CHAPTER-IV

EVALUATION

4.1 INTRODUCTION

It has often been said that a citizen contributes to the civilization when he pays taxes. Though sarcasticlly George Bernard Shw expressed his wish that, "Death and taxes are inevitable, but at least death doesnot get worse".

A developing nation always faces economic crises and to meet this there is also a need for an economic diagnosis and that is how tax is paid on income, on wealth, on gift, on estate etc.

Those who can afford to patronise high class hotels should also the afforded the pleasure of contributing to the national exchequer" [Budget speech for 1987-80, of the late Prime Minister, Mr.Rajiv Gandhi) and this is how the tax on expenditure emerged. The Expenditure Tax Act 1957 was an initial attempt for the first time made in India on the basis of Prof. Nicholas Kaldor recommendations on Indian Tax Reform This Act was withdrawn for Assessment year 1965-66 Prior to this there was a short lived Hotel-Receipts Tax Act 1986. Expenditure Tax Act, 1987, more or less heavily runs on the wordings the 1980 Act. The tragic gloomy fact concerns with a situation, that/at the time it was introduced (in Parliament) there was no quorum "at the time it was introduced, there was no meaningful debate at all. Even two days before it was introduced in the Parliament, the Members did not have copies of the Bill. In fact, the Speaker's memorandum explaining this lapse states :"

"I understand that copies of this Bill will be circulated shortly since it is proposed to enforce the Bill at the earliest. It is necessary that the Bill is introduced and passed during the current session of Parliament."

This indicates that at the time of signing the memorandum, copies of the Bill had not yet been circulated With its steam roller majority in Parliament then, the ruiling party at the Centre passed the Bill into an Act with virtually no change or debate. When it comes to taxing the so-called "rich" persons, it is done in such haste that even normal parliamentary propriety is given the go-by.

This time around Mr. Manmohan Singh has extended the levy of this tax to the expenditure incurred in "air conditioned restaurants."

(Rajesh R.Haldipur-How to meet your obligations under Expenditure Tax Act Taxman Publications 1991 at P.No.1).

The expenditure tax Act when it was passed for the first time was subject to a serious challange regarding its constitutional validity.

From reports on Taxation the following observations by Prof. Nicholas Kaldore throw light on the lukewarm approach to the expenditure tax in India.

"In fact, as the example of India shows, it is just as easy to make a mockery of an expenditure tax as it has been with progressive income tax. The Expenditure Tax Bill, introduced by the Finance Minister, the late T.T.Krishnamachari, in 1957, was so severely mauled in its passage through the Lokh Sabha (the Indian Parliament) that the outcome was a joke -incapable of enforcement, and a sheer waste of time for the tax administration. The particular provision which crippled the tax in the case of India was that the liability to the tax was tied to a minimum income limit and not a minimum expenditure limit. All that was necessary to avoid any liability to the expenditure tax was to manipulate income so that the critical limit was not attained at least in those years in which a sizeable expenditure tax liability would have been incurred. And as everyone knows it is not difficult to avoid having an excessive income. In addition the Act contained a long series of exemptions -such as expenditure on marriage , on medical expenses, the purchase of cottage industry products, etc., which have no counterpart in the income tax laws. There is litle doubt that if the tax had not been withdrawn fairly soon after its introduction these loopholes would have become wider."

If, as has been argued, "the current political climate is not hospitable to the taxation of capital or an increase in the taxation of capital gains," why is it supposed that it is hospitable to the introduction of a progressive expenditure tax ? The very idea of such a tax was unanimously rejected by the Finance Committee of the United States Senate, and this was during a particularly critical phase of World War-II (in September 1942) with the tax intended for the duration of the war only.

There are, as is well known, many millionaires in th United States, in England and in other countries who manage to avoid payment of income tax-because they can avoid having a net taxable income-who yet live in great luxury and manage to become steadily richer as well. It would make these people just as liable to taxation as the man in the street. Since this is not done there must be powerful political reasons for it;

and these reasons would be just as powerful whether the attempt to create a genuine system of progressive taxation were made through a supplemental expenditure tax or through a reform of the income tax.

