Book Reviews

The Case for Capital Taxes

Capital Taxation in a Developing Economy (India) by I S Gulati. Orient Longmans, Pp 201. Price Ra 128

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TRACED with an almost Insatiable demand for an increase in their activities and expenditure modern Governments tend to be always hard pressed and in constant search, of more revenue. In many countries income taxation seems to be exploited to the full. Commodity taxation, though fairly heavy, can be still substantially increased but because of its regressive nature, public opinion would insist that it be resorted to only in the final instance. Under these circumstances, capital taxation, being a relatively unexplored source not offensive to our sense of equity, has much to commend itself, Economists have discussed capital as the basis of taxation hitherto in rather disparaging terms, and the few experiments that have been made with capital taxes (apart from death duties) have not been happy. The present book, therefore, which examines the case for capital taxation sympathetically, and comes to favourable conclusions both regarding its advisability and practicability, deserves our careful attention. The fact that this piece of research was done with special reference to India by Dr Gulati, who assisted Mr Nicholas Kaldor in the preparation of his "Indian Tax Reforms Report of A Survey" adds greatly to the interest of the book to Indian readers.

Theory of Capital Taxation

The book is divided into three parts. The first part deals with the theory of capital taxation. According to Dr Gulati there are three different types of capital taxes: (i) A capital levy; (ii) An annual capital tax and (iii) Death duties. Though these bear the common nomenclature of capital taxes, that is only because capital worth is the basis for them. It does not connote that they are paid oat of a common source—capital. The source of payment depends on whether the tax is recurrent or singular. Capital levy, being an entirely once-for-all tax, will be very largely met by a sale of assets. Death duties, since their timing Is so uncertain from the view point of the individual, and fall only once during a lifetime, also tend to be paid out of capital. On the other hand, an annual capital tax will very probably be met out of income, since it has to be paid from year to year. Compared with an equivalent income tax, the annual capital tax affects efforts and investment less adversely. All efforts, whose fruits will be consumed in the course of the year, do not add to capital, and therefore will not attract the annual capital tax; they will however, be liable to the general income-tax. Further, the more risky the enterprise, the greater the percentage return on the capital invested therein. The burden of a capital tax in terms of income will fall relatively heavily on safer enterprises and specially so on money and gold hoardings. An annual capital tax will, therefore, stimulate risk taking. On the of the hand, since savings add to capital, an annual capital tax differentiates against savings more than an income-tax. On the whole, however, an annual capital tax appeals to the author as a welcome addition to the tax weapons at the disposal of the Government.

Capital Taxation & Indian Economic Development

Having established the case for an annual capital tax, Dr Gulati tries to apply it to the particular circumstances of Indian economic development. India is bent on rapid economic development. Much of the developmental effort must be in the public sector, but the wherewithals are difficult to find. The tax effort contemplated in the First Five Year Plan was much below that necessary for the successful implementation of the Plan. Capital taxation could have been a welcome addition to the tax effort. Even a capital levy under such conditions if collected in a fairly large number of instalments might not be unwelcome as it would give a shock to savings habits and stimulate them. An annual capital tax would have been very welcome would not have raised any specially difficult problems, and brought a handsome revenue of Rs 52-57 crores if levied in the way and at rates suggested by the author.

Critique of Indian Estate Duty

The third part is devoted to a critical discussion of death duties in India. The major defects in the imposition of the Italian estate duties, viz. their high exemption level, low rates, special rules for valuation of agricultural land, their different incidence with different types of inheritance and succession laws, and the consequences of exempting most of the gifts are vividly brought out.

Valuation Problems

Dr. Gulati has done a competent piece of useful research work. There are, however, a few important questions which need further consideration. Property taxation, especially landed property taxation, has been levied in many countries. Considerable experience has been accumulated in its administration. Does this experience lead one to the belief that it is possible to levy a general capital tax and value its worth for that purpose without making the tax too costly to administer and highly ineqitable and object-on able? De Gulati would probably say yes. Whatever the unpleasant results of the past. then have been due. in his opinion, to absence of centralization of, valuation machinery, the tax being local rather •than a national impost. Once this defect is removed, the difficulties would be quite manageable and the cost worthwhile, since death duties an annual capital tax and local property tax would coexist and demand more or less the same technique of valuation. There is, however, a great difference in the types of valuation problems that the three different taxes give rise to and the degree of precision that is essential for them. Death duties are levied once in a generation. and they are levied at a particular psychological moment. Delay in the valuation .and final settlement of the tax or a relatively high margin of error may not matter much. Local property tax is levied only on a specific type of tangible property, is in the nature of the benefit tax, and is often acknowledgedly based on valuation revised once in a decade or even less frequently. Further, in many places It is based

