

RECENT CHANGES IN THE TAX STRUCTURE

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1757 and 1857 were historic years in the history of India. 1957 witnessed a landmark, not in the political history of this country, but in its economic and taxation laws. We have, almost without realising it, passed through a revolution so far as taxation laws are concerned. We are perhaps far too near it to realise the full implications of what has recently happened, but history may note 1957 as the most important year in the history of the taxation laws of this country.

The recent changes in the taxation laws may be dealt with under three heads. First, the introduction of new taxes; secondly, amendments which made the existing laws more complicated (if that was possible); and thirdly, more executive control by means of taxation laws over the actions of private individuals.

Among the new taxes, we have the Wealth-tax, the Expenditure-tax and the Capital Gains tax. On a plain and grammatical construction of the Wealth-tax Act, 1957, it is not possible to submit, in many cases, a statement of net wealth as required by the Act and state on oath that it is correct. The reason

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

President, World Bank

is that in the charging section — (Section 3) — the charge is levied on net wealth; 'net wealth' is defined by Section 2(m) as the excess of the value of assets over liabilities; and the 'value of an asset' is defined by Section 7 as "the price which *in the opinion of the Wealth-tax Officer* it would fetch if sold in the open market on the valuation date." Since you do not know who will be your Wealth-tax Officer, or what will be his subjective opinion regarding the value of your assets, you do not know what in his opinion will be the extent of your wealth, and consequently in respect of matters like jewels and houses where subjective valuation by different persons may give different results, you cannot truthfully say on oath that what you have submitted is the 'net wealth' as defined by the Wealth-tax Act. What you submit to the Wealth-tax Officer is merely your prediction as to what in his opinion your assets would have fetched in the open market at the valuation date.

The Wealth-tax is founded on the theory that one of the main objects of taxation is not merely to bring more revenue to the State but to reduce the disparity between wealth and poverty. But expropriation by the State would achieve the same result and where you have a situation like the present one where the wealth-tax and the income-tax between themselves swallow up the entire income of an assessee and leave no part of the income to the assessee to be spent on himself, the law may be rightly described as a law virtually entailing expropriation under the guise of taxation.

There is another aspect of the matter also and

that is the very large amount of interference by public officials with the private lives of individuals which the administration of the wealth-tax is bound to entail. As regards the imposition of wealth-tax on companies, it is very well known that Prof. Kaldor who conceived the idea of a combined levy of wealth, income-tax and expenditure-tax, was himself against the levy of wealth-tax on companies. The wealth-tax on companies simultaneously with the wealth-tax on share-holders in respect of the value of their shares clearly amounts to double taxation. There is no rational answer to the plea that there should be no wealth-tax levied on companies. The only answer which was given in official quarters was that the tax on companies is at a very small rate, being only half per cent, and therefore there need be no grievance. So far as sheer logic goes, that answer is no more convincing than the defence of the young man who, charged with murdering both his parents, pleaded for mercy on the ground that he was an orphan. The irrational double taxation cannot possibly be justified on the ground that it is at a very low rate.

An assessee under the Wealth-tax Act must have a valuation made of all his assets every year. That process is fairly simple when one deals with shares and securities but it is a difficult process when you deal with other assets like houses and jewels. One wonders how many assessees would put themselves to the trouble and expense, as technically and strictly speaking they should, of trying to ascertain the correct market value of various assets other than shares and securities on each

valuation date. Perhaps it was to relieve the assessee of that bother that the Legislature enacted that the value is to be what it is in the opinion of the Wealth-tax Officer, so that an assessee may make a fair estimate of what the normal mentality of tax officers in India is and on that basis try to ascertain what the officer is likely to take the assets to be worth. In respect of all conceivable assets from bangles to buildings, the omniscient Wealth-tax Officer is supposed to know the true value and his opinion would decide how much wealth-tax you should pay.

The expenditure-tax is a novel mode of taxation and it is one of the ironies of history that a nation which has so little to spend should be the first to levy a tax on expenditure. You first pay Income-tax on the income you earn; when you spend it you again pay excise duty, sales tax, etc., which taxes are always passed on to the consumer; and thereafter at the end of the year of expenditure you again pay expenditure-tax on what you have spent. The epitaph which a famous English peer wrote for himself runs as under: —

What I gave, I have.

What I spent, I had.

What I left, I lost.

The taxation structure in India is meant to hit you whichever of the three alternatives you choose to adopt. What you give by way of gift to others you might continue to have even after your death; but irrespective of the ethical value of large-heartedness, there will in all probability be, before the 31st

March, 1958, a tax on gifts. What you spent, you had. But for the pleasure of having expended your own income, you are again subjected to tax. What you left, you lost. And you would lose it not merely to your heirs, but also a substantial slice to the State in the form of estate duty.

