From Mumbai to Shanghai, with a Side Trip to Washington: China, India, and the Future of Progressive Taxation in an Asian-Led World

*Michael A. Livingston**

Progressive taxation has historically been discussed primarily in the context of developed, Western nations. This Article considers its application in two developing, nonwestern economies, emphasizing the differences in political, economic, and (especially) cultural contexts and their effect on the progressivity equation. In India these differences include long-standing attitudes, such as the Hindu tradition's historic ambivalence towards utilitarian arguments, and shorter-term institutional arrangements, such as the division of power within India's federal system and the tax exemption for agricultural income. In China they include the legacy of Marxism as well as a more long-standing tendency to resolve legal and policy issues based on notions of communal rather than individual welfare. Both countries have limited administrative resources and (by Western standards) a relatively small middle class, so that the income tax remains a relatively small albeit growing source of national revenues. In this Article I consider the impact of these factors, and conclude by asking whether a similar "tax life cycle" will apply to both countries or political and cultural differences will result in divergent tax patterns. Furthermore I also evaluate the progressivity problem as a case

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* Professor of Law, Rutgers-Camden School of Law. The author would like to thank Assaf Likhovski, Shari Motro, and other participants at the conference on Comparative Tax Law and Culture, sponsored by the Cegla Center for Interdisciplinary Research of the Law at Tel Aviv University and Monash University, August 2008 and June 2009, as well as the IAES (International Atlantic Economic Society) annual conference, Philadelphia PA, October 2006, for comments at various stages of this project, and Marissa Sharples, Nicholas Dibble, and Zoha Barkeshli for outstanding research assistance.

study in comparative taxation and assess the need to develop a more sophisticated methodology for dealing with institutional, attitudinal, and other cultural differences.

INTRODUCTION

The concept of fairness in taxation is as old as the Bible, and applies to young or developing economies no less than to large industrial democracies. Yet the debate on progressive (and especially progressive income) taxation has been conducted primarily in the wealthier countries. This has been in part the result of experience: the most advanced and frequently studied progressive tax systems have been in developed countries, and the principal theoretical work was done in them. There is also a certain condescension here, a sense that poorer countries can perhaps not afford too much progressivity, and should content themselves with the collection of sufficient tax revenues — no small task in its own right — without indulging the "luxury" of a progressive or redistributive tax system. Yet tax equity is an issue that applies to all societies, and there is no inherent reason why it should be less important in a new or developing country than in a more established nation.

While being conducted primarily in wealthy countries, the debate on progressivity (and tax policy generally) also has a decidedly Western flavor, emphasizing Western ideas and Western categories of thought. This is, once again, largely a matter of history: with the exception of Japan, the larger developed countries have for the most part been Western, and — although the question of tax equity arises in all cultures — it has of necessity been debated predominantly in Western terms. As prosperity spreads to other portions of the globe, tax policy inevitably encounters other cultures and different ways of thinking. This encounter is particularly significant for progressivity, which implicates underlying values in a more profound way than (say) the dividends paid deduction or the treatment of affiliated groups. Economic and cultural differences often reinforce one another: developing nations more often than not have some sort of colonial or neocolonial history, in which both preexisting cultures and economic systems were challenged by Western hegemony, and the response to which continues to color their tax and nontax policy.

In this Article I consider progressive taxation in China and India, the two largest and, by most standards, most important developing, nonwestern nations in the world today. While China and India are in some ways unrepresentative, being larger and wealthier than most developing countries (and almost everyone else), they are also leaders whose experience is likely to be followed by other countries in the years and decades to come. Both countries are strong and independent enough that their tax policies reflect significant indigenous values, rather than being imposed by foreign countries or multinational organizations, as in the case of many Third World nations. Finally — though there are enormous differences between their economies and tax systems — both China and India have made at least a formal commitment to progressivity and (more specifically) to a progressive income tax, although this tax remains a relatively modest source of revenue in both cases.

The issue being potentially quite broad, it may be wise to impose some limitations at the outset. Thus I will limit myself to tax rather than spending policy and, within the tax system, place special emphasis on the income tax, although as noted it is only one of several revenue sources and — in both China and India — is at this point less statistically important than other, less high-profile taxes. (One of my important questions is whether and when this is likely to change.) I will likewise eschew a statistical evaluation of progressivity, which I am in any case ill-equipped to do, in favor of an abstract but I hope engaging discussion of the issue in theoretical terms.

I will discuss progressivity as a case study in the economic, cultural, and political factors which influence tax policy in developing, nonwestern societies. The economic factors, which emphasize the tradeoff between equity and efficiency in conditions of relative scarcity and limited administrative resources, are to some degree shared by the two countries. The cultural factors are, however, quite different. China and India are each thousands of years old, and approach public policy with a mindset and attitudes that differ both from each other and from Western societies. China and India also have different political histories, which — although both involve a reaction to Western dominance on some level — have expressed that reaction in very different forms. By examining similarities and differences between the two countries, I will attempt to learn something about the countries themselves, but also about the role of cultural factors in tax policy more generally, and the future of progressivity on a global level.

The Article is divided into five Parts. Part I provides background on theoretical approaches to developing country taxation, with an emphasis on progressivity issues. In Part II, I consider the (largely undeveloped) state of work on taxation and culture. In Part III, I consider the economic, cultural, and political factors affecting progressive taxation in India, while in Part IV I do the same for China, in each case emphasizing the period (after 1991 in India and roughly 1980 in China) when the country began to open itself to foreign investment and the global economy. Part V presents my conclusions and suggestions for future work.

