Time for Tax Reform

S *Gulati writes:*

THE Union Finance Minister, T T Krishnamachari, deserves to be congratulated on his decision to resent the 'Economic Survey' to the Parliament a week ahead of the Budget. The public as well as the Parliament will thus be in a position to appreciate whatever Budget proposals The Minister chooses to put forth next week.

As is pointed out in the Survey, the Third Plan period has witnessed a considerable tax mobilisation in that he ratio of taxation to the national icome has increased from a little be ow 10 per cent at the end of the Second Plan to between 13 and 14 per cent now. At the same time. Government current expenditure on goods and services has risen from 7 per cent to 10 per cent of national income with he result that the Government sector's own contribution to the flow of saving has, at best, remained at the same level as at the end of the Second Plan.

While one might not join issue with the observation that "with a rate of wiving of 10 to 11 per cent of the national income at present, the potential for raising resources further in the future cannot certainly be considered exhausted", it will, no doubt, raise considerable debate and controversy whether at the current levels of taxation, especially in the urban sector where, on informed calculations, the proportion of total income taken away in taxes certainly exceeds 20 per cent, there exists much potential for raising resources through the medium of ad ditional taxation.

In fact, while emphasising that strenuous efforts have to be made to contain the pressure of demand on the economy, the survey acknowledges that "in a situation where rapidly growing demands have been pressing against inadequate improvement in production, even traditionally non-inflationary modes of finance such as taxation tend to exert an upward pressure on prices".

In his statement to the Lok Sabha on the opening day of the current Budget session, the Finance Minister argued for "the strictest fiscal and monetary discipline" and indicated that the financial operations of the Government as well as of private and public enterprises "will necessarily have to be guided by the overriding consideration of avoiding inflation".

Now, if taxation, in the Government's own reckoning, tends to exert an upward pressure on prices in the present state of the Indian economy, why, it may well be asked, did Krishnamachari have to impose a 10 per cent regulatory customs duty on imports? Does he seriously believe himself that the duty will slow down imports?

No serious observer of the Indian economic scene will take Krishnamachari seriously even if he were to say categorically that the regulatory customs duty is a temporary measure and that he will withdraw it as soon as the foreign exchange reserves improve. The regulatory customs duty is regulatory in name only. It is, to ail intents and purposes, a revenue duty, a duty which with one stroke, as it were, will yield an additional revenue of between Rs 100 and Rs 125 crores next year. Viewed as a purely revenue impost, according to the Finance Minister's own assessment of the current state of the economy, the measure is difficult to justify. The new duty coupled with the increase in railway passenger and freight tariffs is bound "to exert an upward pressure on prices" and thereby defeat the very objectives of imediate economic policy underlined by the Finance Minister.

The Budget for 1964-65 had to pro vide for an increase of Rs 200 crores in curent expenditure. Of this increase, Rs 120 crores were accounted for by extraordinary claims which are not likely to recur. Defence and developments together accounted for less than Rs 50 crores. At the same time, total Plan outlay for the curent year was to be stepped up by Rs 284 crores over the figure of Rs 1,700 crores for 1963-64. Even allowing for the customary over-estimation of Plan outlay in the Budget, the Plan outlay for 1965-66 would not have to be stepped up by more than Rs 50 crores, may be less, to reach the revised target of Rs 8,000 crores for the public sector.

It apears more or less certain that the additional demands on the Budget for the next year will be very modest compared to those arising last year. If this reading of ours is reasonably correct, the additional revenue already raised through the regulatory customs duty should be more than enough.

The real question which ought to have been exercising the Finance Minister's mind over the past one week is not what aditional taxes he should raise but: what changes he could effect in the existing tax structure to provide maximum incentives for effort in the right directions, even though such changes might involve foregoing a part of this additional revenue.

The 'Economic Survey' underlines, for instance, "the need for rigorous export promotion". Now the existing tax concessions on exports are. first Iv. a 10 per cent rebate on income and super tax on profits derived from exports and, secondly, a rebate to only specified goods of income and super tax. The first concession is obviously available to *all* exports. But. not the second. But even the second is not related directly to additional export earnings. In several countries tax concessions to exporters have been so devised as to relate them directly to *additional* export earnings and this has enabled the Governments concerned to give sizeable larger remissions in income lax.

In the case of small or new companies, too, the Finance Minister could afford to be a little more generous if he really means to help them. The present tax concession of 2.5 per cent to public companies with total income not exceeding Rs 25,000 a year is frivolous. Also, it might be worthwhile examining if the taxation of foreign companies could not be so patterned as to offer maximum encouragement to retention and ploughback in India. The overall rate of tax on foreign companies stands now at 65 per cent. If instead the foreign companies, like Indian companies, were required to pay tax at the rate of 50 per cent only and in addition a withholding tax of 20 per cent were levied on their distributions, they might find it to their advantage to retain in India as much of their profits as they can.

As regards taxation of individual incomes the step that Krishnamachari must not postpone is the abolition of surcharges on unearned income. It has absolutely no justification to exist alongside a wealth tax with such high rates as obtain in India. At the same time, he could take this occasion to plug the important loopholes in the tax treatment of the Hindu Undivided Families.