Two justifications have been pleaded in support of the expenditure-tax;—first, that it is necessary to make the scheme of taxation water-tight and, secondly, that it discourages ostensible expenditure. In reality, instead of making the scheme water-tight the wealth-tax and the expenditure-tax may only provide two more incentives to suppression of income. Till 1957 if you suppressed your income you avoided one kind of tax. Now by suppressing it you can also avoid the expenditure-tax if you choose to save the income. So a tax levy which is intended to make the scheme of taxation water-tight may only make the nation more saturated and dripping with tax evasion. Just as recovery under the Estate Duty Act was not what it was expected to be, in all probability the expenditure-tax and the wealth-tax will not achieve the results they are expected to achieve either by way of recovery of tax or by way of prevention of tax evasion.

The old Roman Poet said that gods sell everything at a fair price, but the new Five-Year Plans are sought to be effected at an excessive price. We have come perilously near the point of breaking the nation's economy in the process of bending it.

Some people might try to justify the imposition of the wealth-tax and the expenditure-tax on the ground that they are experiments which are neces-

sary to the healthy growth of a "dynamic" nation like India. But it is dangerous to experiment in taxation laws. The wisest line of action in enacting the taxation laws of a country is to act on the old wise saying—when it is not necessary to change, it is necessary not to change.

The second justification for the expenditure-tax is the object set out in the Statement of Objects and Reasons, viz., to discourage ostensible expenditure. Ostensible expenditure is hardly indulged in on any wide scale in this country. Even without the expenditure-tax, in a few years' time ostensible expenditure would become as extinct in this country as the dodo or the mastodon. You do not heed a novel tax, never tried in the history of mankind, in order to discourage what is not a widespread evil. Apart from the fact that reckless expenditure is hardly a public evil in India, there are economic consequences of restricting expenditure which merit serious consideration. In the United States, the most prosperous country in the world, more than 75% of all purchases are effected on credit; people buy goods which they have no means of paying for at the moment of purchase. That is understood to promote the economic prosperity of the nation. In India, we are now seeking to go in the contrary direction and discourage people from spending even within their means. The excise and customs duties are already a strong deterrent to purchase of those goods which can procure for us foreign exchange by being exported abroad. And you certainly do not need the expenditure-tax to achieve the same result.

Certain allowances are given in respect of expenditure for certain purchases and, therefore, the Expenditure-tax Officer would be entitled to go into the question as to the purpose for which the expenditure was incurred. Thus, what you spend, what you save, and what you give are to become the subject of scrutiny by the State authorities. This regimentation, this control over the private affairs of individuals, is something against which all lovers of liberty will always rebel. The only difficulty is that this type of rebellion creates no effect in the governmental quarters because it does not result in the burning of tramcars or the stoning of automobiles. If you have a proposal to levy a negligible additional excise duty on tea or sugar, you have riots and civil commotion and the proposal to levy the tax is promptly dropped. If you have the levy of wealth-tax on companies, which is in fact more irrational than the additional excise duty on tea or sugar, the tax is still persisted in because there are no violent demonstrations of public antipathy. That is a very unfortunate aspect of the working of democracy in India. It would be a true democracy where the Executive is as responsive to intellectual arguments as to manifestations of lawlessness and violence.

Even if the expenditure-tax fails, it is unlikely that it will be scrapped in the near future. Questions of pride and prestige will come in; and the second factor which goes to prolong the life of bad fiscal measures is the fact that what brings revenue to the State, in however small measure, is very seldom dropped. It is interesting to note that in-

come-tax, than which few things are more certain in this world, was itself introduced as a very temporary measure for only one year. It was William Pitt who during the time of the Napoleonic war introduced income-tax, honestly believing that it was going to be levied for only one year. That is why the rates were prescribed by the annual Finance Act. The historic accident of the rates being prescribed by the annual Finance Act continues even today when the tax is as permanent as the Ellora caves.

The third tax, the capital gains tax, may not present much of a problem in many cases, because the Government has been thoughtful enough to give to the nation two other taxes, the wealth-tax and the expenditure-tax, which will militate against any appreciable capital appreciation. The main objection to the capital gains tax is concerned with the effect which it produces on the economy of the country. At a time when we need more capital for our industries, the imposition of the capital gains tax cannot be regarded as very opportune. The capital gains tax is one more portent of the growing desire of the State to tax not wisely but too well.

