

CHAPTER I

INTRODUCTORY

The Taxation Enquiry Commission was appointed by the Government of India in pursuance of Resolution No. F.3(7)-B/53, dated 1st April 1953 of the Ministry of Finance, the main part of which is as follows:—

“The Government of India have had under consideration for some time the question of instituting a comprehensive enquiry into the system of taxation in this country. The last enquiry into taxation was conducted by the Indian Taxation Enquiry Committee nearly thirty years ago. Since then far-reaching changes have taken place in the country's political and economic spheres and the picture of India's public finances is very different from that in 1925. In recent years there has been a widespread demand for a fresh enquiry and although a decision in principle to have such an enquiry was taken as far back as 1946, the constitutional changes following the Partition and the other pressing problems resulting from it delayed the implementation of this decision. The Government of India have, as announced by the Finance Minister in his Budget speech, now decided to appoint a Commission to conduct a comprehensive enquiry into taxation. The Commission will consist of

Chairman:

Dr. John Matthai

Members:

Shri Vaikunth L. Mehta, former Finance Minister of Bombay,

Dr. V. K. R. V. Rao, Director, Delhi School of Economics, Delhi,

Shri K. R. K. Menon, Secretary to the Government of India, Ministry of Finance, New Delhi,

Shri B. Venkatappiah, I.C.S., Executive Director, Reserve Bank of India, Bombay, and

Dr. B. K. Madan, Economic Adviser, Reserve Bank of India, Bombay.

Sardar Indarjit Singh, lately Commissioner of Income-tax, Delhi, will be Secretary to the Commission.

The terms of reference to the Commission, which have been settled in consultation with the State Governments, are as follows:

- (1) To examine the incidence of Central, State and Local taxation on the various classes of people and in different States;

- (2) To examine the suitability of the present system of taxation—Central, State and Local—with reference to (a) the development programme of the country and the resources required for it, and (b) the objective of reducing inequalities of income and wealth;
- (3) To examine the effects of the structure and level of taxation of income on capital formation and maintenance and development of productive enterprise;
- (4) To examine the use of taxation as a fiscal instrument in dealing with inflationary or deflationary situations;
- (5) To consider other relevant matters; and
- (6) To make recommendations, in particular, with regard to (a) modifications required in the present system of taxation, and (b) fresh avenues of taxation."

2. A Press Note was issued by the Commission on 8th April 1953, inviting from individuals and organisations a general statement of their views on the issues covered by the terms of reference of the Commission preparatory to framing a detailed questionnaire. The Secretariat of the Commission, consisting of a nucleus staff, was moved from New Delhi to Bombay in May 1953; the full complement of officers and other staff was, however, not appointed until much later. The Commission published its Questionnaire on 17th July 1953. The Questionnaire was divided into six parts, namely, the Tax System; Direct Taxes; Commodity Taxes (Central and State); Agricultural Income-tax; Land Revenue and Irrigation Rates; Other Taxes (Central and State), and Local Taxation. Copies of the Questionnaire were sent to the Central and State Governments, corporations, municipalities and village panchayats, business and commercial organisations and other associations, University Departments of Economics, and a number of individuals in India and abroad who were likely to be particularly interested in the work of the Commission. The Commission's Press Note of 8th April 1953 and the Questionnaire are reproduced in Volume IV.

3. In addition to the Questionnaire issued to the public, separate supplementary Questionnaires were sent to the State Governments, to Ministries of the Central Government, to the Central Board of Revenue, and to 165 selected municipalities and corporations, 83 district local boards and 453 village panchayats. The municipalities, corporations and local boards to which the supplementary Questionnaires were addressed, were selected on the basis of a random sample, while the village panchayats about which the Commission did not have adequate information were selected by the State Governments on the basis of the criteria indicated by the Commission as regards their population, income and date of establishment.

4. Most of the replies to the Questionnaire were received by the end of October 1953. Altogether, 226 individuals and organisations sent memoranda in response to the Press Note of 8th April 1953 and 457 individuals and organisations replied to the Questionnaire, besides Departments of the Central Government, State Governments, local bodies and village panchayats. The replies from the latter

numbered 419 in all. A list of the memoranda received by the Commission is given in Volume IV.

5. At an early stage in our work we felt the need for instituting certain enquiries with a view to gathering information and material bearing on the first and the third of the terms of reference, *viz.*, relating to incidence of taxation and capital formation. An analysis of the incidence of taxation was made, based on the household consumer expenditure data of the fourth round of the National Sample Survey. In addition, a special enquiry into capital formation and the means of its financing in regard to the corporate industrial sector was instituted; a Questionnaire to selected public limited companies was issued on 17th November 1953. A complementary (but more limited) enquiry into the finances of private limited companies was also carried out on the basis of information made available by the Commissioners of Income-tax in response to a special Questionnaire.

