

CHAPTER - XIII

SUMMING UP

Taxation, in the modern world, is instrumental in promoting savings, investment and production, in maintaining economic stability and in increasing the economic well-being of all concerned. With the launching of the First Five Year Plan in 1951, the revenue need of the Government of India has increased many-fold. The rates of income tax have been increased and as many as four new direct taxes have been introduced and levied by the Central Government. In the previous twelve Chapters, these taxes have been discussed in detail, in the light of elaborate historical and adequate theoretical backgrounds. Important tax issues have been examined from the point of view of equity, economic effects and administrative simplicity and attempts have been made to estimate the effects of the present tax system on savings and investment by individuals and also on the growth of the private corporate sector in the country. The structures of direct taxation in India have been compared with those in some foreign countries. Many proposals to improve the existing tax system have been made and many conclusions have been arrived at. In this Chapter the most important of these proposals and conclusions are summarised in brief, at the risk of repetition.

Most of the proposals made for tax reform do not have major revenue significance. But they would certainly make the tax system more equitable, more simple to administer effectively and more desirable from the point of view of economic effects. An equitable tax system would improve the morale of taxpayers and its better economic effects would promote industrialisation. If it is made simple to administer, it would bring in large revenue at less cost.

There seems to be no prospects for a substantial tax reduction in the near future. There also seems to be little scope for increasing the existing level of personal and corporate taxation. However, compared to non-agricultural income, agricultural income is lightly taxed. The coverage of the income tax and wealth tax may be widened considerably by asking the State Governments to delegate their power to the Central Government to tax agricultural income and agricultural property. Or the State Governments should be asked to tax agricultural income of an assessee at the rates applicable to his total income including agricultural and non-agricultural incomes. This is a major tax reform which would not only increase the revenue yield but would make the tax system more equitable.

Personal Taxation

It does not seem to be possible to define the term income exhaustively for income tax purposes and it is not desirable to define it in general terms. It may be left to be interpreted according to its 'natural and commonly understood import', but the Act should give an inclusive definition of income so as to make taxable all items of income which a well designed economic concept covers.

The Haig-Simons concept of income would lead one much nearer to an equitable system of income taxation in accordance with taxable capacity. Every effort should be made to bring it into practice without causing inequity between assesses and unduly heavy administrative burden. This concept favours taxation of all incomes, whether realised or not, whether recurring or casual. In fact, it favours taxation of bequests, gifts and capital gains along with other incomes of the taxpayer. But while equity requires a separate treatment of bequests and gifts, practical considerations require a special treatment of (long-term) capital gains.

Every step has been taken in India to bring all money and non-money income under the Income Tax Act. In order to

avoid unnecessary litigation and the existing ambiguity, it is desirable to specify clearly in the Act that if an income from selling of goods is not taxable as capital gains, it is taxable as revenue income. Further, all casual incomes, not being gambling gains, inheritance and gifts, should be made taxable whether or not they arise from the exercise of a business, profession or vocation. Equity requires some general form of relief for fluctuations in income. For this 'the Simons and Groves retroactive average plan' may be improved and adopted.

For taxing the income of a taxpayer and of his wife and minor children, the joint return system is both equitable and necessary for efficient administration. As the first step to introduce this scheme in India, the unearned income of a mother and minor children may be aggregated with the total income of her husband. At least, the present system of allowing personal allowances should be improved. The exemption limit should be abolished. The marriage allowance of a spouse should be withdrawn when the income of the other spouse exceeds a certain limit. Widows and widowers should be allowed no marriage allowance. The child allowance should be made either to its mother or father and should be withdrawn when his personal income exceeds a limit.

The scheme may be rationalised by increasing a little the child allowance.

The income tax should make no difference between earned and unearned incomes, as there is a wealth tax to do this job more naturally and effectively. This reform would go to simplify the rate structure to a large extent. If such a change is not desired, the present definition of earned income should be improved and the rate structure simplified. There seems to be no case for treating as earned income, income from business or income not derived wholly and directly from personal exertion. Same rate of surcharge may be imposed on all incomes above an exemption limit of say, Rs. 10,000 for unearned income and Rs. 24,000 for earned income.

