

INTERSECTORAL EQUITY AND TAX
BURDEN ON INDIAN AGRICULTURE
- A REVIEW OF LITERATURE

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CHAPTER I

INTRODUCTION

The present study is an attempt to review the literature on the tax burden on Indian agriculture. It also reviews the proposals made in order to reform the existing tax structure on the agricultural sector. The need for estimating the tax burden on the agricultural sector in India was first emphasized by the Taxation Enquiry Commission (1953-54).¹ With the beginning of the planning era of the Indian economy, the States of the Indian Union realized the dire need of resources for the implementation of plan targets. Since taxation of agriculture is under the jurisdiction of the States, it was essential to find out whether there existed any scope for mobilizing additional resources from the agricultural sector through taxation. For this it was necessary to examine the burden of the existing taxes on the agricultural sector. The Taxation Enquiry Commission pointed out:

"In these circumstances and particularly in the view of the financial need of the State Governments in the context of the implementation of their development schemes, a majority of which are for the benefit of rural areas, it is difficult to envisage any real substitute for land revenue. The States realize about 70 crores from this source, and no alternative method which has so far been suggested is

likely to yield a revenue which even approximates to that figure. This as we have indicated makes it all the more important to examine whether by and large the present levels of assessment of land revenue represents an undue burden on the agriculturists."²

Apart from the need of raising additional resources for plan purposes, several other arguments have been made for special tax treatment of the agricultural sector just because it is agriculture. Thus, the classical economists considered taxation of agricultural rent for three reasons. Firstly, a tax on rent is not shiftable. The underlying idea was that an overcharged tenant would move away and so the landlord will have to bear the full burden of tax. As Ursula Hicks³ has pointed out, this might have been quite true in the English conditions, but is wholly inapplicable to the Indian conditions. In a country like India, where the prevalence of acute land hunger results in severe competition for crop-sharing contracts inspite of the insecurity involved in it, it is difficult to envisage that a tax on landlord would not be shiftable. Secondly, rent is considered to be an 'unearned income'. To quote J.S. Mill,⁴ "they (the landlords) grow richer, as it were, in their sleep, without working, risking or economizing".⁵ But, as H.P. Wald⁶ has pointed out, this is likely to be the case with landlords who own land in urban or suburban areas rather than agricultural land. Thirdly, land earns rent owing to

its 'indestructible qualities'. Modern technology has shown that the original indestructible qualities of land have little part to play in increasing productivity of land. Therefore, much of the rent on land is actually return on capital invested in order to bring about improvements on the land and maintain them. "Pure rent", wherever it exists, is inextricably mixed with interest on capital investment. This fact has refuted the argument of J.S. Mill that the landlords "grow richer in sleep, without working, risking or economizing".

The Neo-classical economists considered it desirable to distinguish between income 'earned' and income 'unearned', a distinction approximating the economically meaningful distinction between labour income and property income. On the basis of this distinction, given two equal incomes, the one with larger property income component will have to be taxed more than the one with larger labour income component. On the basis of this principle, agricultural sector can be heavily taxed only when it is proved that the property income component of the agricultural income is higher than that in the non-agricultural income. During the period 1955-58, the ratio of wage-bill to value-added in the agricultural sector in India was estimated to be 42 to 53 per cent and in the industry and mining it was 40-42 per cent.⁷ This data shows that the property income component in agriculture is not higher as compared to the one in non-agricultural sector. Therefore,

on the basis of discrimination between labour income and property income, heavier taxation of agriculture as such does not seem to be justifiable.

The Marxists have a general anti-agricultural bias. According to them, the investible surplus accumulated by the landlords in the form of rent, interest and output of the unpaid serf-labour should be seized by a revolutionary government and further, resources should be extracted from the agricultural sector to be invested in the industrial sector. This ideology resulted in 'collectivization' and 'exploitation' of the agricultural sector under the Russian and East European plans. Raj Krishna⁸ has remarked that on a purely logical level, the Marxists' view is fully rationalizable.

"In the early stages of development the government in search of investible funds, should tax surpluses--excesses of income over subsistence--heavily and progressively wherever they happen to be in that stage. Since they happen to be with traditional landlords and moneylenders as a result of previous accumulation they have to be taxed there. But if they happen to be with a pre-revolutionary non-agricultural bourgeoisie they have to be taxed equally. The object of developmental taxation must be all surpluses and not agricultural surpluses alone." (Raj Krishna, op.cit., p. 1598)

The non-Marxist development economists also assigned a special role to the agricultural sector in the context of

economic development of a country and this role has been emphasized by the advocates of heavier taxation of Indian agriculture. The difference between the Marxist and the non-Marxist is that the former believed in confiscation and the latter in indirect methods like taxation and price policy. Historical experience of the present-day developed countries show that agricultural sector has played a crucial role in the development of industrial sector (which is considered to be the engine of development) by: (1) providing food and raw material; (2) providing a market for goods produced in the industrial sector; and (3) providing labour and capital.⁹ This has also been the experience of the present-day developed countries the development of which is the result of deliberate policy measures undertaken by their governments.

Different methods were adopted by governments to transfer resources from the agricultural sector to the industrial sector depending upon the political milieu which existed in the country. Countries like Russia and China adopted extreme measures of extortion which are unsuitable for a democratic country like India. The Japanese economy adopted a system of heavy land taxation, a system similar to the one prevailing in India and that is why the example of Japan is often cited in the context of India. It is pointed out that land taxes in Japan contributed about 80 per cent of the total revenue in the 1880s--the period of initial deve-

lopment of the economy. On the contrary, in India contribution of land revenue to the total revenue of Centre and State governments in the first plan was only 9 per cent and has been on a declining trend since then.¹⁰ Presently it is barely two per cent.¹¹ This implies that the Indian agricultural sector has not played the special role it is supposed to play in the context of economic development. Therefore, it is suggested that Indian agriculture should be subject to heavier taxation as was done by the Japanese government.

Raj Krishna has refuted the above argument. He has stated that this argument is not applicable to the Indian economy due to historical reasons. When the British Government in India systematized land revenue in the year 1793 with the Permanent Settlement, its contribution to the total tax revenue was 65-70 per cent. The figure continued to be the same till the first half of the nineteenth century and came down to one-third by end of the century. At the beginning of the Second World War the share further reduced to one-sixth or 17 per cent. By the year 1953-54, it was only 9 per cent. Corresponding figures for the Japanese economy are: in 1880s the contribution of land tax to total revenue was around 80 per cent, on the eve of the First World War it was 40 per cent, and in 1930s it was 11 per cent.¹² Thus it is evident from the above data that the trend in the share of land tax in both India and Japan is more or less similar. The difference between the two countries is that resources

mobilized through land taxes in Japan were utilized for financing Japanese industries, whereas resources mobilized by land revenue in India were utilized to finance British industries located in Britain. Hence at the time of Independence, India inherited a totally exploited agriculture which needed revitalizing before it could be taxed once again. Another difference that can be pointed out between India and Japan is that in Japan, despite heavy taxation of agriculture, with feedback from industrial development, Japanese agriculture made a remarkable progress on technological front. In the case of Indian agriculture, there was no such feedback as development of Indian industry was almost insignificant. Indian agriculture therefore, remained stagnant on technological front, and was drained of its resources.

This historical fact indicates that Indian agriculture had finished playing its 'special' role in the context of economic development, though not of India's. After Independence, the policy-makers were faced with an exploited agriculture and under-developed industrial sector. Therefore, the 'special' role could not be expected from agriculture in the immediate post-Independence period. Clearly, the way to mobilize resources is, as suggested by Raj Krishna, is to tax surpluses wherever they happen to be.

In general, the 'lesson' from the historical experiences of Japan, Russia, China including the 19th Century India (where an attempt was made to alter land taxes conforming to

the principles of economic theory - is considered as one of the greatest attempts in history, which failed) is that one cannot recommend policy guidelines which will be applicable to the developing countries in general or any one country in particular. As R.M. Bird¹³ has stated, 'each historical instance appears, on close examination, to be complex and unique in many important respects. This, perhaps, is the real lesson of historical experience of present-day policymakers.'¹⁴

Lastly, a case for heavier taxation of Indian agriculture is made on the grounds of inter-sectoral equity. It is often asserted that Indian agriculture contributes lesser proportion of its (sectoral) income in the form of taxes (both direct and indirect) as compared to the contribution of non-agricultural sector. In the year 1951-52, agricultural sector contributed only one per cent of income originating in the sector in the form of direct taxes and in the year 1974-75, 0.6 per cent. The corresponding figures for the non-agricultural sector are 4.1 per cent and 5.8 per cent respectively.¹⁵ Regarding contribution in the form of indirect taxes, estimates of Ved Gandhi, E.T. Mathew and S.L. Shetty¹⁶ show that the agricultural sector's contribution was much less as compared to that of non-agricultural sector.

Inter-sectoral equity in tax burden is said to exist when the proportionate tax burden, i.e., "estimated tax payments divided by estimated taxable capacity,"¹⁷ is equal for

different sectors in the economy. Raj Krishna has deemed this concept to be superfluous as it is operationally unyielding. A 'sector' is neither an income-earning nor a tax paying entity for fiscal purposes as other tax-paying entities like individuals, families and firms. If the tax system is an equitable one which honours the principle of horizontal equity, i.e., all tax-paying entities with equal incomes are given equal treatment, irrespective of the sources of income, and vertical equity, i.e., higher incomes are taxed on a progressive scale, then the concept of inter-sectoral equity for fiscal authorities to further increase total equity in the system proves to be useless. Clearly, this implies that a case cannot be made for heavier taxation of agricultural sector or, for that matter, any sector, on the grounds of inter-sectoral equity.

Thus, it is seen from the preceding discussion that none of the arguments put forward are able to make a sound case for heavy taxation of agricultural income just because it is agricultural. Nevertheless, a case can be made for collecting larger tax revenue from agricultural sections only if it is proved that the various income groups in the agricultural sector are under-taxed as compared to the corresponding income groups in the non-agricultural sector. This, in other words, is merely an effort to increase horizontal and vertical equity in the tax system. Such a situation is likely to arise only when incomes from different sectors are

treated differently for fiscal purposes, as is done so in our country. Taxation of agricultural incomes is the sole prerogative of State Governments, whereas taxation of non-agricultural incomes falls under the jurisdiction of Central Government which has resulted in differences in tax burdens on tax-paying entities under the two sectors and also as between different States. In the following chapter, a review will be made of the studies which have made attempts to estimate the tax-burden on the agricultural sector in India.

CHAPTER I Notes and References :

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- 4 Mill I.S., Principles of Political Economy, Boston, 1848.
- 5 Ibid. pp. 364-65.
- 6 Wald, Haskell, Taxation of Agricultural Land in Underdeveloped Economies, Harvard University Press, Cambridge, Massachusetts, 1959.
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- 8 Ibid.
- 9 Meier, Gerald, Leading Issues in Economic Development, 3rd Ed., Oxford University Press, New York, 1976.
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- 11 Reserve Bank of India Bulletin, Aug. 1981.
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- 13 Bird R.M., Taxing Agricultural Land in Developing Countries, Harvard University Press, Cambridge, Massachusetts, 1974.
- 14 Ibid. p. 141.
- 15 Krishna Raj, Op. cit.
- 16 Shetty S.L., "An Intersectoral Analysis of Taxable Capacity and Tax Burden", Indian Journal of Agricultural Economics, Vol. 26, 1971.
- 17 Krishna Raj, Op. cit.

CHAPTER II

TAX BURDEN ON AGRICULTURAL SECTOR : A REVIEW OF STUDIES

In the present chapter we shall look into the studies conducted to estimate the relative tax burden on the agricultural sector vis-a-vis the non-agricultural sector in India.

After the study by the Taxation Enquiry Committee (TEC)¹ such a study was first conducted by I.S. Gulati.² He considered it to be essential to take account of agricultural taxation separately while analysing the tax burdens for two reasons. Firstly, which is more important, a distinction is made between the tax bases as per their sectoral origin by the direct tax system in India. Secondly, the 'special' role the agricultural sector has to play in the context of economic development of the country.