I. TAX POLICY IN CONDITIONS OF SCARCITY: DEVELOPING COUNTRY TAXATION AND THE PROGRESSIVITY ISSUE

I think it was George Bernard Shaw who said that the rich are the same as the rest of us, except they have more money. It might be said that tax policy is the same in poorer countries, except they have less of it. While all of the issues that characterize taxation in developed nations remain relevant in developing economies, the issues take on a different character, both because of economic differences and because of the political and ideological differences that accompany them. For this reason tax policy in developing countries has become something of a self-contained field, with beliefs and assumptions that frequently differ from "ordinary" rich-country experience.[1]

The starting point for developing-country tax policy is the relative lack of administrative resources and the (closely related) real or perceived lack of sophistication on the part of potential taxpayers.[2] Because of these limitations, many of the options available in wealthier nations are simply not feasible in developing countries. For example, computerized enforcement mechanisms, which are a way of life in the wealthy countries, may be beyond the reach of developing-country tax administrations. Taxpayers themselves may lack the ability or inclination to make complex calculations, or they may engage in transactions that are not wholly susceptible to tax reporting. For these and other reasons, some experts believe the income tax inherently too complex and time-consuming to be worth the effort in developing nations.

A second, related difference lies in the mix of taxes. Whereas the income tax tends to take or at least share center-stage in developed countries, in developing ones it is likely to be one of a large number of levies and frequently limited to a relatively small segment of the economy — much like the United States' income tax in (say) the 1920s or 1930s, but rather unlike it today. Even a sales or value added tax (VAT), which appears relatively simple in advanced countries, may present problems of enforcement, calculation,

1 I have tried to avoid using the term "Third World," preferring instead "developing country," "young economy," and other less historically charged terms. For our purposes they mean more or less the same thing.

2 These factors are a modified version of those presented in VITO TANZI & HOWELL ZEE, TAX POLICY FOR DEVELOPING COUNTRIES (Int'l Monetary Fund Economic Issues Series No. 27, 2001). Tanzi and Howell identify four principal factors (undeveloped or informal economy, lack of efficient tax administration, difficulty in generating statistics, and high level of income inequality) that restrict tax choices in developing countries. I have condensed the first three into one item and added additional factors relating primarily to political as opposed to economic concerns.

or even knowledge of the tax on the part of the taxpaying population.[3] For these reasons, developing countries often rely on excise taxes, import or export duties, or so-called cascade taxes (essentially a VAT without any deductions) to meet a large part of their revenue needs. Since these taxes are frequently unprogressive or even regressive in character — and since wealthy taxpayers are most able to take advantage of loopholes and other administrative gaps — achieving an overall progressive effect in developing country tax systems is that much more difficult. (Chinese and Indian excise and other non-income taxes are discussed in the appropriate Sections.)

Developing countries differ from developed countries not only in economics, but also in politics, albeit in a less systematic and predictable way. In most developed nations Marxism is either a fringe movement or has morphed into a reformist socialist party that does not seriously question private property. By contrast, Marxist or similarly anticapitalist thinking (e.g., Gandhi's philosophy in India or Islamic thought in certain countries) remains important in many developing nations, even if it is often honored in the breach. The tax systems in such countries must face the reality of high and often increasing economic inequality at the same time that part of the population is ambivalent or even hostile toward the very concept of private wealth — a degree of polarization that progressive taxation, which tends toward a moderate rather than an extreme form of wealth redistribution, may find difficult to address.

Finally there is the simple fact that developing countries, almost by definition, tend to have less economic power than wealthier nations and — while all countries face pressure to conform to international norms — these pressures are likely to be greater in such countries. In some cases this difference manifests itself in effective foreign control over the national tax system by means of the IMF or similar veto power over domestic tax structures. For more powerful countries, like China or India, this is less of a problem. But even larger developing countries feel strong pressure to keep taxes low in order to attract and retain foreign and domestic investment, and to bring their internal tax norms into conformance with accepted international (read: Western) norms. The fact that international tax bodies are dominated by the OECD (that is, developed) countries contributes further to this imbalance.

The challenge faced by developing countries — to balance the goals of

3 In conversations in India I was told that a business turnover tax, based on a flat percentage of receipts, had to be changed because many people allegedly were not comfortable with the percentage concept.

fairness, efficiency, and adequate revenue collection under conditions of limited resources and ideological conflict — is especially apparent with respect to progressivity issues. Progressive taxation refers to the imposition of higher tax rates on higher taxable amounts, so that the tax burden is borne disproportionately by the wealthier segments of society. Although theoretically applicable to any kind of tax, the term is most frequently applied to the income tax, given the difficulty of applying progressive rates to (e.g.) a sales tax, VAT, or other excise levy. Progressivity is conceptually distinct from vertical equity, which refers to a tax system's capacity to achieve equity between social classes, since the latter might (again in theory) be achieved by careful definition of tax bases or the use of generous exemptions without need for progressive marginal rates. In practice, however, the two terms are often used interchangeably, so that the "progressivity" of a tax system becomes a synonym for its overall equity or fairness, including tax rates, tax base, and other factors affecting the distribution of the tax burden.

The arguments for and against progressivity have been discussed in detail in previous pieces and will be alluded to only in passing here. The arguments in favor include the diminishing marginal utility of money (the concept that rich people derive less utility from each additional dollar of income and hence should be more ready to part with it); the overt or intentional redistribution of income; and the so-called benefit theory (the wealthy benefit more from government activities and should pay more to support them). The arguments against include the individual's presumed right to retain the fruits of his labors; and the negative effect of progressive rates on incentives. Even when it is accepted as a goal of tax policy, progressivity may clash with other goals such as economic efficiency, simplicity or administrability, and competitiveness with other nations. In recent years there has been a sense of progressivity being on the defensive in the advanced countries, although with the exception of Eastern Europe most countries retain some version of a progressive income tax.[4]

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4 *See generally* Michael A. Livingston, *Blum and Kalven at 50: Progressive Taxation, "Globalization," and the New Millenium*, 4 FLA. TAX REV. 731 (2000). For a classic statement of the arguments for and against progressive taxation, see Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417 (1952). On the current status of the debate on progressivity in three countries (India, Israel, and Italy), see Michael A. Livingston, *From Milan to Mumbai, Changing in Tel Aviv: Reflections on Progressive Taxation and "Progressive" Politics in a Globalized but Still Local World*, 54 AM. J. COMP. L. 555 (2006). Both flat and non-income (primarily consumption) taxes have been proposed as a substitute for the progressive income tax in the United States, but neither has come close to enactment.

