

Taxation of Agriculture: Some Basic Issues

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Taxation of Agriculture: Some Basic Issues

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It has been argued that if land revenue were replaced by a tax on agricultural incomes as part of an integrated system of income taxation, the loss of revenue as a result of abolition of land revenue would be more than made up and, in addition, a major loophole in the existing system of income taxation would be plugged and a measure of much-needed equity introduced in taxation of the agricultural sector.

Comparison of land revenue with agricultural income-tax, suggests, however, that from the point of ensuring efficient use of land the superiority of land revenue is absolute. Since land revenue is a fixed charge, the marginal rate of tax is zero. Thus the incentives for additional effort and investment to raise the productivity of land are left unimpaired.

From the equity point of view, too, while there is a case for introducing a measure of progression in taxing agricultural incomes, economic considerations suggest that this objective can be more effectively secured within the framework of the existing land revenue system.

IN recent months several State Governments have been seriously considering abolishing land revenue altogether. This has led to suggestions from various quarters for levying income-tax on agricultural incomes. A suggestion which is currently being seriously discussed is to replace the existing land revenue by taxation of agricultural incomes as part of an integrated system of income taxation which would make up for the loss of revenue in consequence of abolition of land revenue and raise additional revenue and, besides, plug a major loophole in the existing system of income taxation in the country and introduce greater equity in rural taxation. There are thus really two distinct issues: One of raising revenue through taxing agricultural income rather than land and the second of equity. We shall, therefore, discuss the problem in two parts.

In Section I we shall discuss land revenue and agricultural income-tax as alternative systems of raising revenue from the point of view of economic efficiency. In Section II the two taxes will be discussed from the point of view of equity.

I

Efficiency of Land Use

Let us take as our starting point the principle that public policy should ensure as efficient use of land as possible. From this point the view, the superiority of land tax vis-a-vis agricultural income-tax is absolute. How this is so can be understood by considering the basis of taxation in the two cases.

The basis of land tax is *potential* production; the basis of agricultural income-tax is *actual* production. The land tax is a fixed charge assessed on

the basis of presumed potential productivity and it is generally fixed for a fairly long period. Since the tax is a fixed charge, the land-owner retains the entire increment in production. The marginal rate of tax is, therefore, zero. This, therefore, leaves unimpaired the incentives for further effort, improvements and investments in land. Further, the fixed land tax would fall relatively more heavily on the less efficient. Their relative position would worsen and this might spur them to better effort.

On the other hand, agricultural income-tax is a tax on actual production and increases with increase in production and *vice versa*. The marginal rate of tax is, therefore, positive. The disincentive effects of this tax are, therefore, obvious. Under income-tax as Henry George said, "we punish with a tax the man who covers the barren fields with ripening grain, we fine him who puts up machinery, and him who drains a swamp".* At its extreme, a tax on current agricultural produce is tantamount to taxing land use and exempting non-use of land. Thus, if the land-tax is replaced by agricultural income-tax there is likely to be a transfer of land from productive to unproductive or less efficient uses and the pace of improvements is likely to slacken. The pressures towards improvement which exist under land taxation would be absent under agricultural income-tax. The perverse effect of the proposed change in our system of agricultural taxation cannot, therefore, be brushed aside.

Our land revenue system also had

a productive end in view. Permanent land settlements were based on the argument that since the entire increment in production would remain with the cultivator or the landlord, the incentives for further improvement would be left unimpaired. Similarly, the Ryotwari settlements were fixed for a period of 25 to 30 years and were assessed on the productive potential of the land. For this purpose the entire agricultural land was carefully classified according to productivity and the liability to tax differed with different classes of land.

PRODUCTIVITY FACTOR

While the merit of land tax serving as an inducement mechanism for better performance cannot be denied, one limitation should be carefully noted. In linking the land tax to potential productivity of land, the economists and administrators had made an implicit assumption that all cultivators had equal access to the capital market. The actual realisation of potential productivity of land depends, however, on the application of labour and capital. If the capital markets are highly imperfect, as is actually the case, even an otherwise progressive cultivator may fail to realise the full productivity of his land for want of adequate resources. Indeed, a land revenue system which fails to take this factor into account can end up as a highly oppressive system as was possibly true of our land revenue system under early British rule when the rate of tax (in real terms) per standard acre was oppressively high.

The above discussion, we hope, should have made it clear that from the point of view of efficient land use raising a rupee of tax revenue through

* Henry George: "Poverty and Progress", Fiftieth Anniversary Edition, Robert Schalkenbuch Foundation, New York, 1939; p 433.

a tax assessed on land is superior to raising it through agricultural income-tax. At the same time, it cannot be overlooked that under a system of land taxation, where the average rate of tax per acre is substantial (which is not really the case in India right now), the case for taxing smaller holdings lightly (or even exempting them altogether) is strong on purely economic considerations. Naturally, therefore, there has to be a certain measure of progression.