Gulati came to the conclusion which is same as the TEC's, that agricultural households below the expenditure level Rs. 3,600 per year cannot be said to be under-taxed as compared to the corresponding group in the non-agricultural sector, but the households in the agricultural sector above the expenditure level of Rs. 3,600 per year can be definitely said to be under-taxed as compared to the corresponding households in the non-agricultural sector and "this advantage which the agricultural households enjoy increases with increase in income".³

Although this study was not a detailed one, Gulati emphasized certain points and facts which it is essential to take into account while conducting a study of this nature. Firstly, he objected to K.N. Raj's⁴ view that the agricultural sector should be made to bear the burden of additional taxation in the Third Plan because most of the additional burden of taxation in the period 1952-53 to 1957-58 was borne by the non-agricultural sector. The first objection raised is that it is technically wrong to identify the rural sector as agricultural sector (as Raj did) because 15.4 per cent⁵ of the rural population was non-agricultural. Such an identification would result in substantial under-statement of the tax burden the agricultural sector has actually to carry. Secondly, comparison in aggregative terms overlooks the important fact that two sectors having different coefficients of distribution of income within the sector, which result in different tax collections given the same progressive rate structures. Thirdly, the two sectors in India are subject to different types of taxation--the agricultural sector is subject to a proportional tax system whereas the non-agricultural sector is subject to progressive tax system. This implies that even if income distribution in the two sectors was same, it would have resulted in different tax collections. For the above reasons it is not appropriate to impose a heavier burden of taxation on the agricultural sector just because as a sector, the burden borne by it is less when compared to the non-agricultural sector and thereby attain inter-sectoral equity

which seemed to be the intention of K.N. Raj. It is only on the grounds that certain sections of the agricultural sector are under-taxed (households above the expenditure level of Rs. 3,600 per year) when compared to the corresponding sections in the non-agricultural sector, that there does exist a strong case for heavier taxation of certain agricultural sections. In short, Gulati showed that an intraclass-intersectoral analysis of tax burden is meaningful than a mere intersectoral analysis of tax burden.

The study by H. Groves and M. Madhavan⁶ also affirms the meaninglessness of a mere intersectoral analysis of tax burden in an odd way. Their estimates for the year 1960-61 revealed that the agricultural sector was over-taxed as compared to the non-agricultural sector. But the point worth noting is, that if agricultural labourers and their incomes were excluded from the estimation, the "non-agricultural sector bears a much heavier burden than the landowning class"⁷. So the authors suggested that the tax structure for the agricultural sector should be formulated in such a way so as to place the burden mainly on the landowning class as the agricultural labourers paid a greater percentage of their income as taxes.

The first detailed and comprehensive study in this field was conducted by Ved P. Gandhi⁸ (1966) which is considered to be a pioneering work. We shall try to look into his methodology in brief.

In order to find out the actual tax burden on a sector revenue from every major Central and State tax (direct plus indirect) is allocated between agricultural and non-agricultural sectors. The per capita income of the sector is taken to be the index of taxable capacity. Given the actual tax burden and taxable capacity of the sectors, there are four different ways of finding out which sector is relatively under-taxed.

The first two measures are the ratios of taxes per capita to income per capita and taxes per capita to income minus subsistence per capita. In the year 1960-61, according to the former measure the average Indian farmer paid 5.6 per cent of his income as taxes (direct plus indirect) while the average city dweller paid 13 per cent. According to the latter measure, in the same year the proportion for the farmer was 13.4 per cent whereas that for the city dweller was 26.6 per cent.⁹ Gandhi has considered these measures to be quite crude, as sectoral income per capita, which is just an arithmetic mean, does not give the true picture of the taxable capacity as it tends to hide the incomes at the extreme ends. In other words, it fails on vertical equity front, i.e., it fails to give "unequal treatment to persons in unlike circumstances". Gandhi has devised the following two measures so as to conform to the principle of equity in both horizontal and vertical aspects.

The first measure, known as the "first approximation" is as follows:

$$B = \frac{t}{(Y - S)^{e_0}}, \quad (1 < e_0 < 2)$$

where, B = burden on the sector

t = taxes per capita in the sector

Y = income per capita in the sector

S = subsistence per capita in the sector

e_0 = desired degree of progression.

Gandhi has chosen the value of e_0 to be 1.5, which he felt to be intuitively more reasonable.¹⁰

Given this measure relative tax burden will be as follows:

$$B_a = \frac{t_a}{(Y_a - S_a)^{e_0}}$$

$$B_n = \frac{t_n}{(Y_n - S_n)^{e_0}}$$

subscripts 'a' and 'n' relate to agricultural and non-agricultural sectors respectively. If $B_a = B_n$, then

$$\frac{t_a}{(Y_a - S_a)^{e_0}} = \frac{t_n}{(Y_n - S_n)^{e_0}}$$

$$\frac{t_a}{t_n} = \frac{Y_a - S_a}{Y_n - S_n}^{e_0}$$

t_a/t_n can be said to indicate 'relative tax burden' and $(Y_a - S_a/Y_n - S_n)^{e_0}$ the relative taxable capacity. Estimates¹⁰ for the year 1950-51 show t_a/t_n to be 0.211 and $(Y_a - S_a/Y_n - S_n)^{e_0}$ to be 0.511. $0.211 < (0.511)^{1.5} = 0.365$. These figures show that the relative taxable capacity '0.365' was greater than the relative tax burden '0.211', implying that the agricultural sector was undertaxed.¹¹

The second measure known as 'second approximation' is a comprehensive one which takes into consideration variables that affect the taxable capacity of a sector. The measure is as follows :

$$B = \frac{t - g}{f(\bar{Y}, \bar{W}, i, w)^{e_0}}, \quad (1 < e_0 < 2),$$

where g = government expenditure per capita,

\bar{Y} = $(Y - S)$,

\bar{W} = wealth per capita,

i = index of income inequality in the sector,

w = index of wealth inequality in the sector.

The denominator is given in a functional form, i.e., the taxable capacity of a sector is a function of the weighted sum of the variables included.

Deploying the above two measures Gandhi has come to a conclusion that despite the limitations of data there is enough evidence to indicate existence of inequity between the agricultural and non-agricultural sectors. The inequity is

not only in favour of the agricultural sector, but it has been increasing over the time period 1950-51 to 1961-62. The following are his main findings.

1. In the year 1950-51, the agricultural sector in India paid Rs. 186 crores in the form of taxes (direct and indirect) while the non-agricultural sector paid Rs. 391 crores. For the year 1961-62 the respective figures were Rs. 381 crores and Rs. 1095 crores. It means that in 1950-51 non-agricultural sector's tax payments were twice the agricultural sector's and in 1961-62, they were thrice. Gandhi is of the opinion that this gap must have increased in recent years.

2. In 1950-51, 3.6 per cent of the income originating from the agricultural sector was paid as taxes while the corresponding proportion of the non-agricultural sector was 8.8 per cent. For the year 1961-62, the respective proportions were 5.9 and 13.2 per cent. Thus in both the years the average tax rate in the non-agricultural sector was double that of the agricultural sector. Gandhi is of the opinion that a similar situation prevails even today.

3. Agricultural sector paid 11.6 per cent of its additional income as taxes whereas the non-agricultural sector paid 20.6 per cent during the period 1950-51 to 1961-62.

4. As regards per capita tax burden in the two sectors, in 1950-51, per capita taxes in the agricultural sector were

Rs. 8.0 as against Rs. 36.0 in the non-agricultural sector - the difference being four and a half times. This inequality widened to five and a third times in 1961-62. In the light of increased taxable capacity of the agricultural sector owing to Green Revolution, this difference between per capita tax burden is expected to widen further. Abolition of land revenue in certain States and reduction of land revenue burden in some other States must have further added to the already existing inequity in the per capita tax burden.

5. Regarding inequity as between similar income groups under the two sectors, it was found that the rural households belonging to all brackets of the lower income group paid lesser proportion of their income as taxes, as compared to their urban counterparts. In 1952-53 urban households in the income bracket Rs. 1200-1800 per year paid 5 per cent of their income as taxes as against 3.2 per cent paid by the rural households belonging to the same income bracket. Similar situation prevailed in the case of higher income groups also. For the same year, urban population belonging to income bracket Rs. 1800-3600 per year paid 5 per cent of their income while the corresponding group in the rural sector paid 3.6 per cent. Gandhi is of the belief that this inequity among the lower income groups must have increased since the year 1952-53 due to the increasing role of indirect taxes which generally fall on the monetized consumption of the urban sector.

6. The upper income group of the agricultural sector paid about 6.2 per cent of its income in taxes whereas its counterpart in the non-agricultural sector paid 20.5 per cent in the year 1952-53. For the year 1961-62, the respective figures were 6.6 and 17.8 per cent. Gandhi has observed that the interclass inequity between upper income groups has been much more serious than in the case of lower income groups.

The conclusion Gandhi has come to is that the agricultural sector has been undertaxed and continues to be undertaxed and "all income classes in the agricultural sector have enjoyed a tax advantage over their counterparts in the non-agricultural sector".¹² Gandhi is basically of the view that the agricultural sector should contribute a greater proportion of its (sectoral) income because of the 'special' role it assumes in the context of economic development. But for the fact that the Indian agriculture is relatively poor (the per capita income in the agricultural sector is lower than that of the non-agricultural sector), a case cannot be made on a priori grounds for imposing heavier taxation. A case had to be made on empirical grounds which Gandhi seems to have made.

Ved Gandhi's study has been severely criticised by two authors--Michael Lipton¹³ and Raj Krishna. Lipton has totally disagreed with Gandhi's argument that the agricultural sector in India has been undertaxed as compared to its taxable capacity. He has contended that in fact the agricultural sector

has been overtaxed both in absolute and relative terms. The reason for Gandhi arriving at a conclusion, that the agricultural sector is undertaxed is, in Lipton's view, the fallacious procedure Gandhi followed.

Lipton, like Gandhi, has made an estimate of the taxable capacity by taking into consideration factors such as income minus subsistence and wealth and income distribution within the sector. In order to take into consideration the income distribution within the sector, Lipton has taken the approximate distribution of income in the rural and urban India percentile-wise. Gandhi has adopted the alternative method--taking an indicator of an overall distribution of income such as Lorenz coefficient, which is taken into account separately from the sector's per capita income as an independent determinant of taxable capacity. Lipton considered this method of Gandhi as highly unsatisfactory for two reasons. Firstly, an overall indicator such as Lorenz coefficient takes little account of really high (and really taxable) incomes on the income scale. The second, and the more fundamental, is the weighting problem. Lower per capita income and greater degree of equality in the sector should reduce taxable capacity of the sector. But in Gandhi's analysis they tend to increase the taxable capacity. This is because, Lipton has pointed out, Gandhi has followed a natural but fallacious procedure. Gandhi has estimated relative taxable capacity in the following way:

$$\frac{t_a}{t_n} = \alpha \frac{l_a}{l_n} + \beta \frac{i_a}{i_n},$$

where, t = taxable capacity,

l = value of Lorenz coefficient,

i = sectoral per capita income,

α & β = linear weights, and

subscripts 'a' and 'n' relate to agricultural and non-agricultural sectors respectively.

l_a/l_n is less than one due to existence of greater income equality in the agricultural sector as compared to the non-agricultural sector, for greater the income equality, smaller is the value of Lorenz coefficient. i_a/i_n is also less than one due to lower sectoral per capita income in the agricultural sector as compared to the non-agricultural sector. Gandhi's estimates show the ratio l_a/l_n to be greater than the ratio i_a/i_n . With a greater weight given to i_a/i_n and a smaller weight to l_a/l_n , it results in increasing the taxable capacity of the agricultural sector, where in fact, with both l_a/l_n and i_a/i_n being less than one, it should have reduced it. Lipton has stated that this odd result --that relatively lower per capita income and greater equality of incomes resulting in increasing the taxable capacity of the sector--could have been avoided if non-linear weights were used instead of linear weights. But, Lipton remarks that this would have been quite arbitrary and also, the problem of a single coefficient concealing high incomes would remain unsolved.

Lipton, like Gandhi, assumed the value of the exponential as 1.5, taking it for granted that progressive taxation is the norm in a country like India aiming at reducing the income disparities. Findings of Lipton are given in Table 2.1.