6. The Commission started on tour for taking oral evidence from 16th November 1953. It visited the headquarters of all Part A and Part B States; the witnesses from Part C States were interviewed at places convenient to them. The tour programme lasted until 5th May 1954, after which the Commission held sittings for taking oral evidence at Bombay which ended on 13th May 1954. In every State, the Commission met the Chief Minister and his colleagues for informal discussions, besides meeting the Ministers concerned and their advisers separately. The Commission also met some representative members of the legislature in each State. At Delhi, the Commission examined officers of the following Ministries of the Government of India: Finance, including the Central Board of Revenue, Commerce and Industry, Production, Transport, States, Natural Resources and Scientific Research. A list of witnesses examined at each centre is given in Volume IV.

7. Before we proceed to indicate the line of treatment we have adopted in our Report, it may be useful to present briefly the background of economic change and policy against which it is necessary to view the problems of Indian taxation.

8. When the last Taxation Enquiry Committee reported in 1925, the political and economic scene in India was different from that which we find to-day. Then, India was still a dependency of the United Kingdom; and it consisted of British India and Indian States. British India included Burma as well as the whole of Bengal and the Punjab, besides the North West Frontier Province, Baluchistan and Sind; in other words, India consisted of the entire area which now forms the three countries of India, Pakistan and Burma. At the same time, the Indian States did not form part of the structure of public finance existing in British India; they had separate budgets and separate sources of revenues; few of them imposed income-tax; nor were they subject to the income-tax of British India; the maritime States imposed their own customs duties, while many of the others levied import and export duties on their trade with British India. There was no plan of economic development, nor was there any attempt at building up a Welfare State. Organised industry except in cotton and jute was in an initial stage of development and

the bulk of the country's requirements by way of manufactures was met by imports from abroad. In the field of public finance, customs dominated central revenues, while land revenue dominated the revenues of British Indian provinces. The salt tax was an important source of revenue for the Central Government, while excise duties on liquor constituted the second major source of revenue for the British Indian provinces. There was no prohibition and no sales tax. Income-tax was an important source of revenue for the Central Government, but the maximum rate of income-tax and super-tax was only 47 per cent. on incomes above Rs. 5½ lakhs. The situation remained substantially the same in the field of public finance till the beginning of the War. During the War and post-war years changes took place in quick succession.

9. The position is different to-day. First of all, India is now an independent country and it includes the former Indian States, but excludes Burma. It also excludes the North West Frontier Province, Baluchistan, Sind, West Punjab and East Bengal, which constitute the new State of Pakistan. A number of manufacturing industries have grown up within the country during the last thirty years, the effects of which are seen in a marked change in the composition of our import trade and in the increased importance of central excise duties. Partition with its loss of areas surplus in foodgrains, raw cotton, and raw jute has made a significant difference to our import trade, and this, taken together with the effects of increasing industrialisation, has considerably reduced the importance of customs as a major and expanding source of revenue. Income-tax has developed greatly and stands out to-day as the most important single source of revenue in the country. The salt tax has been abolished. There is complete prohibition in four States and partial prohibition in many of the others with the result that excise duties on liquor have ceased in many States to be either a major or growing source of revenue. The sales tax has become a principal source of revenue for most State Governments, while the place of land revenue has declined in importance in the fiscal system. War finance and post-war policy have led to inflation and a steep rise in prices so that both national income and public revenues have increased from 4 to 4½ times in money terms and so has public expenditure. Taxation has increased, but not uniformly over its various constituent items, so that the incidence and effects of taxation are also different today. At the same time, the needs of the public exchequer have been growing at a fast pace. The country has adopted a programme of increasing developmental expenditure. The Welfare State has become an accepted objective, involving increased expenditure on social services. The tax system is, however, responding but slowly to the increased effort required of it, and there is currently a large and growing gap between governmental revenues and governmental expenditure. At the same time, numerous sections of public opinion complain of the heavy burden of taxation and its deterrent effect on capital formation and economic development in the private sector. There is also a feeling that the burden of taxation is uneven in its incidence on different classes of income and on different income groups and that unless this is rectified, the tax system will not play its proper role in the new

order envisaged by the Directive Principles of State Policy embodied in the Constitution. The onset of inflation and the threat of deflation have turned public minds to the problem of how far the tax system can be used to deal with such situations.

10. The tax system has grown on an *ad hoc* basis, but its growth is big enough to warrant a thorough and comprehensive enquiry into its structure, composition and level with a view not only to its rationalisation but also its better use as an instrument for implementing the economic objectives of free India. There is the paramount need to increase public outlays on economic development and on social welfare concurrently with increased investment on economic development in the private sector. There is simultaneously an imperative need to diminish inequalities in income and wealth in the community. It is in the context of these apparently contradictory objectives that the tax system has to be examined. It is a complex and difficult task, on which we embark not with any expectation of reaching clear-cut conclusions but rather in the hope that our Report will help a better understanding of the issues involved in Indian taxation.

