	23.72
IX. Total Expenditure	346.64	381.40	390.67	401.30	416.35	440.74
X. Surplus (+) Deficit (—)	+59.22	+128.09	+38.93	+8.50	+33.51	+40.45

Continued on the next page.

Statement I

The Revenue of the Government of India (*a*)—*Continued.* (1956-57 to 1964-65)

Rs. Crores

	1956-57 Accounts	1957-58 Accounts	1958-59 Accounts	1959-60 Accounts	2960-61 Accounts	1961-62 Accounts	1962-63 (Accounts)	1963-64 (Rev.)	1964-65 (Budget)
I. Taxes on Income & Expenditure (1+2+3)	144.17	146.40	151.18	176.88	191.97	228.84	312.39	390.89	449.10
Taxes on Income other than Corporation Tax	151.74	163.70	172.01	148.85	167.38	165.39	185.96	235.00	250.00
Less States' Share	58.75	73.43	75.80	79.32	87.37	93.85	95.27	119.29	108.45
1. Net receipts from I.Tax	92.99	90.27	96.21	69.53	80.01	71.54	90.69	115.71	141.55
2. Corporation Tax	51.18	56.13	54.33	106.56	111.05	156.46	221.50	275.00	306.00
3. Expenditure tax	...	...	0.64	0.79	0.91	0.84	0.20	0.18	1.55
II. Taxes on Property and Capital Transaction (1+2+3+4+5)	2.41	10.61	14.91	17.02	13.49	14.21	16.15	16.76	19.05
Estate Duty	2.11	2.31	2.70	2.91	3.09	4.21	3.94	4.35	7.40
Less States' Share	2.41	2.40	2.38	2.76	2.91	3.88	3.88	4.22	7.22
1. Net receipts from Estate Duty	0.30	0.09	0.32	0.15	0.18	0.33	0.06	0.13	0.18
2. Tax on Wealth	...	7.04	9.67	12.11	8.15	8.26	9.54	10.00	10.20
3. Gift Tax	...	...	0.98	0.81	0.89	1.01	0.97	1.10	3.10
4. Stamps & Registration	2.17	3.31	3.41	3.35	3,68	4.05	5.00	5.25	5.41
5. Land Revenue	0.54	0.35	0.53	0.60	0.59	0.56	0.58	0.28	0.16
III. Taxes on Commodities and Services (Total Indirect Tax) (1+2+3+4)	347.18	448.32	386.97	448.54	524.68	632.32	732.44	902.41	980.93
Custom:									
Imports	140.52	150.94	116.53	135.82	154.61	198.22	238.42	318.82	335.79
Exports	28.67	26.83	20.84	14.89	13.12	12.69	9.60	3.46	2.96
Other Revenue (Land customs, Air customs & Miscellaneous)	7.31	7.28	5.41	9.56	8.21	7.82	7.50	6.42	6.32
Less refunds	3.27	5.06	4.19	4.16	5.91	6.48	9.56	8.70	8.70

(1) Net receipts from customs	173.23	179.99	138.29	156.11	170.03	212.25	245.96	320.00	336.37
Union Excise Duties—	190.43	273.62	312.94	360.65	416.35	489.31	598.83	703.47	769.93
(of which additional Excise)	...	(2.61)	(16.12)	(28.32)	(33.60)	(38.96)	(44.75)	(45.55)	(48.13)
Less States' Share	18.22	40.22	72.99	74.70	75.10	80.65	124.91	135.99	141.37
(2) Net receipts from Excise—	172.21	233.40	239.95	285.95	341.25	408.66	473.92	567.48	628.56
Tax on Railway Passenger Fares	...	3.68	12.24	12.81	15.89	...	...	...	...
Less States' share	...		10.89	13.07	13.79	...	...	...	...
(3) Net receipts from Tax on Railway Passenger Fares	...	4.41 0.73	1.35	—0.26	2.10	...	...	...	...
(4) Other Taxes & Duties	1.74	5.66	7.38	6.74	11.30	11.41	12.56	14.93	16.00
IV. Total Tax Revenue (I+II+III)	493.76	575.33	553.06	642.44	730.14	875.37	1,060.98	1,310.06	1,449.08
V. Total Revenue (IV+VI+VII+VIII)	563.23	673.38	670.21	778.59	877.46	1,036.79	1,427.53	1.753.28	1,970.84
VI. Administrative Receipts	16.90	43.58	53.94	52.31	59.32	53.92	63.44	48.00	47.67
VII. Net Contribution of Public Undertakings	31.81	36.27	35.96	53.89	53.00	65.69	56.07	68.53	66.46
VIII. Other Revenue	20.76	18.20	27.25	29.95	35.00	41.81	247.03	326.69	407.63
IX. Total Expenditure	473.83	631.33	675.46	736.04	826.21	211.94	1,314.14	1,664.94	1,876.76
X. Surplus (+) Deficit (—)	+48.40	+42.05	—5.25	+42.55	+51.25	+124.85	+113.40	+88.34	+94.08

Source : Reserve Bank of India Report on Currency and Finance for 1957-58 and 1959-60 and R.B.I. Bulletins, 1963 (April) and 1964 (March).

(*a*) The Accounts since 1950-51 cover not only the finances of the old Provinces, but also cover the federal expenditure and the federal revenues of the integrated States.

(*b*) Including effect of Budget proposals. Reliefs announced subsequently are not here taken into account,

(*c*) Including recoveries of interest from State Governments and Commercial Departments adjusted as reduction of interest charges till 1961-62.

Note : The figures of the total revenue and expenditure as given in this Statement differ from those in the Budget papers, as receipts from forests, opium, and currency and mint are shown on a net basis, and States' share of taxes have been excluded.

Statement II (a)

Taxes on Income Including Corporation Tax (Broad Details)

1941-42 to 1959-60

Rs. Crores

Year	Taxes on Income other than Corporation Tax					
	Ordinary Collections	Surcharge (Central)	Surcharge (Special)	Excess Profit Tax	Business Profit Tax	Total
1941-42	23.73	7.00	...	1.40	...	32.13
1942-43	30.56	13.90	...	3.60	...	48.26
1943-44	38.82	24.60	...	10.90	...	74.32
1944-45	49.89	35.50	...	18.50	...	103.89
1945-46	49.28	35.67	...	14.50	...	99.45
1946-47	64.97	10.50	...	12.00	...	87.47
1947-48	64.67	4.75	...	4.90	.25	74.57
1948-49	108.82	8.19	...	1.37	1.19	119.49
1949-50	109.22	4.31	...	3.46	4.60	121.59
1950-51	127.13	2.35	...	2.49	.76	132.73
1951-52	139.22	4.07	...	2.44	.46	146.19
1952-53	134.63	6.09	...	.48	.23	141.43
1953-54	161.61	4.94	...	.86	.43	122.84
1954-55	116.03	5.02	...	.90	.31	122.26
1955-56	125.36	4.98	...	.80	.22	131.36
1956-57	145.52	5.49	...	.55	.18	151.74
1957-58	155.54	6.94	.24	.86	.12	163.70
1958-59 (Revised)	152.40	5.75	4.00	.30	.05	162.50
1959-60 (Budget)	155.95	6.00	4.00	.25	.05	166.25
1961-62	155.93	4.94	2.80	.32	1.40	165.39
1962-63	176.98	5.62	4.15	.20	.01	185.96
1963-64 (Revised)	206.01	6.34	4.65	18.00a	...	235.00
1964-65 (Budget)	218.85	6.40	4.75	20.00b	...	250.00

a. Additional Surcharge (Union)

b. Before Distribution to States

Statement II (b)

Year	Corporation Tax				
	Ordinary Collection	Surcharge	Excess Profit Tax	Business Profit Tax	Total
1941-42	3.61	1.09	6.60	...	11.30
1942-43	6.87	.47	22.40	...	29.74
1943-44	12.23	.10	51.35	...	63.68
1944-45	14.54	.07	91.50	...	106.11
1945-46	13.99	.06	75.50	...	89.55
1946-47	9.50	.03	60.00	...	69.53
1947-48	12.51	.02	26.15	1.75	40.43
1948-49	35.21	.04	14.38	12.16	62.25
1949-50	30.31	...	3.98	5.23	39.52
1950-51	34.25	.01	3.81	2.42	40.49
1951-52	39.55	.07	1.03	.76	41.41
1952-53	43.18	.02	.45	1.05	43.80
1953-54	40.34	...	.55	.65	41.54
1954-55	37.33	—.04	—.21	.25	37.33
1955-56	36.33	.03	.73	—.05	37.04
1956-57	50.93	.03	.19	.03	51.18
1957-58	56.21	.07	—.15	...	56.13
1958-59 (Revised)	55.45	...	.50	.05	56.00
1959-60 (Budget)	58.15	...	.50	.10	58.75
1961-62	156.42	...	.15	—.11	156,46
1962-63	178.30	...	.10	.05	178,45
1963-64 (Revised)	187.35	...	.10	.05	187,50
1964-65 (Budget)	195.95	...	.05	...	196,00

Source : Explanatory Memoranda on the Budgets of the Central Government from 1943-44 to 1964-65.

Statement III (a)

Rates of Income-Tax and Surcharge 1946-47 to 1961-62

Grades of Income	Rates of Income-Tax		Rates of Surcharge	
	1946-47 to 1948-49	1949-50 to 1954-55	1946-47 to 1950-51	1951-52 to 1954-55
1. First Rs. 1,500 of total income	Nil	Nil	Nil	Nil
2. On the Next Rs. 3,500 of total Income	1 Anna	9 Pies	Nil	1/20 of the rate specified in the preceding column.
3. On the Next Rs. 5,000 of total Income	2 Annas	1 Anna & 9 Pies	Nil	do
4. On the Next Rs. 5,000 of total income	3 Annas & 6 pies	3 Annas	Nil	do
5. On the Balance	5 Annas	4 Annas	Nil	do

Grades of Income	Rates of Income-tax	Rate of Surcharge
	1955-56 & 1956-57	1955-56 and 1956-57
1. On the first Rs. 2,000 total income	Nil	Nil
2. On the next Rs. 3,000 of total income	9 pies	1/20 of the rate specified in the preceding column.
3. On the next Rs. 2,500 of total income	1 Anna & 9 pies	do
4. On the next Rs. 2,500 of total income	2 Annas & 3 pies	do
5. On the next Rs. 5,000 of total income	3 Annas & 3 pies	
6. On the balance of total income	4 Annas	do

Rates of Income-Tax & Surcharge 1957-58 to 1961-62 In the case of every individual who is married and Hindu Undivided family.

1.	On the first Rs. 3,000 of total income	Nil	5.	On the next Rs. 2,500	11 per cent
2.	On the next Rs. 2,000 do	3 per cent	6.	do Rs. 2,500	14 ,,
3.	do Rs. 2,500 do	6 ,,	7.	do Rs. 5,000	18 ,,
4.	do Rs. 2,500 do	9 ,,	8.	On the balance of total income	25 ,,

Surcharge of 5% and an additional surcharge of 5% on earned incomes which exceed Rs. 1,00,000/-. A total surcharge of 20% on unearned incomes.

Source : The Indian Finance Acts from 1946-47 to 1959-60.

Statement III (b)

Rates of Super-Tax and Surcharge—1950-51 to 1961-62

Grades of Income	Rate of Super-tax	Rate of Surcharge
	1950-51 to 1954-55	1950-51 to 1954-55
On the First Rs. 25,000 of total income	Nil	Nil
On the Next Rs. 15,000 of total income	3 Annas	1/20 of the rate specified in the preceding column
On the Next Rs. 15,000 of total income	4 Annas	do
On the Next Rs. 15,000 of total income	6 Annas	do
On the Next Rs. 15,000 of total income	7 Annas	do
On the Next Rs. 15,000 of total income	7.5 Annas	do
On the Next Rs. 15,000 of total income	8 Annas	do
On the Balance	8.5 Annas	do

Grades of Income	Rate of Super-tax		Surcharge
	1955-56	1956-57	1955-56 & 1956-57
1. On the first Rs. 20,000 of total Income	Nil	Nil	Nil
2. On the next Rs. 5,000 of total income	1 Anna	1 anna	1/20 of the rate specified in the preceding column
3. On the next Rs. 15,000 of total income	3 Annas	3 Annas	
4. On the next Rs. 10,000 of total income	5 Annas	5 Annas	do
5. On the next Rs. 10,000 of total income	6 Annas	6 Annas	do
6. On the next Rs. 20,000 of total income	7 Annas	7 Annas on the first Rs. 10,000 & 7.5 Annas on the next Rs. 10,000.	do
7. On the next Rs. 50,000 of total income	9 Annas	9 Annas on the first Rs. 20,000 & 9.5 Annas on the next Rs. 30,000.	do
8. On the next Rs. 20,000 of total income	8 Annas	8 Annas on the first Rs. 10,000 & 8.5 Annas on the next Rs. 10,000.	do
9. On the balance of total income.	9.5 Annas	10 Annas	do

(Statement III (b)—*Contd.*)

Rates of Super tax and Surcharge 1957-58 to 1961-62

In the case of every individual Hindu Undivided Family, unregistered firm and other Associations of persons.

1.	On the first Rs. 20,000 of total income	Nil
2.	On the next Rs. 5,000 do	5 per cent
3.	do Rs. 5,000 do	15 do
4.	do Rs. 10,000 do	20 do
5.	do Rs. 10,000 do	30 do
6.	do Rs. 10,000 do	35 do
7.	do Rs. 10,000 do	40 do
8.	On the balance of total income	45 do

Surcharge of 5% and an additional surcharge of 5% on earned incomes which exceed Rs. 1,00,000 : A total surcharge of 20% on unearned incomes.

Source : The Indian Finance Acts from 1950-51 to 1961-62.

Statements IV (a)

Receipts of Union Excise Duties (1948-49 to 1959-60)

Crores of Rs.