Lipton has concluded his exercise showing that there has been a small but persistent resource transfer out of the agricultural sector through the tax system (compare columns 7 and 1 of the Table). Lipton claims that such a conclusion has been arrived at in spite of making assumptions at every stage of estimation which tend to overstate the relative taxable capacity of the agricultural sector.

The other economist who severely criticized Ved Gandhi was Raj Krishna¹⁴ who has taken objection to the very method of estimating the taxable capacity. Firstly, Raj Krishna has questioned the sanctity of the value of e_0 which was chosen by Gandhi as 1.5. It is with this value that Gandhi has proved the existence of intersectoral inequity in favour of the agricultural sector. Raj Krishna has shown that given the values of relative taxable capacity and relative tax burden, intersectoral equity can be shown to exist with different values of e_0 . For example, relative taxable capacity and tax burden estimated with the 'second approximation' for the year 1950-51 turned out to be 0.50 and 0.211 respectively. With the value $e_0 = 1.5$, the inequity is of the following order: $0.211 < (0.5)^{1.5} = 0.354$. But Raj Krishna has shown

Table 2.1 : Tax, Equity Tax and Implicit Resource Transfer

Year	Agricultural			Non-agricultural			Tax per head in agriculture if both sectors paid at the same ratio to 'equity' capacity (Rs.)
	Tax per head (Rs.)	Equity adjusted taxable capacity per head	Ratio (per cent)	Tax per head (Rs.)	Equity adjusted taxable capacity per head	Ratio (per cent)	
	1	2	3	4	5	6	7
1950-51	8.3	337.1	2.46	39.4	1641.8	2.40	8.2
1951-52	8.6	330.1	2.61	45.5	1811.5	2.51	8.4
1952-53	8.8	308.6	2.85	41.1	1738.1	2.37	7.7
1953-54	9.3	344.7	2.70	40.8	1782.8	2.29	8.3
1954-55	9.6	263.7	3.64	42.3	1816.4	2.34	7.0
1955-56	10.2	272.2	3.75	41.9	1875.7	2.23	7.1
1956-57	11.4	333.7	3.42	48.6	1349.3	2.63	9.5
1957-58	13.3	307.6	4.32	58.0	2082.8	2.78	9.8
1958-59	15.6	361.8	4.31	60.7	2373.3	2.56	10.8
1959-60	14.2	339.1	4.19	68.3	2144.3	3.19	11.5
1960-61	14.4	379.1	3.80	75.1	2365.3	3.18	12.7
1961-62	14.7	349.9	4.20	82.0	2582.5	3.18	12.0

Source: Michael Lipton. Transfer of Resources from Agriculture to Non-Agricultural Activities: The case of India, p. 214.
Appearing in Toye JFJ, op. cit.

that if the value of e_0 were chosen to be 2.24, there would be intersectoral equity. Similarly, if $e_0 = 2.05$ for 1960-61, and 2.32 and 1.72 respectively for 1950-51 and 1960-61 with the "first approximation", there would be intersectoral equity. Raj Krishna has remarked that Gandhi has succeeded in showing that tax authorities in India have been more progressive than Gandhi would like them to be. Thus, Raj Krishna has further remarked that the existence of intersectoral inequity remains to be proved unless one agrees with Gandhi's subjective preference for the value of $e_0 = 1.5$.

The second criticism is with respect to 'second approximation' where taxable capacity $t = f(\alpha \bar{Y}, \beta \bar{w}, \gamma w, \delta i)$, $\alpha, \beta, \gamma, \delta$ being the respective linear weights. Since the value of concentration ratios (i, w) are taken to be less than one, while the range of income per capita and wealth per capita is Rs. 70 to Rs. 1650, the effect of concentration ratios on the computed index of taxable capacity is negligible, whatever the weights may be. Thus the formula does not reflect the effect of inequality which it was designed to reflect. Again, regarding this 'second approximation', the point raised by Raj Krishna is how far is it justifiable to sum up two different economic concepts of income and wealth with arbitrary weights to arrive at taxable capacity. Income and wealth are two distinct economic concepts--the former is a flow, the latter, a stock. Because of their different time dimension there is little justification to sum them up

to estimate taxable capacity. What should have been done is estimate the taxable capacity of the two sectors taking one indicator at a time. Similarly, taking into consideration direct and indirect taxes together to estimate the total burden, is incorrect because the objectives behind the two types of taxation are different. The agricultural sector can be made to pay more in the form of indirect taxes only with a change in their consumption pattern and by making industrial goods easily accessible in the rural areas. Also, the unique relation that exists in the case of direct taxes and the taxable capacity need be necessarily exist in the case of indirect taxes.

In another attempt to estimate the tax burden on Indian agriculture, Ved Gandhi¹⁵ followed an altogether different method. This time Gandhi tried to find out the 'net fiscal burden'--taxes net of subsidies, both open and concealed--on the agricultural sector. The open taxes taken into consideration were Land Revenue, Agricultural Income tax and Betterment levy. Other direct taxes levied on the agricultural sector were not considered as their effect on the farmers was negligible. Concealed taxation implies that the farmer is taxed in a concealed manner due to the policy measures such as: (a) compulsory procurement of foodgrains by the Government at controlled prices, and (b) through profit oriented pricing as fertilizers distributed by the Government. Open subsidies mentioned by Gandhi are: (a) subsidies

on agricultural inputs, and (b) scheme of minimum support prices. The concealed subsidies mentioned were: (1) supply of low interest government loans to the agriculturists; (2) supply of cheaper cooperative credit; (3) low irrigation rates; and (4) subsidized electricity rates for agriculture. Gandhi has concluded that the burden of open taxes in aggregate terms has declined since 1963-64 and concealed taxes have remained more or less constant. Both concealed and open subsidies have increased in aggregate terms, although the latter are an insignificant proportion of total subsidies given to the agricultural sector. The main reasons for significant increase in concealed subsidies since 1960-61 are: (1) large losses incurred on irrigation works and (2) trading losses incurred by Government on fertilizer sales following 1966 devaluation.¹⁶

Raj Krishna seems to be critical of this exercise also. Firstly, nowhere in the literature does Gandhi explain the reason for his conceptual change nor does he make any attempt to compare the burdens under the two different concepts. The second criticism made by Raj Krishna on this exercise is about the exclusion of indirect taxes from the computation of tax burden. This has strengthened the argument that Indian agriculture is undertaxed because, according to Gandhi's own estimates for the period 1950-51 to 1964-65, the proportion of indirect taxes to total taxes paid was much higher (63-77 per cent) in the agricultural sector to that

in the non-agricultural sector (50-65 per cent).

Moreover, as Raj Krishna has pointed out the whole exercise would have been much more yielding if a similar exercise was carried out for the non-agricultural sector also. Raj Krishna seems to have a strong presumption that the industrial policy measures have enabled the industries in the non-agricultural sector to create and maintain an oligopolistic position and therefore, realize abnormal prices and profits which is the result of heavy protection given to them from foreign competition. The concealed benefit of such government policy is likely to be very large in magnitude.

Gandhi in his paper has admitted the limitations of his exercise and has indicated further research on the subject. If his paper is taken in the spirit of 'search for a direction' (which is the title), in isolation from his previous study, then the criticism--that the conceptual change remained unexplained and comparison of burden under the two concepts unattempted--levelled against him do not seem to be appropriate, although the fruitfulness of the direction suggested by Gandhi remains to be seen.

After Gandhi, S.L. Shetty¹⁷ seems to be the only author who has made a similar detailed and a systematic study. Shetty (we will refer to this study as Shetty-I) has challenged the hypothesis that the agricultural sector is undertaxed, which had come to be accepted as a fact. He has shown that

the agricultural sector has been overtaxed for the first three five-year plans, except for the actual plans. We shall look into his methodology in brief.

Shetty-I finds it essential to place the concept of taxable capacity in a dynamic setting. In order to do so, allowance has to be made for -

(i) 'a permitted rate of increase in the minimum consumption requirements (for any organized society aims at certain improvements in its existing consumption standard);

(ii) a minimal investment rate required for (a) protecting the existing production apparatus, lest it should get depreciated and give reduced income, and (b) facilitating the increase in the minimum consumption requirements.¹⁸

Keeping the above elements in mind, the taxable capacity in per capita terms has been defined as -

$$t = (Y - C_m) - i = (s - i)$$

where, t = taxable capacity,

Y = per capita income,

C_m = minimum consumption requirements

i = allowance for minimal investment, and

s = potential surplus, which is $(Y - C_m)$.

Shetty has estimated the minimum consumption requirements by taking the nutritional requirements of food. He has noted the fact that there exists an amount of population which is below the sectoral $(Y - C_m)$, which has to be taken

into account separately. So, the modified version of taxable capacity will be as follows :

$$T = [Y - (C_0 P_1 + C_m P_2)] - I$$

where, T = taxable capacity of the sector,

Y = income of the sector,

C = actual per capita consumption of households below the sectoral $(Y - C_m)$,

P_1 = population below the sectoral $(Y - C_m)$,

C_m = estimated per capita minimum consumption requirements of the surplus households with population P_2 ,

I = allowance for investment.

After estimating taxable capacity in this manner, Shetty has shown that even by making an allowance for various degrees of progression to take account of the differences in per capita capacity and its distribution; the agricultural sector has been overtaxed for all the first three plans except the Annual Plans. The results are presented in Table 2.2.

The reason for Shetty arriving at a conclusion opposite to that of Gandhi's lies in the methodological differences. Firstly, Shetty has estimated taxable capacity taking one indicator, i.e., income, whereas Gandhi has estimated taking two indicators--income and wealth along with indices of income and wealth inequalities. Gandhi's method is considered¹⁹ as a marked improvement over Taxation Enquiry Commi-

Table 2.2 : Relative Tax Burden Compared with Relative Taxable Capacity--Allowance for Progression

Period	Relative tax burden* (per capita)	Relative taxable capacity [@] (per capita) with varying degrees of progression						
		e = 1	e = 1.5	e = 1.6	e = 1.7	e = 1.8	e = 1.9	e = 2.0
First Plan	3.68	5.13	11.62	13.69	16.12	18.98	22.35	26.31
Second Plan	3.70	4.55	9.71	11.28	13.14	15.29	17.79	20.70
Third Plan	4.09	4.42	9.29	10.76	12.51	14.51	16.85	19.54
Annual Plans	4.15	2.10	3.04	3.28	3.53	3.80	4.10	4.41

* Relative tax burden = t_n/t_a ; where n = non-agricultural sector; a = agricultural sector.

@ Relative taxable capacity = C_n/C_a .

Source : S.L. Shetty. "Intersectoral Analysis of Taxable Capacity of Tax Burden," IJAE, 1971, p. 240.

ssion's method, in which tax burden is seen as a proportion of the income of a certain section of population, when viewed from a conceptual angle. Because, money income alone is not considered to be the sole indicator of taxable capacity. Provision has to be made for factors such as wealth, income and wealth inequalities and the minimum consumption needs. All these factors have been taken into account in Gandhi's analysis. Yet his estimates have not made a headway because (a) unexplained choice of $e = 1.5$ and (b) lack of appropriate data regarding indices of income and wealth inequalities, which have led him to make 'heroic' assumptions.

Viewed from the conceptual angle, Shetty's estimate can be said to be inferior to Gandhi's, as his estimate does not take into account the wealth factor while estimating taxable capacity. Anyway, inclusion of the wealth factor would hardly have made any difference to his conclusion, it would rather have reinforced it. Shetty has taken into consideration the wealth tax, which is one of the major direct taxes levied by the Centre with its incidence falling wholly on the non-agricultural sector, and has shown that the non-agricultural sector is undertaxed. Inclusion of the wealth factor would have increased the taxable capacity of the non-agricultural sector thus resulting in an increase in the extent of undertaxation of the sector.

Secondly, Shetty himself seems to be critical about Gandhi's method of estimating subsistence requirements.

