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Report on Incidence of Taxation.

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CONTENTS.

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By the Financial Secretary.

I have had under consideration since the beginning of 1938 an investigation of the incidence of taxation in Ceylon. Various ways were considered of obtaining the necessary data, and finally the whole of the task was, with the approval of the Minister of Labour, Industry and Commerce, entrusted to Dr. Das Gupta, Professor of Economics, Ceylon University College, with the able assistance of the Statistical Branch of the Department of Commerce and Industries. The admirable Report contained in this Sessional Paper is the result. Too much credit cannot be given to Dr. Das Gupta and his assistants for the skill and patience with which they have extracted and marshalled the valuable statistics contained in the Report.

I do not propose to set out here the conclusions which I personally would draw from the Report, and the changes in our scheme of taxation which appear to be desirable. I propose merely to record a few considerations which may not be obvious to the casual reader but should be taken into account by anyone who seeks to draw conclusions from the Report.

1. *General.*—Any survey of the incidence of taxation must proceed on broad lines and must rely on wide assumptions. Scientific accuracy in such a matter is impossible. The fact that some wide assumption can be shown to be incorrect in a few individual cases does not necessarily invalidate the statistics prepared on the basis of that assumption.

2. *Scope of the Report.*—The Report deals with individuals resident in Ceylon, and is based on 1938 figures.

3. *Total Weight of Taxation.*—One broad assumption which should be made is that all taxation falls sooner or later on individuals. The total taxation of Ceylon can be divided into that borne by (*a*) non-resident individuals, and (*b*) resident individuals. The total Central Government taxation for 1938-39 was about Rs. 90,000,000. The total income reached by such taxation has been estimated roughly at Rs. 600,000,000 giving an average rate of 15 per cent. Of this, about Rs. 80,000,000 accrued to non-residents, and it is not thought that the percentage of taxation levied on them is more than 20 per cent., say Rs. 16,000,000. This means that taxation of about Rs. 74,000,000 was levied on the income of resident individuals totalling about Rs. 520,000,000, which gives an average rate of about 14 per cent. Table 9 of the Report gives the percentage to income of the Central Government taxation which has been brought under review at figures ranging from 5.30 per cent. to 18.97 per cent.; giving due weight to the fact that the lower percentages apply to larger blocks of income than the higher percenatges, the average is probably below 10 per cent. It seems to follow that the taxation not taken into account in the Report is at least half the taxation which is taken into account.

How does this extra taxation arise? I will give two examples A. and B. Readers could themselves multiply them indefinitely.

A. *Purchase of Petrol.*

For each gallon of petrol purchased credit has been given for tax at the current rate of Customs Duty per gallon. But when the motorist buys a gallon of petrol at a filling station the price he pays presumably includes a share, however small, of the following Central Government taxation:—

(i.) Import duty on petrol which evaporates while the petrol is in the hands of the vendor or his agents.
(ii.) Import duty on the petrol and lubricating oil consumed by the motor lorry which brings the petrol to the filling station.
(iii.) Import duty on the same lorry, its tyres, accessories and spare parts.
(iv.) Import duty on the materials and machinery used in the construction of the main installation of the petrol company.
(v.) Import duty on the materials and machinery used in the construction of the filling station.

(vi.) Import duty on other materials used by the petrol company and the filling station in carrying on their businesses.

B. *Purchase of Rice at a Village Boutique.*

The Report takes into account the Customs duty paid on the quantity of rice purchased. In addition the price paid by the consumer will include a share, however small, of the following Central Government taxation:—

(i.) Import duty on any rice which is lost or stolen, or eaten by animals, birds or insects, or damaged so as to be unfit for consumption.

(ii.) Import duty on the original cost of the lorry which brings the rice to the boutique, Customs duty on the petrol it uses, &c.

(iii.) Import duty and other taxes (other than the duty on the rice itself) paid by the rice importer and the merchant who acts as middleman between the importer and the boutique-keeper.

(iv.) Import duty on the oil used by the boutique-keeper in his lamps, and on other articles which he purchases for use in his business otherwise than for sale.

In both the above cases the price paid will include a share of local taxation paid by the importer and distributors, but I am considering only Central Government taxation.

I agree with Dr. Das Gupta that it is impossible to allocate to each individual consumer the proportion of the taxes paid by other persons which are passed on to him in the form of an addition to the price of the goods he buys. The fact must, however, not be lost sight of that the amount so passed on is a very considerable proportion of the tax which can be directly allocated to him.

To sum up—

(1) The Report necessarily takes into account part only of the total taxation borne by resident individuals.

(2) The taxation not taken into account in the Report may alter the relative incidence of taxation on various classes.

4. *Incidence of Taxation on small Incomes.*—The Report (Table 9) produces the result, familiar to those who have read similar reports, of percentage rates of taxation which are higher at the bottom of the scale of incomes than part way up that scale. It does not necessarily follow that persons at the lower end of the scale are over-taxed in comparison with others. The theory has frequently been enunciated that in almost every country (and I do not think Ceylon is an exception) there is at the bottom of the scale a class of persons whose total resources are barely sufficient to purchase the necessities of life. It is argued with some force that it is impossible in the long run to tax this class; their means are only just sufficient to keep them alive, and if a tax were successfully imposed on them so as to reduce their purchasing power, they would simply cease to exist. The argument is therefore that if a tax is imposed on anything used by that class, it is bound to be passed on, either in the form of higher wages if they are wage-earners, by higher prices for their produce if they are produces, or by greater calls on Government assistance or private charity if they are neither. If we admit the existence of a class at the bottom which cannot be taxed, in the sense that any taxation imposed on articles which they use will be passed on to some one else, it seems to follow that when taxation is levied on articles used by classes slightly above that level, some part of such taxation will be passed on similarly. A recent example of this appears in the war allowance to Government servants. It is hoped that no Government servant receives so small a wage as to be on the bare margin of subsistence and therefore on the above theory untaxable; it is assumed that even the lowest paid are a little way up the scale. The war and its results (including the imposition of additional taxation on articles like sugar) have resulted in an increase in the cost of living. In the case of the low paid Government employee, Government as employer is paying a war allowance which covers about half the increase.

As we go up the scale of salaries, the war allowance becomes a rapidly decreasing percentage of the recipient's salary, and disappears at about Rs. 230 per month. It is suggested that this is an example of a tendency which is practically inevitable. If taxes are imposed on articles in common use, the employer in the case of the employee, and the community in the case of other persons, will sooner or later make up the whole of the increased tax in the case of the man at the bottom, and a decreasing part of the tax in the case of persons at higher levels of income.

It is suggested therefore that the present Ceylon system of taxation (or rather the system which existed in 1938, which is the year on which this inquiry is based) cannot be condemned offhand, because, for instance, the person with Rs. 25 a month (rural) is shown as paying a higher percentage of taxation than the person with Rs. 100 per month (rural). On the other hand it is not suggested that the present position is satisfactory, and requires no amendment.

5. *Middle Classes.*—Table 9 shows the usual feature of regression in the case of moderate incomes. In other words, our taxation system bears very lightly on persons with incomes round about Rs. 200 per month. The adequate taxation of this class without imposing undue burdens on classes above and below it has been found difficult in all countries. That is not to say that the present position must necessarily be allowed to remain as it is.

6. *Minimum Taxation.*—At my request, Dr. Das Gupta has been good enough to work out the minimum taxation of each class on a basis explained by him at page 15 of his report. In my opinion it is useful to divide taxation into two parts; the minimum taxation which an economical member of the class in question will be more or less bound to incur, and the remainder of the taxation which may be regarded as optional in the sense that it attaches to luxuries or semi-luxuries. I consider that a perfect system of taxation should recognize this differentiation. The minimum taxation should be steadily progressive and should omit luxuries, *i.e.*, goods or services which are not reasonably necessary to the class in question. Apart from this minimum taxation luxuries should be taxed suitably; those which are considered least desirable should be charged with the highest rate of duty which can be imposed without reducing the yield, while other luxuries should be taxed at lower rates dependent on the need for revenue.

A further advantage to be gained from the preparation of figures of minimum taxation is that the economical member of the class is not given credit for taxation paid by uneconomical members, *e.g.*, the minimum expenditure from a monthly income of Rs. 100 may be Rs. 60, on which taxation of Rs. 4 is imposed. A member of that class whom we will call A may save the balance of Rs. 40 and thereby suffer no taxation on that amount, while B, another member of that class, spends the balance Rs. 40 on highly taxed luxuries, thereby incurring an extra Rs. 20 in taxation. A thus pays 4 per cent. and B 24 per cent. of his income in taxation. This does not necessarily mean that A is undertaxed or B over-taxed. Moreover, if the As and Bs in the Rs. 100 per month class are equal in number, the aggregate for the class may produce a figure of average taxation of $\frac{4+24}{2} = 14$ per cent. We may then come to the conclusion that the whole class is over-taxed, and decide to reduce taxation on something which the whole class uses. The net result may be to reduce the taxation of the already lightly-taxed A from 4 per cent. to 2 per cent., which is clearly wrong. This result will be avoided if adjustments made with a view to making taxation progressive are related to the minimum expenditure of each class and not to average expenditure, leaving the taxation of luxuries to be dealt with as an entirely separate problem.

Dr. Das Gupta has taken a fairly high standard for minimum taxation; to take one instance only, he has assumed that every person whose income is over Rs. 1,000 per month will own a motor car, whereas a considerable number of persons with incomes above that figure do not in fact own motor cars. His minimum taxation figures should be regarded as low averages rather than absolute minima. They indicate with much greater force than the average taxation figures the regression in middle class incomes, *e.g.*, the Rs. 300 per month (rural) class suffers minimum taxation of 3.2 per cent. only.

As indicated at the commencement of these notes, I am not attempting to write a considered opinion on the findings in the Report and the steps, if any, which should be taken to adjust our system of taxation in the light of the Report. I am merely putting on paper a few notes which may be of assistance to persons who wish to draw their own conclusions.

The Secretariat,
Colombo, August 5, 1942.

H. J. HUXHAM,
Financial Secretary.

PREFACE.

The Measurement of Incidence is a very complex problem. Even the most elaborate inquiry must use many assumptions and approximations. Our inquiry has been as thorough as the nature of the problem and the limitations of our resources have permitted. The values we have worked out may not be absolutely accurate, but they may claim to be fair and acceptable. More than that cannot be expected in an investigation of this kind.

The Report could have been shorter, if less explanatory. But I have spared no pains to make it intelligible to the general reader. After all, economic literature of this type is meant as much for the intelligent layman as for the expert. The average citizen can, and in our social system must, understand every important economic issue. A good deal of what he cannot understand is perhaps hardly worth understanding at all. Consequently, I have explained the technique, the limitations and the implications of the inquiry fairly fully. A bare skeleton Report containing only the calculations would have defeated its purpose. Needless to say that for the methods followed and the opinions expressed I am only responsible and not the Government.

I had the opportunity of discussing several points with the Honourable the Financial Secretary and I acknowledge gratefully various suggestions and observations which I have received from him.

Valuable assistance has been given by Mr. K. Williams, the Statistical Officer, in the conduct of the inquiry.

B. B. DAS GUPTA,
Economic Adviser.

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REPORT ON INCIDENCE OF TAXATION.

CHAPTER I.

The Definition of the Inquiry.

THE object of this inquiry is to measure the incidence of taxation on certain selected categories of income.

Meaning of Incidence.—By incidence is meant the *direct money burden* of a tax. This is different from the indirect money burden on the one hand and the direct and indirect real burden on the other. The *direct* money burden is what the Government takes from the taxpayers. The *indirect* money burden refers to any additional expenses or outlay which they may have to incur after the tax, but which does not necessarily go to the Government. The *real* burden is the sacrifice of welfare which the tax may cause. Thus, by taxing sugar the Government may collect a certain sum from the buyer or the seller. This is the direct money burden. Suppose the tax drives the buyer to buy honey instead of sugar. He then evades the tax, but may have to spend in all more than before. This additional outlay is an indirect money burden upon him of the tax. Suppose again he is unable to buy either sugar or honey after the tax. He now buys, in other words, a different and less preferred assortment of goods than before. This means a loss of welfare for him. It may be termed the real burden of the tax. The real burden is not necessarily light. To quote a classical example, the man who walks a long distance to evade a small toll on a bridge, can hardly be said to suffer less than the man who pays it.

In this inquiry we are only concerned with incidence in the sense of direct money burden.

Another point to remember is that incidence is not the same thing as *effect.* A tax on imported butter for instance may take one per cent. out of a particular income. This is its incidence. Its effect may be to reduce the consumption of butter, increase that of margarine, encourage local production of butter and so on. Needless to say that we do not in this Report investigate any such effects of taxation.

Meaning of Income.—Income is taken as the income of the individual in his capacity as a consumer. It includes what he spends as a consumer and what he saves.

The sum of money from which a person meets both living and earning expenses, that is to say, the sum which is used both for consumption and production may be called is gross income. The sum which is spent purely on living or consumption (including taxes payable on it) and what is saved (including taxes, if any) may be called his *net* income. We deal only with the net income. In other words, we approach the problem from the side of the consumer and not of the producer. The unit of our investigation is consumer's income disposed of through the consumption budget, not producer's income disposed of through the production budget. Also, our consumer is an individual and not a group.

It is clear from this that in this inquiry we do not study the incidence of *all* taxes on *all* incomes. Our incomes are in the first place, incomes of the individuals. Incomes earned by companies, clubs, societies, trusts and public bodies which are not passed on to their constituent individuals, are excluded from our study. Consequently also whatever taxes they pay. Secondly, we take the individual only in his capacity as a consumer. In this capacity his income is what he spends on living and consumption plus what he saves, in other words, what he regard as his net income. We do not take him in his capacity as a producer Therefore we do not analyse his production expenditure and the taxes that he may pay on it.

In spite of the fact that it narrows down the scope of the investigation and it has its limitations, this method of approach is for our purpose the most effective and the most practical. Incidentally, it is also the method commonly followed in assessing incidence. The reasons are the following:—

1. The producer is not a suitable unit of investigation for us.

In the first place, producers differ much more widely from one another regarding production than consumers do regarding consumption. Of course consumers also differ according to their race, residence, occupation and the general economic and social context in which they live. The standard of living of the villager for instance is not the same as the standard of living of the townsman. But it is possible to group consumers into a few broad classes. Producers defy grouping. There are virtually as many classes of producers as there are products. A consumer with an income of Rs. 100 is a fairly well-defined person provided we indicate his race, occupation and residence. A producer with an income of Rs. 100 has hardly any meaning unless we indicate the precise branch of production he engages in and the precise scale, manner and technique of his production.