Commodity	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59 (Rev.)	1959-60(a) (Budget)
Basic Duties												
Motor Spirit	1.41	1.73	2.08	2.07	2.11	2.47	9.87	23.05	25.23	30.85	32.29	33.25
Kerosene	0.20	0.22	0.28	0.26	0.24	0.33	0.93	2.43	3.29	3.06	4.20	5.08
Silver	—	—	—	—	0.01	—	—	—	—	—	—	—
Sugar	6.47	7.34	6.46	8.43	9.93	14.36	8.36	18.58	20.88	42.75	46.00	47.82
Matches	7.30	7.57	8.07	8.69	9.45	9.32	9.25	10.08	10.05	15.08	17.70	18.00
Steel ingots	0.46	0.46	.52	0.54	0.55	0.61	0.67	0.69	0.64	6.25	7.00	8.00
Tyres	1.98	3.57	4.04	6.09	4.40	4.95	5.39	5.53	6.15	3.87	6.80	8.55
Tobacco	25.46	28.23	31.99	35.55	34.68	33.00	31.39	36.46	38.43	45.49	41.91	43.49
Vegetable Products	1.96	2.28	2.19	2.45	2.75	2.79	3.13	3.82	4.35	3.92	3.96	4.91
Coffee	0.49	0.50	1.17	0.77	0.59	0.77	0.98	0.93	1.20	1.32	1.20	1.20
Tea	3.66	2.54	3.36	4.31	3.46	2.09	3.19	3.17	3.19	3.86	6.20	7.38
Cotton Cloth	0.87	12.33	9.26	16.36	13.46	21.67	27.59	28.18	51.86	64.60	42.66	42.66
Artificial Silk	—	—	—	—	—	—	0.49	2.18	1.03	1.69	.80	1.80
Cement	—	—	—	—	—	—	2.11	2.22	2.55	11.17	13.83	14.03
Footwear	—	—	—	—	—	—	0.82	0.84	0.99	0.97	1.05	1.05
Soap	—	—	—	—	—	—	1.40	1.55	1.85	1.76	1.85	1.85
Woollen Fabrics	—	—	—	—	—	—	0.02	0.53	0.61	0.61	.62	0.62
Electric Fans	—	—	—	—	—	—	0.05	0.27	0.32	0.46	.48	0.48
Electric Bulb	—	—	—	—	—	—	0.01	0.25	0.28	0.30	.30	0.30
Electric Batteries	—	—	—	—	—	—	0.05	0.73	0.89	0.80	.85	0.85
Paper	—	—	—	—	—	—	0.21	2.68	3.27	5.39	6.50	6.80
Paints & Varnishes	—	—	—	—	—	—	0.09	1.01	1.17	1.20	1.22	1.30
Vegetable non-essential oils	—	—	—	—	—	—	—	0.29	5.30	9.80	8.60	13.20
Refined Diesel Oils & Vaporising oils	—	—	—	—	—	—	—	0.16	2.53	7.01	8.74	17.25
Industrial Fuel Oils	—	—	—	—	—	—	—	0.47	3.03	3.24	4.45	4.61

(Statement IV (a)—*Contd*)

Commodity	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59 (Rev)	1959-60(*a*) (Budget)
Rayon & Synthetic fibres & Yarn	—	—	—	—	—	—	—	—	0.07	0.29	1.32	1.93
Motor cars	—	—	—	—	—	—	—	—	0.05	0.32	0.16	0.23
Coal Cess	1.02	1.32	1.62	1.66	2.42	2.54	2.45	2.38	2.18	2.68	3.00	3.25
Cess on Copra	—	—	—	—	—	—	—	—	—	0.12	0.07	0.07
Cess on oils & oilseeds	—	—	—	—	—	—	—	—	0.15	0.91	0.23	0.23
Miscellaneous	0.36	0.33	0.44	0.42	0.63	1.17	1.91	0.76	1.21	4.74	.51	.51
Total Gross revenue	51.64	68.48	71.50	87.61	84.73	96.06	110.36	149.24	192.75	274.51	264.50	290.70
Deduct refunds and drawbacks	—1.01	—0.63	—3.96	—1.83	—1.70	—1.08	—1.50	—1.25	—2.32	—3.50	—4.50	—4.50
Total Net Revenue	50.63	67.85	67.54	85.78	83.03	94.98	108.22	145.25	190.43	271.01	260.00	286.20

(*a*) Taking into account the effect of tax proposals.

Additional Duties

Sugar	—	—	—	—	—	—	—	—	—	—	12.85	13.11
Textiles	—	—	—	—	—	—	—	—	—	—	21.19	21.39
Tobacco	—	—	—	—	—	—	—	—	—	—	7.10	7.10
Total	—	—	—	—	—	—	—	—	—	2.61	41.15	41.60
Grand Total of Union Excise Duties	50.63	67.85	67.54	85.75	83.03	94.98	108.22	145.25	190.43	273.62	301.15	327.80
States Share of Excise Duties	—	—	—	—	—	—	—	16.57	18.22	40.22	72.99	75.12
Net Receipts	50.63	67.85	67.54	85.75	83.03	94.98	108.22	128.68	172.21	233.40	228.16	252.68

Source: Explanatory Memoranda on the Central Government from 1950-51 to 1959-60.

Statement IV (b)

Receipts of Union Excise Duties
(1961-62 to 1963-64)

(In lakhs of Rs.)

Basic Duties	Accounts, 1961-62 (Provisional)	Budget, 1962-63	Revised, 1962-63	Budget, 1963-64
Motor Spirit	45,51	46,68	51,00	54,00
Kerosene	12,84	14,34	14,34	14,40
Sugar	47,23	46,10	57,30	63,80
Matches	18,48	20,46	21,20	21,50
Steel Ingots	15,51	17,50	6,30	7,00
Tyres & Tubes	14,50	15,50	16,00	17,00
Tobacco	56,45	59,77	61,03	63,03
Vegetable Product	6,06	6,48	7,00	7,00
Coffee	1,92	1,85	2,00	2,00
Tea	10,57	11,32	10,50	10,50
Cotton Fabrics	47,51	52,50	54,50	56,50
Artificial Silk Fabrics	2,91	76	85	85
Cement	18,32	19,00	20,00	21,00
Footwear	1,74	2,00	2,10	2,15
Soap	2,46	2,83	2,83	2,90
Woollen Fabrics	1,35	52	1,10	1,50
Electric Fans	1,20	1,25	1,25	1,30
Electric Bulbs	88	97	1,10	1,20
Electric Batteries	1,79	1,92	2,00	2,05
Paper	11,51	11,94	12,50	12,75
Paints and Varnishes	2,12	2,25	2,25	2,30
Vegetable non-essential Oils	10,47	10,50	11,00	11,00
Refined Diesel Oils and Vaporizing Oil	43,36	45,69	40,00	43,00
Diesel Oil N. O. S.	6,51	7,78	8,50	11,00
Furnace Oil	7,98	9,14	9,14	9,14
Rayon and Synthetic fibres and yarn	5,58	7,35	8,00	8,50
Motor Vehicles	10,30	10,50	10,50	11,00
Asphalt and Bitumen	2,52	2,34	2,35	2,35

(Statement IV (b)—*Contd.*)

(In lakh of Rs.)

Basic Duties	Accounts, 1961-62 (Provisional)	Budget, 1962-63	Revised, 1962-63	Budget, 1963-64
Aluminium	1,04	1,08	1,20	1,50
Tin Plate	1,61	1,60	1,60	1,65
Pig Iron	1,11	1,40	1,30	1,50
Silk Fabrics	4	6	6	6
Cycles, parts thereof	1,34	1,40	1,60	1,65
Internal Combustion Engines	1,34	1,45	1,45	1,45
Electric Motors	1,03	1,10	1,15	1,20
Cinematograph Films	70	70	70	70
Soda Ash	30	35	35	40
Caustic Soda	41	55	55	55
Glycerine	13	14	11	12
Coal-tar Dyes and Coal-tar-Derivatives	2,15	1,40	2,00	2,25
Patent or proprietary medicines	4,19	5,25	5,25	5,40
Cosmetics	1,21	1,15	1,20	1,25
Cotton yarn	4,98	7,07	7,50	7,50
Woollen Yarn	1,02	1,91	2,00	2,00
Glass & Glassware	2,01	2,20	1,40	2,50
Chinaware	84	80	1,00	1,05
Copper	1,75	1,45	1,85	1,90
Zinc	13	15	15	15
Refrigerators and Airconditioning Machinery	86	75	1,00	1,00
Wireless Receiving Sets	1,25	1,45	1,20	1,25
Plastics	1,11	1,05	1,25	1,25
Cellophane	31	35	35	35
All Petroleum Products N.O.S.	...	25	25	35
Nitric etc Acids	...	73	75	85
Gases	...	80	1,00	1,10
Rubber products	26	59	75	85
Plywood	...	57	70	80
Jute Manufactures	...	2,93	3,90	4,00
Asbestos cement products	...	71	85	90
Iron & Steel products	...	5,51	19,00	20,50

(Statement IV (b)—*Contd*)

(In lakh of Rs.)

Basic Duties	Accounts, 1961-62 (Provisional)	Budget, 1962-63	Revised, 1962-63	Budget, 1963-64
Electric wires and cables	...	1,78	2,00	2,25
Gramophones & records	...	27	15	15
Salt Cess	84	55	84	85
Coal Cess	9,98	7,00	6,75	7,25
Cess on Copra	12	10	10	10
Cess on oils and oil-seeds	30	20	20	20
Cess on Iron Ores	...	25	1	25
Miscellaneous	3,71	75	85	85
TOTAL—GROSS REVENUE	4,53,65	4,87,04	5,11,96	5,40,60
Deduct—REFUNDS AND DRAWBACKS	—3,30	—4,50	—4,50	—4,50
TOTAL—NET REVENUE	4,50,35	4,82,54	5,07,46	5,36,10
Additional Duties				
Sugar	11,22	13,83	17,03	17,53
Textiles	19,46	20,21	20,48	21,33
Tobacco	8,28	8,49	8,72	9,00
TOTAL	38,96	42,53	46,23	47,86
GRAND TOTAL—UNION EXCISE DUTIES	4,89,31	5,25,07	5,53,69	5,83,96

Statement IV (c)

Receipts of Union Excise Duty (*Contd.*)

(BUDGET ESTIMATES 1964-65)

(In lakhs of Rs.)

Basic Duties	Accounts 1962-63 Basic Excise	Accounts 1962-63 Special Excise	Accounts 1962-63 Total	Budget 1963-64 Basic Excise	Budget 1963-64 Special Excise	Budget 1963-64 Total	Revised 1963-64 Basic Excise	Revised 1963-64 Special Excise	Revised 1963-64 Total	Budget 1964-65 Basic Excise	Budget 1964-65 Special Excise	Budget 1964-65 Total
Motor Spirit	51,15	41	51,56	66,00	5,75	71,75	61,00	5,25	66,25	66,00	5,65	71,65
Kerosene	16,55	...	16,55	29,63	...	29,63	35,00	...	35,00	39,60	...	39,60
Sugar	60,18	...	60,18	63,80	...	63,80	54,70	...	54,70	58,25	...	58,25
Matches	21,91	...	21,91	21,50	...	21,50	21,50	...	21,50	21,50	...	21,50
Steel Ingots	4,61	...	4,61	7,00	...	7,00	2	...	2	2	...	2
Tyres & Tubes	16,85	19	17,04	17,00	3,40	20,40	18,50	3,70	22,20	20,00	4,00	24,00
Tobacco	63,89	54	64,43	75,58	15,11	90,69	67,00	13,00	80,00	71,30	14,03	85,33
Vegetable Product	7,70	11	7,81	11,20	2,24	13,44	12,00	2,40	14,40	12,50	2,50	15,00
Coffee	1,82	1	1,83	2,00	40	2,40	1,80	36	2,16	2,00	40	2,40
Tea	10,20	1	10,21	13,73	2,25	15,98	12,88	2,10	14,98	13,15	2,13	15,28
Cotton Fabrics	58,37	...	58,37	56,50	...	56,50	56,50	...	56,50	57,60	...	57,60
Artificial Silk Fabrics	1,11	1	1,12	85	17	1,02	1,10	22	1,32	1,15	23	1,38
Cement	21,09	29	21,38	21,00	4,20	25,20	21,50	4,30	25,80	23,00	4,60	27,60
Footwear	2,13	...	2,13	2,15	...	2,15	2,60	...	2,60	2,80	...	2,80
Soap	2,95	7	3,02	4,15	83	4,98	4,15	83	4,98	4,25	85	5,10
Woolen Fabrics	1,92	1	1,93	1,50	30	1,80	1,80	36	2,16	1,80	36	2,16
Electric Fans	1,49	3	1,52	1,30	26	1,56	1,30	26	1,56	1,60	32	1,92
Electric Bulbs	1,28	1	1,29	1,20	12	1,32	1,55	17	1,72	1,70	18	1,88
Electric Batteries	2,20	3	2,23	2,05	31	2,36	2,50	38	2,88	2,60	40	3,00
Paper	13,18	15	13,33	13,00	2,10	15,10	14,90	2,40	17,30	15,10	2,44	17,54
Paints and Varnishes	2,57	5	2,62	2,65	53	3,18	3,20	64	3,84	3,80	76	4,56
Vegetable non-essential Oils	10,54	...	10,54	75	...	75	1,50	...	1,50	1,70	...	1,70
Refined Diesel Oils and Vaporizing Oil	46,60	39	46,99	54,04	5,02	59,06	57,50	5,25	62,75	59,00	5,30	64,30

Diesel Oil N.O.S.	9,64	11	9,75	17,30	1,60	18,90	13,15	1,25	14,40	16,40	1,50	17,00
Furnace Oil	9,14	...	9,14	9,14	...	9,14	11,00	...	11,00	12,00	...	12,00
Rayon and Synthetic fibres and yarn	9,58	13	9,71	8,50	2,83	11,33	9,50	3,17	12,67	10,35	3,45	13,80
Motor Vehicles	10,99	23	11,22	11,00	2,60	13,60	10,50	2,50	13,00	11,00	2,60	13,60
Asphalt and Bitumen	2,40	...	2,40	2,35	...	2,35	2,35	...	2,35	2,50	...	2,50
Aluminium	1,67	2	1,69	1,50	30	1,80	2,00	50	2,40	2,25	50	2,75
Tin Plate	1,96	...	1,96	1,65	17	1,82	1,65	17	1,82	1,65	17	1,82
Pig Iron	1,36	...	1,36	1,50	...	1,50	1,50	...	1,50	1,50	...	1,50
Silk Fabrics	4	...	4	6	2	8	6	2	8	6	2	8
Cycles, parts thereof	1,61	...	1,61	1,65	...	1,65	1,65	...	1,65	1,65	...	1,65
Internal Combustion Engines	1,26	1	1,27	1,45	15	1,60	1,45	15	1,60	1,50	15	1,65
Electric Motors	1,24	2	1,26	1,20	24	1,44	1,50	30	1,80	1,60	32	1,92
Cinematograph Films	73	1	74	70	14	84	1,00	20	1,20	1,00	20	1,20
Soda Ash	41	...	41	40	...	40	47	...	47	50	...	50
Caustic Soda	51	...	51	55	...	55	55	...	55	60	...	60
Glycerine	12	...	12	12	...	12	12	...	12	12	...	12
Coal-tar Dyes and Coaltar Derivatives	2,02	1	2,03	2,25	23	2,48	1,60	16	1,76	1,82	18	2,00
Patent or proprietary medicines	5,06	...	5,06	5,40	...	5,40	5,55	...	5,55	5,55	...	5,55
Cosmetics	1,32	2	1,34	1,25	25	1,50	1,25	25	1,50	1,25	25	1,50
Cotton yarn	8.29	9	8,38	7,50	1,70	9,20	8,00	1,80	9,80	8,30	1,99	10,29
Woolen yarn	1,88	3	1,91	2,00	67	2,67	3,00	1,00	4,00	3,30	1,10	4,40
Glass & Glassware	2,71	1	2,72	2,50	29	2,79	2,65	30	2,95	2,75	31	3,06
Chinaware	1,10	1	1,11	1,05	10	1,15	1,20	12	1,32	1,30	13	1,43
Copper	1,83	...	1,83	2,20	...	2,20	2,25	...	2,25	2,30	...	2,30
Zinc	15	...	15	15	...	15	15	...	15	15	...	15
Refrigerators and Airconditioning Machinery	1,46	3	1,49	1,00	33	1,33	1,15	35	1,50	1,40	47	1,87
Wireless Receiving Sets	1,19	2	1,21	1,25	42	1,67	1,25	42	1,67	1,30	43	1,73
Plastics	1,55	2	1,57	1,25	25	1,50	1,85	37	2,22	2,00	40	2,40
Cellophane	39	...	39	35	7	42	50	10	60	50	10	60
All Petroleum Products N.O.S.	62	...	62	35	...	35	45	...	45	50	...	50

Statement IV (c)

Receipts of Union Excise Duty (*Contd.*)

(BUDGET ESTIMATES 1964-65)

(In lakhs of Rs.)

