

SOME ASPECTS OF  
FISCAL RECONSTRUCTION  
IN INDIA

*Being the Banaili Readership Lectures in  
Indian Economics, Patna University, 1927-8*

BY

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SOME ASPECTS OF  
FISCAL RECONSTRUCTION IN INDIA

*TO MY DEAR FRIEND*

*'RAU'*

*(P.H.P.)*

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## PREFACE

IN March 1927 I delivered a course of six lectures at Patna on the invitation of the University of Patna, which were published by them for limited distribution. But as the views expressed in these lectures are of general interest and have bearing on some of our current problems, they are here presented for the use of those who realize the importance of, and take an intelligent interest in, our problems of taxation.

We are on the eve of great changes. The air is full of war cries, and strange and ominous shadows seem to darken the sky. But this gloom and darkness must pass away, and it is necessary for us to work for the coming of the new day. For that we have to acquire a new attitude towards all matters of national importance ; and among them the questions relating to fiscal reconstruction deserve our earnest and immediate attention. We have, in the past, been dominated by what may be called the negative aspect of taxation. This was inevitable as our political subjection made it impossible for us to look upon taxation as an instrument of progress and development of the dynamic life of the community. But now it is time for us to have faith in our coming freedom and address ourselves to the problems of fiscal reconstruction from a different and wider standpoint. Our taxation policies will, in an increasing measure, be determined by the exigencies of practical politics ; once we realize that our tax system is undeveloped and must be placed on a different basis if we do not want to stand still, we shall have a new orientation of our fiscal outlook and create an atmosphere favourable for the success of new proposals and policies. It will be taking too optimistic a view of our future to assume that this change can be brought about soon or without strenuous efforts. But

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without it, it will be impossible for us to make any headway against our enormous difficulties, or rise to the height of our possibilities. If we appreciate the importance of this aspect of the matter, which is of such vital importance to the well-being of our country, we shall work for a new order of things in the domain of taxation.

This change has to come ; but the immediate need of the hour is clear thinking on our fiscal questions, which is now rendered so difficult on account of passions and prejudices. Even in our universities we allow our thoughts on these questions to be dominated by considerations which, though not irrelevant, loom unduly large in our intellectual horizon owing to certain historical accidents. The universities being centres of intellectual freedom must emancipate themselves from the influence of adventitious circumstances and foreshadow changes, the necessity of which may not be quite obvious to the general public. The present book is intended to stimulate, in some small measure, this process of intellectual emancipation. It cannot carry the process very far ; and even as an attempt at initiating it I am fully aware of its utter inadequacy. But I do hope that those who happen to read this book will find in it an earnest, even though inadequate, attempt to discuss our fiscal questions from the point of view of the future. We have been, in all spheres of national life, almost completely obsessed by the past ; it is now time to shake ourselves free from this nightmare and fix our gaze upon the future.

In this book some aspects only of fiscal reconstruction have been dealt with. The limitations of space and the need of maintaining unity of thought made it necessary to exclude a number of otherwise important questions of taxation. The problems of federal finance,

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which are of immediate importance, have not been dealt with at all except incidentally at some places. This omission is deliberate. I have already dealt, though briefly, with the problem of fiscal readjustment between the Central and the Provincial Governments in my *Financial System of India*. That book was published about four years ago and contained a promise that I would write a book on Federal Finance. I have been slow in fulfilling that promise; but now it has been fulfilled, and the problem of financial readjustment has been dealt with in all its aspects in my *Essentials of Federal Finance* (published by the Oxford University Press). These books can, as a matter of fact, be considered companion volumes, and in some respects supplement each other.

GYAN CHAND



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## CHAPTER I

### A PLEA FOR FISCAL RECONSTRUCTION

#### *Need for fiscal reconstruction*

The necessity for fiscal reconstruction is being felt all the world over. This is due to various reasons. One of the causes, which is common to all countries, is the fact that the tax systems are everywhere haphazard growths, having developed into their existing forms on account of the interaction of diverse historical forces—not the least important among them being 'the more or less thinly disguised efforts of the dominant class to roll the burdens on the shoulders of the weak'. The tax systems are not scientific in any sense of the word, and it is necessary to bring them into harmony with the latest developments in the domain of fiscal theory and practice. In taxation, as in other spheres of social life, a definite and conscious effort is being made in all countries to find an outlet for the expression of the tendency, which seeks fulfilment in the increasing symmetry and effectiveness of all social institutions. The appointment of a number of committees and commissions to inquire into the working of the systems of taxation is due to the widely felt need for introducing fundamental changes in their underlying principles and structure. This natural tendency has, of course, been quickened by the financial strain caused by the War and its after effects and has been further strengthened by the impact of new social and political ideals. The burden caused by the War has, to use the words of Sir Josiah Stamp, rendered the blemishes, which were insignificant before, intolerable, and made it imperative to tap new sources of revenue. A new scale of values is being set up everywhere, and the fact cannot but have far-reaching reactions on the fiscal institutions of the world. Even before the

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War the new social ideals had made the revision of tax systems necessary. Now the need is urgent everywhere, and though the progress in the task of fiscal reconstruction must, as a matter of necessity, be a slow process, it is sure to continue and will afford another proof of an earnest endeavour of society to make its future evolution a matter of creative activity.

The work calls for the qualities of the highest order, and can be successfully carried out by the combination of knowledge, courage and, above all, constructive imagination. It cannot be accomplished all at once, but it can only be accomplished by steadily and consistently working for a well accepted, though a distant, goal; and reconstruction must, therefore, be the order of the day in fiscal as in all other social matters.

### *Special conditions in India*

In India, the problems of taxation have received attention since the beginning of our national movement; but their consideration has been dominated by the peculiar political conditions of this country. In a country governed by an alien power, the difference of opinion on matters relating to taxation is governed more by the psychological factor than any other consideration. The attitude which regards all taxation as robbery is not confined to India, but is here accentuated on account of our political subjection. The governing race, knowing that it can never consider itself in an absolutely invulnerable position, has to be exceedingly cautious in its taxation policy and has to make it an important principle of its administration to keep the level of taxation as low as possible and refrain from initiating any measure or policy that runs counter to the popular ideas and prejudices. The generally prevalent belief is that the Government of India has not kept taxation at a low level, and the limit of endurance of the people has already been reached, if not actually exceeded. It may be so, but it is not possible to go through the historical material bearing on this point without being impressed by the extreme conservatism of our rulers in the formulation of their fiscal policies. They have been extremely reluctant

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to try fiscal experiments or introduce new principles in the working of the tax system. From 1861 to 1916, the Indian tax system practically remained unchanged in its essential features. The land revenue administration was made more efficient and probably more humane, but its basis remained the same throughout this period and is even now what it was more than sixty years ago. Our tariffs occupied a subordinate position in our fiscal system and, apart from the controversy caused by the 'ill-omened shadow of the cotton duties', received very little attention from administrative or scientific standpoints.

The other three important sources of revenue—excise, salt and opium—changed their yield but not their essential character during this period. Perhaps the only exception in this respect is the imposition of income-tax in 1886. The exception can be disregarded in view of the fact that the fiscal expedient found a prominent place in the budget of Mr. James Wilson in 1860; and even if that fact be overlooked, the misgivings with which it was originally imposed and the timidity with which it was used and administered for over thirty years give us another index of the unwillingness of our rulers to make any new and bold departure in the domain of taxation. The financial burden of the War made it necessary to introduce changes which virtually amounted to what may be called a fiscal revolution. Customs and income-tax taken together have now become the most important sources of revenue and have made our fiscal system radically different from what it was fifteen years ago. New principles have found their place in its structure and may, if their significance be understood, make it easier to develop it further on right lines. But the progress of ideas has been slower than that of the system itself and the general attitude of the Government in this respect does not show any signs of healthy growth or a new orientation of outlook.

The limitations of their position make it inevitable for the Government to follow rather than lead public opinion. The Government in India cannot be expected to have a spirit of adventure in fiscal matters. The fear of the unknown is bound to be a more potent factor than the

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desire to increase the yield of taxes or make them the instruments for the realization of non-fiscal purposes. Mr. Massey in concluding his budget speech of 1868-9 used the following words: 'Let me warn you against tampering with your finances. India is no place for sensational or empirical finance'. Tampering with finances is always bad, but unwillingness to take a step forward lest it should lead to 'sensational or empirical finance' often means stagnation. The attitude of the thinking section of the people in India in matters of taxation is a counterpart of the attitude of the Government and is partly responsible for the unprogressive character of the latter. It has, of course, been mainly determined by the exclusion of the people from an effective control of the financial policy of the country, and by the assumption that it is governed by considerations which are generally inimical to the best interests of the country.

It is not possible to promote clear thinking or foster the habit of taking a really broad view of the problems of taxation under these circumstances, when it is taken for granted that the scale of expenditure, its distribution and the methods by which the public revenues are raised for meeting it are primarily responsible for the extreme and, as it is commonly believed, the growing poverty of the people. A belief in the truth of these propositions has almost become an article of national faith and it is extremely difficult to secure an adequate consideration of those aspects of our tax system which require a more comprehensive and, therefore, a more critical study of the fiscal questions.

#### *Effects of negative attitude towards taxation*

It is not necessary to examine at length the soundness or otherwise of this attitude. It is even possible to take it for granted for the sake of argument that the circumstances, under which we are placed, make it impossible for us to adopt any other view. That, however, does not change the fact that its effect on the development of our theory and practice of taxation is cramping in the extreme and is an obstacle in the way of further progress. The

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general atmosphere or, to use the expressive phrase of a modern writer, the intellectual climate, of the country is not favourable to the scientific study of our economic questions—particularly those relating to taxation on account of their more intimate connexion with our political issues. It is easy to give many illustrations of the way in which shallow and unsound ideas acquire currency on account of the all-pervasive effect of this important factor, and real issues get obscured by the clouds of passions that these questions so easily raise in our country. A passing reference to the controversy which has centred round the land revenue in India will be, however, enough to show how we are apt to lay undue stress upon relatively unimportant factors in our discussion of these questions and miss the more important ones. The Indian public opinion was, in the beginning, nursed on the belief that the 'permanent settlement' was a national boon, and its modification in any form would mean a disaster for the rural classes. The necessity of general fixity and permanence of the land revenue demand, wherever this had not been conceded, was urged by the Indian National Congress, year after year, as the only means of ameliorating the growing impoverishment of the agricultural population. In 1893 and 1894, the Congress was of opinion that interference with the existing settlement would amount to a national calamity and, even as late as 1909, its faith in this sovereign remedy as the only means of improving the unsatisfactory economic conditions of the rural classes remained unimpaired. The enthusiasm for the permanent settlement has since then considerably abated, but the one outstanding feature of land revenue, namely, the fact, that it is an impersonal levy assessed on considerations other than the capacity to pay of the individual taxpayer, has hardly received the attention of the general public or the special student of the subject.

Impersonal direct taxes have a rightful place in every fiscal system, but a heavy public impost which affects the interests of the overwhelming proportion of the population of a country ought to make a due allowance for the differences in the economic circumstances

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of the individuals ; and this aspect of the matter would have come into prominence, as a matter of course, if the public attention had not been engrossed by comparatively unimportant considerations. The reconstruction of the land revenue system is not going to be an easy matter. The fact that it is so closely interwoven with the entire fabric of economic life in the villages and the strength of the vested interests that are likely to be adversely affected by the changes which may commend themselves to us in the interest of the fiscal justice or social progress are serious obstacles and have to be reckoned with in every programme of fiscal reform. But we would not have been so far from the solution of this important problem as we are to-day, if the last fifty years had not been wasted in barren discussions regarding the fixity, permanent or relative, of the State demand on land as a remedy for our economic ills. It is not suggested that there is no connexion between the deplorable condition of our agricultural classes and the land revenue system, but it will be obvious to anyone who has an elementary knowledge of facts that the evil effects of the latter have been greatly exaggerated and, what is more to the point for the purpose of the present subject, the whole matter has been viewed from a wrong perspective and has, on that account, gathered round itself a mass of prejudices that cannot be easily got rid of. It is not necessary to dwell at greater length on this point. The whole question of land-tax reform will have to be considered later. Here it has been mentioned as an instance of the confusion of ideas in the consideration of the problems of taxation on account of what may be called a purely negative attitude in our treatment of such questions.

It was natural for our rulers to be governed exclusively by considerations of practical expediency in the development of our tax system and disregard almost completely the requirements of equity, symmetry or scientific perfection. The genius of their race and their position in this country made it imperative for them to follow this course, as it was both a path of safety and of least resistance. It was perhaps equally natural for our

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public men to import a strong political bias in their discussions of fiscal questions. They were called upon to organize and lead national forces against a system which left to them very little scope for constructive thinking and none whatsoever for working out a well-considered policy or programme. These difficulties were inherent in the nature of things, and it is not possible to blame either party for their existence. But it is useful now to recognize their nature and their effect on the working and development of our fiscal system. It will give us a clearer understanding of the present position and enable us to take a more balanced view of the possibilities of the future.

### *Taxation Inquiry Committee and need for survey of existing system*

The arguments used against the appointment of the Taxation Inquiry Committee and the vehemence with which they were pressed in the debate which took place in the Legislative Assembly, in September 1924, show how strong are the prejudices which cling to us in these matters. The object of undertaking the inquiry was, it was clearly stated by the Government, to reconsider our existing system of taxation and see whether it was not capable of improvement both in its incidence and in its machinery. It was categorically affirmed that the object of the inquiry was not to raise a larger amount of taxation. Readjustment, and not enhancement, of taxation was aimed at. The Government failed to carry conviction with the members of the House. One reason, of course, was the deep-seated belief that the professions of the Government were not to be taken at their face value. The personnel of the committee was not considered satisfactory and that also, to a certain extent, accounted for the strong opposition of the House. But the main reason, which had a great weight with the majority of its members and led them to assume an attitude of uncompromising hostility towards the Taxation Inquiry Committee, was the view that the limit of the taxable capacity of the people having been already exceeded, what was really needed was to ascertain the average



income *per capita* in India, and to find out the ratio between this amount and what the people were required to pay in the form of taxes. This, it was asserted, would afford a conclusive evidence in support of the contention that the growing poverty of the masses was due to the oppressive system of taxation and constitutes a scathing indictment of the economic effects of the British rule in India. The taxation inquiry, it was contended, must be abandoned and a comprehensive economic inquiry instituted in its place. It was pointed out that an economic inquiry, in order to be of any use, would have to be prolonged and extensive, would cost a lot and require an elaborate organization, that the calculation of a figure of average income per head would not be easy and, even if it could be worked out with a reasonable amount of certainty, it would be worse than useless for the purpose of the readjustment of taxation; but all these arguments fell on deaf ears. Nothing mattered in view of the paramount importance of resisting the insidious attempt of the Government to throw additional burdens on the poverty-stricken people; and questions regarding the improvement of the machinery of taxation, the re-distribution of its incidence and of the re-allocation of revenues could very well wait till a thorough economic inquiry had been undertaken, and its results had shown that poverty of the people had, in spite of the efficiency of administration, been increasing. It is not necessary to give an unqualified approval to the scope and methods of this taxation inquiry or to the conclusions to which it has led to show how ill-advised and ill-considered the opposition of the members of the Assembly to the Taxation Inquiry Committee was before it started its work, and how short-sighted they have been in treating its *Report* with scant courtesy after it has finished its labours. The need for a thorough survey of existing systems has been felt all the world over. The change in the fundamental attitude towards taxation, and what Professor Seligman calls 'newer and richer content of the conception of faculty', besides, of course, the colossal increase in public expenditure, have rendered taxation inquiry necessary everywhere. But in India there

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are special reasons why the necessity of such an inquiry should have been obvious to every intelligent student of our national problems. The opposition to a committee appointed by the Government has no special significance of its own. The opposition to a Government measure is and will, for sometime, be a normal feature of our political life.

But the attitude which the debate in the Legislative Assembly reveals cannot but be a matter of some concern to every one who can look a little ahead and realize what this legacy of the past, and even perhaps an inevitable consequence of the present conditions, may mean, if a change for the better does not take place in the near future.

#### *Coming freedom and its obligations*

This change has to come and it is right that it should be accelerated. Our political subjection is the most vital fact of our national life and its effect on our whole mental attitude is and must be very profound. We cannot emancipate ourselves completely from it, or refuse to allow our ideas and view-points to be largely determined by its influence. But it is necessary in the interest of larger freedom, into which we want to enter, to make a conscious effort to rise above the limitations of our political environment and get used to the ways of looking at things which are independent of the premises suggested by the present conditions. In Nietzsche's philosophy, the essential attribute of a free spirit is that it should have a taste for the unconditional, be able to transcend good and evil, and look from above downwards and not from below upwards. This view is capable of being grossly abused, but contains an element of truth which is not to be lost sight of. A nation, in order to be free, must surpass itself and assume perfection which it may not possess but has to attain in order to fulfil itself; and this must first be done in the domain of thought before its effect can express itself in the growing fulness of a really free life. We, in our economic speculations, have allowed ourselves to be dominated far too much by the facts of our political situation. It has

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affected our intellectual integrity and made it practically impossible for us to appreciate the importance of less obtrusive elements and to take a synthetic view of our economic problems. We have gained a little in general effectiveness, but have lost much more in a true and full understanding of these important issues.

It is, it may be repeated, necessary to outgrow these limitations if we are to work up to a higher standard of efficiency in dealing with our economic questions; and what is true of the economic questions in general is particularly true of those that relate to our fiscal system. We have to shake off the evil effects of the mentality which has led us to attach undue importance to a few factors and neglect others which are entitled to as much attention on our part. In the theory and practice of taxation we have to bring ourselves in a line with the modern developments of fiscal science. We have been standing still and indulging in merely destructive criticism, while other countries have been going ahead. India is not a free country and her freedom cannot be won easily. But we have to create an atmosphere of thought which may stimulate us to intellectual endeavours worthy of the citizens of a free state. The repeated recital of the sins of others is not an assertion of our coming freedom but its negation and an index of our intellectual ineptitude. It is not suggested that we have to lose ourselves in abstractions or turn away from the unpleasant facts of our political life. This is not a plea for any metaphysical theory of taxation. The programme of fiscal reconstruction must be pre-eminently practical and, therefore, related to the cardinal facts of our national life. But it will not do to cultivate a purely negative attitude in fiscal matters. We have to build for the future and it is, therefore, a matter of utmost importance that we should not have any obsessions.

### *Equity in taxation*

The one object of fiscal reconstruction which is dear to the heart of the tax reformers in every country is equity. It is an object to which everyone can render lip service, but, as is well known, difficulties and differences arise

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as soon as an attempt is made to come to a closer grip with the issues which it presents. Tolstoy, speaking about Henry George's proposal in his well-known book *My Religion*, expresses his agreement with its object, but goes on to say, 'Of course I do not hold with George about taxation of land. If you could get angels from heaven to administer the taxes from land, you might do justice and prevent mischief. I am against all taxation'. This view, in the case of Tolstoy, was the outcome of his absolute lack of faith in political institutions. To him, government was a mere phantasmagoria, and nations and states 'but fine names invented to conceal the plundering of honest people by dishonest officials'. But one need not be an anarchist to feel utterly sceptical about the possibility of realizing justice in taxation, for a closer study of the question has a very sobering effect on our enthusiasm for fiscal equity. So much, of course, depends upon the point of view that, when a conflict of interests arises, it is easy to formulate a convenient principle or interpret it in a way as to make it practically a measure of self-protection. The application of the principles about which there may be general agreement of opinion is extremely difficult under the complex conditions of to-day. The strong words used by Sir Josiah Stamp, in his evidence before the Royal Commission on Income-Tax, in condemning 'the wanton and bigoted way in which persons obsessed by certain mathematical ideas urge the sacrifice of all practical points to their lust for algebra', are a warning not only against the indiscriminate use of curves and other mathematical devices, but also against the disregard of the commonsense and instinctive judgment of the people upon which so much must depend. Equity must necessarily become a somewhat elusive object of pursuit when, of the many alternatives that one can adopt, it has to be said, 'one may be as right as another for all one can say'.

The existence of the Central, the Provincial and the Local Governments is another difficulty in the way of developing a system which may answer fairly well to the requirements of fiscal equity. It is a commonplace of

the writers on taxation to say that the problem of justice should be discussed from the point of view of the system as a whole and not merely of the individual taxes. That is so ; but, to use the words of Lutz, ' amidst the welter of taxation imposed by different authorities, imposed on all manner of different bases and for purposes that are sometimes widely diverse and again overlapping ', there is a little possibility of the entire tax burden being adjusted to any theory of fiscal equity. And when to these considerations is added another—the intricacy of the process by which taxes are shifted and the extreme difficulty of tracing their ultimate incidence—a point which will be developed at some length in the last chapter—one realizes that the Colbertian formula, which requires plucking the goose with as little squealing as possible, is not perhaps a proof of the cynicism of its author, but is a maxim of taxation born of true knowledge and wide experience of the facts of the case.

But in spite of all these considerations, the principle of equity is not merely a will-o'-the-wisp of the tax reformer. It cannot be embodied into the tax system with the finesse of an artist or pursued with the undaunted zeal of an evangelist. The practical limitations of the case have to be carefully borne in mind, if it is to be applied wisely and well. But that it is an object which should be steadily kept in view and carried out with a thorough understanding of its first-rate importance, is an elementary fact which no student of taxation can afford to forget. It is rightly believed that in the reconstruction of the fiscal system of India, there is almost an unlimited scope for a wider application of this principle and if this belief is duly tempered by an appreciation of the difficulties which have to be confronted in carrying out this object, nothing but good can come out of giving it a wider currency. It will give us the necessary motive power for carrying out the required changes and render it easier for us to make up for our past sins. Sir Basil Blackett, in his speech in the Legislative Assembly on the motion for the suspension of the taxation inquiry, drew a distinction between a scientific and more scientific system of taxation and pointed out the

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utility of all attempts to introduce a scientific system of taxation. All that could be done was, he stated, that the system could be more scientific than it had been in the past. The significance of this distinction was lost upon the House and one of the members remarked that the endeavour to make the system more scientific implied a tacit assumption that it was scientific already. The distinction is important and is based on a profound insight into the real character of taxation. It is possible to make every tax system more scientific and therefore more equitable. In India, there is plenty of room for progress in this direction. But a tax system which will satisfy the rigorous tests of scientific perfection and be utterly and entirely equitable may, like the Platonic archtypes, be a source of inspiration for the student of taxation and the fiscal reformer, but cannot be established here down below. 'It is,' to use the words of the Finance Member, 'very difficult to extend science into all the psychological regions which taxation invades'. In India, we should be content if we can explore all possible methods of making our system of taxation less illogical than it is and give freer play to the considerations of fiscal equity. This work will give adequate scope for the expression of our reforming zeal and should, if carried with proper care and intelligence, make it possible for us to improve our heritage and lay the foundations for the future truly and well.

#### *Recent developments in taxation*

The recent developments in the theory and practice of taxation have given a wider connotation to the principle of equity. The newer elements in this conception are still not quite well defined. Even the most competent student of the subject is only aware that they are just visible above the intellectual horizon, and has to give place to them in his treatment of the different problems with a considerable amount of reserve. The controversy about progression having been settled everywhere by the logic of events, the next phase in the development of fiscal theory will probably be a careful application of maximum aggregate sacrifice formula which is just at

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present merely a theorem of what may be called 'pure' economics. 'It will,' in the words of its author, 'carry us very far in the direction of socialism' and has, therefore, to be used with great caution in order that production may not fall off by any precipitate action. The agitation carried on by the single taxers has enriched the content of the conception of equity by laying stress on the elements of privilege and surplus as the criteria of ability. *Noblesse oblige* has, in a new sense, to be made not merely a principle of social conduct but also a maxim of taxation. The ownership of wealth carries with it the privilege of controlling the productive forces of the community for personal profit which can very well be made a proper basis of assessment. The wealthy individuals and corporations enjoy other special privileges which justify their being made liable to special taxes. It is possible to regard this development as a partial revival of the benefit theory of taxation, but it is more correct to take it as an evidence of increasing emphasis on the social aspect of fiscal facts.

A fuller analysis of the concept of the differential taxation of incomes that are social in their origin has thrown light on the essential fact that there is an element of surplus in all large incomes, though it cannot always be assumed that the amount of this surplus varies in direct proportion to the size of the income. Marshall's oft-quoted remark, that rent is the leading species of a genus and not a genus by itself, is one of the most illuminating statements about the present economic life. It recognizes the importance of *conjuncture* in the determination of all incomes and amounts to a denial of the right of individuals to claim absolute and exclusive use of their earnings. Hobson has been so much impressed by this aspect of the economic life as to propose that the entire structure of taxation be erected on the basis of the functionless surplus. The attempts that have been made in the recent years to impose special taxes on 'windfalls' are a practical illustration of the fact that the different countries are feeling their way in this matter, and would go farther and apply the principle of taxation of surplus on a larger

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scale, if productive surplus could be clearly distinguished from non-productive surplus.

It is not possible to divide the earnings of most individuals into two parts from this point of view. The practical difficulty is there, but does not affect the essential soundness of the proposals to reach the surplus or the 'unearned' element in the incomes of individuals for the purpose of special taxation. With the division of the economic society into non-competing groups and the existence of all kinds of privileges which carry with them special opportunities, it is fair that the possibilities of making surplus as an important basis of taxation should be more fully explored.

There is another development in the domain of social science which has a significance for the student of fiscal questions. The necessity of laying down a standard of 'national minimum', not only in the payment of wages but also in the working of the entire economic life, has been widely accepted. The socialists have been pressing for this reform all these years, but now even more orthodox writers like Hobhouse and Laski have given their cordial approval to this principle of working for what the former calls the civic minimum in the organization of national life. The bearing of this view on fiscal theory, of course, is that it changes the basis of exemption limit from the subsistence level to efficiency level, or as Mr. Sydney Webb has said, 'the fundamental reason for any exemption limit is the paramount necessity of not trenching by taxation on the standard of life necessary for the maintenance of the taxpayer in the fullest industrial and civic efficiency'. It is highly improbable that any country will go far enough in the practical realization of this object. The difficulties which have to be met and overcome are almost insuperable. But if it is conceded that the demand for the introduction of national minimum is inherently just, it will reinforce the case for a liberal treatment of the lower classes in the distribution of the burden of taxation. The practical utility of these considerations is somewhat limited. They cannot be reduced to formulas or elaborated into definite rules for the guidance of



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the fiscal reformer or the tax collector. But they are nevertheless very important. In India, these and other similar aspects of taxation have not as yet received sufficient attention; but if we are to keep abreast of the times, it is necessary to incorporate them in our fiscal theories, and they will in due course get embodied in the tax system of the country. In other countries they have passed through the preliminary stage of speculative study and are already, as the phrase goes, in the air. There the process of their precipitation has also commenced, though it cannot, for reasons which must be obvious to everyone who knows what it means, be very rapid. We, in India, have still to bestir ourselves even intellectually to get into the frame of mind which prepares the nation for such changes and thereby makes them almost inevitable. It is time that we should begin to work for a new order of things in this respect.

#### *Social standpoint in taxation*

Professor Seligman has, in his recent writings, laid considerable stress on the social, as distinguished from the individual, standpoint in taxation. The distinction as developed by him is subtle and cannot be easily elucidated. He accounts for a number of recent developments in taxation by a reference to the social theory of fiscal science. According to him, the continued use of indirect taxes and impersonal direct taxes in all countries as important sources of revenue is due to the practical effect of the acceptance of the social theory of taxation. It may appear to some that the fact is due to the stress of fiscal necessity, or even perhaps to the disregard of social considerations in the working of the tax systems. But the distinction has a negative meaning which is of some importance. It is generally assumed that justice in taxation can be done by assessing each individual directly. Suggestions have been made for exclusive reliance on direct taxes, mainly income-tax, for meeting the fiscal requirements of the public authorities. It has to be recognized, that apart from the administrative difficulties of assessing and collecting direct taxes on small incomes,

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the principle underlying these proposals is inadequate in itself and does not comprehend all the elements of justice in taxation. In India, we have to develop direct taxes further and reduce the relative importance of impersonal taxes, both direct and indirect, in our tax system. That, however, should not lead us to the conclusion that all impersonal taxes are wrong in principle and must be recognized as necessary evils, their extinction is a question of time, because it is sure to follow the political education of the taxpayers. The impersonal taxes have to be with us not merely because we cannot do without them on account of fiscal or practical reasons, but also because they have a place of their own in every well-rounded tax system, and so their abolition is undesirable on that account. They must occupy a pre-eminent position in local taxation and cannot be relegated to the background even in national taxation. It is, therefore, inexpedient and undesirable to take it for granted that they have no future in our tax system.

### *Taxation and redistribution of wealth*

The use of taxation for effecting a redistribution of wealth has received the sanction of theory and practice in all countries. There are eminent fiscal thinkers like Sir Josiah Stamp and Mr. Mellon who are not willing to countenance the use of taxation for rectifying the inequalities of distribution. They are at any rate not prepared to go to the length of making it a primary object of taxation. Their view is that for formulating and developing a sound taxation policy, it is necessary to assume the principle that 'differences in wealth and ability have some ethical or economic warrant behind them'. But the spirit of times is against this optimistic contention. The present social order is on its defensive and the world conscience is very uneasy about it. It is not possible to create a new heaven on earth by some heroic measure and certainly not by taxation; but it would be a mistaken policy not to make use of taxation avowedly for the purpose of mitigating some of the existing evils, on account of the possibility of its economic consequences to the dynamic life of the community being disastrous. **Fiscal**

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measures can only be palliatives and not preventives, but the situation is admittedly critical, and it is a matter of urgent necessity to help the process of social readjustment by the use of suitable fiscal expedients. The risk of taking no notice of this imperative need in the development of the tax system is much greater than that of going too far.

In India, it was till recently generally assumed that the problems of production are much more urgent than those of distribution. It has begun to be felt by the most advanced students of our national life that the facts do not bear out this conclusion, and it is necessary to give a new orientation to our opinions on the subject. India is a land of appalling poverty, but it is also a land of glaring inequalities of distribution. The contrast between the extremes of poverty and riches is as great here as anywhere in the world, and the necessity of working for a new social order is quite as urgent on that account. Fiscal reconstruction in India, as everywhere, is to be a part of the general social reconstruction and has to be carried out with a view to reduce social disharmony as far as possible. The need of making use of taxation as an instrument for the redistribution of wealth has to be considerably emphasized in India.

### *Importance of administrative considerations*

Modern economic life has, on account of its complexity, brought the administrative aspect of taxation to the fore in all countries, and the committees and commissions appointed by different Governments have had to devote a great deal of attention to the removal of the administrative imperfections of the tax systems. The tenets of certainty and economy have been discussed by the writers on fiscal science since the days of Adam Smith; but the integration of economic life and its increasing diversity have enhanced their importance and made their practical application very difficult indeed. Though, in India, the problems of efficiency have loomed much larger than those of justice in the development of our tax system, there is plenty of room for improvement in the methods

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of assessment and collection of our taxes.<sup>3</sup> The advent of democracy in this country makes it all the more necessary to safeguard the interest of efficiency in the future evolution of our tax system. Administration is a sore point with democracy everywhere. In India, where the word 'efficiency' has acquired a reactionary odour on account of the frequency with which it has been used by the opponents of our national aspirations, it is likely that it will be some time before it finds much favour with those who are in the vanguard of our national progress. The credit of the tax collector stands very low in the public estimation here. The use of inquisitorial methods cannot be justified in the name of efficiency and, of all the petty tyrants who abound in our country, the revenue underling is perhaps the least desirable. It is, therefore, necessary to provide adequate safeguards against the excessive zeal of the tax officers. All these considerations, however, do not weaken the validity of the argument that administrative efficiency is an essential condition for the success of all fiscal measures and, when it is not or cannot be achieved, the inherent merits of a tax cannot save it from becoming a travesty of its real self in actual practice. The technical perfection of our tax system is a matter of supreme importance and is worthy of the careful consideration of our fiscal reformers.

