

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Volume I—The Tax System

CHAPTER II.—THE TAX SYSTEM AND TRENDS IN PUBLIC REVENUES

1. Compared with other federations, the field within which public revenues are raised and spent regionally is much wider in India, which testifies to the greater importance of State Governments in our federal system. (Paragraph 15)

2. Broadly speaking, there has been very little addition to the national tax effort over the last two or three decades, in average terms. While national income and public revenues have kept pace with each other in money terms, neither of them has shown any significant increase in real terms. The distribution of national income and public revenues, *vis-a-vis* different groups in the country has, however, undergone alteration. (Paragraph 23)

3. A striking fact that emerges from a comparison of the trends in revenues of the Central, State and local Governments is the slow growth of the revenues of local bodies. (Paragraph 40)

4. The sharing by the State Governments in the proceeds of Central taxes, and the institution of substantial grants by the Central Government for both general and specific purposes have, between them, imparted a measure of elasticity to the State revenues which was unknown to the Provinces in the pre-war period. Even in the taxes which are both collected and retained by the States, there is a greater degree of elasticity than was in evidence before the War. (Paragraph 43)

5. Central and State revenues really coalesce for purposes of the public finance of State Governments and the old antagonism between Central revenues and State revenues has largely disappeared. To this extent, an integrated treatment of Indian public finance becomes much more in order. (Paragraph 44)

CHAPTER III.—TRENDS IN PUBLIC EXPENDITURE

6. The need for utmost restraint on the growth of non-development expenditure, whether at the Centre or in the States, can hardly be over-emphasised. Moreover, during a phase of intensive development effort when targets in terms of expenditure also assume a certain degree of significance, there is likely to be, even within the development sector of expenditure, some room for economy and avoidance of waste. We are ourselves impressed by the need for a thorough and careful enquiry both in the Central Government and the States into the whole question of public expenditure, and suggest that such enquiries should be undertaken by sufficiently high-powered bodies and at a fairly early date. (Paragraph 1)

7. Since the War, the changeover in importance from what may broadly be described as unproductive to productive expenditure is

significant both in the Central Government and in the States. (Paragraph 7)

8. The extent to which Indian public expenditure brings about a reduction in inequalities of economic circumstance and thus helps the tax system to achieve one of the objectives which have been suggested for it is modest, partly because the total volume of public expenditure constitutes a small proportion of the total national income and also because the expenditure on social welfare and subsidies by way of transfers to the lower income groups is of little significance. (Paragraph 19)

9. At the same time, a certain measure of territorial or regional redress of inequalities is a conspicuous feature of Indian public expenditure as also of the entire system of public finance. (Paragraph 20)

10. The redistributive process operates not only on the national plane in lessening inter-State disparities of resources, but also within the State themselves, perhaps in an even more significant measure, by reducing the disparities between resources and needs among rural and urban areas. (Paragraph 21)

11. The increasing role which is being assigned to expenditure on social services serves to diminish the unpopularity of the tax system, while, what is of even greater value, the increasing importance given to developmental expenditure tends, in the long run, actually to increase the taxable capacity of the people. (Paragraph 22)

12. The composition of Indian public expenditure as also the trends therein in recent years serve to bring about a moderate reduction in inequalities, both economic and social in the country; and, to this extent, should reconcile the people to an increase in the total burden of taxation. The redistributive effects of public finance operations in India cannot attain really significant dimensions as long as the ratios of public revenues and public expenditure to national income remain as small as they are at present. (Paragraph 23)

CHAPTER V.—INCIDENCE OF TAXATION : ANALYSIS

13. As one moves from the rural to the urban sector and as an area becomes more urbanised, not only (1) per capita expenditure level rises but (2) the proportion of cash expenditure to total expenditure, per capita, increases, and (3) the proportion of tax to cash expenditure, per capita, also goes up as a result of a change in the pattern of cash purchases in the direction of more highly taxed articles; the tax element in urban areas increases and the incidence of taxation is higher as a combined result of all these increases. But as the population of urban areas is small relatively to the rural population the contribution of rural areas in absolute terms to the pool of indirect taxes is much greater than of urban areas. (Paragraph 9).

14. The incidence of indirect taxes seems to be mildly progressive; however, this is so mainly under Central taxation. Sales tax and State taxation show but little of progression. The incidence of both Central and State taxation is higher in the urban sector for each expenditure group, because of the higher incidence of sales tax, Central excise and import duties. Of these three major tax items.

the rural-urban disparity in incidence is least under Central excise: it is larger for import duties and is highest in respect of sales tax. (Paragraphs 11—13)

15. The sales tax is in the nature of a proportional rather than a progressive tax. (Paragraph 16)

16. The rural-urban differences in tax incidence are more pronounced in sales taxation than in Central excise. (Paragraph 17)

17. The relative undertaxation of the rural sector particularly in the higher income ranges is brought out prominently when income-tax is added to tax incidence in the urban sector and land revenue in the rural sector. (Paragraph 19).