Basic Duties	Accounts 1962-63 Basic Excise	Accounts 1962-63 Special Excise	Accounts 1962-63 Total	Budget 1963-64 Basic Excise	Budget 1963-64 Special Excise	Budget 1963-64 Total	Revised 1963-64 Basic Excise	Revised 1963-64 Special Excise	Revised 1963-64 Total	Budget 1964-65 Basic Excise	Budget 1964-651 Special Excise	Budget 1964-65 Total
Nitric etc. Acids	90	...	90	85	...	85	1,00	...	1,00	1,10	...	1,10
Gases	1,70	...	1,70	1,10	...	1,10	2,00	...	2,00	2,25	...	2,25
Rubber products	1,57	1	1,58	85	17	1,02	95	19	1,14	1,10	22	1,32
Plywood	98	...	98	80	...	80	1,10	...	1,10	1,20	...	1,20
Jute Manufactures	5,24	4	5,28	4,00	40	4,40	5,00	50	5,50	5·50	55	6,05
Asbestos-cement products	89	...	89	90	...	90	1,10	...	1,10	1,20	...	1,20
Iron & Steel Products	24,29	...	24,29	20,50	...	20,50	36,00	...	36,00	41,00	...	41,00
Electric Wires and cables	2,57	...	2,57	2,25	...	2,25	3,20	...	3,20	3,40	...	3,40
Gramophones & records	20	...	20	15	1	16	25	5	30	25	5	30
Salt Cess	84	...	84	85	...	85	85	...	85	85	...	85
Coal Cess	12,26	...	12,26	7,25	...	7,25	12,25	...	12,25	12,25	...	12,25
Cess on Copra	12	...	12	10	...	10	10	...	10	10	...	10
Cess on oils and oil-seeds	28	...	28	20	...	20	20	...	20	20	...	20
Cess on Iron Ores	...	...	...	25	...	25	8	...	8	25	...	25
Miscellaneous	1,99	...	1,99	85	...	85	65	...	65	65	...	65
TOTAL—GROSS REVENUE	5,56,35	3,13	5,59,48	5,97,05	55,93	6,52,98	6,08,53	55,39	6,63,92	6,48,82	59,24	7,08,06
Deduct—REFUNDS AND DRAWBACKS	—5,40	...	—5,40	—4,50	...	—4,50	—6,00	...	—6,00	—6,00	...	—6,00
TOTAL—NET REVENUE	5,50,95	3,13	5,54,08	5,92,55	55,93	6,48,48	6,02,53	55,39	6,57,92	6,42,82	59,24	7,02,06

Additional Duties

Sugar	15,03	...	15,03	17,53	...	17,53	15,15	...	15,15	17,00	...	17,00
Textiles	20,34	...	20,34	21,33	...	21,33	22,40	...	22,40	22,83	...	22,83
Tobacco	9,38	...	9,38	9,00	...	9,00	8,00	...	8,00	8,50	...	8,50
TOTAL	44,75	...	44,75	47,86	...	47,86	45,55	...	45,55	48,33	...	48,33
Grand Total—Union Excise Duties	5,95,70	3,13	5,98,83	6,40,41	55,93	6,96,34	6,48,08	55,39	7,03,47	6,91,15	59,24	7,50,39

Source : Explanatory Memorandum—General Budget, 1964-1965.

Statement V

Sea Customs—Imports

(1945-46 to 1953-54)

(Crores of Rs.)

I. Revenue Duties	1945-46	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
Ale, beer, porter, cider and other fermented liquor	.01	.22	.18	.15	.26	.25	.26
Spirits & Liquors	1.58	1.65	1.53	1.52	2.27	2.03	1.86
Wines	.02	.04	.03	.03	.04	.07	.04
Spices	.49	.75	.43	.39	.68	.16	.88
Tea	.03	—	—	—	—	—	—
Tobacco	11.61	8.77	4.89	4.70	3.61	3.33	2.02
Kerosene oil	4.22	2.41	3.93	5.75	8.11	6.66	7.19
Motor oil	6.13	9.72	14.01	19.93	26.04	27.59	27.53
Oils	1.29	1.36	1.72	2.07	3.38	4.00	3.04
Cotton (Raw)	3.21	2.39	4.65	5.75	6.15	4.92	3.13
Motor cars, cycles, scooters, omnibus, chasis, vans, lorries and parts thereof	1.90	8.05	5.24	10.12	12.38	8.70	6.37
Boots & Shoes	—	—	.01	—	—	—	—
Electric lighting bulbs	.69	.40	.45	.15	.40	.37	.28
Wireless reception instruments & apparatus	1.16	0.52	0.63	.51	.93	.68	.45
Coal-tar dyes and coal tar derivatives	—	1.29	.79	1.27	1.65	.90	1.94
Silver, bullion coins and plates & other manufactures	—	.05	.03	—	—	—	—
Machinery	4.63	7.03	6.09	5.38	6.63	5.62	5.34
Gold bullion, coin, sheet & plates not manufactured	—	.39	—	—	—	—	—
Iron & Steel	.74	1.58	2.24	3.54	4.14	3.21	2.86
Tin blocks	—	.07	.15	.09	.01	—	—
Metals, other than Iron & Steel, silver & block tin	1.55	1.58	.59	.09	.10	.12	.11
Railway Plant & Rolling stock	.93	.49	1.01	.75	.08	2.22	2.15
Wood pulp, paper & Stationery	.25	2.90	1.83	1.65	3.11	2.59	3.10

Artificial silk yarn & thread	.16	4.10	4.22	5.29	6.38	3.09	4.53
Yarn & other textile fabrics	1.31	3.71	3.36	.41	.81	.57	.75
Cinematograph films	.24	.44	.52	.51	.51	.59	.48
Port land Cement excluding white port land cement	—	.17	.44	.03	—	—	—
Pneumatic rubber tyres & tubes	—	.03	.06	.07	.10	.14	.14
Toys, games & Sports goods	.06	.09	.13	.04	.09	.05	.07
Betelnuts	.42	2.78	3.99	4.45	4.75	3.69	4.65
All other articles	15.01	29.09	28.62	24.46	39.47	28.94	34.05
II. Protective Duties							
Heavy Chemicals	—	.01	.04	.28	.95	.76	.43
Iron & Steel	.62	.24	.14	.14	.39	.41	.21
Metals other than Iron & Steel	—	.53	.81	1.15	1.59	.94	.93
Raw Silk	—	.89	.29	1.94	1.05	.33	.31
Silk Yarn and Thread	.01	.08	—	.03	.03	.02	.01
Fabrics of artificial silk mixed with other materials	—	.01	—	—	—	—	—
Silk fabrics	.03	.20	.29	.03	.17	.21	.08
Other Textile manufactures	.04	.30	.05	.15	—	—	—
Artificial silk fabrics	.42	.82	1.74	.34	.50	.21	.44
Sewing Machinery & Parts thereof	—	.30	.29	.35	.26	.19	.14
Machinery other than Sewing Machines	—	—	—	—	—	—	1.17
Cycles (other than motor cycles and parts thereof)	—	1.00	2.24	1.53	2.70	2.21	1.28
Sugar	—	.23	—	—	—	—	—
Wheat & Wheat flour	.04	—	—	—	—	—	—
Other Articles	—	.65	1.62	1.93	2.87	2.12	1.14
III. Duties on American disposals	—	.73	1.00	.73	.28	.18	.24
Total Imports		98.23	100.30	107.70	141.58	118.07	119.60

Source : Explanatory Memoranda on the Budgets of the Central Government from 1949-50 to 1964-65.

(**Statement V**—*Contd.*)

(1955-56 to 1963-64)

I. Revenue Duties	1955-56	1956-57	1957-58	1958-59	1959-60	1960-61	1962-63 (R.E.)	1963-64 (B.E)
Ale, beer, porter, cider and other fermented liquor	·53	·54	·50	·10				
Spirits & Liquors	2.33	2.05	2.00	1.30	1.34	1.19	1.16	1.26
Wines	·07	·07	·09	·04	—	—	—	—
Spices	1.18	1.25	1.40	1.19	1.08	1.60	·45	·39
Tea	—	—	—	—	—	—	—	—
Tobacco	·46	·01	2.10	1.91	2.78	2.38	2.25	2.10
Kerosene oil	8.48	6.21	6.80	9.84	17.07	19.94	26.00	26.00
Motor Oil	20.01	7.52	2.96	4.62	4.29	3.99	5.00	5.00
Oils	3.07	2.05	2.16	3.10	16.62	29.09	36.50	36.60
Cotton (Raw)	·04	—	—	—	—	·09	1.50	1.70
Motor cars, cycles, scooters, omnibus, chasis, vans, lorries and parts thereof	9.38	10.25	14.82	12.92	1.70	3.48	1.80	1.80
Boots & Shoes	—	—	—	—	—	—	—	—
Electric lighting bulbs	·40	·50	·52	·34	·19	·28	·13	·11
Wireless reception instruments & apparatus	·58	·74	·80	1.02	1.48	1.47	1.50	1.25
Coal-tar dyes and coal tar derivatives	2.27	1.71	1.86	2.23	3.91	3.20	3.00	2.60
Silver, bullion coins and plates & other manufactures	—	—	—	—	—	—	—	—
Machinery	5.50	7.83	9.84	17.29	28.16	39.34	64.00	70.50
Gold bullion, coin, sheet & plates not manufactured	—	—	—	—	—	—	—	—
Iron & Steel	2.76	5.05	5.24	6.18	11.49	14.84	28.00	25.00
Tin blocks	—	—	—	—	—	—	—	—
Metals, other than Iron & Steel, silver, & block tin	·31	·39	·51	·72	1.60	2.11	2.71	2.70
Railway Plant & Rolling stock	2.14	2.91	3.63	2.62	1.29	2.49	1.00	1.50
Wood pulp, paper & Stationery	2.73	3.93	3.58	3.87	4.59	4.86	4.15	4.40

Artificial silk yarn & thread	4.80	5.63	7.07	6.11	10.36	11.81	11.50	11.50
Yarn & other textile fabrics	.51	.91	1.24	.99	.29	.16	.07	.06
Cinematograph films	.60	.61	.59	.66	.57	.74	1.00	.95
Port land Cement excluding white port land cement	—	—	—	—	—	—	—	—
Pneumatic rubber tyres & tubes	.11	.12	.14	.71	1.16	.42	.40	.35
Toys, games & Sports goods	.15	.19	.20	.19	—	—	—	—
Betelnuts	7.31	7.38	6.79	6.88	2.91	2.62	.80	1.00
All other articles	55.90	47.57	52.49	54.34	63.91	70.86	101.57	110.71
II. Protective Duties								
Heavy Chemicals	1.03	1.11	2.49	2.17	1.06	.57	.60	.55
Iron & Steel	.22	.27	.18	.09	.10	—	—	—
Metals other than Iron & Steel	.96	1.27	1.69	1.95	2.53	—	—	—
Raw Silk	.47	.37	.13	.18	.31	—	—	—
Silk Yarn and Thread	.02	.06	.06	.04	—	—	—	—
Fabrics of artificial silk mixed with other materials	—	—	—	—	—	—	—	—
Silk fabrics	.16	.01	.03	.03	—	—	—	—
Other Textile manufactures	—	—	—	—	—	—	—	—
Artificials silk fabrics	.88	1.67	1.31	.26	—	.04	.07	.01
Sewing Machinery & Parts thereof	.11	.02	—	—	—	—	—	—
Machinery other than Sewing Machines	.52	.71	1.95	1.96	2.02	—	—	—
Cycles (other than motor cycles and parts thereof)	1.54	2.18	2.52	1.63	.90	3.48	1.80	1.80
Sugar	—	—	—	—	—	—	—	—
Wheat & Wheat flour	—	—	—	—	—	—	—	—
Other Articles	1.38	2.74	2.16	3.41	14.51	—	—	—
III. Duties on American disposals	.15	.15	.07	.05	—	—	—	—
Total Imports	141.06	127.98	140.52	140.94	198.22	217.38	293.59	305.88

Statement VI

Sea Customs Exports
(1945-46 to 1959-60)

	1945-46	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58	1961-62	1962-63	1963-64 (R.E.)	1964-65 (B.E.)
Jute—Raw	0.89	1.23	10.07	26.12	59.33	19.48	10.35	7.66	3.98	0.03	—	—	0.10	0.16	0.16
Manufactured	1.72	6.34	—	—	—	—	—	—	—	—	—	—	—	—	—
Raw Cotton	—	1.80	2.20	1.20	8.00	10.07	5.27	2.61	5.52	1.61	1.25	0.70	0.66	0.67	0.73
Cotton Waste								3.07	2.20	1.84	1.44	0.83	0.68	0.33	0.21
Cotton Cloth & Yarn	0.70	4.02	0.36	0.31	3.33	5.97	2.93	1.20	0.88	0.10	—	—	—	—	—
Manganese	—	0.39	0.85	1.32	2.08	3.18	3.57	0.81	0.10	1.89	3.48	—	—	—	—
Tea	—	10.81	10.99	11.24	10.20	10.62	11.62	19.74	17.83	20.47	19.09	9.83	6.60	0.84	0.84
Black Pepper	—	—	0.64	4.26	4.56	3.48	2.84	1.36	0.23	—	—	—	—	—	—
Other agricultural produce	0.19	0.17	0.26	0.40	0.46	0.43	0.41	0.47	0.50	0.42	0.41	0.55	0.68	0.66	0.66
Mica	—	0.22	0.11	0.21	0.33	0.23	0.20	0.17	0.21	0.22	0.23	0.26	0.26	0.25	0.25
Iron & Steel	—	—	0.04	0.29	0.15	0.28	0.19	0.05	0.01	—	—	—	—	—	—
Oils & Oil Seeds	—	1.52	0.05	0.02	1.52	2.13	0.73	2.76	3.33	1.51	0.68	—	—	—	—
Raw wool	—	—	—	1.99	0.78	0.01	0.02	—	—	—	—	—	—	—	—
Rice	0.04	—	—	—	—	—	—	0.11	0.05	—	—	—	—	—	—
Mercury	—	—	—	—	—	0.04	0.06	—	—	—	—	—	—	—	—
Coffee	—	—	—	—	—	—	0.34	1.27	0.10	0.50	0.07	0.15	0.10	0.13	0.13
Coir	—	—	—	—	—	—	—	0.01	0.05	0.06	0.05	0.06	0.08	0.08	0.08
Oil Cakes	—	—	—	—	—	—	—	—	2.44	0.38	—	—	—	—	—
Lac	—	—	—	—	—	—	—	—	—	—	0.07	0.22	0.39	0.34	0.05
All other Articles	—	—	—	—	—	—	—	0.08	0.33	0.09	0.06	0.09	0.05	—	—
Total Exports		26.54	25.74	47.36	90.74	55.97	38.53	41.37	37.76	28.67	26.83	12.69	9.60	3.46	3.11

Source : Explanatory Memoranda on the Budgets of the Central Government from 1949-50 to 1964.65.

Statement VII

Customs, Central Excise and Salt (1920-21 to 1959-60)

(Amount in crores of Rs.)

