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A BRIEF SUMMARY OF EXCISE AND SALES TAXATION IN INDIA

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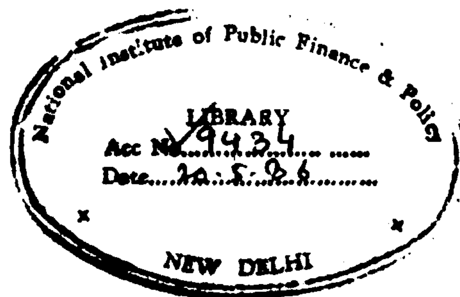

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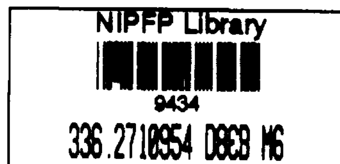

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A BRIEF SUMMARY OF EXCISE AND SALES TAXATION IN INDIA*

The tax structure of India is of interest to Canada and other Federal countries because of the long experience with indirect taxation at both the Central and State levels. There is substantial literature in India on the indirect taxes, and the subject is the focus of much of the work of this Institute. The Report of the Indirect Taxation Enquiry Committee (the Jha Committee) is one of the most exhaustive studies of indirect taxation ever made in any country[1]. The purpose of this paper is to provide a brief framework of the structure and operation of the taxes in India and the significance of the experience for other Federal countries, and call attention to the work on the subject in India[2].

1. The Constitutional Division of Powers

The Indian Constitution allocates taxing powers more precisely than those of most Federal countries; only a brief outline will be provided here.

a. Central Government. The Central Government is allocated personal and corporate income taxes except on income from agricultural land; taxes on wealth, except agricultural land; customs and excises, except excises on

liquor and narcotics, medicinal and toilet preparations that include alcohol; and miscellaneous items. The Central government is also given power over taxes on inter-State sales, and has residual powers not otherwise assigned.

b. States. The States (22) and Union Territories (9) are allocated sales taxes, subject to Federal control over taxes on inter-State sales; taxes on liquor and drugs; taxes on agricultural land and the income therefrom; and a number of miscellaneous levies.

2. Relative Revenue Sources

Of the Central Government tax revenue, about 73 per cent is provided by indirect taxes, 21 per cent by income taxes, and 6 per cent miscellaneous. Of the indirect taxes, the excises yield 46 per cent of total tax revenue, customs 27 per cent. The relative importance of customs revenue has fallen in half over the last 30 years. At the State level, the sales tax is the dominant revenue source, yielding in 1982-83 58 per cent of total tax revenue, including in the total the amount provided by the Central government. In eight States the figure is over 60 per cent of the total. Thus both Federal and State governments depend very heavily upon commodity taxes, which yield nearly 80 per cent of the total tax revenue. This is a high figure even by comparison with many other developing countries. The share of customs duties is much less than common in LDCs, a product of the large size of the country,

its highly protective tariffs, and the early development of domestic manufacturing and domestic indirect taxes.

CENTRAL GOVERNMENT REVENUES

1. Customs Duties

India has followed a policy of the use of very high protective duties, averaging now about 100 per cent of the price exclusive of customs duty. Most are *ad valorem*. In addition there are countervailing duties equivalent to the domestic excises, which change simultaneously with the latter. The government has been moving in the last year from import quotas to open general licensing, thus increasing the relative importance of protectice duties, and there is some pressure to move away from licensing entirely. There are Commonwealth and regional preference rates. The tariff employs CCC nomenclature, with current move to the new consolidated nomenclature, which will also apply to excises.

Smuggling is a problem, primarily of gold from the Arabian peninsula, synthetic textiles, watches and electronic products.

2. Excises

India has one of the most complete excise tax systems in the world. There are 127 excise categories, many with sub-divisions, and a "catch all" category covering those goods not specified by name. Since 1977 virtually all manufactured goods are subject to tax, with widely varying rates. Cigarettes, sugar, kerosene, motor fuel, textiles, and iron and steel products are the major categories on the basis of revenue yield. High rates are applied to luxury goods to check consumption. There are a number of concessional rates to aid small businesses.

The excises apply to both inputs and finished products. Set-off of the tax on inputs against the tax due on the final products is allowed only when the commodities fall within the same tariff heading.