11. In our treatment of the subject, we have found it difficult to make a proper historical analysis of financial trends, mainly because of Partition and the subsequent integration of Indian States which make for a lack of continuity and comparability in the statistical material available to us. Nevertheless, we have attempted, wherever possible, to review the historical background and thus set our analysis and recommendations in their proper perspective. We have refrained from any examination of the problems of federal finance and of the distribution of revenues and expenditure between the Central Government and the States, which have already received comprehensive treatment at the hands of the Finance Commission. We have also not given any detailed treatment of the problems and policies of public expenditure. They have a bearing on a study of taxation, but together they form an entirely distinct subject which needs careful separate inquiry and study. We have, however, included a brief review of the trends of public expenditure in our Report.

12. The Report is divided into three volumes. Volume I deals with the tax system as a whole—Central, State and Local. The second chapter of this Volume describes the tax structure under the Constitution before going on to review the trends in revenue of the Central Government, the States and local bodies. Chapter III gives a brief account of the pattern of public expenditure and of recent developments in the same, particularly in relation to any effects it has in the direction of lessening the economic inequalities as between regions or classes of the people. The fourth and fifth chapters give an analysis of the incidence of the main part of Central and State taxation on various income-groups and in different States. Chapter IV gives our approach to an analysis of the problems involved in a study of the incidence of taxation and Chapter V sets out the results of the analysis. Having regard to the importance in our terms of reference of the development programme in the public sector and development and capital formation in the private sector, the next two chapters attempt an account of the trends in investment in the

economy in the public and private sectors respectively. Chapter VI is concerned with a general assessment of the problems of financing of the development programme and concludes with a reference to deficit-financing. In Chapter VII we give the results of the surveys conducted by the Commission into capital formation and its financing in the corporate industrial sector, including public and private limited companies and attempt to estimate the order of the problem in relation to the company sector. An attempt is similarly made in the chapter to form some estimate of capital formation (investment and saving) in the economy as a whole, including the public and private sectors. In the eighth chapter, we outline the main elements of tax policy appropriate to the present stage of development in the country and indicate the directions along which, within the framework for tax policy that is set out there, we suggest modifications in the field of the important taxes; after a discussion of the use of taxation as an instrument in dealing with inflationary or deflationary situations, the chapter concludes with a section on tax co-ordination and tax research. The last two chapters of the Volume deal with non-tax revenues, Central and State, with particular reference to Central and State Government undertakings and the problems and policy considerations involved.

13. In subsequent volumes, we proceed to a detailed treatment of individual taxes, Central and State. Volume II relates to Central taxes, direct and indirect, principally income-tax (including corporation tax), customs and excise duties, though it also deals briefly with the estate duty levied recently. In Volume III we deal with State taxes relating to land and agriculture, the sales tax and miscellaneous taxes. The problems of local finance are also dealt with in that Volume. The treatment in these two volumes covers the history and development of the individual taxes, their structure, rates and problems of scope, assessment and administration. A summary of the conclusions and recommendations in each volume is given at the end of the volume concerned.

14. We wish to take this opportunity to express our gratitude to all individuals, associations, chambers and other organisations in India and abroad, who assisted us by tendering written and oral evidence before us. Our special thanks are due to the State Governments and Ministries of the Central Government and their officers, including the Central Board of Revenue, who supplied us with comprehensive memoranda and detailed information on the various matters relevant to our enquiry. The State Governments were good enough to make excellent arrangements for our tour everywhere. Our labours were considerably lightened by the co-operation we received throughout from all Governments on whom heavy burdens were placed by our requests for information which were met with uniform promptness.

15. To the Officers and Staff of the Commission, we are deeply indebted for the ability and zeal with which they performed their duties during a long and exceptionally strenuous enquiry. Our Secretary, Sardar Indarjit Singh, brought to the work of the Commission not merely his wide and up-to-date knowledge of taxation matters but a high degree of organizing and administrative ability. Shri P. S. Nadkarni, Joint Secretary, was of special assistance to us

in the field of State taxation in which his clear and accurate grasp of the subject made him a most useful guide and counsellor. The other Joint Secretary, Shri R. Kothandaraman, did valuable work in the elucidation of difficult issues involved in income-tax practice and administration. Dr. N. A. Sarma, Director of Research, brought a well-trained and discerning mind to bear on the investigation of the economic aspects of taxation. We wish to express our warm appreciation of the co-operation we received from these and other officers and from the staff generally.