Gandhi has taken the income of the lowest 30th percentile of population in both the sectors as subsistence. On the contrary, according to Shetty, approximately 60 per cent of the households in both the sectors were below the subsistence requirements. Secondly, Gandhi estimated the subsistence requirements only for the year 1950-51. Although Gandhi has stated that "the price factor will be considered later in the analysis",²⁰ for the entire part of his substantive analysis Gandhi has kept the subsistence requirements constant. To quote Shetty, "His study does not seem to have withdrawn this assumption of constancy in minimum consumption requirements at any stage in the study. This is surely inadmissible."²¹ Shetty fares better in this respect. He has estimated subsistence requirements by taking the nutritional requirements making provision for price changes from year to year. Moreover, he has made an allowance for permitting increase in consumption. Also, his method of taking into consideration the population with below the subsistence requirements along with its actual consumption separately while estimating taxable capacity is surely an improvement over Gandhi's method of altogether excluding the population below the subsistence from the picture.

As regards allowance for progression, Gandhi has shown the existence of intersectoral inequity in favour of agricultural sector with his arbitrary choice of $e_0 = 1.5$, although he has stated that the value of 'e' could range between 1 and 2.

On the other hand, Shetty has shown the existence of intersectoral inequity in favour of non-agricultural sector by application of different values of e ranging between 1 and 2. This implies that with different methodologies and same degree of progression, different conclusions can be derived. Also, same method but different degrees of progression can lead to different conclusions. This has been amply proved by Raj Krishna. In Shetty's exercise too, application of $e_0 = 2$ to relative taxable capacity in the Annual Plans shows intersectoral inequity in favour of non-agricultural sector, and the opposite for values less than 2. This shows the arbitrariness of the use of different degrees of progression. Due to the element of subjectivity entering in the choice of the value of e_0 , the existence of intersectoral inequity remains to be proved. On the basis of the above studies, one cannot say which sector is undertaxed when compared to the other.

P.K. Bhargava²² and A.C. Angrish²³ also have made an attempt to compare the burden of direct and indirect taxes separately on the two sectors. They have come to the conclusion that the agricultural sector is grossly undertaxed as compared to the non-agricultural sector. Findings of Bhargava (regarding direct taxes) are given in Table 2.3. Looking at the tax system relating to Indian agriculture from different angles--direct taxes as percentage of income originating from the sector, per capita direct taxes as

Table 2.3 : Tax Burden on Agricultural and Non-agricultural Sectors

Year	Agricultural sector			Non-agricultural sector		
	Direct taxes from 'A' as % of income from 'A'	Direct taxes from A as % of total tax revenue of Union and State Governments	Per capita direct taxes from A as % of per capita income of 'A'	Direct taxes from 'N' as % of income of 'N'	Direct taxes from 'N' as % of total tax revenue of Union and State Governments	Per capita direct taxes as % of per capita income of 'N'
1	2	3	4	5	6	7
1951-52	1.0	8.0	1.0	4.1	32.5	4.1
1956-57	1.8	10.8	1.8	3.4	27.9	3.4
1961-62	1.5	7.0	1.5	4.8	25.5	4.8
1966-67	0.8	3.1	0.8	6.1	23.2	6.1
1971-72	0.7	1.9	0.7	6.3	21.0	6.3

'A' = Agricultural sector. 'N' = Non-agricultural sector.

Source: P.N. Bhargava and G.S. Srivastava, Bulletin for International Fiscal Documentation, 1974, p. 65. 'Tax Burden on Indian Agriculture'.

percentage of per capita income in a sector, direct taxes on a sector as percentage of total revenue from Central and State taxes--we seem to find that the agricultural sector contributes much less of its income to the Exchequer as compared to the non-agricultural sector. Similar are the findings of Angrish also. But, the method of estimating tax burden adopted by

Angrish and Bhargava are extremely crude, without any allowances for subsistence requirements, distribution of income within the sector, etc.. They are a mere comparison of sectoral burdens.

In another paper, Shetty²⁴-II has estimated the burden of taxes on various income groups in the agricultural and non-agricultural sector. The following are his findings regarding direct taxes burden. (Refer Table 2.4):

1. The lowest income group (below Rs. 3000 per year) in the agricultural sector paid a greater percentage of their income as taxes as compared to the corresponding class in the non-agricultural sector. This group consisted of more than 90 per cent of the rural households and 85-90 per cent of the urban households in the period under study (1952-53 to 1962-63).

2. The middle income group (Rs. 3000-25000 per year) of the non-agricultural sector in the first period (1952-53 to 1953-54) paid 7.5 per cent of its income as taxes whereas the corresponding group in the agricultural sector paid 5.5 per cent. For the rest of the period the difference in the incidence level does not appear to be much significant.

3. A glaring disparity was observed in the case of the high income group (above Rs. 25,000 per year). This income group, in the non-agricultural sector paid 25 per cent of its income as taxes whereas in the agricultural sector

Table 2.4 : Incidence of Direct Taxes by Grades of Income, Farm and Non-farm Sectors

Grades of income (Rs.)	1952-53 to 1953-54			1957-58 to 1958-59			1961-62 to 1962-73		
	Income (Crs.)	Tax burden (Rs. crs.)	Tax burden as % of income	Income (crs.)	Tax burden (Rs. crs.)	Tax burden as % of income	Income (crs.)	Tax burden (Rs. crs.)	Tax burden as % of income
	1	2	3	4	5	6	7	8	9
<u>FARM SECTOR</u>									
3000 and less	3676	49.08	1.3	4464	72.74	1.6	5328	87.42	1.6
3001 - 25000	1496	20.49	1.4	1424	24.42	1.7	1785	30.74	1.7
25000 and above	106	4.67	4.4	120	8.92	7.4	145	10.52	7.3
Total :	5278	74.24	1.4	6008	106.08	1.7	7258	128.68	1.8
<u>NON-FARM SECTOR</u>									
3000 and less	2890	-	-	3785	-	-	4476	-	-
3001 - 25000	1461	27.52	1.9	1753	33.65	1.9	2311	46.40	2.0
25000 and above	506	94.38	18.7	467	123.01	26.3	839	152.73	18.2
Total :	4857	121.90	2.5	6005	156.66	2.6	7626	199.13	2.6

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Source : S.L. Shetty, Economic and Political Weekly, Dec. 1971, Review of Agriculture, Vol. 6.2

paid only 10 per cent. Percentage of households under this income group in the agricultural sector was 0.08 per cent and the non-agricultural sector 0.9 per cent approximately and their share in the sectoral income was 2.0 per cent and 10 per cent respectively.

As noted by Shetty, this disparity is of limited significance from the point of view of revenue potential because of negligible proportion of households and the negligible proportion of income accruing to these households (2.0 per cent approximately) in this income group in the farm sector. Therefore, if this income group is eliminated from the picture because of its insignificant size, it cannot be said that the intersectoral inequity is in favour of the agricultural sector. Shetty is of the view that "since the top income group is almost non-existent in the farm sector and misleading to include the top-income group in working out the average incidence in the two sectors. If this elimination process is adopted, empirical evidence casts serious doubt on the thesis of undertaxation of the farm sector".²⁵

From the studies considered above, it is difficult to say with conviction that the agricultural sector is over-taxed/undertaxed because of two reasons. Firstly, most of these are mere intersectoral analysis and the dubious nature of the concept of 'intersectoral equity' has already been examined in Chapter 1. Secondly, the estimation of taxable 'capacity' and tax 'burden' of sectors present substantial

difficulties and these are "much more than statistical",²⁶ although statistical difficulties are quite serious. This results in the seeping of the element of subjectivity into the analysis. But the studies of Gulati and Shetty-II are exceptions. As they have conducted an intraclass intersectoral analysis, one can say with a degree of certainty that a particular section of the agriculturists is overtaxed/undertaxed. Studies of these types should be conducted with much more detail so that it can be known, with some precision, the degree of overtaxation/undertaxation.

CHAPTER II

Notes and References

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CHAPTER III

ALTERNATIVE REFORM PROPOSALS

From the studies of Gulati and Shetty-II it is observed that within the agricultural sector, the lower income groups are relatively overtaxed as compared to the upper income groups. The reason behind this lies in the type of direct tax system imposed on the sector, which mainly consists of land revenue. Few States also levy agricultural income tax. Land revenue is basically a land tax levied per unit of land which means that it is a tax proportional to acreage. Being a proportional to acreage tax, it tends to be regressive to income in nature. Apart from this defect which arises from the structure of the tax, it is inequitable on similar income groups within the sector for the reason that different States have adopted different bases for assessment of land revenue. As these assessments have been rarely revised as scheduled, and if revised, have been done haphazardly, it has further increased the inequity. Apart from this intra-sectoral interclass and intra-sectoral intraclass inequity, the land revenue system is inequitable inter-soilwise. Studies conducted by C.H.H. Rao,¹ P.C. Jain² and D.N. Dwivedi³ have shown that the burden of land revenue is greater on less fertile lands than^{on} fertile lands and on unirrigated lands than on irrigated lands. Lastly, it is alleged that the land revenue system has not been able to tap increased taxable

capacity which has resulted from higher prices and Green Revolution. In order to remove these defects and to make the tax system more equitable, various recommendations have come forth, which are dealt below. Recommendations made by different authors in order to improve the present direct tax system relating to Indian agriculture can be classified into three groups according to their nature. They are as follows:

1. Proposals for changes in the rates of present direct tax system;
2. Proposals for wholly substituting land revenue by agricultural income tax or vice-versa; and
3. Proposals for imposing an altogether new type of direct tax in place of the existing ones.

We shall deal with each of these one by one.

Changes in the Rates of Present Direct Tax System

Among the direct taxes levied on Indian agriculture, the most significant tax is the land revenue, followed by agricultural income tax. The significance of land revenue is proved by its proportion in the total direct taxes imposed on the farmers - land revenue forms approximately 75 per cent of the burden in the States levying both land revenue and agricultural income-tax, and in the States which levy only land revenue, it is almost 100 per cent. Surcharges and other levies account for a negligible proportion. Since

the land revenue is a proportional ^{to acreage} tax, it falls heavily on the low income groups, implying that it is regressive in nature. Also, being fixed in amount, it is unable to tax increases in taxable capacity, in other words, it is rigid in nature.

Keeping in view these structural limitations Groves and Madhavan⁴ made the following suggestions in order to tap more resources from the agricultural sector for the sake of financing the Third Plan:

1. The existing land revenue rates should be increased by 10-30 per cent depending upon the last revenue settlement in order to standardize land revenue rates and to tax the increased taxable capacity which, according to the authors, is the result of increased prices of agricultural produce.

2. Land revenue rates should be doubled for land under commercial crops so as to maintain a firm relationship between agricultural income and land revenue rates. The authors seem to point out that land revenue should be related to productivity of land with reference to crops. It should not be a tax in rem as the land revenue presently is.

3. Surcharge at the rate of half rupee per acre should be imposed on landholding exceeding 10 acres. While recommending this, the authors seem to have in mind the illegal leases to tenants without security of tenure by the large landholders. But how will this problem be solved by

imposing half rupee surcharge is nowhere explained.

4. The authors did not think it worthwhile to suggest changes in the rates of agricultural income tax because of its limited usefulness in the situation in which the authors put forth their suggestions. But, they suggested that the agricultural income tax should be merged with the central income tax.

The authors felt that the arguments of equity are not applicable to all places at all times. In fact, the principle of equity should be sidetracked for this will make available the much-needed savings for development. Despite this feeling, it can be observed from the suggestions put forth that the authors very much had in mind the principle of equity, especially when they suggest doubling of land revenue for land under commercial crops. The authors seem to adhere to intra-sectoral equity but they do not mind sidetracking the principle of intersectoral equity. This is clear when they suggest that it is quite appropriate to tax the agriculturists heavily and divert a part of their income to the Government for effective and reproductive use as it was observed that the agriculturists generally went in for conspicuous consumption. According to the authors' estimates implementation of the above suggestions will bring in additional revenue amounting to Rs. 200 crores.

In the following year, i.e., in 1963, A.M. Khusro⁵ put forth his proposal so as to accomplish two equally

important objectives--mobilizing additional resources and bringing about an improvement in the existing land revenue system. He seemed to be convinced that the taxable capacity of the agricultural sector has increased and therefore suggested an increase in tax burden on the sector on the ground of revenue mobilization, intrasectoral and intersectoral equity.