Each excise is technically a separate levy on a particular commodity; firms must keep separate records and file separate returns for each tariff-heading commodity produced - though many firms produce only one taxable commodity. The levies are technically excises, applying to production, not to sale, and due when the goods leave the factory. Firms pay on account on a continuing basis, and file a monthly return. On tobacco and tire and tubes, excise personnel are stationed in the factory at all times; on other commodities, control rests heavily on checks at the State border check-points noted below, random checks, and audit. At the check-points, if documents

showing that excise has been paid are not available, the commodities may be seized; the license can be cancelled and the plant seized, but rarely is this done. In fact, much of the collection is based on self-assessment, and some small firms are subject to "forfait" or agreed-upon payment, regardless of the exact amount of output in the period.

3. Administration of Customs and Excise

There is a single Customs and Excise service under the Central Board of Excise and Customs, a unit of the Department of Revenue in the Finance Ministry. Personnel are shifted between customs and excise, but with substantial specialisation at higher levels. The total staff is about 56,000 (1985); there are four classes: (A) policy making (recruited in part at this level), (B) supervisory, (C) main group, and (D) miscellaneous. The first three groups are recruited entirely from university graduates. Ninety per cent of all personnel have university degrees. (C) and (B) classes are assigned to collectors' offices and function under the collector. The (A) group operates nation-wide. The system is not yet computerised, but this is planned.

There are approximately 60,000 active excise duty accounts. Artisan handicraft enterprise is exempt from licensing, as well as all manufacturers with annual sales under 2 million rupees (about $US 160,000). Firms are

registered by "range" in each division; each collection office typically has seven or eight divisions.

As noted, in part control is physical, in part by inspection and audit. There are three categories of personnel: audit groups, which examine records; an investigative branch, which pursues the most troublesome cases; and inspectors, who make brief checks, reaching most firms once a year, larger firms twice. The principal leakages are reported to be undervaluation and unauthorised clearance, that is, shipments of goods not reported[3]. Little problem is reported with firms failing to obtain licenses. Information is shared with the States.

4. Criticisms

While the operation of the excises is believed to be relatively good, the structure has been subject to substantial criticism. The most serious defect, from the standpoint of the economy, is the extensive taxation of inputs; about half of the revenue comes from inputs in production, the other half from final consumer goods. The objections to taxing inputs are well known: the presence of tax in export prices, the distortion in selection of inputs and thus loss in efficiency, the alteration of relative final goods prices since the cumulated tax on inputs will differ, and pyramiding from application of percentage mark-ups. Some tendency is reported for firms to push functions and thus cost elements beyond the point of impact of the tax.

The principal objectionable feature from an operational standpoint is the excessive number of separate excises, which complicates the tasks of the firms and the administration. There are numerous rates, and serious problems of delineation between commodities in various rate groups. There is no simple list of rates; a substantial book is required to provide information on the rates applying to various goods. There is great variation in rates - with little obvious rationable.

Other criticisms advanced include the continued importance of specific rates, which yield about 65 per cent of the revenue, though primarily from commodities on which specific rates are used in most countries, and the limited scope of the tax in the sense that only manufactured goods are taxed.

There have been a number of suggestions for change, including a major proposal by the 1977-78 Taxation Enquiry Commission, which suggested the merger of the various excises into a value-added tax at the manufacturing level, called MANVAT. Such a levy would greatly simplify the tax and would permit elimination _via_ the tax credit device of the taxation of inputs. Concerns have been expressed about the ability of firms to handle the value-added feature. But certainly this offers the most promising avenue of reform.

THE STATE SALES TAXES

The States have developed an extremely complex sales tax structure, without question the most complicated one in the world. The inter-relationship among the levies of the various States and between the States and the Central Government is of particular interest to other Federal countries.

1. Origin

The States began to impose selective sales taxes on cigarettes, motor fuel and some other commodities as early as the mid-1930s. The first general sales tax was imposed by Tamil Nadu (then Madras) in 1939. This was followed during World War II and the post war period by the other States, until ultimately the coverage became general.

