

A
NATIONAL SYSTEM OF TAXATION

BEING A STUDY OF THE THEORY OF TAXATION
IN RELATION TO NATIONAL WELFARE
WITH SOME APPLICATIONS TO BRITISH ~~INDIA~~

A. RAMAIYA, M.A.,
Fellow of the Royal Economic Society (London)
Vakil, Madura, South India

P. S. MAHADEVA IYER
1110, NAICK NEW STREET, MADURA

1924

All Rights Reserved

X72

F4

4219

Printed At
The Authors' Press & Publishing-House
Mylapore-Madras

PREFACE.

In this book an attempt has been made to set out in more or less systematic form, some of my own views on the subject of taxation. Having a profound faith in the validity of the doctrine that the end and aim of all state existence and activity is the promotion of the well-being or good-living of the members of the community for whom it exists, I have tried in these pages to trace in outline, the path along which the logic of the doctrine, in so far as it may apply to the taxative policy of a modern national state, appears fairly to lead. The theory of taxation, discussed on the basis of the doctrine, points to certain important conclusions regarding the conditions and construction of a national system of taxation, which, though they may require further investigation at the hands of research students are well worth the attention of all finance ministers and National Legislatures. So far as the present book is concerned, no pretence is made, that it

contains a complete or comprehensive discussion of the subject of taxation from the standpoint of the doctrine, nor is any claim made to expert knowledge of economics, finance and politics, or even a full acquaintance with the literature on the subject. The aim of the book is very humble and it contents itself with merely suggesting and indicating the lines on which the taxative policy of a modern national state requires to be guided and governed; though in some important matters it has been thought useful to elucidate some of the general considerations arrived at by application to conditions obtaining in British India. On the whole, whatever may be thought of the usefulness of the book from the standpoint of the expert reader who will probably find nothing new or original in it, it is my humble hope that my exposition of the subject may incite further exploration and help the way to a clearer understanding of the nature and conditions of a national system of taxation as it ought to be.

Before I sent the mss. to the press, I placed it in the hands of the late Dr. Alfred Marshall who, while expressing his inability on account of extreme old age to give me any help by way of suggestions and corrections, went through the matter, and

communicated to me that he found it to be an interesting and suggestive contribution on the subject. Dr. Marshall is now dead, and in view of the fact that the little knowledge of economics I possess, and my interest in economic and social problems are largely due to the inspiration of his writings, I dedicate this book respectfully to his memory.

NEW STREET,
MADURA, SOUTH INDIA. }
September 1924.

CONTENTS

CHAPTER I.

NON-TAX SOURCES OF REVENUE (PAGES 1-48)

- Importance of taxation in modern state-finance 1-2.
- Promotion of welfare as the end and aim of the State's existence and activity to be taken also as the guiding principle of all taxative policy 2-3.
- An investigation of the non-tax sources of revenue to precede a study of the imposition of taxation, in order to see how far the direct burden of taxation on the community may be avoided 3-4.
- Three main non-tax sources ordinarily available for the state: income from the public domains in lands and forests, profits from the business activities of the State, and fees 4.
- Decline in importance of public lands and its causes 4-5.
- But many modern states still own vast and valuable forest areas belonging to their governments ... 5-6.
- Proper policy for dealing with public lands is periodical leasing and not outright sale 7-8.
- Nationalisation of all land may be advocated as a means of appropriating for the state all future unearned increments of land values 8-12.
- Four objections against nationalisation stated and answered 12-17.
- Beside its financial importance, its social effects will be far-reaching 18-19.
- Scope for state industrialism in modern states 19-22.
- Programme of the British Labour Party in this connection 22-24.

Lines on which Central Provincial and Municipal enterprises may develop in India ...	24-29.
Objections to state intervention in industry stated and answered	29-32.
Fee as a source of revenue not important or developable in modern states	33-36.
Reasons for the immediate practical importance of the problem of taxation	36-38.
Conditions under which the State may resort to borrowing	38-42.
Ordinary recurring expenditure never to be met by means of loans	42-44.
Special necessity to draw attention to this rule in British India at present	44-45.
Distinguishing features of taxation and the standpoints from which it should be studied	45-48.