Progressivity is thus a contested issue even in advanced societies, but in developing ones it is likely to be even more so. While the politics of such countries make vertical equity arguably even more important than in developed nations — and in some cases may lead to an underlying ambivalence about private wealth altogether — the lack of administrative resources makes it substantially harder to achieve. In some countries it may be impossible even to maintain an effective income tax, while in others the rich may be well-positioned to avoid it by means of various tax-shelter mechanisms.[5] The VAT and similar taxes may achieve a measure of vertical equity, but are more frequently regressive in nature.[6] Even when the means are available, developing economies face strong pressures to keep taxes low in order to compete in the international economy; this is especially true for export-driven economies, as an income tax is not rebatable on exports in the manner of a VAT or similar tax. Beyond that, some developing nations may simply assign a low priority to tax equity, believing that it is more important to let "the pie get bigger for everyone" and assigning the goal of equity to healthcare, welfare, or other spending programs.

Developing nations thus have many good arguments for and against progressivity; but even if they resolve the debate in the affirmative, they may lack the practical capacity or the political will to do so. Of course, this situation varies between countries, depending on their size, reigning political ideology, and historical circumstances. In particular, there is a large gap between countries like China, India, or Brazil — perhaps better described as "transitional" than as purely "developing" countries — and (e.g.) the sub-Saharan African nations, which are at an earlier stage of development and perhaps less capable of asserting a wholly independent tax policy. Nevertheless the experience of the former, who increasingly act as leaders of the developing country movement, may be relevant to the entire category. We will return to this discussion in Part III below.

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5 Two respected scholars have argued that an income tax is, as a general rule, a poor policy choice for reducing inequality in developing countries, since the administrative resources consumed by the tax tend to outweigh the gains, and alternate taxes can achieve these same goals in a more efficient manner. *See generally* Richard M. Bird & Eric M. Zolt, *Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, 52 UCLA L. REV. 1627 (2005).

6 Although a VAT is typically thought of as a regressive tax, it may have some progressive effect if (e.g.) cash transactions are limited to the upper segments of society, or if the tax is limited to a defined category of upmarket or luxury goods. To varying degrees, this situation will apply in many developing nations.

II. APPLYING UNIVERSAL TAX CONCEPTS IN DIFFERENT SOCIETIES: THE PROBLEM OF TAX AND CULTURE

As a general rule, the study of tax and culture, and with it the study of comparative tax law, is less developed than other legal fields. This is in part a question of training: most tax scholars know at least some economics, but little if any anthropology, and the uses of the term "culture" in tax scholarship (including perhaps my own) tend toward the methodologically unsophisticated.[7] There is also a question of institutional self-interest. Economists and other tax experts derive much of their authority from the sense that there are universal, unchanging principles applicable to all tax systems, and would lose a significant portion of their authority if these were determined to be dependent on or conditioned by culture. Finally there is the matter of sheer exhaustion. Comparative law, generally speaking, requires knowledge of two or more legal systems and, frequently, different languages. Comparative tax law, which requires all of the above plus an unusually high degree of technical sophistication, is even more difficult.[8] Requiring scholars to master (say) the American, German, and Japanese transfer pricing rules, and then situate each of them within their respective intellectual and cultural traditions, may simply be more than most people can manage.

Culture has been defined as "the integrated pattern of human knowledge, belief, and behavior that depends upon the capacity for learning and transmitting knowledge to succeeding generations." Alternate definitions include "the customary beliefs, social forms, and material traits of a racial, religious, or social group" and "the set of shared attitudes, values, goals,

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7 On the use of culture by (primarily English-speaking) tax scholars, and the future of comparative tax law, see generally Michael A. Livingston, *Law, Culture, and Anthropology: On the Hopes and Limits of Comparative Tax*, 18 CAN. J.L. & JURISPRUDENCE 119 (2005).

8 *See* Carlo Garbarino, *An Evolutionary Approach to Comparative Taxation: Methods, and Agenda for Research*, 57 AM. J. COMP. L. 677, 684 (2009) ("[t]here are three aspects related to the peculiar nature of taxation that make comparative research particularly difficult: rapid legislative change; the complexity of tax systems; and the heterogeneity of local tax concepts"); *cf.* Omri Y. Marian, *The Discursive Failure in Comparative Tax Law*, 58 AM. J. COMP. L. (forthcoming 2010), *available at* http://ssrn.com/abstract=1404323 (arguing that there have been several efforts at defining a theoretical framework for comparative taxation, but these efforts have been "largely ignored by everybody except their own authors" leading to an ongoing "non-discourse" that characterizes the field).

and practices that characterizes an institution or organization."[9] As the last definition suggests, culture may be defined at the level of an entire society or at various subsidiary levels.[10] In this connection, I and other scholars have suggested that a nation may possess a "tax culture" which is related to, but distinct from, its overall national culture, consisting of the beliefs and practices that are shared by tax practitioners and policymakers in a given society that provide the background or context in which tax decisions are made.[11] American tax culture, for example, might include real or perceived national traits such as individualism, self-reliance, or respect for risk-taking, but also tax-specific elements such as the relatively high level (by European standards) of income tax compliance or the unusually large role that lawyers have traditionally played in American tax policy. Israeli tax culture might include the country's Jewish and socialist traditions, but also its historic tendency — dating from the British Mandate — to collect most of its taxes by withholding rather than by means of tax returns, and its corresponding diffidence, until very recently, about collecting tax on investment and other unearned income. The concept of "legal transplants," always important in comparative law, is especially so here: tax law and institutions are often of relatively recent vintage, and may reflect the influence of foreign ideas and organizations as much as or more than inherited national traits.