The present treatment of capital gains in India seems to be satisfactory. The application of realisation principle for taxing capital gains, in main, makes it necessary to distinguish between short-and long-term capital gains and makes the tax structure more complicated. But taxation of capital gains on accrual basis is both difficult and undesirable. Capital gains realised merely because of changes in the price level are illusory

and require some concession. But, capital gains arising out of changes in interest rates increase one's tax paying capacity. Capital gains often represent unearned increments in the value of assets due to modern technical and industrial planned development. Their exemption from tax would result in severe discrimination between ~~assesses~~ and in tax avoidance.

Reintroduction of the expenditure tax either in addition to or in the place of the income tax does not seem to be desirable. The Indian income tax is based on a sufficiently reasonable definition of income. Even if the present income tax is, as Kalder says, not based on a true measure of the spending power of an individual, taxation of actual spending alone (as against the spending power) cannot make the tax system any more equitable. If the rates of income tax are considered to have disincentive effects, introduction of an expenditure tax does not seem to be a logical solution. Where it is considered necessary, more selective and effective incentives may be given under the present Income Tax Act itself. An expenditure tax is much more difficult to administer than an income tax. In any case, a developing country, like India, cannot be an ideal experimental field for a novel tax measure of this kind.

A tax on net wealth can be supported both on equity and economic grounds. It supplements the income tax to base taxation on a true measure of tax paying capacity. It is a potent instrument to discourage holding of wealth in unproductive forms and to check concentration of unproductive wealth. It can serve as an additional tax on unearned income and warrants repeal of the present differentiation between earned and unearned income made under the Income Tax Act.

In Sweden, assets of husbands and wives are combined for purposes of the wealth tax and in certain cases, the assets of minor children are included with those of their parents. Possibility of introducing such a measure in India should be explored. Steps should be taken to bring agricultural property within the purview of the wealth tax.

For all practical purposes, it is better to consider that the incidence of a death tax is on the inheritors, and an inheritance tax is more equitable than an estate duty. The inheritance tax should take into account the prior wealth of the inheritors and treat gifts and bequests alike. If introduction of such an inheritance tax is not desired on administrative

grounds, a method of integrating the gift tax and the estate duty should be adopted. The method followed in Australia seems to be both simple and reasonable.

After Independence, the lower income groups have been much relieved from liability to direct taxes and since 1957-58, the rates of taxes in middle income groups have been comparatively lower. Available evidences do not show clearly that the total burden of direct taxes on higher income-brackets have affected adversely either the willingness or capacity to save and invest. There is widespread tax evasion in India. For the past two decades or so, only about 6,000 assesseees (that is about 0.5 per cent of the total number of individuals) have been taxed at 50 per cent or more of taxable income. If any individual's income is subject to diminishing return because of taxes, it shows clearly that he has kept his huge wealth comparatively unproductive. It does not, therefore, seem to be desirable to fix a tax ceiling. A reduction in the rates of taxes on upper brackets is preferable to a tax ceiling.

The present personal tax structure favours formation of companies, imposes heavy penalty on unproductive wealth and

aims at reducing the concentration of wealth and income.

The Income-Tax Statistics indicate some reduction in the degree of inequity of income among individuals over the ten years period from 1953-54 to 1962-63. Taxpayers having total income of Rs. 25,000 or below seem to have slightly improved their comparative position over the same period (see Table 1 of Appendix F). While the relative shares of pre-tax and post-tax income of these groups increased in 1962-63 over 1953-54, the relative shares of income of those with income above Rs. 25,000 showed a decrease. While there was a decrease in the share in income received by the top 10 per cent of the taxpayers, there was a slight increase in the share in income taken by the bottom 70 per cent and the middle 20 per cent. Among this top 10 per cent assesses, the non-salary earners seem to have experienced a marked decline both in their pre-tax and post-tax income (see Table 2 of Appendix F).

Available wealth-tax statistics also indicate a similar trend (see Table 3 of Appendix F). While the number of individuals who had net wealth of above Rs. 12 lakhs declined from 1,408 in 1961-62 to 1,202 in 1964-65, the number of those

with net wealth of Rs. 2 lakhs to Rs. 12 lakhs increased from 22,407 in 1961-62 to 27,652 in 1964-65. The total net wealth of the former group decreased from Rs. 336.2 crores to Rs. 304.9 crores, while the total wealth of the latter group increased from Rs. 888.0 crores to 1,030.3 crores.

Tax statistics do not often reflect the real change in the distribution of wealth and income. This is mainly because of widespread evasion and changes made in the legal definition of taxable units.¹ Further, the change in the distribution of wealth and income need not necessarily be a result of taxation. However, the steeply progressive rates of taxes tempt one to conclude that taxation should have been one of the main causes for the reduction in wealth and income concentration during the period under study.