Year	Total tax revenue (Before payment to States)	Customs Revenue[1]		Central Excise		Salt Revenue (Excise-Customs-Miscellaneous)	
		Amount	Percentage to (1)	Amount	Percentage to (1)	Amount	percentage to (1)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1920 (Accounts)	60.9	29.1	47.7	2.9	4.7	6.8	11.1
1921 ,,	66.9	32.6	48.7	2.8	4.2	6.4	9.6
1922 ,,	72.6	39.3	54.1	3.4	4.7	7.3	10.1
1923 ,,	71.2	37.6	52.9	3.2	4.5	10.1	14.2
1924 ,,	74.1	45.2	60.9	4.0	5.3	7.9	10.6
1925 ,,	72.9	45.6	62.6	3.2	4.4	6.4	8.7
1926 ,,	72.6	46.3	63.8	2.0	2.8	6.7	9.3
1927 ,,	72.8	47.0	64.6	2.2	3.0	6.7	9.2
1928 ,,	76.6	47.7	62.3	2.5	3.2	7.7	10.0
1929 ,,	77.8	48.3	62.1	3.8	4.8	6.8	8.8
1930 ,,	72.6	43.6	60.0	4.3	5.9	6.9	9.5
1931 ,,	75.6	41.5	54.9	6.2	8.2	8.8	11.6
1932 ,,	83.4	46.6	55.9	6.7	8.1	10.4	12.5
1933 ,,	76.7	41.3	53.9	7.2	9.4	9.1	11.8
1934 ,,	82.3	43.9	53.3	10.3	12.6	8.2	9.9
1935 ,,	84.0	43.9	52.2	12.1	14.4	8.6	10.2
1936 ,,	82.4	41.9	50.8	13.6	16.6	9.1	11.0
1937 ,,	82.4	47.3	57.4	7.9	9.6	8.6	10.5
1938 ,,	81.9	44.5	54.4	8.7	10.7	8.4	10.3
1939 ,,	90.3	50.4	55.9	6.8	7.5	11.2	12.5
1940 ,,	86.8	41.4	47.7	9.6	11.1	8.1	9.3
1941 ,,	112.1	41.8	37.2	13.3	11.9	10.4	9.3
1942 ,,	151.7	34.9	23.0	12.9	8.5	11.3	7.4
1943 ,,	229.2	49.0	21.4	27.7	12.1	8.8	3.8
1944 ,,	357.9	96.2	22.9	41.3	11.5	9.7	2.7
1945 ,,	387.3	128.7	33.2	46.9	12.1	10.5	2.7
1946 ,,	344.9	99.6	28.9	43.7	12.7	9.3	2.7
1947 ,,	332.2	138.1	41.6	38.9	11.7	2.6	0.8
1948 ,,	385.2	130.4	33.9	51.7	13.4		
1949 ,,	389.0	129.8	33.4	68.5	17.6		
1950 ,,	444.9	161.4	36.3	71.5	16.1		
1951 ,,	512.3	237.1	46.3	87.6	17.1		
1952 ,,	448.6	178.6	39.8	84.7	18.9		
1953 ,,	420.3	161.3	38.4	94.0	22.4		
1954 ,,	455.8	187.2	41.7	108.2	23.7		
1955 ,,	485.1	170.0	35.3	145.2	29.9		
1956 ,,	573.1	176.5	37.9	190.4	33.2		
1957 ,,	695.7	185.1	26.6	273.6	30.8		
1958 ,, (Revised)	692.2	139.4	20.1	301.2	43.5		
1959 ,, (Budget)	723.0	136.3	18.9	327.8	45.3		

1. Includes refunds.

Source : The Taxation Enquiry Commission Report, Volume II, the Explanatory Memoranda on the Budgets of the Central Government from 1945-46 to 1959-60, and Statement 1.

Statement VIII

Details of Tax Revenue of State

Crores of Rs.

	1951-52 (Accts.)	1952-53 (Accts.)	1953-54 (Accts.)	1954-55 (Accts.)	1955-56 (Accts.)	1956-57 (Accts.)	1960-61 (Accts.)	1961-62 (Accts.)	1962-63 (Accts.)	1963-64 (B.E.)	1963-64 (R.E.)	1964-65 (B.E.)
Tax Revenue												
1. *Taxes on Income*	**57.1**	**61.1**	**60.8**	**60.9**	**63.1**	**65.9**	**100.5**	**104.3**	**105.8**	**109.2**	**128.1**	**119.2**
Share of Income Tax	52.7	57.0	57.0	56.0	55.3	57.9	90.6	94.4	95.2	98.3	118.0	108.3
Agricultural Income Tax	4.3	4.0	3.8	4.8	7.7	7.9	9.5	9.4	9.6	10.3	9.4	10.2
Profession Tax	0.1	0.1	0.0	0.1	0.1	0.1	0.4	0.5	0.9	0.6	0.7	0.7
2. *Taxes on Property and Capital Transaction*	**75.4**	**85.4**	**100.2**	**101.9**	**111.0**	**119.0**	**144.4**	**148.7**	**179.1**	**183.5**	**183.3**	**185.6**
Estate Duty	—	—	—	0.5	1.9	2.4	2.9	3.9	3.9	3.9	3.9	4.0
Land Revenue	48.0	57.4	70.7	72.6	78.0	83.2	97.2	95.2	120.0	120.4	118.2	118.5
Stamps & Registration	25.6	26.0	27.7	27.1	29.0	31.3	43.3	46.5	52.2	57.8	59.3	61.7
Urban Immovable Property Tax	1.8	2.0	1.8	1.7	2.1	2.1	1.0	3.1	3.0	1.4	1.9	1.4
3. *Taxes on Commodities and Services*	**148.6**	**158.4**	**169.2**	**174.4**	**182.0**	**210.8**	**379.9**	**409.6**	**509.1**	**536.7**	**604.8**	**645.1**
Union Excise	0.7	16.3	16.0	15.1	16.6	17.9	75.1	80.7	124.9	127.1	136.7	141.7
State Excise	49.4	46.3	44.6	44.6	45.1	46.4	53.1	58.6	62.8	63.1	67.5	71.0
General Sales Tax	54.4	51.2	58.3	66.4	80.1	96.6	142.5	163.1	187.5	195.4	236.6	253.0
Sales Tax on Motor Spirit	4.5	6.0	7.3	7.2	1.5	1.0	16.3	18.3	21.4	24.2	25.7	27.3
Entertainment Tax	6.4	6.1	5.8	6.2	7.3	8.6	13.1	15.1	18.2	18.2	21.4	22.2
Electricity Duty	3.4	3.4	4.8	5.2	5.8	6.9	12.5	14.9	19.5	22.4	26.1	29.4
Motor Vehicles Tax	10.1	11.8	13.7	13.7	15.9	18.6	34.1	37.9	46.3	50.3	54.1	54.9
Tax on Railway Fares	—	—	—	—	—	—	13.8	—	—	—	—	—
Other Taxes and Duties (*a*)	19.7	17.3	18.7	16.0	9.7	15.0	19.4	21.0	28.5	36.0	36.7	45.6
Total Tax Revenue (1+2+3)	281.1	304.9	330.2	337.2	356.1	395.7	624.8	662.6	794.0	829.4	916.2	949.9

Source : Reserve Bank of India Bulletins, June 1959, p. 678 and May, p. 592.

(*a*) Includes sugar cane cess, tax on passengers and goods, tobacco duties, tax on prize, competitions and betting, inter-state transit duties, tax on raw jute etc.

Statement IX

Additional Taxation in States (Statewise) (1951-56) (Part A and Part B).

Rs. Crores

	Five Year Targets (1)	Achievements (as estimated) (1951-56) (2)	Percentage of (2) to (1) (3)
Part 'A'			
Assam	3·5	3·3	94·2
Bihar	7·3	3·0	41·1
Bombay	23·5	24·0	102.1
Madhya Pradesh	10.6	2·3	21·7
Madras (including Andhra)	39·3	8.0	20·3
Orissa	9·4	2.0	21·2
Punjab	5·0	4·5	81.0
U. P	50.2	11.0	21·9
West Bengal	36.9	4·5	
Total 'A'	185.7*	62.6	33·7
Part 'B'			
Hyderabad	7·4	1.0	13·5
Madhya Bharat	4·9	2.7	55·1
Mysore	9·2	3.0	32.6
Pepsu	4·1	0.4	9·7
Rajasthan	3·3	2.6	78.7
Saurashtra	4·7	2.1	44.6
Travancore-Cochin	11.0	6.0	54·5
Total 'B'	44.6	17.8	39·9
Total of 'A' and 'B'	230.3	80.4	34·5

Source : The Planning Commission, Review of the First Five Year Plan pp. 26 and 27.

* Estimated Figures.

Statement X

Additional Taxation in the States (Second Plan Period)

Rs. Crores

States	1956-57 Actuals	1957-58 Likely Actuals	1958-59 Agreed	1956-59 Total	Five Year Estimates 1956-61
Andhra Pradesh	0.7	3.3	4.6	8.6	11.3
Assam	...	...	...	...	5.0
Bihar	0.1	0.7	4.4	5.2	28.3
Bombay	...	...	4.5	4.5	23.3
Kerala	...	2.1	2.6	4.7	8.6*
Madhya Pradesh	...	1.6	1.9 1.3	4.8	23.04*
Madras	0.6	1.5 0.6	2.0 2.9	7.6	12.6*
Mysore	0.2	1.3	4.8	6.3	9.2
Orissa	...	0.5	1.7	2.2	8.0
Punjab	0.6	4.3	2.8	2.1	4.3
Rajasthan	0.8	1.0 0.8	0.8 1.8	5.2	9.0*
U. P.	3.8	0.5 0.6	...	17.3	46.0
West Bengal	1.7	1.7	5.0	8.4	15.1
Jammu & Kashmir	...	0.2	0.4	0.6	...

Source : Planning Commission Review of Progress of Second Five Year Plan.

(* Tentative estimates worked out by the Planning Commission for the reorganised States).

Financial estimates for 1958-59 are based on Planning Commission's discussions with State Governments which took place prior to the presentation of their budgets for the year to the State legislatures. These estimates would need to be reviewed to some extent in the light of the budgets as finally passed.

Statements XI

Estimated Yield from Additional Taxation over Third Plan

States	Yield in 1961-62	Yield over a year	Yield over the Third Plan
1. Andhra Pradesh	...	...	...
2. Assam	0.15	0.23	1.51
3. Bihar	...	...	...
4. Gujarat	1.19	1.55	7.69
5. Jammu & Kashmir	...	...	...
6. Kerala	1.13	1.32	8.54
7. Madhya Pradesh	0.14	0.15	0.74
8. Madras	...	...	...
9. Maharashtra	1.26	1.86	10.62
10. Mysore	1.14	1.90	8.14
11. Orissa	1.50	2.92	13.91
12. Punjab	2.71	3.09	16.78
13. Rajasthan	1.23	1.50	8.30
14. Uttar Pradesh	4.10	5.70	26.95
15. West Bengal	0.14	0.72	3.26
	14.69	20.95	106.44

Source : Progress Report, Third Five Year Plan (1961-62) p. 34.

Statement XII

Expenditure of the Government of India—Revenue Account

	1951-52 (Accounts)	1955-56 (Accounts)	1956-57 (Accounts)	1957-58 (Accounts)	1958-59 (Accounts)	1959-60 (Accounts)	1960-61 (Accounts)	1961-62 (Accounts)	1962-63 (Accounts)	1963-64 (R.E.)	1964-65 (B.E.)
1. Collection of taxes, Duties and other Principal Revenues(*a*)	10.24	12.51	14.45	15.56	19.44	20.84	22.43	21.16	23.57	23.67	25.34
2. Civil Administration(*b*)	21.29	33.57	38.06	42.01	48.11	52.04	58.66	59.17	75.18	80.45	81.84
3. Defence Services	164-13	172.23	192.15	256.72	250.93	230.86	247.55	289.54	425.30	692.55	717.80
4. Debt Services(*c*)	37.36	43.14	39.06	42.08	48.63	69.38	77.09	82.85	245.43	282.06	318.41
5. Pensions, Superannuation and Privy Purses (including allowances)	6.99	8.97	8.96	9.24	9.52	9.97	10.04	10.24	10.63	10.77	11.04
6. Extraordinary Charges (*d*)	0.07	—	—	—	—	—	3.68	13.63	64.22	83.90	147.31
7. Miscellaneous (*e*)	44.28	48.82	42.34	61.03	73.05	90.41	117.82	57.10	81.31	71.53	78.80
8. Social Developmental Services(*f*)	39.50	82.41	108.09	154.14	175.74	210.09	236.40	176.9	186.09	177.29	199.54
9. Contributions & Miscellaneous adjustments between Union and State Governments (*g*)	15.59	35.87	28.26	42.90	46.25	48.94	48.55	198.01	198.45	239.16	293.21
10. Other Expenditure(*h*)	7.19	3.22	2.46	3.65	3.79	3.51	3.99	3.95	4.06	3.56	3.47
Total Expenditure	346.64	440.74	473.83	631.33	675.46	736.04	826.21	911.94	1,314.14	1,664.94	1,876.76

Note : The figures from 1962-63 onwards, particularly in respect of items VII, X, XII and XVI are not comparable with those for earlier years, owing to changes in accounting classification.

(a) Excludes forests, opium and State's share of Union excise duties and additional excise duties.

(b) Comprises General Administration, Audit, Administration of Justice, Jails, Police, Tribal Areas and External Affairs, with effect from 1961--62 expenditure relating to Tribal Areas is adjusted under the relevant major heads closely connected with the object of the expenditure. From 1962-63, this includes miscellaneous departments of Administrative nature and Supplies and Disposals.

(c) Include appropriation for reduction or avoidance of debt. From 1962-63, these also include interest charges on capital advanced to commercial departments like Railways and Posts and Telegraphs which were hitherto booked in the accounts in reduction of receipts.

(f) Include provision for grants to States for G.M.F. Schemes, relief in natural calamities, etc. From 1954-55 these items were transferred to miscellaneous expenditure under appropriate ministries from 1961-62 These figures are shown against item XVII. Since 1957-58 it includes provision for transfer to the special Development Fund of grants received under P. L. 480. From 1962-63 (R.E.) it includes Emergency Risks (Goods and Factories) Insurance Funds.

(e) Includes certain grants to States. From 1961-62 these grants are shown against item XVII.

(f) Comprise irrigation and multipurpose river schemes, ports and pilotage lighthouses and lightships, scientific departments, education, medical, public health, agriculture, rural development, animal husbandry, co-operation, industries (and supplies upto 1961-62), aviation, broadcasting, civil works, post-war reconstruction and electricity Schemes, community development projects, national extension service, labour and employment, overseas communications service, and miscellaneous departments.

(g) Include grants-in-aid to States; all grants to States are grouped together under this item from 1961-62.

(h) Comprises famine, stationery and printing, civil defence and pre-partition payments,.

Statement XIII

Development and Non-Development Expenditure of States

(Crores of Rs.)

	1951-52 (Accts.)	1955-56 (Accts.)	1956-57 (Accts.)	1960-61 (Accts.)	1961-62 (Accts.)	1962-63 (Accts.)	1963-64 (B.E.)	1963-64 (R.E.)	1964-65 (B.E.)
Development Expenditure									
Education	60.3	104.1	113.4	195.4	234.5	250.5	266.3	276.2	307.7
Medical and Public Health	29.2	47.2	47.5	80.8	94.0	106.8	110.9	113.1	127.8
Agriculture, Veterinary and Co-op.	25.9	39.0	38.8	66.0	75.8	85.5	100.7	100.7	120.0
Irrigation	17.6	23.5	22.9	31.4	35.5	39.9	40.8	45.5	48.3
Electricity Schemes	4.6	8.4	10.4	5.4	3.0	2.4	3.6	3.7	4.5
Rural and Community Dev. Projects	0.8	26.9	26.9	52.3	57.6	62.1	63.2	64.9	80.1
Civil Works	41.0	68.3	55.1	67.4	84.4	88.9	87.1	90.5	95.8
Industries and Supplies	5.8	3.5	7.1	21.8	23.8	26.2	30.1	28.6	33.8
Other Development Expenditure (*a*)	11.0	17.0	19.6	49.2	5.15	57.8	71.9	73.3	87.0
Total Development Expenditure	196.2	337.9	341.9	56.97	660.2	720.1	774.6	796.4	905.0
Collection of Taxes, Duties and other Principal Revenues	26.9	46.0	49.2	66.2	62.2	58.7	66.0	66.5	70.7
Debt Services	8.5	18.8	26.9	84.4	99.7	152.5	178.6	201.0	209.9
Civil Administration	106.7	122.4	131.5	167.0	185.4	202.3	203.5	209.3	215.6
Miscellaneous	17.5	31.0	36.3	42.9	50.2	68.6	75.2	80.4	82.7
Famine	4.0	16.6	13.0	21.5	22.5	15.6	11.6	17.5	10.7
Other Non-Development Expenditure (*b*)	32.8	31.4	29.9	35.7	41.1	43.2	55.8	50.9	53.3
Total Non-Development Expenditure	196.4	266.2	286.8	417.7	461.1	540.8	590.7	625.5	642.9
Total Expenditure	392.6	604.1	628.4	987.4	1121.3	260.9	1365.2	1422.0	1547.9

Note : (*a*) Includes expenditure on scientific and miscellaneous departments, aviation and ports and pilotage; from 1962-63 expenditure on miscellaneous departments of an administrative nature has been shown under Civil administration.