18. The incidence of land revenue has ceased to be appreciable, practically over the whole country. (Paragraphs 18, 25 and 29)

19. Apart from any general scope for stepping up tax incidence in urban areas, there appears to be greater room for increased taxation of higher rural incomes. (Paragraph 28)

20. The large area of the non-monetised sector in the rural economy is at once an index to the limits of taxation and a pointer to the possibilities of extending taxation to the field of comparative essentials, if that should be advisable otherwise, with the knowledge that the great mass of the rural population will remain outside its bounds: in general, the part of the population which is more within the frontiers of the money economy is also relatively more affluent and able to bear taxation than the part outside it. (Paragraph 30)

21. Indirect taxes can be used as a means of progressive taxation, in a limited way. There is scope for widening the base for taxation. (Paragraph 31)

22. No major shift in income from the urban to the rural or from the rural to the urban sector *as a whole* can be established to have occurred in the period since the beginning of the War, though certain shifts appear to have taken place *inter se* among the different groups within the respective sectors. (Paragraph 35)

23. It would seem that the total burden of taxation has increased in the urban sector as compared to the rural sector since the pre-war period. (Paragraph 39)

CHAPTER VI.—THE DEVELOPMENT PROGRAMME AND TRENDS IN INVESTMENT: PUBLIC SECTOR

24. There is need for the utmost endeavour to enlarge the role of taxation and borrowing in the financing of the development programme of the public sector, and to minimise the role of deficit financing. (Paragraph 23)

CHAPTER VII.—THE DEVELOPMENT PROGRAMME AND TRENDS IN INVESTMENT: PRIVATE INDUSTRIAL SECTOR

25. Gross capital formation during the five year period 1946—51 in the manufacturing sector for all public limited companies is estimated at Rs. 134 crores a year, of which addition to fixed assets was at an annual rate of Rs. 63 crores. (Paragraph 26)

26. In the financing of industrial expansion during post-war years, retained profits formed a larger source than fresh capital. (Paragraph 30)

27. While the largest increase among the principal means of financing took place in borrowing, the increase in borrowings was more than accounted for by the rise in inventories, and fixed assets formation was on the whole not dependent on borrowing. (Paragraphs 32-33)

28. Additions to paid-up capital in the entire public limited companies sector of manufacturing industry were at an annual rate of Rs. 29 crores or 8.4 per cent. during the period, of which two-fifths was represented by bonus issues. (Paragraphs 35 and 37)

29. The return in relation to net worth (shareholders' equity) would seem to have been satisfactory over the period 1946-51 in the industrial sector as a whole. (Paragraph 40)

30. The relative figures of distributed and retained profits indicate that there is a clear tendency to keep distributed profits steady or rising in absolute terms, so that the impact of any adverse turn in business conditions falls with disproportionate weight on retained profits. (Paragraph 44)

31. It would appear that the amount of retained profits and its proportion to profits are influenced more by the volume and rate of profit than by the volume and rate of taxation; profit is, of course, also the more variable factor. (Paragraph 48)

32. In 1951, as in 1946, managing agents received in all forms of remuneration about one-half of what accrued to shareholders in dividends. (Paragraph 50)

33. For all public limited companies in the manufacturing sector, the replacement costs of depreciable fixed assets (excluding buildings) acquired before 1946 work out to Rs. 420 crores, or Rs. 28 crores annually, for 15 years as from 1951. The magnitude of the replacement problem differs from industry to industry and, within an industry, also in terms of units. (Paragraphs 55-57)

CHAPTER VIII.—OUTLINES OF TAX POLICY

34. An increase in progression in direct taxation, supplemented by measures of more effective tax enforcement, is necessary for reducing inequalities. At the same time, the need to extend taxation to the masses would limit the increase in progression in the tax system. (Paragraph 10)

35. On the whole, the kind of tax system which would be best adapted to meet the requirements of the Indian economy, having regard to the development programme and the resources required for it, appears to be one which would increase the resources for investment available to the public sector with as small a diminution as practicable of investment in the private sector, and which, therefore, is accompanied by the largest practicable restraint on consumption by all classes. Restraint on the consumption of higher income groups must, of course, be greater than in respect of low income groups. (Paragraph 14)

36. The State has to assume a major responsibility for securing a diversion of resources from private consumption to public investment; the structure of taxation must be properly diversified for the purpose, with both depth and range. An extension of the taxation of necessaries would seem to be unavoidable. (Paragraphs 14-15)

37. The limit of taxable capacity is relative to the purposes for which the proceeds of additional taxes are expended. (Paragraph 19)

38. Efficiency in administration and economy in public expenditure should at least diminish people's unwillingness to suffer an increase in tax burdens. (Paragraph 19)