Before giving the suggestions, Khusro has made an attempt to clarify certain misconceptions. It is firmly believed that land revenue is regressive in nature because it is a proportional tax--tax per unit of land. In a study conducted by Khusro himself, it was found that farm business income per acre to be a decreasing function of acreage, where farm business income is net profits plus all accruals to farmers as a return to family labour, bullocks, other equipment owned and rental values of land owned. And since farm business income is a decreasing function of acreage, land revenue becomes a mildly progressive tax. Khusro has selected farm business income to calculate the burden of tax because neither gross value of output nor net profits can be easily and more or less accurately calculated in the Indian conditions which makes these concepts not very illuminating. Land revenue as percentage of farm business income will no doubt rise with rise in farm business income, precisely because farm business income does not exclude the imputed cost of family labour, which forms a high proportion on small farms

and almost negligible on big farms. Accepting a concept such as farms business income as tax base seems to be improper as it does not exclude imputed cost of family labour. In such a case, value of family labour is considered to be zero (because it is not a paid-out cost) which is an injustice done to the small land owners.

A three-tier land revenue system was suggested by Khusro keeping in view that land should be the main basis of tax in order to prevent evasion; there should be a noticeable degree of progression; the tax system should be as simple as possible; and the tax system should make avoidance impossible or at least difficult through sub-division of landholdings. Land revenue has been favoured to agricultural income tax because, firstly, land revenue is difficult to evade as it is obviously visible and secondly, since the marginal rate of taxation is zero, it encourages increases in productivity. The three-tier land revenue system suggested is as follows:

1. 0-5 acres size group will continue to pay the then existing land revenue which is Rs. 3/acre on an average. Enhancement of rates in this land bracket is not desirable, as some recent studies have revealed that landholdings below five acres do not fulfil the norms of efficiency and surplus generation.

2. On the size group 5-10 acres land revenue at the rate of Rs. 5 an acre should be imposed. It is proved to be

an economic holding and it is observed that some marketed surplus also emerges from this land bracket. Also, Khusro has pointed out that the new land revenue rates are not so high as compared to the old ones to encourage subdivision of holdings, and if at all this phenomenon occurs, transfer duties and registration fees, etc., can be imposed in order to discourage subdivision.

3. On holdings above 10 acres, land revenue at the rate of Rs. 10 an acre should be imposed.

Implementation of this three-tier system was expected to raise resources amounting to Rs. 300 crores instead of the present Rs. 100 crores.

Khusro seems to be aware of the objection which can be taken to levying land revenue on the small income farmers whose counterparts in the non-agricultural sector are exempted from direct taxation. But Khusro is of the view that these objections can be met when the following are taken into account: (a) the differences in the burden of indirect taxes on the agricultural and non-agricultural sectors; (b) differences in the cost of living on the two sectors; and (c) possibility of enhanced taxation of non-agricultural incomes, both through higher rates and lower exemption limits.

But objection can be taken to these points also. The objection to point (a) is that the unique relationship which exists between direct taxes and taxable capacity need not exist in the case of indirect taxes and taxable capacity. On this ground, it does not seem to be fair to burden the low-

income groups of the agricultural sector with direct taxes. Secondly, the generally accepted proposition that cost of living is low in the rural areas is not always correct. Food items are no doubt cheaper, but all the manufactured items, education, health facilities, etc., are expensive because of the transport costs involved.

Later, in 1967, Khusro⁶ again put forth his suggestion for bringing about progression in the land revenue. This suggestion is an improvement over the previous one just discussed in which, apart from suggesting land revenue rates different from the previous one, for different land brackets the increases in resources raised if these suggestions are implemented are estimated for States of Punjab, Bombay (Maharashtra), Andhra Pradesh and Uttar Pradesh. These estimates are then compared with the existing collections.

The suggestion made is that the state governments should adopt the following land revenue rates with suitable adjustments for special circumstances:

1. The existing land revenue rates should be halved on the landholding size below certain limits, say five unirrigated (standardized) acres thereby benefiting a substantial proportion of landholders.

2. Landholdings above the minimum landholding size should be divided into not more than three to four land slabs so that there is simplicity in administration and is easier to understand. The rates are as follows :

- (a) Holdings between 5 - 7.5 acres--existing plus 25 per cent of the existing land revenue per acre.
- (b) Holdings between 7.5 - 10 acres--existing plus 33.3 per cent of existing land revenue per acre.
- (c) Holdings between 10 and above--existing plus 50 per cent of existing land revenue per acre.

Khusro has claimed the economic and political feasibility of these percentages shown in Table 3.1.

Prior to Khusro, I.M.D. Little⁷ had suggested a progressive structure of land revenue with 27 land brackets. The lowest bracket of land size 0-5 acres was exempted from the tax and the highest bracket of 30 acres and above was to pay about Rs.450 per year instead of the then current of Rs. 90 per year. Khusro has expressed the fear that such a sharp increase in tax amount for holdings above 30 acres would encourage bogus sub-division of holdings in order to avoid the tax. But such a fear can be removed, if as Little has suggested, a law could be enacted to prevent such malafide transactions by risking the ownership rights thereby preventing tax evasion. Little has further pointed out that the highest marginal rate of tax should be such that, on the one hand, it should be unattractive to hold such large holdings and, on the other hand, it should be difficult for the landholder to work without loss.

Table 3.1 : Existing and Proposed Land Revenue Collections in Selected States

States	Size group	Net sown area in '000 acres	% of area	% of land-owning households	Existing land revenue rates per acre (Rs.)	Proposed land revenue rates per acre (Rs.)	Total collection by land revenue at existing rates (Rs. lakhs)	Total land revenue proposed (Rs. lakhs)	% change in revenue over existing receipts
Andhra Pradesh	0 - 5	3,272	11.64	53.7	11.45	5.72	375	187	
	5 - 7.5	2,090	7.44	18.3	9.35	11.69	195	244	
	7.5 - 10	2,021	7.19		8.95	12.07	181	244	
	10 and above	20,722	73.73	28.0	9.19	13.66	1,904	2,831	
		28,105	100.00	100.0			2,655	3,506	32.05
Bombay (Maharashtra) and Gujarat	0 - 5	1,169	1.74	46.7	1.72	0.86	20	10	
	5 - 7.5	1,312	1.95	19.7	1.13	1.41	15	18	
	7.5 - 10	2,797	4.16		1.04	1.42	29	40	
	10 and above	61,945	92.15	33.6	0.65	1.17	403	725	
		67,223	100.00	100.0			467	793	69.81
Punjab	0 - 5	247	1.37		2.10	1.05	5	3	
	5 - 7.5	830	4.58	83.9	2.09	2.61	17	22	
	7.5 - 10	1,087	6.01		1.94	2.64	21	29	
	10 and above	15,943	88.04	16.1	1.29	2.26	206	360	
		18,107	100.00	100.0			294	414	66.27
Uttar Pradesh	0 - 5	3,262	7.80	85.4	8.92	4.46	291	145	
	5 - 7.5	4,453	10.65		8.21	10.26	366	457	
	7.5 - 10	7,151	17.10	9.7	8.52	11.26	609	805	
	10 and above	26,949	64.45	4.9	7.92	12.18	2,134	3,282	
		41,815	100.00	100.0			3,400	4,689	39.91

Source : A.M. Khusro, "Should Land Revenue Be Abolished? Feasible Alternative with Progression in Levy", Economic Times, 17 June 1967

Also Khusro's allegation that this scheme is unreal as the tax had little relation with the income derived from land is not quite appropriate because the basis of the tax as suggested by Little is "standard acre". Little has defined the value of standard acre as the total value of all holdings divided by total number of actual acres. Putting it in quantitative terms,

$$\text{Value of S.A.} = \frac{\sum_{i=1}^n V_i}{\sum_{i=1}^n A_i}$$

where, V = value of the acre;

A = acre;

S.A. = standard acre.

The value of a standard acre is to be derived taking into consideration the total number of acres and their respective values in a given district/state/economy. After deriving the value of a standard acre, the actual acres have to be converted into standard acres, which is done by dividing the market value of an actual acre by the value of the standard acre. Thus, one actual acre can be equivalent to five standard acres and vice versa. It all depends on the value of actual holdings which in itself depends upon the income-generating capacity of the land. But the problem here is of ascertaining land values, which depend upon multifarious factors, and then finding out a 'standard acre' in a vast country such as India. Such a method is beset with numerous

practical difficulties which makes the scheme unreal. At least in principle, it is not a pure acreage tax as Khusro thinks it to be.

K.N. Raj⁸ also had suggested a scheme in order to enhance the burden of direct taxes on Indian agriculture. The following were his proposals:

1. On holdings above five acres the present land revenue should be doubled.
2. Imposition of tax on agricultural rent which is to be deducted at source so that the incidence would fall on rent.
3. Imposition of surcharge on holdings above five acres under commercial crops.

According to Khusro, the first proposal of doubling the land revenue for holdings above five acres is good from the point of view of resource mobilization but lacks progressivity. The second proposal is administratively less feasible as there is lot of camouflaging of agricultural rents. Regarding the third proposal of surcharge on commercial crops, Khusro has commented that it will require a great deal of administrative machinery.

In short, the land revenue system as suggested by Khusro is, as he seems to claim, better than the ones suggested by I.M.D. Little and K.N. Raj in the following:
(1) it is administratively simple to implement in contrast

with Little's 27-bracket scheme; (2) it is progressive in contrast to K.N.Raj's scheme; (3) the degree of progressivity is not so high as to induce sub-division of holdings; and (4) being a tax in rem it cannot be avoided which is likely to happen in the case of a tax on agricultural rent as suggested by K.N.Raj.

The land revenue system as suggested by Khusro will no doubt mobilize greater (than current) amount of resources and introduce intersectoral and intrasectoral equity, which were put forth as reasons for enhanced land taxation by the author himself. There is little to comment on the resource mobilization and intrasectoral interclass equity in the tax burden as this system has some degree of progression. As regards intersectoral intraclass equity in tax burden, nothing can be said as Khusro has not tried to compare the relative tax burden in the different sectors. If the assumption that the agricultural sector is undertaxed as compared to the non-agricultural sector is proved to be correct, implementation of this land revenue system will surely be a step towards equalization of tax burdens on the two sectors.

I.S. Gulati⁹ too had suggested a progressive rate schedule of land revenue which would have brought an additional revenue of Rs.61 crores. He emphasized that it is essential to bring the similar income groups under the two sectors on par with each other as regards tax burden, but one should also remember that the high rates were not imposed on

the non-agricultural sector all of a sudden, but have evolved gradually. In such a case, Gulati has pointed out, that "it won't be prudent to think in terms of immediate equality. (Therefore), for the Third Plan period, a much more modest target will have to be adopted, though the direction in which the things ought to move is clearly indicated."¹⁰

All the above proposals, from the viewpoint of mobilizing additional resources automatically as a result of increase in taxable capacity of the farmers over a period of time, do not seem to be appropriate. Taxable capacity can change due to technological and/or economic reasons over a period of time. Any changes in the rates of the present land revenue system made in order to observe both the principles of intrasectoral and intersectoral equity in tax burdens will be workable only for a certain period of time. Over a period of time, with changes taking place in the taxable capacity, the proposals made above are bound to become outdated as the existing land revenue system has become presently.¹¹ All the same, change in the rates of land revenue as a short term measure is very appropriate while, in the meantime, a new tax system which will suit the circumstances for a considerable period of time, is under construction.

Land Revenue vs. Agricultural Income Tax

The present direct tax system on Indian agriculture mainly consists of land revenue and agricultural income tax. Authors are of the opinion that one of the either has to be

removed from the picture in order to make the tax system consistent. Opinions differ as to which of the two taxes, land revenue and agricultural income tax, should be retained abolishing the other. We shall examine the arguments put in favour of both land revenue and agricultural income tax.

The object of taxation under land revenue is the land which makes it a fundamentally land tax. The rate of tax is fixed by taking into consideration the potential productivity of land which is usually decided by taking into consideration the average produce per acre over the past few years. The tax rate is fixed for a certain period of time, say for 15-40 years as was done with the Ryotwari and Mahalwari land revenue settlements in India. The tax is levied at a flat rate per unit of land which makes the tax a proportional tax. Being a proportional (to acreage) tax it falls heavily on the low income groups violating the principle of vertical equity. In other words, it can be said that the tax is regressive. Also, being levied at a flat rate it does not vary with the produce. Especially in times of bad crops and low prices it is harsh on the farmers. In other words, the tax system lacks elasticity¹² or is rigid in nature.