Some aspects of "tax culture" are primarily attitudinal in nature, like a tendency toward tax evasion or a widely shared belief in redistribution of income. Others are primarily institutional, like the role of lawyers in American tax policy or the historic division in taxing authority between the Swiss cantons and central government. Some people may prefer using the term "tax sociology" or simply "tax institutions" rather than "tax culture" to describe these latter features. A further distinction may arguably be made between religious or quasi- religious values, such as the resistance to gay and unmarried heterosexual couples on the part of some evangelical

9 *Culture*, *in* MERRIAM-WEBSTER ONLINE DICTIONARY, http://www.merriam-webster.com/dictionary/culture (last visited Oct. 12, 2009).

10 The concept of "subcultures" is relevant here, the latter being defined as special ways of behaving characteristic of particular segments of a large and complex society. These segments may be defined by various factors including class, geographic area, or — in the case of tax culture — a particular profession or activity. *See* RALPH L. BEALS & HARRY HOIJER, AN INTRODUCTION TO ANTHROPOLOGY 106 (4th ed. 1971).

11 Livingston, *supra* note 7, at 121.

Christians in the United States, and more secular outlooks.[12] The point is that there exists in any society a substantial body of noneconomic and largely unquantifiable factors that impacts upon the society's tax and fiscal policy, and which must be taken into account if the society's tax choices are to be properly understood. To ignore these factors, or to treat them as irrational constraints upon the adoption of otherwise "correct" policies, does not constitute merely an error, but rather willful ignorance.

One of the difficulties confronting any study of culture is that societies are not isolated from each other: instead they interact with and influence one another at an ever- increasing rate. (It is perhaps for this reason that cultural anthropologists have conducted so much of their work in isolated areas.) This phenomenon is especially advanced in the tax area, where the need to coordinate or at least reduce conflicts in the taxation of cross-border transactions has resulted in a high level of interaction among national tax systems. Conferences, electronic exchanges, and international tax programs like those at Harvard, NYU, and similar universities have resulted in a still higher level of academic and practical contacts. The increasing volume of such contacts has led some scholars to speak of the emergence of a global tax culture, in which specified rules and assumptions are shared by worldwide tax professionals notwithstanding differences in their broader political and cultural outlooks.[13] It is possible to overstate this phenomenon: with the exception of certain regional networks (notably the EU), the process of integration is at an early stage, and is probably more advanced for areas involving a high volume of cross-border activity and few deeply held values, like corporate and capital income taxation, than (say) individual tax rates or the taxation of families. Yet, at the very least, the acceleration of international contacts has increased the rate of change within national tax systems, so that national tax cultures are less a static reality and more a dynamic process.

In Parts III and IV, I will consider the effect of cultural differences, including both attitudinal and institutional factors, on progressive taxation in India and China. My approach will be eclectic in nature, considering a variety of evidence without claiming to resolve any or all of the methodological issues above. In Part V, I will consider the implications of the study for

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12 *See* Marjorie Kornhauser, *Wedded to the Joint Return: Culture and the Persistence of the Marital Unit in the American Income Tax*, 11 THEORETICAL INQUIRIES L. 631 (2010).

13 *See generally* Allison Christians, Steven Dean, Diane Ring & Adam H. Rosenzweig, *Taxation as a Global Socio-Legal Phenomenon*, 14 ILSA J. INT'L & COMP. L. 303 (2008).

the role of cultural factors in comparative tax analysis and the future of progressivity.

III. GANDHI, THE *GITA*,[14] AND THE ROLE OF INSTITUTIONAL FACTORS: TAX CULTURE AND PROGRESSIVITY IN INDIA

A. Political and Economic Background

Economics, together with much else in India, calls to mind the image of a giant who was long asleep and only recently revived. Twenty years ago there would have been no hesitation in labeling India as a poor, Third World nation with a long colonial past and an uncertain economic future. Today, though it is headed toward second or third place among national economies, India still retains much of the essential structure of a developing country, including low median incomes (per capita income is in the $700 range[15]), a high level of economic inequality (a substantial portion of the population lives on less than $1 a day), and political and bureaucratic structures that are still in the early stages of transition from "old" to "new" ways of thinking. While India is thus not an average or typical developing country, it remains an attractive place to begin our study. India's relative political transparency and the fact that tax policy debates are conducted largely in English make the endeavor particularly appealing.

For the first four decades following independence (1947), Indian taxation was part of a broader economic policy that emphasized equality and independence (autarky) over private enterprise and international trade. Central to this approach was the philosophy of India's founder, Mahatma Gandhi, who believed that colonialism and the caste system were responsible for India's backwardness and that a policy of economic self-reliance, coupled with social and economic egalitarianism, were the correctives to these

14 The Bhagavad-Gita (literally Song of God) is part of the Hindu scriptures and is frequently taken as the supreme statement of Indian philosophy. *See infra* note 23 and accompanying text.