The strongest political argument in favour of a supplemental expenditure tax is that it remove (or at least it greatly weakens) the case which is so frequently made aagainst progressive taxation on the grounds that it reduces the funds available for savings of those taxpayers who, on account of their high incomes, are alone in a position to save a substantial part of their incomes. If net savings are exempt from taxation (or taxed only at a low rate) it cannot be said that the well-to-do are deprived through taxation of the means to save

However, this argument is not as strong as it appears-not if one believes that the market mechanism always generates sufficient profits to finance the investment that entrepreneurs decide to undertake. An expenditure tax, by encouraging savings and discouraging spending of the well-to-do, will not thereby cause more investment to be undertaken unless there are other incentives (of a monetary or fiscal kind) which ensure that there is more investment pari passu with the reduced spending of the well-to-do.

But assuming that such instruments are available, and appropriate policies of economic managment are followed by the Government, much the same distribution of resources between investment and luxury consumption could be secured (in principle) under the one system as under the other."

The above remarks point out the governments approach to the issue. However, recently, the interest in the introduction of expenditure tax has received serious considerations from eminent Parliamentarias such as Mr. Vasant Sathe. This concern for the introduction of expenditure tax is true, because although the direct taxes quantititatively are on an increase along with the indirect taxes the major thrust of the government is on indirect taxes. The following chart reveals the figures which speak for themselves.

Table- : Budgetary Position of Central and State Government and Union Territories

Sr.No.	Particulars	1980-81	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91		1991 -92
1	Current Revenue	24563	47098	56773	61823	73485	85714	10315	117855	112273	13241
		18.1	20.4	21.6	22.1	22.1	21.7	22.9	22.3	21.2	21.7
a)	Tax Revenue	19844	35813	43267	49540	56976	66925	77693	89183	89303	102896
		14.6	15.5	16.5	16.9	17.1	17.0	17.2	16.8	16.0	16.9
i)	Direct Taxes	3268	5329	6252	6890	7483	9757	11165	13047	13397	15338
ii)	Indirect taxes	16576	30484	37015	42650	49193	57168	66328	76136	75906	87558
b)	Non Tax Revenue	4719	11285	713506	15283	16509	18789	25122	28672	22970	29516
	Budgetory deficite	3451	5105	3439	9150	5504	5102	10613	8999	11847	10946

Source : Quarterly Economic Report April-June 1992.

The budgetory deficits have also assumed proportions causing inflationary pressures. In the given situation when the inflation adds to the level of existing incomes, the tax on income at a higher rate fallows major positon of income leaving insignificant amounts for investible funds. The last years budgets for 1994-95 has left behind a legacy of still huge defecit of unparallel quantum and it has almost set in motion price rise. In the background it is observed that in the situation of complexities in the existing tax on income and the evasion it inflicts it is high time that serious rethinking be made about the introduction of expenditure tax.

4.2 REVIEW of DISTORTIONS

The Government revenue more particularly the current revenue consists of tax and non tax revenue and the percentage of the total current revenue to the gross nationl product is significant in determining the financial strength of the nation. It is observed from the data published by World Development Report 1993 that (i) amongst the low income economics the percentage of tax revenue in India for 1980 was 18.3 and it came down to 15.4 in 1991. (ii) However, the percentage of total current revenue to GNP has increased from 11.7 percent in 1980 to 14.3 percent in 1991. This is however, a Typical situation in case of India requiring a careful consideration by fiscal experts for investigating the overall thrust of direct tax policies.

[World Development Report Table 12 P.No.260).

It is further observed at Page 92 by the World Bank in the said report "Income taxes have long been the principle means of taxation in industrial coutries. With relatively few distortions they can generate a great deal of revenue and leave scope for income redistribution. Experience in developing countries however, suggests that personal income taxes are dificult to/be administered and with revenue week in redistribution and are often unfair." Therefore, there is need to enhance the revenue and eficiency of a tax system. The said report further observes that,: (At page 96)

"Personal income taxes account for about a tenth of total tax revenue in developing countries. The low yield reflects limited coverage and poor design. Improving the yield requires changes in the base and rates to make the tax easier to administer, without adverse effects on incentives to work and save."