#### *Taxation as a social investment*

In the last generation, the general attitude towards taxation has undergone one remarkable change which needs to be stressed in India. 'It is,' to use the words of Professor Seligman, 'no longer regarded as a burden to be exacted from the unwilling victim, but as a contribution cheerfully rendered by those who are alive to the sense of collective responsibility implicit in the very conception of democracy.' This change is very well reflected in the statement made by Sir Leo Money before the Royal Commission on Income-tax. 'The income-tax which I pay,' he said, 'I consider it to be one of the cheapest purchases I make; it buys me citizenship, it buys me safety, it buys me security. To write that out of income and say that I do not get value for it, if you

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will forgive my saying so with respect, I cannot imagine anything more absurd'. The change is not as general as it would appear from these quotations, and the mien of the tax gatherer is, as it has always been, harsh everywhere. But the theory that money necessarily fructifies in the pockets of the people, and the ideal that the Finance Minister has to work for is to make the level of taxation as low as possible, have been definitely abandoned. It is realized that co-operative expenditure is not only a necessity under modern conditions, but also the best investment for the individual and the nation. True economy does not, therefore, consist in reducing expenditure and remitting taxation, but in developing the material and moral resources of the country by a judicious outlay of public revenues. The principle of maximum social advantage, in most cases, points to the necessity of transferring national income from individual to collective channels and of promoting the welfare of the people at large by a well-considered policy of national development. This does not imply a faith in the omnipotence and omniscience of the State. The trend of modern political thought is away from Hobbes's *Leviathan* or the Hegelian 'doctrine of general will' which makes State a super-organism of indefinite and infinite power. The common belief, however, is, to quote from Brown, that 'the primary purpose of State is life, its plenary purpose is good life'; and it is in the interest of the community to organize its social life on a more intelligent and efficient basis. Taxation, from this point of view, becomes the means by which society turns its resources to best account. It is not to be treated merely as a deduction from the income of individuals for which they get poor or no return.

#### *Necessity for increase of public expenditure and additional taxation*

We, in India, are not suffering from an excessive distrust of the activities of the State. The charge which is generally laid at our doors is that we consider the State to be a fairy god-mother who is going to confer all kinds of boons on us without our having to work for

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them. There is an insistent demand for Government intervention in many directions, and very little belief in the efficacy of private initiative. But it is not realized sufficiently and clearly that Government expenditure means Government taxation; and it is not possible to combine a high level of the one with a low level of the other. This is due to the popular misconception which attributes a kind of mythical character to the public purse. It is believed that it is somehow very long, and we can dip into it indefinitely without ever reaching its bottom. This belief is not confined to India; but, as is well known, there are special circumstances here which account for the firm hold that it has acquired on our minds. Mr. Gokhale, in his budget speech of 1906 reviewing the surpluses of the preceding years, pointed out their evil effects on the welfare of the people and went on to say, 'with such a plethora of money in the exchequer of the State, the level of expenditure was bound to be pushed up in all directions. Economy came to be a despised word, and increased establishments and revised scale of pay and pensions for the European officials became the order of the day'. The sentiment expressed in these words gives us the explanation of our belief that, in India more than anywhere else, the true governing principle of our finances must be, to quote Mr. Gokhale once more, 'to keep the level of taxation as low as possible so as to leave the springs of the national industry free play and room for unhampered development'. The fact that the destiny of the country is not in the hands of the children of the soil, and a very large portion of our public expenditure is incurred for purposes unconnected with the material or moral advancement of the nation is an important factor in determining our general attitude towards taxation.

An irresponsible Government cannot expect to receive the ready assent of the people to the proposals for increasing revenue, as it is known that money is not likely to be spent for objects of real public utility. In India, the Government expenditure is a by-word for waste and extravagance, and it is impossible to create a

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more reassuring atmosphere under the present conditions. The difficulty is real, and it is not easy to suggest measures by which it can be surmounted. It is nevertheless necessary in the best interests of the country that the public should be educated to a better appreciation of the realities of the situation.

We are passing through a period of transition. India is a democracy in the making. The old regime cannot pass away at once and will not pass away soon. But we have to prepare ourselves for a new order of things. New habits of thought have to be acquired on the assumption that freedom, for which we are striving, will be ours if we are really worthy of it. We have to outgrow the mentality that assigns to us the role of indiscriminating critics of the policy and actions of the Government. We have already some scope for the exercise of our constructive ability; it is likely to become wider with the passage of time. It is our duty to equip ourselves intellectually for opportunities for more effective work that must come to us. It would be a folly to assume an identity of interests between the Government and the people and to adopt a less vigilant attitude towards the former. The need of the times is not a more quiescent outlook, but one that may make us much more wideawake and alert in the handling of our public issues. We have, however, to work off the effects of having breathed so long in an atmosphere of inferiority and rise to the height of our possibilities by showing a truer understanding of the essentials of our problems. In taxation, as in all other matters of national importance, we have to cultivate the right sense of proportion which may enable us to face the facts of our present situation without allowing our vision of the future to be dimmed by them. The development of the country necessitates an outlay of larger resources. Funds for the purpose may partly be found by greater economy, so far as it is possible for us to enforce it. That, however, will not carry us very far. The necessity of increasing public revenues by the fullest development of the existing taxes and the introduction of newer ones cannot be obviated. The common belief

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that we have already reached the limit of taxable capacity may be correct, but it will be extremely short-sighted to starve the vital services of the country by banning all proposals for further taxation.

The point of view which dominates the discussion of all questions of taxation needs to be modified. Recently the Punjab Legislative Council had the opportunity of choosing between the reduction of water rates and a more liberal expenditure on nation-building activities, and it preferred the former course owing to the prevailing belief in the propriety of reducing the existing level of taxation. We have, by pressing for the abolition of the Cotton Excise Duty, demonstrated our willingness to forego the reasonable certainty of increasing the Provincial resources for education and sanitation by about three crores for the sentimental satisfaction of redressing a historic wrong. Our local bodies all over the country are marking time on account of their slackness in the assessment and collection of taxes and their extreme reluctance to make a full use of even their present powers of taxation. The present level of expenditure on services, which have at best a utility from static standpoint, is unduly heavy ; but the prospect of our being able to reduce it in the near future is so very remote that it is not worth while to count upon it for expanding the resources of our public authorities for dynamic purposes. India not being a democracy yet, the sense of collective responsibility which is implicit in its conception cannot be fostered rapidly enough even to approximate adequately to the ideal of making the payment of taxation a civic duty, if not a civic privilege. The need of developing the potential resources of the country is, however, urgent enough to make it desirable for us to put in an earnest endeavour to divert a larger proportion of national dividend from individual to collective channels ; and if that is to be done, we ought to assimilate our general attitude towards taxation to the one which is gaining ascendancy in free countries. Even there it has not permeated the common consciousness of the people to any considerable extent. Here progress will be slower on account of the



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special exigencies of our national life. But if we understand the real and ultimate interests of our country, it is necessary for the progressive elements in the community to give it a right lead by pointing out the futility of regarding taxation as such an unmitigated nuisance. The time is ripe for giving up the slogan of low taxation as our national cry. It is an obstacle in the way of our social and intellectual progress.

### *Taxation : its possibilities and limitations*

The arguments relating to taxation raise fundamental issues of social philosophy, and its effects are co-extensive with the entire social life. 'Taxation,' in the words of Professor Ely, 'may create monopolies, or it may prevent them, it may diffuse wealth or it may concentrate it, it may promote liberty or equality of rights, or it may tend to the establishment of tyranny and despotism, it may be used to bring about reforms or it may be laid so as to aggravate existing grievances or foster hatred or dissension among classes. Taxation may be so controlled by the skilful hand as to give free scope to every opportunity for the creation of wealth or for the advancement of all other interests of States and cities, or it may be so shaped by the ignoramus as to place a dead-weight on a community in the race of industrial supremacy.' The non-fiscal aspect of taxation and its close connexion with social policies does not, after what has been said already, need further emphasis. The amount of earnestness with which some specific taxation proposals have been advocated, and the idealism that has been imported in controversies which they have given rise to, put them on a par with movements that have stirred men to the innermost depths of their being. The advocates of single-tax on the surplus value of land held out the prospect of a social millennium as a result of the adoption of their proposal. Mr. Lloyd George characterized his 'people's budget' of 1909, in which, as is well known, land value duties figured so prominently as a war budget—a budget which was to be the beginning of an implacable warfare against poverty and squalidness and which, according to its author, was 'to

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make poverty and wretchedness and human degradation which always followed in its camp, as remote to the people of England as the wolves which once infested its forests'. The tariff reformers have been inspired by the visions of imperial unity and cohesion; and the protectionists of every country have, of course, considered their policy absolutely essential for its economic regeneration.

The history of taxation is full of instances of the rise, decline and fall of the movements of tax reform which in their inception and early career were sustained by the most buoyant hopes. The different phases through which they have passed have a very important lesson for us. The work of fiscal reconstruction has to be taken seriously in hand and its social significance carefully borne in mind. We have to do this with a full conviction that the tax reformer is not only concerned with the adequacy or otherwise of public revenues, but is also a craftsman of the new social order. No object is ulterior to taxation which can be shown to be conducive to the highest good of the community. This conviction should, however, be combined with a proper appreciation of the limitations of taxation. It is idle to expect that it, by itself, can effect a revolution or change the whole social life out of recognition. It can be a social engine of very great power, but it cannot be a panacea of all ills. In India, just at present, there is no danger of the country being swept by the fervent ardour of a new fiscal gospel. The enthusiasm which is necessary for starting or conducting a movement of this character is entirely lacking and cannot easily be created. This fact makes it unnecessary to sound a note of warning against the possibility of pitching our expectations too high or allowing our zeal for fiscal reform to get the better of our practical wisdom. It is, nevertheless, worth while to remember that in other countries the fiscal reformers have often raised false hopes and thereby done a great disservice to the cause of fiscal reconstruction of the right kind. We should profit by the experience of other countries and not repeat the same mistakes here.

## CHAPTER II

### DIRECT TAXES—THE INCOME-TAX

#### *Development of direct taxes in India*

The movement from indirect to direct taxation is considered a significant sign of the times. There are fiscal reformers who are working for the ultimate repeal of all the indirect taxes ; for the feeling has grown since Lassalle called them taxes on working classes, that a real democracy, which wants to hold the scales even between the different classes, can have no use for these 'crooked' taxes. As experience has shown the impossibility of making the indirect taxes really progressive, increasing reliance on direct taxes is held to be absolutely essential in the interest of equitable distribution of the tax burden. Their educative value, in a country where the bulk of voting power is in the hands of the masses, is considered a reason for making them as universal as possible. One writer has justified even the retention of the poll-taxes in the fiscal system of America, in spite of their limited yield, on the ground of their being the best means of bringing home to every adult citizen a consciousness of the existence of Government and his obligation to contribute something for its support. Mr. Harold Cox is of opinion that the payment of direct taxes should be made a necessary qualification for exercising political franchise. He is so strongly convinced of the soundness of his view that he is prepared to go so far as to carry out a measure for its practical application even at the risk of a serious social convulsion ; and he confidently asserts that 'in life we have first of all to think what is right and then secondly think what is practicable'.

The points of view, from which these arguments in favour of direct taxes are urged, are widely divergent and reveal the effect of class consciousness which

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is now such a vital factor in all fiscal speculations. The feeling in favour of direct taxes has grown in volume and strength, but a complete extinction of indirect taxes or their reduction to a position of insignificance is not a practical proposition. The social and political conditions, however, render a larger recourse to direct taxes necessary. In most countries their development can be justified on the plea of compensating for the regressive character of the indirect taxes. Progress in administrative methods has made many reforms practicable which were regarded only desirable a few decades ago. Direct taxes have, therefore, a great future before them. It would, however, be rash to predict that indirect taxes have had their day. Fiscal necessity gives them an important place in every tax system, and administrative limitations have not ceased to have a practical bearing on the choice between these alternatives. The view of Seligman, that the social point of view in taxation not only makes their use necessary but also desirable, has already been mentioned. In India, there is almost an unlimited scope for the development of direct taxation, and the danger of fiscal equilibrium being upset on account of its indiscriminate extension is so remote that it need not be seriously considered. Recent changes have not in any way impaired the position of indirect taxes in our fiscal system. The feeling against direct taxes, about which so much was said in our earlier controversies, though not ineradicable, is deep-rooted enough to serve as a brake on any tendency towards their unduly rapid development. It is much more necessary to have a bias in favour of direct taxes than against them. The lee-way, that has to be made up before direct taxes can come to their own in India, makes it a necessary part of our intellectual equipment for a proper appreciation of their real position in our tax system.

### *Position of income-tax in Indian fiscal system*

The distinction between direct and indirect taxes is not clear-cut. A closer economic analysis has almost destroyed its scientific validity. But income-tax is *par*

*excellence* a direct tax and may, therefore, be first considered. Sir Auckland Colvin, in his budget speech of 1886, quoted the well-known aphorism of Burke, which had also been quoted by Mr. Wilson in 1860: 'It is difficult to tax and to please as it is to love and be wise'. He described the impression that the study of the earlier debates upon direct taxation had produced on his mind in the following words: 'The financial history of the last twenty-five years is strewn with skeletons of discussion on direct taxation, and more than one of my predecessors is gibbeted on that dismal Golgotha for the part which he took in connexion with it. It has been my duty, in the course of my studies on the subject of direct taxation, to read again lately the various debates upon the much vexed subject in which, at different times, my predecessors took part during the twenty years between 1860 and 1880. I have, in truth, just emerged from them like Æneas visiting his ancestors in the Shades, and I am still overcome and overwhelmed with sulphureous atmosphere in which I have lately been groping my way, atmosphere from whose flames no light but rather darkness visible, regions of sorrow, doleful abodes where peace and rest can never dwell. So that I am not likely to underrate the oppressive climate of the region into which I am doomed to re-enter and into which I must invite the council to follow me'. This description, though somewhat overweighted with classical references, is vivid enough to enable us to get a realistic idea of the different phases of the history of income-tax from 1860 to 1886, and understand the attitude of the author of the Act of 1886 which gave to it a permanent place in our tax system. Three successors of Mr. Wilson were bitterly opposed to the introduction of income-tax in India. It was Mr. Laing, his immediate successor, who declared it to be 'about as bad and obnoxious a mode of raising revenues as it is possible to imagine in a country like India'. Mr. Treveleyan, who came after him, had already suffered for having committed errors of discretion owing to the intensity of his conviction that it was wrong to make any experiments in direct taxation in India.

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Mr. Massey, the third Finance Member after Mr. Wilson, condemned the erection of machinery for the administration of income-tax as a standing menace to the people who would regard it with extreme dread, horror and repugnance. The opposition to income-tax in the early years of its career was not a feature peculiar only to India. When it is remembered that in England, it was not till 1890 that income-tax was regarded as a permanent part of her revenue system and early attempts to impose it had been keenly resented; and in America as late as 1894 in the Congress its introduction was opposed on the ground that it would put a premium on perjury, corrupt the people, bring in its train the spy and informer, and was contrary to the traditions and principles of republican government; it is not difficult to understand why in 1886 the Finance Member of India felt that in proposing the imposition of income-tax as a permanent measure, he was treading on a very delicate ground. The opposition to a new fiscal device by the classes whom it adversely affected is easily intelligible. Their natural repugnance was, however, not the only cause of the grave forebodings with which its introduction was viewed in this country. It was reinforced by an apprehension of some members of the Government that it would make the British rule more unpopular and give an instrument to the disaffected classes to foment discontent and disseminate sedition. Sir Auckland himself expressed a hope in 1886 that, in India as elsewhere, a great change would take place in due course in public sentiment towards the measure and time would wear down, if not entirely efface, the edge of the objection regarding its inquisitorial character.

Now income-tax has been a part of our fiscal system for over forty years; and it has, since 1916, occupied a more pre-eminent position in its working. The least that can be said about it is that it has now worked its way up to the point at which it is considered a desirable and necessary constituent of our tax system. The political atmosphere of the country is not more favourable now than it was in 1886, but in other respects there is nothing in the present situation which need cause any misgivings about the future of income-tax in

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India. The Act of 1922 has put it on a more assured basis. It has improved its technique and increased its scope and effectiveness. The tax can and ought to be further developed.

#### *Definition of taxable income and capital gains*

The fiscal conception of income is everywhere more limited than the economic, on account of reasons of administrative convenience, and the Act of 1922 does not raise any difficult issues so far as the definition of income is concerned. It enumerates the different items of taxable receipts, and in this it keeps as close to the conception of actual money income as possible. Those elements of income, which are an undoubted means of economic welfare and have, therefore, a bearing on the ability of the taxpayer but whose money's worth cannot be easily calculated, have been excluded. The exception made in the case of a self-owned or rent-free residence is in accord with the fiscal practice in the United Kingdom and other countries and only confirms the importance of administrative considerations in framing the definition of taxable income. The business deductions allowed in respect of depreciation, insurance premia, repair charges, interest on capital borrowed or raised by debenture for the calculation of taxable income are, of course, justified by the elementary considerations of assessing the liability to the tax by net income as distinguished from gross income. It is well known that in actual practice the work of making these deductions is far from simple and requires a high order of ability and considerable experience on the part of the assessing officers. More intimate contact with the actual conditions of different trades and industries, better training in the theory and practice of accountancy and larger experience of the working of the measure will enable our young officers to cope adequately with the practical difficulties of assessing the net incomes.

There is one other consideration, however, which further limits the meaning of income for this purpose and which has some theoretical interest and importance.

✓ The definition of taxable income excludes all casual gains on the assumption that anticipated recurrence

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and regularity are essential features of true income. The income arising from any venture or concern in the nature of a trade, though speculative or irregular, is not exempted; but all receipts, which are not annual and are sporadic in their nature, are not liable to the payment of the tax. Prizes in a lottery, gifts and inheritances and gains that are neither anticipated nor likely to recur, are not taken into account in calculating the taxable income. This is fair as far as it goes, but open to criticism if it is taken as a correct concept of income. In America the capital gains, not only those which are realized in the ordinary course of business but all others, are taxable. Profits which accrue by the disposal of property are considered as a part of income. If an individual, not necessarily in the real estates business, sells his house and realizes a capital gain, he has to include it in his annual income-tax return. This practice has not even there given universal satisfaction and lately the tax has been restricted to 12½ per cent increase in the capital value of property. This restriction is illogical, but shows that even there the operation of this provision is not held to be unexceptionable. As a matter of fact, Mr. Mellon has actually proposed that capital gains and capital losses should be altogether ignored for the purpose of income-tax. But the growing weight of opinion seems to be in favour of this practice, and Professor Seligman attributes the British usage, which treats the gain from the sale of an isolated piece of property as an accretion to capital, to 'a survival of old error fortified by the desire to avoid practical administrative difficulties'. The inclusion of capital gains in income, it may be admitted, complicates administration. In India it would be a mistake to include them in taxable income at present, but it should be definitely recognized that this administrative problem is not incapable of solution. In the opinion of a competent student of the subject, 'accounting technique has made remarkable strides during the past twenty years, and every advance makes law which takes capital gains or losses into account easier to administer'. That is also true of a number of other fiscal devices which may not be



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practicable now. The trend of modern developments in taxation is to impose special fiscal burdens on fortuitous accretions of wealth. For inheritances a separate legislation will be necessary. But other windfalls will have to be placed either in a separate category and made subject to special taxes, or be brought within the ambit of income-tax. The latter course affords an easier solution of the problem and should be adopted when we can place greater confidence in our administrative machinery.

#### *Practical methods of applying principle of graduation*

The future of income-tax will be primarily determined by considerations of wider import. Its fiscal aspect will be of great and growing importance, but both it and the inheritance tax will have to perform a special function in our fiscal system as make-weights to other taxes. The question of a correct rate structure is, therefore, a matter of fundamental importance. The principle of graduation, which was once a subject of bitter controversy, has become almost an orthodox tenet of taxation and scarcely calls for defence anywhere. The discussion of this question, therefore, turns upon the methods adopted for securing graduation and a proper adjustment of the tax burden to the varying capacity of the different classes of the community. The method by which the income-tax is graduated in India is also adopted in a number of other countries. The tax is charged at different rates on different amounts of incomes, and graduation is steepened by the imposition of the super-tax which is only an additional duty of income-tax and which is further graduated by the application of various rates in the scale to sections or slices lying between specified limits. The intervals in the scale or zones on which it is based are broad and changes in the rates make a considerable difference in the amounts which taxpayers are required to pay.

The method has its merits. It is workable in conjunction with the maintenance of the principle of the collection-at-the-source which is held to be indispensable by several competent authorities for the success of the

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tax. The zones being fairly broad, the different incomes can be charged generally at final rates. It easily lends itself to the application of the principle of differentiation and has the advantage of having been worked in a number of countries with a facility which cannot be lightly disregarded. Its chief disadvantage is that it is subject to abrupt rises or jumps, as they are called, at certain points. It is an anomaly which can be easily illustrated by giving a practical example. For instance, the incomes below Rs. 2,000 are entirely exempt from the payment of the tax. The taxpayer who is receiving Rs. 1,999 does not pay any tax. But the increase of one rupee in his income brings him within the range of income-tax and makes him liable to the payment of Rs. 52/1, and leaves him with a clear income of Rs. 1,947/15. An individual whose income is Rs. 4,999 pays Rs. 130/4, but at Rs. 5,000 the rate changes and the deduction on account of the income-tax becomes increased to Rs. 156/4. The operation of this method at the margins is so manifestly unjust as to reveal its radically defective character at once. Section 17 of the Act of 1922 is designed to remedy this anomaly, but the relief that it provides on the margins practically amounts to the imposition of a cent per cent tax at certain points of the income. A person whose income is Rs. 2,020 pays Rs. 21 instead of Rs. 52/1, and another whose income is Rs. 5,005 pays Rs. 136/4 instead of Rs. 156/4. This relief ensures that the taxpayer should not be worse off on account of his having just exceeded one stage in the scale of rates, but the grievance still remains that the persons on the margins are hit rather hard by the application of this method.

There are other defects in this system, but this one is the most serious and has attracted a great deal of attention. Several suggestions have been made for securing a smooth graduation of rates. A detailed study of the relative merits of these suggestions cannot be undertaken here. The simplest method for removing the inequalities caused by the present method is to increase the number of zones and rates and thereby mitigate the existing hardship to a certain extent. This will, however,

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multiply the number of marginal points and the number of rates, increase the complexity of the tax and necessitate a more intensified scrutiny of the annual returns. The grievance is legitimate, but it is very doubtful whether it gives rise to any acute dissatisfaction. The four senior Income-Tax Inspectors, who gave evidence before the Royal Commission on Income-Tax, expressed their opinion that this feature, though open to criticism, did not cause any widespread irritation, and the attitude of the relatively small number of taxpayers whose incomes fell within the marginal fields was that of the tacit acquiescence in and acceptance of this method. The *Reports* of the Central Board of Revenue or the Provincial Income-Tax Commissioners, so far published, are silent on this point, and it may, therefore, be presumed that in this respect the experience of the administrative officers here is not very different from that of the officers of the Income-tax Department in England. The Taxation Inquiry Committee is in favour of maintaining the existing method of graduation and the reason given by it in support of its conclusion is quite valid. The existing system of income-tax is still on its trial and it is necessary to watch its practical working for some time longer before we make any bold experiments. The formulas for producing a smooth curve of graduation are many, but it is not wise to take any risks for the sake of mathematical elegancies which may not work in actual practice.

#### *Scale of graduation, exemption—limit and principle of differentiation*

There are three other questions which are closely related to this subject, but which need not be discussed at length. It is not possible to say much that can be of any practical value regarding the sufficiency or otherwise of the rates applied to the different sizes of income. The element of arbitrariness is sure to enter any scale of rates that can be drawn up. In India a case can easily be made for making the graduation steeper under the present circumstances. The decision must depend upon a number of considerations to which different persons

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will attach different weight. The other question which can be taken up in this connexion is the question of the reduction of the exemption limit. The present limit of Rs. 2,000 is certainly not the right minimum, if it is to be considered as the subsistence minimum. According to the trend of most progressive fiscal ideas, however, a more liberal view of the matter seems to be called for and it is not wrong to fix the exemption limit at a level higher than the one for which a justification can be found in the prevailing minimum of subsistence. There may be a difference of opinion about the advisability of importing this wider consideration into the discussion of this question. The fact that by lowering the limit, the increase in the number of assesseees and, therefore, in the burden of administrative work will be quite out of proportion to the increase in the yield of the tax cannot, however, be easily dismissed. In 1919, the year in which the limit was raised from Rs. 1,000 to Rs. 2,000, the change gave relief to no fewer than 2,37,000 assesseees out of the total number of 3,81,000 persons who were liable to pay the tax, and, what is more significant, out of a total collection of 9.34 crores in 1918-9 the amount contributed by persons whose income was below Rs. 2,000 was only Rs. 50.73 lacs. The difficulty of introducing allowances for wife, children and dependents which the Taxation Inquiry Committee has probably somewhat over-emphasized, strengthens the conclusion that the present exemption limit should not be lowered on the ground of its being above the minimum of subsistence in India. The third question which has a greater intrinsic importance, but which does not deserve a more extended consideration on account of the limitations inherent in the present conditions, is the question of differentiation. The rates in India are graduated according to the amounts of the incomes, but not their sources. This is contrary to the accepted theory and general practice of rate structure in other countries and its continuance can be justified on the assumption of the circumstances being exceptional in India. It is right to recognize the fact that incomes differ in quality as well as quantity, and every well-planned scheme of taxation should discriminate between

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the different social values of the various kinds of incomes. All this is commonplace in the writings on fiscal science and no more need be said about it. The most common method of achieving discrimination is the imposition of a special tax on the capital value of property together with a general income-tax.

In German States, Norway, Denmark and Holland, this method is used with considerable success. In India, in view of the considerations of administrative convenience and the special features of our existing fiscal system, the easiest method of differentiating between incomes which are and those which are not the result of personal exertion is to supplement the general income-tax by having special taxation on real and personal property. The Taxation Inquiry Committee considers it invidious to levy a differential tax on investments in industry and commerce so long as the incomes from land lie outside the range of income-tax. That is so; but it has to be realized that we will go a very long way towards achieving effective discrimination if we can impose a graduated income-tax on agricultural incomes or, better still, a graduated tax on the capital value of land. It ought to be evident to any one who knows the antiquity of our land revenue system and its intimate connexion with our rural economy, that it cannot be radically changed without causing a social upheaval. It can be modified in some respects and that has to be done if it is to shed its quasi-feudal character. But it cannot be abolished and replaced by an absolutely different fiscal expedient. This is an elementary fact of our present situation which it is well to bear carefully in mind. The rates at which land revenue is assessed vary in different Provinces, but with the exception of the permanently settled areas, a charge of more than 25 per cent is levied on the net assets of land throughout the country. If the recommendation of the Taxation Inquiry Committee is accepted and the charge is standardized at 25 per cent of the annual value of land, it will not be by any means a low rate. If the landed proprietors have to pay income-tax on their total earnings like other persons who live by trade, industry and professions and have to part with 25 per cent of their

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incomes from land in the form of land revenue, our tax system will discriminate against them to an extent which ought, in the initial stages of fiscal reform, to give satisfaction to the most ardent advocates of differentiation in taxation. In other countries, the fiscal reformers have been content with introducing differentiation gradually, by making slight distinctions to start with and then pushing the thin end of the wedge further in as the people get used to the working of the new principle. In India, the imposition of a tax on agricultural incomes, along with the retention of the land revenue system, will give us a measure of discrimination which will not be, in any sense, merely a thin end of the wedge. It will be a real and substantial differentiation. When this has been done, it will not be difficult to devise means for imposing heavier fiscal burdens on other kinds of investments. A beginning in that direction can be made at once by having a low corporation tax<sup>1</sup> which can be further developed when experience gives us a warrant for adopting a more ambitious policy. The absence of differentiation in our existing income-tax is a matter which need not disturb our fiscal conscience.

#### *Relative merits of the principle of collection-at-the-source and information-at-the-source*

The consideration of administrative efficiency is a decisive factor in these and similar other cases. The system of stoppage-at-the-source is an obstacle in the way of a more thorough-going application of a number of progressive ideas, but it is generally held that the certainty which is guaranteed by this method of collecting the tax outweighs every other consideration. The principle of taxation-at-the-source was introduced in England in 1803, and since then it has held its own in spite of the fact that many desirable reforms have had to be dropped or postponed on account of the necessity

<sup>1</sup> The proposal of the Taxation Committee to convert the super-tax on joint-stock companies into a tax on corporations without any exemption is, from this standpoint, quite sound and ought to be accepted.

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of maintaining its efficacy unimpaired. The Committee of 1905 and 1906 and the Royal Commission of 1920 have been emphatic in their approval of this system, and the Board of Inland Revenue regards it as a buttress of income-tax stability and efficiency. The British officials cling to it with great tenacity and consider its abandonment almost a sacrilege. As 70 per cent of the yield of income-tax is collected by this method, it is easy to understand why the authorities in England should consider it so very important for the security and efficiency of this powerful fiscal engine. Our income-tax is also being collected by this method to a very considerable extent and our administrative officers would also probably regard any attempt to abandon it with very grave misgivings. The proposal to substitute this method by any other has not been seriously put forward by any well-qualified student of the subject, and it is very unlikely that it can be made a practical issue for some years to come.

The system has, however, some disadvantages of its own; and it is worth while to know that a different method is being tried on a large scale in the United States of America which has, during recent years, become a laboratory of so many fiscal experiments. This method is called the method of 'information-at-the-source' and is different from the other method in this that the employers, bankers and others who are responsible for the disbursement of incomes, instead of being required to deduct the amount of the tax before paying the sums due, are placed under the obligation of reporting to the tax authorities the payments made by them to different individuals. If the reports of the payments are sent in regularly and are otherwise complete, there is no reason why this method should not provide a fairly adequate safeguard against fraud and evasion. In the opinion of the Royal Commission of 1920, this method is likely to be a source of trouble and irritation to the community in general and cannot be an efficient and practical substitute for the method of collection-at-the source. In the United States, on the other hand, it is growing in popularity; and it is the older

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method which has been practically discredited by the experience of recent years. There a committee of experts, the Committee on Model Taxation, has definitely expressed its dissatisfaction with the method of collection-at-the-source and holds that 'it presents serious administrative difficulties, imposes unwarranted burdens upon third parties in respect of transactions which strictly concern only the taxpayer and the Government, and not infrequently shifts the burden to the wrong shoulders'. These are two divergent views, and it is, therefore, desirable to suspend our judgment till we can acquaint ourselves more fully with the actual results of the method of information-at-the-source. It has already been remarked that, in India, the necessity of making a choice between the two methods does not exist. The method of taxation or, to be more correct, deduction-at-the-source is already in the field and nothing is to be said against it from the practical standpoint. It is, however, not necessary to make a fetish of it or take it for granted that any other method would be unworkable. It is a useful fiscal device and should not be abandoned without sufficient reason; but when the time is ripe for introducing changes of wider social significance in our income-tax, they should not be held up merely because they will affect the efficiency of the method of collection-at-the-source adversely. In the United Kingdom, the praise of this method has engendered an unduly conservative attitude which need not be copied here.