Secondly, the burden of taxation on the producer is more difficult to trace than the burden on the consumer. The consumer pays a tax either directly like the income tax, or indirectly through the goods he purchases. We can discover this purchase from his consumption budget and therefore also discover his tax burden. What an individual pays as a producer is not so easily ascertained. Suppose sugar is taxed. If its price increases by the amount of the tax, it means that the consumer pays it. We can estimate how much he pays from how much he buys, that is to say from his consumption budget.* But suppose the price does not increase. That means that the Government collects the tax wholly from the producer. How much does he actually pay? Obviously, it cannot be ascertained from his or anybody else's *consumption budget.* His loss will be in the shape of a reduction in his net profits or net income. It is certainly a burden, but one which cannot be traced through consumption budgets. To measure it, we shall have to study the particular producer's production costs and production receipts before and after the tax. This is extremely difficult to do. In this Report we have made no attempt to measure the burden on the producer imposed in this manner.

2. The incidence of most taxes, though not of all, can be ascertained by this method.

The taxes levied by Government are many and various and (*a*) they are not all paid or expected to be paid by individuals as consumers, and (*b*) even if they are, in some cases the burden cannot be discovered from a study of their consumption budgets. A tax on sugar leaves a clear mark on the consumer's budget. But suppose there is a tax on curios which are bought only very occasionally in small quantities by consumers. Hardly any consumption budget would show this purchase. Particularly elusive are the taxes on production goods. If dynamos are taxed, the tax will probably load the price of electricity and though dynamos do not appear in consumption budgets we can measure the incidence of the tax through the consumption of electricity. But what about a production good like manure? It appears in no consumer's budget. A tax on it may not at all be paid by consumers. Even if it is paid, it will probably be paid in the form of a very slight increase in the price of a number of agricultural products, which will be extremely difficult to trace. Goods like dynamos which are traceable are very limited in number. Most production goods elude consumption budgets. By taking the consumer as our unit we may thus miss the burden of certain taxes, particularly those on production goods. It is only if we assume that (*a*) all taxes are paid by consumers, (*b*) every taxed good fully appears in or can be traced through consumption budgets, and (*c*) we have full and reliable budget

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* The manner in which a tax impinges on an income is explained in detail in the next chapter.

returns that we can trace all incidence by this method. But these assumptions are not quite true. However, they are true of most of the important taxes levied in this country. The taxes that are not traceable to consumers or are not actually borne by them will of course escape our inquiry. But this omission is inevitable. Incidence can only be studied in relation to *definite* units of tax payers. Since all taxes are not meant to be paid by all tax payers, whatever the unit taken, there is thus bound to be some omission. This explains why the whole of the community's tax burden cannot be traced in relation to the unit selected. No study of incidence can ever be or has been quite complete. We discuss later in Chapter 4 the nature and the extent of the taxes which have for one reason or another escaped our survey. On the whole the omission has not been serious.

3. We are interested in persons, not groups, companies or societies as such. Besides, most corporate bodies distribute their earnings to their members. In personal net incomes therefore are included much of corporate net incomes.

4. In comparing relative economic positions of individuals, net income is a better criterion than gross. Economic welfare is related to net and not gross income.

It is on all these grounds that we have taken the consumer and his net income as the unit of investigation. This, as already stated, is the practice commonly followed in the study of incidence.

It is well to mention here that in certain cases the incomes we study are not the incomes of individuals, but of families. This is specially the case with regard to the village incomes of Rs. 25 and Rs. 50. Here it is the family and not the individual which is the unit of earning and spending. In the case of the higher incomes however the situation is different. Although the family is the spending unit, the individual is generally the earning unit. Incomes of the members of the family are not pooled to the same extent as in the case of the lower incomes. Consequently here incomes have been taken as individual income.

The Selection of Precise Income-classes.—Consumers differ in their spending habits and consequently also in their vulnerability to taxation. Of course the differences are not so great as in the case of producers. Each producer is almost a class by himself. But consumers also differ. The same income for instance, is spent differently by men in different places and of different nationalities. Occupation, source of earning, size of family, social standing and various other factors also affect the mode of living, but we cannot possibly consider each different type. We must therefore select from the general community of consumers the more important anl representative groups or classes. Having selected the classes, we must also fix the precise points of income in relation to which incidence is to be measured. Incomes are continuous from zero upwards. We can only select a few convenient and useful points for examination.

In selecting these classes and points, we have kept in mind three considerations.

1. We should limit them to a convenient number. To multiply classes would be to make the inquiry unwieldy and unmanageable.
2. They should be representative, useful and realistic.
3. In selecting them, we must remember how far we are able to collect information about their spending habits. It is no use selecting a class for which no information is available.

In this country the two main causes of differences in spending habits seem to be (1) place of residence, whether it is town or country, and (2) nationality of the earner, whether it is Ceylonese or European. We have therefore divided our classes mainly on these two lines. At the same time we have not quite ignored occupational contexts. Our village incomes are all agricultural incomes which is the most important type of income in the country. Three of our town groups are recruited from two important town occupations, namely, industrial labour and clerical service. The rest of the town incomes however are unspecified. Regarding sources of earning, we have where appropriate, divided incomes into "earned" and "unearned". This is necessary because the unearned income pays different and higher direct taxes. Regarding size of family, we have not shown much variation. We have accepted the size of the sample families we have studied and assumed likely sizes for others. In the case of higher incomes for instance, we have uniformly assumed the family to consist of husband, wife and two children. Needless to say that expenditure and consequently taxation would be different if other sizes of family were taken.

Our next task is to select precise points of income for these various classes. It is obvious that incidence should as far as possible be measured in relation to fixed *points* of income, not *ranges*. There is not much sense in measuring taxation paid for instance by incomes ranging from Rs. 0 to Rs. 25 or Rs. 25 to Rs. 50, since, the burden changes appreciably with every change of income. The deviations from the average would be so large that the average itself would become little more than an abstraction and an exercise in arithmetic. We have therefore tried to keep as close as possible to fixed points of income. But where sufficient samples of any point of income could not be obtained, we had to admit a small latitude.

What are the most convenient and significant points of income for our purpose? Clearly, we should consider here two things (1) the general distribution of resident individuals' incomes in this country, and (2) the relative importance of various sizes of income from the point of view of national tax revenue.

We have no complete and absolutely accurate census of income. But we have information on two sections. (1) We know from the Income Tax Returns the number and distribution of all incomes above Rs. 200 per month. (2) The Rural Economic Surveys, so far made, have given us data regarding the possible number and distribution of rural incomes below Rs. 50 per month. These two sectional distributions show the same characteristics. Therefore from any of them, assuming that incomes in this country are distributed according to Pareto's law*, a rough estimate of the distribution of income can be made. This distribution comes out as follows: (estimate made by Mr. K. Williams). Although it is a distribution of *all* incomes, the distribution of personal incomes probably does not differ much from it.

Distribution of Resident Incomes (1935).

Monthly Income.	No. of Incomes.	Per Cent. to Total.
Below Rs. 25	1,317,080	78·16
25 and less than 50	233,420	13·85
50 ,, ,, ,, 100	85,371	5·07
100 ,, ,, ,, 150	21,896	1·30
150 ,, ,, ,, 200	9,328	0·55
200 ,, ,, ,, 250	4,980	0·30
250 ,, ,, ,, 300	3,028	0·18
300 ,, ,, ,, 500	5,233	0·31
500 ,, ,, ,, 1,000	3,022	0·18
Over 1,000	1,742	0·10
	1,685,100	100·00

* Briefly, the law holds that as income rises the number of earners steadily falls, and there is a fixed relationship between the change in one and the change in the other. In other words, a graph showing on a logarithmic scale various levels of income and the aggregate numbers of persons in receipt of each level of income will be a *straight line*. The slope of the line may not be the same in two countries or in two periods of time. Indeed distribution is everywhere tending to be less unequal, but what the law emphasizes is that it nevertheless tends to remain a straight line. The law is not based upon any abstract economic reasoning, but is entirely empirically derived from statistics of income in various countries.

The actual points of income we have selected for our inquiry are Rs. 25, 50, 100, 200, 300, 500, 750, 1,000, 2,000 and 3,000. This we believe is a fairly compact and representative range. The selection of three incomes up to 50 hardly requires justification. Ninety per cent. of the incomes of the country, as the table shows, fall within this range. We have taken Rs. 25 and 50 as two convenient stages of this range. Consistently with their importance, we have been specially thorough in estimating the incidence of these two classes. Above Rs. 50, we have gone up by fairly regular intervals to Rs. 3,000. The higher incomes though numerically few are from the point of revenue quite important. Much of the tax revenue of the country is derived from them. They must therefore be included in a study of incidence.

It is unnecessary to go beyond Rs. 3,000 because there are very few incomes in this country above that figure. On the other hand, to go below Rs. 25 would be to invite an unreal picture of incidence. There are undoubtedly many families which earn less than that as the Economic Survey has revealed. But their true money expenditure is difficult to ascertain. Many of them supplement their income by using their own garden or field produce, by borrowing or by assistance from friends and relations. It will not be right to deduce their tax burden merely from their apparent money income and expenditure.

The complete scheme of categories of income that we have selected for study is given below. It will be seen that we have not included every possible type in it, but confined ourselves to the more important and probable ones. "Earned income" it may be explained, is income derived from work, while "unearned income" is income derived from property. It will be seen that all village incomes up to Rs. 200 and all town incomes up to Rs. 750 have been taken as fully earned. Village agricultural incomes beyond Rs. 200 have been regarded as half earned, as is done in the assessment of income tax. Since the rich generally live in towns, the limit of village incomes has been set at Rs. 500. Regarding division of income into earned and unearned, only one possibility has been considered, viz., fully earned and half earned. Actually, of course, many different proportions of earned and unearned income exist, but it is impossible for us to examine every possible type.

Table of Income Categories.

Serial No. of the Class.	Income Per Month. Rs.	Description of the Earner. Residence.	Occupation.	Nationality.	How far the Income is earned.
1	25	Village	Agriculturist	Ceylonese	Fully earned
2	50	,,	,,	,,	,, ,,
3	50	Town	Industrial labourer	,,	,, ,,
4	100	,,	Clerk	,,	,, ,,
5	100	Village	Agriculturist	,,	,, ,,
6	200	Town	Clerk	,,	,, ,,
7	200	Village	Agriculturist	,,	,, ,,
8	300	Village	,,	,,	Half earned
9	300	Town	Unspecified	,,	Fully earned
10	500	Village	Agriculturist	,,	Half earned
11	500	Town	Unspecified	,,	Fully earned
12	750	,,	,,	,,	,, ,,
13	1,000	,,	,,	,,	,, ,,
14	1,000	,,	,,	,,	Half earned
15	1,000	,,	,,	European	Fully earned
16	2,000	,,	,,	Unspecified	Fully earned
17	2,000	,,	,,	,,	Half earned
18	3,000	,,	,,	,,	Fully earned
19	3,000	,,	,,	,,	Half earned

Our first class is Rs. 25 Rural. The importance of this class is self-evident. The taxation of this class is an index of the taxation of the vast majority of our rural population. Not that there are no incomes below Rs. 25, indeed in many districts the average tends to be lower than this, but it is an important and convenient point of income for studying incidence. Rs. 50 per month on the other hand seems to be the limit of income of the peasant class. This is the reason why we have taken these two categories. We had, however, no complete data on the spending habits of these classes. The Economic Survey provided general but not detailed family budgets. That information was not enough. We had, therefore, to undertake a special inquiry into the budgets of these two classes of people.

We have not taken any town incomes below Rs. 50, mainly because we have no statistics about them. Besides, small incomes in towns are not comparable in importance with small incomes in villages. The nation, it is well to remember, mainly lives in the village. The Rs. 25 rural income may indeed claim to be the most numerous income-group in the country. It is also perhaps safe to assume, as we have done, that all incomes above Rs. 500 live in towns. By town, we refer generally to Colombo. Conditions of living and of taxation are somewhat different in the provincial towns, but many of them cannot be described as typically or wholly urban. For a true picture of urban taxation Colombo is a better guide. In point of population also there is no comparison between Colombo and the other towns.

Our town income of Rs. 50 refers to the income of the average working class family in Colombo. Family expenditure budgets were already available for this class, having been collected in 1938 for the preparation of a cost of living index for them. This class again, though small, is an important part of the country's population. It is bound to grow in importance as industrialization advances. Corresponding to it, we have taken a rural income of Rs. 50. It represents the income of the upper stratum in villages.

Our town categories of Rs. 100 and Rs. 200 refer to the incomes of two grades of clerks resident in Colombo. The reason why this particular social class was taken up was that a certain amount of data was available about them. Rough family budgets had already been collected for them in 1938 in connection with the work of the Retrenchment Commission. We had no information about any other classes of town dwellers in this income range. It is reasonable to hold, however, that the methods of living of other social classes earning similar incomes are very nearly the same.

The rural incomes of Rs. 100 and Rs. 200 are supposed to be incomes of small estate owners. Actually, there are not many in villages who earn incomes above Rs. 50, but we have taken these classes to complete the scale and also to show the difference between rural and urban tax burdens for parallel incomes. We continue this distinction between rural and urban incomes up to Rs. 500. The rural incomes of Rs. 300 and Rs. 500 refer to the incomes of the fairly well-to-do estate owners who possess coconut and perhaps also some rubber lands. They are not assumed to be owners of tea estates.

The higher town incomes have been occupationally unspecified. This is not only because occupation after a point ceases to have any determining influence on spending habits, but also because to introduce any occupational classification would be to multiply categories indefinitely. We introduce, of course, the division between Ceylonese and European and between earned and unearned incomes in appropriate cases. But it is neither possible nor perhaps necessary for us to do anything more than that. To keep the inquiry within manageable limits, we have to confine ourselves to only the most important, the most representative and the most probable categories. The list that we have drawn is, we believe, sufficient to give us a good picture of the course of incidence through the scale of incomes in the country.

The Time Factor.—The incidence of any tax at any given moment may be different from its incidence in the long run. Three instances taken from three different fields will make this clear. A tax (rate) on buildings may for a length of time be borne by owners because rents cannot be increased. But it may discourage building construction, reduce the supply of houses and increase rents ultimately. The tax then is shifted to tenants*. Similarly taxes increasing workers' cost of

* The question of shifting is discussed in greater detail in Chapter II.

living may reduce the number of workers coming forward for employment and force wages up. The tax bill is then footed by employers. They in their turn may put prices up and throw the burden on to consumers. Thus shifting may go on until the tax is paid by someone who has a real surplus. Or take yet another instance. The income tax is in the short period generally unshiftable. But it tends more or less to curtail investment or consumption or both. If investment is materially checked, production will fall and prices will rise. This means that the producers will be able to shift the tax to the consumers.