In addition to these structural defects, the land revenue system in India lacks uniformity due to historical reasons. Land revenue settlements of the three types-- zamindari, Mahalwari and Ryotwari, were done at different times in British India. Under Mahalwari and Ryotwari system,

land revenue rates were fixed only after carrying out detailed field surveys and soil classification, so that land revenue rates bore some relationship with the productivity of the soil. But such a detailed soil-classification was not undertaken in the zamindari system, the oldest of the three. Revision of tax rates after the settlement period was over, was done at different times. For the past decade or two, hardly any revisions have been made by the States. So, although in some areas land revenue was originally fixed according to the productivity of the soil, it has lost much of its validity. In short, it can be said that the system has become outdated. All this has resulted in inequitous burden of land revenue in the sector.

Measures adopted in order to correct the deficiencies of land revenue system, viz., outdatedness, regressivity and rigidity, have further increased the inequity within the sector. Several states have imposed progressive surcharge on land revenue and additional cesses in areas under selected crops in order to update the system and introduce progressivity, but it is observed that these attempts have not served the purpose. Crops covered by cesses are rarely comprehensive enough and secondly, productivity of land under such crops has not been taken into consideration while determining the rate of levy. The most serious objection taken against using land revenue as the basis for surcharge for introducing progression is the different principles and procedures

followed in different states and in different areas within the same state to fix the rate. This has resulted in vast inter-regional and inter-State differences in land revenue as a percentage of income from agriculture, which is wholly inequitable. Surcharge based on such land revenue (which is already inequitable) will only aggravate the already existing inequity.

It is because of these deficiencies, i.e., rigidity, regressivity and outdatedness, imposition of income tax on the produce from the agricultural sector has considerably appealed to many authors. As the income tax is levied on realized income and not potential income, multifarious factors which affect productivity of land and income--all of which cannot be taken into consideration therefore posing a difficulty in determining an equitable rate of land revenue throughout the country--will indirectly be taken into consideration which will introduce equity as between different soil-climatic-conditions tracts and crops having different prices. Also the rates of income-tax applicable to different levels of income will introduce the necessary degree of progression and will take care of the problem of vertical equity. Since the income-tax has flexibility, increases in taxable capacity over a period of time will be duly tapped. It can be said that there is no better way of making the entire direct tax system equitable.

If income-tax on agriculture scores on equity front, it is believed to fail from the point of view of optimal use of land. As pointed out by Gulati and Kothari,¹³ land revenue is absolutely superior to agricultural income-tax from the point of view of ensuring efficient use of land and that is what is required in a developing country like India. The reason for this superiority lies in the fact that land revenue is based on potential productivity whereas income tax is based on realised income. Since land revenue is based on potential production, any increase in production as a result of improved efficiency on the part of the farmer, will be retained by the farmer himself and will not be subject to tax. Also, since it is a fixed charge per unit of land, it will fall heavily on relatively less efficient farmers. Therefore, the land tax will induce (or compel) the farmers to improve their efficiency. Such an inducement will not be provided by the agricultural income tax which taxes realised income thereby taxing the efforts of the farmer.

The superiority of land revenue over agricultural income tax proves to be correct only under certain conditions. As observed by the authors¹⁴ themselves, when a tax on potential productivity such as land revenue is advocated, it is implicitly assumed that all farmers have equal access to the capital market. If there exists an imperfect capital market (which is true in the case of India), even an otherwise efficient cultivator may fail to realise full productivity of

land. In such a case, the land revenue system will end up as highly oppressive system and "the Ricardian zest for taxing economic rent might actually lead us into taxing labour."¹⁵ The authors also seem to realise that "there is nothing in the mechanism to compel to do better or to turn over their lands to more efficient cultivators. They may simply accept reduction in income as a result of land tax."¹⁶ As the authors seemed to have realized the inability of land revenue to induce the farmer to increase efficiency and production, they have expressed the view that "it would be different were it possible to devise a tax that is assessed and perhaps progressively directly on non-use or inefficient use of land".¹⁷

Ved Gandhi¹⁸ has observed that the argument, that a tax on agricultural income would act as disincentive to agricultural production, is weak. He has pointed out that the effects of progressive income-tax on production cannot be specifically identified, even in theory. To what extent would a tax on agricultural income will have disincentive effects will depend upon the relative strengths of the 'substitution' and 'income' effects of higher taxation. Gandhi has further pointed out that it is quite possible that an income-tax on agriculture might motivate the farmers to adopt 'new technology' and encourage the farmers to increase production if there is a 'slack' existing in agriculture. In what way will it motivate is nowhere explained by the author.

In a situation where otherwise efficient farmers are not able to increase their productivity because of imperfect capital market, or the land revenue is incapable of inducing inefficient farmers to become more efficient, agricultural income-tax proves to be superior to land revenue. For although the farmers with greater efficiency are taxed more, the inefficient farmers are not penalized for circumstances not under their control. It can be said that at least in principle, agricultural income-tax fares better than land revenue with reference to taking an account of diverse situations--in terms of human capacity and production conditions along with equity considerations.

Presently, agricultural income-tax is levied only in some States, those are Assam, Bihar, Karnataka, Kerala, Maharashtra, Orissa, Tamilnadu, Tripura and West Bengal and Bhopal. Each of the States have different exemption limits ranging from Rs. 3,000 to Rs. 36,000 per year. This has created inter-State inequity in tax burden. In order to eradicate this inter-State inequity it has been suggested to extend the Central Income Tax to the agricultural sector. The benefits of bringing taxation of agricultural incomes within the purview of Central Income Tax, as enumerated by Ved Gandhi are as follows. Firstly, such an extension would increase tax revenue of the Government by reducing the scope for tax-avoidance which is done by splitting the incomes as agricultural and non-agricultural. Such a splitting is because

the present tax system accords different treatment to the two types of income. Secondly, extension of Central Income-tax will introduce uniformity in the tax rates throughout the country as the States levying agricultural income tax have different exemption limits and rate schedules. Also, the States which do not levy agricultural income-tax will come under the purview, thereby increasing the tax yield and introducing equity in the system. Thirdly, in the interest of balanced economic development, a unified income-tax structure may regulate intersectoral flow of resources. Fourthly, it will help to arrest inflationary tendencies in the economy to some extent as high agricultural incomes, which presently go untaxed, will be taxed. And lastly, there would be some sort of fiscal balance between Government's expenditure on and revenues from agricultural sector. Against the above-mentioned benefits, the costs of extension of Central Income-tax to agricultural incomes, as foreseen by Gandhi, seem to be mainly of administrative and legislative in character, which can be overcome.

Apart from overcoming administrative and legislative hurdles, there are formidable difficulties which have to be encountered while assessing agricultural income itself, which arise from the nature of agricultural operations. Experience shows extensive evasion of tax wherever it has been administered. This has been the experience of an advanced country like U.S.A. with relatively high degree of literacy and admini-

strative efficiency. In India, in the States where agricultural income-tax is levied, the revenue from this tax is negligible not because of the incomes above the exemption limits are negligible, but as pointed out by K.N. Raj,¹⁹ because of the difficulties encountered in actual administration of the tax. In the case of plantations, continuous losses are shown in the accounts along with growth in acreage and output. But, as pointed out by K.N. Raj, "the internal inconsistency of the phenomena cannot by itself be a valid legal ground for questioning the correctness of the accounts, since there is no law in the country which lays down that only enterprises in the public sector can show continuous losses and still insist on expanding their operations".²⁰ In India, lack of proper accounts maintained by the farmers pose a major problem in assessing agricultural income. With various systems of landholding and tenancy locating the assessee further increases the problem. Y.K. Alagh²¹ has suggested the presumptive method for estimating agricultural income, already in operation in this country for assessing land revenue. But as Mahesh Bhatt²² has pointed out that if agricultural income is assessed on a presumptive basis, much of the superiority of agricultural income tax with respect to equity considerations is lost. With respect to administrative ease, land revenue stands superior to agricultural income-tax. As land is the object of taxation under land revenue, locating the assessee is not difficult and since the tax rate is fixed for

a certain period of time, it facilitates prompt and convenient collection.

To conclude, in principle, land revenue is superior to agricultural income-tax from the point of view of providing inducement to increase production and on the other hand, agricultural income-tax is better than land revenue by equity considerations. In practice, due to the way they are operated at present both the taxes are unable to fulfil their aims. The policy-maker in such a case faces a dilemma of choice. Nevertheless, his choice is certainly going to be affected by other factors such as existing level of taxation in the economy, political sanction, administrative costs, etc..

Alternative to the Existing Direct Tax System

Despite the considerable appeal for extending income-tax to agriculture, most of the authors have recognized the need for an alternative method of direct taxation of agriculture, especially in countries where agricultural output forms a high proportion of national income. The common features of the alternatives suggested are: (1) that the tax should be based on potential productivity of land and (2) it should have a progressive rate structure. Such a tax system will tax non-use of land, because it will basically be a land tax linked to productivity and that too at a progressive rate--a tax system visualized by Gulati and Kothari. Such a tax is Agricultural Holdings Tax (=AHT) which has been devised by the Raj Committee.²³ We shall examine AHT in the

following.

AHT can be said to be a refined and a detailed version of tax formulated by T.M. Joshi²⁴ and his collaborators. Also, Raj Krishna²⁵ put forth a tax-reform proposal which is quite akin to the AHT. The designers of AHT have made an attempt to introduce uniformity, progressivity and flexibility, which are absent in the existing land revenue system. The main features of AHT, in brief, are as follows:

1. AHT is basically a tax on land to be levied on aggregate rateable value (ARV) of each holding, although the name suggests it to be a 'holdings' tax.
2. The basis of tax is an 'operational' holding, which is owned land plus leased in land minus leased out land and the tax paying entity is the 'nuclear' family consisting of husband, wife and minor children.
3. The ARV of the operational holding is the sum of rateable value per hectare of land comprised in the holding. A schedule of rateable value per hectare of land would be made for the principal crops grown in different areas which is to be derived from the norms of output, prices and costs fixed on the basis of average of past years. In order to take account of factors having significant influence on prices, costs and output, the country would be divided into sufficiently large number of soil-climatic homogeneous districts/tracts. Norms of output would be worked out for every

district/tract on the basis of the yield for the previous 10 years, valued at the harvest prices of preceding 3 years. In this manner we get the gross value of output. From this gross value of output 40 per cent would be deducted as cultivation costs, considering irrigation costs separately. Doing so, we get the 'net value of output' or 'rateable value of land' per hectare, which would be revised every year for crops/crop group.

4. The rateable value of each holding would be assessed annually on the basis of the schedule of rateable value of land per hectare for different crops grown in the area in which the lands of the holding in question are located, after taking into consideration the crops actually harvested on the land under the holding.

5. AHT would be levied on ARV of operational holding of a family. The rate of AHT is determined with the help of the formula - if rateable value of an operational holding is 'X' thousand rupees then the rate of AHT is $X/2$ per cent of this amount.

6. The AHT would be levied on ARV after deducting 20 per cent as development allowance subject to the maximum of Rs. 1,000.

7. Trusts having operational holdings would be liable to pay AHT, but whose beneficiaries are unknown, it would be required to pay AHT at the rate of 20 per cent of ARV of their

holdings. Companies also would have to pay AHT at the minimum rate of 20 per cent.

8. The Raj Committee suggested setting up of a standing All-India Committee on AHT consisting of experts and experienced administrators in order to ensure uniform and objective application of AHT all over the country.

9. The taxpayers would be given an opportunity to challenge the correctness of the computation of the tax liability and the cropping pattern recorded for his holding. But the taxpayer cannot challenge the schedule of rateable value of land determined for his district/tract. Relief would be allowed in case of crop failures in a district/tract only after inquiry by appropriate authorities.