#### *Impracticability of assessment by non-official agencies*

The administrative hierarchy set up by the Act of 1922 is perhaps its most notable achievement. The future of income-tax in India will depend more upon this factor than upon any other feature of the system. The brunt of the burden will, of course, fall on the Income-Tax Officer whose efficiency is a matter of paramount importance. This new department has now been almost completely organized in every Province, and its members have to settle down to their work with the zeal of pioneers. The measure of success already achieved by



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it is a good augury for the future and a strong reason for strengthening it in every legitimate manner. The department has to steer clear of the two extremes of inquisitorial procedure and laxity in administration and the opinion is at times expressed that it can best be done by associating non-official agency with the work of actual assessment. The constitution of *ad hoc* local boards was advocated by a witness in his evidence before the Taxation Inquiry Committee in order to supplement and correct the work of the Income-Tax Officers, and there is a general, though vaguely defined, feeling that this would be a step in the right direction. The existence of this desire can be explained in two ways. The distrust of official bureaucracy is one reason for the feeling that the association of the local agency in the work of assessment will be a check on the arbitrary or high-handed exercise of their powers by the administrative officers. The more important reason, however, for this demand is the belief that the success of income-tax in England is due to, what Professor Seligman calls, a 'happy blending of regard for local interests and for fiscal productiveness'.

Theoretically the Local Commissioners have had very wide powers and the impression has, on that account, been created that the credit for the smoothness with which income-tax has been worked in England is in no small measure due to their share in its administration. Our Income-Tax Act of 1860 provided for the assessment of the tax by local *panchayats*. Under Section 101 of the Act, the Local Governments were authorized to order that the assessment might be made by *panchayats* consisting of not less than three persons. These *panchayat* were to be appointed by the Collector and perform their duties subject to his general supervision. The individuals had the option of objecting to being assessed by them and in such cases the assessment was to be made by the Collector or a specially appointed officer. Mr. Wilson dwelt at some length on these provisions in his budget speech and said that this would make it possible for the business incomes to be assessed with the aid of 'a special commission to whom the traders may apply to be

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assessed without their return going through the general commission or the public office'. He expected that by this means the extremes of ineffectiveness and inquisition would be avoided; and referring to this safeguard he further added, 'by this means we hope to shape the practical working of the tax through the aid of *panchayats* and by using the instrumentality of heads of the towns and trades'. The Act of 1860 was modelled on the English Act and the insertion of the provision for assessment by the local bodies was, of course, due to the desire to have an agency of assessment similar to the Local Commissioners in England. It is not known how far these arrangements were carried out in actual practice and with what results.

Since 1886 no attempt has been made to enlist the co-operation of the local agencies in the work of assessment and collection of the tax. This omission may be regretted, but it is urged that the facts must be frankly accepted and no attempt made to introduce local element in the assessment of the tax. There are three reasons why this course seems to be undesirable. In the first place, the association of elective local bodies with the assessment of the tax will have a prejudicial effect on the development of self-governing institutions. These are already contending against numerous difficulties and if to their existing functions another is added which makes them assessing authorities for the purposes of income-tax or any other taxes except those which are directly under their control, their future progress will be considerably retarded. The Decentralization Commission considered it essential to the efficiency and popularity of the *panchayat* system that it should not be associated with any new form of local taxation. Its association with the assessment of a Provincial or a Central tax will have a similar effect and what is true of the *panchayats* is also true of all other local bodies. Assessment is the most crucial part of the administration of taxes and the participation of local bodies in this work will only increase their existing difficulties. The creation of *ad hoc* local bodies for this work will not in any way make it easier for the non-official assessors

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to discharge their onerous duties without favour or fear. The task is as thankless as it is important and its performance requires a standard of civic ethics which cannot be attained in most cases. In the prevailing atmosphere of distrust and suspicion it will, therefore, be exceedingly difficult to secure the honorary services of men who may assist the Income-Tax Officer in the fair assessment of their fellow citizens. But the most important reason why an attempt to revive the statutory provision of 1860 will not serve any useful purpose is that it is now admitted that assessment is not a task for amateurs. The British Income-Tax Commission have shown how, though in theory local authorities have, since 1842, been in supreme control of the administration of income-tax, in practice the Inspector of Income-Tax has become a pivotal figure in the whole system and the wide powers of the Local Commissioners been virtually made over to him. The consummation has been brought about under the pressure of circumstances without any change in the formal constitution of the administrative system. The Commission have recorded their definite opinion that the income-tax is successfully administered, but they also maintain that without this gradual devolution to the Inspector, the machinery of the tax would have been found to be hopelessly inadequate, and they would have had a very different report to make on this aspect of their subject. They recommended that legal sanction should be given to the existing practice and the work of local administration concentrated in the office of the Inspector where in fact it was already largely performed. This makes it clear that the presence of local element in the administration of income-tax has had very little, if anything, to do with its undoubted success in the United Kingdom; and it is, therefore, misleading to advocate the association of local agencies with the administration of the tax in India or elsewhere, on the ground that the combination of local knowledge with expert training has yielded such happy results elsewhere.

The fact of the matter is that the complexity of modern economic life has changed the nature of income-tax administration. It is no longer possible for the

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leading citizens of a locality to cope with this work with the knowledge and the time that they ordinarily have at their command for the purpose. The elaboration of the income-tax law, on account of the introduction of graduation, differentiation, abatements and reliefs, has increased the inherent difficulties of this work and has made it practically impossible to utilize the local unpaid agencies for a fair and efficient assessment of the taxpayers. The future of income-tax in India does, as already remarked, depend upon the efficiency of administration, but for that we must mainly rely on the exercise of a high order of ability and integrity on the part of the permanent officers of the department and not on the honorary services of the representatives of the people. The political conditions of the country make it very unlikely that the right kind of men will be forthcoming for the discharge of these unpopular duties and, even if that were not the case, the nature of the work and its increasing intricacy would make local co-operation ineffective and weaken the hands of the trained officers. In England, the Additional and General Commissioners have now practically become tribunals of appeal, and for that work their competence cannot be questioned. It may, perhaps, be possible in India as well to constitute appellate authorities in large centres, consisting of public-spirited citizens whose function may be to revise the original assessment of the Income-Tax Officers; but it is best to concentrate on improving the efficiency of the newly created department. Income-tax can never be popular, but good administration can do a great deal to reconcile the taxpayer to it. If he can feel confidence in the efficiency and honesty of the assessing officers and made to realize that, within the limits of the law, he has had a square deal; he can bear his fiscal burdens with stoic indifference, if not with the satisfaction of having done his bit for the State. It is up to the officers of the Income-Tax Department to create conditions favourable for the efficient and smooth working of the administrative machine, for without it the full possibilities of income-tax will remain unrealized in India.

*Exemption of the income of charitable institutions*

There are two other important aspects of income-tax which deserve to be carefully studied, but about which it is only possible to say a few words here. Under Section 4 of the Act of 1922, income derived from property which is held under a purely religious or charitable trust is exempt from the payment of the tax. Charities also enjoy exemption from income-tax in England. There the definition of the purpose for which relief can be granted is extremely wide and though attempts have been made to repeal or curtail the relief enjoyed by these institutions (the most memorable among them being the proposal of Gladstone in 1863), they have aroused strong opposition and so far nothing has been done and the State is still losing between £4,000,000 and £5,000,000 in revenue every year on account of the operation of this provision. There are strong objections against exempting such institutions from the tax. It means practically a grant of subsidy to them from public resources, for purposes which may not be beneficial to the community and which in certain cases are diametrically opposed to each other. The grant of subsidies from public funds, without an adequate safeguard against their misapplication, is against the elementary principles of public finance. The question raises very wide issues and it is not possible to argue it without touching one of the most thorny problems of our national life. But it is generally admitted that the management and administration of funds of the religious and charitable institutions in India amounts to a grave public scandal and it is the duty of our legislatures to take the question of their reform immediately in hand. This has to be done in the interest of the purity of our social life and to get rid of a number of evils, the existence of which is a matter of common knowledge.

But apart from this consideration, it is necessary to secure a certain measure of public control when public money is granted for activities which are not directly carried on by the Government. It is not possible to estimate the amount which is being lost to the public

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exchequer on account of this exemption, but that it must be substantial is a fact which cannot be disputed. It is a matter of great importance to inquire into the question without any further delay. It may be suggested that the relief should be granted on condition that the institutions concerned should submit their accounts to the scrutiny of duly qualified auditors. This can be done and need not wound the susceptibilities of any community or individual, but it will require a definition of the purposes for which the expenditure of their income can be permitted. That cannot be done without raising the whole question of the reform of these institutions and is far too vital to be made merely a side issue of the income-tax administration. The issue, if it has to be raised at all, must be frankly and squarely faced. The public, however, is already alive to the urgent necessity of doing something for settling it at an early date and the legislation for this purpose will have to be undertaken before very long. The question has its fiscal aspect which will have to be taken into account when it is brought to the fore for reasons of national importance. Then the principle of granting exemption to the religious and charitable institutions will have to be reconsidered and, if its soundness is conceded, the purposes for which the relief can be afforded will require a very careful definition. The public audit of the accounts of the institutions entitled to exemption will, of course, have to be enforced. This is the least that can be done, if the ordinary maxim of public finance that the grant of public money ought to carry with it public control is to be acted upon. At present it is not necessary for income-tax authorities to satisfy themselves that the income derived from property held for religious or charitable trusts is so applied.

### *Problem of double taxation and impending financial readjustments*

The other question, which too is of fundamental importance, has to be dealt with here very briefly. The problem of double taxation has become an international issue after the War. It was of considerable importance before its outbreak and in the federal countries

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like the United States it was very much before the public eye. But on account of the enormous increase of fiscal burdens in every country after the War it has, in the words of a writer in *Economica*, 'ceased to belong to the sphere of academic discussion and it must be considered as a very disquieting reality'. There is no prospect of the international aspect of the question being satisfactorily settled in the near future. It requires unification in the fiscal legislation of the various countries and earnest desire to put an end to the causes of conflict between the different taxing authorities. These two conditions, it need not be said, cannot be fulfilled under the present circumstances. India, as a debtor country, is in a position in this respect which has elements both of weakness and strength. She can take action independently, for the amount of income which our people derive from abroad is negligible, or at least the amount which flows out of the country is much greater than what flows in and that can give us some advantage in international negotiations. On the other hand, as a general principle, it may be accepted that the imposition of a new or higher tax, though it hits the existing investments, makes it necessary for the future investors to insist on better terms being offered by the borrowing country and this enables them to throw back the burden of the tax on the taxing country. We depend upon the supply of foreign capital for our industrial development and cannot penalize the non-resident investors without impeding our economic progress. The international aspect of double taxation is not, however, of any practical importance for us, as the majority of our foreign investors are British and, under the existing arrangements, can get relief from Great Britain if the Indian rate does not exceed half the British rate. When the Indian rate is higher than half the British rate, further relief is to be given by India, but that does not involve a heavy cost to the Indian exchequer.

But there is a national aspect of the problem as well which is not to be overlooked. The Indian States, in an increasing number, are introducing income-tax in their

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own fiscal systems. Whatever may be their future in the political systems of the country, they are and must be an integral part of our economic system. It is, therefore, necessary to work out an arrangement which may be equally fair and acceptable both to British India and the States to avoid the duplication of taxation on the same income. A beginning in this direction has already been made and relief is granted to the assesseees who are liable to the payment of the tax both in British India and in an Indian State by refunding them the lower of the two taxes, the cost of the relief being shared equally between the two taxing authorities. From the *Report* of the Central Board of Revenue for 1925-6, it appears that twenty States have accepted this principle of the division of the cost of relief. This is a good working compromise which will have to be assimilated later on to the development that may be necessary in the interest of the greater fiscal harmony among the different administrative units of the country. The more important aspect of the problem of double taxation, however, is that in the future evolution of a system of federal finance in India, the possibility of friction between one Province and another on the one hand, and between the Provinces and the Central Government on the other, on account of taxation of the same income by different authorities, has to be minimized in the constitutional readjustments of the future.

This aspect of the matter will acquire special importance if in Provincial finance is introduced, as is often proposed, an element of elasticity either by giving the Provinces a more substantial share in the yield of the income-tax or a power to super-impose their own sur-tax over the rate levied by the Government of India for Central purposes. In either case, it will be necessary to provide for the development of inter-Provincial conventions for the harmonization of federal taxation. The difficulties will not be confined to the domain of income-tax. They have already been experienced in the case of excise, and overcome by an agreement between the Provinces that the duty should follow consumption. The imposition of inheritance taxes will bring in similar



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difficulties in its train. It will, therefore, be necessary to formulate principles which may be implemented in the revised constitution of the country, for putting the system of federal finance on a sound basis. The problem cannot be dealt with at greater length here. The Committee appointed by the League of Nations to enquire into and report on the matter have analysed the position with remarkable lucidity, and most of the principles laid down by them are of very general application. The most important proposition which they have commended for acceptance with great earnestness and which gives us a clue to the solution of the problem is that political allegiance no longer forms an adequate test of individual fiscal obligation; and the allocation of the yield of the tax ought to be governed by the doctrine of economic allegiance, that is, it should be distributed among the different taxing authorities according to the relative economic interests of the assessee in different political jurisdictions. The classification of income according to different elements of economic allegiance is not an easy matter, but has to be attempted in order to apply the principle of fair distribution to the receipts of the tax. The Committee have suggested that the best method for remedying the difficulty of double taxation is to exempt the income going abroad from the payment of the tax. The method has the merit of simplicity, but cannot be adopted in a country like India so far as international aspects of the matter are concerned. But the reciprocal exemption of the non-residents may perhaps provide the most desirable method of avoiding these evils of double taxation within the country; though Provinces like Bihar and the Central Provinces whose resources are being exploited by firms domiciled in the presidency towns will not willingly acquiesce in this arrangement. It is necessary to appreciate the complexity and importance of this problem and address ourselves to its solution as a part of our general fiscal reconstruction.

## CHAPTER III

### DIRECT TAXES—LAND TAX AND INHERITANCE TAX

#### *Land tax reform and the need of right perspective*

The reorganization of the system of land taxation must form a very important part in any scheme of fiscal reconstruction in India. The system, as it exists to-day, has been under the fire of criticism all these years and has engrossed the attention of the writers on taxation to such an extent as to have affected the validity of their conclusions on a number of economic questions. The working of the system affects the welfare of an overwhelming proportion of our population. It has been an integral part of our entire village economy from times immemorial and its effects on the general well-being of our people cannot but be very far-reaching. This is obvious and it is not necessary to dwell at length on this aspect of the subject. But we have to realize that in the past we have exaggerated its evil effects and attributed to it the economic miseries which are really due to radical defects of our whole economic organism. The recurrence and severity of famines, the indebtedness of our rural class, the malignant activities of the money-lenders, the lack of capital and enterprise among the landholders and cultivators, the stagnation of our entire economic life in the villages have been attributed to our land revenue system; and the importance of other factors, which account for the persistence of these evils, has hardly been appreciated. This fact has given us a wrong perspective in the study of these questions and is the cause of our having withheld our active co-operation from movements which otherwise would have found many ardent workers among the public-spirited citizens. The imperative need of lifting the cloud of depression which hangs so heavily over our villages is admitted both by

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the Government and our public leaders. The work that has to be done and the difficulties which have to be surmounted are so stupendous, that it is not at all easy to suggest the line of advance which may soon yield results appreciable enough to evoke the enthusiasm necessary for undertaking it.

The first requisite of well co-ordinated and concerted efforts for bringing hope and cheer into the homes of the humble dwellers in the villages is to impress upon everyone, who is interested in our rural reconstruction, the magnitude and complexity of the task and the need of unlimited patience and sympathy on the part of those who have, by choice or necessity, thrown their lot with the agricultural classes. The obstacles that bar the road to rural progress can only be removed by a well-organized work which will have to be carried on for generations. Ignorance, harmful social institutions, lack of foresight, absence of the habits of self-reliance and self-help, low and inelastic standard of living, indiscriminate increase of numbers, and in some Provinces the systems of land tenures, which have, as is well known, created the worst form of absenteeism, are evils which cannot be remedied by any single measure or in the course of a few years. The reform of land revenue system is necessary and will, within certain limits, accelerate the rate of general rural progress. The lines on which it has to be carried out will be suggested by the needs of bringing it into harmony with the new conditions which we may seek to establish in the villages and by its place in our tax system as a whole. It will, however, be one of the many steps which have to be taken to reorganize our rural life; and when we realize this simple fact, we shall have the right viewpoint and proper sense of proportion for the study of this otherwise important question of taxation. The only excuse for this emphasis on this almost self-evident consideration is the fact of our having neglected it in the past. Future generations will probably wonder how, even in the second decade of the twentieth century, the only contribution which the Indian National Congress could make towards the solution of our agricultural

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problem was the passing of a resolution in which the old demand for permanent settlement was repeated in familiar words ; but we have not yet quite outgrown the attitude which determined the range and character of our speculations on this question in the past and it is necessary to keep the right point of view in the forefront when we are discussing problems relating to the taxation of land in India.

#### *Abolition of land revenue is impossible*

There is another preliminary consideration about which it is necessary to say a few words and which also needs to be stressed in the beginning, on account of its bearing on the general trend of our discussion. A number of proposals have been made for improving our system of land taxation, but some of them contemplate a complete abolition of the land revenue system and its replacement by some entirely new system of taxation. The defects of the existing system are numerous, but it may be accepted as an elementary fact of the present situation that its complete abolition, even if it be desirable from the point of view of theory, is not within the range of practical politics ; or, in other words, it is not possible to wipe out the past and write on an entirely clean slate in the matter of taxation of land in India.

There are two very good reasons for urging the necessity of setting our face against the adoption of any very radical proposals. We have, in the first place, to remember that the land revenue yields 34 crores, is the most important source of revenue next to customs and is also the mainstay of our Provincial finance. Before the land revenue system is abandoned in favour of some other method of land taxation, there must be a reasonable assurance of our being able to raise an amount equal or approximately equal to the present yield of the land revenue, in order that our financial equilibrium may not be unduly disturbed. In view of the admitted need for a very large expansion of our public income, it will be a short-sighted policy to go ahead with any fiscal reform which materially reduces the yield of this tax.

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But the other reason, which reinforces the advisability of taking a conservative line of action in this respect, is the fact that its antiquity, its intimate connexion with the systems of land tenures which vary from Province to Province and the place which it occupies in the habits of life and thought of the people in general give to the land revenue a position of its own in our entire tax system. The maxim that old tax is no tax has often been put forward for turning down proposals of fiscal reform. It is taken for granted that it is much better to put up with the evils that we have got used to than to fly to others that we know nothing of. The fear of the unknown is the root cause of conservatism in all matters and its influence on fiscal practice is, therefore, not at all surprising. But the maxim is a practical rule of some importance and is based on correct economic theory. A fiscal burden which has been borne by the community for a long time produces suitable reactions in its economic life and is taken as the working hypothesis which governs the conduct of its members. In some cases it ceases to be a burden and becomes an ordinary incident of economic life which does not decrease the real income of the individuals concerned; in others the fact that the burden has been carried for a long time creates a power of endurance and disposition to bear it cheerfully, if it does not become unduly heavy. It is not suggested the land revenue is not a burden. That it is and in most cases quite a heavy one; but it has got a long history behind it and cannot be discarded at once. In no other country of the world has a step like repealing an important tax like the land revenue been taken merely because certain theoretical considerations were in its favour. It is not known what place the land revenue will occupy after two generations in our fiscal system. Its ultimate destiny is merely of academic interest. It will most likely become a local tax and be administered by local authorities. But we are just now concerned with the next step and that, for reasons referred to above, cannot be its complete abolition. Its reform is, therefore, the line of development with which we are immediately concerned.

## *Direct Taxes—Land Tax and Inheritance Tax .*

*Land revenue—a tax or rent ?*

*confusion of ideas*

No discussion of the proper place of the land revenue in our fiscal system can be considered complete without reference to the hoary old controversy, as to whether it is a rent or a tax. The Taxation Inquiry Committee has attempted to give an answer to this question, but its treatment of the subject is extremely unsatisfactory. It proves to its own satisfaction that historically there is no warrant for assuming that the Hindu or Mohammedan rulers ever claimed a proprietary right to land or that the British Government inherited it on its accession to power. Having admitted this much, the logical sequence of the argument would have been either to prove that this right was subsequently acquired, or that since it had neither existed in the past nor accrued in recent years, the land revenue is a contribution imposed by the State by virtue of its sovereign authority and is, therefore, a tax. But the Taxation Committee, having affirmed that both the zemindars and the ryots are 'possessors of proprietary rights', proceeds to discuss the pros and cons of the question and sets forth three arguments in support of the theory that it may very well be defined as rent. The first of these is the contention that since it cannot be altered to suit the requirements of the State, it partakes of the nature of rent. It is a little surprising that this argument should be seriously adduced by the Committee or that it should have caused a difference of opinion among its members. The fact that reassessment of the land revenue can only be made on the basis of changes in prices or the development of transportation facilities, etc., makes it more like the land value duty than like rent.

The other arguments urged in support of this view are weaker still. The fact, that the State gives loans to the cultivators in times of distress or performs similar other functions, has hardly any bearing on the matter. They are a part of the normal duties of the State and have nothing to do with the land revenue being rent or tax. It is futile to bring in the amortization theory into the discussion of the question. It is important in connexion

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with the incidence of taxation, but a tax amortized does not cease to be a tax on that account. The conclusion of the Taxation Inquiry Committee that, since it is a deduction from the national dividend, it ought to be taken into account in dealing with the question of the incidence of taxation, does not in any way further clarify the issue. The mere fact of its being a deduction from the national dividend does not justify in its inclusion in the tax burden, and even if this aspect of the question is ignored, the cardinal issue as to whether the equity or otherwise of the contribution made by the individuals is to be judged, by the tenets of valuation or price-making, or those of taxation, still remains unsettled. The answer to this question seems to be simple, if once we get away from the conception of the State being entitled to a certain share of the differential value of land irrespective of the effect of this demand on the well-being of the revenue payers. The Taxation Inquiry Committee has stated that the canon of ability has only a limited application to land revenue as a tax on things and not on persons. But even a tax on things needs justification. Tax on the public value of land does not take any account of the paying capacity of the individuals. There are, however, other reasons why its imposition is fair and it is necessary to find a place for it in every good fiscal system. The Ricardian theory of rent is true under the Indian conditions, and the differences of fertility and situation count for as much here as anywhere else. This does not mean, however, that it is right to levy a contribution on the ryots who are making a bare and precarious livelihood out of the cultivation of land. A man who owns and cultivates an acre of fertile land is getting a surplus from his labour and investment, as compared with the corresponding return of another man who is working on the margin of cultivation. But if the latter owns ten acres of poor land while the former has only one, he is in a better position to make a heavier contribution to the public treasury and ought to be made to do so. The point is not whether there is an element of surplus in the income of the revenue payer. There may be, and it may either be a real surplus or only a nominal one on account of the

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intensity of competition for the acquisition of land, which is responsible for cultivation having been pushed far below the margin all over the country. But if the income is very small and does not afford a sufficient measure of economic protection, the presence of the surplus element does not make any difference so far as the capacity of the ryot to pay is concerned; or, in other words, what really matters is not whether there is a surplus over the return on the margin of cultivation, but whether there is a surplus over the margin of subsistence.

The land revenue has been with us for centuries and is going to be there for a long time to come. It is one thing to take a practical standpoint and admit the necessity of our not being able to do without it. It is another to confuse the whole issue by invoking the Ricardian theory of rent and thus to make out as if differences in the taxable capacity do not matter and, therefore, need not be taken into account. It is an axiom of fiscal science that tax on things is also paid by persons. A tax which affects the interest of a vast majority of our people can either be tolerated as a necessary evil or its continuance vindicated on account of its merits from the social standpoint.

#### *Importance of subjective factors in the working of existing system*

The evidence given before the Taxation Inquiry Committee by a number of official witnesses reveals a state of things which is very damaging to the existing system of land revenue in India. Apart from the question of its incidence, it shows that the system, judged by its own standards, is open to criticism all along the line and makes it necessary for the Government to adopt a much less complacent attitude towards it than it has done so far. It is not possible to analyse this material here and set forth the surprising diversity between theory and practice which prevails not only from Province to Province, but also from district to district almost in every Province. A closer study of the system leaves an impression of a state of hopeless confusion which makes it very difficult to bring out clearly these fundamental



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defects in a limited compass. The system has till now been criticized on account of the weight of the burden which it imposes on our poorest classes and its undesirable effects on the development of the agricultural industry in general ; but its objectivity has never been called into question. It has been accepted that the system works with a fair amount of definiteness according to rules which are well understood and precise, and produces uniform results over the area to which they are applicable. The actual facts point to a different conclusion. They establish the supreme importance of the subjective factor in the entire working of the system ; and as variety is the essence of all that is subjective, we have a wealth of differences which makes its intensive study a very interesting pursuit, but is not conducive to its development on scientific lines.

#### *The Bombay system*

The Bombay system may be taken as an illustration for explaining, though inadequately, the meaning of the statement that in our land revenue system the subjective factor has a free play. The system is worked from aggregate to detail. The land revenue does not represent any standard proportion of the net produce of land or its rental value and is determined only by general considerations. That needs to be explained a little further. The first two operations in the process of assessment do not introduce any uncertainty. The first is the classification of fields. This was done in 1868 and since then has not been revised and according to law it has been declared final. The other operation is the grouping of villages into homogeneous circles. This is done every time that reassessment is made. With the third operation, the personal equation comes into prominence. The officer has to determine the total demand for the group and this he does, we are told, by going into revenue history of the tract in question or calculating what the area ought to pay on the basis of general considerations. In this comprehensive survey he takes into account the general state of communications, the impediments to transit, the various

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classes of cultivation, the condition of population with reference to castes, general property, amount of agricultural stock, health, education, the statistics of land revenue and occupation, the trend of prices, past, present and prospective and several other factors. An estimate framed on such wide and varied considerations must necessarily be more or less conjectural and include a very wide margin of error. The amount so determined has to be distributed over the individual villages of which the group is composed. This is done by fixing a maximum rate for the first class land, and other lands pay the rate according to the values in the scale. The minuteness of differentiation permitted by the system enables the aggregate to be distributed without much difficulty, but does not ensure a close adjustment between the amount assessed and the real revenue paying capacity of the land. The system has been described as empirical. It may be characterized as such, but it makes it possible for the idiosyncracies of the Settlement Officers to have an unhampered scope for their expression.

### *The Central Provinces system*

The system in the Central Provinces works from details to aggregate and it is, therefore, of interest to know whether it yields better results. There, as in Bombay, the Settlement Officer begins his work of reassessment by making a general survey of the revenue tract and prepares a forecast. This he does on the basis of the calculation of out-turn, prices and scrutiny of land values and rental history. But this forecast is for the general guidance of the Settlement Officer and is not a determining factor in the assessment of the land revenue. The distinctive feature of the settlement in the Central Provinces is the minute attention bestowed on the rent paying capacity of each cultivator. The classification of soils is expressed by assigning to each class of soil in every position a factor which represents the number of soil units that it contains—a soil unit being a measure of the productive capacity of the soil. It is claimed that relative values of soils are, on this system, established with a considerable degree of accuracy, sufficient for practical comparison

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between villages and groups. In the assignment of factors a number of elements, more or less incalculable, have to be considered and this statement cannot, therefore, be accepted at its face value. In order to facilitate comparison of rent pressure, a revenue division is divided into groups ordinarily containing from fifty to eighty villages. These villages are supposed to be more or less similar in character.

The next and the most important operation is fixing the standard rate for the group, the village rate for every village in the group and a different rate for every individual in the village. Here again a great deal has to be left to the discretion of the Settlement Officer who, at every step, has to estimate the relative importance of a number of considerations and arrive at a definite conclusion which embodies the judgment of what ought to be or is reasonable. The group rate is fixed with reference to the general conditions of the district and the particular circumstances of the group, the village rate to the general conditions of the group and the particular circumstances of the village; and the final step is the determination of the actual rent of each cultivator with reference to the general conditions of the village and the particular circumstances of each cultivator and it is here that the subjective factor becomes specially important. In fixing the rents for each cultivator, the Settlement Officer depends upon a confidential document which divides the cultivators into five classes according to their rent paying capacity in the estimate of which not only the yield of land or its situation matter, but sufficiency or otherwise of his income from other sources is also taken into account. For example, a man with money-lending or a cotton growing and pressing business, or even a big pension from the Government, is held to possess a much higher rent paying capacity than a man who has mortgaged his cattle, or a widow who supplements the income from her holding by her manual labour.

The introduction of these considerations may make the administration of the land revenue a little less impersonal than it otherwise would have been, but is bound

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to make the basis of assessment, for the land revenue demand is a certain proportion of rents thus fixed, very speculative. The Bombay and the Central Provinces systems are different from each other inasmuch as one is worked from the general to the particular and the other in the reverse direction, but both make the work of assessment guess-work to an extent which would not be permitted in the administration of any other tax.

#### *The Madras system*

The Madras system is different both from the Bombay and the Central Provinces systems. Here the determination of the demand depends upon the calculation of what is called the net produce and the general economic conditions of the tract. This is preceded by a classification of the soils and their grouping into homogeneous circles—a process which is further complicated by the distribution between the wet and the dry lands. The calculation of the net produce, which is the basis of assessment, involves an estimate of the gross out-turn, its conversion into money value and the calculation of the expenses of cultivation. In the determination of the gross out-turn, only the standard food crops are taken into consideration; the commercial crops, the importance of which is, of course, increasing everywhere, are completely left out of account. The assumed out-turn of the food crops is converted into money at the commutation price based generally on the average of 20 non-famine years. The work of the calculation of expenses of cultivation is from the nature of things most difficult and highly conjectural. Each item of expenditure is recorded separately, the cost for the best soil is thereby calculated and the cost of cultivation of inferior soils is deduced by making deduction proportional to the reduction in the assumed out-turn—a procedure which ignores the ordinary fact that the proportion of cost of out-turn must be higher on the inferior soils. The assessment, therefore, depends on a number of assumptions which do not correspond to the actual facts of economic life and involve elaborate estimation of out-turn, prices and cost of cultivation, in the working out of which the views of the Settlement

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Officers and their subordinates as to what these elements ought to be count for a great deal.

### *Systems in the Punjab and the United Provinces*

In the Punjab and the United Provinces, the use of nebulous and more or less conventional data is avoided by basing the assessments on rent actually paid or the assumed rent for which land can be let out if it is cultivated by the owner, but as rents can not be easily determined, much depends upon the personal judgment of the officers in charge of the work of assessment or re-assessment.

The uncertainty created by the hypothetical character of the basis of assessment is further increased by the fact that the rate at which the demand is fixed in different areas is determined in each case by the Settlement Officer with, of course, the approval of the Local Government; and though the maximum is supposed to be 50 per cent of the assumed differential surplus, the actual rate depends upon a number of subjective factors which make assessment an extremely speculative process. The Taxation Inquiry Committee admits the existence of this defect, but does not sufficiently emphasize its gravity. The complexity of the system has been a matter of common knowledge and has been generally accounted for by the diversity of conditions prevailing in different parts of the country. But now it is necessary to realize that this complexity has been considerably increased by the latitude given to the individual Settlement Officers in fixing the basis and the rate of assessment; and at present it disguises the fact that the land revenue, instead of being a determinate share of the economic surplus of land, is a general label for a levy, the character, the amount and the incidence of which are determined by a number of divergent factors.