CHAPTER II.

JUSTIFICATION OF TAXATION (PAGES 49-65).

The Benefit theory of taxation and its recognition by the older political economists—Hobbes, Vonjusti, Cossa, Proudhon, Mirabeau, and even Adam Smith ... 49-53.

In the sense that the purpose of all taxation is to confer benefit on the community, it is true 53.

But taxation is not a price for benefit received from the State, and cannot be adjusted in proportion to such benefit, for three reasons 53-58.

The Organic theory of the State and its over-emphasis on the State's unlimited powers of taxation discussed, and it is finally shown that benefit to the community is the only justification for the imposition of all taxation 58-62.

An emphasis on the beneficial aspect of taxation is useful in considering new tax proposals, especially in the case of a dependant State like British India ... 62-65.

CHAPTER III.

DISTRIBUTIONAL PRINCIPLES OF TAXATION

(PAGES 66-114).

Taxative policy not to be guided by mere fiscal expediency 66-68.

'Justice' or 'equity' now the ruling principle of taxation in modern states 68-69.

Likely to be superseded or supplemented by a new and more comprehensive principle founded on "good government" as leading to the promotion of the maximum happiness of and involving the infliction of minimum sacrifice on the members of a state 69-70.

The Principle of 'justice' or 'equity' points to 'equality of taxation' 70.

Different meanings of the term "equality" ... 70-71.

Interpretation of the term in the light of the Law of Diminishing Utility 71-73.

Explanation of the law in relation to wealth or its general representative 'money' 73-79.

In its special application to the problem of taxation, it signifies equality of the sacrifice involved in the tax burden 79-80.

The proposition arithmetically demonstrated and shown to point to progressive taxation of some kind 81-83.

The distribution of taxations viewed from the standpoint of 'good government' 83-84.

The meaning of the term 'happiness' and the extent to which it may be said to be influenced by material resources 84-87.

Taxation to be so contrived as to facilitate the promotion of maximum national happiness and involve the infliction of minimum national sacrifice ... 87-89.

'Maximum individual happiness' and 'minimum individual sacrifice' considered as a principle of distribu-

tion of taxation, point to progressive taxation in the same way as 'equal sacrifice' ...	89-90.
'Maximum aggregate happiness' and 'minimum aggregate sacrifice' logically considered, lead to the confiscation of all properties and incomes reaching above a certain level ...	90-101..
But there are serious objections against a policy of entire confiscation which cannot be ignored ...	101-102.
On the whole, however the case for progressive taxation, and that in steep form is strongly made out ...	102-106..
Objections even against a steep form of progressive taxation, falling short of entire confiscation, stated and answered ...	107-110..
Political and social grounds on which such progressive taxation may be additionally supported ...	110-114..

CHAPTER IV.

EXEMPTION OF THE MINIMUM OF SUBSISTENCE
(PAGES 115-129)

The principle of distribution of taxation whether based on 'justice' or 'minimum individual sacrifice' points to the exemption of the minimum of subsistence from taxation ...	115-118.
The same principle deduced from 'minimum aggregate sacrifice' or 'maximum aggregate happiness', <i>a fortiori</i> leads to the same conclusion ...	118-119.
Special difficulty in determining the minimum required for subsistence ...	119-120..
Circumstances of place, time, habits of life, occupation and social conditions to be taken into account ...	120-121..
Political social and moral objections against the exemption stated and answered ...	121-126.
In addition to the negative policy of exempting the minimum of subsistence from taxation, there is need for a positive programme for the universal enforcement of a national minimum, ...	126-129..

CHAPTER V.

CONSTRUCTION OF THE TAX SYSTEM (130-170).