2. Structure

The States have used three forms of general sales tax, according to the point of application. Most started out as purely one form or the other, but today many of the States use elements of two or three forms.

a. Multi-point or turnover tax. Four States rely significantly upon the multi-point t x, which applies to each transaction through which the commodity passes,

levied at relatively low rates. These are Tamil Nadu, Karnataka, Kerala, and Andhra Pradesh, all in the south. But other States apply multi-point taxes to some commodities, and the four relying substantially on this form apply single-point taxes to many commodities. The first-point taxes yield over 60 per cent of the total sales tax revenue in all four.

b. Last-point (retail sales) taxes. Several of the taxes were initially imposed at the retail level, the last point of sale, and many States still apply the tax on some commodities at this stage. But in general the States have moved away from it to the first-point because of enforcement problems with retailers and the establishment of "bogus" retailers - dummy firms executing declarations that they are buying for resale, when in fact they do not function at all.

c. First-point. The trend has been toward first-point taxes, that is, taxes applying to the first sale in the State, by the manufacturer on goods produced in the State and by the firm "importing" into the State and making the first sale. This form lessens the problems of controlling retailers but is not without problems. Because of the higher rates, licensed firms have greater incentive to evade tax. There are problems of ensuring that the tax has been paid on the first transaction; as a consequence most States have established check-points on roads coming into the State, and truckers must provide evidence that tax has been paid on the merchandise carried. But there are ways

of avoiding the checkposts, and there is widespread belief of corruption. Complete checking of all trucks is impossible. Rail shipments are not checked in most instances.

On the whole, however, the States have come to prefer the first-point, confining the last-point application to a few high margin commodities. For 15 States for which the data are available, on the average 70 per cent of the revenue is collected at the first-point, with figures over 90 prr cent in Bihar, Jammu and Kashmir, and Rajasthan (northern States that typically concentrate on the first-point), to 34 in Pubjab (which concentrates on the last-point) and 47 in West Bengal[4/].

One State, Gujarat, continues to apply the tax at both the first and last-point (but not intermediate stages), a policy also long followed in Maharashtra (Bombay), before the latter shifted to single-point in 1981.

Apart from the basic structure of the tax applying to licensed dealers, several of the tax structures include purchase tax elements, applying to purchases by licensed firms, primarily of unprocessed farm products sold by a number of small producers.

To add to the complexity, a number of States add surtaxes to the sales taxes, often earmarking the revenue for a particular purpose. Others impose an additional sales tax at a low rate, and some impose both a surtax and an additional tax. Both of these result in higher overall sales taxes.

3. The Rate Structures

No simple generalisations about the rate structures are possible, except that they are very complex.

The number of rates is very large, averaging 15, ranging from 19 rates in Bihar and Gujarat to 6 in Orissa. The basic rate as of 1985 ranges from 5 per cent in Kerala to 10 per cent in Maharashtra, Gujarat, and Madhya Pradesh; the median basic figure and the most typical one is 8 per cent. In some jurisdictions, most commodities are subject to the same rate; this is particularly true in Haryana and the Punjab (both 10 per cent). Cereals and pulses (grains) and fertiliser are subject to lower than typical rates (and exempt in five States). Goods regarded as luxury items are typically subjected to higher rates than widely used goods, Orissa using rates up to 16 per cent on some goods. There are some very fine distinctions in some States; Andhra Pradesh has rates of 2, 3, 4, 5, 6, 7, 10, 11, 12, and 13 per cent. In some States higher rates are applied to large firms.

Exemptions are relatively limited, but vary among States. Five for example, exempt basic foodstuffs, while others tax them at lower rates; but overall there is very little exemption of necessities.

4. Taxation of Inputs* (Producers Goods)

The taxes in general make no effort to exclude inputs into production. There is no general exemption of raw materials, other ingredients, basic inputs in agriculture, or capital equipment, and there is, of course, some multiple application of tax to final products. In several States, materials that become physical ingredients are exempted, in some, regardless of where sale of the finished products occurs, in others only if the product is sold within the State. Other States tax materials at a lower rate. No State seeks to exclude all items directly used in production or all business inputs.

One estimate indicates that 34 per cent of all sales tax revenue is collected on inputs in the production process. In a sample of six States, the range is from 39.3 per cent in Madhya Pradesh to 22 per cent in Karnataka[5].

While no serious effort has been made to exclude inputs, the States have provided a number of concessions to lure new industry, and in the process have reduced input taxes, but in a random and haphazard way, primarily excluding raw materials and capital equipment purchases from tax, but also excluding the sales by eligible firms. These concessions are granted for a limited period of years, and some are mere deferments of tax.