### *Uncertainty regarding incidence of land revenue*

It is, in view of the considerations referred to in the foregoing paragraph, not at all surprising that different areas are being assessed at different rates and the variations cover a very wide range. In Bombay, according to

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Mr. Mackee, the Settlement Commissioner and Director of Land Records, the pitch of assessment' varies in the most unreasonable fashion even from group to group in the same taluka, and these discrepancies, for which he uses the word 'outrageous' in another place, spread and increase from taluka to taluka and from district to district, so that the assessment may be half the rent in one place and only one-fifth in another. Mr. Hamsworth, a Madras Officer, referring to the extraordinary inequalities of land revenue, said before the Taxation Inquiry Committee that the land revenue varied from a small fraction of the economic rent in some cases to a figure which approaches the economic rent in others. The Board of Revenue in the United Provinces is of opinion that conditions as regards the incidence of land revenue differ from division to division, and even from district to district. The fact that the Provincial Governments themselves are not in a position to give any definite information about the incidence of land revenue is a convincing proof of the bewildering complexity and uncertainty of the system. The figures that are available show that in the temporarily settled areas the incidence varies from 6·7 per cent in some areas to 42 per cent in others. It is in this connexion not necessary to make a specific mention of the inequalities created by the existence of the permanent settlement in the Provinces of Bengal and Bihar. The fixity of the revenue demand in these Provinces gives them a position of invidious distinction which cannot but cause a certain amount of soreness in other Provinces. This fact is sure to become a complicating factor at the time of the re-allocation of revenues between the Central and Provincial Governments and impede the development of these Provinces themselves.

But what needs to be stressed just now is the fact that even within these Provinces there are great inequalities in the incidence of land revenue. These are, of course, due to the different stages of development attained by different districts at the time of the introduction of the permanent settlement and subsequent economic changes which have affected their relative position. The inequalities are, however, there as well as in the other Provinces.

In Bengal, the range of variation is wider than perhaps in any other Province; the actual incidence being 6·5 in some districts and 57·7 in others. The Taxation Inquiry Committee has examined land revenue according to the canons of taxation and it is satisfied that, judged by the canons of economy, convenience and certainty, nothing can be said against it. The canons of economy and convenience are, relatively speaking, of secondary importance though some of the recent writers have interpreted economy very widely and given it a premier position as a maxim of taxation; but if the canon of certainty is also to include precision in the basis and the rate of assessment and is not merely to mean certainty regarding the amount and the time of payment, then the system is, according to the Committee's own admission, open to very serious criticism. It does not satisfy the canons of equality and universality even if they are to be applied in the most limited sense. The present methods of assessment are extremely laborious, but in spite of the imposing array of statistics which they produce, they lead to results which are lacking in certitude and precision.

*Growing rigidity of the system—  
a hindrance to readjustments*

It is not at all easy to suggest methods by which the system may be reformed. The Taxation Inquiry Committee has recommended that a uniform basis of assessment should be adopted all over the country to which a standard rate be applied. This can be done in theory, but its application to the actual conditions will present very great difficulties. The framework of the settlement will have to be changed. It is not possible to disturb the existing settlements during their currency; and it is no use waiting till the resettlements are due everywhere, for the new settlement cannot be undertaken all over the country at the same time. The first requisite for any change for the better seems to be the appointment of committees of experts in all the Provinces to inquire into the practical results of the existing systems. In any scheme of the reorganization of federal finance, land revenue is likely to remain a Provincial source of revenue.

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When the facts regarding the existing systems are more fully known, each Province will have to take action independently and adopt measures to remove the anomalies. The Provincial committees, that have been appointed since the Reforms, have merely sought to increase the period of settlements, reduce the maximum rate that can be charged and limit the pitch of enhancement. These measures will stereotype the existing inequalities and increase the difficulties of adopting uniform basis and rates of assessment in future. The rules, adopted in Bombay and Madras, that enhancements should not exceed 33½ per cent and 18¾ per cent respectively of the current assessment, are already making it difficult to level up the assessments. Nothing should be done to give greater rigidity to the land revenue system. The permanent settlement itself will now have to be on the defensive and every advance towards self-government will strengthen the case for the revision of the principle on which it is based. The land revenue systems in other Provinces are also full of contradictions whose removal depends upon keeping the liberty of legislative action completely intact for making the future readjustments.'

#### *Merits of a tax on capital value of land*

This conclusion is only of negative value. It rests on the assumption that it is not possible to scrap the

<sup>1</sup> From this point of view, it is fortunate that the recommendation of the Joint Select Committee that the process of land revenue assessment should be brought under close regulation by statute has not been carried out in any of the Provinces. From the constitutional standpoint, it is wrong that the revision and enhancement of land revenue should be outside the purview of the legislatures, but a measure which crystallizes the inequalities of the present system will militate against its orderly development and perpetuate the existing anomalies. The bills framed in Madras, Assam, the United Provinces and the Central Provinces all take the *status quo* as their starting point and provide safeguards against frequent and sudden enhancements in future. This view rests on the assumption that it is not advisable to disturb the existing settlements. It is not easy to comb out the inequalities of the system, but the task will be rendered almost impossible if it is held that we cannot rectify the mistakes of the past.



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existing land revenue system, even though very little can be done to remedy its defects. This assumption makes it unnecessary to examine the proposals which have been made for introducing fundamental changes in the basis and administration of the system. The proposals for the redemption of land revenue and the imposition of a tax on agricultural produce carried by rail, therefore, need not be considered. The objections urged against these proposals by the Taxation Inquiry Committee are valid. Their adoption is a question which has neither theoretical nor practical importance. A few words, however, may be said about the proposal to convert land revenue into a tax on capital value, which has also been turned down by the Taxation Inquiry Committee for reasons which are not equally convincing. This proposal was again put forward by Professor Thompson of the Allahabad University in a paper, which he read before the Economic Conference held at Calcutta in 1927, in which he successfully answered the objections of the Committee. Professor Thompson claimed for his proposal advantages which a less enthusiastic advocate would not be ready to accept, but it has merits which should not be ignored. Its greatest advantage is that it will obviate the necessity of having elaborate calculations of out-turn, commuted value, cost of production, net produce which have at present given us, what the Burma Land Revenue Committee calls 'quagmire of statistics' that veils what are really the 'outrageous' inequalities of the existing system. It will give us a basis which is simple and will, as the Taxation Committee itself admits, be intelligible to the most ignorant cultivator. The valuation will be a much simpler process than the present settlements and, even if the revaluation cannot be undertaken at frequent intervals, the change will be a considerable improvement on the existing order of things.

Land has already become a commercial commodity, and the future economic progress will make it easier to ascertain its selling value on account of the increasing frequency of market transactions. The speculative element cannot be eliminated altogether; but compared to the results of the present

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methods the new basis of assessment will be very definite indeed. It is true that investment in land is still not regarded in India as a purely business proposition and its selling value does not, on that account, bear a close relation to the capitalized value of its net yield. This consideration is sure to decrease in importance with the increasing dominance of commercial values in our economic life; and even if there is a divergence between the selling value of land and its real capitalized value, the fact will not materially vitiate the efficiency of the new procedure of assessment. The fact that in land there are a number of capital values in certain cases does not present any serious difficulty in adopting this proposal. One of the worst evils of the present land tenure system is the co-existence of a number of interests in land. In Bengal, the evil, it is well known, has grown to a very serious magnitude and is a standing menace to the future agricultural progress of the Province. The assessment of capital value will cease to be a simple process when so many have an interest in it. But generally speaking, it will be necessary to assess the capital value of two or three interests, which will not be a difficult task. In Australia, the lessees' interests are also liable to land tax, and the proposal for not including leasehold as taxable interests on land has been rejected by the Australian Commission on Taxation. The interests which are definite and can be alienated and inherited have a selling value of their own, which can be assessed without any extra difficulty.

#### *Capital value tax as a substitute for land revenue*

The question will, therefore, naturally arise as to why this proposal should not be adopted. This has already been answered. It is not only in the permanently settled areas that the tyranny of the 'dead hand' blocks the way of fiscal reform. The Government of India, in their famous resolution of 1902, referred to the historical origin of the existing systems and pointed out how it had evolved from the practices of the most decadent period of pre-British rule; and by the use of empirical methods, it had been put in a shape which was well suited to the

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present conditions of the country and compatible with its future development. The claim that it does not in any way hinder the future development of the country cannot be accepted without question, but it is well suited to the present conditions in the sense in which any historical survival can be considered an organic part of the social life of the country. The Settlement Officers had a very difficult task set before them and they have performed it in a manner which does them credit, though the fact that local factors have played such an important role in the evolution of the system is mainly responsible for the absence of exactitude which has been sufficiently emphasized already. This system has been allowed to grow in this way far too long to make it possible for any radical measures to be adopted for its thorough-going reform. The existence of the thirty years' settlements and the working of a number of rules of the land revenue administration have created vested interests all over India, as the permanent settlement has done in Bengal and Bihar. This proposal has to be very seriously considered when an attempt is made to come to closer grips with the realities of the situation. It is, however, not possible to liquidate the liabilities of the past by turning away completely from it and making a fresh start altogether.<sup>1</sup>

<sup>1</sup> This conclusion, of course, relates to the proposal for replacing the land revenue system by a tax on the capital value of land. It does not affect the validity of the argument urged a little later for imposing a graduated tax on the capital value of land on bigger landholders as a measure of differentiation.

It has already been pointed out that the incidence of land revenue in different Provinces varies over a very wide range. The substitution of land revenue by a tax on the capital value of land will, if the present yield of taxation on land is not to be appreciably decreased, involve a heavier fiscal burden on millions of landholders for no other reason except that considerations of equity and administrative efficiency require this change. It is not necessary to add that such a step is fraught with possibilities which cannot be lightly dismissed. The landlords and the ryots are used to the revision and enhancement of their revenue demand owing to the rise of prices or the increase of their net profits of cultivation. But a measure, which throws additional burden on so many individuals on the ground that the existing burden is not evenly distributed, will cause very serious revulsions, which make it necessary for the tax reformer to adopt a less heroic course.

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The taxation of the capital value of land can and ought to be introduced in the urban areas. The annual value is now ordinarily adopted as the basis of assessment, and for general purposes of taxation the present practice is sound and does not call for any revision. But an increase in capital value which is due to the general social progress of the community or the result of specific measures of improvement has everywhere been placed in a category by itself and regarded as a basis for the imposition of special taxes. This is one of the methods by which taxation of capital value can be immediately introduced in India and can, later on, be applied on a larger scale, when the need of changing our system of land taxation is better appreciated by our people and the ground has been prepared for carrying through a well-devised scheme of land tax reform.

#### *Exemption of small cultivators from land revenue necessary but impracticable*

The Taxation Committee has come to another conclusion which is inherently sound, but has supported it by arguments of a very controversial character. The proposal for the exemption of the small cultivators from the payment of land revenue has found many advocates in India in recent years. The reasons given in support of this view are very simple. The burden of indirect taxes—customs, excise, salt, stamps and registration—mostly falls on the small cultivators and it is unfair to make them pay a larger proportion of their income to the public treasury in the form of land revenue. Even if land revenue is not taken into account, our system is highly regressive, but with its addition its inverted progression becomes very steep indeed, and if the evil is even to be partially mitigated, the exemption of men who are living on the margin of barest subsistence is an obvious necessity. According to abstract fiscal theory the case for the exemption of the small cultivator is almost unanswerable. In spite of this consideration, however, the reform cannot be seriously considered as a practical proposition. The argument against exemption is as simple and, for practical purposes,

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as conclusive as the one which is urged in support of the measure. A vast majority of the land revenue payers will be below the limit of exemption if it is fixed at Rs. 2,000. The facts given a little later bear that out, and even if the limit is reduced to Rs. 1,000—it cannot be made lower—the productivity of land revenue will be very appreciably decreased. It is not possible to say with any degree of definiteness what the amount or the proportion of loss will be; but there is consensus of opinion among those who can speak with authority on the point that land revenue will, if the exemption is granted, become merely a vestige of the past, and have no significance whatsoever in the working of our fiscal system. In a number of Provinces, land revenue will practically be wiped off from the right side of the public accounts.

#### *Taxation Inquiry Committee's rejection of their demand*

This is a very strong argument against the introduction of exemption limit, but the Taxation Inquiry Committee does not base its rejection of the proposal on this ground. The fiscal argument is only very casually mentioned; the adoption of the proposal is considered undesirable for other reasons. It is, for example, stated that the present miserable condition of the poor cultivators is not mainly due to the land revenue system. It was, perhaps, necessary to bring in this point on account of the frequent contentions to the contrary, but that is no reason why the exemption should not be granted to the cultivators, if the taxpayers of other classes are entitled to it. It is also urged that the introduction of exemption limit will put a premium on fractionization. Fractionization is a serious evil and one hardly knows how it is going to be checked. But it is due to the economic pressure which is the result of the growth of population, the absence of other means of employment and the working of our social institutions. It is idle to suggest that fractionization will proceed more rapidly on account of the remission of land revenue in the case of men whose income falls below a particular limit.

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There is another argument against the grant of exemption which was forcibly put before the Committee by two important witnesses and which has influenced its conclusion, though it has not been specifically mentioned in its *Report*. Prof. Hamilton put this objection against the lowering of the land revenue demand in the following words. 'It is evident that where there is a strong tendency to borrow up to the limit of available credit and to subdivide land up to the point at which the holding will just support the occupier and his dependents, a reduction of the land revenue is likely to be accompanied by an increase of borrowing and further subdivision of holdings. There the cultivator just manages to subsist on his earnings, or any surplus is absorbed either by the landlord or the *mahajan*, the responsibility for the land revenue must be a burden, however small the revenue may be'. This is the Professor's objection against the reduction of the land revenue demand, but it would, of course, apply with greater force to the grant of complete exemption. Professor Jevons, of Rangoon, considered the question of exemption itself and gave four reasons for his opposition to the suggestion; but 'the most serious objection' according to him 'is that the abatement or exemption of poor ryots from revenue would merely encourage the growth of population, whilst the standard of living remains so low. A larger number of children and relatives would be supported on the income of the holding and in many cases, doubtless, the disagreeable necessity of one or other member of his family, whether to agricultural or industrial work elsewhere, would no longer operate'. The conclusion, if this line of reasoning is sound, naturally is that exemption will increase the burden of debt, reduce the incentive to work and give an artificial stimulus to the growth of population; and all these undesirable results will follow, because the standard of living of the cultivators is as low as it is. The point of view from which this objection is urged is in itself sound. Low standard of living and the high birthrate are our most serious economic evils. No abiding improvement in our economic life can be effected unless our standard of living is appreciably raised and

the size of our families appreciably reduced. The seriousness of these evils is often overlooked, but their existence is an outstanding fact which has to be borne in mind in the discussion of all economic questions. But it is very doubtful whether high taxation is the right method to remedy these evils. If this objection is valid, tenancy legislation should be condemned and any movement towards the rise of wages discouraged, as an increase in the purchasing power of the cultivators would only lead to greater density of population. This argument need not be developed at greater length. It is reminiscent of the controversy which centred round the iron law of wages and of the contention that it was futile to do anything to improve the conditions of the workers, unless the primeval instinct to beget was held in check by the equally powerful acquisitive instinct. The practical importance of combating it is very little on account of the impracticability of introducing any exemption limit in the administration of land revenue. The aspect of the matter, which is of immediate interest, is the fact that there is no difference of opinion about the necessity of making concerted efforts to raise the standard of living of the cultivators by making a liberal provision for expenditure on educational and economic development in the budgets of every Province. The present level of taxation of the small cultivator may be maintained; it may even be raised if the financial policy of the State is shaped with a view to give him an adequate return for the money that he has to go without on account of the fiscal exigencies of the country. The commonly accepted view regarding the absolute necessity of increasing the public expenditure on what are happily termed as the nation-building activities is reinforced by the arguments against the exemption of small cultivators from the payment of land revenue.

*Imposition of income-tax on agricultural incomes justified as a measure of differentiation*

This, by a natural transition, brings us to the question of making agricultural incomes liable to income-tax. The matter has two aspects which have to be carefully

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distinguished. There is, firstly, the proposal that the land revenue should be assimilated to income-tax, that is, it should be converted into a tax on agricultural incomes and, therefore, be entirely abandoned. It is not necessary to say much about it, as the reasons, practical and fiscal, against a radical departure of this kind have already been given. There is the other proposal that incomes derived from land, besides of course being subject to land revenue, should be included in the definition of taxable income for the purpose of income-tax. The Taxation Inquiry Committee has dealt with the latter proposal. It has cleared the air by definitely stating that there is nothing in the history of the case to justify the continued exemption of this class of incomes from income-tax. This simplifies matters by getting out of the way the difficulty about prescriptive rights. The question can, therefore, be discussed on its own merits. There may be no objection to the imposition of income-tax on agricultural incomes on historical grounds, but that does not settle the issue. There may still be very good reasons for maintaining the present exemption, not merely because of the so-called political and administrative difficulties but such as can commend themselves to us on account of their intrinsic soundness.

The question which at once arises and which has to be answered is this—why the same income should be taxed twice over. The recipients of agricultural incomes pay land revenue. Where is, after all, the justification for assessing them again for income-tax? It means double taxation of the wrong kind, unless this course can be shown to be correct on really satisfactory grounds. The Taxation Inquiry Committee has not raised the question and, therefore, does not answer it. It is, however, of primary importance and must be faced. Land revenue is to be treated as a tax in any discussion regarding the incidence of taxation in India. The Committee was definitely asked to include land revenue within the scope of its inquiry from that standpoint. The view that it is rent and not a tax has, therefore, no bearing on the issue now under consideration. It may, however, be contended that it is a tax *in rem*



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and in a large number of countries a flat rate on land is being combined with the income-tax on agricultural incomes. This is so ; but there the rate of the tax is low, generally it does not exceed 10 per cent and its yield is used for local purposes. The land registers—known as *cadastres*—are, in the words of Dr. Jacobsson, of the League of Nations, ‘notoriously out of date, giving profits quite out of correspondence with the profits earned to-day’. Our land revenue is not assessed at a low rate, and though our assessments are far from perfect, they cannot be called ‘ridiculously low’. The maximum rate in the temporarily settled areas can, in theory, be 50 per cent ; and even if the correctness of the claim that actual rates are much lower than the maximum be taken for granted, they impose a burden for which due allowance has to be made in the discussion of this question. In the United Provinces, for example, roughly speaking the incidence of land revenue is about 30 per cent. The landowners may in this Province well claim that they are already paying a tax which is much more onerous in its incidence than income-tax and it is grossly unfair to make them liable to income-tax in addition to land revenue.

It may, however, be urged that land revenue has already been amortized, that is, allowed for in the purchase price paid by the present owners and it has, therefore, been absorbed by the transfer. This involves the discussion of a theory which is somewhat abstruse, but the general consideration relating to it may be stated in simple words. The amortization of a tax becomes possible when it is a differential levy or is imposed specially on certain kinds of incomes and does not affect the earnings of the industry in general. In a country like India where two-thirds of the people are directly dependent on agriculture and at least three-fourths of the national income is derived from it, a tax on agriculture cannot be called a differential tax. It is, moreover, necessary for completely discounting a tax in the selling value of property that its rate should be fixed once and for ever. In the permanently settled Provinces, this process has gone on because of the fixity of the revenue

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demand and may be said to be complete. In the temporarily settled areas, the enhancements of land revenue are not only possible but generally the rule, and when there are so many speculative elements in its assessments, it is not right to affirm that the land revenue has already been capitalized and is a factor of no consequence in the incidence of taxation. With the rate of the incidence of land revenue varying from district to district, and its future enhancements being incalculable, the capitalization or amortization theory does not hold good for justifying the imposition of income-tax on agricultural incomes. The selling values of land will be raised if land revenue is abolished, but that is not the reason for assuming that land revenue does not constitute a fiscal burden on the landed interests. It is to be remembered that so far as income-tax is concerned the effective rate of 11·5 per cent is reached when the amount of income is Rs. 5,000, and the rate of 32 per cent is applied for incomes of Rs. 50,000 and more. Even in the permanently settled Provinces the lowest average rate of incidence, taking the calculation only at a very rough approximation, is 12·5 per cent; the average rate for the other Provinces may be taken at 30 per cent. That, of course, means that all land revenue payers are being taxed at a rate which is applied to incomes of Rs. 5,000 and more; and most of them at a rate which is effective in the case of income-tax for incomes over Rs. 50,000. In view of these facts there is something to be said for the exemption of agricultural incomes from income-tax.

The only argument which can be given in support of bringing the agricultural incomes within the range of income-tax is drawn from a social theory which, though sound in itself, is bound to cause an acute difference of opinion. From a practical standpoint it is probably inexpedient to give it a great prominence in the discussion of the question; but since that it is the only argument on the basis of which this step can be advocated, it may be briefly stated. The argument is very simple. A very large proportion of persons who are living on incomes derived from land, exceeding say Rs. 2,000, are leading an existence which has no social utility. They are not

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rendering any service in return for their income from land and are not otherwise playing any useful role in the rural economy of the country. Their influence over the cultivating classes is not at all wholesome, and in the collection of their rents and the general administration of their estates they have recourse to methods which lower the moral stature of our peasantry.

In one word, we are suffering from the worst evils of absenteeism on account of the existence of this rent receiving class and it is to the interest of the community not to do anything to strengthen its position in our economic life. It cannot be taxed out of existence, but the imposition of a differential tax which may stimulate its members to become aware of their social obligations is a step in the right direction. The Taxation Inquiry Committee has made a somewhat inconclusive reference to the political difficulties of imposing income-tax on agricultural incomes. The difficulties are there, but they have to be squarely faced and overcome. There are always difficulties when a new tax is introduced. It is the duty of the leaders of public opinion to place the issue frankly before the country and educate the people to the right understanding of the merits of the case. The work of the fiscal reconstruction requires social courage, and if our public men are up to the efforts which are necessary for carrying a measure of this kind through, the imposition of income-tax on agricultural incomes offers no insuperable difficulties.

#### *Administrative aspects of the measure*

The administrative difficulty of making the agricultural incomes liable to income-tax has also been referred to by the Taxation Inquiry Committee; but all that it has done to suggest a way out of it is to put the views of two officers, one of whom believes in the practicability of assessing agricultural incomes while the other does not, in juxtaposition with one another and it leaves the matter there. The assessment of incomes from land has everywhere been attended with a certain amount of difficulty which has led to the adoption of a number of devices for getting over it. The difficulty is mainly due

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to the fact that the farmers do not keep any accounts and the valuation of the stock-in-hand is not an easy matter. In India, most of the persons who will become liable to income-tax will not be farmers but rent receivers. In the Provinces in which the records of leases are complete, it should not be difficult to calculate the actual income of the landholders. In others, the adoption of a conventional measure for incomes between Rs. 2,000 to Rs. 5,000 a certain multiple of the land revenue demand will probably remove the administrative difficulties in the initial stages of the change. The assessee whose incomes do not reach the conventional figure will, of course, have the option of satisfying the Income-Tax Officer that their actual incomes are lower and have themselves assessed on these amounts. For the large landholders the actual income should be made the basis of assessment. They can even be required by law to keep simple accounts on prescribed forms to facilitate the work of assessment. The work will be so easy and affect such a small proportion of the assesseees that it will not be a great hardship, if this condition is enforced. The administrative difficulties in India will, on account of the existence of fairly complete land records, be less serious than those that have been experienced and successfully surmounted in other countries.

#### *Yield of income-tax on agricultural income often over-estimated*

There has been a tendency in some quarters to anticipate a very large yield from the income-tax on agricultural incomes. Prof. K. T. Shah has estimated an addition of 15 crores to the public revenues on this account. Wasteful expenditure, which is so common in those parts of the country where the landlords are conspicuous, has raised high expectation regarding the likely receipts of this tax. But the facts which are so far available suggest the need of not being over-optimistic about the fiscal result of this reform. Mr. King, the Financial Commissioner of the Punjab, is of opinion that in his Province out of the total revenue payers of 3½ millions only about 2,000 persons will be affected by the imposition of income-tax on agricultural

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incomes and considers that it would not be justifiable to cause a great ferment among the whole agricultural population for a small sum. In Bengal, the number of proprietors, sub-proprietors and tenants with an annual income of Rs. 2,000 or more has been estimated at about 5,500. In Bombay, it has been calculated that the income-tax on agricultural incomes will bring about seventy lacs. In Bihar, it is reckoned that the yield of the tax will not exceed this amount. These estimates are, of course, very rough guesses, but are useful inasmuch as they show that it will not do to expect too much from the removal of the exemption of agricultural incomes given under Act XIV of 1886. It is not that the yield will be so small as to make it undesirable for us to raise the issue. An addition of three to five crores may well be expected and with an increase in efficiency in the administration of income-tax better results will be achieved. But it is necessary that in framing our estimates of the receipts of the income-tax on agricultural incomes we should keep as close to facts as possible. There is, therefore, good reason for making the agricultural incomes liable to income-tax and there is nothing to be said against the proposal from theoretical or administrative standpoints, if it is to be introduced as a measure of differentiation.

#### *Differentiation can be better achieved by a tax on capital value of land*

There is, however, an alternative method by which the same purpose can be achieved in a more effective manner and certain difficulties obviated. The method has already been discussed, but if its application is limited to individuals against whom it is advisable to differentiate, it is not open to criticism on the ground of being unduly revolutionary. This method is, of course, a tax on the capital value of land. Its merits have already been stated, and if the exemption is limited and is fixed high so that the small landholders are not affected by its imposition, a tax on capital value graduated according to the value of property will enable us to introduce the principle of differentiation in a

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manner which will be satisfactory to all concerned. It is not necessary to go into details or state what the exemption limit or the scale of rates should be. The question requires an exhaustive consideration of the local conditions which will vary from Province to Province. The general principle is, however, sound and may be accepted as a working proposition of great value. A graduated tax on the capital value of land will introduce a personal element in the system of land taxation in India. Its incidence will fall on the big landlords. It will not be difficult to ascertain the market value of land; and what is perhaps most important from the practical standpoint, each Province will be able to act independently, to determine the form and the rate of tax to suit its local conditions and appropriate its yield for its own purposes.

Uniformity in the rate of income-tax is highly desirable if not absolutely necessary, and the interests of efficiency require that its administration should be centralized. The limits within which each Province can regulate its incidence are determined by all-India considerations. But it is possible to give considerable latitude to the Provinces in the case of a tax on the capital value of land. If it is conceded that it is the necessity of differentiation which justifies the imposition of either income-tax on agricultural incomes, or a tax on the capital value of land, it is essential that the extent of differentiation should be determined by the local conditions, and each Province be granted the liberty to have its own rate in view of the actual incidence of land revenue and other considerations of local importance. It is possible for each Province to act on its own account, if the principle of differentiation is applied by the imposition of a capital value only. The diversity of rates and the methods of administration will not lead to any conflict between different tax jurisdictions, or involve the difficulties of multiple taxation; and if it is desirable that additional taxation should be levied by the Provinces and its receipts utilized for vital public services like education, health and industries, the case for introducing a capital value tax rather than income-tax on agricultural incomes is further strengthened. A tax on public value of land in the cities

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and a capital value tax on land in the rural areas will go a very long way towards removing some of the glaring defects in the existing system of land taxation in India.

The consideration of direct taxes may be concluded by a passing reference to inheritance tax. India is perhaps the only important country in the world which does not make use of this tax at present. It, as is well known, did not, till very recently, occupy an important position in the fiscal systems of the world. 'In 1885 it was,' to use the words of Professor Adams, 'a fiscal curiosity. Now it is one of the most important sources of revenue in almost every country.'

### *Inheritance tax—its imposition necessary for social and fiscal reasons*

The social significance of this movement is generally well understood and its future developments will have results which will go to the very root of the present economic order. 'The laws relating to succession should,' in the words of Tocqueville quoted by Dr. Dalton in his *Inequality of Incomes*, 'be placed at the head of all political institutions, for they exercise an incredible influence on the social conditions of the people.' The institution of inheritance being one of the most important pillars of the modern economic society has to bear the brunt of criticism which is now being directed against it; and death duties are, of course, the instrument by which its ascendancy is being undermined. Rignano's scheme, which has been avowedly put forward to reconcile the advantages of an orthodox economic system—unhampered individual enterprise, free competition, etc.—with the exalted principles of justice proclaimed by socialism, is only an explicit statement of the purpose which has been the prime factor in the rapid spread of this movement all over the world. The increasing fiscal needs have rendered easier for this movement to make a successful headway, but the real motive force has been supplied by the permeation of new social ideals. In India, circumstances justify the introduction of these taxes at an early date. The equity of the existing social institutions is not being challenged as persistently in India as it is

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in the western countries. We have still to think strenuously about these important matters, before we move to the new orbits of effective social action. The urgency of our fiscal needs, however, affords us a very good reason for increasing the resources of the State by the introduction of death duties and thereby stimulating our social conscience to a higher level of creative activity. The proposal for the imposition of these taxes have been made since 1860, but the excessive conservatism of our rulers and the absence of pressure from a well-instructed and organized public opinion have prevented any steps being taken with regard to them. It is necessary for us to make up for the deficiency of the past by taking early steps for their imposition. The special function of these taxes as compensatory factors in our tax system has already been referred to and need not be further emphasized.

#### *Inheritance tax and joint family system*

The Taxation Inquiry Committee has examined and answered the different objections which have brought against the imposition of death duties. The most important among them is the one which rests on the absence of succession in a Hindu joint family. The property being vested in a corporate personality, the taxation of individual shares is said to run counter to the fundamental conception of the institution of joint family and to create divisions where none exist. It is very doubtful whether the institution will be able to hold its own against the onslaughts of the modern tendencies which are emphasizing the importance of individuality and its unhampered growth as a factor of first rate social importance. Its disintegration has already commenced and proceeded far enough to lead a number of social thinkers to advocate the conscious acceleration of an inevitable process. It is, therefore, possible to hold that it is in the interest of the community to make use of death duties for the purpose of hastening the end of an institution which has outlived its social utility and has no future in our national life. If this view were accepted, it would be desirable to ignore completely the



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difficulties which the existence of *Mitakshara* law of inheritance present in the way of introduction of these taxes. This would be a heroic measure and probably in conformity with the general trend of our social evolution, but its adoption will raise a storm of opposition which fiscal reformers may not like to face. It is, therefore, advisable to take a more conservative line of action and make a due allowance for the peculiarities of the Hindu law under which a share in the property is acquired by birth and not by death. The Taxation Inquiry Committee has, on the basis of expert legal advice, come to the conclusion that the tax should be imposed on the value of the share in the joint family property which the deceased would have received, if the partition of the property had been made immediately before his death. The correctness of this conclusion has not as yet been questioned; and it is, therefore, safe to assume that its application would not be followed by any untoward consequences. The view of a Madras officer, expressed by him in his evidence before the Taxation Inquiry Committee, that the law of personal inheritance should have nothing to do with the payment of taxation is perhaps the right way of looking at the whole question. It should anyway not give any community a position of differential advantage in the working of our tax system; and that under the present circumstances the law discriminates against certain communities with regard to the payment of probate fees which are the nucleus, out of which a fully developed system of taxation of inheritances has to grow, has been clearly established by the Taxation Inquiry Committee and is a grievance which calls for an early redress. The legislative action for the execution of a well-considered policy of the taxation of inheritances has, as already stated, been postponed for too long to justify any unnecessary delay in carrying out these proposals.

#### *Impersonal character of inheritance tax as a duty on mutations*

The use of the plural number in the foregoing paragraphs in the references made to the taxation of

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inheritances is, as all students of the subject know, due to the fact that taxes on bequests, or rather the principles on which the schemes of such taxation are based, are essentially of different character, and distinct in their intent and effect so far as the working of the tax system as a whole is concerned. The taxes are either imposed on the transfer of property and graduated according to its total value or on the portion of the estate left to each beneficiary and also graduated according to its value. The other two varieties of taxes are graduated according to the amount of wealth which the legatee already possesses or according to the nearness or remoteness of his relation to the testator. The Taxation Inquiry Committee has recommended that in India the death duty should be a duty on the mutation of property and graduated according to its total value. It has given two reasons for making this recommendation. The first is that the idea of succession or acquisition being foreign to Hindu law, duty graduated according to the amount left to each beneficiary will not be acceptable to a large majority of the taxpayers. It is further stated that on account of the plurality of heirs and the difficulty of assigning to them a definite position in the scale drawn up on the basis of the degree of relationship, it would not be easy to graduate the tax on the ground of consanguinity. The mutation duty is comparatively easy to assess and simple in operation, and in view of the legal difficulties pointed out by the Committee, it will probably be advisable to adopt this scheme of taxation of inheritances.