39. The knowledge of widespread tax evasion undermines morale, puts a heavy strain on tax compliance by the honest tax-payer, and undoubtedly impairs taxable capacity. (Paragraph 20)

40. Public expenditure in India has been moving increasingly towards beneficent expenditure, but it cannot be said with equal certainty that it is moving also towards economy and efficiency. (Paragraph 20)

41. There is a presumptive case for holding that Indian taxation on the basis of its existing structure and rates has not fully tapped the taxable resources of the country. (Paragraph 20)

42. Increases in both direct and indirect taxation are indicated. The disincentive effect of higher taxation on the will to work on the part of the higher income groups is generally exaggerated. There should be a ceiling on net personal incomes after tax which, generally speaking, should not exceed approximately 30 times the prevailing average per family income in the country; this may be attempted to be secured by stages over a period of time. The accomplishment of this objective cannot merely be the result of tax changes, but must be related to an integrated approach along several directions. At the same time, it is necessary to promote savings and investment through incentives in the income-tax system, designed primarily for encouraging industrial expansion. The selective principle is appropriate in this context. (Paragraphs 28-29)

43. The greater the increase in tax revenues desired, the larger is the part that indirect taxes may have to play in bringing about such an increase. (Paragraph 31)

44. Efforts to secure uniformity throughout the country of system and rates in respect of the State taxes should be limited to achieving a necessary minimum degree of uniformity without abridging the essential autonomy of the States in financial matters. (Paragraph 32)

45. While there can be no objection to (small) cesses continuing to be employed, the proceeds of taxes should not, as a rule, be earmarked for specific purposes. While differentiation between organised and unorganised industry in the levy of certain excise duties is justified, it does not seem a wholesome practice to link a specific burden on a segment of industry with benefit to another segment. (Paragraphs 36-37)

46. In the immediate future, apart from the impact of external factors, internally, the stronger possibilities are for the continuance of inflationary forces generated by, and related to, the pace of development planning and its financing. (Paragraph 43)

47. Our tax system has in its income-tax and commodity taxes important means of counteracting inflationary situations. But it may become necessary to levy special taxes on those sectors that benefit the most in an inflationary situation, including the possible imposition of special taxes like excess profits tax. (Paragraph 49)

48. Viewed in the long term, the objective of maintaining stability in the economy merges into the larger objective of economic development. The problem, then, is of adapting fiscal and other policies to the end of maintaining an even course of development, of adjusting the pace and content of public expenditure, the level and forms of taxation, and the overall budgetary position—surpluses or deficits—with reference to the variations of the economic weather; all the elements of fiscal policy must, however, remain basically attuned to the climate of economic development. (Paragraph 51)

49. While the excess profits tax may be kept in reserve for use in a highly inflationary period, it should not form a normal component of the tax system. (Paragraph 61)

50. Considering the increase that has occurred, and may occur hereafter, in commodity taxation, a tax on salt cannot be justified merely on the ground that its incidence by itself is relatively light. (Paragraph 64)

51. The setting up, under Article 263 of the Constitution, of an All-India Taxation Council is recommended, to secure the co-ordination of tax policies and tax administration of the States, as between the States themselves and between the Union and the States. (Paragraph 71)

52. The Council will have a permanent secretariat in the form of a Tax Research Bureau, for continuous study of the problems involved. (Paragraph 74)

CHAPTER X.—NON-TAX REVENUES: PROBLEMS AND POLICY CONSIDERATIONS

53. A Committee including officials of the Railways and other Ministries concerned and of the Planning Commission should be set up to consider the formulation of an adequate Railway freight rates policy, having regard to the interests of industrial and economic development, on the one hand, and the resources required for railway development, on the other. (Paragraph 7)

54. There should be no objection in principle to using travel as a basis of taxation like other services or commodities of general consumption. A tax on travel is not more regressive than several other taxes that are levied at present and needs to be considered as a source of revenue. (Paragraph 8)

55. There is no objection to pricing policies which aim, over a long period, at realising a surplus from the operation of State undertakings. (Paragraph 17)

56. Public purpose rather than profit should be the guiding factor in the operation of a public undertaking but the antithesis is more apparent than real. Every effort should be made to place Government industrial undertakings on a sound financial basis, so that losses are avoided and a reasonable net return is secured as far and as soon as possible. (Paragraphs 20-21)

57. No change in the present exemption from income-tax of Government business undertakings is recommended. (Paragraph 28)

58. In all cases, there should be adequate and proper accounting and financial reporting by all public undertakings. The Comptroller and Auditor-General may have the subject examined to evolve suitable standard forms of accounting for different categories of public enterprises. (Paragraph 33)

59. Fiscal monopolies, as an alternative to excise duties, present possibilities for an increase in revenue. An appropriate expert enquiry should be instituted at an early date into the possibilities of setting up fiscal monopolies with a view to augmenting public revenues, with due regard to the employment and other aspects of these schemes. (Paragraph 42)