(i) *Customs Duties*.—Customs duties as part of a good system of taxation 130-131.

Circumstances under which their burden will fall on foreigners 131-132.

Illustrated from the Indian import and export duties 32-1391.

Particular attention to be paid to political expediency, in order to avoid rupture with foreign powers... 139-140.

Importance of British connection to India, and the proper policy for India to pursue in regard to her economic relations with Great Britain, the other members of the Empire, and countries outside the Empire ... 140-146.

In all cases the fundamental principle is for customs duties to be imposed according to the nature and importance of the articles dealt with and so as to conduce to the promotion of national welfare ... 146-149.

(ii) *Taxation of Non-necessaries*.—Hindrance by taxation of all things that hinder the promotion of national welfare 149-150.

This logically leads to a levy on luxuries of all kinds as a necessary part of our tax system ... 150-152.

Classifying commodities into necessities and non-necessaries, and non-necessaries further into luxuries of comfort and superfluous and undesirable luxuries, a scheme of customs and excise duties is worked out, with reference to the nature of the articles imported and produced in a country 152-157.

This is followed by an elaborate application of the general principles to Indian conditions; first with regard to the imports and manufactures by the State, then with regard to the general imports and manufactures ... 157-171.

CHAPTER VI

CONSTRUCTION OF THE TAX SYSTEM—*continued*
(PAGES 171-197).

(iii) *Inheritance Taxation.*—Inheritance taxation as a means of raising revenue with the least disturbance of the material acquisitions of existing and future persons 171-172.

Though there is a strong case for the State's appropriating to itself the whole of dead men's properties, other and important considerations deter such a step ...172-176.

But there is great scope for curtailing and in some cases even abolishing the right of inheritance of others than near relations 176-177.

The special case of bequests 177.

On the whole, considering the nature of a tax on inheritance, a method of double progression is advocated, one according to the degree of distance of relationship of the heirs and the other according to the size of the properties inherited by them 178-181.

The existence of different laws of succession among the different communities of the world does not create any difficulty in the way 181-182.

A suggestion as to the mode or modes of levying the tax 182-83.

A special difficulty in applying the general considerations of an inheritance tax to India on account of the peculiar mode of devolution by survivorship of the properties of joint Hindu families, 184-187.

The difficulty will be solved by the levy of an appropriate tax on the devolution of the management of such families 187-188.

The absence of an inheritance tax in the tax system of British India criticised... .. 188-189.

Economic objections to the levy stated and answered 189-193.

- (iv) *Taxation of Unearned Profits.*—True nature of unearned profits and the propriety of taxing them before resorting to a taxation of earned resources ... 194-196.
Larger rights of the State over monopoly profits 196-197.

CHAPTER VII.

CONSTRUCTION OF THE TAX SYSTEM—*continued*
(PAGES 198-245)

- (v) *Income Taxation.*—If the wants of the State cannot be satisfied with the non-tax revenues and the positive taxes mentioned in the preceding chapters, resort to be had to a general taxation of the personal resources of individuals 198-199.

Difficulty and inexpediency of a capitation tax 199-201.

Taxation must necessarily have reference to the possession of wealth 201-203.

An elaborate discussion of the question whether all individuals in the State should be taxed and in what ways 203-206.

Political and social dangers of taxing the poor either in terms of money or in services 206-210.

Personal taxation to take the shape of a tax on incomes 210-211.

Meaning of the term 'income' 211-213.

Many kinds of income omitted from income taxation in modern states 213.

Elaborate discussion of the principles of income taxation with reference to the Indian Income tax ... 213-245.

CHAPTER VIII

CONCLUSION (PAGES 246-252)

Practical considerations with regard to the reforming of taxation in accordance with theory ... 246-247.

Theory and practice not opposed to each other 247-248.

Progress consists in efforts to bring practice to conform to theory 248-249.

Political and international aspects of a national taxative policy require special attention 249-252.