#### *Objections against this form of levy*

It has, however, to be borne in mind that a duty on mutations is an impersonal tax which does not take any account of the capacity to pay of the persons on whom it falls. The Royal Commission on Taxation in Australia has summed up the objections against estate duty, as this kind of tax is generally called, in the following terms in its final *Report*:—

1. An estate may generally be taken as having paid during the process of accumulation, its proportionate

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share of such taxes as income-tax, land tax and other charges incident to the acquisition and possession of real and personal property.

2. Tax is more properly leviable upon the person who acquires a new interest than upon the mass of property left by a person for distribution possibly among many.

3. The trend of modern thought is in the direction of taxing a person in respect of his interest in something of value, rather than taxing the thing of value irrespective of its ownership or the distinction of any beneficial interest derivable from it.

4. A succession duty is simple in principle, as the acquisition of a new beneficial interest, or of an addition to capital resources as a result of a testamentary disposition or its equivalent affords a clearly understandable basis of taxation.

5. A succession duty, which is duty not only charged upon but also measured by the value of interest devolving upon the taxpayer, rests upon a basis of equity which is absent in the case of estate duty.

These are strong objections and point to the necessity of supplementing the duty on mutations at an early date by other duties, which may be imposed on the principle of adjusting the burden to the personal capacity of the taxpayer. The administration of the tax will itself suggest ways and means by which this purpose can be realized. The social value of the death duties mainly consists in their effect on the distribution of wealth, which can be produced only if there is a close correspondence between their amount and the faculty of the taxpayer.

#### *Concluding observations*

The review of the direct taxes and their position, present and prospective, in our fiscal system lays bare a situation which is hardly reassuring. Its most unsatisfactory feature is the fact that land revenue, our most important direct tax, is full of anomalies and contradictions which are very serious and sure to baffle our fiscal reformers for years to come. It is necessary to turn the

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searchlight of scientific inquiry on its inequalities and devise measures for rectifying them as soon as possible. The task has to be undertaken in spite of the fact that we are almost certain of not being able to achieve an appreciable measure of progress for several decades, if not for generations. In the meanwhile, it is necessary to introduce a personal element in the taxation of land in India. This can be done by making the agricultural incomes liable to income-tax as a measure of differentiation. But the object can be better realized by imposing a tax on the capital value of land. It is necessary to carry out this reform both for fiscal and social reasons. It is a measure to which we have to turn our immediate attention and we must mobilize public opinion for putting up a determined fight against the stubborn and prolonged opposition of vested interests. The exemption of the small cultivators from land revenue is called for as an act of elementary fiscal justice, but it cannot be granted on account of the impossibility of finding alternative sources of revenue. The fact that income-tax has already become an important source of revenue and can be further developed is the only redeeming feature of our present situation. In death duties we have a fiscal measure of great potential importance, which has so far been neglected on account of the lack of constructive imagination on the part of the framers of our taxation policy. It has to be introduced and utilized to the utmost limit of its possibilities without any further delay.

## CHAPTER IV

### INDIRECT TAXES

#### *Importance of indirect taxes*

India is one of the few countries in the world in which the importance of indirect taxes has not been decreased by the developments of the War and post-War finance. More than 55 per cent of our public revenue is raised by these taxes and there is no prospect of their becoming less important in the near future. The problems relating to them are many and complex. Their range and variety make it impossible to consider, even briefly, the more important issues which they raise in the course of this chapter. They involve questions of policy. India stands committed to the policy of what is called discriminating protection. It is vain to hope that it has been adopted as a temporary measure to enable the nation to attain to the stage of economic maturity. The experience of other countries belies such a hope and we may take it as axiomatic that once we have embarked upon this venture, there is no going back for us. We have to accept it as the working principle of our fiscal system. The continuance of this policy, it need hardly be said, will ensure for indirect taxes a place of greater pre-eminence than they occupy at present in our fiscal system. Apart from protection, even the duties, which are avowedly imposed for revenue only, have been made so high that they cannot but have an important effect on our economic life in general. They can, in some cases, be hardly distinguished from protective duties and as the possibility of their being reduced very much below their present level is rather remote, indirect taxes are sure to retain their present importance.

On account of the growing volume and intensity of feeling against the traffic in intoxicating drinks, it is generally assumed that the extinction of revenue derived from the duties imposed upon them is well

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within sight. But it is very unlikely that this consummation, however devoutly it may be wished for, will be actually accomplished in the next generation. The facts of the case make it impossible to achieve this end and when a serious attempt is made to grapple with the difficulties which they present, it will be realized that it is not practicable to carry out this measure of social reform for quite a long time to come. The reduction of salt tax is more likely when the normal upward tendency of the public revenues is given a fair chance of asserting itself, but it will not have any serious effect on the predominance of the indirect taxes in general. Stamps and registration are difficult to classify on account of the uncertainty about their incidence, but if they are to be put under the category of indirect taxes, they will also remain an important source of public revenue and have a considerable bearing on this aspect of taxation. Railways and irrigation have, on account of the magnitude of their operations and their intimate connexion with the Indian finances, to be given an important place in the consideration of fiscal questions. The process of fixing railway and water rates bears a very close resemblance to the determination of the rates of taxation and is, to a certain extent, governed by similar considerations. It is difficult to eliminate an element of taxation from the revenue which they yield and at present their receipts have to be taken into account in considering the incidence of taxation in India. The extent to which they contain an element of taxation is also a measure of the additional importance of the indirect taxes in our fiscal system. One has to realize the significance of these facts to appreciate the necessity of developing those taxes which can be more closely adjusted to the personal capacity of the taxpayer and also the difficulties of making our tax system, as a whole, correspond to the tenets of fiscal equity. It is, as already remarked, not possible to deal with even the important questions relating to the indirect taxes in this chapter. It is proposed to restrict the scope of observations by speaking on the issues which have an immediate importance from the standpoint of fiscal reconstruction.

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### *Necessity of overhauling Indian tariffs*

The question which has to be taken up first is the need of overhauling our tariffs. The importance of this work has been duly emphasized by the Fiscal Commission and the Taxation Inquiry Committee. The structure of our tariff schedules is simple and, having been designed with a view to raise revenue by a system of low duties, is not suitable when the rates are high and our fiscal policy has undergone a change. For a revenue tariff, under which the majority of articles are taxed at one general rate, it is sufficient to define broad groups of articles. A detailed specification of various commodities is not necessary. The form of our tariff follows the general lines of tariffs imposed by countries which have adopted a general tariff for revenue rather than for protective purposes. Our dutiable articles are grouped under 149 heads as compared to 1,370 of Sweden, 1,389 of Switzerland, 780 of Canada, 558 of Austria, 647 of Japan, 705 of the United States of America, 990 of Germany, 1,270 of France and 430 of Australia. The numbers of the tariff items of other countries have been taken at random to show how our schedule stands in need of further elaboration. Mr. G. S. Hardy, then Collector of Customs at Calcutta, gave instances in his evidence before the Taxation Inquiry Committee of the doubtful cases which have to be disposed of by the customs' authorities on account of the ill-defined series of groups in which the articles have been classified in the Indian tariff schedule. He pointed out that in 1894 there were three possibilities in the assessment of the general group—iron and steel manufactures. They might be free, or they might pay either 1 per cent or 5 per cent. The rates being low, difference was a matter of trivial importance to the merchant. Now things having been changed, the rates are very much higher and these differences cannot be easily neglected. Now there are five possibilities. An article of steel can be assessed :—

(a) free, as a component part of the manual machinery,

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(b) at 2½ per cent, as a component part of the power machinery,

(c) at 10 per cent, as structural iron or steel,

(d) at 15 per cent, as hardware, or

(e) at one of the various protective rates of duty.

Mr. Hardy also stated that the luxury duties which are now imposed at 30 per cent relate to ill-defined classes of goods and give rise to considerable amount of doubt and trouble. This is inevitable and the only way by which the difficulty can be got over is to provide for a more detailed specification of the various commodities. But this is not the only reason why it is necessary to overhaul our tariffs. When the duties are many and are as high as they have now become in our country, they have very powerful and far-reaching reactions on trade, prices, industry and the habits of the consumers. Their consequences are serious and it makes hardly any difference whether they are levied for protective or revenue purposes. It is a matter of vital importance to understand the working of these duties and bear their effects in mind in the revision of our tariff schedules. It is no longer a simple matter to raise or lower them. Their influence on the industrial activity and the economic life of the people makes it necessary to exercise very great discrimination in making any change in the structure or the rates of these duties.

#### *Appointment of a permanent body of experts*

The performance of this work requires the creation of a permanent body for the collection of information relating to, and for the study of, the problems of tariff-making. The Tariff Board, appointed in 1924 in pursuance of the recommendations of the Fiscal Commission, investigates into, and reports on, the conditions and possibilities of industries which apply for the grant of protection. The Fiscal Commission was of opinion that the successful working of the scheme of protection recommended by them depended upon the existence of such a body. This Board, having been constituted for the discriminating application of the policy of protection, confines itself to the specific issues arising out of the



questions of granting protection to a particular industry. The Fiscal Commission had suggested that it should study the tariff systems of other countries, watch generally the effect of the tariff policy on the cost of living and perform several other functions, one of them being the work of reporting upon what commodities revenue export duties can safely be imposed and at what rates. These functions do not properly belong to the list of duties which have to be performed for carrying out the policy of protection. But they suggest the need of widening the scope of the Tariff Board's inquiries. Questions of policy must, of course, be outside the purview of the Tariff Board. They must be settled by the Government and the Legislature. But the Tariff Board, or if it is necessary to give it a more dignified name the Tariff Commission, should be entrusted with the work of surveying the whole of economic life with special reference to the working of tariffs, whether revenue or protective, in the country and help in the carrying out of the policy which may be adopted by the Government with the consent of the Legislature. It should be a permanent body consisting of members of unimpeachable integrity and exceptional ability and create for itself a special position in our fiscal system by the quality of its work and its traditions should be worthy of a judicial tribunal.

In America, the prestige of the Tariff Commission has recently been considerably lowered on account of the revelations regarding its having yielded to the political pressure of the party in power. America is a country in which political scandals are a matter of common occurrence and it is not, therefore, surprising that the Tariff Commission should have come under the cloud of suspicion. In India, the conditions of our political life render it very improbable that the Commission would be amenable to this kind of pressure. Democracy here will, for some time, be tempered by the extensive powers enjoyed by the executive and this danger is particularly remote in the sphere of the discharge of the functions which are here under consideration. A well-constituted and well-equipped body of

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experts can, therefore, do very good work in India, not only in providing safeguards against the indiscriminate extension of protective duties, but also in avoiding the pitfalls of an unsystematic tariff-making. It is not safe to trifle with tariffs under the complex economic conditions of to-day, either from ignorance or deliberate dishonesty. It is highly desirable to take effective action to prevent any such development.

### *Functions of the Tariff Commission*

The work of this body which we may, for our purpose, designate as the Tariff Commission, will cover a wide field. It will, of course, conduct all inquiries connected with the practical working of the policy of protection. The Tariff Board has, so far, only confined itself to the investigation of the cases of individual industries. There are a number of other functions which have to be performed, even for carrying out the policy of protection. It ought to address itself to the other duties which were recommended by the Fiscal Commission. The extension of the scope of its inquiries will make it necessary for it to collect information from foreign countries. Their tariff systems will have to be studied, their treatment of the Indian products investigated and the general reaction of their tariff policies on Indian interests brought under review. As the number of industries which get the benefit of the protective policy increases, the inter-relations of these industries will have to be carefully watched and the effect of their sheltered existence on the general economic life of the community made a matter of vigilant concern. But the most important function which has been grievously neglected so far is, as it has already been suggested, the elaboration of the tariff schedule. The administrative difficulties of giving effect to the policy of protection are at present needlessly increased on account of the ill-defined character of the groups in which the articles are classified.

The appraisalment of the value of the dutiable articles under a system of *ad valorem* duties is a work which must always require a high standard of efficiency and honesty ; but the existence of the marginal field, which gives rise to

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many doubtful cases and thereby causes uncertainty of assessment, throws an additional responsibility on the officers concerned which they can, in most cases, ill-afford to bear and increases the possibility of collusive action between them and the merchants. This is the most important duty which the Tariff Commission must take in hand and the necessity of constituting it for the purpose has to be appreciated. The effects of the revenue duties on our trade, industry and economic life have also to be carefully studied. The revenue duties have been raised to their present level under the pressure of War and post-War finance. As the Taxation Committee has pointed out, these duties are stimulating the growth of certain industries, all of which are not on a sound basis and it is not fair to let them take a deep root into our economic life without carefully weighing the consequences of this fact on its future progress. The longer these duties remain at their present level, the more numerous and lasting will be their effects on our economic system and the more difficult will it be to prevent unhealthy developments in its working. It is time to take action as soon as possible, make a complete survey of the existing situation and ascertain how far the revision of the revenue duties is called for, in order to control it more intelligently. The real economic cost to the community of the revenue duties, as of all other taxes, is to be measured not merely by the amount of money that is contributed by them to the public exchequer, but also by their indirect influences on the social life as a whole. It is, therefore, desirable that, in making future changes, these effects should be taken into account and the Tariff Commission consulted and, if necessary, be required to institute a special inquiry for the purpose. Tariff-making is a work which cannot be performed by the hit-or-miss methods. It requires a great deal of knowledge and experience which the officers of the Treasury cannot be expected to possess. Tariff must always remain, in its essential character, speculative to a considerable extent. A 'scientific' tariff cannot be framed and no formula can be used according to which it may be worked in

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actual life. But it is necessary to collect all the facts about the production and consumption of commodities and interpret them with very great care in drawing up the tariff schedules.

#### *Constitution of the Tariff Commission*

The composition of the Tariff Commission is a matter with regard to which it is not necessary to say much; that it should be absolutely above suspicion, of course, is too evident to be specifically mentioned. The present Tariff Board consists of three members—a Government official, a legislator and an economist. The commission should not be a large body. Its strength may be increased to five, but it should not exceed that number. It is not necessary to find a seat for legislators on the commission. Nomination by the Government is the method which can be used for constituting the commission. The representation of any special interests has to be scrupulously avoided. The American Commission has lately been utilized for giving a share to special interests in its deliberations. The duties of the commission will be so extensive that it will not be possible to give representation to any interests whatsoever. Its impartiality can be safeguarded by giving it the dignity and detachment of a really judicial body, composed of men whose competence to deal with and advise on the various issues can, on no account, be questioned. The commission will require a large and highly qualified staff for carrying out its duties. The work of the commission will, incidentally, lead to the collection of a lot of information which will be useful for other purposes as well. But the work of economic inquiry, which it will be doing, will only be a by-product of its proper duties which relate to the discriminate application of the policy of protection and the intelligent making of tariffs in general. They are imperative enough to justify the creation of the commission at an early date.

#### *Export duties and the policy of protection*

There are two other matters which may be referred to here, briefly, before we turn to other indirect taxes. The

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Finance Member has, in his speech which has been referred to a number of times in the course of these pages, expressed his disappointment at finding that the Taxation Committee had to some extent gone back on what he regarded as the wiser views of the Fiscal Commission on the subject of export duties, and in particular on the undesirability of using them for protective purposes. It was held that their use for protection was undesirable as they, in order to be really effective, had to be imposed at a high rate and, therefore, involved a serious burden on the producer. Their use for raising revenue was also disapproved for the same reason; and it was recommended that they should be sparingly used, in the case of monopolies and semi-monopolies: and their rates should be moderate. It may be accepted that, on the whole, the Finance Member's predilection in favour of the views of the Fiscal Commission is justified by the facts of the case. The incidence of export duties is generally on the producers and as they cannot dictate their own terms in most cases, it is not right to handicap them in foreign markets by levying special taxation on the commodities which have to be sold abroad. But it may be stated that there is no reason why the fact that a tax falls on the producers should always be urged as a reason for not using it for revenue or protective purposes. The producers and consumers are not divided into two watertight compartments. If a tax on producers is imposed, it may fall on the same individuals on whom the taxes on consumption generally fall. That seems to be true of the tax on oilseeds and manures, about the propriety of which this difference of opinion has arisen. These taxes will fall on the producers of seeds, etc., who are practically paying all the consumers' taxes and therefore it is merely another method of reaching them. The use of such taxes cannot be banned merely because they involve taxation of producers. In this case there is a good reason why this consideration should not have any weight against its imposition, because what the producers will lose on account of having to accept a lower price of their articles will be more than made up by the gain

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which will accrue to them by their being able to get manures and fertilizers at a lower price. It is not suggested that a tax on oilseeds is desirable under the present circumstances. The prejudices against the use of some of these manures are strong and will not wear out easily ; and even if they can be overcome, the cost of these manures may place them beyond the means of a large majority of our cultivators. When cowdung has to be used as fuel on account of the poverty and ignorance of the people, it is somewhat premature to advocate a tax on bones, etc., in the interest of agricultural progress. We are here, however, concerned with the general principles according to which this question is to be settled. Export duties for protective or revenue purposes should not be used indiscriminately, but it is wrong to avoid them altogether on account of their incidence on producers. There may be, in cases, very good fiscal or social reasons for making use of them within certain limits.

#### *The Indian States and the Indian tariff policy*

It is necessary to place the relations of the Indian States with British India on a more satisfactory footing, so far as the fiscal policy of the country is concerned. The consideration of the question raises a constitutional issue of first-rate importance which it is not possible to discuss here at any length. It is a part of the bigger question as what should be the place of the Indian States in the future constitution of our country and has to be taken up in the political readjustment of the future. There cannot, however, be any difference of opinion regarding the end which it is necessary to secure in making these changes. Economic unity of a country is a necessary basis of its political unity ; and the latter must be precarious to the extent to which the former is not fully assured and so long as any possibility of its being put in jeopardy by an ill-considered policy or action on the part of a political unit within the country is not completely provided against. It is not possible to divide India into two distinct halves for any purpose that is really essential and it is inevitable that in all matters.

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the Indian States should be drawn into, what the authors of the *Joint Report* called 'the orbit of the Empire'. But in economic matters the unity of the Indian States with British India is a vital condition of their mutual existence, and it is impossible to preserve it without establishing a customs union. The precise nature of the existing relations between the Indian States and the Government of India is known only to those who have an access to the Government archives, but it is well known that several States have a right to impose their own tariffs. They have not till now used these rights to the detriment of the economic interests of the country at large; but this harmony has been achieved by the exercise of the authority of the paramount power in more or less an arbitrary manner and cannot endure when their mutual relations are put on a more definite basis, unless it is deliberately provided for in the adjustment of their future relations. The breakdown of the treaty of 1917 and the reimposition of the customs' cordon at Viramgam is only a presage of the future; and now that some of the States have developed maritime ambitions, it is essential to ensure that their fiscal policy should not be at variance with that of the country as a whole. The methods by which this object can be realized have to be carefully considered and will depend upon the scheme by which the financial relations of the States with the Government of India is to be regulated. The States have a legitimate grievance inasmuch as in the recent developments of the fiscal policy of India, their interests and viewpoints have not been duly taken into account. It will, of course, be necessary to provide some machinery by which they can be given an effective share in the determination of our tariff policy and practice; but it is inconceivable that they should have the freedom to have their own tariffs and to place obstacles in the way of the growing economic unity of the country. This is an important problem of our fiscal reconstruction and so much depends upon its solution that it is necessary it should receive an immediate and earnest attention at our hands.

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### *Dangers of discriminatory tariff*

A word may also be said about discriminatory tariffs. India has not as yet been drawn into the network of treaties which regulate the commercial relations of nations. But it is very unlikely that she can keep out of it for very long. These treaties are, as is well known, negotiated as a result of prolonged bargaining which is preceded by a period of bluff and in some cases by actual tariff warfare. The rates are put up to suit the exigencies of the contest and have very little, if anything, to do with the economic interests of the countries concerned. The post-War experience shows that the margin between maximum and minimum of general and conventional rates has been considerably widened. The maximum rates of the French tariff, which in 1892 were only 25 per cent and in 1910, 50 per cent higher than the minimum rates, are now four times as high. Tariffs in Norway, Portugal, Belgium and Spain show the same tendency towards wider bargaining margins. These combative policies have created tariff barriers which are making the economic recovery of the world such a painful process.

An improvement in the political status of our country will carry with it a larger measure of fiscal autonomy, which will enable us to negotiate commercial treaties with foreign countries to promote the interests of our trade in the world markets. This will, of course, be satisfactory as a measure of our political emancipation, but the newly-acquired freedom will have to be used with a considerable degree of moderation. The practice of padding tariffs to secure commercial concessions is a part of the order of things, which has to pass away if the new dawn is to fulfil the promise of a brighter day. It would be well if India does not feel the need of framing discriminatory tariffs. But even if the world is slow to learn the elementary lesson of reciprocal gain being the essential condition of international trade, it will be in our interest to exercise restraint in this respect and never overlook the needs of our economic situation while carrying on our tariff negotiations. The Tariff,



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Commission will, of course, be the agency which will help us to reach wise decisions in these matters and ought to be placed in a position to give its advice on the basis of all the relevant facts of the case. Discriminatory tariff is a double-edged weapon and has to be used with the utmost care.

### *Economics of excise duties*

The greatest disservice rendered to India by the imposition of the cotton excise duty is that it has discredited excise duties as a whole. The question of their place in our fiscal system is not considered on its own merits and the passions engendered by the former controversies fill the atmosphere with noxious vapours which make it difficult for us to view the matter in the clear light of reason. The Fiscal Commission urged the necessity of beginning with a clean slate. But the prejudices against excise duties cannot disappear by wiping the slate clean and echoes of these controversies will continue to be heard long after the cotton excise duty has become a dead issue. The arguments in favour of excise duties have been clearly and concisely stated by the Fiscal Commission. 'Theoretically imposition of equal excise and import duties is a sound method of indirect taxation in cases when the home industry does not require protection.' If the State has to get what the consumers have to pay, it is necessary that a revenue import duty should be accompanied by a counter-vailing excise duty, if the success of the latter can be ensured from the administrative standpoint. This is not only economic orthodoxy but plain commonsense and should be a cardinal feature of our tariff policy. The mere fact that cotton excise duty had an unhappy history does not change the essentials of the situation. The cotton mill industry in India is an old and well-established industry, and the presumption against it being granted protection is very strong indeed, if our real object is to promote the best interests of the country and not to pay off the old scores. The export of three-fifths of the cotton grown in the country or the import of two-thirds of cloth required by the people has no bearing on this aspect of

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the question. It is not possible to ignore the part that sentiment plays in human affairs and we may refuse to impose excise duty on cotton industry as it revives evil memories of the past; but we should know that we are paying a price for keeping these apparitions out of sight and the price is to be paid by those who can least afford it.

If a high import duty of 11 per cent is continued and an excise duty is not imposed, even if there is no case for protecting the cotton industry, we will be repeating the wrong that has been committed in every protectionist country, the wrong of pampering the few at the expense of the community as a whole.<sup>1</sup>

### *Salt tax—its place in the Indian fiscal system*

Of the other excises levied for the purpose of revenue, it is not necessary to say much. Salt tax, which is, however, partly a customs duty, is the most important among them and is another impost which has a history

<sup>1</sup> The recommendations of the Tariff Board for the grant of a bounty and an all-round increase of import duty to help the cotton industry to tide over the existing difficulties have not been accepted by the Government of India on the ground that cotton industry should need no stimulus at the cost of the general taxpayer, if such development is in its own interest. The Tariff Board's recommendations were based on the assumption that cotton mill industry was suffering on account of competition from Japan. According to the findings of the Tariff Board, the effects of these conditions, which give Japan an unfair advantage over India, will have disappeared by the end of 1929-30. If this is so, it should be possible, in a few months, to raise the question of the reimposition of cotton excise duty. Cotton industry will presumably then be in a position to stand on its own legs and it will be in accordance with general principles and the recommendations of the Fiscal Commission to impose an excise duty on cotton industry not of 3½ per cent but of 11 per cent and if that be more than sufficient to meet the revenue necessities of the country, a lower rate can be fixed both for customs and excise duties. But even the Government of India, armed as it is with extraordinary powers, cannot contemplate with equanimity the possibility of imposing 11 per cent excise duty on Indian cotton industry. It may be a very sound theory, but it is extremely bad politics. The clean slate does not carry us very far. The stern realities of the situation have to be accepted, but the principle of discrimination in its application to the cotton industry is thereby sacrificed.

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of its own and played a prominent role in our political controversies. The arguments for and against it are very simple and the frequency with which they have been discussed makes it unnecessary to mention them here. Is the salt tax to go? The answer to this question does not involve considerations of principle, but only of practical expediency. The Taxation Committee argued that if it was desirable to impose any tax on the mass of the community at all, there was much to be said for the continuance of the salt tax. But this view is hardly worth considering, as most of the taxes in India are paid by 'the mass of the community', and it is not possible to justify the retention of the salt tax on this ground. It is not even necessary to preserve it as an emergency reserve. This consideration might have been important in the pre-War years, but now the development of income-tax and customs has changed the situation and they can be jointly relied upon for giving to our tax system the elasticity which it ought to possess, if we are to be prepared for all contingencies. The Taxation Committee has given certain figures to show that the present rate of duty does not restrict salt consumption below the quantity necessary for health. General averages do not afford a very safe guide and it is necessary to examine the effect of this duty on consumption more carefully; and if it is a fact that the people are in a position to buy all the salt they require for their health at present prices, the continuance or the repeal of this tax should then be determined by practical considerations.

The abolition of the tax can be urged on the plea that either it will materially improve the purchasing power of the people and make it possible for them to raise their standard of living, or otherwise give them a margin to increase their savings. If this is to be the crucial consideration for reaching a decision on this point, it will be obvious to everyone who can discuss it in a detached manner, that the continuance of the salt tax cannot be a factor which will in any way adversely affect the economic welfare of the people. The average yield of the tax is about 7 crores out of the total revenue of

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about 150 crores and its incidence per head is  $3\frac{1}{2}$  annas. If the tax is repealed, the country as a whole will lose about 4·8 per cent of its tax revenue and each individual will increase his purchasing power by  $3\frac{1}{2}$  annas. The loss of revenue will cause serious inconvenience to the community and make it necessary for it to tap new sources or restrict its expenditure, while the individual practically will gain nothing by the change. It has already been stated in the first chapter that, in view of the urgent need of increasing our public expenditure in so many directions, it is a wrong policy to strive to reduce the general level of taxation. The people can afford to pay the existing taxes and even more, if their money is spent for dynamic purposes. The right line of advance is, therefore, to seek to bring about a more effective utilization of the yield of this tax, as of other taxes, and not its abolition.

#### *Tobacco duty and its fiscal possibilities*

Among the excise duties, which are not imposed at present but have very great potential importance as revenue producers, a tax on tobacco produced and manufactured in India easily comes first. The hesitation felt by our Government till now in introducing this tax is another testimony of its lack of enterprise in matters relating to taxation, which has been such an outstanding feature of its policy in this country. The only argument for inaction, which has been consistently urged, whenever the proposal for taxing tobacco has been made, is that there are great administrative difficulties in the way of ensuring the success of such a measure of taxation. James Wilson, who gave an important place to the tobacco tax in his budget of 1860, expressed his opinion on the proposal in the following words. 'The only other tax which we propose is a duty on home-grown tobacco to an amount as nearly corresponding with the import duty as possible. I am aware that there has been much discussion in respect of this duty; I am aware that the opinion is not unanimous on the subject, but it is very nearly so and the objections of those who have opposed it have been confined chiefly, I think, to the difficulty of

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levying it. Sir, when a minister in England complains of the difficulty of his task, he is not infrequently told that he occupies his high office for the purpose of overcoming these difficulties—let us accept the same obligation. I hope within a short time, when my hands are less full, to offer a measure to the council which it will approve for the purpose'. During the few months that Wilson was spared after making this memorable speech, his hands were full at the time and he could not elaborate his proposal.

Though since his death the finances of India have been in charge of twenty-three Finance Members, though the tax has been developed in almost all the civilized countries of the world and is being levied with considerable success in as many as seventy-two Indian States, the customs duty on tobacco, after passing through a number of vicissitudes, now stands at 100 per cent and yields a revenue of 190 lacs, though the manufacture of cigars and cigarettes has been undertaken within the country and has become a large scale industry ; still the question of taxation on tobacco is under consideration and the Provincial Governments have to formulate their views on it. The difficulty of levying it has been, as it was in 1860, the main objection all these years against its introduction and the ministers who have held this high office have not been told that they occupy their responsible position for overcoming this difficulty. But it is time that this obligation should now be accepted and no further delay allowed to occur in the imposition of this tax. An estimate of its probable yield must be more or less a conjecture, but that it will be considerable does not admit of any doubt. According to one calculation, the tax will yield about 12 crores, if its incidence is as high as it is in the Travancore State.

In the initial stages the rate of the tax will have to be kept low and it will take time before the point of maximum revenue is reached. Even in the beginning a revenue of at least three crores can be expected and it will not take long to work up to a higher figure. The form in which this tax is to be imposed will, to a certain

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extent, depend upon as to whether its yield is to go to the Central or the Provincial treasuries. A State monopoly of tobacco production and manufacture need not present insuperable difficulties, if it is to be a central source of revenue. But this will probably be against the trend of federal finance in India and a license duty on vend ✓ combined with excise duty on manufacture will be a satisfactory method of introducing this tax. We have waited long enough. It is necessary to take immediate action in the matter.

#### *Lack of constructive thinking about excise duties*

It has already been said in the opening paragraph of this chapter that the extinction of revenue derived from the taxation of liquors and drugs, howsoever desirable it may be, is out of the question for the period that we need take into account for practical purposes. This is the official view of the matter ; and the consistency with which it has been urged against the popular view makes it difficult for a scientific student of the subject to associate himself with it without incurring the suspicion of becoming a partisan in the controversy which has now been carried on for over forty years without producing any effect on the general tenor of debate. The arguments used on both sides are familiar and it is not necessary to set them forth here for getting the whole question into the right focus. The controversy has, all these years, been conducted on the same plane of thought. If one reads the despatch of 1888, which Lord Cross, the then Secretary of State, addressed to the Government of India on the subject of the excise policy of the latter and the speech of Sir Basil Blackett in the Legislative Assembly in September 1925 on the resolution recommending the prohibition of the import, manufacture, sale and use of liquor in India, we find that the official view has not changed since 1888 and besides citing the figures of the excise revenue and liquor consumption of recent years, the Finance Member said nothing which had not been expressed several times over by his predecessors. Similarly the perusal of speeches delivered by our legislators in the full-dress debates, which have taken

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place on this subject in the Central and Provincial Legislatures 'since the introduction of the Reforms, produces the impression of our having got into a mental rut, which has become an important limiting factor in our discussion of the question. The charge that the Government officers attach greater importance to the consideration for public revenues than for the social well-being of the people has always been levelled against them and as often indignantly repudiated by them.

The relative merits of the auction and fixed-fee system of licensing the vendors have been discussed threadbare ; and now three Provinces are using the fixed-fee system, with the modification of charging a sliding scale of duties according to the quantity sold and the rest are satisfied with the system of auction sales. The Government of India, in paragraph 7 of their despatch No. 12 of 1914, thus concluded their observations on this point : ' For the present, therefore, while we desire to retain the existing systems as they have developed to meet local needs, we do not regard the question as closed '. The question is open still and we are no nearer its solution now than we were in 1914. The desirability of ascertaining and deferring as much as possible to reasonable public opinion has been conceded by the Government ; but they have, all along, been strongly opposed to giving the local licensing boards any executive powers lest it should be converted into a system of local option, which development, according to them, would be antagonistic to genuine progress in the cause of temperance. The Government have held that, to use the words of the despatch referred to above, ' their primary duty, and one of greater importance than the reduction of licit consumption, is the complete suppression of illicit manufacture and vend.' This point has always been greatly stressed by the exponents of official view ; and its bearing, it may be added, on the issues involved not adequately appreciated by its critics. It seems, therefore, futile to dwell on these points at greater length, or try to forecast the future developments. Public opinion in favour of prohibition has gained strength in the last decade, but the prospect of its being enforced has become more

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remote than ever on account of the increasing dependence of the Provincial Governments on this source of revenue.