Thus, what the ultimate effect will be is very difficult to predict. Every tax is a disturbance of the existing economic equilibrium. It starts a process of re-adjustment which may take much time and many different paths to work itself out. But it is also often obstructed by various elements of friction. It is, therefore, neither wise nor possible to look too far ahead. Consequently, we have in this inquiry measured incidence as we have found or believed it to be at the time of the inquiry, not as it might be at some future date as a result of hypothetical economic changes.

In general our investigation relates to conditions obtaining in 1938. The budgets as well as the taxes refer generally to that year. But in some cases we have used earlier data for want of up-to-date information. In certain other cases, for instance regarding income tax rates, we have used later data, because we have felt that these will remain and conditions will not return to what they were in 1938. The tax level is undoubtedly higher to-day than in 1938. But much of the rise is due to the War and may not last. Prices and earnings also have been disturbed with the result that the composition of budgets has also changed. But all this again may be a passing phase.

Average and Minimum Incidence.—From each of our classes we have taken two members for study. The first is the *average* member, whose ways of living are average. We have discovered him either statistically from a large number of samples or where samples have been insufficient or unreliable, we have constructed him logically out of our judgment. Since his way of living is normal and average, he pays the average taxes for his class. But it is also interesting to know what the most careful member of the class would pay, the member who for instance does not smoke or drink, who as far as possible avoids luxuries, who is anxious to use untaxed or less taxed articles, who in short leads a most frugal life consistently with the social position he holds as a member of the class. He is our second representative and we may describe him for want of a better term as the minimum-taxed or the *minimum* member of the class. His budget, it is clear, must be hypothetically constructed. It is impossible to get any actual samples of him. He is a logical possibility rather than an actual specimen. It is useful to introduce him because he bears for his class the inescapable and irreducible burden of taxation. Others, it may be argued, pay by choice.

How far it is desirable or practicable to base taxation policy on a consideration of such minimum tax burdens, is a different question. But if at all it is desired to do so, these additional values that we have worked out will be of some use. That is the reason why we have included them in our estimates.

CHAPTER II.

The Taxes and the Methods of calculating their Incidence.

Different taxes bear in different ways upon income. Some, like the income tax, are self-announcing and to all intents and purposes unshiftable.* To know the income is also to know the tax. Others like commodity taxes, fall upon a given income only in so far as it is used in buying taxed goods and in so far as the terms of buying are changed. In such cases the collection of family expenditure budgets becomes a very necessary procedure.

* Strictly, there is no tax which is quite unshiftable and even the income tax is liable to be shifted in special cases. The earner may demand and obtain an increase in his income after the imposition of the tax. He then shifts the tax to others and leaves his income untouched.

Let us briefly review the tax structure of the country and consider how different taxes impinge upon different classes of income. It is important to remember that the income we deal with is consumer's income. Every consumer is of course also a producer, but we measure only the taxes that he pays in his capacity as a consumer. There are many taxes upon producers also. But we measure them only in so far as they are passed on to consumers. Unfortunately the impact of most producer's taxes upon consumer's budgets is very difficult to ascertain. We have been compelled therefore to leave most of them out of our inquiry. In this category fall export duties and taxes on various production goods like machinery, manure, chemicals, &c. They may be partly borne by consumers, but we have no means of measuring their exact incidence. We omit them not because they are producers' taxes, but because they cannot be traced to the consumers' budget.

Our existing taxes may be broadly divided into the following groups. The Excess Profits Duty is not included in this list because (*a*) it did not exist in 1938, the year to which our study generally relates, and (*b*) it is in any case a war measure and is not likely to remain a part of the normal tax structure.

(1) *The Income Tax.*—This tax does not apply to incomes below Rs. 2,400 per year. Our lower incomes are therefore immune from it. The tax is progressive. For incomes to which it applies, the present rates are 7½ per cent. up to Rs. 6,000, 15 per cent. upon the excess up to Rs. 30,000, and 22½ per cent. upon the excess beyond that point. Certain rebates, limited to a maximum, are granted according to family obligations and the division of the source of income between work and property. Income from property, called " unearned income " pays at a higher rate than income from work or " earned income ". Whatever the amount of rebates however, a minimum of 1 per cent. is payable by all incomes above Rs. 2,400.

The calculation of its incidence is simple. It is regarded as completely unshiftable and is a clear charge upon every income on which it falls.

(2) *The Estate Duty.*—This tax is payable on inherited estates. As at present in force, the duty starts with estates exceeding in value Rs. 20,000. The rate of duty increases with the size of the inherited estates from 1 per cent. at the bottom to 20 per cent. at the top.

Its incidence on a given income depends on (*a*) how far the income is derived from inherited property, and (*b*) what arrangements are made by the owner or the successor of the property for its payment.

Regarding the first, we regard all our village incomes up to Rs. 200 and town incomes up to Rs. 750 as wholly " earned " (that is to say not derived from property, inherited or otherwise). This is perhaps in accord with facts. Small incomes and dutiable estates seldom go together. These incomes are therefore immune from the tax. Village incomes above Rs. 200 are taken as half earned. Regarding town incomes above Rs. 750, we show taxation in two possible cases, (*a*) incomes fully earned, (*b*) incomes half earned.

Regarding the second question, we assume that the duty is paid by the owner of the estate in his life time. He takes an insurance policy against the liability and bequeaths the estate intact and free of tax to his successor. The premium on the policy is paid out of the income of the estate and is a measure of the incidence of the tax.

It cannot be however regarded as a universal or a very certain measure, because not every estate owner covers the tax liability by insurance in this manner or covers it at the same age. The greater the age, the greater will be the annual premium. But it is perhaps the only method open to us. It was this method which was used by the Colwyn Committee on Taxation in England. It would be very difficult to relate the tax directly to the incomes of the legatees, because they may be many in number and the share of the property received by a particular legatee would give no indication of the total tax paid on the inheritance of the property.

An example will explain the method. Suppose a person has a fixed and assured income of Rs. 5,000 a year from his estate. Assuming that capital value is twenty times the income value, the value of the estate is Rs. 100,000. The estate duty on it under existing rules will be Rs. 3,000. It is against this liability that the owner takes an insurance policy. The annual premium will depend on the number of contributions he proposes to make and the probable expectation of his life. Thus, assuming an age for the estate owner and assuming this method of provision, the burden of estate duty on estate incomes may be worked out in the light of prevailing insurance rates. This is the method we have followed. We have assumed the age of the insurer to be forty.

It is not easy to capitalize a given income. In the instance given above, we have taken the value of the estate to be twenty times the value of its annual yield. But it is not necessarily so always or in every case. Two factors are of importance here, (*a*) the true long-period yield of the estate, as distinguished from the immediate and visible yield, and (*b*) the current yield on investments in general.

Very often the apparent yield is quite different from the real. For example, the return on rubber estates appear high to-day, but the long-period average, considering past returns and future prospects, is hardly so. It is the net long-period return that is capitalized when an estate is sold or purchased.

The current yield from investments in general is the basis of comparison. It is obvious that if the current yield is 5 per cent. (that is, if the investor can alternatively earn 5 per cent. on his capital), he will not pay anything more than Rs. 5,000 × 100/5 for an estate whose annual yield is Rs. 5,000. This means that the capital value of the estate is twenty times its annual yield. If the prevailing general yield on investments was 4 per cent., the estate would fetch Rs. 5,000 × 100/4, or twenty-five times its annual returns.

Village estates, so far as they come into our inquiry, can be safely assumed to be chiefly coconut lands. The long-period return from them is rather low. Consequently, their capital value is also low. After taking everything into consideration and also consulting the Government Valuer on the point, we have taken the capital value of such lands to be ten times their annual income. Where, however, the estate income accrues to a town resident, we have assumed the yield to be higher, as the investments are likely to be different and more profitable. Here the capital value has been taken to be 20 years' purchase of the annual income.

(3) *The Betting Tax.*—This tax does not probably touch the villager, but the other classes living in towns cannot be said to be quite immune from it. The extent to which the various classes take to betting, cannot however be ascertained. Except for the higher incomes, the amount spent is not perhaps appreciable. For these reasons we have not attempted to estimate the incidence of this tax at all in our inquiry.

(4) *Commodity Taxes.*—This is for our purposes the most important group. Nearly 75 per cent. of the total tax revenue of the country is raised from commodity taxes. They fall upon nearly every important class of consumption and production goods. Since however we measure incidence through and upon consumption only, we deal with very few production goods. The reason as already explained is that very few producers' taxes enter conspicuously or measurably into the consumer's budget. But the range of consumption goods affected is itself very large. Consequently the incidence of these taxes is very pervasive. They impinge upon all incomes. Since the small incomes pay few, if any, direct taxes, their tax burden almost entirely consists of commodity taxes.

The taxes fall into two broad groups (*a*) Customs Duties or taxes on goods exported and imported and (*b*) Excise Duties or taxes on goods produced or sold within the country. The excise list is small and consists virtually of the tax on country liquor and the tax on matches. But the customs tariff includes hundreds of items. The revenue from customs is many times the revenue from excise. The customs list again mainly consists of *import* duties. *Export* duties are few and bring normally only about one-thirteenth of the revenue brought by import duties. A few of the export duties are earmarked for specific purposes and returned to the tax-payers. They can hardly be called taxes in the strict sense of the term.

In any case, we leave out export duties altogether, because their bearing on net incomes and consumption budgets is small and obscure. It is even possible that a part of these duties is borne by foreign consumers.

Commodity taxes are collected in two ways, viz., *ad valorem* (that is according to the value of the commodity), and specific (that is according to quantity). The majority are *ad valorem;* though by the amount of revenue collected, the specific ones are more important. Another point is the difference in the rate between Empire and non-Empire goods. Empire goods pay generally a lower rate of tax. This differentiation was introduced in 1932, with the adoption of the policy of Imperial Preference.

In whatever form they are levied, commodity taxes are notoriously shiftable. The Government may legally collect them from one party, but it often happens that the burden is shifted to others. It follows that to measure the incidence of a commodity tax upon an individual it is necessary to know (*a*) the volume or the value of his purchase and (*b*) the behaviour of price after the tax. The former determines the total sum collected, that is, the total money burden of the tax, and the latter the distribution of the burden between the buyer and the seller, that is, the degree of shifting. As we have already observed, nearly every tax is liable to be shifted, however slightly it may be. But nowhere is shifting so common and conspicuous as in the case of commodity taxes.

Suppose the price of sugar is 10 cts. per lb., and a man buys normally 10 lbs. Suppose a tax of 2 cents per lb. is now levied, payable by the seller. How much will the Government collect and in what proportion from the buyer and the seller?

Suppose the man still buys 10 lbs. The total collected is then 20 cents (2 cents per lb.). It is taken from the seller, but suppose he is now able to sell at 12 cents per lb. instead of 10 cents. Clearly he recovers the whole amount he pays from the buyer. If the price had gone up to 11 cents, he would have recovered 1 cent per unit, that is to say, half the amount of the tax. The change in price is thus an index and a measure of the division of the burden between the buyer and the seller. The more the price rises, the more is the tax shifted to the buyer.

How price and purchase will change, depends upon the nature of the supply and demand conditions of the article, or in more precise economic terms, on the elasticity of demand and supply of the article round about the pretax price. If buyers demand the same amount whatever be the price (that is, if demand is absolutely inelastic) the price would rise by the full amount of the tax. If sellers supply the same amount whatever be the price (that is, if supply is absolutely inelastic), the price would not rise at all.

The following table illustrates certain possibilities and shows how the burden on the consumer varies in different cases.

Possible changes in Price and Purchase after tax.

Tax.	Price.	Total Quantity Purchased.	Total Sum Collected.	Burden on Buyer.	
				Per Unit.	Total.
	Cts.	Lb.	Cts.	Cts.	Cts.
Nil	10	10	Nil	Nil	Nil
2 cents per lb.	12	10	20	2	20
Do.	11	10	20	1	10
Do.	10	10	20	Nil	Nil
Do.	12	9	18	2	18

The table shows how price and purchase determine incidence. The same considerations apply where the tax is *ad valorem*. Suppose for instance it is 2 cents for every 10 cents worth of sugar purchased, that is 20 per cent. *ad valorem*. Here also the total collected (the total direct money burden of the tax) depends on the total purchase. But since the tax is related to value, we have to ascertain the value rather than the volume of the purchase. If the total purchased is 100 cents the tax collected will be 10 cents, if 90 cents, it will be 18 cents, and so on. One additional qualification however may be necessary here. It may be, and in practice it almost always is, that the tax is payable on wholesale or Port value of the article and not on its retail value. The buyer may actually spend 100 cents, but it is not on this value that the Government collects the tax. The retail value, that is, the consumer's actual investment must therefore be converted into its taxable equivalent, after deducting middleman's profits, transport and other charges. Obviously these charges will not be the same for all commodities. But since it is impossible to estimate them correctly or separately for various goods, we have adopted in general a flat rate of discount of 30 per cent. Where profits are transparently higher, for instance, in fancy goods sold to the rich or monopolised goods, we have used an appreciably higher discount. Similarly where some material is taxed, but is processed in the Island before it is sold to the consumer, for instance imported dress materials which are tailored here, an additional discount is necessary to represent the price of processing. We have done that where necessary and possible. Thus, the discount actually used has varied, but it has been in general 30 per cent. This is perhaps the usual difference between wholesale and retail value. A consumer's expenditure of 100 cents is thus equal to taxable expenditure of 70 cents and if the tax is 20 per cent. *ad valorem*, the total collected is 14 cents. How this levy is shared between the seller and the buyer, that is, how far the seller is able to shift his burden to the buyer, is another question and depends, as we have already explained, on the behaviour of price.

Family Budgets.—Thus the two important factors are the behaviour of price and the behaviour of purchase. Unfortunately, precise information on these factors is not easy to obtain. The volume or value of purchase can only be ascertained from detailed family budgets. Yet, we could not possibly obtain full and separate budgets for every class of income. It was neither possible nor indeed quite necessary for us to do so. We therefore paid special attention to the lower income groups whose budgets are more or less standardized and where inquiry was essential and likely to yield definite statistical results. Thus, we collected either by fresh investigation or from existing records, budgets for (1) Rs. 25 Rural Income, (2) Rs. 50 Rural Income, (3) Rs. 50 Urban Income, and (4) Rs. 100 and Rs. 200 Urban Incomes. In each case the samples were sufficiently numerous and the information sufficiently detailed. For incomes above Rs. 200 however, we had to depend mainly on assumed budgets, although a certain number were also actually collected. The budgets collected served as guides. In constructing these budgets, we have been careful however to consult a number of individuals belonging to each income group, so as to ensure the greatest degree of dependability. This is the procedure that is commonly followed for higher incomes and is neither quite unorthodox nor quite illogical. It is justifiable for three reasons.