II Equity

There are, as we see it, two aspects of the equity argument in favour of the suggestion currently being debated. First, there is the question of introducing progression in the taxation of the agricultural sector for which there is no doubt as much a case as there is for progression in taxation of the non-agricultural sector. This argument is, of course, valid insofar as progression in the taxation of non-agricultural incomes derives from the equity consideration. It cannot, at the same time, be disputed that existing land revenue systems in the country operate regressively. But it ought to be recognised that the highly progressive rates of tax on non-agricultural incomes exist only on paper. Through various devious ways of avoidance and evasion, persons in the high-income categories are able to keep their effective rates of income-tax quite low so that the extent of inequity that might appear to exist in the tax treatment of the high-income non-agriculturist as against the high income agriculturist may not actually exist, at least not in that large a measure.

The second aspect concerns integration of income from the agricultural and non-agricultural sectors for purposes of taxation. Even equally progressive but separate taxation of agricultural incomes would involve inequity so long as it permits splitting up of income into agricultural and non-agricultural income. This, again, is a perfectly legitimate point. At the same time, it would be wrong to ignore the fact that even in countries with well developed and integrated systems of income taxation, special legislative and administrative measures have to be devised to prevent high income-tax payers from using the agricultural source as a means of reducing their tax liability. The hobby farm provi-

sions in British tax law are, at best, only a half-hearted measure to plug this loophole. Further, in the Indian context, the extent of such a deliberate attempt at tax avoidance even today, when agricultural income gets away by paying a nominal tax, could not be very large in view of the extensive restrictive legislation with respect to land acquisition, ownership ceiling, tenancy, etc, even when one allows for loopholes in the implementation of such legislation. If and when land revenue is put on a comparable progressive basis, the inequity would operate against the agricultural part of one's income because then the effective rates of tax are likely to be higher on agricultural incomes than on non-agricultural incomes (for land unlike income from land is hard to conceal). To talk of integration is, to our mind, only to chase a shadow.

Let us concentrate on the first aspect of the equity argument. We concede that there is a strong case, in terms of equity, for taxing agricultural incomes on a progressive basis. At the same time, however, let us not for-

get that the effective rates which apply to non-agricultural incomes are far lower than those shown on paper. Therefore, to seek to introduce the same degree of progression in the agricultural sector as exists on paper with respect to taxation of non-agricultural incomes would amount to replacing one stark inequity by another, if not worse.

Granting, however, that a certain measure of progression ought to be introduced in taxation of the agricultural sector, economic considerations suggest that we should seek to secure it within the framework of the existing land revenue system, i.e., taxing land on the basis of its potential productivity and not actual productivity. There is, in our opinion, scope for considerable improvement in the present system of land taxation but to give it up in favour of agricultural income-tax would be a most ill-advised move. Unfortunately, the preoccupation of our planners with the revenue consideration seems to be so intense that the basic issues involved in the question of taxing agriculture are getting ignored.

Use of Thorium in Nuclear Reactors

PROGRESS in the use of thorium in nuclear power reactors was reviewed at a meeting of experts organised by the International Atomic Energy Agency in Vienna last month. That the use of thorium as a fertile material in power reactors (i.e., as an element in which nuclear reactions could create new fuel) was attractive technically and economically and that the problems to be solved, though difficult, would not prove limiting had been clear for long. Now a great deal of progress has been made as a result of which the problems are more clearly defined and satisfactory solutions, generally, either exist or are in sight. There are, however, formidable obstacles still to be overcome to make practical and economic use of thorium. Success in overcoming them would assist in obtaining the fullest benefit from the potential energy in nuclear fuels.

Thorium reactors have to compete with fast breeders, and other advanced thermal reactors. Even when the technology was fully developed, electric utilities would have to be convinced that the economic advantages were large enough to justify their investing in an entirely new reactor system.

They would also need to be assured that the fuel cycle services were adequate.

In reviewing the progress made so far, the meeting of experts noted that high temperature gas-cooled reactors had reached an advanced stage and that encouraging experience was being accumulated from the Dragon, Peach Bottom and Julich reactors. It had been decided to proceed with a 330 megawatts high temperature gas-cooled reactor at Fort St Vrain, and designs had been completed in Europe for a 300 megawatt thorium high temperature reactor. The Molten Salt Reactor Experiment was giving valuable experience in the basic reactor technology of the concept and the design study for a 1000 mw molten salt breeder reactor was well advanced. The aqueous suspension test reactor in The Netherlands was nearing completion. Encouraging studies and evaluations had also been made on the use of thorium in solid-fuelled heavy water reactors. Invaluable experience on refabrication of spent fuel would be forthcoming from work in Italy and later from the thorium-uranium recycle facility in the United States.