(*b*) Includes pensions, stationery and printing and extraordinary charges, dividends in respect of all investments in autonomous undertakings but excludes transfers to funds.

Source : Reserve Bank of India Bulletin, June 1964, p. 593.

Statement XIV (a)

Income and Expenditure of All Local Authorities (First Survey)
(Revenue and Capital) 1951-52, 1955-56 & 1956-57

Rs. in Lakhs

	1951-52	1955-56	1956-57	Percentage variation of 1955-56 over 1951-52	Percentage variation of 1956-57 over 1951-52
1. Taxes	22,94.14 (33.80)	20,37.88 (31.71)	31,78.93 (32.33)	+28.06	+38.57
2. Grants-in-aid	2,88.72 (4.25)	4,10.30 (4.43)	4,74.62 (4.81)	+42.11	+64.39
3. Loan Receipts	7,96.97 (11.74)	17,67.29 (19.07)	14,27.30 (14.47)	+121.75	+79.09
4. Other receipts	34,08.06 (50.21)	41,50.03 (44.79)	47,83.37 (48.49)	+21.77	+40.36
5. Total Income	67,87.88	92,65.50	92,64.22	+36.30	+45.32
6. Total Expenditure	64,20.54	82,35.69	100,21.95	+28.27	+56.09

Note : Figures in brackets represent percentages to total.
Source : Reserve Bank of India Bulletin April 1958, p. 369.

Statement XIV (b)

Income and Expenditure of All Local Authorities (Second Survey)
(Revenue and Capital) 1956-57 to 1958-59

Rs. in Lakhs

	1956-57	1957-58	1958-59	Percentage variation of 1957-58 over 1956-57	Percentage variation of 1958-59 over 1956-57
1. Rate & Taxes	46,67.50 (46.26)	49,92.44 (44.63)	51,25.29 (39.75)	+6.96	+9.81
2. Receipts from Remunerative enterprises	12,14.80 (12.04)	13,21.77 (11.82)	14,84.77 (11.51)	+8.81	+2.22
3. Fees Fines, etc.	1,03.46 (1.03)	1,06.06 (0.95)	1,17.84 (0.91)	+2.51	+13.90
4. Grants from Government	3,85.65 (3.82)	4,59.17 (4.10)	6,69.51 (5.19)	+19.06	+73.61
5. Loan Receipts	14,85.03 (14.72)	17,19.85 (15.38)	27,92.97 (21.66)	+15.81	+88.07
6. Other Receipts	22,32.57 (22.13)	25,86.56 (23.12)	27,04.91 (20.98)	+15.86	+21.16
Total Income	100,89.01	111,85.85	128,95.29	+10.87	+27.82
Total Expenditure	97,31.22	118,92.71	138,54.77	+22.21	+42.37

Note : Figures in brackets represent percentages to total.
Source : Reserve Bank of India February, 1959, p. 166.

Statement XV

International Comparison of Consumption of Expenditure (1952)

Country	Personal consumption Expenditure of percentage of National Expenditure (per cent)
Norway	59.8
Sweden	62.9
Canada	64.8
Australia	65.0
Germany	65.9
Japan	67.5
U.S.A.	68.7
Denmark	70.5
Netherlands	70.8
U.K.	71.3
New Zealand	71.5
France	73.2
India	80.0 (Approx.)
Ceylon	81.0
Ireland	81.8
Peru	81.9
Burma	82.3
Guatemala	82.3
Columbia	82.6
Chile	86.0
Philippines	86.5
Mexico	87.4
Puerto Rico	88.8

Source : U. N. Monthly Bulletin of Statistics, June 1953,pp. x-xiv.

Statement XVI

Balance of Payments on Current Account (International) 1946 to 1950

	In millions of currency units				
	1946	1947	1948	1949	1950
Ceylon (Rs)	—	—180	+13	—30	+150
India[1] (Rs)	—268	—1194	—1029	—2018	672
Pak[2] (Rs)	—	—	+79	—449	—99
Burma[3] (Rs)	—	—242	—240	+175	+62
Phillippines (pesos)	70	—184	103	—137	405
Thailand (US $)	—11	—41	+69	+63	+65
Indonesia (rupiahs)	—	—	+52	—106	+646

1. Excludes transactions with Pakistan. Balances of these were as follows :

July 1948—June 1949 —338
July 1949—June 1950 — 54
January-December 1950 — 17

2. Excludes transactions with India, Afghanistan, Nepal & Tibet

3. Year ending September

Source : Economic Bulletin for Asia and Far East, Vol. II, No. 3, 1951, p. 25.

Statement XVII

Trade Balances (International) (1950 to 1951)

	In Millions of Currency Units		
	January-June 1950	July-December 1950	January-December 1951
Ceylon (Rs)	+ 75	+320	+255
India (Rs)	— 20	— 52	+189
Pakistan (Rs)	+204	+131	+672*a*
Burma (Rs)	+164	+ 56	+220
Philippines (Pesos)	— 89	+ 90	+ 67
Thailand (baht)	+302	+682	+597
Indonesia (rupiah)	+365	+832	+1499

a. Includes export duties but excludes overland trade in June.

Source : Economic Bulletin for Asia and Far East Vol. II,No. 3, 1951, p. 26.

Statement XVIII

Central Government Investment(*a*) as Percent of Deficits (International) 1947-48 to 1951-52

	1947-48	1948-49	1949-50	1950-51(*d*)	1951-52(*e*)
Ceylon	156	130	115	121	77
India	120	64	193	101	110
Pakistan	34	65	55	102	...
Burma	394	(*c*)	194	764	59
Philippines	(*c*)	183	61	63	86
Thailand(*b*)	...	180	158	42	82
Indonesia(*b*)	..	...	19	33	163

(*a*) Capital outlay and loans and advances to local Government for capital outlay.

(*b*) Calender year; thus 1948/49 refer to 1948 Calendar year.

(*c*) There was no deficit this year.

(*d*) Preliminary.

(*e*) Budget estimate.

Source : Economic Bulletin for Asia and Far East, Vol. II, No. 3, 1951, p. 29.

Statement XIX

Pattern of Expenditure in India—April-September 1952.

Items	Expenditure per Head per Person			Percentage to total		
	Rural	Urban	Rural & Urban Combined	Rural	Urban	Rural & Urban Combined
1. Foodgrains	8.70	6.14	8.28	40.57	20.66	36.32
2. Pulses	0.82	0.75	0.81	3.82	2.52	3.55
3. Milk & Milk products	1.35	2.46	1.53	6.30	8.27	6.71
4. Edible Oils	0.45	0.82	0.50	2.10	2.76	2.19
5. Fruits & Vegetables	0.69	1.39	0.81	3.22	4.68	3.55
6. Other Food items (*a*)	1.53	3.25	1.82	7.14	10.94	7.99
Total Food Items	13.54	14.81	13.75	63.15	49.83	60.31
7. Clothing	1.54	2.44	1.69	7.18	8.21	7.42
8. Rent & Taxes	0.37	1.79	0.60	1.73	6.02	2.63
9. Ceremonials	1.22	1.40	1.25	5.69	4.71	5.48
10. Semi-Luxuries(*b*)	1.19	2.45	1.41	5.55	8.25	6.18
11. Education & Medicine	0.51	1.73	0.70	2.38	5.82	3.07
12. Rest (*c*)	3.07	5.10	3.40	14.32	17.16	14.91
Total of Non-Food Items	7.90	14.91	9.05	36.85	50.17	39.69
Grand Total	21.44	29.72	22.80	100.00	100.00	100.00

(*a*) Includes meat, egg and fish, sugar, salt, spices and refreshments.

(*b*) Includes amusement & Musical instruments, pan, tobacco, intoxicants, toilet, sundry equipment and ornaments.

(*c*) Includes fuel and light, bedding, footwear, conveyance, services, furniture, domestic utensils and petty articles.

Source : National Sample Survey Report No. 13 (1952).

APPENDIX I

Central Government Budget, 1965-66

The main features of the budget were—reduction in personal income taxation at all levels, moderate relief in corporate taxation, selective abolition or reduction of excise duties on certain consumer goods along with increases in both import and excise duties on some others. The budget, after several years was presented with an overall surplus of about Rs. 10 crores at existing rates of taxes.

Being the last budget for the Third Plan, it necessitated some additional efforts to achieving the Plan objectives. However, apart from serving the ends of our Plans for development, the Finance Minister stated, "the budgetary policy must also make an impact on the immediate problems that confronted us from year to year." Further, he emphasised, "with the continuance of inflationary pressures in the economy, the need for restraint on wasteful or avoidable expenditure and for efforts to get the maximum benefit from outlays already incurred remained as great as ever."

1965-66 budget also acts as a precursor to Fourth Plan activities. About the Fourth the foremost condition for mobilisation of resources for financing the large investment that would be involved is the maintenance of an environment of financial and monetary stability. "It was only then", the Finance Minister stated, "that voluntary savings could be enlarged and directed to productive uses." Equally important is a degree of stability in taxation policies. It might be necessary to adjust the rates of indirect taxation from year to year in keeping with supply and demand conditions. But a greater degree of stability in regard to the structure of direct taxation is no doubt, of vital importance as it has a bearing on long-term decisions in regard to savings and investment. The budget proposals this year were designed to serve this end at least in part.

As a result of the budget proposals there was anticipated a net loss in revenue of Rs. 6.38 crores which would reduce the overall surplus of Rs. 10.16 crores at the existing levels of taxation, to a net surplus of Rs. 3.78 crores, as against a deficit of Rs. 80 crores (revised estimate) for 1964-65.

As far as direct taxes are concerned, changes in the general scheme of corporate taxation were designed to overcome some difficulties of the corporate sector and to eliminate some of the fears regarding the uncertainties in tax laws of the country. While changes were made in the general scheme, essential features of corporate taxation remained unchanged. For example, no changes were made in respect of the Dividend Tax as there is continued need for a restraint to some extent on dividend distribution to check inflationary pressures and also for procuring required resources for investment in corporate sector. Also, no major changes were made in surtax, as the full effects of this measure were still to be assessed. Alterations in the personal taxation were, on the other hand, to simplify the tax structure by integrating super-tax with income-tax and to put a revised and simplified schedule, thereby giving an incentive to save and minimise the scope for tax evasion.

Certain changes in Estate duty, gift tax, wealth tax and Capital gains tax were made to provide some relief to the assessees. Under wealth-tax, to curb down large investments in urban property, a levy of an additional wealth tax was also imposed on assets—buildings or lands other than business premises or any right in such buildings or lands—situated in areas with a population exceeding one lakh, included in the net wealth of an individual or a Hindu Undivided Family at graded rates on the slab system.

While making changes in indirect taxation a balance was tried to be struck between the revenue objective and the anti-inflationary use of taxation. The hardship to public on account of the high prices of commodities of daily use was kept in view. Also, levies on certain items were raised or new ones imposed with a view to restraining consumption of luxury goods. Further, in order to correct distortion in the prices of various other commodities based on scanty materials—imported or indigenous, it was decided to mop up excessive profits through selective increases in both import and excise duties.

The financial effects of the various changes in taxation in 1965-66 Budget (main) were estimated as follows :

Tax Proposals	*Estimated Loss or Addition to revenue*(—or+)
1. *Direct*	
(*a*) Income Tax (Loss of revenue on account of proposed changes offset by increased collections expected)	Nil
(*b*) Corporation Tax	—14.40
(*c*) Wealth Tax	+ 1.50
Total	—12.90

2. *Indirect*		
(*a*)	Union Excise	— 7.98*
(*b*)	Customs (Including countervailing duties)	+14.50
	Total II	+ 6.52
3. *Grand Total* (*I* + *II*)		— 6.38

Revenue from income-tax was expected to show a loss of Rs. 21 crores as a result of (*i*) streamlining and replacement of the existing tax structure by a revised and unified schedule with lowered taxes at all levels of personal income (*ii*) integration of super-tax with income-tax (*iii*) tax relief to professionals like Chartered Accountants, Architects and Solicitors etc., and (*iv*) the raising of the monetary limit for tax rebate in respect of contribution to provide fund, insurance premia and the cumulative time deposits to Rs. 12,500 together with the offer of straight deduction from income of 50% of the amount contributed to the items eligible for relief. However, the loss of revenue on account of these changes were estimated to be offset by improvement in tax collection.

The new loss of Rs. 14.40 crores under corporate taxation was estimated on account of the modifications in its existing structure as summarised below :

(1) *Income-tax on Companies* :—In the case of companies, a composite rate of income-tax at 80% has been prescribed for the assessment year 1965-66, consequent on the integration of super-tax with income-tax (made up of the pre-merger income-tax at 25% and super-tax at 55%) on incomes other than capital gains. But this is subject to various rebates on different categories of income, corresponding to the rebates of super-tax admissible under the Finance Act, 1964. The additional concessions given in the Finance Act 1965 are (*a*) concession to companies in which public are not substantially interested and which are wholly or mainly engaged in the manufacture or processing of goods or construction of ships or in mining or the generation or distribution of electricity. (*b*) The area of benefit of special rebate granted to companies engaged in priority industries under the Finance Act 1964 was enlarged by addition of new items such as ship-building and also industries engaged in manufacture of limestone, flame and drip proof motors malleable iron and steel castings, etc.

(2) *Export Incentives* :—As a measure of export promotion a tax credit certificate would be granted (exempt from income-tax to the extent of the amount of tax credit certificate) to any person exporting goods or merchandise out of India after February 28, 1965 and who receives the sale proceeds thereof in India through recognised foreign exchange channel.

* Exclusive of a sum of Rs. 5.02 crores as States' share.

(3) *Tax on Capital Gains arising in Transfer of Lands in Urban Areas* :—A relief was provided to public limited companies owning an industrial undertaking, from tax on the capital gains arising to them from the transfer of lands and buildings, situate in an urban area, where such transfer has been effected with a view to shifting to any other area. This may also help to solve the problem of overcrowding of factories in big cities.

(4) *A tax credit certificate scheme* was introduced for granting the certificates to companies engaged in the manufacture or production of any of the articles specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 for a period of five years from 1966-67. Similarly, it was proposed to provide *tax-free* tax credit certificate to manufacturers who produce goods during any one or more of the five financial years from 1965-66 in excess of their production during the base year, at an amount not exceeding 25% of the difference between central excise duty paid for relevant year and the base year. These reliefs were intended to serve as an incentive to production of selected industries and also provide resources for expansion of such industries.

(5) *Development allowance to tea plantation industry.*

(6) *Development rebate* :—In respect of the machinery (except new ships and new coal mining machinery) and machinery plant installed after March 3, 1965 two rates of development rebate were introduced for different specified industries.