(1) It is difficult to collect an adequate number of samples of higher budgets or collect sufficiently detailed information. The higher the income, the larger and more complex is the assortment of goods it buys.

(2) Expenditure being complex, the returns actually submitted tend to be inaccurate. Few people belonging to these classes keep correct accounts of their expenses. Obviously, it is safer to construct a logical budget than accept returns of doubtful value.

(3) Higher incomes mean highly variable budgets. Each man spends his income in his own way and the variability is so great that there can be no true average for the class as a whole. Consequently a reasonably assumed average may claim to be as much accurate as one obtained from an elaborate inquiry.

All things considered, the budgets we have used whether actual or assumed, may be regarded as an acceptable foundation for our calculations.

Price Changes.—So much about purchase. Regarding movements of price however, we have very little information. It is impossible to say how the price of an article has changed after it has been taxed. In the first place, we have no proper record of changes of prices. Secondly, it is impossible to isolate the effect of a tax on price. Price may have risen, but where is the guarantee that it has risen simply because of the tax and not because of other factors? *Post hoc* is not *propter hoc*. To take an instance, the price of textile goods in Ceylon has risen considerably since the imposition of import duties. But the whole of this rise cannot be said to be due to this factor alone. The quota system has also materially contributed to it. Similarly the Agricultural Production (Regulation) Ordinance of 1939 by fixing importable quotas for certain articles has increased their prices. It would obviously be wrong to attribute this part of the rise to taxation. Yet we have no means of separating the effects of the two factors.

Because of these difficulties, we have done the next best thing possible, which is to *deduce* the rise in price from the nature of the taxed article. This is commonly done in all investigations of incidence. It means that we have tried to go by the theoretical elasticity of demand and supply of the taxed article. The articles bought by the lower incomes are nearly all inelastic, and we have generally assumed that taxes on them are paid entirely by the consumers, that is to say they are wholly added on to the price. But since no article is absolutely inelastic, this assumption has exaggerated however faintly, the burden on the consumer. The higher incomes buy many articles of elastic demand, and in their case we have, where possible, divided the tax between the buyer and the seller. But here again, in general, the assumption has been that the buyer pays the full amount of the tax.

Producers' taxes bearing upon consumers.—As already explained*, we are unable to measure the incidence of most producers' taxes, because our unit is the consumer and very few of these taxes show clearly in the consumer's budget which is our source of information. Strictly of course every producer's tax ought to leave some mark however faint upon some consumer's budget. But in practice it is mostly either untraceable or unmeasurable. Take for instance the tax on chemicals which the " dhoby " uses. He probably passes it on to his customers with his bill, but the amount is almost impossible to estimate. Again, a tax on a machine which produces different kinds of articles is difficult to distribute over these articles. Taxes like income tax and local rates paid by producing concerns are in certain special circumstances loaded upon the price of their products and shifted to buyers. But only in special cases. Ordinarily the income tax and the local rate are regarded as the result and not the cause of the price. Besides, even if shifted, the amount paid by a consumer is difficult to ascertain. We therefore make no attempt to trace the incidence of these taxes upon consumers.

There are however three taxes imposed in the first instance upon producers, which are shifted to consumers in a *measurable* degree. These are taxes paid by producers on gas, electricity, and passenger bus transport. We have estimated the burden of these taxes on consumers and included them in our inquiry.

All three are fairly important items in the consumer's budget. They are of course not the only instances where consumers are hit indirectly and unawares, but they are perhaps the only cases which can be measured.

There is no tax on gas or electricity as such, but machinery, lubricating oil, pipes, mains, cables, &c., are subject to import duty. On the basis of total taxes paid and total receipts from sales, the tax per rupee spent by the consumer on gas is estimated roughly to be 3.5 per cent. and that on electricity 5 per cent. The estimates are based on figures supplied by the producing concerns. Income tax and local rates have not been included, nor in the case of electricity, any contribution to public revenue made by the Electrical Department. Needless to say that the esimates are very rough and the underlying assumption has been that the taxes are fully shifted to consumers.

Regarding travelling, railway travelling need not be considered at all, because the railway is now heavily subsidized by the Government. Money spent on railway journeys brings now a bonus rather than pays a tax. Travelling by tram, motor car and bus however is subject to taxation. We may omit trams, because

* Page 9 Meaning of Income.

very few of our classes use them. Regarding motor cars, where a consumer has a car, he pays taxes on it directly and we take full account of them. But when he rides in a bus, he pays indirectly the various taxes which the bus owner adds to the fares. These taxes include import duty on the bus, on petrol, lubricating oil, spare and repair parts, registration fee, stand and examination fees and licences for the car and the driver. The aggregate taxation works out at roughly 40 cents per rupee collected as fare. This estimate has been made in consultation with the Commissioner of Motor Transport and is based on returns supplied by a representative transport concern.

A fourth possible case is expenditure on entertainments. There is no entertainment tax as such in Ceylon, but there is a fairly heavy tax on imported Cinema films. Consumers' expenditure on cinemas is also not quite negligible. Yet we do not take this tax into consideration because (*a*) the prices of admission tickets do not seem to have risen after the tax, which shows that the burden is borne by the producers, and (*b*) even assuming that the buyers paid, we cannot estimate the burden on the average cinema-goer. We assume that the consumers expenditure is unaffected by the tax.

(5) *The Stamp Duties.*—These are a mixed lot and include duties on various kinds of deeds and instruments, on legal proceedings, and on various commercial and professional transactions. We have left them out of our inquiry completely, because they are, in general, taxes on capital and production and as such their bearing on consumer's income is neither direct nor conspicuous and easily traceable. A tax like the duty on cheques is perhaps paid by all consumers beyond a given income range, but even in his case the amount actually paid is almost impossible to ascertain.

(6) *Licences and Fees.*—These are imposed by Local and Central Governments on a host of objects and activities. However, their incidence is in most cases insignificant, inapplicable to net incomes or impossible to determine. We therefore leave most of them out of our inquiry.

Examples of licences are those on firearms, domestic animals, hunting, vehicles and sale and manufacture of liquor. Of these, the liquor licence and the motor car licence are the two that appreciably impinge upon consumers' income. We have taken both of them into consideration. The motor licence is discussed later under Local Taxation. Regarding the liquor licence, its burden is not very easy to assess. The licences are sold to taverns or producers annually by tender or auction. The holders certainly try to reimburse themselves by increasing the price of liquor, but we do not know to what extent they succeed. This again is a question of shifting or change in price. If competition is very keen they may pay the tax out of their profits rather than put prices up. Even assuming that the whole tax is shifted, the burden per gallon consumed is difficult to assess, because the same tavern may sell more than one kind of liquor. Then again the revenue collected is not known till the Government publishes its accounts, which may take a long time. It is impossible to say how *present* licences hit *present* consumers. Although thus difficulties are many, some measure of assessing the burden is necessary, because liquor, particularly toddy, has a place in many consumers' budgets. We have taken it to be 52 cents per gallon of toddy (or 10 cents per bottle), on the basis of revenue and sales for the year 1938. This estimate is based on the Excise Report for 1938. It is however a rough and arbitrary measure and perhaps on the whole exaggerates the burden.

Examples of fees are those for administration of estates, cattle branding, headman's services, and services given by the Medical, Postal and Education Departments. Fees charged by the Port authorities may also be said to come under this list. Most of these however are payments for specific services rendered and cannot at all be regarded as taxes.

(7) *Local Taxes.*—These are taxes which Local Authorities collect from their residents. The residents must of course pay all Central taxes to which they are liable. Local taxes are to them an additional burden.

The three most important local taxes are (*a*) the "rate" on property payable in towns, (*b*) the licence on motor cars, the proceeds of which in towns are given to the town authorities, and (*c*) the capitation tax on all adult males collected by Village Committees.

Apart from these, local authorities also collect licences and fees of certain other kinds. But we take no account of them because (*a*) their incidence is insignificant or difficult to assess and (*b*) they are mostly taxes on production and therefore irrelevant to net incomes.

The town rate varies. In Colombo it is 20 per cent. of the annual value of the real property. In the two other Municipalities, Galle and Kandy, it is slightly less. In the Urban District Councils, it generally ranges from 10 to 12 per cent. We are only concerned however with the Colombo rate because we assume all our town incomes to be resident in Colombo. Three of our categories, viz., the urban working class with Rs. 50 and town clerks with Rs. 100 and Rs. 200, are definitely taken from Colombo. Regarding other town incomes also, it is better to assume that they live in Colombo rather than anywhere else. This is because (*a*) it is Colombo that gives a true picture of town taxation, the other towns being mostly glorified villages, (*b*) in point of population Colombo is the most important town, and (*c*) we have no knowledge of the distribution of urban incomes between Colombo and other towns and therefore cannot prepare any weighted average of town rates.

Like the question whether the buyer or the seller pays a commodity tax, the question whether the tenant or the owner pays the house rate depends on the elasticity of demand and supply of houses. If demand is great and supply not at all responsive, the owner will be able to collect it entirely from the tenant. This seems to be usually the case regarding smaller houses. For bigger houses the conditions seem to be, for the present at least, different, and it is doubtful if the owner is able to add the rate fully to the rent. However we assume that the owner in all cases is able to pass the rate to the tenant. In other words, he is able to collect from the tenant the rent as well as the rate on the house. If for instance the rent is Rs. 100, the rate is Rs. 20 (20 per cent. of annual value). The tenant pays a gross rent of Rs. 120 (rent plus rate). Of gross rent paid, one-sixth thus represents the local rate. This is how we have calculated the incidence of the rate.

The motor licence is payable by owners of motor vehicles. We are however not concerned with all types of vehicles. The licence on trucks and lorries for instance is paid by the producer and we cannot trace its incidence on the consumer's income. We are therefore only concerned with the licence on private cars. This is a direct and unshiftable charge on every consumer who possesses a car. Its amount varies with the weight of the car. If the weight is between 5 and 10 cwts., the licence is Rs. 20. The tax then steps up gradually to Rs. 50 if the weight is between 25 and 30 cwts. It may perhaps be assumed that few private cars exceed in weight 30 cwts. The motor licence is an item of local taxation only in towns. The licence paid by village residents goes to Central revenue.

The village capitation tax is imposed by Village Committees generally at the rate of Re. 1 per head per year. The alternative to this tax is a few days labour on village roads. But most villagers pay the tax. The tax is unshiftable and may be said to be a definite charge on all village incomes. The new Village Committees Ordinance provides for an acreage tax on village lands, but so far no Village Committee has adopted it. It will take some time before it is generally adopted. The capitation tax remains still the most important rural local tax.

(8) *Government Monopolies.*—It may be asked if the net revenue collected by the Government from industrial and commercial monopolies is a tax. In strict theory, it cannot perhaps be called a tax, but there are certain types of undertakings which are purely intended to be instruments of tax collection. They should obviously be included in a study of incidence.

The essence of a tax is that it is a compulsory contribution for which no *quid pro quo* is either promised or given. When payment is definitely related to a good or service, it becomes a *price* and not a tax. It is only where price is an exploitation price, yielding an abnormally high net profit, that the profit becomes like a forced levy upon the consumer. But in most cases this net profit cannot at all be clearly ascertained, far less proved to be abnormal or forced. Further, profits in one year may be offset by losses in another. Are we to take short or long period profits? What about negative profits, which for instance the Ceylon Government Railway has been showing for some years? Further, private monopolies also often make abnormal profits, but we do not regard them as taxes. For these reasons, the generality of monopoly revenue cannot be regarded as taxation. But in Ceylon the case of the Government salt and arrack monopolies is different. They are both worked as undisguised engines of taxation. Consequently we must estimate their incidence.

The arrack revenue consists of three elements. (1) The Government produces arrack through contractors and sells it at a small *profit* to retailers. (2) The retailers have to pay a *licence* for the sale of arrack. (3) On every gallon sold, the Government imposes an open *tax*.

The Excise Administration Report for 1937-38 estimated the net aggregate collected by the Government on these three heads at prevailing prices to be Re. 0.83 on every rupee spent by the consumer on arrack. We have generally taken this as the measure of taxation of arrack. It is obviously a rough measure and one which is likely to vary from year to year. But it is the only one which we can use.

Regarding salt, the net profit from salt, as far as it can be worked out from the returns of sales and costs for the year 1938, is estimated to be 3 cents per lb. We have used this as the measure of taxation of salt.

CHAPTER III.

The Estimates of Incidence.

In this chapter we present the estimates of incidence that we have worked out for the various categories. The list of categories has already been given in Chapter I*. We have altogether nineteen categories of income in this list. They can be broadly divided into two divisions for treatment in this chapter. Categories 1, 2, 3, 4, and 6 (that is to say rural incomes up to Rs. 50 and town incomes up to Rs. 200) form one division. The values for these classes have been obtained from a sufficient and detailed study of actual sample budgets. The rest of the classes form the other division. Here, actual budgets have been collected only for a few classes, chiefly for urban incomes ranging from Rs. 500 to Rs. 2,000. Even these budgets have been rather sketchy and insufficient in number. It would have been quite unsafe to make such inadequate budgetary data the basis of our calculations. Consequently we had to modify and reconstruct these budgets partly by our judgment. The actual budgets have served as guides. We have however consulted individuals and associations regarding these budgets to give them as broad a foundation of empirical evidence as possible. But the fact remains that the budgets we have used are *probable* budgets which we have ourselves partly created. As already explained in Chapter II., this is a justifiable procedure for this part of the investigation, considering its natural difficulties and the limitation of our resources. The budgets prepared may not be absolutely accurate, but they are good enough to give us a dependable picture of incidence for these classes.

The actual sample budgets used have been obtained either from special new investigations or from investigations made in the past. In every case care was being taken to see that the number of budgets selected is adequate and the information sufficiently detailed and dependable. The budget samples for the first two categories, viz., Rural Rs. 25 and Rs. 50 were collected by a special survey. A large number of samples were collected for each group from all the

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* See page 13.

nine Provinces of the Island. The actual number finally used was 50 for the first group (Rs. 25) and 37 for the second group (Rs. 50). To secure representativeness, the families and the villages were both selected at random. The returns collected were quite detailed and the manner of collection ensured reliability. Forms were carefully drawn up and trained investigators of the Economic Survey lived in the village for some time to collect the data. This budget survey which was a special feature of the present inquiry was very necessary because the information supplied by the Economic Survey was not quite detailed or representative of the whole of the Island.