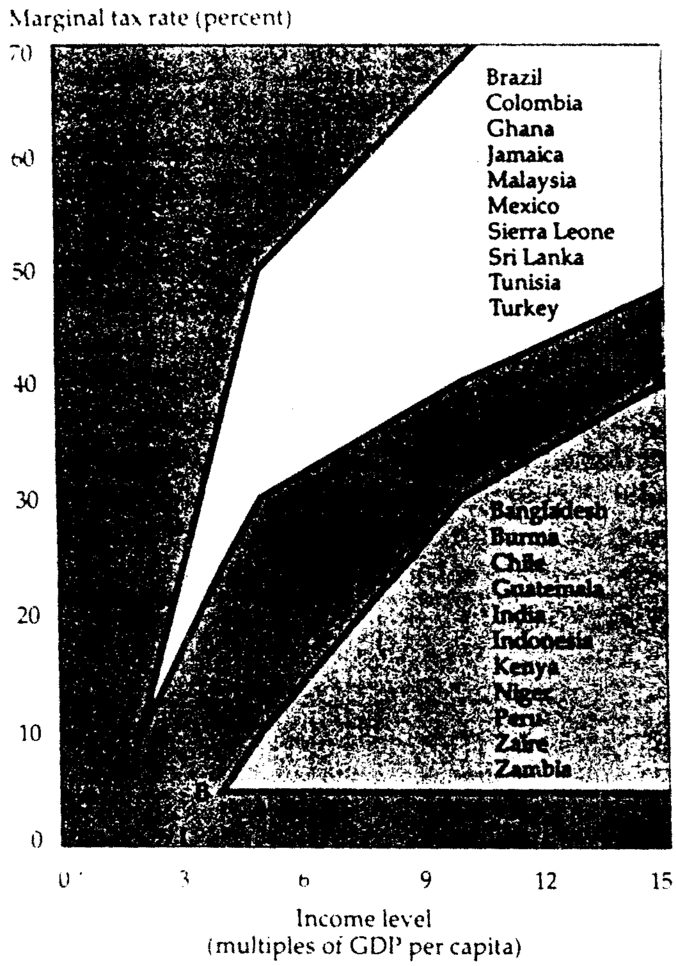
BASE AND RATE STRUCTURE. The typical personal income tax is levied on net taxable income, derived by deducting allowances and exemptions from gross personal income. A schedule of rates is applied to determine tax liability. Tax credits are then subtracted from this tax liability to generate the final tax obligation.

The design of personal income taxes varies considerably across countries. In some countries, such as Gnana in 1984, very low levels of inncome are legally subject to tax; in others, such as India, exemption increases very rapidly-as in Jamaica before tax reform. In others the rate schedule is relatively flat-as in Cote d'invoire. Finally, the highest marginal rate and the level of income to which it applies vary significantly.

Fig.4.8 shows two groups of countries, based on their legal or intended tax structures, not the tax structures as actually enforced. In the group A countries low levels of income are subject to tax, and the marginal tax rate increase rapidly. This structure is difficult to administer since large numbers of small taxpayers are caught in the tax net and subject to high rates. The higher exemptions and more gradual increase in marginal tax rates of the group B countries are better suited to the administrative capacity of most developing countries.

Fig.4.9 shows that many countries have maximum rates above 50 percent. These rates often affect only a handful of individuals-those with incomes in excess of fifty times per capital GDP. High rates on narrow bases generate little revenue and, if not enforced, damage the credibility of the system.

Figure 4.8 Income level at which personal income tax liability begins and the subsequent structure of the marginal tax rates during 1984 and 1985



Source: Sicat and Virmani 1988.

Figure 4.9 Maximum marginal tax rate (MTR) and the level of personal income at which it becomes effective during 1984 and 1985

Maximum MTR (percent)	Multiples of per capita GDP at which the maximum rate becomes effective: Less than 30	30 to 50	Greater than 50
Greater than 70	Portugal	Republic of Korea Zambia [illegible]	[illegible]
50 to 70	Ghana Greece Jamaica Malaysia Mali Pakistan Sri Lanka Sudan	Argentina Brazil India Sierra Leone Zaire Zimbabwe [illegible]	[illegible]
Less than 50	Hong Kong Yemen Arab Republic	Burkina [illegible] Ecuador [illegible]	[illegible]

Source: Sicat and Virmani 1988.