15 *See India's Per Capita Income Increases to Rs 33,283*, FINANCIAL EXPRESS, Jan. 30, 2009, *available at* http://www.financialexpress.com/news/indias-per-capita-income-increases-to-rs-33-283/417094/ (indicating per capita income of 33,283 rupees or about $718 at current exchange rates). Both China and India register higher numbers if the purchasing power parity (PPP) rather than exchange rate method is used. (This point is addressed elsewhere in Part I.)

evils.[16] Gandhi and Nehru likewise believed that high accumulations of wealth were inappropriate in an Indian context and supported policies including high tariffs, strict economic regulation, and near- confiscatory taxes consistent with this philosophy.[17]

India's economic policy began to change in the 1990s following the collapse of Soviet communism and the success of the East Asian "tiger" economies, which threatened to leave India permanently behind if corrective action were not taken. On a wider level, this involved the reduction and/or repeal of import tariffs, dismantling of the so-called "license raj" which regulated most aspects of domestic production, and the adoption of market- oriented policies consistent with India's democratic nature and the government's interest in social and economic justice. Tax reforms followed the work of various expert reports, beginning with the Chelliah Commission in 1991[18] and proceeding through the Kelkar Commission in 2002,[19] although not all recommendations were accepted. In general, the reforms involved the reduction of marginal income tax rates from an astronomical 95 percent-plus in the 1970s to a current 30 percent maximum rate,[20] together with a significant increase in the exemption amount; attempts to expand the tax base by imposing more efficient taxes on the small business and service sectors; and increasingly assertive efforts to improve tax administration and identify potential taxpayers. An important goal was increasing the share of direct vs. indirect taxes, which had fallen during the previous decades. Although initially undertaken by the Congress Party, the reform policy has continued through two changes of government, albeit attracting somewhat reduced attention under the current leadership (ironically headed by a Prime Minister,

16 *See generally* JOHN MCLEOD, THE HISTORY OF INDIA (2002).

17 *Id.* at 137-39.

18 RAJA J. CHELLIAH, CHAIRMAN, GOV'T OF INDIA, REPORT OF THE TAX REFORMS COMMITTEE: PART I (1992), *reprinted in* ACADEMIC FOUNDATION (NEW DELHI), ECONOMICA INDIA: INFO SERVICES, REPORTS ON INDIA'S TAX REFORMS (2003); RAJA J. CHELLIAH, CHAIRMAN, GOV'T OF INDIA, REPORT OF THE TAX REFORMS COMMITTEE: PART II (1993), *reprinted in* ACADEMIC FOUNDATION (NEW DELHI), *supra*.

19 VIJAY L. KELKAR (CHAIRMAN), GOV'T OF INDIA, REPORT OF THE TAX FORCE ON DIRECT TAXES (2002), *reprinted in* ACADEMIC FOUNDATION (NEW DELHI), *supra* note 18; VIJAY L. KELKAR (CHAIRMAN), GOV'T OF INDIA, REPORT OF THE TASK FORCE ON INDIRECT TAXES (2002), *reprinted in* ACADEMIC FOUNDATION (NEW DELHI), *supra* note 18. *See generally* M.M. SURY, INDIA: A DECADE OF TAX REFORMS 1991-2001 (2001).

20 The maximum rate including surcharges is actually 33 percent, *see infra* Section III.B.

Manmohan Singh, who first came to prominence in the earlier tax reform process). While attracting widespread support, the process has been slowed down by political conflict both between and within governing parties and the persistence of numerous federalism issues, most notably the exemption of agricultural income from the national income tax base and the difficulty of coordinating various state policies with respect to VAT and other excise taxes.

B. Current Tax System

The Indian tax system includes an income tax imposed at rates of 10, 20, and 30 percent, with the 10 percent rate starting at Rs 150,000 or about $3,000 per year[21] and the 20 and 30 percent rates being reached at Rs 300,000 ($6,000) and 500,000 ($10,000) respectively. A 10 percent surcharge is imposed on incomes exceeding Rs 1,000,000 ($20,000) for an effective 33 percent top rate. There is also a flat 20 percent tax on inflation-adjusted capital gains; a company (corporations) tax with a maximum 30 percent rate for Indian companies and floating rates, depending on the type of income, for foreign entities; and a wealth tax, although the latter is limited to "unproductive" assets and in conversations with the author was reported to be easily avoided. In addition, there is a 10 percent tax on specifically designated services, although there have been proposals to adopt a new, comprehensive goods and services tax in its place. A uniform VAT with a 12.5 percent "standard" and several reduced rates replaced previous state sales taxes in 2005. Additional taxes are imposed at the state level.[22]

While it is difficult to come by comprehensive statistics regarding tax incidence, it seems clear that the income tax reaches a relatively small number of affluent, largely urban wage-earners and thus — even assuming it is imposed fairly and comprehensively — can account for only a modest

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21 Increased to Rs 180,000 for women and 225,000 for senior citizens.

22 *See generally* Worldwide-Tax.com, India Income Taxes and Tax Laws, http://www.worldwide-tax.com/india/india_tax.asp (last visited Oct. 14, 2009); Worldwide-Tax.com, India V.A.T. and Other Taxes, http://www.worldwide-tax.com/india/ind_other.asp (last visited Oct. 14, 2009). On August 12, 2009, the Indian Finance Ministry introduced a bill which would exempt all income below 160,000 rupees from tax, with a 20 percent rate beginning at 1,000,000 rupees and a 30 percent rate at 2,500,000 rupees, thereby imposing an effective flat (10 percent) income tax rate on all but a relatively small number of upper-income taxpayers. The law would be applicable, at the earliest, in 2011. *See* etaxindia.org., New Income Tax Slab Under New Direct Tax Code 2009 (Aug. 14, 2009), http://www.etaxindia.org/2009/08/new-income-tax-slab-under-new-direct-tax-code-2009.html.

amount of tax as opposed to spending-based redistribution of income. This is apparent from the fact that the tax begins at more than three times the median income and the number of returns remains relatively low. The persistence of tax evasion, particularly on nonwage income, contributes further to this perception. As the economy grows, and income tax receipts increase further, this situation may change.