The budgets for urban Rs. 50, Rs. 100, and Rs. 200 were already available. The first was collected in connection with the preparation of a cost of living index of working classes in 1938. 341 samples of various incomes were included in this survey. The budgets for Rs. 100 and Rs. 200 were collected in 1938 in connection with the work of the Retrenchment Commission. 63 budgets were collected in this inquiry. The budgets for town incomes between Rs. 500and Rs. 2,000 were collected by us specially for the present inquiry, because there was no material available about these. Some 50 budgets were collected by circulating forms at random.

It will be seen that in presenting our Tables, we do not show detailed budgets in all cases. There are many reasons for this. To start with, our task is to measure taxation, not to analyse budgets. It is therefore unnecessary for us to collect or show those parts of the expenditure which are not taxable. Even the items which are taxable need not all be shown fully. We show them fairly fully for the first few incomes. This explains our method. Thereafter for other classes to save our space and the reader his patience, we summarize the budgets under a few broad heads. Secondly, we have not collected or prepared full budgets for every class. We could not, even if we wanted to do so, present detailed information for every class. Thirdly, in the case of the higher incomes it is unnecessary to collect or present elaborate expenditure budgets because for them direct taxes are more important than the indirect. Budgets are important only where the taxes are chiefly paid through commodities. As income rises, the direction of tax liability changes. The higher incomes pay mainly through direct taxes like the income tax and the estate duty. For all these reasons we have gradually condensed our budgets as we have proceeded from the lower to the higher incomes.

Similarly regarding the details of calculations. It is unnecessary to show them fully in every case. For the first income we analyse (Rs. 25 Rural), we show in separate columns the volume and the value of the expenditure, its precise part which is taxable, the rate of the tax and the total tax paid. Thereafter, for other classes these particulars are scaled down. For classes above Rs. 100 we show only two columns, the chief heads of taxable expenditure and the tax paid under each.

As already stated, budgets and taxes all generally relate to the year 1938. As the incomes are *monthly* incomes, so the budgets are *monthly* budgets.

Where budgets have been given in skeleton form, certain heads perhaps require explanation. "Food" includes both local and imported food. Needless to say that since different foodstuffs are taxed differently, the composition of the head is important. We have roughly ascertained or assumed this composition for every head. Since the composition varies irregularly for different incomes, neither expenditure nor taxation under a head can be expected to rise proportionately with rise of incomes. The item "Fuel and Light" includes electricity, gas, kerosene, firewood and matches. The head "Clothing and Household Necessaries" includes personal wear and domestic furnishings of all kinds. "Conveyance" includes cycle, motor car, bus, railway and other expenditure on travelling and holidaying. It is a composite head of which the motor car is generally the most weighty item. The expenditure and taxation on cars, has been calculated on (*a*) Purchase Price worked out for a month of the life of the car assuming 6 years' life, (*b*) Registration Fee, (*c*) Annual Licence which goes to central revenue in the case of town residents, (*d*) Chauffeur and Cleaner, (*e*) Petrol, Lubricants, Tyres, Tubes, Repairs, Replacements, Insurance and other expenses. These items make up a large total. The possession of a car therefore makes a considerable difference to a person's expenditure and taxation. Incomes below Rs. 500 have been assumed not to possess cars. The head "Miscellaneous Expenditure partly taxed" includes such items as radio, hobbies, clubs and sports, entertainments, medical expenses, &c. The "Rest of the Budget" includes money spent on objects and services which are not generally taxed or which we assume not to be taxed, such as (*a*) dhoby, servants, post, telegraph and telephones, education, charity, &c., and (*b*) savings, provident and insurance contributions. It may be interesting to note that according to our budgets (average budgets), town incomes below Rs. 500 show little or no saving. Among them Rs. 50, Rs. 100, and Rs. 200 save nothing, Rs. 300 saves Rs. 22.50 and Rs. 500 saves Rs. 18.84 per month. The record is naturally better for the rural classes who have fewer temptations for spending. Saving here starts with Rs. 50 and increases substantially as income rises.

Of the different heads, the specific items of local taxation (*a*) in the case of town residents, are house rent which is the basis of the assessment rate imposed by local authorities, and the motor car licence, and (*b*) in the case of village residents, only the village committee tax. The motor car licence paid by village residents is credited to central revenue. For reasons already explained in Chapter II. other minor items of local taxation have not been taken into consideration.

Minimum and average incidence.—For each class we show average and minimum incidence.

We have explained in Chapter I. what we mean by these two measures of incidence and why we estimate both. Briefly, the average is what is paid by the average member of the class and the minimum is what no member of the class can escape paying. It is unusual to show minimum incidence, but it reveals an interesting aspect of taxation and may be of some use in framing or revising taxation policies.

The minimum budget is a reduced edition of the normal or average budget. It is naturally an assumed budget because (*a*) the difference between the normal and the minimum is a matter of opinion, and (*b*) it is impossible to find actual samples of the minimum. For lower incomes, the difference between the two budgets is bound to be small. These budgets are almost entirely spent on necessaries and the only direction in which they could be reduced or simplified would be perhaps by omitting tobacco and liquor. The average budget minus these expenses, gives us the minimum for these classes. This is what we have broadly done for incomes up to Rs. 200. For incomes above that however, expenditure spreads out to many avoidable articles and the gap between the minimum and the average widens. For these classes we have done a general pruning of the average budget to find the minimum. To explain the nature of this pruning, the minimum budget is given side by side with the average in two cases, namely, Rs. 300 and Rs. 500 town incomes. For no other classes are the minimum budgets separately shown. Only the measures of incidence are given.

Correction for samples.—Where the budgets have been actual samples, we had to correct the results to bring them up or down to the precise income of the category selected. For instance our class I. is Rs. 25 Rural Income. The actual budget samples studied had Rs. 24.25 as average income and Rs. 24.41 as average expenditure. The deficit is probably due to the fact that in furnishing returns incomes have been rather deflated and expenditure inflated. We have assumed the true income to be higher and to balance expenditure at Rs. 24.41. The tax burden of this balanced income and expenditure has, according to our calculations, come to be Re. 1.86 (see Table 1). It is simple next to work out what the tax burden on an income of precisely Rs. 25 would be, assuming taxation to change proportionately with income. In other words, we have assumed the percentage of taxation to be the same for Rs. 25 the actual category, as for Rs. 24.41 the sample.

It goes without saying that the *size* of the family largely determines its expenditure and consequently also its tax burden. It is impossible however to say what the standard or the average sizes of families are for different classes of incomes. Therefore, where we have studied actual samples we have accepted the sizes found in these samples. For instance for class I. (Rural Rs. 25) we have taken the family to consist of—

Adult Males	1·7
Adult Females	1·3
Children below 15	2·3
Total ..	5·3

as shown by the samples. This may not be the true size of village families in this income group, but we have made no further corrections. Where no samples have been collected or the samples have not shown the composition of families, we have assumed a probable representative size. Thus for incomes beyond Rs. 200 we have assumed the family to consist of husband, wife and two children.

Table 1.

Budget and Taxation of Class 1 (Rural Rs. 25).

Composition of Family—	
Adult Males	1·7
Adult Females	1·3
Children under 15	2·3
Total	5·3

For the Sample (Rs. 24·41).

Articles.	Quantity Bought.	Money Spent. Cts.	Rate of Tax. Rs. c.	Taxable Quantity or Taxable Expenditure.	Tax Paid. Cts.	Remarks.
1. *Food*—						
Rice : Local	20 m	267	—		—	
Imported	40 m	513	1 0 per cwt.	40 m	71	Approximately 2 lb. = 1 measure
Chillies, imported	1·7 lb.	38	1 25 ,, ,,	1·7 lb.	2	
Pepper	·2 lb.	5	1 50 ,, ,,	·2 lb.	·2	
Ginger, dry	·1 lb.	3	5 0 ,, ,,	·1 lb.	·5	
Pulses, imported	2 m	37	0 50 ,, ,,	2 m	2	
Red onions, imported	4 lb.	25	0 20 ,, ,,	4 lb.	1	
Potatoes	2 lb.	17	1 0 ,, ,,	2 lb.	2	
Dry fish, imported—						
Empire	·3 lb.	6	1 0 ,, ,,	·3 lb.	·3	
Foreign	·2 lb.	3	2 0 ,, ,,	·2 lb.	·3	
Maldive fish	1 lb.	31	2 0 ,, ,,	1 lb.	1	
Coffee, imported	·09 lb.	3	0 20 ,, lb.	·09 lb.	1·5	
Sugar	6 lb.	85	5 50 ,, cwt.	6 lb.	32	Since July 23, 1940, the tax is 6·50 per cwt.
Salt	4·74 lb.	21	0 3 ,, lb.		14	Based upon Salt Revenue
Total food including all untaxed expenditure on this head)		1,565			127·8	

Table 1—(*contd.*)

Articles.	Quantity Bought.	Money Spent. Cts.	Rate of Tax.	Taxable Quantity or Taxable Expenditure.	Tax Paid Cts.	Remarks.
2. *Fuel and Light*—						
Kerosene oil	4 bot.	63	Re. 0·25 per gallon or Re. 0·04 per bot.	4 bot.	16	
Matches: Local	5 boxes	10	*Vide* remarks	5 boxes	3	Excise—40·00 per case of 7,200 boxes or ·56 cts. per box
Imported	·4 boxes	1	—	·4 boxes	1	Import duty—2·00 per gross box or 1·4 cts. per box
Candles	—	1	15% *ad valorem*	1	·1	
Torches and Cells	—	2	*Vide* remark	1·40 cts.	·3	Torch 25% general; cell Re. 1 per gross. Bulb 25% general
Total Fuel and Light		77			20·4	
3. *Clothing*—						
Cotton	—	232	5% *ad valorem* preferential, 10% *ad valorem* general, weighted average tax 6·5%	162 cts.	11	Information regarding local, Empire and non-Empire purchase could not be collected. A rough division based upon the Textile Commission's Report was adopted. The weighted average tax represents that devision
				—	—	
Silk	—	3	25% *ad valorem* general	2 cts.	·5	
Total clothing (including untaxed expenditure)		255			11·5	
4. *Miscellaneous*—						
Travelling	—	28	40% of amount spent	—	11	
Soap: Local	—	—	Rs. 4·50 per cwt. or 20% *ad valorem* whichever is higher	—	—	
Imported	3	15		·3 lb.	1	The specific rate is generally paid
Cigarettes local	5 no.	11	*Vide* remarks	5 no.	3·4	63 cts. per 100 cigarettes

Liquor, arrack	·01 bot.	3	—	·01 bot.	2	Roughly 80% of expenditure, according to Excise Report
Lamps, Toys, &c.	—	1	15% *ad valorem*	·5 cts.	·1	
Total miscellaneous (including untaxed expenditure)		453			17·5	
House rent		82			—	
Direct Tax paid		9			9	
Saving		Nil			—	
Total Budget		2,441			186·2	(7·63 per cent.)

Summary for the Category (Rs. 25.)

Central Taxation.				Local Taxation.				Total Taxation.	Minimum Taxation of the Class.
Income.	Estate.	Commodity.	Total.	Assessment Rate.	Motor Car Licence.	V. C. Tax.	Total.		
		Cts.	Cts.			Cts.	Cts.	Cts.	Cts.
—	—	181·78	181·78	—	—	9·22	9 22	191	185

Table 2.

Budget and Taxation of Class 2 (Rs. 50 Rural).

Composition of Family—	
Adult Males	1·8
Adult Females	1·6
Children under 15	1·9
Total	5·3

For the Sample (Rs. 47·88).

Articles.	Quantity Bought.	Money Spent.	Taxable Quantity or Taxable Expenditure.	Tax Paid.
		Cts.		Cts.
1. *Food*—				
Rice, local	44 m	593	—	—
Rice, imported	33 m	406	33 m	59
Chillies, imported	2 lb.	54	2 lb.	3
Pepper	·3 m	9	·3 m	·4
Ginger, dry	·1 lb.	4	·1 lb.	·5
Pulses, imported	3 m	50	3 m	2
Red Onions, imported	6 lb.	34	6 lb.	1
Potatoes	3 lb.	29	3 lb.	3
Dry Fish, imported—Empire	1 lb.	19	1 lb.	·8
Foreign	5 lb.	10	·5 lb.	·8
Maldive Fish	1 lb.	58	1 lb.	2
Coffee, imported	3 lb.	8	·3 lb.	5
Sugar	11 lb.	144	11 lb.	44
Salt	8·06 lb.	30	—	24
Total Food (including untaxed expenditure on this head)		2,492		145·5
2. *Fuel and Light.*—				
Kerosene oil	6 bot.	98	6 bot.	26
Matches, Local	7 boxes	13	7 boxes	4
Imported	·2	·5	·2	·2
Candles	—	4	3 cts.	·5
Torches, &c.	—	9	6·30 cts.	1·4
Total Fuel and Light		125·5		32·1

3. *Clothing.*—				
Cotton, Local		40	—	—
Imported		437	306 cts.	20
Silk		14	10	3
Total Clothing (including untaxed expenditure)		492		23
4. *Miscellaneous.*—				
Soap, imported	·5 lb.	27	·5 lb.	2
Cigarettes, local	26 no.	52	26 no.	16
Liquor, arrack	·01 bot.	3	·01 bot.	2
Lamps, Toys, &c.		14	10 cts.	2
Travelling		129		52
Total Miscellaneous (including untaxed expenditure)		1,257		74
Total consumption (all heads)		4,366		274·6
House Rent		245		—
Direct tax paid		13		13
Saving		164		—
Total Budget		4,788·5	(6·01%)	287·6

Summary for the Category (Rs. 50).

Central Taxation.				Local Taxation.				Total Taxation.
Income.	Estate.	Commodity.	Total.	Assessment. Rate.	Motor Car Licence.	V. C. Tax.	Total.	
Rs.		Cts.	Cts.					Cts.
50	—	286	286	—	—	14	14	300

Minimum Taxation—Rs. 2·82.

Table 3.

Budget and Taxation of Class 3 (Rs. 50 Urban).
Size of Family : 5·64.

Composition of family :	Adult male	1·8
	Adult female	1·8
	Children under 15	2·1
	Total	5·7

For the Sample (Rs. 52·74.)