Company Taxation

A company is a legal, economic and social entity. It is desirable to treat it as a tax entity as well. It is better

1. For other reasons see:- Report of the Committee on Income Distribution, Part I, pp. 10-11.

to tax it at a flat rate of non-refundable tax and to consider for all practical purposes, the right of the company to retain part of its profits undistributed as one of the privileges of incorporation rather than as a source attracting a separate rate of tax. It is almost impossible to integrate the corporate and personal taxation. Neither does it seem to be necessary. Where it is considered necessary, some concessions may be allowed in taxing dividend income in the hands of shareholders.

Since 1960, companies in India have been taxed at flat rates and no refund of the tax paid by a company has been made to its shareholders. In 1965, the super-tax on companies was integrated with income-tax. It is only proper to name the tax on companies corporation tax.

There seems to be no compelling reason to treat a closely held company differently from a widely held company for the purpose of corporation tax. There should, however, be some provisions for preventing closely held companies from unreasonably accumulating profits. Indian provisions in this regard seem to be satisfactory. However, the present system of imposing penal tax on the entire undistributed balance of the distributable

profits of the company in default, should be withdrawn. Instead, a penal tax of, say, 50 or 60 per cent of the excess retention over the statutory percentage may be imposed. Such a scheme is only reasonable and would involve neither revenue loss nor additional administrative burden.

Coming to the computation of taxable business income of a company, the residuary provision should be improved. For this, the following two provisions may be introduced: (i) a provision to allow deduction for trading losses connected with or arising out of the business or profession, and (ii) a ^{provision} to make it clear that no deduction other than those mentioned in the Act shall be allowed in computing business income.

For income tax purposes, no distinction need be made between depreciation and obsolescence and they should be treated as revenue expenditures or losses. Depreciation allowances may be made either on straight line method or on diminishing balance method. There is no case for preferring one to the other. It does not, however, seem to be desirable to base depreciation allowances on replacement cost of the assets. If, on the other hand, industries find it rather hard to replace and renew their old

assets because of inflation, some concessions may be allowed.

For stock valuation, option should be given for the taxpayer to adopt the market value even if he had valued his stocks for some years at cost. But the LIFO method of estimating cost price should be rejected on the ground that it does not reflect the real profits of the business.

The present system of treating carried forward losses, depreciation allowances and development rebate should be rationalised and simplified. Unexhausted depreciation and balancing allowances should be treated alike and they should be considered as a part of business losses carried forward. It is only reasonable to allow business losses to be carried forward as an off-set against business as well as non-business income.

Extensive tax concessions and incentives have been granted for industries. They make the tax system too complicated and burdensome to administer effectively. But they may be supported mainly in view of the present higher rates of taxes. However, it is imperative that an expert enquiry should be made as to how the tax concessions allowed are utilised by the industries con-

cerned. There seems to be a case for further reducing the rates of tax on intercorporate dividends received by a parent company from its subsidiaries.

The tax on bonus issues was rightly withdrawn. The tax on excess dividend distribution may also be abolished as it serves no purpose except perhaps to increase the total tax burden on certain companies. The companies (profits) surtax need not necessarily be an emergency or wartime tax. It may be a permanent levy. It would be useful to achieve some economic and social objectives, if the definition of 'statutory deduction' is kept varying from time to time. The 'deficiency in statutory deduction' may be allowed to be carried forward for one or two years.

Available evidences do not indicate clearly that company taxation has affected in anyway the growth of the private corporate sector in the country. The traditional theory of incidence of corporation tax seems to have no more any value, and at least a part of the corporation tax might have been recouped by companies, especially, through higher prices. The increases made in taxes on companies in recent years have affected much the

retained profits. If, inspite of this and the continued sluggishness of the Indian capital market in recent years, the companies have raised adequate funds for expansion etc., it is due to the strengthening of the capital market through the establishment of a variety of financial institutions not only for granting loans but for underwriting the new issues of capital and for mobilising individual savings for investment in industrial securities. However, if industry has to progress under its own steam, it should be enabled to plough back greater proportion of its profits and vigorous steps should be taken to revive the capital market. A reduction in the total tax burden on companies would increase the volume of corporate savings and make industrial securities attractive. As a special incentive to individual investors, capital gains, if they are invested in industrial securities, may be exempted from tax.