II

We may now pass on to the second aspect of the recent changes in the tax structure--making the existing laws more complicated. It would be futile to give a detailed list of the instances of this particular aspect of legislative activity. One instance of the increasing complication of the tax laws is the

provision for making current profits deposit with the Government as a condition precedent to the grant of depreciation allowance, balancing allowance and development rebate. The current profits deposit law is really foreign to the main purpose and spirit of taxation laws. It is not the function of a taxing statute to mop up liquid funds with a view to preventing them from getting invested elsewhere to the detriment of the nation. That function has to be discharged by laws other than taxation laws. The basic scheme underlying the current profits deposit law is that you must make the deposit with the Government before you can get the depreciation and other allowances and the Government would refund you the amount if the Government is satisfied that you need it for an approved purpose. Apart from two purposes which are specifically mentioned in the Rules as 'approved purposes', it is left to the Government to decide what are 'approved purposes' for a particular business. The Current Profits Deposit Rules constitute a bizarre piece of legislation. It has nothing to support it except the keen desire of the State to get the maximum amount of money belonging to citizens with the minimum delay.

By way of another instance of recent amendments making the existing laws more complicated, one might refer to the provisions of Section 23-A of the Indian Income-tax Act where recently the definition of companies in which the public are substantially interested was amended in a manner which leaves very large room for speculation as to what the true effect of the amendment is. In 1957'

a further complication has been introduced by prescribing different statutory percentages for different Section 23-A companies, and even different statutory percentages for one and the same company in respect of its income derived from different sources. The last-mentioned provision will give rise to questions of apportionment of overhead expenses and other common expenditure which are likely in their application to be difficult of solution.

Another instance of the increasing complications introduced in existing taxes is the provision prescribing different rates for companies declaring different percentages of dividend. There is no logical reason why the rate of tax should differ with variations in the rate of dividend. This is an instance of how the tax laws are getting complicated in a manner which is not reasonably related to the object of taxation and, secondly, how by means of taxation laws control is sought to be exercised on the discretion of even public companies to declare such dividend as they think right. Moreover, if a company in which the public are not substantially interested declares a lower dividend, it has to pay additional super-tax under Section 23-A of the Income-tax Act. If it declares a higher dividend, it has to pay additional super-tax under the relevant Finance Act. Thus, there is no consistent policy underlying the tax structure. And even with all these bothersome complications, it is not as if the State is really being fair and just. Let us take a simple example. Suppose a company declares 12% dividend, it pays additional super-tax; and if another company declares 6% dividend, it

does not pay additional super-tax. But the company which declares 12% dividend may have declared no dividend during the last eleven years. So the average dividend which it has declared for twelve years works out to only 1%. And yet it pays higher super-tax than the other company which has declared 6% dividend. One can easily conceive of a large number of other factors which would go to make the declaration of a higher dividend fully justified in one case and not justified in another. The above illustration shows the inequity and injustice inherent in the present scheme of taxation where increasing complications based on diverse rules of thumb have not really brought about an equitable distribution of the tax burden.

III

The third aspect of the new tax laws is the growing interference with individual freedom. The tendency of the State to encroach more and more on the freedom of the individual is as clearly reflected in recent tax laws as in other branches of the law.

Let us make no mistake: Civil liberty and individual freedom can die as surely, though not as swiftly, in a democracy as it can in a totalitarian State. The nose-counting method—one man, one vote—will certainly survive. But it is only the husk of democracy. When civil liberties and individual freedom are excessively restricted, it is poor consolation to know that the persons responsible for such a state of affairs were the elected representatives of the people.

There are three well-known types of freedom—Freedom of Thought, Freedom of Speech and Freedom of Action. Thought is certainly free in this country; what we lack is thought, not the freedom of thought. Speech is also free in this country. The right to freedom of speech not only exists in India but is exercised in the amplest measure. "Speechifying" is one of the main hobbies of the Indian nation. There is an interesting story about the propensity of the Indian to speechify. The story goes that once an Italian, a Frenchman, an Englishman and an Indian were put under laughing gas. Now, laughing gas makes you act naturally and brings out your innate propensities which have been driven into the sub-conscious mind by inhibitions imposed by civilization. Under the influence of laughing gas, the Englishman started swearing, the Italian started singing, the Frenchman started making love to the nurse, and the Indian got on his feet and started an address commencing with the well-known words, "Ladies and Gentlemen". But the third freedom—Freedom of Action—is being more and more unduly restricted. It is no one's case that the old doctrine of laissez-faire can be revived in the present age. But excessive State interference can be even more deadly to the true spirit of democracy than laissez-faire. If there is any one thing which is required to be carefully guarded in this country it is individual liberty and civil freedom. We have come to a stage where executive interference, all in the solemn name of Welfare State, has become so pronounced in every walk of life that only supreme exertions on the part