(7) *Preference Shares (Regulation of Dividends) Act,* 1960 :—In view of the proposed integration of super-tax with income-tax, a new section was introduced in preference Shares (Regulation of Dividends) Act, 1960 which seeks to provide that in respect of preference shares, the stipulated dividend on which is subject to a deduction by the company concerned of the income tax payable by it, the company shall not make a deduction in excess of 25% of the amount of the stipulated dividend on such shares, 25% being the existing rate at which income-tax is chargeable on companies.

(8) *Companies(Profits) Surtax Act,* 1956—Besides a few drafting amendments to the companies (Profits) Surtax Act, 1956 which were needed in view of the merger of super-tax with income-tax, the two amendments were : (*a*) The aggregate amount of income-tax and surtax on certain categories of companies was limited to 70% of their total income, (*b*) Certain items to the list of articles in the Third Schedule to the above Act were added, the profits derived from the production or manufacture of which qualified for a rebate of surtax.

Changes in Indirect Taxes: *Excise Duty* :—Excise duty on footwear, cycle parts, cycle tyres and tubes, printing and writing paper used in the publication of registered dailies including their weekly issues was removed.

Effective rates of fabric duty on price controlled varieties of grey as well as processed coarse and medium cloth were reduced

by 50%. Duty on vegetable products was reduced by 50%. On cheaper type of printing and writing paper and certain other qualities of typing and manifold paper it was reduced by 30%. Duty on rayon yarn of coarser quality and cellulose staple fibre was also reduced. There was also a marginal reduction of duty on staple fibre yarn. Duties on a few other items such as silk fabrics, gramophone, cigars and silver were also removed. These reductions were estimated to cause a loss of Rs. 29.5 crores.

The duty on the following items were increased—Copper and copper alloys in crude form; steel ingots, plates and rails; sleeper bars; semi-finished products; bars, rods and structurals; black sheets and hoops; skelp, strips, galvanized plates and sheets; tin plates and sheets. The increase of duty on the group were estimated to yield an additional revenue of Rs. 15.75 crores. The total exemption now enjoyed by a large number of small powerloom units producing cotton fabrics was replaced by a small compounded levy of Rs. 25 per annum per loom.

The net loss of revenue as a result of all changes in excise duties were estimated to be Rs. 13 crores. Because of the steady increase in excise duty revenue from Rs. 145 crores in 1955-56 to about Rs. 773 crores in 1964-65, the government for the first time in many years was able to give relief to the consumer without any significant sacrifice of revenue on the whole.

Customs Duties.—The regular customs duty of 10% of the value of imported goods imposed some time earlier was continued. In some cases, it was necessary to increase the present rates of duties where there was a very large gap between the landed prices and the current market prices. Therefore, it was proposed to increase the import duty on stainless steel plates and sheets, steel tin plates, non-cellulose silk yarn and thread paints, colours and painter's materials not otherwise specified, sodium hydro-sulphate, essential oils and perfumery not otherwise specified, paper not otherwise specified but excluding newsprint, printing and writing paper, and raw cotton.

Total additional revenue for customs were estimated to be Rs. 14.5 crores. The net effect including customs and excise, as estimated, was a small increase in revenue of Rs. 1.5 crores in 1965-66.

Supplementary Budget (August, 1965)

The Central Finance Minister presented to the Lok Sabha on August 19, 1965 a supplementary budget proposing additional duties to yield about Rs. 173 crores in a full year—Rs. 130.9 crores from customs and Rs. 42.2 crores from excise, Excluding the State's share of Rs. 6 crores, the additional revenue accruing to the Centre would be about Rs. 167 crores in a full year or a little over Rs. 100 crores for the rest of the current financial year.

The Finance Minister explained that the supplementary tax measures were inevitable in order to meet additional commitments (payment of Rs. 25 crores of increased dearness allowance to Central Government Employees and additional assistance of Rs. 40 crores to States to enable repayment of their over-draft obligations to the Reserve Bank) and to cover anticipated short falls in revenue, together accounting for Rs. 110 crores. Supplementary measures were necessary to avoid deficit financing during current year. He contended that the measures adopted had to be consistent with the long-range interests of the economy. Mobilisation of internal resources of another Rs. 3,000 crores and something more would be required during the next Plan period if the tempo of development of the economy was to be maintained at a reasonably satisfactory level.

New tax measures.—A statutory import tariff of 40% on machinery has been imposed. The effective rate will be 35% for the time being. The rate for agricultural machinery and implements has been put to 15%, for certain basic industrial raw materials 60% and for consumer goods 100%. The 10% regulatory import duty will be continued while the surcharge of 10% of duty payable on imports has been withdrawn.

The import of books, fertilisers, contraceptives and sulphur will be duty free. The duties on certain essential drugs, baby foods, milk powder and newsprint have been changed.

The entire tariff was proposed to be recast to secure both higher revenue and rationalization, bearing in mind the considerable development that had taken place in the industrial structure over three plans and the imperative need to accelerate the pace of this development.

The following changes have been made in excise duty—

Duty on high-speed diesel oil reduced by Rs. 60 per-kilolitre.

Duty on motor spirit raised by Rs. 50 per kilolitre.

Duty on superior kerosine oil raised by Rs. 50 per kilolitre.

Duty on furnace oil raised by Rs. 40 per metric tonne.

Duty on steel and pig iron and their products up by Rs. 10 per metric tonne.

Duty on copper ingot and copper manufactures raised by Rs. 500 per tonne.

Duty on unwrought lead and zinc raised by Rs. 500 per tonne.

As for industrial development, it was stated, that the priority in coming years must be given to activities asociated with agriculture as well as to the production of materials and equipments

to ensure greater utilisation of existing capacity and improvement in the balance of payments.

Direct taxes.—An exemption has been granted from the tax on the bonus received by individuals on cumulative time deposits and concessional rate of tax on interest received by individuals on the encashment of the recently issued National Savings Certificates (first issue) and authorizing the payment of tax on these certificates without deduction of tax at source. Exemption would also be due in respect of the recently issued 7% Gold Bonds 1980, from Wealth Tax and Capitals Gains arising on the transfer of such bonds from income-tax on such bonds without deduction of tax at source in certain cases, on the same lines and subject to the same condition as already applied in respect of the Gold Bonds 1977.

Donations made for charitable purposes now qualify for a rebate of income-tax. It was also clarified that a charitable purpose would not include a purpose which was wholly or mainly religious in nature. This amendment will have effect in respect of donations made on or after April 1, 1964. Similar amendments were made in Gift Tax Act and Estate Duty Act.

Some concessions to the corporate sector were also announced. The rate of development rebate was raised from 25% to 35% in the case of certain priority industries in which coal mining was also included. In the case of all other industries it was proposed to extend the period of operation of the general development rebate of 20% by 3 years upto March 31, 1970, after which the lower general rate of 15% would apply.

Income-tax and Surcharge on Income-tax (1965-66)

Paragraph A

In the case of every individual or Hindu undivided family or unregistered firm or other association of persons or body of individuals, whether incorporated or not, or every artificial juridical person referred to in sub-clause (vii) of clause (31) of section 2 of the Income-tax Act, not being a case to which any other Paragraph of this Part applies—

Rates of Income-tax

(1) where the total income does not exceed Rs. 5,000	5 per cent. of the total income.
(2) where the total income exceeds Rs. 5,000 but does not exceed Rs. 10,000	Rs. 250 *plus* 10 per cent. of the amount by which the total income exceeds Rs. 5,000.
(3) where the total income exceeds Rs. 10,000 but does not exceed Rs. 15,000	Rs. 750 *plus* 15 per cent. of the amount by which the total income exceeds Rs. 10,000.

(4) where the total income exceeds Rs. 15,000 but does not exceed Rs. 20,000.	Rs. 1,500 *plus* 20 per cent of the amount by which the total income exceeds Rs. 15,000.
(5) where the total income exceeds Rs. 20,000 but does not exceed Rs. 25,000	Rs. 2,500 *plus* 30 per cent. of the amount by which the total income exceeds Rs. 20,000.
(6) where the total income exceeds Rs. 25,000 but does not exceed Rs. 30,000	Rs. 4,000 *plus* 40 per cent. of the amount by which the total income exceeds Rs. 25,000.
(7) where the total income exceeds Rs. 30,000 but does not exceed Rs. 50,000	Rs. 6000 *plus* 50 per cent of the amount by which the total income exceeds Rs. 30,000.
(8) where the total income exceeds Rs. 50,000 but does not exceed Rs. 70,000	Rs. 16,000 *plus* 60 per cent of the amount by which the total income exceeds Rs. 50,000.
(9) where the total income exceeds Rs. 70,000	Rs. 28,000 *plus* 65 per cent. of the amount by which the total income exceeds Rs. 70,000.

Provided that for the purposes of this paragraph, in the case of a person, not being a non-resident—

(*i*) no income-tax shall be payable on a total income not exceeding the following limit namely

(*a*) Rs. 6,000 in the case of every Hindu undivided family which at the end of the previous year satisfies either of the following two conditions, namely:—

(*i*) that it has at least two members entitled to claim partition who are not less than eighteen years of age; or

(*ii*) that it has at least two members entitled to claim partition who are not lineally descended one from the other and who are not lineally descended from any other living member of the family :

(*b*) Rs. 3,000 in every other case;

(*ii*) Where such person is an individual or a Hindu undivided family, the income-tax computed at the rate here-in-before specified shall be reduced by so much of the amount specified hereunder, as does not exceed the amount of income-tax so computed :—

(*a*) Rs. 100—in the case of an unmarried individual;

(*b*) Rs. 175—in the case of a married individual who has no child wholly or mainly dependent on him or a Hindu undivided family which has no minor coparcener;

(c) Rs. 195—in the case of a married individual who has one child wholly or mainly dependent on him or a Hindu undivided

family which has one minor coparcener wholly or mainly supported from the income of such family;

(*d*) Rs. 215—in the case of a married individual who has more than one child wholly or mainly dependent on him or a Hindu undivided family which has more than one minor coparcener wholly or mainly supported from the income of such family;

(*iii*) where the total income is twenty thousand rupees or less, the income-tax payable shall not exceed forty per cent of the amount by which the total income exceeds the limit specified in sub-clause (*a*) or, as the case may be, sub-clause (*b*) of clause (i) of this proviso.

Surcharge on Income-tax

The amount of income-tax computed in accordance with the preceding provisions of this Paragraph shall be increased by a surcharge for purposes of the Union, which shall be equal to the aggregate of the sums computed as hereunder :—

(*a*) where—

(*i*) in the case of an individual or a Hindu undivided family, the amount of unearned income, not being income by way of interest on any security of the Central or State Government or income-received in respect of units from the Unit Trust of India under the Unit Trust of India Act, 1963 included in the total income, or

(*ii*) in any other case, the amount of unearned income included in the total income

exceeds Rs. 15,000.

a sum calculated on the difference between the amount of income-tax computed in respect of the income referred to in sub-clause (*i*) or, as the case may be, sub-clause (*ii*), if such income had been the total income and the amount of income-tax computed in respect of an income of Rs. 15,000 if it had been the total income, at the following rate, namely :—

(1) where the amount of the difference does not exceed Rs. 14,500	20 per cent. of the amount of such difference.
(2) where the amount of the difference exceeds Rs. 14,500	Rs. 2,900 *plus* 25 per cent. of the amount by which the difference aforesaid exceeds Rs. 14,500.

(*b*) where—

(*i*) in the case of an individual or a Hindu undivided family, the earned income and income by way of interest on any security of the Central or State Government and income received in respect of units from the Unit Trust

of India under the Unit Trust of India Act, 1963 included in the total income, or

(*ii*) in any other case, the earned income included in the total income

exceeds Rs 1 lakh.

a sum calculated on the amount of the difference between the income-tax computed in respect of the income referred to in sub-clause (*i*), or, as the case may be, sub-clause (*ii*), if such income had been the total income and the income-tax computed in respect of a total income of Rs. 1 lakh, at the following rate, namely :—

(1) where the amount of the difference does not exceed Rs. 65,000	5 per cent of the amount of such difference.
(2) where the amount of the difference exceeds Rs. 65,000 but does not exceed Rs. 1,30,000	Rs. 3,250 *plus* 10 per cent. of the amount by which the difference aforesaid exceeds Rs. Rs. 65,000.
(3) where the amount of the difference exceeds Rs. 1,30,000	Rs. 9,750 *plus* 15 per cent. of the amount by which the difference aforesaid exceeds Rs. 1,30,000.

Paragraph B

In the case of every association of persons being a co-operative society as defined in clause (19) of section 2 of the Income-tax Act,—

Rates of Income-tax

(1) where the total income does not exceed Rs. 5,000	5 per cent. of the total income.
(2) where the total income exceeds Rs. 5,000 but does not exceed Rs. 10,000	Rs. 250 *plus* 10 per cent of the amount by which the total income exceeds Rs. 5,000.
(3) where the total income exceeds R. 10,000 but does not exceed Rs. 15,000	Rs. 750 *plus* 15 per cent of the amount by which the total income exceeds Rs. 10,000.
(4) where the total income exceeds Rs. Rs. 15,000 but does not exced Rs. 20,000.	Rs. 1,500 *plus* 20 per cent. of the amount by which the total income exceeds Rs. 15,00.
(5) where the total income exceeds Rs. 20,000 but does not exceed Rs. 25,000	Rs. 2,500 *plus* 25 per cent. of the amount by which the total income exceeds Rs. Rs. 20,000.
(6) where the total income exceeds Rs. 25,000	Rs. 3,750 *plus* 41 per cent. of the amount by which the total income exceeds Rs. 25,000.

provided that—

(*i*) No income tax shall be payable on a total income not exceeding Rs. 3,000 and;

(*ii*) where the total income is Twenty Thousand rupees or less, the income-tax payable shall not exceed forty per cent. of the amount by which the total income exceeds Rs. 3,000.

Surcharge on Income-tax

Where the total income exceeds Rs. 25,000, the amount of income-tax on such total income computed at the rates hereinbefore specified shall be increased by a surcharge for purposes of the Union of 6.25 per cent. of the amount of the difference between the income-tax so computed and the income-tax computed in respect of a total income of Rs. 25,000.

Paragraph C

In the case of every registered firm,—

Rates of Income-tax

(1) where the total income does not exceed Rs. 25,000	Nil
(2) where the total income exceeds Rs. 25,000 but does not exceed Rs. 50,000	6 per cent. of the amount by which the total income exceeds Rs. 25,000.
(3) where the total income exceeds Rs. 50,000 but does not exceed Rs. 1,00,000	Rs. 1,500 plus 8 per cent. of the amount by which the total income exceeds Rs. 50,000.
(4) where the total income exceeds Rs. 1,00,000	Rs. 5,500 *plus* 12 per cent. of the amount by which the total income exceeds Rs. 1,00,000.

Surcharge on Income-tax

The amount of income-tax computed at the rates hereinbefore specified shall be increased by a surcharge for purposes of the Union of twenty per cent. of the amount of income-tax.

Provided that in the case of a registered firm whose total income includes income derived from a profession carried on by it and the income so included is not less than fifty-one per cent. of such total income, the amount of surcharge for purposes of the Union computed at the rate hereinbefore specified shall be reduced by one-half of such amount.

Paragraph D

In the case of every local authority,—

Rate of Income-tax

On the whole of the total income ... 45 per cent.

Surcharge on Income-tax

The amount of income-tax computed at the rate hereinbefore specified shall be increased by a surcharge for purposes of the Union of ten per cent. of the amount of income-tax.

Paragraph E

In the case of the Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956,—

Rate of Income-tax

On the whole of its profits and gains from life insurance business ... 47·5 per cent

Paragraph F

In the case of every company, other than the Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956,—

Rate of Income-tax

On the whole of the total income.....80 per cent.