The revenue share of personal taxes has grown slowly in the past two decades. Their base had been expected to expand more rapidly than GDP as more and more activities entered the formal sector. The ability to fine-tune tax rates according to ability to pay was another reason to expect the share of personal taxes to rise. But these factors have been outweighed by the difficulties of enforcement and collection. In many coutriess personal income taxes are collected from less than 15 percent of the population; in South Asia and Sub-Saharan Africa the figure is less than 5 percent .Almost everywhere the potential revenue from personal taxes is further eroded by avoidance through loopholees and tax shelters, as well as outright evasion. A 1981 study of Boliva estimated that 75 percent of the revenue due from labor income was collected primarily because of withholding taxes on wages, whereas the equivalent figure for capital income was 20 percent. (World Bank Report)

Many of the same features that limit the revenue yield of personal income Taxes also limit the equity features of these taxes in practice. In developing countries personal income taxes are not the mass taxes they are in industrial countries. The progressivity of the rate structure is therefore less important when

80 to 90 percent of the population, primarily the lowest income groups and those in subsistence or informal activities, are outside the personal income tax net. With the difficulty of enforcing this tax on high-income recipients in agriculture, trade, and the professions, plus the prevalence of a multitude of allowances and provisions benefiting wealthier groups in society, it is not surprising that in many countries it is now recognized that the personal income tax does not significantly improve the distribution of income. However, a less ambitious distributive objective can be attained. Legally excluding the poor from the tax base altogether is a more powerful was to protect them than incorporating lower rates in a multirate structure. Revenue lost from more exemptions at the bottom of the income scale can be largely offset by eliminating loopholes for those at the top. This will also improve the equity features of the tax.

Horizontal equity requires that all sources of income (from agriculture, trade, manufacturing, and services) and all types of income(wages, interest, rent, profits, and so forth) be treated equally. This favors a global income tax over schedular taxes for different sources or types of income. A global tax, however, entails a tradeoff between equity and savings. Personal income taxes can affect the volume of private saving by reducing both the income of would-be savers (usually) higher income households) and the returns to savings. The second effect depends on the openness of capital markets and the extent of financial intermediation-that is, the availability of nonbank institutions to attract savings through insurance schemes, social security schemes, pension plans, and so forth."

"Some governments have tried to exclude the returns to savings from the income tax base. They have exempted interest from certain types of deposits, for example, small post office deposits in India and Malawi, or interest income up to a ceiling, as in Jamaica. In other countries schedular income taxes are used to tax different sorts of income-such as interest from savings deposits-at a lower rate. Such taxes are used, s in West Africa, because they are considered easy to administer."

"There is some evidence, however, that in developing countries changes in the returns to avings may have a greater effect on the composition of savings than on the level. Taxes on the return to financiial savings can reallocate savings between different types of assets-for example, between stocks and bonds in middle-income countries(if capital gains and dividend income is treated differently from interest income) or between financial and real assets in lower income countries. These switches can disturb the efficiency of intermediation between savings and investment. Some have therefore argued that personal taxes based on expenditures are preferable to personal taxes based on income; expenditure taxes do not tax income that is saved. However, such taxes applied to individuals, as opposed to transactions, have not yet been implemented anywhere.

It makes better sense to ease the tasks of administration and enforcement by simplifying personal income taxes. Most allowances can be eliminated. Instead the threshold should be set high enough-say up to incomes three times per capita GDP- to exclude most low-income earners, and the maximum rate should be set low enough-say 30 to 40 percent-to reduce the incentive for tax evasion. Revenue would in any case be low from the very lowest income groups and from those subject to confiscatory rates. A multitude of brackets can be replaced by a few brackets. Even a single rate tax with the fewest number of loopholes and a high threshold can still be reasonably progressive, as, for example in Jamaica

The observations of the bank on tax administration are worth noting.

Tax administration in industrial countries by and large carries out the intent of tax legislation; In developing countires tax administrators often make their own tax policy by selective administration.

As a result steps to simplify the task of tax administration are likely to make tax policy more effective. Administrative reforms can improve the tax structure by bringing reality in line with intentions. But they can also magnify distortions that were dormant when the structure was badly administered. Setting goals for long term tax policy-broadening the base, say, or shifting the tax base from proeduction and trade toward consumption-can identify needed improvements in administration. So, even though present administrative resources limit the scope for tax reform, thinnking about reform helps to set administrative priorities. The bank observes as regards, the cost of complience & enforcement as

Poorly drafted tax forms, long queues, rude officials, and cumbersome appeals procedures all reduce compliance. Slow -or-no-refunds of legitimate claims can foster reluctance to pay taxes in the first place. High tax rates increase the benefits of evasion, particularly if the tax authorities are known to lack the resources to track down the offenders. In most developing countries the sanctions on fraudulent taxpayers are neglible.