In short, the Committee has attempted (1) standardization of production conditions to attain horizontal equity by standardizing intersoil and intercrop differences; (2) tapping increases in taxable capacity over a period of time; and (3) introduction of progressive rate structure so as to attain vertical equity as it is in the other sectors of the economy. Apart from equity considerations, the Committee has stressed the need for direct taxation of agricultural income and wealth in order to reduce economic disparities and promote more efficient use of land. In the following we shall try to review the critical evaluation of AHT as done by different authors.

Raj Committee has made the nuclear family consisting of husband, wife and minor children as the tax paying entity. The justification given by the Committee is that income from given production activity is not liable to tax but income from all sources, which accrues to the individual as a recipient of income, is taxed. The Committee states that "family and not the individual earner is the recipient of income from all sources. ... The family is the unit of income receipt, of consumption and all related decision-making. This consideration applies both to the non-agricultural and agricultural sectors."²⁶ Gulati also in his proposal to mobilize additional resources for the Third Plan, suggested 'household' as the taxable unit in order to prevent division of holdings within a family to reduce tax liability. But a precise definition of the 'household' was not given by the author.

Objection has been raised by E.T. Mathew²⁷ on the Committee's recommendation of family as a tax-paying unit. He has pointed out that adoption of family as a taxpaying unit cannot be justified on any grounds except for the reason that the ceiling has been applied to family holdings. Mathew has contended that "if on equity grounds family is adopted as the taxpaying unit, on the same grounds, differences in family size should be given due consideration".²⁸ Mathew has tried to focus on the problem of equity as between the families in the two sectors. But suppose this is removed, still the problem of individual versus family as a unit of assessment

has to be faced. The Committee has made a note of the fact that the idea of pooling husband and wife's income for the purposes of taxation has been rejected for such a "pooling would cause hardship to lower and middle class families where women take up employment out of sheer necessity".²⁹ But the Committee has pointed out that if individual is made the tax-paying unit in the agricultural sector, income would be split up as between husband and wife, and the "incomes of a large percentage of even the better off farmers will, after the imposition of ceiling on landholdings, correspond only to the so-called middle classes in the urban areas and there would be no justification for inflicting similar hardship on them".³⁰ From this it seems that the Committee has sidetracked the principle of equity for the sake of raising more resources.

If family is made the taxpaying unit, it has been pointed out that it will encourage divorces in order to avoid the tax liability. According to Lall and Mittal,³¹ "in India, people have developed a way of living wherein divorces and separation are not recognized as healthy. Then why separate them fiscally?" Raj Committee has made a note of this fear, but has remarked that such fears are exaggerated to high proportions. It is difficult to believe that a family--a sacred institution preserved against all odds and at all costs--will break up merely to avoid tax.

Secondly, Raj Committee has proposed "operational holding, not ownership holding as the basis of tax. Operational is defined as owned land plus leased-in land minus leased-out land. The Committee has justified operational holding on the ground that ceiling on land holdings are on the area owned by the family and not on the area on which a family may operate. Thus, income from agriculture, i.e., from operational holding will not necessarily be limited by the lower ceilings on owned holdings. Furthermore, technological improvement including extension of irrigation shall increase productivity of land and hence income, over a period of time. Adoption of 'operational' holding as the basis of assessment has been severely criticized by C.H. Hanumantha Rao.³² Operational holding leaves out rental incomes of the landowners from the purview of agricultural taxation. Since there is an even stronger case for taxing rental incomes than farm business incomes, acceptance of Committee's recommendation in this respect would "introduce fresh element of inequity and in fact-perversity"³³ in the direct tax system. This can be remedied by adding the (legal) rent on the leased out land to, and subtracting the (legal) rent on leased in land from the rateable value of the operational holding. But Rao's suggestion is to include rateable value of owned land leased out as the part of the operational holding for assessment of AHT. Because, if instead of rateable value of owned land leased out, legal rents on this land were taken into account, an

inducement is provided to create fictitious though legally registered leases. This would happen because tenancy legislation in India stipulates maximum rents to be received and not minimum rents which would enable the landowners to report nominal rents received from their tenants, as the actual rent (or the market rent) received is much higher than the legally stipulated rents.

Further, the Committee states that adoption of operational holding will discourage illegal or concealed leases. This argument seems to be quite true for one side's gain will be other side's loss. The owner leasing out land will be the gainer and obviously he would have no incentive to get his lease registered. But the tenant who leases-in would be the loser as he has to pay rent. According to Rao, it is difficult to believe that adoption of operational holding will discourage concealed leases. In the face of acute land hunger, there prevails severe competition among tenants to get land leased in and in such a situation, the tenant might agree to the conditions as laid down by the landowners. Also, by getting the leases registered the landowner runs the risk of losing ownership rights. All the same, the whole debate regarding operational holding protecting the rights of the tenants, does not seem to be a meaningful one because fiscal policy does not aim at protecting rights. It calls for a strong tenancy legislation, as pointed out by I.M.D. Little, fiscal policy can be just considered as supplementary.

With the acceptance of operational holding, as Rao has pointed out, 'small' landowner is likely to be exploited by the large operator, as the small landowners would have to accept the legally stipulated rent which is much lower than the free market rent. Such a thing cannot be avoided due to imperfect market conditions. Even without legislation the 'small' owner might have to accept lower rents because of his 'small' size, or, weaker position. This point is not of great importance, as pointed out by Sotthiyya,³⁴ because the proportion of small landowners leasing out land to large operators is almost negligible.

All the criticisms regarding rental incomes not covered by the proposed AHT have been accepted as valid criticisms by K.N. Raj³⁵ himself. Suggestions have been made in order to correct this deficiency, like making ownership holding as the basis for tax or apportioning the tax liability on operational holding between owners and tenants. K.N. Raj has pointed out that these solutions can be accepted with caution. The solutions have to be ensured that they do not either conflict with the concept of potential productivity crucial to the proposed tax or make the administration of the tax more complicated.

For a soil-climatically homogeneous district/tract, norms of output for different crops per hectare for each year would be worked out on the basis of the estimates of the yield for the previous 10 years. Again, Rao has pointed out that the Committee is aware of the technological progress which has taken place in the last 10 years resulting in in-

creased incomes of the farmers, they have been increasing upto this date with constant application of new and modified techniques and they are expected to rise in the future also. In such a case, Rao has pointed out that incomes of the large farmers would be understated because the normal performance in the current year will be much above the average of the past 10 years. Such a procedure would violate the objectives of equity and revenue as it would largely bypass the gains from increased productivity in a situation of rapid technological change. It is further pointed out that in any case the Committee proposes assessment to be made every year, instead, if current yields are made the basis they will fully represent good as well as bad years. Therefore, there is hardly any justification for 10 year period output norm. In terms of administration costs too, as Dantwala³⁶ has pointed out, these 'moving' averages of productivity of each crop and their prices will be too demanding. This, as Ved Gandhi³⁷ has commented, would have been acceptable if AHT was a complete break from the present land revenue system, which, it is believed, is not the case. Gandhi seems to consider AHT to be placing the existing land revenue system on a more systematic, scientific and rational plane. It might prove costly as it certainly requires more frequent 'resettlements'. Gandhi remarks that the only consolation from the added costs of resettlements is that given the Committee's revenue estimates, the benefit-cost ratio of AHT would be considerably favourable.

From the equity angle, several criticisms have been directed towards the Committee. The Committee had made it clear that equity in tax burden on comparable income groups as its primary objective. According to D.N. Dwivedi,³⁸ as the Committee has not made any attempt to compare the tax burdens on the comparable income groups in the two sectors, it did not find this exercise worthwhile, therefore, "what follows in the Report remains without any factual or empirical base (although theoretically sound) and is therefore nothing than beating around the bush in dark".³⁹

Rao has taken objection to the Committee's proposal that rateable values below Rs. 600 should pay Re. 1 as tax. This, according to Rao, is done because exempting low income groups in the agricultural sector would mean a sizable loss of revenue. Rao has pointed out that "the Committee allowed itself to be guided by the fiscal expedient and apparently considered it wiser to sacrifice this aspect of equity for the sake of revenue rather than vice versa".⁴⁰ The Committee is aware of the fact that some State Governments (on the grounds of equity), have either abolished land revenue or exempted small landowners from land revenue. Even then, the Committee finds it useful to levy Re. 1 tax on all holdings having ratable value below Rs. 600 as it would help maintaining up-to-date records which would help credit institutions associated with agricultural activity to provide financial help to such farmers. Also, as pointed out by

I.M.D. Little in a different context, the resultant inequity is unimportant with a tax of Re. 1 a year.

As regards the rate structure, there is absolutely no doubt about it being progressive. But the progression in the rate structure, as shown by J.F.J. Toye,⁴¹ is mild to bring the comparable income groups in the agricultural and non-agricultural sector on an equal basis. Toye has made a comparison of AHT and income tax payable by different taxable income groups/rateable value. Toye is aware that the taxable income of the non-agricultural sector and the rateable value of the agricultural sector are not comparable. The former is the realised income of the current year whereas the latter is the 'normal net output' estimated with the help of historic data. In a state of rising prices, the current output is likely to be much higher than the normal net output which will result in reduction in the burden of AHT thereby increasing the inequity as between comparable income groups. Also, the progression in the rate structure of AHT is milder as compared to the progression in the Income-tax rates. Toye has pointed out that "if equals are not being treated equally, the inequity involved is magnified the more progressive the tax is made"⁴² and the Committee is certainly aware of this point. This awareness is revealed by the Committee's objection to levying surcharges on the existing land revenue system.

Amaresh Bagchi,⁴³ while retaining its basic characteristics, has tried to simplify the AHT. While formulating the AHT, the State Governments were consulted, but it is observed that not a single State has adopted the AHT. Bagchi has pointed out the reasons for the States not adopting AHT, which arises from difficulties in respect of the following:

1. Preparing schedules for rateable value of land for each homogeneous tract separately for each major crop/crop group grown in the tract in question;
2. Yearly revision of schedules of rateable value;
3. Yearly assessment of each holding on the basis of crops grown every year; and
4. Determination of an operational holding.

Bagchi has tried to modify AHT from the viewpoint of overcoming the difficulties mentioned above. His modified version of AHT shall be discussed below.

Instead of 'operational' holding, Bagchi has opted for ownership holding. Bagchi has accepted that the argument--adoption of operational holding would bring out concealed leases--has some force, but it would be administratively cumbersome to maintain correct records and cross-check them. Besides, the rental incomes which were left out from the purview of taxation under AHT would be taken care of. The assessment and the rateable value would be assessed every 5 years. This would leave with the farmer any yearly increases

in production thereby providing an inducement to the farmers to increase production. This inducement can be further enhanced if rateable value of land in a particular district is determined by taking into consideration the average value of output of one or two crops commonly grown in the area, letting the farmer to go in for more remunerative crops without the fear of increased taxation. Bagchi has realized that this might result in all farmers going for remunerative crops and thereby creating an imbalance in agricultural production. On this point Bagchi has remarked that although the above argument has a grain of truth, at the same time, "it has to be borne in mind that not all social objectives can be achieved with only one instrument".⁴⁴ The remedy suggested is to adopt differential pricing policy.

The rateable value of land in a given district/tract would be determined on the basis of average output of past five years of only one or two crops commonly grown in the area valued at the average prices of past three to four years. The assessment would be made on gross value of output instead of value of output net of costs, because, as Bagchi has pointed out, "determination of costs in agriculture is notoriously difficult".⁴⁵ This would simplify administration but that it would provide inducement to the farmers to reduce costs is less admissible. Under AHT, the Committee has proposed to deduct 40-50 per cent as paid out costs. If the farmer can reduce costs till further, by increasing

efficiency, all the gain will be his; his tax liability will not increase.

Bagchi has conceded that since the assessment will be on gross value of output, enforcement of a tax schedule with high degree of progression will result in widespread evasion through splitting up of holdings, therefore, a schedule with a mild degree of progression is advisable. But Bagchi's fear seems to be irrational, because if nuclear family is made the taxpaying unit, there is hardly any scope for splitting of holdings.