It should be noted that most redistribution in India — almost certainly more than accounted for by the income tax — has historically been provided by nontax programs, including subsidized water and energy for farmers, affirmative action for poorer or so-called "scheduled" castes, and similar programs. Given this reality and the lack of administrative resources, Indian tax reform may be seen less as a process of making the system "fairer" and more as a process of making it "rational," broadening the tax base and minimizing distortion so that the government can obtain sufficient revenues to achieve its goals by other means. If successful, these efforts will arguably advance the cause of vertical equity both directly (since broader-based, better-enforced taxes are likely to be more progressive than high-rate, leakier ones) and indirectly (since more money will be available for healthcare, welfare, and other programs). But redistribution within the tax system remains a highly elusive goal.

C. The Role of Cultural Factors

In considering the role of Indian culture, it may be useful to distinguish between attitudes and institutions ("anthropology" and "sociology") as suggested above. India has a 3,000-plus-year old culture whose attitudes and values differ from the West in many important aspects. Indeed, there is a threshold question whether redistribution should even be a goal in a traditionally hierarchical, caste-based society, together with a related question whether utilitarian analysis is appropriate in a society one of whose principal religious texts, the *Bhagavad Gita*, suggests that actions should be taken without regard for their worldly consequences.[23] Whether because Western (especially British) values successfully penetrated the Indian elite,[24] or because of Gandhi's philosophy which tended to read traditional texts as

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23 *See* Bhagavad Gita, Canto V: The Yoga of Renunciation, http://thedivinedialogue.blogspot.com/2009/06/canto-v-yoga-of-renunciation.html (June 17, 2009) ("Abandoning the fruits of work, the balanced mind attains peace; but the unsteady mind, motivated by greed, is trapped in its own reward.").

24 On Indian law as a hybrid of indigenous and British traditions, see generally MARC GALANTER, LAW AND SOCIETY IN MODERN INDIA (1989).

supporting a modern, reformist agenda,[25] these considerations appear to play a secondary role for contemporary policymakers, although they lurk in the background. Indeed, it is sometimes difficult to discern even the effect of Gandhi and Nehru, whose philosophy of self-sufficiency has largely been abandoned in favor of a market-driven approach.[26]

While it is difficult to discern a specifically Indian attitude toward tax policy, it is much easier to see the effect of institutional factors, especially when one moves from the realm of national to specifically tax culture. One obvious point is the relative lack of administrative resources which — together with the perceived lack of sophistication on the part of taxpayers — contributes to a sense that taxes must be kept simple and, perhaps, limited to more elite sectors of society if they are to be successful. For example, a substantial amount of resources and ingenuity was invested in a program designed to isolate simple, easily identifiable factors (ownership of a car, cell-phone, foreign travel, etc.), which triggered the responsibility to file a tax return. A business tax was likewise reworked several times in an effort to find a formula simple enough for (allegedly) unsophisticated small sellers to comply with. Whether to call this a "cultural" factor is an open question, but it gives Indian tax law and administration a particular flavor, and puts significant limits on redistribution within the tax system.

Indian tax policy is likewise affected by a series of institutional arrangements, many dating from the colonial period, which are the products of historical happenstance rather than deep-seated cultural differences. For example, under the present constitution, agricultural income may be taxed only by the states rather than the Union Government, not a small matter in a country much of whose population (and an even larger percentage of whose land) is devoted to agriculture.[27] Also — whether resulting from the

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25 For example, in a philosophical *tour de force*, Gandhi read the *Gita* — which on its surface appears to justify war — as an essentially pacifist text, and opposed the caste system despite its at least superficially religious basis. *See* LOUIS FISCHER, THE LIFE OF MAHATMA GANDHI 32 (1983) (arguing that Gandhi saw the *Gita* as describing the metaphorical duel between duty and evasion that took place within the hearts of men with "[p]hysical warfare [being] brought in merely to make the description of the internal duel more alluring"); *id.* at 146 ("Gandhi regarded untouchability and the caste system as an 'excrescence,' a perversion of Hinduism.").

26 A process which to some degree dates back before 1991, as indirectly reflected in the remark, mistakenly attributed to Nehru but actually made by the poet Sarojini Naidu, that "it costs a great deal of money to keep Gandhi living in poverty." *See* K.R. RAMACHANDRAN NAIR, THREE INDO-ANGLIAN POETS: HENRY DEROZIO, TORV DUTT AND SAROJINI NAIDU 91 (1987). The remark, while originally referring primarily to Gandhi's lifestyle, appears equally pertinent to his economic philosophy.

27 The relevant provision is Entry 82 of List I (Union List) of the Seventh Schedule

British tradition or simply because it is more lucrative — Indian tax lawyers appear to be occupied primarily with litigation, leaving tax policy in the hands of economists and others who, while sophisticated in their own areas, may lack practical experience of tax evasion and how to combat it. These observations suggest an important role for serendipitous, even quirky factors that affect a country's tax outcomes and which, in many cases, may have more day-to-day effect than other, seemingly deeper differences in national character or outlook. This is, indeed, a realization that I have come to in several countries, and which suggests the need for "thick description"[28] of national and legal cultures rather than broad and often misleading generalizations.

IV. DEVELOPMENT, "HARMONY," AND THE ISSUE OF CHINESE EXCEPTIONALISM: TAX LAW AND CULTURE IN CONTEMPORARY CHINA

A. Economic and Political Background

China's economy requires no introduction, although it does require constant updating. As the reforms initiated in the late 1970s and accelerated in the past decade continue, the country's per capita income has risen from a few hundred to $2,000-$3,000 per year, but substantially higher in coastal regions.[29] (Based on conversations with Chinese officials, as of 2007, average salaries were estimated at $5,000-$6,000 in Beijing and Shanghai with a figure of $8,000-$10,000 being cited for Guangzhou (Canton) in the south although this depends on the measuring tool used.) The country faces stiff

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of the Indian Constitution although the exemption itself dates to the Income Tax of 1886, when India was a British possession. M.M. SURY, INCOME TAX IN THEORY AND PRACTICE 210 (2002).