5. Inter-State Transactions

Under the Constitution, the Central Government was given power over inter-State sales. By legislation first enacted in 1957, inter-State sales of "declared" goods, which include most commodities, are subject to the Central Sales Tax, originally at a 1 per cent rate, in recent year at a 4 per cent rate on sales to registered dealers, 10 per cent on sales to unregistered buyers. This tax is collected by the States, but separate registration is required. The revenue accrues to the State of origin of the sale. Then, of course, subsequent sale in the State into which goods come is subject to the sales tax of that State. Substantial reliance is placed on the check-point system to ensure that tax on the inter-State sales is paid.

Since 1957, sales taxes on mill-made textiles, tobacco and sugar have been replaced by increased Central excises, which are collected by the Central Government and the revenue allocated to the States.

Goods sold for export outside India are exempt from tax, but there is no drawback of taxes paid on inputs or previous sales. Imports from outside India are not subject to tax until they are sold by a licensed firm in the State. Thus imports by manufacturers or others for use and not resold are never subject to sales tax.

6. The Octroi

Distinct from the Central excises and the State sales taxes are the octroi levies, imposed by the cities on goods entering their jurisdiction for consumption or sale therein, enforced primarily by check-points at which trucks are stopped before entering the city. Many of these are levied on a specific rate basis, without regard to the value of the goods. These resemble the local import duties imposed by the cities of medieval Europe.

7. Operation of the Taxes

Only a brief summary of the operation of the taxes is feasible in this paper. The taxes are administered under the jurisdiction of the sales tax (or commercial tax) Commissioner of the State. In addition to office personnel, a staff of commercial field officers maintains contact with the registered firms and one of assessing officers makes assessments, and in most States an investigation unit tracks down evasion.

a. Registration. All firms are required to register for the tax, provided their sales volume exceeds a specified figure. The exemption figures vary somewhat with the type of business and have been changed from time to time; it is difficult to give a simple summary. For example, in West Bengal, the 1985 exemption figures are Rs 20,000 for an importer, Rs 50,000 for a manufacturer. Rs 100,000 for a

manufacturer of cooked food and other dealers. These are roughly, in US$ 1,600, 4,000, and Rs 8,000 respectively, very low figures by usual standards. The figure is Rs 50,000 in Maharastra. In Tamil Nadu the figure is Rs 50,000, but there is no exemption for first-point dealers. In Assam the figure is only Rs 20,000 for dealers, with no exemption for manufacturers and importers. In general, these figures are relatively low, thus making large numbers of relatively small firms subject to registration. In fact, however, it would appear that many are not registered. In West Bengal, for example, there were 59,714 firms registered in 1977, whereas according to the commercial census there were 217,895 establishments.[6]

In the States as a whole, there are about 2.5 million registered firms. No exact figures are available, as many States report the registrants for the State sales tax and the Central sales tax separately, and the combined figure exceeds the actual number of registrants, as many are registered for both taxes. Maharashtra (Bombay) with 379,000, has the largest followed by Tamil Nadu (Madras), Uttar Pradesh, and Andhra Pradesh, all of which have in excess 300,000 registered firms. By contrast, Nagaland and Pondicherry Union Territory have only 3,000 and 4,000 respectively[7].

While most States are making some use of computers for tax purposes, the use is often limited, in some instances to data of goods entering the State. Karnataka is one of the

few to have the master file of tax-registered firms on computer.

b. Returns. The most common pattern is to require returns on a monthly basis, plus an annual return. But some are moving to longer intervals: Maharashtra, for example, to quarterly payments with monthly payments by the larger firms.

Some States prefer payment in cash rather than cheque, and require the firms to bring this in person to the local office.

c. Assesmment. All returns are assessed, in the traditition of income taxes. This involves a brief check by assessing officers, not detailed audit. But most States have had serious difficulty in keeping assessment on schedule, with long time-lags, to the detriment of effective administration. Assessment in this sense differs from North American practice in which the returns are merely checked for arithmetic and completeness before the data are entered into the computer or other system.