*Inadequacy of the formula 'maximum of revenue with minimum of consumption'*

It may, however, be useful to say a few words about two aspects of the question, the one economic and the other administrative. The formula in which the Government policy has been embodied is 'maximum of revenue with minimum of consumption'. This has been interpreted to mean that it is the duty of the Government to minimize temptation to those who do not drink and discourage excess among those who do; and the methods employed for realizing this aim are the reduction of the number of licensed shops and hours of sale, the control of their location and the imposition of as high a rate of duty as possible without encouraging illicit manufacture and vend. Since 1906-7, the number of shops for the sale of liquor and drugs has been reduced from 1,12,086 to 76,484 in 1913-4, and to 59,125 in 1923-4. The revenue during the same period has increased from 8.84 crores in 1906-7, to 13.30 crores in 1913-4, and 19.27 crores in 1923-4; and the incidence of taxation per head of population from 6½ annas in 1906-7 to 8 annas 5 pies in 1913-4, and to 12½ annas in 1923-4. The consumption during the same period has not increased, but has not varied in inverse ratio to the increase in the rates. Complete figures for the consumption of country spirits, toddy and drugs are not easy to obtain, but from the figures of the consumption of country spirits given by the Taxation Committee it appears that it has decreased from 6,957 thousand gallons in 1906-7 to 4,976 thousand gallons in 1923-4. In seventeen years while the incidence of taxation has increased by nearly 100 per cent and revenue by 113 per cent, the consumption has decreased only by about 16 per cent. This points to the conclusion that the demand for liquor is, relatively speaking, inelastic; and the policy of reducing consumption by raising taxation can be effective only within very narrow limits. The same can be said of intoxicating drugs as



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well; and if this be true, it will appear that the raising of duties to a high limit, even though it does not encourage illicit production, may lead to the maximum of revenue without the minimum of consumption in the sense in which the phrase is ordinarily understood.

This consideration suggests the need of attacking the evil in some other way. The policy of raising the prices of liquor and drugs by raising the rates of duties can be carried too far; and in a country, where the purchasing power of an average family is so low, it may depress the standard of living of the people without causing an appreciable reduction of consumption. Mr. G. P. Hogg, Commissioner of Excise (Bengal), pointed out very clearly the limitation of the formula adopted by the Government in his evidence before the Taxation Inquiry Committee. He hit it off so well that it will not be amiss to quote his statement in full. 'I have,' he said, 'always felt that the dictum "minimum of consumption with maximum of revenue" is not an adequate statement of policy. As between consumption and revenue it expresses a valuable connexion but only *relatively*. It affords no guide to the absolute minimum consumption or maximum of revenue which the State is prepared to collect. For every given level of consumption, there is a maximum revenue obtainable and vice versa. But as to what the level ought to be, the principle gives us no clue whatsoever. The criticism is, therefore, not without some force that the Government is making it more difficult every year to replace the revenue which, on the whole, is increasing. It seems to me that if it be really conceded that the aim of the Government policy is to effect a steady reduction of the consumption of country spirits and hemp drugs, one of the first steps should be to fix the maximum amount of revenue which the Government requires from the sources and then press down the consumption to the corresponding minimum level. As new sources of revenue are secured and the old sources yield increased amount, the excise revenue would be correspondingly reduced and consumption further diminished. The position at present is that consumption goes up, Govern-

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ment increases its estimate of revenue and then it becomes more difficult to carry measures likely to affect budget expectations. I need not elaborate the argument at length, but I think that the Government might express its policy in more definite terms—*absolute* rather than *relative* in character—on the assumption that future developments in India will be steadily in the direction of reducing the consumption of excisable articles.' This is an admirable statement of the present position and coming as it does from an officer intimately connected with the excise administration, it should carry the weight which it deserves. The charge against the excise policy of the Government is not that it has increased consumption, but that it has not reduced it to any considerable extent. The Government must, therefore, adopt more positive methods for reducing consumption and not rest contented with the automatic effects of increased taxation.

#### *Diversity of excise duties—a special feature of the Indian fiscal system*

The rates of excise duties are not uniform in India and in this respect practice in this country is different from what is held to be right policy and practice elsewhere. In the American constitution, it is provided that 'the Congress shall have power to lay and collect taxes, duties, imposts and excises, and to pay the debts and provide for the common defence and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States.' In other countries, a similar constitutional provision is made and diversity of excise duties is rightly considered as subversive of the principles of federal union. In India, the rates of duty on country spirits per proof gallon vary from 6 annas to Rs. 21-2; and the rates vary not only from Province to Province, but also in the same Province. The rates in Bihar and Orissa vary from 10 annas to Rs. 10, in Bengal from Rs. 1-12 to Rs. 21-2, in Madras from 15 annas to Rs. 10-10, in Burma from 6 annas to Rs. 13-12 and in the Central Provinces from 10 annas to Rs. 13-12. The rates on drugs are also different,

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though the range of variations is not quite so wide. This diversity of rates is accounted for by various reasons. It is due to difference in the economic conditions of the people, facilities for illicit distillation, varying standards of efficiency reached in different parts of the country and proximity or otherwise to the Indian States where lower rates of duty are charged and control over production is not quite so strict. All the administrative officers seem to be agreed that the uniformity of rates is not practicable in India. The different rates may be tolerated as a necessary evil; but it should be possible to reduce their variety considerably if the inconvenience caused by them in a system of federal finance is fully realized. The difficulty has already been experienced and overcome by a makeshift device. But the danger of smuggling from a low-duty zone to a high-duty zone must always remain an embarrassing feature of the fiscal systems if the rates of duty vary from Province to Province and from district to district in the same Province. There are certain hilly tracts inhabited by backward tribes, where it is not possible to enforce a high rate of duty; but such areas are not many and it would not be difficult to apply to them special regulations for excise administration, but there is no reason why the progress of the country as a whole towards a greater uniformity of rates should be held up because of this difficulty. The highest rate in Bengal is Rs. 21-2 and in Bombay only Rs. 10. It cannot be maintained that this difference in rates is justified by difference in economic and other conditions of these two Presidencies. There is a close connexion between the excise revenue and the economic condition of the people, closer perhaps than between the latter and other sources of revenue; but the incidence of revenue varies from 3 annas 5 pies in the North-West Frontier Province to Rs. 2-2-5 in Bombay. In Madras it is Rs. 1-2-6, in the Punjab 15 annas 10 pies, in the United Provinces 9 annas 1 pie, and in Bengal 7 annas 4 pies. The difference in the purchasing power of the people in different Provinces cannot possibly correspond to these extreme variations in the incidence of excise duties.

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### *Need for a greater uniformity of rates*

It ought to be possible to level up these rates and reduce their diversity within well-defined limits. The first step should, of course, be greater uniformity in each Province itself. Bombay has more than eleven rates, while Madras has practically two. In the latter Presidency, in twenty districts the rates vary from Rs. 8-7 to Rs. 8-13, and is Rs. 10-10 in five districts. In twenty-five out of its twenty-seven districts there are thus practically two rates of duty on country spirits. It should be possible to do in Bombay and in other Provinces, what has been done in Madras. Everywhere the conditions in capital towns and industrial centres are different from those in smaller towns and rural areas, but this is not made a reason for levying varying rates of excise by other Governments. Mr. A. G. Stokes, Commissioner of Excise (Madras), in his evidence before the Taxation Inquiry Committee, expressed himself thus: 'The nature of the country and the propensities of the people are not uniform. Many facts arise while the question of fixing duty is considered and though uniformity is on general grounds desirable, I do not regard it as essential'. Mr. Hogg of Bengal adopted a similar view. 'I do not see,' he said, 'any merit in uniformity. Where good reasons exist for variations, then the only opposing factor that need be considered is complication and confusion of accounts and figures.' The right view is that the uniformity of rates is both desirable and essential. And it is because uniformity in such matters is a factor of considerable importance in a well-organized system of federal finance, that varying excises are not permitted anywhere in the world. Variety should be an exception rather than the rule. It is necessary to make concerted efforts to introduce greater uniformity of rates and even an absolute uniformity should not be dismissed as a purely Utopian ideal.

### *Opium policy of the Government of India*

Opium, once the most important source of revenue, next to land revenue, is now, relatively speaking, of

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very little fiscal importance. The opium policy of the Government of India has, since John Bright led a campaign against it, been condemned vehemently from time to time. Now the Government has stopped the sale of opium by auction and undertaken to extinguish the exports of opium for other than medical and scientific purposes. There will be no exports of opium for purposes other than those to which no exception can be taken after 1935. The Government of India derive a net revenue of 1.45 crores by the sale of opium outside India. Their net revenue for three years before the War was on the average about 8 crores. It will, in ten years, be practically reduced to a vanishing point. The Provincial Governments receive about 1.6 crores by the sale of excise opium and the amount is likely to remain a fairly constant factor in the Provincial revenue for some years to come. It will be beside the point to say anything about the controversy which has arisen regarding India's right to regulate her domestic consumption without any outside interference. The action which the Government of India has already taken in restricting exports will go a long way in removing the misunderstanding that has arisen. It is necessary to go further and restrict the consumption at home.

There is unmistakable evidence that in certain areas opium evil does exist. Assam with a population of 7.6 millions has an annual consumption of 838 maunds; while in the United Provinces, with its population of 45 millions, the consumption is 550 maunds; and in Bombay, with its population of 19 millions, it is 754 maunds. The fact that the average consumption per head in this country in 1893, when the Royal Commission on Opium conducted its inquiries, was 27 grains, and now it is 17 grains, does not mean anything, if in certain local areas consumption is very large and undermining the health and morals of the people. It is possible to adopt a more rigorous policy in the case of opium than in that of other intoxicants, on account of the Government monopoly of cultivation and manufacture. Smuggling, that has been growing of late, will have to be put down and will require a greater degree of inter-

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**Provincial co-operation.** But now that the Indian States are coming gradually into line with British India in this matter, it should be possible to reduce the consumption within the country much more rapidly. This will satisfy the world conscience and be also desirable from the national standpoint. If this line of action is adopted, it will, of course, mean that even for Provincial purposes opium will dwindle in importance as a source of revenue. This result will not cause any serious inconvenience and be welcomed by the advocates of temperance.

### *Stamps, registration and court fees*

Stamps and registration together contribute 14·6 crores to the public treasury in India, which is more than 9 per cent of our total tax revenue. The receipts from these duties have been increasing since 1878-9. They were then 3·2 crores, increased to 5 crores in 1900-1, to 8·41 crores in 1913-4 and to 14·26 crores in 1924-5. They have increased not only absolutely, but their relative importance in our tax system has also increased. They were 5·5 per cent of our tax revenue in 1878-9, 6·8 per cent in 1900-1, 8 per cent in 1913-4, and over 9 per cent in 1924-5. Their incidence is very doubtful and it is, therefore, difficult to classify them. It has even been argued that they are not taxes, but fees for services rendered. It is possible to maintain this view, but the balance of arguments is in favour of regarding them as taxes, though it is almost impossible to say whether they are shifted and, if so, on whom their incidence rests. It is not possible to graduate them according to the paying capacity of individuals and the rates cannot be framed with reference to any principle other than that of not raising them so high as to reduce their yield. Hobson is of opinion that they are 'cumbersome relics of the past, haphazard methods of catchpenny improvisation, which have no place in a scientific system of finance'. From a theoretical standpoint it is difficult to dissent from this view and there is, therefore, a great deal to be said against placing an undue reliance upon them for fiscal purposes. But the place which they have already secured for themselves in the tax system of our

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country as well as in those of other countries makes it very unlikely that they will be dislodged from their present position of considerable importance. They will, therefore, continue to remain an important source of revenue in the near future and have to be reckoned with in our schemes of fiscal reconstruction.

It is not possible to determine whether the stamp duties on various kinds of transactions are rightly imposed and whether their rates are or are not unduly high. The question whether court fees should just cover or more than cover the cost of judicial administration has been debated since 1886; and apart from the fact that it is impossible to say how far the existing rates are yielding profit, the issue cannot be settled on *a priori* grounds. Bentham's view that justice should not be sold is one view of the matter; the other view is that the imposition of court fees is necessary to deter the people from indulging to excess in their favourite pastime of litigation. The practical consideration that it is undesirable for the different Provinces to have varying rates of these duties has been emphasized by the Taxation Inquiry Committee. It ought to be clear now that what the Meston Committee called 'a genuine and complete separation of resources' does not require that the receipts of non-judicial stamps should be appropriated by the same authority which gets the yield of court fees. Complications are arising which ought to be avoided; and Central legislation and Central control of these taxes is necessary in the interest of, what the Australian Commission on Taxation called, the harmonization of taxation.

#### *Concluding observations*

This review of indirect taxes and their place in our tax system may now be concluded. They have been dealt with in this chapter in a somewhat fragmentary manner on account of the necessity of covering a wide range and of taking into consideration a variety of issues. The fact, that they occupy such an important place in our tax system steepens its otherwise inverted progression and supports the view that the right line of advance in

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India, since these taxes have to be with us for a very long time, is to change the incidence of the benefits of expenditure rather than that of the burden of taxation; though the need of developing direct taxation to the utmost is imperative and has to be properly appreciated. Administrative considerations are particularly important in connexion with these taxes and have to play an important role in the determination of our future policy with regard to tariffs. If the latter are to be administered well, they must be placed in the charge of a competent body of experts who should not only consider the question of granting protection to particular industries, but examine their effects on our entire economic life, specially on our position in the world markets. Early financial settlement with the Indian States is of immediate importance and should be concluded to dispose of the outstanding issues and provide for an orderly and harmonious development of our entire economic life. Indirect taxes cannot be abolished, but they can be wisely regulated; and the way to do so is to understand the intricacy of the problems which they give rise to and take a matter-of-fact view in these matters. These taxes, or most of them, have been very much to the fore in our political controversies, but that has not helped us to clarify our ideas with regard to them; and it would not lead to a better understanding of their position in our tax system if we continue to treat them solely as political issues. Denunciation is at best a negative virtue and we need a great deal more than that for the task of fiscal reconstruction that awaits us.



## CHAPTER V

### NON-TAX SOURCES OF REVENUES

#### *Importance of non-tax sources of revenue*

The distinction between tax and non-tax sources of revenue is not clear cut. Non-tax sources of revenue, apart from administrative receipts which are not important are either fiscal monopolies or public domains and industrial undertakings. Fiscal monopolies like salt, tobacco and matches are made the exclusive preserve of the State primarily and specifically for the purpose of increasing public revenues and can be and are made use of as a means of indirect taxation. Public domains and industrial undertakings are managed as quasi-commercial concerns but can also be utilized for realizing a monopoly revenue which, in the last analysis, can hardly be distinguished from taxation proper in the case of public authorities. In India, opium is the only fiscal monopoly, but as it has no future, it is not necessary to add to what has been said already in the last chapter. If salt and tobacco are not to be made public monopolies in India, the question of fiscal monopolies does not possess any practical interest for the fiscal reformer at present. But the same cannot be said of public domains and industrial undertakings. Posts and telegraphs, railways, irrigation and forests are, collectively, important sources of revenue for the State and their importance in our fiscal system is not only great but also growing. Of these, nothing need be said about posts and telegraphs. Their net receipts hardly amount to 50 lacs; and as the Government has always disowned the intention of relying upon these departments for expanding its revenues, it may be assumed that they will in future just pay their own way; and if they yield a substantial surplus, it will either be used for improving their efficiency of service or dissipated by a reduction of rates.

*The bearing of railway finance  
on problems of fiscal reconstruction*

The other three activities of the Government are, however, on a different footing. Railways have been made autonomous by the separation of railway finance from general finance, but they have not ceased to be of interest to the student of taxation on that account. The convention, according to which autonomy has been secured to them, is subject to revision and is being provisionally tried for three years. It is, therefore, possible for the Government to levy a higher contribution on the railways than they are paying under the existing arrangements. The Government is now receiving about 5.5 crores from railways and this amount is likely to grow larger with their increasing prosperity. The Taxation Committee has come to the conclusion that the amount so paid is to be included in pure taxation; and though the point is, as the committee itself has admitted, debatable, the arguments in its favour are fairly convincing and the amount in question can well be taken as part of the tax revenue of the Government. But the most important reason why the railway earnings and the principles which govern their aggregate amount cannot be left out of account by the fiscal reformer is the fact that the problem of rate-making is exceedingly complex and is, in many ways, similar to the problem of taxation. The principle of charging what the traffic will bear has been interpreted by some eminent authorities as analogous to the principle of ability to pay and justified on that ground. 'Acworth interprets,' to quote Ripley, 'charging what the traffic will bear as something analogous to this. His allegation is that the rate schedules are built upon the principle of "equality of sacrifice" otherwise characterized as tempering the wind to the shorn lamb'. Hadley is more explicit, defends the principle against its abuse and adds that 'it is unpopular because it has been misapplied by railway managers and made an excuse for charging what the traffic will not bear. Really applied, however, it is the only sound economic principle. It means taxation according to ability—ability being determined by actual

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experiment'. It is open to question whether the experimental method, which the railway managers can use for assessing the ability to pay, can be taken as a safe guide for the purpose; for the mere fact that the traffic is not appreciably diminished by raising a particular rate may be more a proof of the inflexibility of the demand for the commodity which has to pay a heavier rate than of the ability of those on whom it falls.

But it may be admitted that the process of railway rate-making is so far removed from the process of valuation in the ordinary sense of the word that it can be maintained that it is, in some respects, not different from the process by which the schedules of customs and excise duties are built up. The principle of charging what the traffic will bear can be justified on the ground that it leads to the fuller utilization of railways. That is so; but the limits within which the Traffic Manager can vary his rates, without consciously infringing the principle of rate-making, give him an amount of power which can very well be likened to the taxing authority of the State. There is an element of arbitrariness in the exercise of this power; considerations of cost and utility afford very little guidance in the determination of individual rates; and the officer has to rely more upon his judgment of what is right and ought to be, rather than upon objective facts which he must take for granted. Railways in India are the property of the State and even if the lines which have recently been brought under State management and others whose contracts have not as yet expired are leased to indigenious companies later on, public control of rates in the interest of the community will be a necessity. Internal autonomy of railways is highly desirable; but the enormous financial stake which the State has in their management and their vital importance to the economic life of the country, besides, of course, the complexity of rate-making itself, make it equally desirable that the policy of our fiscal reform should be shaped with due regard to the position of railways in our financial organization. In accordance with the provisions of the London Protocol,

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1924, the German railways have been transformed into an autonomous undertaking with its own property and its own liabilities; but the organization has had to assume a liability of eleven milliard marks for the payment of reparations which will not be completely redeemed till 1964. This, of course, means that the German people are to be taxed through their railways for forty years to meet the Versailles Treaty obligations. A similar possibility of levying heavy taxation on the people through the railways, exists in India, as in every other country where they have been nationalized. Changes in railway rates cannot but have a profound effect on the entire working of our fiscal system. They are intimately connected with the questions of the incidence of protective duties, the price of salt and similar other issues which have to be considered when the practical aspects of taxation policies are under discussion. Railway finance has, therefore, a considerable bearing on all problems of fiscal reconstruction.

#### *Water rates in relation to Indian tax system*

It is also unnecessary to point out the relation of water rates to the Indian tax system. They are, at present, almost an integral part of our land revenue system in some Provinces and these rates are changed to suit the varying needs of the Provincial exchequers. The intimate connexion which exists between them and the land revenue system is open to criticism from the standpoint of fiscal theory and sound business methods and has to be revised, if irrigation is to be made an autonomous undertaking. But even then it will be almost impossible to divorce water rates completely from land taxation; and in their case again the problem of fixing rates is a difficult one and presents issues which are similar to those that have to be dealt with while considering the questions of taxation. Their place in any scheme of fiscal reorganization has to be carefully considered; and it will not, as it will be pointed out a little later in this chapter, be easy to make the necessary adjustments.

*Development of forests for fiscal purposes*

Forests do not present any complex issues at present ; but it is the view of all who are entitled to speak with authority on the matter that their potential importance is great and, apart from conferring incalculable benefits on the country from the standpoint of its economic development, they can become very good revenue producers for the State, if they are exploited scientifically and adequate funds are provided for the purpose. A responsible forest officer anticipates the addition of an annual revenue of 50 crores from forests in about fifty years, if the Government is prepared to finance the schemes of development, the future success of which cannot be a matter of any doubt or difference of opinion. This is, of course, a guess ; but when it is remembered that now the net revenue from this source is about 2·2 crores and more than 20 per cent of the area of British India is under forests, one can very well expect a very great expansion of forest revenue without taking an over-optimistic view of their future possibilities. Forests are the public domain of the Government, which have to be fully developed as much in the interest of public revenues as of the general welfare of the community.

*Railways : a public utility enterprise*

It is always stated that railways are a business undertaking and ought to be run on purely commercial lines. Whether this consideration should be accepted as all-important in the management of railways depends upon how we interpret it. That their working expenses, which must include an adequate provision for the depreciation of plant and equipment, should be fully covered by the railway earnings, and that the claims of the stock and bond-holders be met out of the surplus, of course goes without saying. In this sense the railways should certainly be managed as a commercial undertaking. The Inchcape Committee was of opinion that the country could not afford to subsidize its railways, and that it was necessary to ensure that not only the railways be placed

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on a self-supporting basis, but an adequate return obtained for the large capital expenditure which had been incurred by the State ; and it held that if they were to yield an economic return on the capital invested by the State, they should, after allowing for interest, annuity and sinking fund payments, give an average return of at least 5½ per cent on the capital at charge. This rate is not excessive and happens to correspond to the rate which the Inter-State Commission of the United States has, under the Act of 1920, been instructed to take as a fair return for railway properties held and used in transportation and to keep in view in fixing the rates of the railway corporations. But this, of course, should not be taken to mean that all non-commercial considerations are to be ruled out of court in deciding railway policies.

Railways are not a commercial undertaking in this limited sense of the word. They are a first class public utility enterprise and are to be managed on that basis. The non-commercial considerations, which are really social considerations, are, within the limits set by the necessity of earning what the English Railway Act of 1921 calls 'the standard revenue', of paramount importance and should have free play in determining the railway rates and conditions of service. For this, it is necessary that the railways should, even when their management is in the hands of several administrative units, be treated as one joint concern and the problems of their development approached from the national standpoint. They are a vast undertaking ; but their efficiency and utility are sure to be impaired, if the essential unity of their different administrative organizations is lost sight of in the actual working of railways. The same consideration requires that there should be a complete co-ordination between the different forms of land transport and between them and the carriers by sea and river. The recurrence of a case like the one cited by the Acworth Committee, in which railway rates were actually changed to kill a small navigation company, should be rendered simply impossible. And, of course, the railway rate policy should be so regulated that, though ordinarily the rates should

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be determined by business considerations, it should be possible to realize objects of social utility through changes in these rates. Taussig is of opinion that all traffic is ancillary to the division of labour and that a railway is not economically advantageous to the community unless it pays its way. This is, as already stated, true within certain limits. It is, nevertheless, of great importance that within these limits the railways should be managed not merely as freight-carriers, but also as a means of achieving ends, regarding the social utility of which there cannot be any question, but whose value cannot be measured by any pecuniary calculation. This means that the rate-fixing authority should have a wide discretion in framing the schedules, and steps be taken to see that it is exercised strictly for bona fide purposes.

It may be legitimate to offer concession rates to an industry, not merely because it is of advantage to open a new region by railways which may not pay at the outset, though this consideration will in most cases suffice, but because it is in the interest of the community to develop a particular area or industry. The exercise of this power needs to be hedged by certain safeguards. Railway rates are very flexible and can be made a cover for personal or local discrimination of an anti-social character. The need of constituting an authority which should do this work and run the enterprise as a social undertaking is the more imperative on this account. But just because they are flexible and must be so in the very nature of things is the reason why it is necessary that the social standpoint should receive adequate consideration when railway policy is conceived or executed. Railways, to repeat once more, are of such vital importance to the community that the economic considerations must be subordinated to those of social well-being. And though on account of the immense expenditure involved in constructing and running them, it is not possible to make them a charge on the general revenues, it is pre-eminently desirable that the administration of railways be informed by a spirit of public service, without which it is impossible to

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make them really efficient, in the sense of getting the utmost out of them for the community.

#### *Social significance of the separation of railway finance from general finance*

The separation of railway finance from general finance is a measure of great consequence from the financial standpoint, but it is something more. It is a step towards bringing India into line with the course of evolution which the development of railways and similar undertakings is taking everywhere. The Government undertakings are, in an increasing number of countries, being conducted by *ad hoc* administrative bodies specifically created to suit the exigencies of services rendered by them. It may be assumed that such bodies will function as efficiently as the boards of large joint-stock companies. It is essential for the success of these new experiments that the internal organization of these undertakings should be improved, their capital and revenue accounts maintained on an up-to-date basis, and the traditions of a high standard of public duty which we associate with all well-organized public services built up in the conduct of these operations. The Indian railways are in charge of the Railway Board whose internal constitution has been recently revised. The system of railway accounts has been recast, but it needs to be greatly improved. The divisional system of administration which has been recently introduced will make greater decentralization possible and relieve the officers at the headquarters of routine work which is really outside the proper sphere of their duties. But it is necessary to carry the reform further, if we are to have a unified and well co-ordinated system of railways in India. It is necessary to have regrouping of our railways to avoid overlapping of the spheres of operations or duplication of plant. Separation of audit from accounts, introduced recently, will have to be made a part of the wider reform which should aim at the separation of executive from supervisory functions. Experience will itself suggest further lines of development, but the management by a well-organized and fully-equipped administrative body



detached from the Central Government should be a *sine qua non* of our future railway policy.

'One of the most interesting and unnoticed developments of recent decades,' according to Mr. J. M. Keynes, 'has been for the big enterprise to socialize itself.' This development has two aspects. The first is that public interest becomes a dominant factor in the management of these undertakings, and the other is that their internal organization is brought to a high level of efficiency by entrusting their management to those who have the necessary experience and ability for the work. The latter are placed in a fiduciary position, and the undertaking in their hands becomes a public trust and an organ of the dynamic life of the community. This is the function which our railways have to perform in our social economy; and the step that has recently been taken, though primarily dictated by financial considerations, is in keeping with the line of evolution of similar undertakings in the other countries of the world. In India, the Government already owns big enterprises. It may be necessary to extend the scope of what is known as State trading. It will be desirable to apply the same principles of administration to all socialized enterprises. The need of constituting *ad hoc* bodies for irrigation and forests will be referred to a little later. But as posts and telegraphs are not to receive any further consideration, it may here be stated that it is necessary to reorganize this public department on the same lines. Now that the process of separating capital account from current account has been completed in posts and telegraphs, it is possible to take the next step and make this department an autonomous undertaking. In Germany, since 1924, postal and telegraph services have an organization of their own, with its own property and its own liabilities. Of the current receipts 80 per cent are to go to a reserve fund until the fund has risen to a hundred million marks, when the whole surplus will be paid over to the treasury. A similar change has to be introduced in the organization of our postal and telegraph services. It is called for in the interests of efficiency and public utility.

*Theory and practice of rate-making and  
the need of public regulation of rates*

The questions of the function and organization of railways have a bearing on the problem of finding a suitable place for them in our fiscal system. It is in the domain of rate-making that they assume special importance. The theory of the matter, although not simple, is not difficult to understand. But the art of rate-making is neither simple nor easy, and as strictly economic considerations cannot be depended upon as guides in its practice, there is room not only for honest and wide divergences of opinion, but also for a great deal of discrimination of social and anti-social character. The difficulties of rate-making arise, as is well known, from the very conditions under which the railway operations are, and have to be, conducted. The first and the most important of these is that the construction of railroads entails a very heavy capital expenditure which makes the overhead charges a very important determining factor in rate-making. The total capital at charge of Indian railways in 1924-5 was 733·4 crores and their gross earnings 114·8 crores, or in other words the former is more than six times the latter. The other condition, which is almost as important, is the fact that a very large proportion of the current expenditure is independent of the volume of business; and what is more, it is not possible to allocate it among different items of traffic; and the apportionment of even the variable expenditure is, in most cases, an impossible task.

If we take the railway expenditure for 1923-4, we find that the working expenses amounted to 62·93 crores and interest on capital, including annuities, to 23·95 crores. The interest charges are, of course, fixed and do not vary with the volume of business. It is not possible to analyse the working expenditure here in order to see how far it is constant and independent of the volume of traffic and how far variable. But it is certain that a large portion of this expenditure has to be incurred, irrespective of the amount of the traffic carried over the lines. Maintenance

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of lines, for example, cost 13·01 crores during that year. A part of this expenditure is due to wear and tear, but this amount is small and the bulk of the amount spent for this purpose is not variable to an appreciable degree. Locomotive expenses in the same year amounted to 21·60 crores. The proportion of variable expenditure in this item is probably higher than in that of the maintenance of way ; but even then not more than half of the expenditure of a railway on locomotives depends upon the volume of business. Ripley, in summarizing his observations on the expenditure of American railways, comes to the conclusion that approximately two-thirds of the total expenditure of a railroad and more than one-half of the actual operating expenses are independent of the volume of traffic. If we assume that the same proportion holds good in the case of Indian railways, and for our argument this assumption will not be unwarranted by the facts of the situation, out of the total expenditure in 1923-4 about 53 crores can be taken as constant or independent of the volume of traffic. That, of course, means that the cost per unit of weight or per passenger decreases with the increase of business, and that it is not possible to differentiate it for different items of traffic. The rate-making authority has, therefore, to fix the rates with reference to what is known as the principle of charging what the traffic will bear, which has been condemned by some as 'the method of squeezing as much as you can without exceeding the limit of endurance', and hailed, as already stated, by Acworth and others as the ethical maxim of 'tempering the wind to the shorn lamb'. It can, as a matter of fact, be used for both the purposes ; but what is of importance is that, as the cost of rendering each service is indeterminate, it is the only principle which can give any guidance in framing railway tariffs. The necessity of using it as the basis of railway rates does not, however, provide safeguards against its abuse ; and the experience of all countries has established the fact that without the public regulation of rates it is impossible to ensure that they shall be just and reasonable. Railways cannot conduct their operations under competitive conditions. The

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existence of the latter is not only impracticable but also uneconomical.

The consolidation of different railways is in accordance with the highest interests of the community; and the power, which rate-making places in the hands of those who are charged with this all-important duty, ought to be exercised in the public interest. The corrupt manipulation of railway rates has probably shown the present economic system at its worst; and the measures, like the Act to Regulate Commerce of the United States and the Railway Act of 1921 of Great Britain, are a practical recognition of the supreme importance of remedying these evils. It is not enough that there should not be any unfair discrimination or favouritism. That is only a negative aspect of the question. Its positive aspect is that the rates should be determined by considerations of social well-being. They should embody a policy of social development. Even when there is no discrimination, the principle of charging what the traffic will bear does not guarantee that exorbitant rates will not be charged; and what is more, there is nothing inherent in the principle itself which may suggest that it should be applied with a view to realizing the maximum social advantage. It is to be interpreted very widely, if it is to serve as a dynamic principle of social importance. This positive aspect of the policy of the public regulation of rates makes the task of the rate-making authority infinitely more complex. The application of the principle of charging what the traffic will bear is difficult enough if its scope is confined to securing the fullest utilization of railway plant. But if, like taxation, it is to be used, even though within certain limits, as a means of developing the economic and social resources of the community, the task becomes almost baffling and has to be done well, to be placed in extremely competent hands. The power which the railway rate-making authority possesses to make and unmake individuals, industries, cities and even wider territorial units, has to be used with strict regard to the interests of the community, and it has to be consciously exercised with the full understanding of its far-reaching importance. Public regulation of rates is, then,

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a necessity to prevent personal and local discriminations of the wrong kind and to promote the economic and social development of the country.