Articles.	Quantity Bought.	Money Spent. Cts.	Taxable Quantity or Value.	Tax Paid. Cts.	Remarks.
Food—					
Rice	84 m	980	84 m	152	All assumed imported. Hoppers converted into rice.
Chillies	2 lb.	41	2 lb.	2	
Pulses	2 lb.	30	2 lb.	1	Weighted average tax.
Onions	10 lb.	49	10 lb.	2	
Potatoes	3 lb.	21	3 lb.	3	
Dry fish	3 lb.	57	3 lb.	4	
Maldive Fish	1 lb.	49	1 lb.	2	
Coffee	·5 lb.	15	·5 lb.	10	
Sugar	11 lb.	106	11 lb.	64	
Salt	6 lb.	30		18	
Total Food (including other untaxed articles)		2,764		258	
Fuel and Lighting—					
Kerosene oil	11 bot.	148	11 bot.	46	
Matches	14 boxes	14	14 boxes	8	All local matches.
Total Fuel and Lighting (including untaxed articles)		331		54	

Clothing		441	308 cts.	20	Information incomplete, weighted average tax of 6·5 per cent.
Miscellaneous—					
Cigarettes	87	174	87	55	
Toddy	3 bot.	43	3 bot.	24	On the basis of Excise Revenue
Arrack	·1 bot.	24	·1 bot.	16	
Soap		43	43 cts.	3	
Travelling		96		38	
Total Miscellaneous (including untaxed articles)		896		136	
Total Consumption (all heads)		4,432		468	
House Rent		842		140	
Direct Tax paid		—		—	
Saving		Nil		—	
Total Budget		5,274		608 (11·53 per cent.)	

For the Category (Rs. 50).

Central Taxation.				Local Taxation.				Total Taxation.
Income	Estate.	Commodity.	Total.	Assessment. Rate.	Motor Car Licence.	V. C. Tax.	Total.	
		Cts.	Cts.	Cts.			Cts.	Cts.
—	—	444	444	133	—	—	133	577

Minimum Taxation—Rs. 4·87.

Table 4.

Budget and Taxation of Classes 4 and 6 (Rs. 100 and Rs. 200 Urban).

	Class 4.	Class 6.
Composition of Family—		
Adults	4·0	3·1
Children	1·8	2·0
Total	5·8	5·7

For the Samples.

Heads of Expenditure.	Class 4. Amount Spent. Rs. c.	Class 4. Tax Paid. Rs. c.	Class 6. Amount Spent. Rs. c.	Class 6. Tax Paid. Rs. c.
1. Food	40 60	4 2	79 75	5 37
2. Liquor	1 45	0 50	7 75	2 50
3. (*a*) Tobacco	2 56	0 85	3 99	1 26
(*b*) Betel and arecanuts, &c.	0 81	—	0 64	—
4. Fuel Lighting—				
(*a*) Electricity	0 80	—	3 68	0 18
(*b*) Gas	—	—	0 22	—
(*c*) Kerosene oil	3 4	0 91	1 84	0 55
(*d*) Firewood	2 71	—	4 39	—
5. Clothing	9 23	0 43	13 81	0 63
6. Household necessaries	2 78	0 22	5 88	0 98
7. Education	4 50	—	18 27	—
8. Servants	5 75	—	11 32	—
9. House rent	22 85	3 74	40 74	6 79
10. Miscellaneous—				
(*a*) Travelling	6 80	1 36	8 59	1 71
(*b*) Clubs and sports	1 55	—	2 38	—
(*c*) Other	8 90	—	9 99	—
Total Commodity Taxation		12 3		19 97
11. Direct taxes	Nil	—	2 0	2 0
12. Savings	Nil	Nil	Nil	Nil
Total Budget	114 33	12 3 (10·52%)	215 25	21 97 (10·20%)

For the Categories.

	Central Taxation.				Local Taxation.				
	Income.	Estate.	Commodity.	Total.	Assessment Rate.	Motor Car Licence.	V. C. Tax.	Total.	Total Taxation.
	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.			Rs. c.	Rs. c.
Class 4	—	—	7 25	7 25	3 27	—	—	3 27	10 52
Class 6	2 00	—	12 24	14 24	6 30	—	—	6 30	20 51

Minimum Taxation—

Class 4—Rs. 9·34.
Class 6—Rs. 14·60.

Table 5.

Classes 5, 7, 8 and 10 (Rural Rs. 100, Rs. 200, Rs. 300, Rs. 500.)

Budget and Taxation.

Items in Budget.	Class 5—Rs. 100 Rural.		Class 7—Rs. 200 Rural.		Class 8—Rs. 300 Rural.		Class 10—Rs. 500 Rural.	
	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.
Food	35 0	2 4	60 0	4 0	71 5	4 6	85 0	5 18
Liquor	1 12	0 93	5 0	4 15	10 0	5 0	15 0	7 50
Tobacco	1 0	0 32	3 0	0 95	4 0	1 26	6 0	1 89
Fuel and light	2 89	0 52	3 92	0 63	6 50	0 77	9 0	1 25
Clothing and household necessaries	10 0	0 69	15 0	1 5	22 50	1 23	30 0	2 41
Conveyance	2 0	0 80	3 0	1 20	8 0	1 17	104 81	23 86
House rent	5 0	—	15 0	—	15 0	—	30 0	—
Miscellaneous Expenditure (partly taxed)	10 0	—	21 0	—	16 0	0 20	44 0	1 0
Direct Taxes.								
(1) Income Tax	—	—	2 0	2 0	3 0	3 0	5 63	5 63
(2) Estate Duty	—	—	—	—	—	—	1 2	1 2
(3) V. C. Tax	0 9	0 9	0 9	0 9	0 9	0 9	0 9	0 9
Rest of the budget including savings (not taxed)	32 90	—	71 99	—	143 86	—	169 45	—
Total	100 0	5 39	200 0	14 7	300 0	16 78	500 0	49 83

Summary.

	Central Taxation: Income.	Central Taxation: Estate.	Central Taxation: Commodities and Services.	Central Taxation: Motor Car Licence.	Central Taxation: Total.	Local Taxation: Assessment Rate.	Local Taxation: Village Committee Tax.	Local Taxation: Total.	Total Taxation.
	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.
Class 5	—	—	5 30	—	5 30	—	0 9	0 9	5 39
Class 7	2 0	—	11 98	—	13 98	—	0 9	0 9	14 7
Class 8	3 0	—	13 69	—	16 69	—	0 9	0 9	16 78
Class 10	5 63	1 2	40 17	2 92	49 74	—	0 9	0 9	49 83

Minimum Taxation.

	Rs. c.
Class 5—(100)	4 14
Class 7—(200)	8 97
Class 8—(300)	9 59
Class 10—(500)	17 54

Table 6.

Classes 9 and 11 (Urban Rs. 300 and Rs. 500).

Budget and Taxation.

Items in Budget.	Class 9—Town Rs. 300. Average for the Class. Amount used.	Class 9 Average for the Class. Tax Paid.	Class 9 Minimum for the Class. Amount used.	Class 9 Minimum for the Class. Tax Paid.	Class 11—Town Rs. 500. Average for the Class. Amount used.	Class 11 Average for the Class. Tax Paid.	Class 11 Minimum for the Class. Amount used.	Class 11 Minimum for the Class. Tax Paid.
	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.
Food	103 0	4 78	97 50	4 28	120 0	5 68	115 0	5 18
Liquor	4 0	2 0	—	—	15 0	7 50	—	—
Tobacco	4 0	1 26	—	—	6 0	1 89	—	—
Fuel and light	12 50	0 75	12 0	0 73	20 50	1 5	20 50	1 5
Clothing and household necessaries	22 50	1 59	15 0	1 5	32 50	2 60	27 0	2 17
Conveyance	12 0	0 78	12 0	0 78	98 6	28 86	30 0	1 95
House Rent	50 0	8 33	50 0	8 33	80 0	13 33	80 0	13 33
Miscellaneous Expenditure (partly taxed)	29 50	0 93	17 0	0 25	54 0	1 50	44 0	1 0
Direct Taxes.								
(1) Income	3 0	3 0	3 0	3 0	5 0	5 0	5 0	5 0
(2) Estate Duty	—	—	—	—	—	—	—	—
(3) V. C. Tax	—	—	—	—	—	—	—	—
Rest of the Budget including savings (not taxed)	59 50	—	93 50	—	68 94	—	178 50	—
Total	300 0	23 42	300 0	18 42	500 0	67 41	500 0	29 68

Summary.

	Central Taxation.				Local Taxation.			Total Taxation.
	Income.	Estate.	Commodities and Services.	Total.	Assessment Rate.	Motor Car Licence.	Total.	
	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.
Class 9	3 0	—	12 9	15 9	8 33	—	8 33	23 42
Class 11	5 0	—	46 16	51 16	13 33	2 92	16 25	67 41

	Minimum Taxation.
	Rs. c.
Class 9	18 42
Class 11	29 68

Table 7.

Classes 12, 13, 14, and 15 (Urban Rs. 750 and Rs. 1,000.)

Budget and Taxation.

Items in Budget.	Class 12—Rs. 750.		Class 13—Rs. 1,000 (Ceylonese—Fully Earned).		Class 14—Rs. 1,000 (Ceylonese—Half Earned).		Class 15—Rs. 1,000 (European—Fully Earned).	
	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.
Food	140 0	6 68	150 0	6 68	Same as for Class 13	Same as for Class 13	170 0	9 28
Liquor	20 0	10 0	25 0	12 50			55 0	27 50
Tobacco	6 0	1 89	15 0	5 3			18 0	5 76
Fuel and light	24 50	1 20	31 50	1 47			31 50	1 47
Clothing and Household Necessaries	47 50	3 82	60 0	4 82			75 0	6 2
Conveyance	155 66	34 83	165 61	37 83			160 61	44 53
House rent	100 0	16 67	120 0	20 0			120 0	20 0
Miscellaneous Expenditure (partly taxed)	85 0	3 10	123 0	4 0			117 50	4 0
Direct Taxes.								
(1) Income	10 63	10 63	31 87	31 87	41 25	41 25	31 87	31 87
(2) Estate Duty	—	—	—	—	16 77	16 77	—	—
(3) V. C. Tax	—	—	—	—	—	—	—	—
Rest of the budget including savings (not taxed)	160 71	—	278 2	—	251 87	—	220 52	—
Total	750 0	88 82	1,000 0	124 20	1,000 0	150 35	1,000 0	150 43

Summary.

	Central Taxation.				Local Taxation.				
	Income.	Estate.	Commodities and Services.	Total.	Assessment Rate.	Motor Car Licence.	Capitation Tax.	Total.	Total Taxation.
	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.
Class 12 ..	10 63	—	58 60	69 23	16 67	2 92	—	19 59	88 82
Class 13 ..	31 87	—	69 0	100 87	20 0	3 33	—	23 33	124 20
Class 14 ..	41 25	16 77	69 0	127 2	20 0	3 33	—	23 33	150 35
Class 15 ..	31 87	—	95 64	127 51	20 0	2 92	—	22 92	150 43

	Minimum. Taxation.
	Rs. c.
Class 12 ..	58 98
Class 13 ..	87 52
Class 14 ..	111 5
Class 15 ..	110 70

Table 8.

Classes 16, 17, 18 and 19. (Urban Rs. 2,000 and Rs. 3,000).

Budget and Taxation.

Items in Budget.	Class 16—Rs. 2,000 (Fully Earned).		Class 17—Rs. 2,000 (Half Earned).		Class 18—Rs. 3,000 (Fully Earned).		Class 19—Rs. 3,000 (Half Earned).	
	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.	Amount used. Rs. c.	Tax Paid. Rs. c.
Food	200 0	13 18	Same as for Class 16	Same as for Class 16	225 0	20 18	Same as for Class 18	Same as for Class 18
Liquor	60 0	30 0			75 0	37 50		
Tobacco	25 0	8 0			40 0	13 3		
Fuel and Light	41 50	1 90			50 0	3 0		
Clothing and Household necessaries	85 0	6 83			125 0	11 0		
Conveyance	289 6	71 31			410 89	94 69		
House rent	200 0	33 33			300 0	50 0		
Miscellaneous Expenditure (partly taxed)	198 0	5 94			290 0	8 70		
Direct Taxes.								
(1) Income	156 25	156 25	176 25	176 25	306 25	306 25	311 25	311 25
(2) Estate duty	—	—	42 36	42 36	—	—	77 4	77 4
(3) V. C. Tax	—	—	—	—	—	—	—	—
Rest of the Budget including Savings (not taxed)	745 19	—	682 83	—	1,177 86	—	1,095 82	—
Total	2,000 0	326 74	2,000 0	389 10	3,000 0	544 35	3,000 0	626 39

Summary of Position.

	Central Taxation.				Local Taxation.				Total Taxation.
	Income.	Estate.	Commodities and Services.	Total.	Assessment Rate.	Motor Car Licence.	Capitation Tax.	Total.	
	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.	Rs. c.
Class 16	156 25	—	132 99	289 24	33 33	4 17	—	37 50	326 74
Class 17	176 25	42 36	132 99	351 60	33 33	4 17	—	37 50	389 10
Class 18	306 25	—	181 1	487 26	50 0	7 9	—	57 9	544 35
Class 19	311 25	77 4	181 1	569 30	50 0	7 9	—	57 9	626 39

	Minimum Taxation.
	Rs. c.
Class 16	213 68
Class 17	269 80
Class 18	224 57
Class 19	498 40

Table 9.

Summary of all Tables.

Taxation as Percentage of Income.

Class.	Description.	Taxation. For the Average Member. Central.	Local.	Total.	For the Minimum Member
	Rs.				
1	25 Rural	7·27	0·36	7·63	7·41
2	50 Rural	5·72	0·29	6·01	5·63
3	50 Urban	8·88	2·66	11·54	9·74
4	100 Urban	7·25	3·27	10·52	9·34
5	100 Rural	5·30	0·09	5·39	4·14
6	200 Urban	7·12	3·15	10·27	7·30
7	200 Rural	6·99	0·05	7·04	4·49
8	300 Rural	5·56	0·03	5·59	3·20
9	300 Urban	5·03	2·78	7·81	6·14
10	500 Rural	9·95	0·02	9·97	3·51
11	500 Urban	10·23	3·25	13·48	5·94
12	750 Urban	9·23	2·61	11·84	7·87
13	1,000 Urban (fully earned Ceylonese)	10·09	2·33	12·42	8·75
14	1,000 Urban (half earned Ceylonese)	12·70	2·33	15·03	11·10
15	1,000 Urban (fully earned European)	12·75	2·29	15·04	11·07
16	2,000 Urban (earned)	14·46	1·88	16·34	10·68
17	2,000 Urban (half earned)	17·58	1·88	19·46	13·49
18	3,000 Urban (earned)	16·24	1·90	18·14	14·15
19	3,000 Urban (half earned)	18·97	1·91	20·88	16·61

CHAPTER IV.

The Meaning and Limitations of the Figures.

It now remains to make some critical observations on the figures that we have worked out.