"A 1985 study estimated India's black, or unrecorded, economy to account for roughly a fifth of GDP. NOt only was the treasury losing revenue, but evasion was also blunting the allocative and distributive features of the system. For example, tax rates could not be lowered to reduce tax-related distortions without a loss in revenue given that the tax base had been narrowed by evasion. Other older studies in the 1960s and 1970s for Chile, Colombia, Kenya, and Nigeria all found similar high rates of evasion."

TAX AMNESTIES . It serves no purpose to have a tax assessed but not paid. In some countries the problem of tax arrears has become so critical that governments have taken emergency measures such as tax amnesties and provisions for rescheduling tax payments. These may make it easie to collect delinquent taxes, but they can also undermine voluntary comliance if used frequently.

It is also said that it helps to raise substantial revenues and might even help foreign trade through harmonization of the tax structure (Ibid) Expenditure tax is opposed because of being highly regressive. However since such tax covers major population the tax revenue would be significant. The existing expenditure tax in India suffers from major drawback as it is vary symbolic and concerns with fraction of expenditure. The same Author in as above observed as under :

The major arguments in support of a consumption-based tax over an incoome tax may be categorized as follows : such a tax is more equitable over time; it is conceptually easier to implement; and as a practical matter it might be expected to have fewer distortionary effects on the allocation of capital investment. The major arguments given in opposition to such a tax are that the tax may alter the distribution of the tax burden from what it is today in a regressive way; it may lead to vast accumulations of wealth by some households, and such concentration of wealth with the accompanying economic power is undesirable; it is considerably different from the current income tax, and any major movement to a consumption-based tax would give rise to severe transitional problems, including a windfall gain to younger workers who have not yet accumulated assets (such a windfall gain would be at the expense of older workers); and since consumption fluctuates less than income, it would be less stabilizing than the current income tax.

4.3 RELATIVE MERITS OF INCOME AND EXPDNDITURE TAXES

It is believed that the consumption tax does not meet the test of taxation according to he ability to pay : It would tax the wrong people at the wrong time; it would be as prone to erosion through lopholes as the income tax; and it would lead to an excessive concentration of wealth.

Income is the best measure of ability to pay tax If taxpayer A has $ 25000 of income and txpayer B has $ 20,000 it is resonable to say that A has more taxpaying ability. Now suppose A save $5000 and B spends all his income. A would pay more income tax than B, but the would pay the same consumption tax. Most people would regard the consumption tax result as unfair.

As already noted, substitution of a consumption tax for the income tax would raise the taxes on the young and the old and reduce the taxes of those in middle age who save more. Similarly, unemployed and disabled workers who are using up their savings would find themselves paying tax even though they had no income.

It is already explained why a tax that omits savings from the tax base is the same as a tax applying only to labour income and exempting all property income. Such a tax would be regarded by most people as an outage, yet that is what the consumption tax really is.

In theory, the progressive nature of the income tax- (higner tax rates for those with higher earnings)- could be aproximated by a consumption tax. But to do so, it would be necessary to set much higher tax rates. For example, assuming no savings, a 33 per cent income tax rate is equivalent to a 50 percent rate on consumption, and a 50 percent income tax rate is equivalent to a 100 percent rate on consumption. Result : a 33 percent bracket taxpayer under the income tax would pay a $ 5000 consumption tax on a car costing $ 10,000 and the 50 percent taxpayer would pay $ 25,000tax on $ 25,000 car. Congress is hardly likely to accept such rates and the result would be a snarp decline in progressivity.

Consumption tax advocates usually compare the results of an ideal consumption tax with the imperfect income tax we have today. But most of the preferences under the income tax would probably be carried over into the consumption tax. Housing is favourably treated under the income tax and would doubtless be exempt under the consumption tax. Charitable contributions, medical xpenses, state and local property and sales taxes, child care expenses, exemptions for the elderly, as well as other personal allowances would all become deductible. And with savings also deductible, the consumption tax would probably turn out o be a monstrosity not capable of raising sufficient revenues.