28 *See* CLIFFORD GEERTZ, *Thick Description: Toward an Interpretive Theory of Culture*, *in* THE INTERPRETATION OF CULTURE: SELECTED ESSAYS 3, 5 (1973) ("Believing, with Max Weber, that man is an animal suspended in webs of significance he himself has spun, I take culture to be those webs, and the analysis of it to be therefore not an experimental science in search of law but an interpretive one in search of meaning.").

29 Chinese economic statistics vary significantly according to the source and method used. One newspaper estimated 2009 per capita income at $2912, *A Per Capita Income of $494 Only Due to Overpopulation,* FINANCIAL EXPRESS, Aug. 9, 2009, *available at* http://www.thefinancialexpress-bd.com/2009/08/08/75459.html, while another, using purchasing power parity, arrived at a figure of $6,000, Country Profile and Demographics: Per Capita Income, http://siakhenn.tripod.com/capita.html (last visited Oct. 16, 2009).

challenges owing to the global economic crisis, regional unrest, environmental degradation and other issues: and unequal distribution of income is recognized as a major threat to political stability by the regime itself (see below). Despite these issues, China remains on schedule to become the world's largest economy within the next generation if not sooner.

Describing China politically is a somewhat more difficult task. While Maoism is largely dead other than in nostalgic form, and even "communism" is used less frequently, the society remains authoritarian and highly regimented by Western standards. The difference is in the ideology cited in support of the system, socialist transformation having given way to economic prosperity and political and social harmony (*he*) — what Americans would be more likely to call balance or stability — as the governing ethos. An implicit question is whether and how the regime can survive if economic growth should slow down or if it should continue to lead to large inequities between groups and regions. Conversations with Chinese officials suggest that the regime is intensely aware of these problems, although China-watchers remains as always divided regarding its likely success.

B. Current Tax System

Since 1994 China has had, at least on the surface, a modern or modernizing tax system, including various Western-style elements. At present these include an individual income tax with highly progressive rates, beginning at 5 percent on the first 0-500 yuan of monthly salary income and rising to 45 percent on monthly income exceeding 100,000 yuan (1 yuan = $0.146 at official rates as of October 14, 2009). The progression is roughly logarithmic, with a 10 percent rate being reached at 500-2,000 yuan, 20 percent at 5,000-20,000, and 30 percent at the 40,000 yuan level. Somewhat lower rates apply to self-employment income.[30] Individual income taxes as a whole account for only 7-10 percent of tax revenues, the remainder deriving from a 25 percent company tax (20 percent on small companies and 15 percent on certain grandfathered entities); a 20 percent tax on capital gains;[31] a VAT

30 China has frequently distinguished between wage and nonwage income in its national tax system. *See* Thomas Piketty & Nancy Qian, *Income Inequality and Progressive Income Taxation in China and India, 1986-2015* (Ctr. for Econ. Policy Research, Discussion Paper No. 5703, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=922116.

31 Special calculation rules apply for real estate.

maintaining a standard 17 percent rate, but lower rates on certain specified activities; a services tax at rates from 3 to 20 percent; and other levies.[32]

In recent years, China undertook a significant tax reform whose principal effect was the equalization of taxes on domestic and foreign companies; the reform also included a series of compliance measures, including the requirement to file individual tax returns over a specified level of income and other changes.[33] These changes were consistent with — or in any event justified by — the government's harmony theme, specifically the need to restore balance between domestic and foreign interests and (in the longer term) between different sectors of Chinese society.

Because only a small percentage of tax revenues is derived from the income tax — and because nontax income, property, and other policies remain so much more pervasive — it seems likely that, at this point, the tax plays a relatively modest role in redistribution of income. However, China currently has many more middle-and-high wage earners than India, and is developing faster; the income tax also kicks in at a relatively lower level of income. There is thus a reasonable likelihood that this situation may change in the next few years. This issue (both China and India) is discussed further in the concluding Part of the Article.

C. The Role of Cultural Factors

Like India, China is several thousand years old and has cultural traditions that differ substantially from those in Western countries. China differs from India in that it has a long history of centralized, authoritarian government (albeit interrupted by internal divisions and European intervention for much of the recent past); has remained, at least nominally, independent at all times (i.e., was not controlled by a single colonial power); and embarked on economic, if not political, reform a decade or two earlier (late 1970s as opposed to 1991). The discontinuities in modern China (the creation of the People's Republic, the Great Leap Forward and Cultural Revolution, Tienanmen

32 *See generally* Worldwide-Tax.com, China Income Taxes and Tax Laws, http://www.worldwide-tax.com/china/china_tax.asp (last visited Oct. 14, 2009); Worldwide-Tax.com, China V.A.T. and Other Taxes, http://www.worldwide-tax.com/china/chi_other.asp (last visited Oct. 14, 2009).

33 The individual income tax has historically been paid mostly by foreign companies and their employees, on an essentially withholding basis, and only recently has begun to hit large numbers of other workers. There are significant compliance issues, as might be expected in a country only recently adjusting to the concept of private property and taxpaying obligations.