Two questions arise,

(1) How far are they complete and accurate?
(2) What conclusions can we possibly draw from them? What in other words is their meaning and significance?

Accuracy.—Our answer to the first question is that in spite of limitations, inevitable in an inquiry of this kind, the values that we have prepared are on the whole accurate and acceptable. The limitations have been of two kinds. First, there has been a margin of error in our calculations. Secondly, we have been, for one reason or another, compelled to omit certain taxes.

The chief sources of *error* have been the following:—

(1) The assumption that all taxes are shifted to consumers. This has exaggerated the burdens. It is well to remember, however, that (*a*) this assumption is true of an important, perhaps the most important part of taxed goods bought by consumers in this country, (*b*) we have made appropriate exceptions in the case of luxuries competitively sold, and (*c*) for want of information regarding price changes this must be our only working formula.

(2) The assumption that the taxable value of the purchase is generally 30 per cent. less than its retail value. It may actually be more or less. This assumption also has not been rigidly followed and we have modified it in appropriate cases.

(3) In ascertaining the incidence of estate duty, the assumptions that (*a*) all rural incomes beyond Rs. 200 are half-earned, (*b*) that the capital value of the villager's estate is ten times its annual income, and (*c*) that the owner of the estate provides for estate duty by insuring against it at a certain age. Actually, the burden of estate duty may be different from what these assumptions lead to. These assumptions, however, are both reasonable and probable in present circumstances.

(4) Assumptions regarding composition of families which conditions expenditure and regarding the division of the source of income between earned unearned, which conditions the payment of the income and the estate taxes. We cannot guarantee that our assumptions in this respect are absolutely correct. Actually, it is possible that the liabilities of higher incomes are greater than what these assumptions suggest.

However the assumptions are convenient and the population census and the Income Tax Returns indicate that we are perhaps not far wrong.

(5) The assumption that all town incomes are resident in Colombo. Since taxation in other towns is less, this has exaggerated though perhaps only slightly, the burden of urban local taxation.

This however, is justifiable, because (*a*) we have no data about the exact distribution of incomes in various towns, and (*b*) the contrast between urban and rural taxation should be shown by taking the most important and typical town. The other towns when they are properly urbanized will perhaps adopt the same " rates " of taxation as Colombo.

(6) We could not collect sufficient budget samples containing detailed information for every class. There is no guarantee therefore that the incomes are exactly spent in the way we have represented. In certain cases, budgets have been partly created by us. This however, is not as serious as it appears, because (*a*) we have got ample and exhaustive budgets for the lower and the middle incomes, (b) the budgets for the higher incomes are never standardized and being widely variable, the possibility is that a logically created budget would be fairly representative.

(7) The assumption that the gross revenue derived by the Government from its monopolies of salt and arrack is the measure of their taxation. Strictly, it should be the net long-period revenue. The assumption has exaggerated the burden on the consumer. Here the answer is that the exaggeration is perhaps slight and some assumption is indispensable in the absence of precise information.

(8) Where actual budget samples have been collected it is probable that expenditure has been over-stated. This has tended to exaggerate the tax burden. The budget returns, however, have been very carefully collected. We believe, we have succeeded in reducing this error to its minimum.

A point about these errors is that they do not have a uniform bias. If some tend to increase incidence, others tend to lower it. The net effect is perhaps on the whole small. Therefore, taking all things into account, the error in our estimates is tolerably low and not beyond what is inevitable in an investigation of this type.

Next about *omissions*. These fall into two groups, Intentional and Unintentional.

Regarding the first, since our unit of investigation is the individual consumer, the taxes that do not bear upon his income have necessarily been left out. This part of the omission is intentional and is logically implied, as has already been explained in Chapter I., in our method of approach.* In this category come the Export duties, the Stamp duties and taxes on goods which the consumer does not buy, that is to say, which are purely production goods. It is true that there is no production good which the consumer does not buy *indirectly*. For example, to buy electricity is also to buy in a sense the dynamo which generates it, and assuming that the buyer pays every tax, his expenditure on electricity would contain his share of the tax on dynamos. But few taxes on production goods can be traced and linked so easily to consumption budgets. The tax on bleaching power, for instance, may lie hidden in our dhoby bill, but so faintly that it can hardly be traced or isolated. In other cases like taxes on machines the impact may be substantial but again too difficult to isolate because many machines may be used together and many different products may be turned out. In general therefore the taxes on production goods have remained outside our inquiry.

Taxes exclusively paid by companies, societies, public departments and other institutions have also stood out, because our unit is the individual. For example, undistributed profits of companies are taxed, but the incidence of this portion of national taxation is not shown anywhere in our study.

We have selected the individual consumer's income as the unit of our study because, as already explained in Chapter I., it is for our purpose the most significant, effective and workable unit. All taxes are not related to all incomes and by selecting a certain unit, we must by definition exclude certain taxes. It is easy to find out per head taxation and relate it to per head national income. But the incidence of taxation on income in this general sense is an abstraction and of little practical significance. The study of incidence to be fruitful must be related to selected and well-defined income units. This, incidentally, is the practice in all incidence inquiries.

Next regarding unintentional omissions. Even for goods which the consumer buys, our estimate of incidence has not been quite complete because of two reasons.

(*a*) The budgets have not fully revealed all such purchases. No man ever keeps a full and frank record of all his expenditure. Articles that are rarely or irregularly bought, articles of very small value and articles whose consumption the consumer does not want to disclose, are liable not to be shown in family budgets. We had for example to ignore altogether the expenditure on betting. Fortunately, the range of such articles is small and expenditure on them insignificant. Even if they were included, the aggregate taxation paid by the various groups would not have been perhaps materially different.

* See p. 9 *Meaning of Income*. Also p. 20, *Producers' Taxes bearing upon consumers.*

(b) Where the consumer buys the article but pays only a *share* of the tax, the share paid by others has escaped measurement. However, we have roughly got over this difficulty by assuming in nearly every case that the buyer pays the whole tax. Here we have perhaps been more guilty of commission than of omission. However in appropriate cases, such as luxuries, we have assumed the consumer not to be fully hit.

What our figures would have been if all errors and the unintentional part of the omissions could have been avoided, there is no direct means of finding out. Indirect evidence, however, shows that we are probably not far wrong.

Two methods of checking suggest themselves:—

(1) A comparison with the ratio of national taxation to national income.

No elaborate estimate of national income is available for 1938. The estimate for 1937, puts it at Rs. 613,000,000. (Estimate made by Mr. Williams). Aggregate tax revenue for that year was Rs. 78,000,000. This means that taxation was 12·7 per cent. or roughly 13 per cent. of income. This measure of general incidence, however, does little to prove or disaprove our estimates, because (a) it is a flat average, while our estimates are for selected and separate categories of income, (b) it is based upon all incomes and all taxes, while our figures relate only to the resident individual consumer's income and his taxes, and (c) the estimate of national income itself is approximate and subject to an unknown margin of error, (d) it is for 1937, while our figures are for 1938.

This method of checking must, therefore, be given up.

(2) A comparison of the *actual* yield of the taxes that bear upon consumers with the *estimated* yield according to our figures.

This though theoretically sound, practically presents many difficulties. In the first place, any list of taxes that we may prepare as bearing primarily upon consumers must be somewhat arbitrary. Secondly, the returns from all such taxes are not separately shown in published Tax Returns and therefore difficult to aggregate. Thirdly we have no precise knowledge of the distribution of *consumer* incomes in 1938. The Table given in Chapter I., even if correct*, deals with all incomes and for the year 1935. We have to convert it rather arbitrarily into a distribution of consumers' income for 1938, because it is the only distribution available. Fourthly our measures of incidence relate to specific points of income in specific income groups, while the distribution of incomes given in Chapter I. (which we have to use in a modified form) goes up in broad and continuous intervals such as Re. 0 to Rs. 25, Rs. 25 to Rs. 50, &c. It is not easy to deduce from our figures the average incidence for these broad groups, because we do not know how incomes are actually distributed between towns and villages, between earned and unearned incomes and between Ceylonese and non-Ceylonese. The weights used in averaging must be arbitrary.

However, making allowances and adjustments as far as possible for all these factors, calculations show that in 1938 the potential revenue obtainable by taxing consumers according to our figures, would fall short of the actual revenue derived by the Government by 12 per cent. (Calculations made by Mr. Williams). This roughly may be taken as the degree of error in our measures. Considering all the complexity of the inquiry, an error of 12 per cent. can hardly be said to be too great.

Meaning and Significance.

We now come to the second question, namely, what do the figures suggest? What aspects of the tax system do they reveal and what conclusions can be possibly drawn from them?

* Some of the limitations of this distribution are that (a) the Pareto law on which it is based is itself of doubtful validity, (b) the slope of the individual incomes curve drawn from the Income Tax Returns does not quite agree with that of the curve drawn from the Economic Survey Returns, and (c) the total number of incomes in the country assumed for the preparation of the estimate may not be right.

For various reasons the observations we can make on this subject must be rather cautious and limited.

In the first place, it is not strictly within the scope of our inquiry. Our task is measurement, not interpretation.

Secondly, the inquiry, as just explained, has been subject to various limitations and the results obtained cannot be taken absolutely at their face value.

Thirdly, the import of incidence in a study of taxation is itself limited.

This last point deserves some explanation.

Incidence on consumer's income is only one aspect of taxation. It is certainly an important aspect, but it is not everything. Taxation raises many economic aspects and issues. A study of incidence offers neither a complete analysis of nor a complete key to all the issues. There is, for instance, the question of objects to be served by taxation. Very often these objects are mixed and ill-defined. We not only want to raise a certain sum of revenue (that is to say, the object is not simply fiscal), but also redistribute wealth and income, protect national trade and industry, control monopolies, regulate unearned or excessive profits, stimulate savings, correct booms and slumps, penalize foreigners, safeguard health and morals, and serve various other economic and political ends. It is in the light of objects that the efficiency of a tax system should be judged. Incidence says nothing directly about these objects and their fulfilment.

Then there is the question of choice of tax forms. Each tax has its own administrative and economic implications, quite apart from the implications and effects of the tax system as a whole. On this question also incidence by itself throws no direct light.

Incidence attempts mainly to measure the degree of justice in the distribution of tax burdens among different magnitudes of income, on the working principle that progressive taxation means justice. But the issue of inter-consumer justice is not the only issue in taxation, nor is progression an absolute test of this justice. What about justice between other kinds of economic units? What about the distribution of *real* burdens as opposed to *money* burdens. Are the objects themselves for which the burdens are imposed, right? What are the other economic implications and effects of the taxes, apart from their appearance as burdens on taxpayers?

If taxation is much more than a question of justice between taxed consumers, the word " justice " itself is not necessarily synonymous with " progression ". Other things being equal, progression is a good working principle of taxation and it is widely accepted in theory and practice. But it cannot guarantee justice in every sense, or perhaps absolutely in any sense.

To begin with, no definition of justice or equity, which progression seeks to ensure, is final. Is it simply payment according to ability or should it rest on a comparison of benefits and burdens, or should it be interpreted in some larger sense of " social good "? All three may involve progression in practice, but in different degrees and differently tempered or weighted by other considerations.

Assume it is payment according to ability. The next question is, what is the true test of ability? Is it income, or property, or consumption? Assuming, again rather arbitrarily that it is income, how should different incomes pay to raise a given sum, so as to ensure justice? Should everyone make an equal sacrifice or should the aggregate sacrifice of all together be the least possible or should sacrifices be such that after taxation the relative incomes of all taxpayers remain as before?

Whatever interpretation is accepted, it will only led to progressive taxation *if* we assume that ability increases in a known degree with increase of income. But the relation between ability and income is not so simple. An increase of income may go with increase of responsibilities and really wipe out ability. Again, no two individuals regard increase of income in the same light. The personal equations are bound to be different. Thus it is almost impossible to say how much more than one per cent. we should take from an income of Rs. 200, if we take one per cent. from Rs. 100, so as to ensure equal sacrifice. In other words, we do not know how the marginal utility of income falls with increase of incomes. It certainly does not fall in the same manner for different individuals or even for the same individual in different periods of time. Thus although the *principle* of progression may be admitted*, the rate of its *application* still remains unknown. Yet, in a matter like this, the rate of application is nine-tenths of the principle.

If justice is to rest on a comparison of burdens and benefits, its connection with the principle of progression becomes even more remote and uncertain. Yet, this comparison is nothing but logical. After all, taxation is not an end in itself. It creates various benefits which are distributed among the taxpayers. The distribution of *burdens* may be unequal, but it may be compensated by the distribution of *benefits*. Indeed, the modern tendency is that although taxation is progressive, the distribution of benefits is regressive. If the two are taken together, what method of taxation will preserve justice? The answer would have been simple if the community consisted of only one individual. Justice from his point of view would then mean that he should be taxed to the point till he got no further positive benefits from his contributions, or, in other words, till the utility of the last rupee surrendered by him was equal to the utility of the last rupee spent by the State for him. Only thus could he maximize his net gains. But this formula is useless in practice, because the community consists of not one, but of many individuals, all differently placed, with different ideas and measures of benefits and burdens. Their personal estimations can never be compared or averaged. Even the same individual cannot measure what his share of the benefits is. Certain benefits like peace and order cannot at all be measured in terms of money. In any case, we have actually no data, however rough, on the incidence of benefits. Therefore either we have to give up the correlation of benefits and burdens altogether, or assume an arbitrary distribution of benefits. Justice would then be secured if *net* burdens, or rather *net* benefits, of different individuals were equal. Whether this would actually mean progressive taxation and what precise degree of progression, is very difficult to say, because we know nothing about the distribution of benefits.

Lastly, if justice is to mean maximum social good, progression by itself can never secure it. It must then be qualified by various other considerations. Social good is more than a question of allocation of money burdens. We must weigh the very objects of taxation. We must consider *real* burdens. We must consider effects of taxation on production and national income. The incidence of money burdens may be satisfactory, but the taxes may ruin the trade and industry of the country or produce friction with other countries. Is such a tax structure desirable or just in the real sense?

To conclude, incidence throws light principally on one aspect of taxation, namely, justice of relative burdens. But it is not the only important issue nor can it be said to be measured strictly by the degree of progression in taxation.

It is in this background that we have to make our observations about the figures. They must therefore be cautious and limited. We make some observations below, grouping them under four heads. It will be unsafe to go beyond and try to obtain from our figures conclusions which they do not justify.