In Bagchi's scheme, landholdings of the size 0 - 2.5 acres irrigated and 0 - 5 acres unirrigated are exempted from tax. Progressive rate schedule will apply to holdings of aggregate rateable value above Rs. 5,000. For holdings more than 2.5 acres irrigated and five acres unirrigated having ARV below Rs. 5,000, will pay tax at a flat rate of Rs.7/acre for unirrigated and Rs.10/acre for irrigated land. The rate of progression for ARV above Rs. 5,000 is as follows:

<u>ARV of holdings</u>	<u>Rate of tax</u>
On the first Rs. 5,000	2.5 %
On the next Rs. 5,000	5.0 %
On the next Rs. 5,000	8.0 %
On the rest	10.0 %

Plantations are to be left out of the purview of this tax, they would continue to be liable for income tax.

Bagchi had contended that an intersectoral comparison of tax burden is desirable, but such a straightforward compa-

rison has its own limitations because of differences in the basis of tax as well as the nature of tax.

Except for division of the country into soil-climatically homogeneous tracts in order to maintain intrasectoral intraclass equity, the rest of the scheme has been drastically simplified by Bagchi. The rate of progression in the tax schedule has been reduced to a great extent leaving the question of vertical equity unresolved at the expense of simplicity in the rate structure.

Toye seems to be doubtful whether the Committee's (also Bagchi's) procedure of deriving rateable value of dividing the country into soil-climatically homogeneous tracts will achieve the aim of treating equals equally. It is no doubt an improvement over the existing land revenue system. According to Toye, this procedure "tries" to secure as much horizontal equity as possible, without undertaking the individual assessment of gross agricultural revenue and costs--which if it were feasible, would dictate the replacement of an 'ideal land tax' by a normal 'agricultural income tax'. Toye contends that as long as it is accepted that agricultural income-tax is not administratively feasible, hardly any more can be done to improve horizontal equity of the AHT.

Another point of the Committee brought to notice by Toye is the incentive effect which this horizontal inequity stated above will have in order to raise the "standard of cultivation". In a paragraph, which is curious according

to Toye, the Committee states, "that as a matter of policy, we should expect the standards of cultivation in larger agricultural holdings to be above the average; if they are not, it would be right and proper to introduce into the fiscal measures of this kind the bias necessary to improve the standards of cultivation in larger holdings and to bring them at least on par with the average."⁴⁶ Toye has pointed out that this 'incentive' effect a tax like ART is supposed to have--that those who produce less than normal output, will start producing normal output after the imposition of tax, which will bring them on par with the other producers thereby washing out the horizontal inequity--is surrounded by ambiguities and confusions, which can be briefly stated as follows. Firstly, the term standard of cultivation is never defined. Secondly, in what manner the farmer will be motivated to produce more by levying a certain type of tax is also never clearly stated. In the third, it is considered that a tax on land provides an inducement to the farmer to produce more, so that he can reduce the proportionate burden of tax. Granted that everyone produces more, this will result in an increase in the rateable values in the following year. The question then is, as passed by Toye, "how long will the farmers continue to seek the ART tax advantage, when it becomes clear that they must redouble their efforts in each successive year to stay ahead of the game?"⁴⁷ Obviously, some kind of illusions have to be attributed to them. Again the question arises, - what kind of illusions? Fourthly, when it is considered that a

tax like AHT has incentive effect, it implies that it is a penalty on the farmers who fail to produce the normal output. Toye has pointed out (Gulati also had pointed out earlier) that a farmer may fail to achieve the normal output due to circumstances beyond his control, and not only due to laziness. Toye has brought to notice that the Committee does not seem to be aware of the fact that in India, only a certain section of the farmer class dominate the access to essential inputs such as credit, irrigation, fertilizers, etc., "at the expense of the mass of farmers".⁴⁸ In such a case, how far is it fair to levy a tax on presumptive basis which is supposed to have an inducement effect? Such a tax will be oppressive on the farmers who do not have access to credit, irrigation, and other essential factors.

The Committee has suggested partial integration of incomes from agricultural and non-agricultural activities in order to deal with the problem of camouflaging non-agricultural incomes as agricultural income. The partial integration would be done by placing the income from non-agricultural sector on top of income from agricultural sector. E.T. Mathew has criticized this integration by making a basic point that if income from agriculture can be computed for the purposes of partial integration, it can also be computed for the purposes of agricultural income tax. Granted that this scheme of partial integration is accepted, Ahmed Raza⁴⁹ has shown that this scheme, though well conceived, does not

suppress the temptation to camouflage non-agricultural incomes as gains from agriculture. To curb this temptation, an amendment in the scheme is necessary, so that the amount gained by the way of reduction in the income-tax liability is lost by way of AHT liability.

According to Ved Gandhi,⁵⁰ since the Committee is silent about the imposition of agricultural income-tax, it has the intention to impose agricultural income-tax along with AHT. In that case, it is not clear as to how agricultural income-tax will be integrated with AHT in order to yield a smooth progression in the direct tax system on Indian agriculture and how it would be compared with the burden of direct taxes on the non-agricultural sector. Firstly, Gandhi is wrong in presuming that the Committee is silent about the imposition of agricultural income-tax along with AHT; this is clear from the Committee's statement: "AHT should not be allowed as deductible expenditure while computing agricultural income."⁵¹ But as to how the combination of two will yield a smooth progression comparable to that in the non-agricultural sector is a question which remains unresolved.

In order to tax agricultural wealth and capital gains which are not at all accounted for under AHT or agricultural income-tax, the Committee proposes a wealth tax and a capital gains tax. Wealth-tax should be levied on a family basis with the basic exemption limit of Rs. 1.5 lakhs. The Committee is of the view that all other exemptions should be abolished

as far as possible; with such a high exemption limit only few agricultural families will be required to pay wealth tax thus reducing a good deal of administrative work. Value of shares, with their market worth rigorously determined should be considered as taxable wealth. Farm lands, for the purpose of wealth tax should be valued by the method of income capitalization. The Committee has suggested a simple method of valuation, i.e., "to take four to six times of the rateable value of a holding averaged over a period of years". The Committee has proposed to widen the definition of capital asset so that taxation of capital gains is possible from transfer of all agricultural lands irrespective of their location. Since the capital gains cannot be taxed until the asset is sold, the Committee has suggested that other alternatives have to be searched in order to regain a part of expenditure on developmental projects within a reasonable period.

With the enactment of Finance Act, 1969, wealth-tax was introduced on agricultural property for the first time, with the hope that it would be a patent instrument for mobilizing additional resources from the wealthy section of the agriculturists.⁵² But the tax has been discontinued since the assessment year 1981-82 because of belied expectations. Complaints of harassment have been received in the valuation of agricultural land. But the tax continues to be levied on lands under tea, coffee, rubber and cardamom plantations.

Apart from all the criticisms levied against the Committee, Gandhi has expressed a basic fear whether this tax will be politically accepted because AHT would raise the average effective burden on the farmers excepting the very small ones with its progressive tax schedule. Gandhi has pointed out that politicians may not/do not attach much importance to the principles of ability-to-pay and equity in taxation as economists do. On the other hand, Toye is of the view that the reason for mild progression in the AHT, as compared to the income-tax, is to make the scheme acceptable to the politicians.

The AHT scheme, nevertheless is workable despite the criticisms which can be fruitfully utilized to modify the scheme. The scheme without any doubt is superior to the existing land revenue system for the reasons that (a) it introduces equity among landholders in the country; (b) it has a progressive rate structure; and (c) it is capable of mobilizing additional resources with increases in taxable capacity.

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- 11 When Land Revenue was imposed on Ryotwari and Mahalwasi settlements, a detailed land survey and soil classification was carried out. Such classification was not done under Zamindari Settlement. After Independence, the Zamindari settlement was converted into Ryotwari and at the time of conversion, detail land survey and soil classification was carried out so as to fix the rate of assessment.

- 12 Elasticity of tax system is defined as response of total tax revenues to changes in income of the group, which is in turn a function of two types of elasticities - a) elasticity of tax rates is response of tax rates to changes in income and b) elasticity of tax-base is response of tax base to changes in income. Source : Musgrave R.A., Theory of Public Finance, McGraw Hill, 1959.
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CHAPTER IV

CONCLUDING REMARKS

The entire debate about whether the agricultural sector in India is overtaxed or undertaxed as compared to the non-agricultural sector arose from the fact that the Indian Economy was, and still is, in need of resources for implementing its development plans. Since it was believed that the non-agricultural sector was already overloaded with taxes and that a similar amount of taxation did not exist in the agricultural sector, it was thought that there was a good scope for finding the much required resources in this sector. It was proposed that not only should the agricultural sector be taxed more heavily than heretofore, but that it should be made to contribute a higher proportion of its (sectoral) income, relative to other sectors, to the tax revenues of the Exchequer. It was believed that the agricultural sector is supposed to play a special role in the context of economic development. The special role, for a democratic set up like that of India's, was that it should contribute a sizable portion of its (sectoral) income to the Exchequer in the form of taxation. This belief was doubted for the reason that India, at the time of independence, inherited an exhausted agriculture, although exhausted in what sense is not precisely known.

Studies were conducted to find out whether there

existed any taxable capacity in the agricultural sector. Unfortunately, the only two detailed and comprehensive studies have come to opposite conclusions making it difficult to say something firmly. The other studies, though not detailed and comprehensive, show that certain income groups in the agricultural sector are undertaxed as compared to the corresponding income groups in the non-agricultural sector. Generally, the studies reveal that the tax system is regressive in nature, and if the effective burden on the income groups in the agricultural sector which are undertaxed is to be raised, it can be done only by modifying the entire tax system. With the realization of this fact a host of reform proposals were put forth by different authors. But as is observed, hardly any reform proposals have been implemented by the Government. The same old system, with slight modifications here and there, continues to exist. In addition, some State governments have abolished land revenue, and in some States exemption limits have been fixed. Why this cold shoulder treatment on the part of the Government?

If the reason(s) behind the indifference of the Government has to be discovered, one has to examine whether anything is wrong with the proposals themselves. The proposals could be unsound in three respects: equity, administrative ease and political acceptability. All the proposals examined here would not have passed the equity test with flying colours,

but surely they would have introduced a higher degree of equity than in the existing tax system. Any step taken to increase equity is bound to complicate the tax system, for, equity and administrative ease are two conflicting objectives. The more complicated the tax system, greater the requirement not only of administrative effort, but also of advanced administrative skills. This might have been one of the reasons for not implementing the reform-proposals. As R.M. Bird¹ has pointed out, the developing countries can neither afford extra administrative effort, nor do they possess advanced administrative skills, and this particular fact has been overlooked by most of the tax-professionals.

The contention that India, being categorized as a developing country, does not possess advanced administrative skills can be suspect, but surely, all the tax-proposals did not require so much administrative effort so as to hinder their implementation. There were some which required legislative amendment and/or heavy administrative costs. But most of them could have been implemented within the prevailing administrative and institutional framework.

Political unacceptability also could have been the reason for not implementing the reform-proposals. The proposals, if implemented, would have resulted in increasing the tax-burden on the upper income section of the agriculturists, which is politically dominant in most of the States. Agricultural taxation being a State prerogative, these sections

might have restrained the proposals from implementation in order to avoid an increase in tax burden upon themselves.

Whether it is politically acceptable or not, some are of the view that the ability-to-pay (and equity) considerations should not be made the cornerstone of the tax structure in a developing economy. "The desirability of higher taxation of agriculture, or of particular groups within the agricultural sector, must be assessed in light of its effects on the relevant objectives of national policy, not merely in terms of static indexes of tax capacity and tax effort."² The burden-approach lays too much emphasis on relative burdens. The absolute burden of tax which affects saving, investment, etc., which are more relevant considerations of a developmental tax policy, receives inadequate attention under the burden approach.

If the above point of view is accepted, then not only the agricultural tax structure, but also the tax structure on the non-agricultural sector will require examination of its effects on savings and investment. If the above viewpoint is accepted only for the agricultural sector it will imply that the agricultural sector is given greater importance than the non-agricultural sector. This is not so. Study of our Plans reveals that both agricultural and non-agricultural sectors have been given equal importance.

The hard fact is that we are in need of resources and they have to be raised, from anywhere. To find out where they can be raised, it is essential to examine which income-groups are undertaxed, irrespective of the sectors.

CHAPTER IV

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