Square and its aftermath) have also been rather more violent than those in the Indian case. One consequence of these differences is that, when one discusses modern Chinese culture, it is often unclear whether one is talking about longstanding traditions (Confucianism, Buddhism, meritocracy and the historic role of the mandarins, etc.), more recent norms arising under the People's Republic (equality, collectivism, and so forth), or, as is very frequently the case, an uneasy hybrid of these two elements. Sorting out these trends can be difficult if not impossible, but a few observations seem pertinent.[34]

First, it seems fair to say that China has historically emphasized the needs of the collective over those of the individual and the balance between different elements (in art, food, and society) over uniqueness or self-expression. While the concept of harmony is a convenient political slogan, it thus also finds a very deep resonance within Chinese culture. Since the government (formerly the Emperor) was responsible for maintaining harmony between Heaven and Earth — the word *tian* in Chinese means "heaven" or "royal" depending on the context — the concept of harmony may also be associated with a high degree of hierarchy in the relationship between the state and its citizens, a hierarchy which the communist regime in theory sought to overturn, but has in practice continued.[35]

Second, China has a longstanding tradition of resolving disputes by administrative rather than judicial means and of emphasizing maintenance of social relationships rather than the application of written rules, so much so that it is often difficult to say whether "law" in the Western sense is at stake, at all.[36] These traditions are reflected in contemporary tax rulemaking: the State Administration of Taxation appears to make most of the key decisions, even maintaining its own staff of academic experts, while legislation tends to be short and tax litigation, in most courts, exceedingly rare. When I visited Chinese law schools, I was struck that many subjects being taught (the conduct of criminal investigations, the rules affecting state enterprises, and so forth) were closer to the subjects that might have been

34 I am indebted to Jinyan Li for helping me to clarify my thinking on these issues, although the fault for any errors or misstatements is mine alone.

35 One of the most impressive tourist sites in Beijing's Forbidden City is the so-called Hall of Supreme Harmony (*tai he dian*). The *I Ching*, a classic of Chinese philosophy, similarly emphasizes a balance between elements and emotions as the key to attaining happiness. On Chinese philosophy see generally CHINESE THOUGHT: AN INTRODUCTION (Donald H. Bishop ed., 2001).

36 *See generally* STANLEY LUBMAN, BIRD IN A CAGE: LEGAL REFORM IN CHINA AFTER MAO (1999).

taught in American management programs or even police academies rather than in American law schools.

Third, China maintains a strong sense of its uniqueness and exceptionality, which — together with the country's large size — make it perhaps more reluctant than other developing nations to bend to international tax and other norms.

It should be noted that, while China shares several features with India — large size, nonwestern culture, and (perhaps) an ambivalence toward Western concepts of individualism and the good life — in many respects it is quite different. In particular the colonial influence, so powerful in India, is largely absent in China, while the Chinese identification of order and justice with the state has no precise parallel in Indian tradition. Nor can Indian politics — frequently tribal but assertively democratic in nature — be compared with China which remains, by most standards, autocratic. If one seeks a pithy summary, it might be said that China and India face similar economic but different and in some cases even opposite political and cultural challenges: the issue for the twenty-first century may be less the displacement of the Western by an Asian model as which Asian model displaces it.

Nor is it any easier in China than India to identify the effect of cultural factors, whether "attitudinal" or "institutional" in nature. For example, Chinese tax practice tends to give a rather prominent role to accounting firms and a more limited role to law firms, especially foreign ones, which are subject to various restrictions. This may reflect a peculiarly Chinese approach to these professions, but also a distrust of foreign lawyers, whom the Chinese fear — no doubt rightly — are more likely to introduce Western ideas like due process, individual rights, and so on into tax (and broader legal) decision-making.[37] Similarly, the Chinese tend to discuss progressive taxation less in terms of competing individual rights (e.g., by reference to diminishing marginal utility) and more in terms of preserving social harmony. This, again, may reflect deep philosophical differences or (alternatively) may simply be a convenient slogan that connects tax policy to a larger political theme.

It must be remembered that the systematic study of Chinese taxation and of Chinese law generally is at an early stage of development: further studies will no doubt cast more light on these issues. Particularly promising

37 A pithy, if largely accurate, statement might be that India is over-lawyered and China under-lawyered, at least with regard to tax issues.

are comparative studies involving the People's Republic and other Chinese-speaking jurisdictions, including Taiwan, Singapore, and (to a degree) Hong Kong.[38] Since these jurisdictions share a common Chinese culture, but have different political institutions, comparative studies should help to separate long-term cultural factors from short-term political expedients.

V. ECONOMICS, CULTURE, AND GLOBALIZATION: ON THE FUTURE OF PROGRESSIVITY IN AN ASIAN-LED WORLD

The experience of China and India suggests the difficulty of generalizing about progressivity or other tax issues in the developing world. While developing nations face similar economic challenges, they have significant political and cultural differences that may cause them to take diverging paths. Even if these differences can be successfully described and catalogued, it is often difficult to discern their precise effects, or to separate deep-seated cultural differences from short-lived political tropes. In many cases attitudinal differences ("tax anthropology") are less important than institutional factors ("tax sociology"). Historical accidents, or quirks, sometimes loom largest of all.

One of the key questions in comparative law is the convergence between different legal systems (or the lack thereof). It is interesting in this context to ask whether various tax systems are converging, or at least follow a similar historical pattern. In private conversations tax experts sometimes muse about the existence of a "tax life cycle," in which progressivity becomes a concern at an early stage of national economic development and somewhat less pressing when a country reaches a more mature phase. If this were true, countries like China and India would now be entering a period of greater progressivity, while Western countries, Japan, etc. might be moving in the direction of flatter or less progressive tax systems. Yet this theory assumes that universal economic factors predominate, and may allow insufficient room for cultural differences, or for the ability of individual large countries, like China and India, to go their own way and defy global patterns. The discussion above, with its emphasis on national differences, may provide a significant corrective. Yet the discussion also suggests the malleability of cultural concepts and the importance of legal transplants: no one single explanation is applicable.

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38 Hong Kong reverted to China in 1999, but retains a different economic and (in part) political system.

Although the study of legal cultures cannot provide simple answers, it does suggest a promising avenue for future study. In this context, broad-brush generalizations, like the Chinese affection for harmony or the persistence of regional differences in India, are less valuable than detailed studies of specific problems — the "thick description" that is famous in anthropology, but often eludes legal scholars. There is a corresponding need to systematize the idea of legal culture, developing a more rigorous methodology that distinguishes between institutional and attitudinal factors and between national, legal, and tax cultures. All this is difficult; some of it may be tedious. But the payoff is immense.