1. *The Element of Progression in the Tax-System.*—The chief service of the figures is to reveal this element. It will be seen that our tax system is neither consistently nor rapidly progressive and that there are even stages of regression in it where, with rise of income, the percentage of taxation actually falls. If we draw a curve of the percentages paid by different incomes, it would rise fairly fast up to Rs. 100, then actually go down for a certain length and thereafter follow a steady upward course. This middle class " dip " is curiously a feature in English taxation also, although progression on the whole is much steeper there (*vide* Appendix for estimates of incidence in England).

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* De Viti De Marco says " The principle of equality of sacrifice does not demonstrate the validity of progressive taxation ".

This slow and interrupted progression is easily explained. It is due in the first place to the dominance of commodity taxes in our tax system. Three-fourths of the tax revenue come from commodity taxes, many of which are upon necessaries. Their consumption does not increase with income. These taxes are therefore regressive. Secondly, higher incomes reserve substantial amounts for servants, education, charity and saving which are not directly taxed. Thirdly, the extent of progression in our direct taxation is also rather moderate. The income tax which is the most important direct tax starts at a fairly high level, namely, Rs. 2,400 per year and is tempered by many kinds of rebates and allowances. For a married person with two children the rate remains only one per cent. up to Rs. 6,750, provided the income is wholly earned. In other words, the tax really becomes effective only when income exceeds this point. Thereafter, the rate goes up in rather distant stages. Thirdly, local taxation which contributes an important part of the total burden on urban classes tends to be regressive. The value of rateable property owned or occupied does not increase proportionately with increase of income.

From the point of view of strict distributional justice, the gaps in progression are certainly an unsatisfactory feature in our taxation. But as we have just explained, justice is not the only consideration in taxation nor is it absolutely safeguarded by progression alone. We also do not know what precise readjustment will safeguard it. On the whole, justice will perhaps be broadly secured if only we eliminate regression and steepen the rate of progression in the higher incomes.

2. *The Level of Taxation.*—The figures show that the level of taxation varies from 5 to 20 per cent. for the different incomes. Few dogmatic conclusions can however be made from this. It is difficult to say if the level is too high or too low *generally* or for any *particular* group. It raises the question of taxable capacity which is hard to define or measure. If the State uses the money more productively, there is no reason why the individual should not surrender the whole of his income in taxes. In a sense therefore the limit of taxable capacity for the individual is his whole income. The danger however is that (*a*) the State may not be able to use the resources as productively as the taxpayer and (*b*) the greater the tax burden on the individual the less may be his capacity for administering the balance of his own resources effectively. He may for one thing lose part of his initiative for work. The optimum distribution of resources in different industries may also be interfered with. The result will be that aggregate national income will fall. This suggests another limit of taxable capacity, but even this is not very precise. We cannot say at what point exactly taxation should stop if national income is not to fall.

In this country the Central Government takes normally about 13 per cent. of the national income in taxes (excluding non-tax revenue), and devotes about 41 per cent. of its total expenditure to economic development and social services. (Based on figures for 1936-37. See Economic Survey of Colonial Empire). If taxation is tending to increase, productive public expenditure is also steadily increasing year by year. In this context, a general incidence of 13 per cent. cannot be said to be too heavy. In most countries the incidence is higher*. The general burden, however, includes the burden of all taxes upon all taxpayers. The burden on consumers, as our analysis shows, is for most categories less than that. Few of our higher classes can therefore complain of over-taxation. The case of very small incomes is, however, different, not because the percentage of taxation is high, but because the incomes themselves are on the margin of subsistence.

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* See Appendix for comparative figures. During the war the percentage of national income taken in taxation has, of course, substantially increased everywhere. In the second year of the war in Great Britain it was estimated to be over thirty per cent. It is now threatening to rise up to 50 per cent. Yet, tax revenue is only a part of the total revenue. In 1941, total public expenditure in Great Britain (of tax and non-tax revenue) represented 67 per cent. and total private expenditure 63 per cent., together 130 per cent. of the national income. The country was thus spending 30 per cent. more than its annual income, evidently out of its internal and external savings. (Report of Bank for International Settlements 1940-41).

Regarding effects, none of the individual taxes levied in this country can be said to contain yet anything which seriously reduces economic incentive and effort.

All this seems to indicate that taxation is still generally below capacity. In any case as far as the higher classes are concerned it cannot be asserted that the time has come to stop further taxation and allow money to fructify in the pockets of the taxpayers.

The case of the lower incomes, particularly the Rs. 25 to 50 group however, as just mentioned, is doubtful. Their present high incidence may easily lower their efficiency and standard of living and through that ultimately the national income. It is idle to argue that before that happens the incomes themselves will rise by economic forces and actually the burden will be shifted to others. Incomes do not in practice respond so easily or quickly and much harm may be done before any adjustment takes place. It is not suggested that small incomes should not pay anything at all, although even that can be justified if our aim is to cause the *least aggregate sacrifice* to all members of the community. All that is questioned is if the burdens should be as high as now.

It is hardly necessary to explain that this high incidence on lower incomes is another consequence of our tax structure being largely weighted by taxes on necessary commodities. No income however small can escape them. Indeed, below a point, the lower the income, the greater must be the proportion of taxation, because income may fall but consumption of necessaries cannot. From this point of view, taxes on necessaries consumed by the poor are, on principle, objectionable. This rather unhealthy feature of our tax system seems to call for correction, unless it can be proved to be unavoidable or amply balanced by advantages in other directions.

3. *The Composition of the Tax Burden.*—Two aspects of the composition invite attention. First, the division between direct and indirect taxes. Secondly, the division between central and local taxation.

Regarding the first, our Tables show clearly the great weight of indirect taxes on all classes and particularly on the lower incomes. This is because (*a*) commodity taxes are generally highly regressive and (*b*) the range of commodities taxed is very large and includes many necessaries. It is only when we ascend fairly high in the scale of incomes that we find direct taxation coming into importance.

This preponderating impact of commodity taxes in our tax system cannot in theory be regarded as very satisfactory. Direct taxes are preferable to the indirect, if the main objects of taxation are, as they are generally recognized to be, to redistribute wealth and income and transfer resources from the individual to the State without impairing the aggregate productivity of the community. A few commodity taxes may be necessary for promoting special objects, such as protection of local trade and industry, control of consumption, &c. But even these objects might perhaps be served by other devices. Again, commodity taxes, particularly taxes on necessaries, may be useful if the revenue *must* be raised in small contributions from a very large circle of taxpayers, many of whom are poor. But a good tax policy does not necessarily mean that the largest number of people should be taxed or that they should be taxed mainly by commodity taxes. It must first be proved that the limit of sound taxation by direct taxes has already been reached. Commodity taxes have also various other advantages, such as prompt and resilient yields and cheapness of collection. The danger about them, however, is that to be effective, (*a*) they must fall upon many articles and; like misfortune, come in battalions, because otherwise consumers will escape them by buying untaxed articles, and (*b*) they must specially concentrate on necessaries, which means hitting the poor particularly. This will have injurious distributional and economic consequences.

It is not suggested that there should be no indirect taxes at all. But our tax system at present is over-weighted by them and it is time we pruned them down to only those few for which special justification exists. We have perhaps already started moving from an indirect to a direct tax economy, as the introduction of the income tax shows. It is now only a question of accelerating the pace. The income tax is the backbone of the direct tax structure. It is a tax which can be easily graduated and easily varied. It is also within limits unshiftable and free from any seriously adverse effects on production or consumption. In the reform of our tax system, the expansion and intensification of the income tax is bound to play a leading part.

Needless to say that these observations relate only to the normal peace-time tax structure. During the war commodity taxes, on account of their effectiveness in reducing consumption and providing a prompt and easy method of raising revenue are naturally bound to be very much used.

Regarding the division between central and local taxation, we need only consider local taxation in towns. Its incidence in villages is generally negligible. It will be seen that local taxation falls more heavily on lower incomes than on the higher. Indeed, it constitutes for such small incomes a substantial portion of the total tax burden. This again is natural because the two principal local taxes, the rate on property and the motor licence, are both regressive.

Viewed separately, the distribution of central tax burdens seems much more equitable than the distribution of the local. However, the two systems are the products of separate economic, political and historical forces and it is idle to expect any uniformity or complementarity between them. They are not easily comparable. In the first place local taxes are not quite taxes. There is a greater element of " price " or *quid pro quo* in them. In return for his taxes, the resident gets various services and amenities which are not obtainable in the village. That is why many people who have the choice of living in the country still prefer the city. If they did not regard the taxes to some extent as prices paid for the services, they would have probably left. Urban taxation apparently has not gone up to that point yet. Secondly, since the central government subsidizes local authorities in many ways, all central taxation is also partly local. All this makes it difficult to draw up any hard and fast rule about the division of the total tax burden between central and local taxation. However, the two should as far as possible pull in the same direction. At present they are in many ways contradictory. This is clearly seen in the degree of progression in the two systems. While there is a measure of progression in central taxation, local taxation is conspicuously regressive.

Incidentally, not only local taxation but central taxation also is less in the village than in the city. The villager by choice or compulsion spends less on taxable objects. Besides, the villager consumes partly his own or local produce. The man in the town has to depend mainly on taxed imports. The same income in the village therefore pays less in taxes than in the city.

4. *Average and Minimum Burdens.*—We have for reasons already explained in Chapter I., prepared two sets of estimates of incidence, one, normal or average incidence for the average member of the class, the other, minimum incidence for the member whose habits enable him to escape a good deal of the tax burden of the class. Our observations so far relate only to average incidence.

The minimum incidence estimates are naturally arbitrary, being entirely based on hypothetical budgets. However the minimum incidence though its general level is lower, also shows more or less the same characteristics, and the points we have noted about average incidence apply also generally to the minimum incidence. In the lowest incomes there is hardly any room for the cutting of expenditure and taxes. Consequently the minimum burden is almost the same as the average. Then the gap between the two widens. Higher still, it begins to lessen, because after a point on the one hand consumption and its taxation cease to grow proportionately with income and on the other the inescapable direct taxes (income and estate) become progressively more burdensome. However with these qualifications, the curve of minimum taxation has more or less the same shape as the average curve. It shows for instance the same slow progression and the same stages of regression. The general level is of course bound to be lower, because the minimum man by definition eschews smoking and drinking, does not own a car if he can avoid it, prefers a small to a large house and in general lives more economically than the average man.

What weight, if any, should be given to minimum incidence in framing taxation policy is not for us to discuss here. The minimum represents the inescapable burden. Anything in excess of that may be said to be paid by choice and not by compulsion. The State may with some justice ignore this self-inflicted burden and base its policy only on minimum incidence. The principle is perhaps already implicitly accepted in existing taxation in discriminatory taxation of luxuries. Yet on the whole it is perhaps unacceptable, because (*a*) the definition of the minimum standard of living is arbitrary and to base taxation on it would be to thrust that standard on the class, (*b*) the minimum members are probably too few to speak for the class and it would be wrong to penalize the whole group for them, (*c*) it would be impracticable administratively to tax one set of members, minimum or average, without affecting others in and out of the class, and (*d*) if, as one of its ostensible objects perhaps is, it forces all members down to the minimum way of living, tax revenue would fall and the minimum burdens themselves would then have to be lifted up to the average.

Conclusion.

This, broadly, is an analysis of the meaning and significance of the figures. While no dogmatic conclusions are possible, perhaps the only noteworthy blemishes which they reveal in our tax system are that progression is generally weak and broken in stages, that no class however poor is immune from taxation, the burden on lower incomes being particularly heavy, and that the composition of the burden is rather unsatisfactory, direct taxes, particularly the income tax, playing in it a minor role. Apart from these here is nothing very unorthodox or objectionable revealed by them. Even the defects revealed are not perhaps too serious or too difficult to adjust. As far as justice between taxpayers is concerned, which is the primary object of a study of incidence, the existing degree of progression perhaps assures a sort of broad if not strict justice.

However, to say that there is nothing fundamentally wrong with incidence is not to say that everything is right with our taxation. Incidence is not everything in taxation. It is only one of the issues involved. The more important questions are if taxation is serving its appointed objects, if we have chosen the right objects, if the various parts of the tax structure are consistent with one another and with the whole, if the State is using the revenue productively and in social interests, if the taxes in their economic effects are interfering with national productivity, if the distribution of benefits is right and if national income and national welfare on the whole are being promoted. These questions involve an examination of public expenditure on the one hand and of the economic effects of the various taxes on the other. Our taxation system has grown up in a rather piecemeal fashion. Many forces, passing and permanent, have left their marks upon it. It is perhaps time that a thorough investigation was made of its character and contents in their larger relationship to the national economy.

APPENDIX.

Some Comparative Figures.

Some comparative figures of incidence are given below.

Needless to say that the comparison is intended to be very rough. No strict comparison of international incidence is possible or safe. The figures generally relate to different periods of time and the methods of calculations, the definition of categories and the degree of accuracy all vary widely from one investigation to another. Besides, even if the course of incidence is the same, the composition of the tax structure, the distribution of benefits from public expenditure, the level and distribution of incomes, in short, the whole economic context differs from one country to another. The significance of each set of figures is closely related to its special context.

TABLE I.

General Incidence of Taxation.

Total Tax Burden as Percentage of National Income, 1933.

Sweden	15·2	Italy	30·6
Denmark	20·1	U. S. A.	23·4
Germany	23·0	U. K.	25·2
France	26·3		

TABLE II.

Incidence of Taxation in England.

For a Married Person with 3 Children.

(Two estimates are given. " A " is the Colwyn Committee's estimate revised for 1930–31. It excludes local rates, but includes death duties. The second estimate " B " excludes death duties. Regarding expenditure budgets, both unfortunately depend upon " not very well-informed guesses ").

" A " (1930–31).

Taxation as Percentage of Income.

Annual Income (£)	All Earned.	Wholly from Investments.
50	—	—
100	10·9	13·1
150	11·3	13·2
200	9·6	11·7
500	5·1	10·1
1,000	10·9	20·7
2,000	17·5	30·8
5,000	28·2	47·7
10,000	37·6	63·8
20,000	45·3	83·4

" B " (1934–36).

Taxation as Percentage of Income.

Annual Income. (£)	Direct Taxes (Income and Surtax).	Commodity and Indirect Taxes.	Local Taxes (Rates.)	Total Taxes.
65	—	9·9	7·2	17·1
100	—	9·8	6·8	16·6
150	—	9·5	5·3	14·8
225	—	7·6	4·4	12·0
335	—	5·2	4·5	9·7
500	1·2	3·6	4·3	9·1
750	5·7	2·8	3·9	12·4
1,125	9·8	2·3	3·3	15·4
1,675	13·0	1·9	2·8	17·7
2,500	17·2	1·7	2·5	21·4
10,000	36·1	1·2	1·8	39·1

(The tables taken from U. K. Hicks—The Finance of British Government).

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