The transition from the income tax to a consumption tax would create great inequities. The retired elderly, who already paid tax on the income they saved. would pay tax again when they spent it. Something would have to be done to avoid taxing such accumulations under the consumption tax. Exemption of all accumulated assets at the time an expenditure tax is initiated would leave a big loophole for people with large amounts of accrued capital appreciation that had not been subject to tax, but it would be very difficult to make the necessary distinctions in order to prevent wholesale tax avoidance.

Under any consumption tax, taxpayers who save large fraction of their income would be able to accumulate large fortunes over a lifetime. Corporations, and through them their shareholders, would also amass huge aggregations of wealth without payment tax. Many but no means all, consumption tax advocates suport effective wealth and power in the hands of wealthy individuals. But there is no way to tax the income of corporations under a consumption tax and the history of taxation in this country provides no assurance that adequate death and gift taxes would be levied on individuals to supplement the consumption tax.

The present income tax is flawed, but it can be greatly improved without departing from this widely-approved method of taxation. The solution is to tax all income alike and to eliminate all personal deductions and tax credits except for unusual medical expenses and casualty losses, which do impair ability to pay.

The present expenditure tax in operation is confined only to certain areas such as expenditure in hotels and restaurents . This tax ropes within its net certain types of expenses but it fails to broaden the tax base. In a country like India the need is to have wider tax base with lower tax rates so as to expedite the economic growth, avoid evasion and mobilise revenues from a wider sector of the society. Expenditure tax "enhances equity, economic efficiency and the level of new investments." Others have suggested that such a tax woulld simplify the tax structure.

(The structure and Reform of the U.S.Tax system by Albert Ando, Marshal E.Blume, and Irwin Friend. The MMIT Press, England).

It is also said that it helps to raise substantial revenues and might even help foreign trade through harmonization of the tax structure (Ibid). Expenditure tax is opposed because of being hihgly regresisve. However, since such tax covers major population the tax revenue would be significant. The existing expenditure tax in India suffers from major drawback as it is vary symbolic and concerns with a fraction of expenditure.

4.4 An Overview of Supreme Court Case Law :

The judicial approach to the Expenditure Tax Act 1987, has been summarised in "Federation of Hotel & Restaurent Association of India and Others", Vs. Union of India & Others, by the Supreme Court of India at Page 97 in Vol. 178 (1989). The court dealt with the aspect concerning the legislature competence of Parliament. However the significant observations in this case throw light on important issues and as such these issues have been extracted from the said case.

Shri Palkhivala, learned senior counsel for the petitioners, contended that the appellation of "expenditure tax" given to the impost is a misnomer as the concept of "expenditure tax" as known to law and recognised by the theorists of public finance is not a tax on a few stray items of expenditure but is a term of art which has acquired a technical import as "nomen juris" and that the impost envisaged by the Act, in its true nature and character, is no more and no less than a tax on luxuries under entry 62, List II, within the State's exclusive power. Learned counsel urged that the delicate balance in the demarcation in a federal polity of legislative powers between the Union and the States would impose on the Union, the repository of the residuary power, the sensitive task of recognising both the line of demarcation as well as the constitutional mandate - and a disciplined reluctance - not to cross it. The contention as to lack of legislative competence emphasises two aspects - one with a negative implication and the other of a positive import. Negatively, it is urged that the impost is not, and does not satisfy the concept of an "expenditure-tax" which has a technical connotation both in law and in public finance. A tax on certain stray items of expenditure is not, it is contended, a general "expenditure tax". The nomenclature of the levy is really a mere ill-fitting legal mask for what is really a tax under entry 62, List I. The nomenclature of the tax, it is urged, is irrelevant in deciding its true nature and character. It belongs to the rudiments of the subject, says learned counsel, that a constitutional grantee of a power cannot enlarge its own by choosing for the legislation enacted in exercise of the power, a nomenclature that corresponds to and semantically subsumes with the grant. Shri Palkhivala submitted that the true nature and concept of "expenditure-tax", as known to the theories of public finance, has a specific, well accepted legal connotation and is a tax levied on income or capital spent or "consumed" in distinguishment of income or capital "saved". It is this concept of "expenditure-tax", as a fiscal tool, which has certain social and economic objectives informing its policy. The present impost and its incidents, it is urged, have no rational connection with the concept of "expenditure-tax" known to and accepted by the principles of public finance and recognised by established legislative practice.