Provided that a rebate shall be allowed in the case of such companies on such income at the rate or rates specified, and according to further provisos given. (*Vide* Finance Act, 1965), Schedule I)

APPENDIX II

Fourth Finance Commission

Under Article 280 (3) of the Indian Constitution, the Fourth Finance Commission headed by Dr. P. V. Rajamannar, was appointed by the Union Government in May 1964. The Commission was asked to cover the entire Fourth Plan period from 1966-67 to 1970-71. The following were the terms of reference of the Commission :

(*i*) To determine the distribution of the net proceeds of taxes between the Union and the States. (*ii*) To formulate the principles which should govern the grants-in-aid from the Centre to the States. Besides these, the Commission was asked to make recommendations in respect of the following :

1. The quantum of assistance that may be granted by way of grants-in-aid under Article 275 to those States which are in need of such assistance. For this purpose the Commission had to take into account the following factors : (*i*) the revenue resources of the States during period of the Fourth Plan other than those to be raised by way of additional taxation, (*ii*) the requirements of these States to meet the committed expenditure on maintenance and upkeep of Plan schemes completed during the Third Plan, (*iii*) the moneys required for servicing of the debt, including the debt to be incurred in the Fourth Plan, (*iv*) the setting apart of the proceeds of estate duty on property other than agricultural land, over specified limits for the payment of States' debt to the Centre and (*v*) the scope for economy consistent with efficiency, which may be effected by the States in their administrative expenditure.

2. Changes, if any, to be made in the principles governing the distribution among the States, under Article 269 of the net proceeds in any financial year of estate duty in respect of property other than agricultural land.

3. Changes, if any, to be made in the principles governing the distribution of the grants to be made available to the States in lieu of taxes on railway fares.

4. Changes, if any, to be made in the principles governing distribution of the net proceeds of additional excise duties

levied in replacement of States' sales tax on cotton textiles, tobacco and sugar.

5. The effect of combined incidence of State's Sales Tax and Union excise duties on the production, consumption or export of commodities or products, the duties on which are shareable with the States and the adjustments, if any, to be made in the States' share of Union excise duties as a result of the increase in the States' Sales Tax on such commodities or products over a limit to be specified by the Commission.

Th Commission submitted its report on August 13, 1965. The Commission's report together with the Government's decision thereon was presented to the Parliament on September 10, 1965, by the Finance Minister, the salient features of which are discussed below :

States' Share of

1. *Income-Tax* : The Commission has assessed the revenue receipts and non-Plan expenditure of the different States for the five-year period 1966-67 to 1970-71 and estimated the total non-Plan revenue gap at Rs. 2,426.69 crores. On the basis of the quinquennial review of the financial relations between the Centre and the States, the Commission has recommended the transfer of additional resources of the order of Rs. 780 crores by the former to the latter. The Commission has stepped up the States' share in the divisible pool of revenue from income-tax from 66-2/3 per cent to 75 per cent. The share of each State will continue to be determined on the existing basis of 80 per cent on population and 20 per cent on collection. This was the formula suggested by both the First and Third Finance Commissions, while the Second Finance Commission had put greater weightage on population by raising the share from 80 to 90 per cent.

2. *Excise Duties* : As far as excise duties are concerned, there is no change in the share of the States and it will continue at 20 per cent of the actual collection, but the States will get a share of the excise duties on all commodities instead of only 35 commodities at present.

The entire net proceeds of additional excise duties, other than those attributable to Union Territories, on textiles, tobacco and sugar, which were levied in lieu of States' sales tax, will accrue to the States. Of the total net proceeds, the Commission has retained the share of Union Territories at 1 per cent. The shares of Jammu and Kashmir and Nagaland are fixed at 1.5 per cent and 0.05 per cent respectively. The excess over the guaranteed amount has been recommended for distribution among the States, other than Jammu and Kashmir and Nagaland on the basis of the proportion of sales tax revenue realised in each State to the total sales tax collection in all the States taken together.

3. *Estate Duty* : The States will get the net proceeds of the estate duty on property other than agricultural land, except those attributable to Union Territories. The Commission has increased the share attributable to Union Territories from one per cent to two per cent.

4. *Railway Fare Grant* : Besides a larger share of income-tax, excise duties, and the whole of the net proceeds of estate duty, the States will be entitled to get grants in lieu of the loss suffered by them following the abolition of tax on railway passenger fares. The distribution of the grant payable will continue to be based on the principle of compensation so as to place the States broadly on the same footing as they were before the tax was abolished. The Finance Commission has recommended only the percentage distribution; the actual amount of the grant will be fixed on the recommendations of the Railway Convention Committee.

Grants-in-Aid

The Finance Commission has also recommended more liberal grants to States. At present 12 States are receiving grants-in-aid of their revenues amounting in all to Rs. 63.75 crores. The following table shows the individual shares of the substantive grants-in-aid received by various States at present, the recommendations of the Fourth Finance Commission and the recommendations accepted by the Union Government.

GRANTS-IN-AID

(*Rupees in crores*)

States	Grants-in-aid received by States at present	Fourth Finance Commission's recommendations	Government's decision
Andhra Pradesh ...	9.50	7.22	13.51
Assam ...	6.00	16.52	16.52
Bihar ...	0.75	...	...
Gujarat ...	5.25	...	...
Jammu and Kashmir ...	2.00	6.57	6.57
Kerala ...	6.25	0.82	20.82
Madhya Pradesh ...	3.00	2.70	2.70
Madras ...	3.00	6.84	6.84
Mysore ...	6.75	18.24	20.82
Nagaland ...	2.75	7.07	7.07
Orissa ...	13.25	29.18	29.18
Rajasthan ...	5.25	6.73	6.73
Uttar Pradesh ...	...	...	9.85
TOTAL ...	63.75	121.89	140.81

From the above table it can be seen that the Government has decided to give larger share than the Commission recommendations to Andhra Pradesh, Mysore and Uttar Pradesh. The Government had to take this decision because the Commission could not include in the expenditure estimates provisions for certain dearness allowance increases on account of orders issued by the State Government's of Andhra Pradesh, Mysore and Uttar Pradesh in July 1965. The Union Government requested Prof. D.G. Karve, a member of the Commission, to assess the liabilities of these States and to recommend on them. On the basis of Prof. Karve's recommendations, an additional grant of Rs. 6.29 crores and Rs. 2.58 crores was granted to Andhra Pradesh and Mysore respectively. Similarly a grant of Rs.9.85 crores will be paid to Uttar Pradesh also. The grant in the case of Uttar Pradesh was fixed after taking into account the surplus of Rs.17.02 crores otherwise available to that State over the Fourth Plan period which will now disappear.

Under the Rajamannar Commission's recommendations, States will thus get Rs. 2,800.42 crores from the Union Government during the Fourth Plan period by means of share of taxes and duties and grants in lieu of tax on Railway fares (Rs.2,190.97 crores) and grants-in-aid (Rs.609.45 crores), while the aggregate non-Plan revenue gap of the States during the Fourth Plan period has been estimated at Rs. 2,426.69 crores. Thus there will be a surplus of Rs. 373.73 crores (Rs. 215.66 crores in Maharashtra, Rs. 89.25 crores in Bihar, Rs. 29.83 crores in Punjab, Rs. 17.02 crores in Uttar Pradesh, Rs. 13.97 crores in West Bengal and Rs. 8.00 crores in Gujarat).

General Recommendations

Some recommendations of a general nature were also made by the Commission relating to institutional provision for inter-Government consultation public indebtedness of States, States' indebtedness to the Centre, etc. The Commission is of the view that the institutional provision for inter-Government consultation will be helpful to all concerned in promoting clearer understanding and formal approval of common financial policies. Once such consultation practice is established it will tend to cover a growing area of common financial interest.

In respect of borrowings by States, it has recommended an early enquiry through a representative and expert body to decide the principles of a scheme of amortisation of public borrowings by States. The recommendations of this body should form the basis on which all State Governments should be given an opportunity to recast their expenditure for the next five years.

The more important is the inter-Government borrowings, The Commission is of the view that the Government of India cannot appraise the credit of a State Government and certainly not of a number of State Governments, differently from its own

credit. So it has recommended a survey of the soundness of the present system of inter-Government borrowings. It is necessary to be clear about the purpose and nature of a loan before its service and amortisation can be put on a sound basis. The Commission has emphasised the need for collection and maintenance of an up-to-date information on consumption data, both household and non-household, on excisable articles as well as commoditywise information of sales tax and excise duties.

The establishment of an organisation in the Ministry of Finance for continuing the Commission's work is also suggested by the Commission.

The Chairman and one of the members have added minutes in which general questions of financial relationship between the Union and the States and the role of the Finance Commission *vis-a-vis* the Planning Commission have been raised. The Chairman in his minutes suggested that the Planning Commission should be made a statutory body independent of the Government. Further, the relative scope and functions of the Finance Commission and the Planning Commission should also be clearly defined by an amendment of the Constitution. He also suggested the review of the financial relationship between Union and State Governments by a special Commission, which can approach several problems that have arisen in the past and are likely to arise in future objectively and realistically. Due to insufficient data, the Commission was unable to undertake a study of the combined incidence of Union excise duties and State's sales tax on production, consumption or export and their effects.

General Reaction

The Commission's award will help the States in filling up their Plan gaps. In all, the States will get over the Fourth Plan period a total of Rs. 2,800 crores, thus not only covering the State's entire non-Plan revenue gap of Rs. 2,426 crores, but also leaving a surplus of Rs. 374 crores. This appears to be essential in view of the widening range of functions of States in the field of social services as well as economic development and the need to maintain the financial viability of States. However, the State Governments will have to show financial responsibility. They will have to do earnest efforts to raise more resources and effect economies. The Commission showed some concern over the mounting debt of States and the heavy servicing burden and has pleaded for a thorough probe of the debt position of States. The Commission's recommendations to continue the existing formula of determining the State's share in the net proceeds of taxes on income other than corporation tax appears to be equitable. In the case of basic excise duties, the Commission has stressed the importance of economic backwardness as a factor in estimating the share of States and has recommended a weightage of 20 per cent. As a result, the percentage shares of

Jammu and Kashmir, Madras, Maharashtra, U. P. and W. Bengal would go up and those of others would be reduced. The formula however does not bring additional benefit to States like Assam, Kerala, M.P. and Orissa which appear to be more backward than some of the benefited States.

(State Bank of India, *Monthly Review*, Oct. 1965).

APPENDIX III

The Tax System in the U.S.S.R.[1]

"Taxation is as prominent a feature in Soviet economic life as it is under capitalism. In fact, because of the commanding role of the State in economic affairs, the average rate of taxation in the U.S.S.R. is perhaps the highest in the world today. The functions commonly performed by taxes are modified in the U.S.S.R., however, by extensive use of direct controls over resources and prices."[2]

This is necessarily due to the planned centralised economy, which makes a difference in the rate of taxation in the Soviet Union as compared with a market economy where taxation is an independent factor affecting economic decisions. Still they have a large role to play in the Soviet Union.

The tax system in the U.S.S.R. aimed from the very beginning the objectives of, first, the redistribution of national income (though the redistributive effect of the Soviet Tax system was not very large), and secondly, the fiscal task of providing the revenue to the State. Besides this, it also pursued social and political aims by taxing incomes, not only according to their amount but also according to their source. Incomes earned in the State and co-operative enterprises and institutions are taxed at privileged rates, and taxation policy is linked to wage policy. Further, incomes derived from private activities and particularly unearned incomes are taxed very heavily.

In the first month of the existence (October 1917) of the Soviet Government, an attempt was made to collect the previously existing taxes and levies; and in 1918, work was carried out for the adaptation of the old tax system to the new conditions. But as the nationalisation of all branches of economic activities as

1. Source: Alexander Baykov—*The Development of Soviet Economic System*, Maurice Dobb—'*Soviet Economic Development since* 1917'; Holzman F. D. *Soviet Taxation*; Harry Schwartz—*Russia's Soviet Economy*; B. Brutzkus—*Economic Planning in Soviet Russia*; V. Lavrov, "*The Soviet Financial System*" (1959), supplied *by Russian Embassy in India*; *and Economic Survey of Europe* (1951).

2. Holzman, *Soviet Taxation*, p. 12.

well as the depreciation of money proceeded very rapidly, this source of State revenue played a very insignificant role.

Other sources of revenue from taxation, besides the existing ones, were the extraordinary taxes. By the decree of October 30, 1918, the extraordinary 'Revolution tax' of 10 millard roubles was put into operation, and was levied on the better-off sections of the urban and the rural population.

From the beginning of 1921, monetary taxation on agricultural population was levied parallel to taxation in kind already imposed. During 1921-22, excise on many 'packed goods' such as wine, tobacco, matches, salt, sugar, tea were introduced together with a number of other duties and levies. The first direct tax on non-agricultural population was introduced in September 1921 as a trade or craft tax, levied at first only on private and co-operative trade and industrial enterprises. Since 1922 this tax was levied on State enterprises also. In 1922 an 'income property tax' was also introduced on private persons and private property which was extended to State enterprises in 1923. Besides these main taxes, there also existed some special purpose taxes like housing tax, military tax, *etc.*

In 1931, a novel tax system was evolved by the Soviet planners. A tax akin to indirect taxes in other countries, known as the turnover tax, was levied on all kinds of goods meant for either investment or consumption. It accounted for about half of the total revenue in 1931. Evidences show the growing incidence of this tax. In relation to gross national product, the percentage of turnover tax increased from 41% in 1937 to 57% in 1948. Though the ratio of turnover tax to national product has fallen between 1948-52 to 1954, it still accounts for about half of the Soviet national product.

Turnover tax is criticised by non-Soviet writers. It is considered to be discriminatory and oppressive, the highest rate of tax being levied on commonly consumed commodities. For example, on an indispensable article like salt, the tax was so high (in 1951) as to raise its price more than ten times[1] (raising the wholesale price of 95 roubles to the retail price of 980 roubles per ton). The tax is, however, one of the devices to regulate consumption according to the available supplies. Over and above it is one of the most effective instruments to mop up people's surplus purchasing power. The incidence of turnover tax on agricultural population may be considered as very slight.

Profits tax was introduced at the same time as the turnover tax. By this tax the Government is able to drain off profits from different enterprises and industries for reinvestment in other industries and enterprises that may be making no profits or inadequate profits, or for other Government expenditures.

There is the need for the use of both turnover tax and profits

1. *Economic Survey of Europe* (1951), p. 140.

tax, though from the point of view of the consumer, both serve an identical purpose, viz., they constitute a mark-up on cost and thus the absorption of purchasing power. They, however, differ in fiscal reliability, cost of administration, frequency of computation and collection, and effect on incentives.

Turnover tax is used more largely than the profits tax because of the reason that it is impervious to fluctuations in costs. Because of the huge expenditure of the Soviet State, a large amount and constant flow of revenue is required. This purpose is fulfilled by turnover tax. On the other hand, receipts from sales tax, or profits tax fluctuate with the quantity of goods sold, and the latter also depends on costs. This difficulty is obviated by turnover tax which is a good device to collect a bulk of the State revenue.

The Soviet income-tax is not sharply progressive. The principal aim of personal taxes is only that of narrowing down income disparities. Highest rate of taxation in 1959 on incomes of workers was 13% or 2s. 7.½d. in the £. For the lowest paid workers it was only 1.5%.[1] Dobb points out, "It is often believed that the Soviet income-tax is negligible. . . .(But) it is by no means negligible since personal allowances are very small. For certain classes of people such as professional men, craftsmen and artisans whose income must depend on personal enterprise, the rates are higher and the exemption limit is lower. For instance, the tax on handicraft is believed to be 10% higher and the exemption limit is lower still."[2]

Income taxation in the U.S.S.R. possesses the characteristic feature that there are two systems in force, one applied to the urban population and the other to the rural population.