Serious audit is confined to a relatively few firms, mainly aimed at finding outright evasion. Maharashtra, with over 300,000 accounts, found only 54 cases of evasion in 1982-83.

d. Revenue from large firms. As is typical in other countries, a very large portion of the revenue comes from the larger firms. Eighty per cent of the revenue is obtained from 12 per cent of the firms in Gujarat, 6.5 per cent in Madhya Pradesh, 6 per cent in Karnataka, 10 per cent in Uttar Pradesh.[8]

c. Costs of collection. The unweighted average of cost of collection as a percentage of revenue in 19 States was 1.64 per cent in 1980-81[9]. Of the larger States, Maharashtra, for example, has a figure of 1.01, West Bengal, 0.88. For the 19 States, the high is 3.12 in Assam, the low 0.13 in Himachal Pradesh. A very low figure often indicates inadequate control. Figures between 1 and 2 per cent are common in other countries.

f. Overall effectiveness. Overall effectiveness of administration is difficult to assess. But detailed studies by the NIPFP in West Bengal[10] and the paper by R.J. Chelliah, one of the country's most distinguished public finance experts, suggest that administration is not highly effective[11]. Information systems are particularly inadequate. Trained personnel are difficult to obtain and retain.

8. Distribution of Burden

Despite the substantial taxation of basic food, medicines, and clothing, studies made by the 1977-78 Indirect Taxation Enquiry Committee conclude that the

tax burden is distributed in a highly progressive fashion as a percentage of total expenditure, ranging from 0.65 per cent in the lowest income bracket to 3.99 with those in the highest bracket[12]. The distribution in relation to income is without doubt less progressive. A more recent (1982) study by Ahmed and Stern concludes that the distribution is more or less proportional[13].

9. Elasticity and Buoyancy

The sales taxes have demonstrated a high degree of both elasticity and buoyancy. The buoyancy in the period 1970-71 to 1981-82 was 1.55 , that is, as GNP rose, the sales tax revenue rose by almost a 50 per cent higher percentage. This figure was far higher than that of the income tax (0.98)[14]. Twelve of the large States showed figures in excess of 1.5, and Karnataka showed a figure of 1.82. Most of the buoyancy was a product of high elasticity, which averaged 1.31 for the 16 larger States, with highest of 1.6 in Andhra Pradesh and Tamil Nadu. Only Assam showed elasticity and buoyancy figures less than 1.

10. The Defects of the System

There has been extensive discussion in India of the defects in the sales tax system, but as is common, it is far easier to point out defects than to devise acceptable avenue of reform. Some of the issues relate to defects in the structure, others to inter-State aspects.

a. Cascading and taxation of inputs. The sales taxes, like the Central excises, involve substantial taxation of inputs. While, as noted, some concessions are made to lessen the impact, there is no overall serious attempt to exclude inputs. There is, in addition, some multiple taxation of products as some turnover tax elements remain, although for the most part the taxes are now collected at one point. As noted below, additional cascading results from the treatment of inter-State sales. The concentration of collection at the first-point results in pyramiding of tax through application of percentage mark-ups and in the shifting of activities and costs forward of the point of the impact of the tax.

The consequences are well known. Input choices are distorted, as are relative prices on final products. Vertical integration is encouraged, as firms are given incentive to produce their own inputs. The export prices contain tax elements, and prices to consumers rise by more than the amount of the tax because of pyramiding.

A related economic effect results from the failure to tax imports into India unless they are sold after entering the country. Thus large firms in a position to import on their own are favoured over smaller firms.

b. Inter-State problems. Under Central Government legislation, firms are permitted to apply tax, at 4 per cent, on sales to registered buyers in other States. When the goods are subsequently sold in the State into which

they move, the tax of that State applies. Thus, the inter-State transactions are taxed more heavily than intra-State transactions, so long as there is a subsequent sale in the importing State. Thus, in effect, the operation of the domestic common market is disrupted. Firms also have discovered means of escaping the tax on inter-State sales by establishing distribution units in the importing State; shipments to these, essentially on consignment, are not subject to the tax. A recent constitutional change permits taxation of these transactions, but the tax has not yet been extended to them.

In addition to multiple taxation and interference with free flow of goods, the present system allows the manufacturing States to burden consumers in the less wealthy States - which would not occur under retail sales taxes without multiple application.