Referring to the economists' concept of "expenditure-tax", learned counsel referred us to the report of the Study Group "On Taxation of Expenditure" (Government of India, Ministry of Finance, April 1987) :

"An expenditure tax is generally taken to mean a direct tax on personal consumption, i.e., the total annual consumption (minus an exemption, if any) of an individual taxpayer or family. This implies that the tax will be payable in the year in which consumption takes place. One can conceive of the tax base being computed by adding up all items of expenditure, which are by law defined as consumption expenditure,..... or alternatively, by summing up all the receipts and subtracting therefrom expenses of earning income as well as outflows in the form of savings (going into different types of investments, including repayment of past loans). In practice, the latter method would be preferable" (emphasis* supplied).

"India has the distinction, shared with Sri Lanka, of having actually experimented with a direct tax on consumption expenditure though the idea itself had caught the imagination of many tax theorists in developed countries, some of whom had developed practical systems for implementation. In both India and Sri Lanka, the tax was introduced on the basis of the recommendations of Prof. Nicholas Kaldor. Prof. Kaldor had been invited to come to India by the Indian Statistical Institute to make an investigation of the Indian tax system in the light of the revenue requirements of the Second Five Year Plan. In his report, he recommended the introduction of a direct tax on personal consumption expenditure as a limb of a comprehensive and self-checking system comprising the income-tax, (which was already in operation in India), a tax on capital gains (which had been tried for two years in the post-war period and then withdrawn), an annual tax on net wealth, a general gift-tax and a tax on personal expenditure. He envisaged that these five levies would be assessed simultaneously on the basis of a single comprehensive return,......" (emphasis* supplied).

"Under the scheme of expenditure taxation suggested by Prof. Kaldor, a taxpayer would not be required to give any detailed account of his outlays on consumption but only a statement of his total outlays as part of a comprehensive tax return showing all his receipts, investments, etc, and all the items for which he claimed exemption.....".

"In India too, although the expenditure tax was tried twice and was given up, there has been a revival of interest in making expenditure the base for personal taxation. In particular, it has been maintained that India should seriously consider moving towards a progressive expenditure tax for three important reasons :

(a) it will promote savings;

(b) it would be, on the whole, more equitable than the present or any practicable form income tax, and

(c) it will significantly reduce the inducement of direct tax evasion".

In Musgrave on "Public Finance", referring to the concept of a personal expenditure tax, it is stated :

".... In analogy to the income-tax, the taxpayer would determine his total consumption for the year, subtract whatever personal exemptions or deductions were allowed, and apply a progressive rate schedule to the remaining amount of taxable consumption".

Shri Palkhivala also referred to certain passages of Nicholas Kaldor "On Expenditure Tax" and the same eminent economist reports on "India Tax Reform", to reinforce the submission that the conceptualisation of "expenditure-tax", as a fiscal tool for economic regulation, has a specific and definite connotation and the "tax" so conceptualised by experts on public finance is an entirely different idea from the one built into the present legislation. The very concept of "expenditure-tax" envisaged in the impugned legislation, it is urged, is unknown to accepted principles of public finance and is the result of a grave misconception as to the essential nature and incidents of what in law and legislative practice is recognised as "expenditure-tax". The whole exercise, learned counsel said, is a draft on credibility and that the Finance Minister's speech on the Bill leaves no doubt that what the Government wanted from the law was really a tax on 'luxuries'. The impost, it is urged, is not susceptible of any other legitimate understanding than that it is in substance and effect, a tax on "luxuries" within the States' power. Shri Palkhivala emphasised the relevance of what was implicit in the observations of this court in H.H. Prince Azam Jha Bahadur v. Expenditure-tax Officer [1972] 83 ITR92; [1972] 1 SCR 470, made while upholding the legislative competence of the Union Parliament to enact the Expenditure-tax Act, 1957, as referable to the residuary entry 97 of List.I. The implication of the observations of this court at page 479 of the report, according to learned counsel, is that what distinguished an "expenditure-tax" from a levy under entry 62 of List II, was that the scheme of taxation took into account the totality of expenditure over a unit of time, as distinct from sums laid out on stray purchases of luxuries.