Personal tax is admittedly discriminatory, there are higher taxes for those who depend on private initiative and do not contribute to productive activities in the public sector of industry or agriculture. The urban population liable to pay income-tax is subdivided into the following groups :—

(1) Workers and employees and those ranking as such (co-operative craftsmen working either in co-operative enterprises or in homes). A high non-taxable personal allowance is granted to this category and low rates are fixed for income-tax.

(2) Professional men (writers, artisans, doctors, etc.) The non-taxable personal allowance in this group is much lower, tax rates are higher and increasing in a steeper progression.

(3) Craftsmen and artisans, non-members of co-operative associations and other persons deriving their income otherwise than from paid employment—the non-taxable personal allowances granted to this group are below those of group two, whilst rates are higher and their progression increase steeper.

1. John Baker, *Direct Taxation in Russia*, 'Hindu', March 4, 1959.
2. Dobb, M., op. cit., p. 383.

(4) Persons having an unearned income—No personal allowances are granted to them and the rates of taxation are very high and increase in a particularly steep progression.

Moreover, for the first category of tax payers, taxes are levied separately according to each source of income, whereas in the case of other categories, taxes are levied on the total incomes whatever its sources may be.

Heroes of the Soviet Union—Heroes of Socialist Toil, and holders of the U.S.S.R. awards are exempt, and the pay of men in the forces is also tax free.

Tax payers in the rural population fall into three groups, (1) collective farmers liable to tax on their domestic economies, (2) individual working peasant households, and (3) households having unearned incomes. The first group is subject to lowest tax rates, a more lenient assessment of profits of their domestic economies, and exemption in special cases. Heavier taxes are levied on the second and more so on the third.

Money taxation of agricultural population is relatively unimportant in the State budget, and in recent years probably it has not accounted for more than 2% of total revenue. This is the result of two factors—the dominance of commodity taxation in the Soviet budget and the tax in kind paid by the agricultural sector. Taxation in kind enables the State to impose a high rate of forced saving on the agricultural sector, at the same time it gives the State direct control over agricultural output. Since in the agricultural sector the only State-owned producers are the Sovkhozy, State farms account for only a small share of total agricultural output. Therefore, the State must secure a substantial share of the output of the agricultural sector for urban consumption, industrial use and export.

Taxation in kind takes the form of compulsory deliveries to the State and co-operative procurement agencies, of a specified part of the output of collective farms and individual farmers at very low prices. These prices are a fraction of the retail prices at which the State resells the same commodities and they do not cover the cost of production. The difference between the cost of the commodities to the State and retail price is usually siphoned into the State budget by the turnover tax. The portion of the turnover tax which is collected by virtue of the low procurement price, is in effect a tax on agricultural producer rather than on general consumer, and is the monetary equivalent of the tax in kind. Part of it represents land rent. The remainder represents savings exacted from the rural population over and above the savings exacted from the population as a whole through monetary devices.[1]

The new law on agricultural tax effective from July 1, 1953

1. Holzman, op. cit., p. 82.

lays bare some of the peculiarities of Soviet personal tax structure. It provided the lowering of agricultural tax rates and annulment of tax arrears in order to compensate for the fall in household farm incomes because of the reduction in retail prices of food products. The law laid down that agricultural tax should be computed on the basis of the area of the collective farmers' personal holdings. The annual tax rates on the 100th of a hectare ranged from 3 roubles in the Russian republic to 25 roubles in Georgia, with an average rate of 8 roubles. The actual tax rate to be levied in different regions was left to the discretion of the respective authorities in the republics, territories and districts, but the overall rates fixed under the law could not be changed. The provision that no agricultural tax would be levied on people between the ages of 55 to 60 might at first sight appear to be a benevolent measure, but actually this was made applicable only where they had no able bodied family member capable of working; otherwise they had to pay the usual tax. While concessions to older people were thus severely hedged, households with members working in especially arduous occupations, such as mining and factory were exempt from tax. Persons engaged in skilled professions and liberal arts and living in rural areas—described as the 'rural intelligentsia'—were also exempt from agricultural tax. Those families which had members doing active duty in the armed forces were not made liable to pay this tax, if the family had no other person capable of work, except a wife or mother with children under eight years of age. Families of disabled war veterans were either exempt from tax or were assessed at a concessional rate depending on the category in which the veteran was placed.

On the other hand, for those farmers who had not completed the minimum number of workday units on a collective farm or did no collective farm work, the tax rates were to be respectively higher by 50% and 75% unless they were included in the category of 'workers and employees' in State enterprises, or were pensioners. Individual peasants, that is those who had somehow escaped collectivisation, whose number assuredly would be very small, were to pay double the tax.

In the Soviet Budget for 1959 Mr. M. Nikita Krushchev had promised to abolish direct taxation (income-tax etc. on individuals) which was fulfilled in the Budget for 1960. It hit the world's headlines. It captured the imagination of many. The answer for this lies in the fact that as direct taxes provided only 8% of total Revenue it would not upset the budget balance to cut it altogether. The following breakdown of the sources of tax revenue (1958-59) makes the point clear[1]—

	Percentage of Revenue
Turnover Tax	46
Profits Tax	21

1. Source : 'Hindu,' March 4, 1959.

Taxes paid by Collective farms, Factory Enterprises and foreign trade organisation	25
Direct taxes, income-tax, etc. on individuals	8

For the year 1958-59, the Soviet Budget provided for an expenditure of £ 64,300 millions. It was twice the American and thirteen times the British expenditure. A comparatively small cut in armaments spending might offset the loss of revenue from abolishing income-tax.

APPENDIX IV

Taxation In China[1]

The financial system in China has played an important role in the development of the new economy[2] there, and is "more and more becoming an organ of social transformation."[3] Further, Dr. Gyan Chand in his 'New Economy of China points' out that "It is not, and was never intended to be, merely a revenue collecting and allocating agency; it is really a part of the core of the new economy and,. . . . one of the most important instruments through which it works and fulfils its purposes.[4]

However, revenue aspect of taxation is yet to be considered important, "Both taxation and profits of the State-owned industrial and commercial firms or the co-operatives are the most important channel of raising capital for economic construction. It has to be raised and applied in such a manner as to avoid fundamental disequilibrium in national economy and yet attain and maintain the required rate of development and for purposes vital to the future of the community."[5] As a matter of fact, the difference between profits and taxation there is not very clear. To what extent profits and/or taxation can and should be used for revenue collection are to be determined by experience.

1. The main source of the above information regarding taxation in China is, Dr. Gyan Chand's '*The New Economy of China*'. Some of the research papers issued by the Union Research Institute, Hong kong were also examined by me but they were not found very useful for our ourpose.

2. The avowed object of the new Chinese regime is 'transformation step by step of the economy into a socialist economy'. It is not only the establishment of socialism but something more, *viz.*, establishment of Communism. 'The ultimate perspective of the Chinese revolution is not capitalism but socialism and communism.' This was written by Mao Tse-tung in 1939 when the grim struggle against the Japanese was being carried on against odds and the future was so very uncertain. The principle governing there economic policy was described in 1934 by Mao Tse-Tung as "to proceed with all kinds of economic construction possible as well as essential and at the same time do our best to improve the peoples' living conditions to consolidate the economic alliance of workers and peasants, to ensure the hegemony of the proletariat over the peasantry, to strive for the hegemony of state enterprises over private enterprises so as to create the pre-requisite for future development into socialism. Gyan Chand, op. cit., p. 39.

3. Gyan Chand, op. cit., p. 325.

4. Ibid.

5. Ibid., p. 334.

The proportion of the tax revenue to the total State revenue showed some decrease from 1952 to 1955. On the other hand the proportion of receipts from public enterprise increased as given below :

Table 85

Receipts from Main Sources of Revenue in China from 1952 to 1955 (millions of yuans)[1]

Year	Total Revenue (millions of yuans)	Percentage of Tax revenue to total revenue	Percentage of receipt from Public Enterprise to total Revenue
1952	18,928	50.7	24.6
1953	23,351	49.1	29.9
1954	30,754	42.9	32.3
1955	31,194	44.1	35.6

The composition of tax revenue also underwent a radical change during these years. Tax receipts derived from taxation of public undertakings relatively increased. Receipts from tax on agriculture and taxation of private sector, both fell as shown below :

Table 86

Percentage contribution to the total revenue of (*a*) State co-operative an jointly operated enterprises (*b*) Taxation of peasants (*c*) Taxation of private sector in China (1950 to 1955)[2]

	1950	1951	1952	1953	1954	1955
1. State, Cooperative and jointly Operated Enterprises (Taxation and Profits)	34.08	49.35	56.33	59.79	70.56	76.22
2. Taxation of Peasants	29.63	18.17	17.68	14.56	14.23	11.76
3. Taxation of Private Sector	32.92	28.66	24.06	22.30	13.23	10.7

Besides this, customs and salt, the two most important sources of revenue before the war which yielded 34% and 22% of tax revenue respectively in 1936-37 were reduced to a secondary position.

Income-tax is not levied in China, the reason for it is not clearly stated. There, this tax has never been of any importance. Inheritance tax, which was proposed to be levied in 1936, could not be put on the statutes. The only direct tax levied is the profit tax on private industry and commerce. Through the

1. Source : Gyand Chand, op. cit., p. 331.
2. Source : Ibid., p. 333.

advance of socialism, this is being reduced and would soon be eliminated.

It is expected that it would take about fifteen years before a fully developed socialist economy can be brought into operation. Under the new economy all strategic points are completely under the control of the new State. However, in the industrial sphere China is still following 'mixed economy,' and as Dr. Gyan Chand remarked, private enterprise in China was not merely tolerated but was assigned an integral part in national development projects.[1]

Tariff, both as a source of revenue and means of protecting home industries, has lost its significance. Most part of the imports are either duty free or subject to very low rates. Only under certain circumstances, like negotiating trade agreements and as bargaining counters they may have some value, otherwise their utility is nil. This is due to the reason that all foreign trade is practically a State monopoly and the internal prices are fixed by the State.

The old system of land taxation had become so onerous and inequitable that it was replaced by the new regime, by an entirely new system of land taxation. The new tax on agriculture is a part of the new agrarian economy and is, therefore, free from its old evils. It reduces the burden of the peasant, improves the methods of assessment of taxation and makes its distribution more equitable, and also makes the administration simple. The important points of difference between the old land-tax and the new tax are—(1) In the new tax the produce and not the area is the basis of assessment and (2) The tax is levied at a graduated rate. There is a limit below which the produce is not taxed, and above the limit the rates are progressive.

The relative importance of land tax as a source of revenue is decreasing. It is of greater importance from the point of view of grain deliveries. This is due to the reason that about 93% of the collection is in kind, and only 7% in cash, which enables the State to acquire control on a part of grain surplus. It is interesting to note that this along with quotas fixed under the system of monopoly procurement, provides the grain reserves required to work and sustain the rationing system.

China is a highly centralised State, therefore its finances are also highly centralised. In 1955, of the total State revenue, 78.44% was allocated to the centre and 21.96% to the Provinces. This is perhaps unavoidable at the present stage of political and administrative development and as a reaction to the chaos and centrifugal tendencies from which China was retrieved. "It is, however, fairly obvious that a country of the size of China and diversity of conditions cannot financially and otherwise be admi-

1. Ibid., p. 132.

nistered as a very highly centralized state without her polity being unduly rigid; and in due course, it may be hoped, the necessary readjustments would be made in financial relations between the Centre and the Provinces to accord greater financial autonomy to the Provinces."[1]

APPENDIX V

Finances of Local Authorities

A noticeable gap in available financial statistics is the lack of adequate information regarding the finances of local authorities. In order to collect detailed information in respect of the borrowings and investments of local authorities, the Department of Research and Statistics of the Reserve Bank of India conducted a survey of the finances of some of the selected local authorities covering the period 1951-52 to 1956-57.[1]

According to the Taxation Enquiry Commission Report (1954), there were in all 12 city corporations, 1426 municipalities, 379 small town committees, 56 cantonment boards, 196 district and other rural boards and 87,018 village panchayats. Besides, there are Port Trusts, improvement trusts and development boards in a few places. As it was obviously difficult to cover all these, it was decided to confine the survey to corporations, municipalities and Port Trusts in towns with a population of more than 1,00,000 according to the 1951 census. The total number of local authorities addressed was 82 of which 65 responded. Of the returns received, 11 had to be excluded from the survey either because they were incomplete or because the figures obtained were obviously not correct.[2]

Total income and expenditure of local authorities included in the survey are given for selected years, in State 10 (a). Total income of all the 54 local authorities included in the survey amounted to Rs. 98.6 crores in 1956-57 (revised estimates) and total expenditure to Rs. 100.2 crores.[3] Of the total income, tax revenue formed 32%, grants from Government 5%, loan receipts 14% and the balance is accounted for by other receipts, a detailed breakdown of which was not available.[4]

Between 1951-52 and 1956-57, the income of all local authorities rose by 31 crores to Rs.90 crores while expenditure increased

1. *Reserve Bank of India Bulletin*, April 1958, p. 367.
2. Ibid.
3. Income and expenditure as given here include both revenue and capital account.
4. *Reserve Bank of India Bulletin*, April 1958, p. 368.

by Rs.36 crores to Rs. 100 crores. Tax revenue increased by 39%, grants by 64% and loan receipts by 79%. Of the total increase in income between 1951-52 and 1956-57, Port Trusts and corporations each accounted for Rs.13 crores and municipalities for Rs. 5 crores. In percentage terms the increase was 62% for Port Trusts, 36 % for corporations and 46 % for municipalities. The increase in tax revenue during the period has not been inconsequential, rising from Rs.23 crores to Rs.32 crores, which is appreciable in view of the fact that tax resources of the local authorities are generally inelastic.

A second survey was also conducted by the Reserve Bank of India in 1957-58.[1] The survey continued to be confined to city corporations, municipalities and Port Trusts in towns with a population of more than 1,00,000 according to the 1951 census. The number of local authorities addressed were 82 and the returns received were 72, out of which 60 local authorities were included in the survey.

The total receipts (both on revenue and capital account) during 1957-58 of the 60 local authorities included in the second survey amounted to Rs. 11.9 crores. Of this, about 45% was accounted for by rates and taxes, while receipts from remunerative enterprises and from loans formed about 12% and 15% respectively. Grants from Government formed 4% while fees and fines together brought in less than 1% of the total receipts. 'Other receipts' accounted for 23% of the total receipts.[2]

Of the total receipts amounting to Rs. 111.9 crores, city corporations accounted for Rs. 58.5 crores, Port Trusts for Rs. 35.9 crores and muncipalities for the balance of Rs. 17.5 crores. As regards sources of receipts, rates and taxes constituted the major source of income for all the three types of local authorities. For municipalities this item accounted for 49%, followed by 'other receipts' (22%) and grants from Government (11%). In the case of city corporations, receipts from rates and taxes formed 40% and receipts from remunerative enterprises and loan receipt about 20% each of their total receipts. In the case of a corporation, receipts from remunerative enterprises formed 30% of its total receipts. In the case of Port Trusts, rates and taxes comprised half the receipts (50%) followed by 'other receipts' (38%) and loan receipts (12%); they had no receipts from remunerative enterprises, fees and fines, and grants from Government.[3]

1. *Reserve Bank of India Bulletin*, Februay 1959, p. 163.
2. Ibid., p. 165.
3. Ibid.

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