on annual rental value, rather than property value. An annual capital tax, on the other hand, covers all types of property including business property which is the most difficult to evaluate. It is levied on the same person from year to year, thus demanding a greater standard of exactness. Compared to death duties, the number of assessees is much larger. It must be assessed fairly quickly, and not on historical costs. Probably Dr Gulati would not agree with the last proposition as he thinks the procedure of evaluating annual capital tax on market value would be fatal. That indeed goes to the heart of the matter. In a fluctuating property market, market value of property is too difficult to determine from year to year* especially when a preponderant part of the property is landed property and private businesses**, But any other process would be inequitable. Book valuation may reduce capital transactions in booms and increase them in depressions. Further in such cases apart from the list of property, which is also a need for efficient enforcement of the income-tax, the annual capital tax could furnish little useful information for the collection of death duties. Dr Gulati does not attach sufficient importance to this aspect of the problem.

Capital: Source of Payment

Since Dr Gulati thinks that an annual capital tax should be paid normally out of income a discussion of the pre-conditions needed for this would have been in order. There are two exceptions of sufficient general importance which he should have considered, viz periods of falling prices and the presence of a highly progressive income tax. If it is desired that an annual capital tax should be paid out of income, it is imperative that the tax should not exceed the income. In times of recession, this salutary principle may not be observed, as was the experience during the Great Depression. This may culminate in widespread distress sales greatly aggravating the fall in property values. It is obvious that if wealth taxes are to yield net revenue above that obtained from the present income tax the combined weight of these two taxes must be greater than that of the existing progressive income tax. If already the rates of income tax in the higher ranges of income are very high, unless the wealth tax falls on very different people, the combined weight may be felt too oppressive to be borne out of income. The case is completely foolproof in a country like India, where the present income tax and the wealth tax rates are such that assuming any reasonable relation between property and income the taxes amount to more than cent per cent of income. To pay them from income becomes a sheer physical impossibility, however drastic the reduction in consumption that is made. It will have to be paid out of property. An annual tax which must be financed from capital sales not only does not serve the main purpose of taxation of reducing consumption, but. is highly detrimental to the' habit of saving in general and fosters the habit of capital consumption, a dangerous habit in any country out specially so in countries which are yet to build up healthy traditions in this regard and where institutional saving is yet *in* an incipient stage.

Needs of a Developing Economy

The great difference between a developing economy and a mature one is that in the former there is a chronic deficit of savings in relation to investment, whereas in the latter it may be quite the reverse. The problem of increasing savings Is one of the toughest problems of economic development. Dr Gulati agrees that a capital tax affects savings more advesely than an income tax, but does not realize its special inaptness in a country like India, nor does he discuss the possibility or ways of counteracting it. say, for instance, by a highly progressive expenditure tax.

Capital Taxation Vs Commodity Taxation

Why think only of comparing income and capital taxes, Why not also discuss equivalent commodity taxes? The last may be regressive, but once income and capital taxes have been made progressive and their exemption levels lowered as much as administrative considera tions would allow, there is hardly any other alternative. Regressive taxes lose much of their character when they are paid to finance economic development with which will go economic betterment of the tax-payers, and out or additional incomes which economic development, has made possible. Dr Gulati like Mr Kaltior has not devoted attention to this very powerful argument of the Taxation Enquiry Commission. The latest budget, has brought out that however novel the taxes you introduce, the mainstay of developmental effort in this country is like ly to be commodity tax measures for a long time.

Dr Gulati's book is written in a very lucid style and will prove a happy choice for students who would like to study the case for capital taxation.

* "To provide for annual valuation of property will be suicidal to the new tax, and the earlier Government relents on it, the better". P. 202.

** "Indeed, if a large proportion of private property were not susceptible of easy appraisal through stock exchange a good deal of glamour in the scheme for taxation of capital would be lost. The task of general valuation by the State would perhaps be so prodigious and prove so irritating that any government would think many times before embarking upon it." p. 39