Quite apart from the discrimination against inter-State sales, is the tendency of some States and Union Territories to lower their sales tax rates deliberately to lure business activity and to provide special sales tax concessions to new industry. Two areas currently criticised for such rates are Delhi and Goa.

c. Operational aspects: The check-point system. As the States moved to the first-point collection, most but not all - established check-points on the roads entering the State, at which trucks are required to stop and provide evidence that tax has been paid on commodities

carried. These are in addition to the check-point established around cities to enforce the octroi. This is a source of substantial nuisance and delay, and cost to the truck operators, and a source of deliberate harassment and reported corruption. The Indian States have in effect established fiscal frontiers - though rather leaky ones - as the EEC countries move away from them. There are ways and means of escape, by using back road, and air and rail shipments are not subject to control.

d. The complexity. There is no other sales tax structure in the world that is as complicated as that of Indian States - and countries that have relatively complex systems, such as New Zealand, are moving toward simplification. The prime source of the problem is the multiplicity of rates. Sales taxes of all types clearly work most effectively with a single uniform rate. Two or three may be tolerable. But the use of large numbers - as many as - 19 makes compliance and administration tremendously complicated and impairs the operation of the taxes. There can be no possible rationale of using, for example rates of 6, 7, 8 and 9 per cent on various commodities.

The complexity is aggravated by the use of the surcharges and additional sales taxes most States use - instead of adjusting the level of rates - and higher rates on larger firms. Procedures also vary widely among States.

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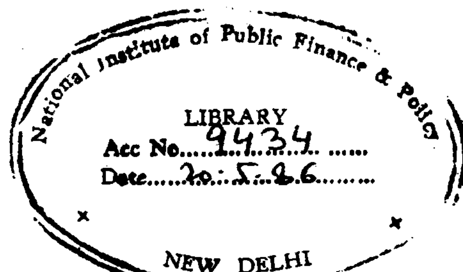

c. General administration. Apart from the check-point problem, there are numerous criticisms of the administration of the taxes. Firms must register separately for the Central sales tax and the State taxes, although the States administer both, and in some States separately for various State Acts. The task of operation is tremendously complicated by the multiple rates. Some of the forms are complex and copies sometimes not available. The exemption figures for small firms have not been updated for inflation, and it is widely argued that too many small firms are required to register.

As noted above, there is widespread belief that the taxes are not administered well by the State, in part because of inadequate personnel and salaries. While some steps have been taken toward computerisation, limited use is made in most States - though the sales tax field is particularly suited for computer use. Stories of corruption are widespread. One has the impression that the sales tax commissioners are highly competent but lack the staffs to do an adequate job.

In summary, it should be noted that some of the criticisms of the system arise from features of the taxes that are inevitable so long as the States have autonomy in the sales tax field - the rate differentials, for example, that may distort location of business activity. The pyramiding is inevitable so long as the taxes cannot be administered at the retail level. Inter-State sales inevitably create complications under the circumstances.

The most serious criticisms relate to the cascading and excessive taxation of inputs, the discrimination against inter-State transactions made possible by the Central Sales Tax legislation, and the complexity.

Despite these defects, it must be recognised that the taxes are highly productive of revenue. The States, of course, did not set out to make the structures complicated; it is often argued that the special features are all products of attempts to meet various difficulties that have arisen. But one cannot help concluding that extensive restructuring is needed to make the system much more efficient and the source of much less excess economic burden.

11. Possible Avenues of Reform

Possible general reform of the State sales taxes is much more difficult than reform of the Central excises, and no obvious solutions appear. It is generally agreed that if the States could administer retail sales taxes, this would be the optimal solution. A single rate, or use of no more than two or three rates, would greatly simplify operation. On inter-State transactions, with retail taxes, the State of consumption would receive the revenue. There would remain the problem of inter-State sales to final consumers; the consuming States could reach these to some extent by the equivalent of the use taxes of the American States, and the leakage would not be too great. But it is rather clear that given the nature of

retail activity in India today, a retail (final-point) tax is not feasible; it can be regarded as an ultimate goal.

A substantially different alternative would eliminate the State sales taxes completely, merging them into the Central general excise system, hopefully readjusted into the value-added form. The revenue would be distributed to the States on the basis of a formula. But this approach, strongly supported by some business groups, while simplifying operation, would greatly reduce the fiscal autonomy of the States, since the sales taxes are their principal revenue sources. It is likely not politically feasible and is objectionable in principle, given the acceptance of the desirability of a Federal State.