of right-minded citizens will save civil liberty in this country, The right to have redress in a Court of law is being gradually restricted and the Executive is being vested with the powers taken away from the Court. Executive Officers, with minds not trained to weighing evidence judicially, or deciding impartially, or eliminating the irrelevant and confining attention to the relevant, are being vested with the widest powers. Under our Constitution the balance of power between the Judiciary, the Executive and the Legislature has been sought to be maintained, but in actual practice the powers of the Executive, in the historic phrase, "have increased, are increasing and ought to be diminished". For instance, even in the enlightened Bombay State there is still in force the Bombay Land Requisition Act, which is a more drastic piece of legislation and gives wider powers to the Executive than any requisition law which England ever knew during the worst days of peril in the First or the Second World War. If "in the opinion of the Government" your flat has become vacant, or if "in the opinion of the Government" you have not resided in your flat for a continuous period of six months, you can be rendered homeless by the requisitioning authority. This "opinion of the Government" business, i.e., subjective determination of vital facts by an Executive Officer, whose decision is not supported by any grounds or reasons and cannot be questioned in a Court of law, or, in many cases, not even in appeal to higher executive authorities, is becoming the main feature of recent Indian legislation. This sinister tendency is as pronounced in

taxation laws as in other branches of the law. The Wealth-tax Act levies tax not on the value of the assets of an assessee but on what, in the opinion of the Wealth-tax Officer, is the value of the assets. After the amendment made last year, the subjective opinion of the Income-tax Officer is now made to decide whether certain expenses incurred by a company are "excessive" or "unreasonable" having regard to the business needs of the company [Section 10 (4A) of the Income-tax Act]. The decision on the question whether having regard to past losses or smallness of commercial profits the declaration of a larger dividend would be unreasonable is left to the subjective satisfaction of the Income-tax Officer (Section 23-A of the Income-tax Act). In practice the power of passing an order on the company under Section 23-A has been arbitrarily exercised against the company in a large number of cases where no mind, judiciously directed, could have possibly reached the conclusion arrived at by the Income-tax Officer. The recent Current Profits Deposit Rules leave it to the Government to decide what purpose should be regarded as an 'approved purpose' for the purposes of a particular company. The deduction of depreciation allowance is universally recognised as essential for computing the true commercial profits and yet from this year this right is denied to the Indian tax-payer unless he deposits with the Government the moneys represented by the depreciation allowance or spends them on purposes approved by the Government. Surely, it is for the businessman to decide on what purpose he will spend the funds of his business. If he uses

his funds in a manner detrimental to society, the arm of the law is wide enough, or should be wide enough, to prevent him from doing so. But the fact that some businessmen may use their surplus funds in an anti-social manner is no justification for denying the right of depreciation allowance to all assessees unless they spend the funds in a manner approved by the Government.

The clap-trap about the Welfare State and the Government making decisions in the national interest has been widely resorted to as a justification for all kinds of restrictions on civil liberties without the recognition of the import of such restrictions and their detrimental effect on the growth of a healthy democracy. Where shall we draw the line? If the Government can decide what purposes a company will spend its moneys on, why should it not also decide how much new additional machinery you must instal every year, or what the individual should have for breakfast since bad diet may result in the rearing of an unhealthy generation? Why should not the Government also decide what the individual will spend on, how much jewellery he should buy for his wife and how much he should invest in shares and how much in Government Securities? A system of law is growing up in this country with more and more powers being conferred on Government officers which can only be described in the words of Lord Hewart as the "New Despotism", or in the words of A. P. Herbert as "Despotic Executive". It is difficult to come across any new piece of legislation which does not leave decisions, of the most

far-reaching effect from the point of view of the individual, to the Government, which often in practice means a not very highly-placed administrative officer. The wide room for harassment and corruption which such a state of the law provides, needs no underlining. This regimentation of a nation's life by executive action is not peculiar to this country; it is growing all over the world. The tides of civil liberty are gradually receding over many democracies. But the mischief is imponderably greater in a country like India where the masses are illiterate, not conscious of their civil rights, and public opinion is not mobilised or educated. Chapter 3 of the Indian Constitution, which deals with Fundamental Rights, will cease to have any practical significance if more laws of the type indicated above continue to be passed. The wise have said that the final guarantee of the fundamental rights, of a people is not a code or a constitution but the personality of the Judge; and, one may add, the personality of the executive officers in charge of administering the plethora of restrictive laws made in the name of the Welfare State. If after the present Five-Year Plan has been implemented, you find that the national income has been doubled and civil liberties and individual freedom have been halved, the people will have sold their priceless heritage for a mess of pottage.

(Views expressed in this publication do not necessarily represent the views of the Forum of Free Enterprise.)

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Free Enterprise was born with man and
shall survive as long as man survives.

—A. D. Shroff

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