Shri Palkhivala, then, submitted that the notion of expenditure-tax, as recognised by legislative practice is a relevant factor. In Croft v. Dunphy [1933] AC 156 (PC), Lord Macmillan held that when power is conferred on the legislature on a particular topic, it is important, in determining the scope of the power, to have regard to what, in legislative practice, is ordinarily treated as embraced within the topic and particularly in the legislative practice of the State which has conferred the power. In Wallace Brothers and Co.Ltd., v. CIT [1948] 16 ITR 240 (PC) ; [1948] L.R. 75 IA 86, Lord Uthwatt referred to the permissibility and, indeed, the importance of referring to the legislation practice as to what is ordinarily treated as within the topic of legislation in understanding the scope of a legislative power. The notion of expenditure-tax in the scheme of the Expenditure-tax Act, 1957, would, it is urged, detract from such legislative practice.

The second limb of the argument is that the impost is clearly of the nature of a tax on luxuries within entry 62 of List I. The simple test, according to the argument, is whether, if a State Legislature had enacted a similar law, it would not have been held to be within its competence under entry 62 of List II? The answer would, according to the submission, be an emphatic affirmation. Referring to the concept of a luxury tax, learned counsel referred to the New Encyclopaedia Britannica Vol.7, which, referring to "luxury tax", says :

"Luxury tax, excise levy on goods or services considered to be luxuries rather than necessities. Modern examples are taxes on jewellery and perfume. Luxury taxes may be levied with the intent of taxing the rich, as in the case of the late 18th and early 19th century British taxes on carriages and manservants; or they may be imposed in a deliberate effort to alter consumption patterns, either for moral reasons or because of some national emergency. In modern times, the revenue production of luxury taxes has probably overshadowed the moral argument for them. Furthermore, the progressive nature of the early taxes began to be lost as more lower invome people's luxuries' were taxed in the interest of generating additional revenue; an example is the amusement tax."

The Court further observes at Page No. 129 in the said case

Mr. Nicholas Kaldor, Reader in Economics in the University of Cambridge, was the proponent of a levy styled "expenditure-tax". When the Government of India requested him, some time in the fifties, to have a look at the system of direct taxation prevailing in this country and make his recommendations for a comprehensive scheme of tax reform, he suggested, inter alia, the levy of an "expenditure-tax". His opinion was that such a levy, supplementing an income-tax levy at rates lower than those prevalent then, would enable the Government to more effectively harness its resources. In the course of arguments before us, copious references have been made to passages from Nicholas Kaldor's book ("An Expenditure-tax" published by George Allen and Unwin Ltd. of U.K.) and his "Survey Report on Indian Tax Reform" (published by the Government of India) but it will be sufficient to mention here that Prof. Kaldor's report was implemented by Parliament by enacting the Expenditure-tax Act, 1957 (hereinafter referredto as "the 1957 Act"). The validity of the above Act was challenged before this court but unsuccessfully. The decision of this court is reported as H.H. Prince Azam Jha Bahadur v. ETO (1972) 83 ITR 92 (SC); (1972) 1 SCR 470. The nature and scope of the Act have been dealt with in the above decision and it is unnecessary to repeat the same here.

The 1957 Act was withdrawn after a few years; to be precise, with effect from the assessment year 1965-66. It was given up both because it was found to be too cumbersome and difficult to administer and also because the yield of revenue therefrom was not substantial due to the limited number of assessees it covered. After it was given up, as already mentioned, the 1980 Act occupied the field for a very short time, the pendency of writ petitions challenging its validity having perhaps largely contributed to its withdrawal. After some interval, now, Parliament has come in with the 1987 Act. The ambit and scope of this Act along with, on the one hand, its distinguishing features, as contrasted with the 1957 and 1980 Acts and its simiarities, when compared to the State legislations, on the other, have been brought out in the judgment of brother Venkatachalian J. and do not need repetition here. It is in this background that we have to determine the pith and substance of the 1987 Act and decide whether Parliament had the legislative competance to enact the same or not.

It is evident that various issues in shifting the income base taxation to the expenditure base are likely to be contraversal.