#### *The present position and its liabilities*

The present position with regard to railway rates is admittedly unsatisfactory. The Railway Act does not make any provision for fixing them. But the Government has, since the very beginning of railway construction in India, been trying to regulate them within certain limits. Clause 8 of the original contracts of the late guaranteed companies was intended to make it possible for the Government to exercise some control over the rates; but, as is well known, its actual operation turned out to be unsatisfactory and the railway companies were not amenable to the control of the Government of India. A guaranteed system of railway finance not only made the companies reckless regarding capital expenditure, but took away from them all incentive to develop traffic by the reduction of rates. They sought to increase their profits not by increasing their volume of business, but by raising their rates. The Secretary of State made matters worse by his frequent interference with and circumscription of the powers of the Government of India in this matter. The maximum rates and fares laid down by the Government were of no practical value; and, even after 1879 under the new system of company management, the Government did not assume wider powers of control. It could fix maximum and minimum rates, change maxima and minima, but had no authority to challenge the discretion of the companies in fixing the individual rates. The position, so far as the company-managed systems are concerned, is even now just the same. As Sir Clement Hindly, the late Commissioner of Railways, in a meeting held on 22 August 1923 at Calcutta said, when the question of reduction of freight on coal was under discussion, 'In the first place I want it to be clearly understood that the question of fixing railway rates is one which the Government of India delegate entirely to the companies. The Government of India

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confine themselves to fixing maximum and minimum rates; and in accordance with the terms of the contract, the companies fix their own rates.' The Government and the public are thus helpless against the company-managed railways; and as about 15,000 miles of railways are either owned and managed by companies or owned by the State and managed by companies, and as the contracts of some of them will not expire till 1950, it is not possible to expect a more effective control of rates in the near future. That the Government should have given the companies such a wide latitude in fixing rates in spite of their having contributed only a very small portion of the capital required for the construction of these lines, is a conclusive argument against the arrangement by which this valuable public property has been leased to private concerns. The system has now been fully discredited, but it is not possible to liquidate the existing liabilities for some years to come.

### *Railway rates as an instrument of economic development*

The inequalities which have existed between goods for export and imported articles on the one hand, and goods for internal use and locally manufactured articles on the other, have been subjects of complaint for many years, and their removal has been urged successively by the Industrial Commission, the Acworth Committee, and the Fiscal Commission; but there has not been any appreciable improvement in the situation in this respect, and it is even now maintained by the indigenous manufacturers and business men that export and import traffic still enjoys differential advantage over the movement of goods within the country. There is some justification for charging lower rates for traffic to and from the ports. It costs the railways less to handle this large volume of business than what the Industrial Commission called 'a number of casual dribbles'. But now it is acknowledged that the low port rates have to go, as they have exercised and are exercising a depressing influence on the development of home industries. This step is called for not merely as an application of the principle of charging what the traffic will bear, though in some

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cases the need of developing certain industries which may eventually give a large volume of business to railways may justify the grant of concession rates to them at the outset, but it is also necessary for the success of the policy of developing the economic resources of the country.

The Railway Board issued a circular in 1915, in which the railways were asked to make a special endeavour to do all that was possible for the encouragement of indigenous industries, and since then three commissions have advocated the adoption of a wider standpoint in the policy of fixing railway rates; but we have not yet made much headway in this direction and it is only when we realize how very impracticable and inadvisable it is to base it on narrow business considerations, that a real change can be effected. The railway administration ought to be an autonomous undertaking; but it should be run as, what it essentially is, a public utility enterprise and within the limits set by the need of making it self-supporting as a whole, the railway fares and freight should be determined by social needs. This is, of course, true not only of industries but also of agriculture and, as a matter of fact, of every kind of traffic. Special concession rates are necessary in the case of fertilizers and implements, and a very good case may be made for favourable treatment of certain areas which are now undeveloped and backward. It is neither necessary nor possible to go into details. Railway rate policy of the Government is open to criticism and it is essential to alter its fundamental basis. Even from the orthodox standpoint the existing rates have to be thoroughly revised; but if it is conceded that it is necessary to take into account wider considerations for a really progressive policy, it is highly desirable to go further and examine their effects on the whole economic life of the community. This change cannot be carried out in its entirety on account of the limitations imposed by the terms of the contracts and the special features of our political life; but if we admit its necessity and do all that is possible under present conditions, we shall be acting in a far-sighted manner and in conformity with the trend of events everywhere.

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### *Agency for public control of railway rates*

Public regulation of rates requires that a special body should be constituted for the purpose. The Railway Board cannot perform this function. It is, of course, outside the province of the Legislature or a committee appointed by it. It is necessary to create a special agency for fixing railway rates. The Acworth Committee recommended the establishment of a rates tribunal to adjudicate upon disputes between railways and the public in the matter of rates levied by the former. The Government has appointed a Rates Advisory Committee instead to investigate and make recommendations to it regarding complaints about undue preference and unreasonableness of rates and other conditions of packing, etc. This committee has to deal with cases referred to it by the Government on the application submitted by the parties affected by the rates to which exception is taken. The Indian Chamber of Commerce has expressed its dissatisfaction with this committee, as, in its opinion, a body so constituted cannot be relied upon to arbitrate impartially between the railways and the public. It is necessary to provide a tribunal of appeal against the decisions of the railways; and it is, therefore, desirable that it should be able to do its work without any fear or favour. But even the Rates Advisory Committee can, if its proceedings are open to the public and the results of its investigations published for the information of the latter, develop traditions of independence, and for all practical purposes be a tribunal of appeal against the decisions of the railway authorities. Now the rates are fixed by the Agents of the State or the company-managed lines between the maxima and minima laid down by the Railway Board. The report of the Rates Advisory Committee will be submitted to the Government of India, and the latter may be depended upon for taking necessary action to redress the grievances, if a case against the Agents has been made out by the committee; and even if the Government is found wanting, the Railway Finance Committee or even the Legislature can exercise a certain



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amount of pressure on the railway administration for the redress of grievances.

A statutory body, with a well-recognized status, functions and power to enforce its decisions on the railways, would have been more effective for protecting the public against unfair treatment; but the Rates Advisory Committee can, if circumstances are not against it, do fairly well for the purpose for which it is constituted. There is, however, another objection against its working which is more fundamental. It is not really a rate-fixing authority. The scope of its activities is limited. It will only take cognizance of cases in which the rates are alleged to be unreasonable or of a discriminatory character. The Railway Rates Tribunal in England—a statutory body set up by the Act of 1921—has been empowered to so regulate and control rates, charges and conditions of service as to yield the companies a standard revenue. It deals with all railway rates and examines them with a view to see that they are fair and reasonable. The tribunal is not only a court of appeal, but also an administrative and supervisory body. In India, we need a similar agency of control. It will probably be necessary to have a number of local boards with a central board for co-ordinating their activities. These boards will bring all the rates under review from time to time, revise them in the light of changes in general conditions, approve of the proposals of railway officers and examine the cases which call for special consideration and in which concession rates are to be granted.

It will be necessary to give the widest possible publicity to their proceedings and to the principles by which they are guided in fixing the tariffs. In due course a body of case-law will grow up, principles of general application will be enunciated, and rate-fixing will become a social function of the highest importance. If we really take a long view, we shall realize that these central and local boards are a necessary part of the autonomous organizations to which a public service like the railways should be assigned as a social trust. Acworth, in his *Historical Sketch of State Railway Ownership*

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deplores the tendency to mix up politics with railways and goes on to say, 'Some day perhaps, having learnt wisdom from experience, a parliament and a people may recognize that a management for the people is not necessarily a management by the people.' It may be hoped that the Indian railways, now that the railway finance has been separated from general finance, will evolve a fully developed organization of their own, in order that they may be managed for the people though not necessarily by them; and if this consummation is to be achieved, it is necessary to create central and local boards for the regulation and control of railway rates.

#### *Importance of irrigation*

Irrigation is, next to railways, the most important activity of the State, which is intimately connected with the fiscal system of the country and has a great future. It would be wearisome to cite figures to show its relative importance, but it will help us to have a proper setting for our arguments if we bear in mind certain facts. Of 19·4 per cent of the cropped area under irrigation, 11·8 per cent is irrigated by works directly constructed or maintained by the Government, the total capital cost of these works amounts to 99·84 crores and the net return on these investments is 7·4 per cent. The percentage of net return is not quite an exact figure and has, therefore, to be accepted with qualifications, about which more will be said a little later; but there is not the slightest doubt about the irrigation works being very important assets of the State. The importance of these works varies from Province to Province. In the Provinces of Sind and the Punjab, of the total irrigated area Government works account for 70·8 per cent and 73·6 per cent respectively; and with the completion of the Sukkur Barrage and the Sutlej-Valley projects, this area will be increased by millions of acres and become a dominant factor in the economic life of these Provinces. In other Provinces, Government works are not so important, but still they are vital to the life of the people, and nowhere does their percentage fall below 22 per cent of the area under irrigation. It is clear that

the irrigation policy of the Government is bound to exercise a profound influence over the finances of all the Provincial Governments, and it is of the utmost importance that the principles underlying it should receive careful consideration and be clearly enunciated.

*Water rates and taxation*

The Taxation Inquiry Committee has pointed out how very unsatisfactory the present position is. The practice of charging for water shows not only a very great variety, but also the absence of any well-accepted theory and principle. The Chief Engineers of Irrigation in different Provinces, who gave evidence before the Taxation Inquiry Committee on the Government policy in respect of water rates, were themselves almost at sea while dealing with this question and could not suggest any method by which the existing complications could be removed. They laid considerable stress on the fact that water rates were not taxes, while people spoke of them as if they were; but they did not realize that the general confusion of ideas was due more to the mistakes of the Government than to the lack of clear thinking on the part of the people themselves. From the point of view of theory, there is no difference between profits from irrigation and pure taxation, and the net revenue of 3.6 crores which the Government derives from this source has to be taken as such; but the prevailing impression that water rates are taxes is not due to the knowledge of this fact. It is the result of the Government having erred in the matter of fixing water rates. These rates have not been determined with reference to any guiding principle. They have been merged into the land revenue assessment over a very wide area and have, of course, suffered from the diversity of theory and practice, which is, as has already been duly emphasized, such a marked characteristic of the land revenue systems in India. But even when specific charges have been levied for water, no provision is made for their periodical revision and they have remained unchanged for over eighty years in some and over twenty years in most cases.

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Of late, the Provincial Governments have been changing them spasmodically to balance their general budgets and in accordance with the exigencies of party politics in their Legislatures. It is, therefore, not at all surprising that the people have assumed that the charges for water are also a part of the tax system of the country and that their enhancement constitutes an increase in their tax burden. It is now idle to complain that the rural classes resent bitterly any proposal for the revision of water rates and have used their voting strength in the Legislatures to defeat them. The Irrigation Officers hold that water rates are low in all cases and in a few ridiculously so and urge the necessity of their revision in the interest of the general taxpayer at whose expense, according to them, certain classes of the community have grown undeservedly rich and are enjoying advantages to which they have no rightful claim. The need of a careful examination of the existing situation with regard to the charges for water is obvious and its result may bear out the contention of the Irrigation Officers that an upward revision is called for by the facts of the case; but it is well to realize the fact that any radical change in the present practice is out of the question on account of the prescriptive rights which have been allowed to grow up freely all these years. Water rates may contain an element of taxation, but are essentially different from land revenue or other taxes. In principle it is right to vary them as frequently as railway rates and other public prices; but the charges for water in India have not been levied on that basis, and we have to suffer for the mistakes of the Government in the past. It is, however, necessary to formulate right principles for future guidance, remove the anomalies of the present system and educate public opinion with a view to creating a proper appreciation of the difference between water rates and taxation. It may be taken for granted that whatever changes may be made in the allocation of revenues between the Central and the Provincial Governments, irrigation will remain a Provincial subject and its receipts will go to the Provincial treasury. Even now in the Punjab, the United Provinces,

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Madras and Burma, irrigation revenue is of considerable importance for the Provincial budgets and with future developments its importance will become greater still. In Sind, if it becomes a separate political unit, it will overshadow every other source of revenue in importance after the completion of the Sukkur Barrage scheme. This irrigation work will add 5 million acres to 2·3 million acres now under irrigation and a very large part of the revenue of Sind will then be derived from irrigation. It is necessary to regularize the working of this important source.

#### *Consolidation of water charge with land revenue*

The greatest anomaly of the existing system is the consolidation of water charge with land revenue. A certain share of the produce of land and water is assessed as land revenue and a part of the yield of the latter is credited to irrigation as the land revenue due to irrigation. In 1924-5, out of the total gross irrigation revenue of 10·3 crores, 4·34 crores or a little less than half was realized in this manner. The division of the land revenue receipts into two parts, one due to water and other to land, cannot but be more or less arbitrary. Provinces have different formulas for calculating the land revenue due to irrigation and most of them are incomprehensible to a degree. In almost all countries, the administration of the 'unearned increment' duty is complicated by the difficulty of distinguishing between the return due to investment and that due to the natural properties of the soil. In India, on the other hand, the Government combines the two charges which ought to be levied on different bases and then proposes to differentiate them for the purpose of ascertaining the net receipts of its irrigation works. The amount shown as the net return from irrigation is calculated in this way; and though it is not right to assume that irrigation revenue is thereby inflated, it is clear that much reliance cannot be placed on an estimate of receipts worked out on such a hypothetical basis. The critics of the Government can very well maintain that the amount credited to irrigation is not really due to it, but is the

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land revenue proper ; and though Irrigation Officers may be able to convince themselves that it is not so, they will find it very hard to convince others who are not in contact with primary facts on which these calculations are based and who need some objective data to go upon for their satisfaction. The whole procedure is a bad system of accounting and ought to be abandoned for this, if for no other, reason.

#### *Their separation desirable but impracticable*

But there are other and better reasons why a consolidated rate assessed on the settlement principle of taking a share of the produce of the land and water together is wrong in principle. The land revenue is a tax, while charge for water a public price. The land revenue has no reference to the special benefits conferred upon the individual by the activities of the Government ; while the charge for water is a payment for services undertaken in the interest of the community, but which confers special benefit on the individual and should be made the basis of a special levy on him. The distinction between the two is clear ; and though it is possible to impose taxation by enhancing the charge for a monopoly service like irrigation, it is much better to keep the two apart, or at least not to merge a tax and a public price together. The consolidation of water charge with land revenue has not only led to a confusion of principles, but has circumscribed the freedom of action of the Government in respect of the charge for water, on account of its close association with the more archaic form of public revenue. The incidence of this charge varies as much as the incidence of the land revenue itself and is as uncertain on that account. Different rates are charged for water supplied by the same work and are assessed on the same vague and nebulous data of prices, gross returns, cost of production and 'general considerations'. The proportion of produce assessed as water charge is the same as that which is taken as land revenue and the two are treated exactly alike for the purpose of assessment revision. The charge for water cannot be changed during the period of settlement,

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and the Government is bound to apply the land revenue regulations to it for administrative purposes. It is really a very ill-assorted combination; and that it should have been allowed for no other reason than that of administrative simplicity shows how badly the Government has erred in following the line of least resistance in this as in so many other matters. That, wherever possible, the charge for water should be separated from the charge for the land is a counsel of perfection which the Taxation Inquiry Committee has given for the benefit of the Government and the public.

But the crux of the matter is that the separation is not possible where the two are already combined without a radical change in the system of land taxation; and if it is conceded that the latter can be modified but not fundamentally altered, the prospect of a revision in the method of charging for water, so far as this aspect of the question is concerned, is very distant indeed. The least that can, of course, be done is that the two charges should be kept distinct in future and any tendency towards their consolidation be carefully watched and immediately checked. In Burma, before the Taxation Inquiry Committee submitted its *Report*, it was contemplated to introduce this method in one or two new works. It is to be hoped that the proposal has now been dropped. But that is all that can be done for some time to come. This means that the present anarchy of local variations, because that is what it really is, has to continue.

#### *Cost of 'service' and 'benefit' principles unsuitable for fixing water rates*

With regard to the special charges for water, that is, the water rates, there is also a great deal of diversity of principle and practice, which is not very easy to understand. This is to a certain extent inevitable. The conditions under which the irrigation facilities are provided by the Government vary very widely from Province to Province and it is not possible to attain uniformity all over the country. The variations in rainfall, spring level, the physical configuration, the system of land tenure, the size of holdings and even the stage of general level of develop-

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ment of the people have all to be taken into account in fixing water rates ; and it is useless to prescribe rules for general application to the whole country. The Government of India has, on several occasions, emphasized the necessity of recovering the full value of water distributed by the Government works ; but it has not been possible to state with any amount of precision what 'full value of water' really means. It cannot mean merely the cost of water, for that is different in the case of different works, and even if it is charged by volume, it is not easy to allocate the cost per unit of water. The Taxation Inquiry Committee has laid down that the minimum charge should cover the cost of maintaining the irrigation works plus interest on capital cost. If this rule is to apply to each individual work, each work will have its own tariff for water ; and as the facilities which make it possible for the irrigation department to lay water cheaply on certain lands are essentially a gift of Nature, it is wrong to make them the basis of differential charges for the supply of water. The maximum suggested by the Taxation Inquiry Committee is of even less practical value. The difference between the value of irrigated and non-irrigated crops cannot give us any measure of what the State can charge for water. In areas where no cultivation is possible without irrigation, it would entitle the State to the whole produce of land minus the bare cost of maintenance of the cultivators. This is obviously an untenable position and cannot afford a basis for the determination of water charges.

#### *Integration of irrigation works as a basis for sound water rate policy*

The minimum of the cost price of water and maximum of its value cannot, therefore, be of much use in fixing the water rates. The only sensible plan, which is both practicable and right in principle, is the one which was suggested by the Punjab officers. They were of opinion that the irrigation enterprise should be treated as a whole, the profit on more favourably situated schemes going to make good the loss on others ; and the rates should be uniform on all Government works. This plan cannot be worked on an all-India basis. Its scope must be



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confined to each Province, but within the Province itself it embodies the only sound principle of irrigation administration. The receipts of all Government works should be pooled and the undertaking, managed as a public service, ought to be self-supporting and may even yield net profits to the State; but its policy should be determined by considerations of its social utility. The uniformity of rates may make them below the cost price of water in certain cases, just equal to it in others and much above it in favourably situated areas; but it is in the best interest of the community. It was in 1893, that the Government of India brought to the notice of the Madras Government the fact that the rates on the Kistna and the Godavari canals had not been changed for the last thirty years and ought to be revised. They were raised in 1895 and the Government added thereby 10 lacs to its revenue. But since then they have not been changed; and Mr. P. Hawkins, Chief Engineer for Irrigation (Madras), expressed his opinion, in his evidence before the Taxation Inquiry Committee, that they were absurdly low. He told the committee that on the Mettur project they had to push up rates to Rs. 15 per acre on account of the high cost of water; and there was another district where irrigation was urgently needed, but could not be provided as the cost of the scheme was very high and they could not supply water for anything less than Rs. 28 per acre; and still the rate for paddy in the Godavari and the Kistna deltas was Rs. 5 per acre and could not be revised without evoking a terrible outcry.

This is the result of the Government having followed an extremely shortsighted policy in charging for water, since it started its own irrigation works. It is necessary to level up. But the variety of rates is so great in certain Provinces that the process will necessarily be slow and even painful, in most cases. The ideal, however, is that rates should be uniform within each Province in the areas watered by Government works and irrigation policy be shaped by considerations of commonweal. But agrarian parties are in power in most of the Provincial Legislatures and they

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are influenced by narrow selfish considerations in matters like land revenue and irrigation. Future constitutional changes are likely to strengthen them still further and it cannot be hoped that the accession of greater power will make them more susceptible to higher considerations. The outlook is, therefore, far from promising; but we are here concerned with first principles, and the policy of pooling the irrigation schemes in each Province and treating them as one enterprise is in conformity with these principles. For some time the dominance of sectional interests will make it difficult to realize this object; but eventually the wisdom of subordinating them to the welfare of the community will have to be learnt, when the futility of the alternative policies has been fully demonstrated after actual experience of their working. This will, of course, take time; but it is useful to envisage future developments as clearly as we can.

#### *Separation of irrigation finance from general finance*

If the different irrigation enterprises are to be integrated, it will be necessary to make two changes. The first is that irrigation finance, like railway finance, should be separated from general finance. This is absolutely necessary for the unification of the irrigation schemes. The arguments in support of this proposal need not be elaborated. This is obviously the only way by which the irrigation receipts can be pooled and profits from good schemes used for making up the losses from those which, on account of the engineering difficulties or other circumstances, cannot do equally well. A portion of the net profits may be devoted to the expansion and improvement of the existing irrigation works; and though it may not be necessary to make provision for depreciation in all cases, it will be desirable to credit a certain portion of the net receipts to reserve fund, till it is adequate to meet the contingencies which may be taken as the ordinary incidents of such undertakings. The question of irrigation contribution to general finance will have to be settled by practical considerations and each Province should decide for itself whether it is desirable to tax the people through irrigation works and, if so, to what extent. Theoretically

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there is nothing to be said against the principle of taxing the people by making irrigation works yield handsome profits after meeting all the charges of upkeep and interest on the capital invested, but each Province will have to see how far it is expedient to do so. In the Punjab, the separation of irrigation from general finance can be effected at once. The magnitude and importance of the works make such a course pre-eminently desirable. There, about 39·2 per cent of the total area sown is irrigated by the Government irrigation works; and out of total amount of 99·24 crores invested in irrigation by the Government the cost of the Government irrigation works comes to 28·2 crores, and the net return on this amount is about 15 per cent. The charge for irrigation is levied separately; and what is more important for our purpose, the rates are more or less uniform throughout the Province. This fact makes it easy to introduce the change immediately in the Punjab. In other Provinces, the situation is not so favourable from this point of view. But in the United Provinces, the Central Provinces, Bihar and Bengal, it should not be difficult to introduce this reform; if the variations in the rates can be reduced within very narrow limits. In Madras, Bombay and Sind, it is not possible to make the irrigation works into separate and self-contained undertakings on account of the consolidation of water rates with land revenue. But even there steps must be taken, in due course, to separate the two; and when this is done, the separation of irrigation from general finance would follow as a matter of course.

#### *Provincial boards for fixing water rates*

The other important change which has also to be made, if there is to be a separate irrigation budget in each Province, is that the water rates should be fixed by a body independent of the Provincial Legislatures. The general policy will, of course, have to be laid down by the accredited representatives of the people; and irrigation finance, like all vital activities of the State, will be under the general supervision and control of the Legislature. But the question of fixing water rates and their revision should be left to a body of experts who, within the limits

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set for them by the supreme authority, should be free to fix and change them according to their judgment of what is just and desirable. Rate-making in irrigation is not as intricate a business as in railways, but it is not simple by any means ; and the function can be efficiently discharged only by those who have acquired the necessary knowledge and experience for the purpose. Water rates may and can contain an element of taxation ; but they are not taxes and their determination ought to rest with men of tried ability and integrity. It has been suggested that water rates should be revised once in five years and only when there is an appreciable change in the level of prices. It is not advisable to change the charges for water very frequently ; and it may, therefore, do if they are revised once in five or preferably three years. But there is no reason why the rate-fixing authority should be precluded from revising or raising the charges, on any ground other than that of the change of prices. The cost of the upkeep of these works may go up, the Government may decide to derive a larger revenue from irrigation, or some other circumstance may make it necessary to revise the rates. The changes in rates, once they have been put on a stable basis, will not be many or frequent ; but it should be possible to revise them without any let or hindrance when it is necessary to do so in the interest of the community. It will be necessary to constitute an *ad hoc* board in each Province for administration and rate-making, and it will occupy a fiduciary position of great social responsibility.

#### *Separate tax on increment in capital value of land due to irrigation unnecessary*

It is not necessary to impose special taxation on the unearned increment of land accruing to the owners on account of the supply of water guaranteed by the State. In theory, of course, a very strong case can be made for levying a special taxation on them on this account ; and the fact that this has not been done till now is another proof of the Government having pursued a short-sighted policy in developing our tax system. But if the suggestion made in Chapter III for the imposition of a tax on

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the capital value of land is given effect to, it will not be necessary to devise a special measure of taxation for getting at the unearned increment due to the provision of irrigation facilities. The increase in the capital value due to this factor will be included, as a matter of course, in the assessment of the total value; and as this tax is to be levied primarily as a measure of differentiation, its rate will be partly determined by the fact that the owners of land have derived special benefit from the capital expended by the State on irrigation works. Each Province will have its own rates to suit the local circumstances and its pitch will depend upon the degree of importance which can be attached to this factor as a determinant of the capital value of land. It may even be necessary to have a number of rates in the same Province, in view of the varying importance of irrigation in its different parts. Increase in the value of land on account of the public expenditure on irrigation is an outstanding instance of individuals getting rich at the expense of the community, and it is fit and proper that a differential tax should be imposed upon it; but if the tax on the capital value of land is rightly assessed and efficiently administered, it would do fairly well for the purpose and there will be no necessity for having a special tax for getting back for the society a part of what is socially produced.

#### *Financial aspect of the development of forests*

It is not necessary to say much about forests. Their preservation is of vital importance to the country. A very large area of British India is covered by them. A part of it is being released for cultivation and it may perhaps be necessary to consider seriously the question of reclassification of forests in view of the increasing pressure of population on land. But even then the forests will occupy a very important place in our national economy and will have a special significance from the fiscal standpoint. In thirty years, the net revenue from forests has increased from 75 lacs to 260 lacs; and it is, as has already been stated, capable of very great expansion. The bulk of this revenue is derived from the removal of timber by the Government agency,

### *Non-tax Sources of Revenues*

consumers and purchasers. The forests which supply timber will have to be exploited more fully and the forest industries will have to be developed as far as possible. It will not be possible in all cases to place revenue considerations above all others. It will, as a matter of fact, be necessary to work and develop this valuable estate primarily in the interest of the economic development of the country; but it should, even when in its management wider considerations of social utility are given a prominent place, still remain an important source of revenue. And in Provinces like Burma and Assam, they will occupy a really important position in the Provincial fiscal systems.

The financial side of forests, as distinguished from the technical, presents special features of its own; and the forest officers, who may be qualified for the latter, cannot be expected to deal also with the financial questions which are bound to grow in intricacy and importance as forests are further developed. The whole management of forests will have to be entrusted to a board which should consider fiscal and social considerations as equally important and be competent to deal with both adequately and well. The achievements of the forest department, great as they are, are nothing compared to its possibilities; and it is important that it should also be constituted into an autonomous undertaking. It will be premature to have separate forest budgets in all the Provinces in the near future, though in due course forest finance will have to be separately administered. It is, however, pre-eminently desirable to maintain a clear distinction between the revenue and capital accounts, and make a more liberal provision for capital expenditure on them. Up to the end of 1924-5, the total capital expenditure on forests was only 28.55 lacs. This amount is obviously inadequate and it will be necessary to provide ample funds for the development of forests.

#### *Concluding observations*

This chapter may be concluded with one or two general observations. India is in advance of other countries in having established the public ownership of these public

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utility enterprises. They are vital for the welfare of the community and it is essential that they should be administered as socialized, if not nationalized, undertakings. Considerations of social utility should be given much free play in their management, and commercial considerations assigned a place of secondary importance. They are generally called quasi-commercial undertakings, but they are so only in the sense that their accounts are to be maintained on a business basis. The distinction between capital and revenue accounts has to be enunciated clearly and made operative in actual practice and, as a rule, the cost of maintenance is to be covered by their receipts. But it is neither possible nor desirable to adhere strictly to the cost of service principle in fixing their rates. The rates must be determined by the requirements of economic and social progress and must embody principles of cardinal importance from a social standpoint. The fact that, in fixing these rates, rigidity is to be avoided makes it necessary to provide safeguards against the abuse of the element of elasticity in rate structures. In practice the plea of public interest can be used to cover a multitude of sins; and it is of the highest importance that the task of implementing social policies should be entrusted to independent and competent bodies, on whose decisions should beat the light of publicity far fiercer than any that has ever beat on a throne. This searchlight of criticism, if it is followed by severe penalties in cases of social default, should be an effective safeguard against the anti-social activities of the rate-fixing authorities. The fiscal aspect of these activities is and will always be of first-rate importance. The extent to which they should be utilized to produce revenue for the State is a matter with regard to which it is not possible to lay down any general principles. There can be no question regarding the validity of any policy that may aim at getting a net revenue for the treasury from the working of these enterprises.

It is perfectly legitimate for the State to administer them in such a way as to realize considerable revenue for the benefit of the general taxpayers. The decision whether it should do so in a particular case must be determined by empirical considerations.

## CHAPTER VI

### DISTRIBUTION OF TAX BURDEN

#### *Readjustment of taxation in the interest of poorer classes*

The primary purpose for which the Taxation Inquiry Committee was constituted was to inquire into the distribution of the existing burden of taxation. In the Finance Department Resolution No. 1412-F of 26 May 1924, in which its terms of reference were laid down, the committee was instructed to examine the manner in which the burden of taxation was distributed between the different classes of population. The Finance Member, in his speech on the resolution regarding the suspension of the taxation inquiry, laid considerable emphasis on the necessity for a readjustment of taxation in India and justified the appointment of the committee mainly on the ground that it would provide the necessary material for bringing about a more equitable distribution of the burden of taxation. The need of the redistribution of the tax burden is sure to become obvious to anyone who has even an ordinary acquaintance with the facts of our fiscal system. The preponderance of indirect taxes in its working has already been commented upon, and the proportion which they bear to the total revenue cannot but be a matter of serious concern to every student of taxation in India. The most important sources of Provincial revenue are land revenue, excise and stamps; and all of them are mostly paid by persons of very limited taxable capacity. In view of these simple and well-known facts, one does not require a special capacity for economic analysis or an intimate knowledge of statistical data to posit the extremely regressive character of our tax system as a whole and be convinced of the necessity of relieving the poorer classes of the disproportionately heavy fiscal burden which they have



been carrying on their shoulders. It is easy, therefore, for every student of the subject to assent readily to the general proposition that the readjustment of taxation in India is a matter of vital importance, and it is highly desirable to introduce early the necessary changes with this object in view. In our treatment of the general and the particular aspects of the various problems of taxation in the preceding pages, the absolute soundness of this proposition has been taken for granted and the different issues dealt with on that assumption.

*Conclusions of the Taxation Inquiry Committee in regard to the redistribution of tax burden unsatisfactory*

For the practical guidance of the statesmen and the officers of treasury, however, it is not enough that the regressive character of tax system be admitted, and different questions relating to it discussed on the assumption of the necessity of reducing the fiscal burden of the masses who are, as everyone concedes, living on the margin of barest subsistence. The need of appointing a committee of experts to inquire into the distribution of the burden of taxation was felt here, as in other countries, because of the utter inadequacy of this general statement of the situation as a guiding principle of practical utility. It is necessary to acquire a more definite knowledge of the present distribution of the tax burden and estimate the proportions of the contributions to the total revenue made by the different classes of the community in order to formulate an intelligent and intelligible policy of fiscal reconstruction and take the necessary legislative action on this basis. The conclusion of the Taxation Inquiry Committee on these questions have been set forth in Chapters XXIV and XXV of its *Report*. The Finance Member, in reviewing the *Report* of the committee in the speech delivered by him in the Legislative Assembly on 19 August 1926, expressed at some length his approbation of the services rendered by the committee in having brought together within the compass of an easily-handled volume, all the facts in regard to the various taxes levied in India and pointed out how the material collected by the

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committee enabled those who are concerned with the question of Indian taxation, 'to survey the whole of the activities of the Indian tax gatherer from *chaukidari* tax to super-tax, from *thathemada* tax to the occupier's rate in Sind'.

The utility of a general survey of the whole domain of taxation—Central, Provincial and Local—which is the first of its kind in the history of Indian finance has to be conceded, and the committee's work is worthy of commendation from this point of view. It would, however, be of some interest to know from the Finance Member his opinion on the practical importance of the conclusions arrived at by the committee in regard to the distribution of the existing tax burden and of the suggestions made by it for making it more equitable. The Finance Member made some casual reference to the need of reducing the true cost of sacrifice which the taxpayer was called upon to make and thus raising the revenue with the least possible economic cost, but he had practically nothing to say about the positive contributions made by the committee to the solution of this problem. As a spokesman of the Government which had not come to any final conclusion on these questions, the Finance Member had to speak with great reserve on the matter; but he would probably have admitted, if he had been pressed to make a definite statement on this point, that the committee's conclusions in this respect, though not devoid of value, do not carry us very far in enabling us to make any considerable improvement on the present order of things so far as the distribution of tax burden is concerned and are not very illuminating or helpful for the practical fiscal reformer.

### *Conclusions based on general considerations*

This somewhat disappointing result is not in any way due to the inability of the Taxation Inquiry Committee to rise to the height of the occasion. In the very opening paragraphs of Chapter XIV of its *Report*, the committee emphasizes the limitations imposed upon any inquiry into the incidence of taxation and admits that for want of statistical material it has had to fall back upon

general knowledge and general considerations which cannot lead to very definite conclusions. The futility of finding the average income and burden of taxation per head is pointed out by the committee; and this method, the adoption of which has so often and so insistently been demanded for ascertaining the existing burden of taxation, has therefore been rejected by it. This need not be regretted, as the real sacrifice of taxation depends upon factors which cannot be taken into account in the calculation of the average, factors like the distribution of income and the objects for which the public expenditure is incurred have an important bearing on the incidence of taxation, but have to be left out in working out the averages. The committee, however, has not been able to suggest any alternative method which may yield better result. The general considerations on which it had to depend have led it to divide the population into eight classes, and of these it has tried to work out the incidence of taxation only in the case of urban and rural labourers. That has been done on certain assumptions which are open to question for various reasons; but since in the case of other classes, it has not even done that much, it is not possible to use the results of its inquiry for comparing the burden of taxation in their case with the burden borne by other classes of population, and they have, on that account, no value for getting a definite idea of the relative position of the different classes with regard to the incidence of taxation.

With regard to other classes it does not say anything which could not have been said with almost the same assurance before the Taxation Inquiry Committee was appointed. The small holder, we are told once again, is leading a very hard life and it cannot be improved by reducing the tax burden. The peasant proprietor is, according to the committee, a prosperous member of the community and if he can resist the temptation of becoming a rent receiver and does not become addicted to drink, he should not have any legitimate grievance in the matter of taxation. The large landholder is, of course, in a privileged position and ought to submit to additional taxation cheerfully. The village trader is

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lightly assessed and should be made liable to special taxes. The town trader is not as well off as the village trader, but it is nevertheless necessary to equalize the burden in his case by means of local taxation. The big merchant and the higher professional classes have had to bear the brunt of the additional burden of taxation imposed during the recent years, but still they can afford to pay more and ought to make a bigger contribution to the public exchequer. The professional classes of the lower grades have to maintain a high standard of living and have been hard hit by the recent rise of prices, but are not entitled to any relief as their contributions to the general taxation of the country is comparatively small and the relief that they require must come either through a reduction of prices or an increase of salaries.

#### *Utterly inadequate conclusions*

Such are the general considerations to which the Taxation Inquiry Committee has been thrown back on account of the want of statistical data about the economic conditions of the different classes; and though these have a bearing on the question of the readjustment of Indian taxation, they cannot form the basis of a practical scheme of fiscal reform. The committee suggests an order of precedence for the reduction and substitution of taxation; but apart from the fact that it will, if followed in actual practice, afford some relief to the poorest classes, this order cannot be regarded as a programme for carrying out any well-planned policy for the redistribution of the burden of taxation. The committee, as a matter of fact, disowns any intention of recommending any programme for the immediate future and has confined itself to certain general tendencies which, in its opinion, are likely to operate for a generation. The recommendations of the committee have been determined more by the considerations of practical expediency than by the need for fiscal readjustment; and though something is to be said for them from that standpoint, their utility for redressing the inequalities of taxation in India is strictly limited.

*Complexity of the subject*

It may be urged that the fact that the Taxation Inquiry Committee has not been able to achieve this purpose justifies the opposition which its appointment evoked in the country. But the inability of the committee to do justice to this part of its work is, as it has been already remarked, due to inherent complexity of the subject itself; and though the want of statistical material has accentuated these difficulties, it would not have been possible to formulate any very definite conclusions even if circumstances had been more favourable in this respect. The committee was called upon to deal with a question which is one of the most baffling problems of fiscal science. Its solution raises issues which not only defy the ingenuity of the fiscal administrator, but are in some cases incapable of being analysed for even theoretical purposes. It is well known that all kinds of theories have been propounded by the adherents of the different schools of thought in dealing with this subject of taxation; and some of them are, in spite of their ingenious character, a confession of the impossibility of giving any definite answer to the central problem of taxation, the question as to who ultimately bears the real burden of taxation.

Mr. J. Row Fugo, in referring to the controversy which was carried on in England for some time in 1902 regarding the real incidence of local rates, sums up the conclusions of the different writers, each of whom was equally competent to make his own contribution to the subject, in the following words: 'The economic theorist's answer to the question "who pays the rates?" is that deceased landlords, landlord and tenant all pay rates and the proportions in which they do so vary not only from place to place, but according to the infinite number of circumstances, most of which are incalculable and incapable of being expressed in definite terms. Briefly expressed, it is simply thus: "Goodness knows." For practical purpose the answer is useless. It is impossible to prepare a scheme of finance if the taxpayers are goodness knows who.' Some of the theories regarding the incidence of taxation practically come to saying that taxpayers are

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goodness knows who. If that were true, it would make no difference what system of taxation was adopted, for the incidence of taxation must mainly remain a matter of pure conjecture and guesswork. The same conclusion is arrived at from another point of view which attributes to taxes, what Professor Seligman calls, an expansive force, a quality by virtue of which they tend to seek a level in a continually larger sphere. It is from this point of view futile for the theorists to devise schemes for a better adjustment of taxation; as eventually by the working of the law of equilibrium of advantages its burden gets equally distributed or, to use the word by which the theory is generally described, equally diffused in different parts of the economic organization.

Canard, one of the best-known exponents of this view, compares the taxation of one branch of industry to the operation of cupping. The industry which is subject to taxation suffers no more from this process than the vein from which blood is taken by the surgeon, for the profits flow into it from other industries, as blood flows into the vein from which it is originally let out, till the economic equilibrium is restored and the burden of the tax finally disappears. These views are interesting, not because they are essentially correct, but because they show how very perplexing the problem, which the Taxation Inquiry Committee has practically found insoluble, has been felt to be by all well-qualified students of the subject. The discussion of this question in everyday life, in the press and on the platform, is generally characterized by what Parieu calls 'the simplicity of ignorance', and the difficulties of ascertaining the real economic cost of taxation and its incidence are very often overlooked. In view of this fact, it is a matter of some importance to appreciate a little more fully the inherent complexity of the question and bear it constantly in mind in our discussion.

We shall now refer in some detail to the factors which are generally taken to determine the incidence of taxation, in order that it may be realized that the failure of the Taxation Inquiry Committee to formulate definite conclusions in regard to the distribution of the existing

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burden of taxation is not entirely or even mainly due to the absence of statistical data. It will be necessary for us to get into the rarified atmosphere of abstract theory to understand the relative significance of the different factors which have to be taken into consideration in this connexion. The intellectual effort which has to be made to get the right perspective in the matter is well worth making, as the slipshod way in which the question is generally discussed is a great obstacle in the way of clear thinking on the subject. It is not possible to unravel its intricacies completely in these pages on account of the limitations of space. Those who feel interested in it and are inclined to acquire a fuller mastery of the subject, may read Professor Seligman's standard book *Incidence of Taxation* for themselves in order to understand how difficult it is to answer the question 'Who pays?' with anything like real confidence or certainty. A brief statement of the general principles may, however, be attempted to show their bearing on the practical issues with which we have to deal. It will be to a certain extent helpful in clarifying our ideas on the subject.

### *Incidence of indirect taxes depends upon a variety of factors*

The complexity of the theory of incidence and shifting of taxation is due to the fact that it is an integral part of the theory of value. In order to trace the person who ultimately bears the burden, we have to study the effect of taxation on prices; and when we set ourselves to this task, a number of questions at once present themselves which raise fundamental issues and make it necessary for us to survey the whole field of economic life. Taxes on commodities particularly bring us face to face with the problem in all its complexity. If we ask the question 'Who pays these taxes?', the ordinary answer is, of course, the consumers. They may in a number of cases have to do so. In some cases their contribution may even be greater than the amount of the tax. But whether they pay the whole of the tax or only a part of it, or none at all, depends upon a number of conditions, the most

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important of which is the resisting power which the consumers and the producers can bring to bear on their attempt to roll off the burden on the other party. The theory is that 'the degree to which a tax on a particular commodity will be shifted to the consumer will vary inversely as the inelasticity of demand and directly as the elasticity of supply'. This comes to saying that the tax will be bandied about between the two parties, till one of them can get the upper hand of the other and throw the burden on the party which cannot hold its own in the contest. If the demand is sensitive, and consumers can easily do without the commodity in question or can satisfy their demand by some other substitute, the producers, being in a relatively weak position, will have to submit to the exigencies of the situation and take the burden of the tax on themselves. 'The consumers' strike is a very effective weapon of defence and, when it can be used, the producer has to suffer on account of his inability to hit back. If, on the other hand, the producer can restrict the supply at once, transfer his capital and organizing capacity to some other industry and the consumer cannot dispense with the commodity, the burden of the tax has to be borne by the latter.

These are the two extremes. In one case the producer pays the tax, in the other the consumer; and between these there are a number of possibilities of both sharing the burden in varying degrees. When a tax has to traverse a long distance before it can finally rest on the actual consumer, the tossing about of the tax takes place at every point at which it is handed on to the person who stands next in the chain of production. It may be assumed that in the long run the tax will fall on the consumer, but during the interval a number of things may happen whose effect on the ultimate incidence of taxation is incalculable. The view that taxation is an incentive to work was referred to in our discussion regarding the question of exemption of small holders from land revenue. A similar view has been held regarding the effect of taxation on the efficiency of production. Taxation can act as a spur to inventive ability or to organizing capacity and thus result in the



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reduction of the cost of production. A tax, which is not very heavy, is likely to put the producer on his mettle and may not prove a burden on account of the compensatory improvements in the methods of production. This line of argument cannot be pushed beyond a certain limit, but suggests a possibility of development which has some bearing on the question, and there are historical instances to show that it can take place in actual practice.

There are other considerations which also point to the need of qualifying the statement that it is the consumers who pay the taxes on commodities. The commodities produced under non-competitive conditions are generally sold at prices higher than those which are sufficient to cover the cost of production. When producers have an exclusive or partial control of the sources of supply, the tax imposed upon an industry conducted under such conditions is likely to fall on the producers themselves though, if it is levied in a manner as to necessitate a change in the total output, it may to a certain extent have to be borne by the consumers as well. The existence of monopolistic elements in the working of our economic life is a fact which has to be borne in mind in this connexion. There are, of course, all kinds of monopolies. From mammoth concerns, like the Standard Oil Co., or the Steel Trust, to a small retail seller who has his own goodwill and therefore assured customers, there are different degrees of monopolistic control which restrict the free play of competitive forces and prevent a close adjustment between the prices and the cost of production. Even if a tax is not imposed in the first instance upon an industry carried on under monopolistic conditions, it may, in the process of onward shifting, have to be transmitted over an area in which the producers are in a position to dictate their own terms, on account of their occupying a favourable position, and may find a final resting-place there.

The relation of the cost to the output is another factor which affects the incidence of taxation. If a tax by restricting demand reduces the economies which can be realized by enlarging the scale of production, it may not

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only raise the price of the commodity by the amount of the tax, but cause some addition thereto on account of the higher cost per unit of the output. It is also possible that the imposition may not be followed by an equivalent rise in the price of the commodity on account of its being produced under what is ordinarily called the law of diminishing returns, for in this case the cost of production will be reduced by the more expensive sources of supply going out of the field. It is just possible that a tax may, when the commodity is produced at varying costs on account of the differences in ability, capital equipment or other circumstances of the producers, make it impossible for the least efficient among them to keep up a losing battle, and the market will be left clear for their more capable or more fortunate rivals who will then be able to assume the burden of the tax without raising the price above its former level. There are other possibilities which make the ultimate incidence of a tax very uncertain; but enough has been said to show how very difficult it is to find out who eventually pays the tax when it is levied on commodities in the hands of manufacturers or merchants. The practical importance of these factors on the incidence of taxation is further increased on account of the impossibility of isolating their effects in actual life. It is not easy to say how the burden of a particular tax is borne or shared when these factors are at work; but it would be inadvisable to ignore their existence altogether when the distribution of the tax burden is under discussion. It simplifies matters if we assume that the consumer pays these taxes; but when the facts do not give a warrant for the assumption, it is wrong to argue about the matter in this specious but misleading manner.

#### *The bearing of capitalization of taxes on the problem of their incidence*

The complexity of this question is further enhanced by what is described as the capitalization of taxes. This is a familiar phenomenon and was also referred to in passing in the chapter on land tax. A tax which is constant is always allowed for in the prices which purchasers

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offer for the commodities upon which it is imposed; the original owner has the capital value of his property reduced on account of the levy of the tax, and the future purchaser, notwithstanding the fact that he pays the tax every year, enjoys an immunity from its burden and is, therefore, in the happy position of making a contribution which does not in any way affect the return of his investment. This is ordinary commonsense; but when one thinks about it a little more carefully, it at once raises certain issues which cannot be easily disposed of. All taxes cannot thus be discounted. If that were so, taxation in every country should in this way be progressively absorbed and its heaviness be a matter of no consequence whatsoever. There are certain conditions which have to be fulfilled before taxes can cease to be burdensome by the process of capitalization. The one condition which obviously must be present for the purpose is that the commodity taxed should have a capital value and yield a recurring income. This further requires that the article must be durable and should not belong to the category of 'producers' goods'. If it is used for further production, the tax becomes an element in the cost of production and can be passed on to the consumer. It is also necessary that the mutual relation of supply and demand of the commodity should not be disturbed by the tax.

But the most important condition without which capitalization cannot take place is that the tax must, if it is to be discounted in the purchase price of the commodity, be an exclusive tax; or, in other words, it should reduce the annual income from a particular investment below the rate which is normal for the industry as a whole. A general tax will hit all industries alike and cannot reduce the capital value of any specific commodity. It is also essential that the rate of the tax must not vary from year to year and must be proportional, if it is to produce its full effect on the purchase price of property. These qualifications are important and have to be borne in mind when the capitalization of a particular tax is made an argument for leaving it out of account in estimating the burden of taxation on the

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community as a whole or on an individual belonging to a particular class. Capitalization is an important factor in incidence, and its existence cannot be denied. But the considerations suggested above make it very difficult to fix upon the persons who bear the burden of a particular tax.

### *Element of taxation in income from State undertaking*

The socialization of industry has a fiscal aspect which has already been dealt with in the preceding chapter. The problem of fixing rates in the case of certain industries, like railways and irrigation, is important on account of the size and scope of their operations; but it is also intimately connected with the question of incidence of taxation. That Government can tax the people through public utilities admits of no doubt whatsoever. The prices which it may charge can contain an element of taxation. It is, however, very difficult to differentiate the tax revenue of such undertakings from their purely economic receipts without using some more or less arbitrary method. This does not need to be further emphasized. But what is more important, so far as the question of incidence is concerned, is that it is not possible to calculate what each class of a community has contributed towards the total tax revenue of a public utility, even if that amount can be definitely ascertained. In India, the Government owns railways, irrigation works and forests. The importance of this complicating factor is obvious. The difficulties which it raises have to be duly appreciated in the discussion of the question.

### *Real cost of taxation depends upon its effects which, though obscure, are of profound importance*

Economists generally distinguish between the incidence and the effects of taxation. Incidence is taken to mean the money-burden of taxation. The problem relating to it is solved when we can specify the person on whom it falls and whose income is diminished on account of the imposition of the tax. The effects of taxation, in the wider sense, mean the results which follow subsequent

to taxation. The writers on fiscal science generally confine their attention to the study of the incidence of taxation. That has to be done in order to make the economic analysis fruitful. This subject is intricate enough to be dealt with by itself. But the real economic cost of taxation cannot be estimated without taking the effects of taxation into consideration. The effects of every tax are numerous and very far-reaching. Professor Seligman has put the whole matter in a nutshell when he says that a tax may be an unmitigated curse, it may be a necessary evil or it may be an unqualified boon to the community regarded as a whole. The effects of taxation may be, and often are, more important than its incidence. A man may avoid the tax on salt by foregoing its consumption, but what he will lose in efficiency and health will entail a greater real burden on him than the money-burden of paying the tax. The tax does not fall on him, but his suffering is all the greater on that account. This is a simple illustration of what happens over the whole field of economic life. The convenience of exposition requires that questions regarding the effects and the incidence of taxation should not be mixed up. But it is wrong to overlook the effects of taxation when the distribution of tax burden is under discussion. Difficult as it is to trace the incidence of taxation, a complete analysis of its effects is more difficult still. The imposition of a tax has been compared to throwing a pebble in a still pond of water. It produces effects of ever-widening range until the whole social life is brought within its scope; and the further we recede from the centre—the original impact of the tax—the more difficult it is to discern or describe them. These difficulties are due to the essential character of the social life itself. But the fact remains that the real burden of taxation cannot be gauged without taking into account its incidental effects. It is hardly necessary to add that the study of these effects do not yield results which may be tabulated or illustrated by graphs. They are exceedingly subtle and demand the gifts of intellect and imagination of the highest order to comprehend them. The problem of the burden of taxation is a tangled skein. It is exceedingly difficult to unravel it.

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### *Incidence of income-tax*

These general considerations can be made a little more definite by applying them to particular taxes. It is not necessary to say more about the effects of taxation. The question of the incidence of income-tax may first be taken up on account of its simplicity. Income-tax ordinarily cannot be shifted. It cannot be added to the cost of production if every one has to pay the tax. It is, however, possible that a class of workers may be in a specially advantageous position. Their standard of living may be high. They may cling to it tenaciously and may be in a position to pass on the tax to the employer or to the consumers in case they are selling their services directly, if it trenches on their standard of living. It is not a matter of practical importance to consider this point more fully. It is, however, interesting enough to be mentioned. The incidence of the super-tax on companies is very uncertain. It is a corporation tax, but it has for all practical purposes to be paid by the shareholders. Their dividends are diminished on account of the payment that has to be made by the corporation. It is very difficult to trace the individual shareholders on whom the tax falls, as they belong to different classes of the community. Sir Herbert Samuel delivered an address to the Royal Statistical Society, in which he calculated the burden of taxation on the different classes of the people in the United Kingdom before and after the War. He did not include the excess profit duty on account of the impossibility of determining its real incidence. Even if we have complete statistical data regarding our different classes and the super-tax on companies is converted into a corporation tax, it will not be possible to know how its burden is distributed between these classes. It will have to be left out of any calculation regarding the distribution of the burden of taxation.

### *Incidence of land revenue*

The incidence of our land revenue is a matter with regard to which it is possible to speculate a great deal without coming to any definite conclusion. The primary

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difficulty of finding out how its burden is distributed between different classes has first to be taken into account. As it is a tax on land and not on the holders, the calculation of the amount paid by the different classes will always remain a matter of considerable uncertainty. But apart from this difficulty, it is not possible to say that it is never shifted. It is supposed to be a tax on surplus; and it is, therefore, assumed that it stays where it is put. The landlords may put up their rents on account of the enhancement of their land revenue demand. They may do so either because they were not charging full competitive rents, or are led to take off the 'slack' on account of the increase of the State demand. They may shift the burden to the cultivator even when they are already receiving their full economic rent. The cultivators are in a weak position. They are, on account of the exigencies of economic circumstances, entirely dependent on their landlords. It is possible for the latter to rackrent them even if the land revenue demand is not increased, but the landlord is more likely to do so when he has to make a larger contribution to the treasury. It is also possible for the cultivator to include the land revenue in his price, if he is producing a commodity for which there is a persistent demand. In India, the cultivator will be able to do so very rarely, but this possibility cannot be ruled out completely. The theory of the capitalization of taxes is specially applicable to an impost like the land revenue. In the permanently settled areas a very good case can be made for the tax having been absorbed by the lower capital value of the land. In other Provinces, the variations in the demand make its applicability much more doubtful; but any approximation to the fixity of land revenue makes it theoretically justifiable to take into account capitalization as a factor in determining the burden of the tax. The incidence of land revenue, instead of being a simple matter, is a very puzzling question indeed.

#### *Incidence of taxes on commodities*

The export, the import and the excise duties, here as everywhere, raise the most knotty problems of

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incidence. Even if it be assumed that the consumers pay these taxes, it is, in most cases, impossible to say what is the contribution of the different classes. The Taxation Inquiry Committee has calculated the incidence of import duties on cotton goods in the case of rural and urban labourers by dividing their yield by the total population of the country. There may be no objection to their doing so, if the object is to find out the comparative burden of the same class in two different years; though even then this method will give us a very rough measure of their incidence. But if it is, on the other hand, desired to determine the incidence of taxation on these classes when compared with other classes, then this method cannot be used. The commodities liable to import duties are grouped in India under 149 heads. It is not possible to say with any amount of confidence whether these taxes fall on one class of the community or the other. This difficulty has to be reckoned with even if it is assumed that the consumers pay the tax. It has, however, been already made clear that it is not correct to argue on that assumption. The real incidence of these duties depends upon a number of factors, the most important of which are the relative elasticities of supply and demand. The duties cannot always fall on consumers. This is particularly true of our export duties. The taxes on jute, rice and tea cannot be said to fall on the consumers of these commodities in foreign countries. Even in the case of the export duty on jute, it is not safe to take it for granted that the tax is passed on by producers. About the export duties on rice and tea, it may be said that they probably stick where they fall, that is to say, the point of their impact is also the point of their incidence. If there are any taxes with regard to the real incidence, of which it is necessary to speak with the greatest reserve, they are the indirect taxes which occupy such an important place in our fiscal system.

#### *Incidence of indirect taxes and price statistics*

It may here be stated that it is generally not a profitable pursuit to study the incidence of these taxes by



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collecting the statistics of price changes. The students of tariff history know how very misleading statistical arguments have been in controversies regarding the effect of tariff policies on the prices of commodities. Tax is merely one of the factors upon which the price of a taxed commodity depends; and it is, in most cases, not possible to study the effect of a tax upon price apart from the effects of other factors. Its effect on the price changes may be and often is small as compared to the effects of the other factors. The statistical data are, on this account, not very useful for answering the questions relating to incidence. We have mainly to depend upon general reasoning which, however, presupposes the acceptance of a particular theory of value and distribution. This is why the subject of incidence has been a source of so much vexation both to the student of economics and the fiscal reformer.

#### *Incidence of stamp duties and court fees*

The incidence of stamp duties, judicial and non-judicial, is again a matter about which widely divergent views have been held. Some of these taxes are supposed to fall on the sellers, because it is assumed that they have to come to the market under circumstances which leave them no choice and it is not possible for them to hold out for a better bargain. This, however, may not be true in all cases; and the tax may fall on the buyers, or be shared between them and the sellers. It is all a question of the elasticities of demand and supply—a phrase which does very useful service in a discussion of the incidence of these and other taxes, but does not give any definite answer to the question itself. The court fees are generally taken to fall on the litigants themselves, as there is no one on whom these taxes can be shifted. It is, however, not quite certain whether the litigants bear them in all cases. Money-lenders, for instance, whose contribution to the revenue derived from the court fees is by no means negligible, are likely to pass on the tax to the borrowers. The amount of money that they lose in bad debts and the legal costs of recovering other loans have to be

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included in the cost of running their business and must be a determining factor in the rate of interest which they charge on their loans. The monopolistic position which the money-lenders usually enjoy is sure to render it easier for them to pass on the burden of court fees to their helpless clients. It is, moreover, almost impossible to say how the burden of these taxes is distributed between the different classes. Sir Herbert Samuel, in the address referred to above, did not include even stamp duties in his calculations. That is the only way of dealing with the question, but is also a confession of our ignorance regarding the real incidence of these taxes.

#### *Some misleading calculations*

Professor K. T. Shah, of Bombay, has made an attempt to calculate the distribution of the burden of taxation between different classes. His conclusions with the underlying assumptions on which they are based may be referred to here to show how very arbitrary all such calculations must be. He takes the figures of 1923-4 as the basis of his estimate. During this year, out of the customs revenue of 45 crores, import duties yielded 36 crores, export duties 5.40 crores, cotton excise 1.88 crores and miscellaneous 2.12 crores. Professor Shah assumes, in the first instance, that all export duties are paid by foreigners. Very few students of the subject will be prepared to accept this statement as correct. It is difficult to calculate the amount which falls on the foreigners. But it is certainly not true to say that the Indian producers do not pay anything whatsoever in the form of export duties. He divides the receipts from the import duties into two classes—the amount paid by the richer classes only and the amount shared between the richer and the poorer classes. The former amount is estimated by him at 12.5 crores and the latter at 28 crores. Out of the 28 crores supposed to be jointly borne by the two classes, he thinks that 21 crores are paid by the poorer classes and the remaining 7 by the richer; that is to say in the proportion of 3:1. There is no reason given as to why he adopted this

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ratio. The ratio of 4 : 1 or 5 : 1 or 5 : 2 could as well have been adopted. The land revenue and irrigation receipts in 1923-4 amounted to 41·87 crores. He treats the irrigation receipts as taxes. They are in some cases indistinguishable from them, but it is not right to reason about their incidence as if they are taxes in all cases. The total amount of 41·8 crores is, according to him, shared between the richer and the poorer classes almost equally, the former contributing 20·37 crores, the latter 21·5 crores. These figures are again arbitrary and there is nothing to be said for them. They are open to criticism, even if they are examined superficially. It is certain that the poorer cultivators contribute much more to land revenue than the rich landlords. It is impossible to say how much more, but any estimate which distributes land revenue equally between the richer and the poorer classes is obviously wrong. The salt revenue of 8·7 crores is divided between the two classes in the ratio of 7 : 1. This may not be very far from the facts of the case; but it is even here possible to say that the proportion should be 10 : 1, or some other ratio which makes the incidence on the poorer classes heavier. Out of registration and forest receipts of 7 crores, the richer classes are supposed to contribute 5 crores and the poorer 2 crores. The stamp revenue of 12·81 crores is divided into 6 crores for the poorer and 6·81 crores for the richer classes. Here again the division is purely hypothetical and it is not possible to give any reason in its support. The incidence of income-tax is taken to fall on the richer class and of excise on the poorer. The total population of India is, for this purpose, divided into two classes, those living on or below the margin of subsistence and those who are above it. This twofold division can be of no practical value; but even if this fact be neglected, the arbitrary assumptions on which these calculations have been worked out robs them of any significance that they otherwise may have for explaining the incidence of taxation in India. It is, as it was stated above, certain that the bulk of our taxation is falling on the poorer classes. But such calculations cannot strengthen the case for giving them relief in any

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possible manner. They are misleading inasmuch as they ignore the complexity of the problem altogether, and tend to create a confidence in themselves which they do not deserve.

#### *Intricacies of the theory of incidence of taxation and fiscal reconstruction*

It is not necessary to apologize for bringing in these refinements of the theory of incidence of taxation while discussing the question of tax burden and laying so much stress on its inherent complexity. The Taxation Inquiry Committee was well advised in not undertaking any special inquiry into the economic conditions of the various classes, while collecting the data necessary for calculating the burden of taxation; as such an investigation, besides being laborious and expensive, would not have given any results of great practical utility. It had, therefore, to depend upon general considerations on that account. The conclusions to which the committee has come cannot be made the basis of fiscal reconstruction. They are indefinite and of a nebulous character. The whole problem, as it has been said repeatedly, is baffling in the extreme. The easiest way to solve it is to say that it is insoluble. But this is a way of shirking its difficulties, without making an honest and earnest effort to overcome them. It is much better to take a more sensible view of the matter. The difficulties are there. They have to be recognized and borne in mind in the study of the question. It is not altogether impossible to reach correct conclusions with regard to the incidence of taxes, if we are prepared to make the necessary intellectual effort. But it is a matter of the utmost importance to remember that the readjustment of taxation is not a simple matter. In the first chapter the distinction made by Sir Basil Blackett between a scientific system and a more scientific system was referred to and it was pointed out that the distinction was significant and its bearing on the problems of the future had to be duly appreciated. From what has been said, it ought to be clear that it is not possible to frame a scheme of taxation which will be absolutely scientific; but it is possible to make the

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existing system more scientific by understanding it in its entirety, realizing its shortcomings and introducing the necessary improvements after a careful consideration of their direct and indirect effects on the welfare of the community. But it will not serve any good purpose to act in ignorance of them, or make light of their real importance. The intricacies of incidence make it essential to cultivate a realistic attitude in our study of the problems of taxation. It is not enough to indulge in vague generalizations and advocate changes without understanding their full effect on the system as a whole.

### *Fiscal reconstruction essential for national reconstruction*

This subject may be concluded by once more emphasizing the necessity of making fiscal reconstruction a part of the whole scheme of national reconstruction. Taxation, properly levied and administered, is a beneficial phenomenon of very great importance. It is time that we should consider its place in our national economy from this point of view. New opportunities of constructive work have already been opened, which can only be fully utilized if we give up what is called the consumption theory of taxation. The view that Government is merely a necessary evil and that public revenue is a net deduction from the national dividend has been abandoned in theory everywhere and is also being given up in actual practice. In India, the conditions for adopting the same attitude have become more favourable recently and will become more and more favourable with the widening scope for carrying out policies of great social utility. Taxation can be made a means of promoting happiness, preventing disease and ignorance and creating conditions for a full and wholesome life. It can, of course, become an instrument of oppression, ruin trade and industry, and lead to results which may be highly detrimental to the material and moral welfare of the people. The work of reconstruction cannot be carried out without providing for adequate safeguards against the evils which have always been associated with the maladministration of taxation. But it is necessary to lay stress on the positive side of the subject, as it has been utterly neglected in the

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past and is not likely to receive sufficient attention even in the near future. The particular problems present issues of their own, which have to be considered in the light of general principles and of the policy which is to be worked out in the entire scheme of taxation. It is not right to assume that these problems are capable of easy solution. A tax reformer cannot obtain a free hand anywhere, on account of having to reckon with the survivals of the past. In India, this consideration presents special difficulties as the ground for carrying out measures of radical reform has not as yet been prepared and the necessary psychological atmosphere for their general acceptance is practically non-existent. The administrative difficulties and those which arise out of questions regarding the proper allocation of revenues between different public authorities must be a serious obstacle in the way of giving effect to any fiscal policy which may, otherwise, commend itself on account of its intrinsic merits. The tax reformer who has thought out his proposals well is further handicapped by the consciousness of having to deal with questions, with regard to which it is difficult to acquire an attitude of absolute certainty. These aspects of the matter have already been considered. But in spite of these difficulties, the work has to be seriously taken in hand. It has already suffered, because its vital importance has not been generally appreciated. To neglect it any longer will be dereliction of national duty.

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