A third alternative, designed to retain autonomy but improve operation, would be to develop a system comparable to that of Brazil[15]. The Central tax would be modified into a value-added tax at the manufacturing level; the States would develop their own value-added taxes covering all firms in distribution with sales above a specified volume. All sales would be taxable regardless of the purchaser (except exports from the country); registered purchasers would in turn receive credit for tax paid on purchases against tax due on their sales. Each State would give credit for sales tax paid to another State as well as that paid to itself. This system would eliminate the present multiple taxation of inter-State sales as well as cascading of the tax and would eliminate - if operated effectively - the need for check-points. It

would have one undesirable effect: the manufacturing States would gain more of the total tax revenue and the non-manufacturing States less than under a last-point system. This could be offset only by some form of Central Government grant system. The other objection raised relates to the ability of the firms to comply with the tax. Firms would have to keep records of tax paid on purchases as well as tax due on sales. Any system excluding small firms favours such firms over larger ones - but of course only the margin of the small firm escapes, not the entire amount of tax on the commodity.

There are other issues of reform distinct from these basic issues, such as the desirability of taxing the purchases of basic food crops, which many States do, though at lower rates. This can be questioned on equity grounds, but some States defend this policy on the grounds that they have no other effective revenue sources.

12. Implications for Canada and other Countries

What implications does the Indian experience have for other countries using sales taxes, and particularly other Federal countries? First, the experience in a sense unfortunately confirms the experience in some other countries that a complex indirect tax structure with many potential objectionable consequences does function and it does yield substantial revenue. The harm to the economy is difficult to measure. Second, the system shows the hazards of *ad hoc* adjustments to meet particular

problems that arise; a multiplicity of such adjustments results in a confusing and complex system. Third, the experience with inter-State transactions indicates the danger of potential multiple taxation of inter-State sales, with consequent interferences with free functioning of the domestic market. If the exporting States were allowed to tax and the importing State was not, double taxation would be avoided and enforcement would be relatively easy but the importing State has legitimate claim to all or most of the revenue. Indian experience stresses the evils of allowing both the States to tax.

The problem of different rates among States and among Canadian provinces involves a basic quandary: differences lead to mislocation of economic activity, but preventing differences would destroy the fiscal autonomy of the States. Clearly, if the Central Government alone were to operate sales taxes, the inter-State complexisies, differentiation, and multiple taxation would end - but again the autonomy of the States would be lost. There is no ideal solution. But in India, introduction of value-added elements in the taxes would solve one of the most serious difficulties - the taxation of inputs. Many of the problems could be solved if the States could use retail sales taxes, but it is rather clear that in India they cannot.

Thus the experience is of somewhat limited significance for Canada and other Federal States, except for stressing the difficulties of attaining optimality in indirect taxation in a Federal system, especially when retail sales taxes or value-added taxes through the retail level do not appear to be possible elements in the solution. Perhaps the greatest significance is in stressing what should not be done in the field.

NOTES

* The author is greatly indebted to the staff of the National Institute of Public Finance and Policy, particularly the director, Dr A. Bagchi, and Dr.M.C.Purohit for their assistance, and to officials of various Central and State revenue departments.

1/ Government of India, Ministry of Finance, Department of Revenue, New Delhi, 1978.

2/ Major recent sources include R.J. Chelliah, Reform of the Sales Tax (New Delhi: National Institute of Public Finance and Policy (NIPFP), 1981); A. Bagchi, Sales Taxation in West Bengal - Interim Report (New Delhi: NIPFP, 1983 mimeo unpublished); NIPFP, Rationalization of the Sales Tax in Bihar, (New Delhi, 1979); M. Govinda Rao and V.B ulasidhar, "An Economic Analysis of Sales Tax in India," unpublished paper, NIPFP, 1985; M.G. Rao and G. Pradhan, Excise Duty Evasion in Cotton Textile Fabrics, NIPFP, 1984; M.C. Purohit, "Structure of Sales Taxes in India", Economic and Political Weekly, August 21, 1982, pp. 1365-1375; M.C. Purohit, "Buoyancy and Income Elasticity of State Taxes ji India", Artha Vijnana, Vol. 20 (September 1978), pp. 244-87; G. Thimaiah, "Sales Tax Controversy in India", Bulletin for International Fiscal Documentation, Vol. 27 (March 1983), pp. 115-23.

Earlier studies include James Cutt, Taxation and Economic Development in India (New York: Praeger, 1969); W.R. Mahler, Sales Taxation in India (Bombay: Orient Longmans, 1970).

There have been several Ph.D. dissertations of widely varying quality on the sales taxes of particular Indian States. Note, for example, M.C. Purohit, Sales Tax in India, New Delhi:(S. Chand, 1975), stressing Rajasthan; A.K. Agarwal, Commodity Taxes in India (Allahabad: Chugh Publications, 1981) stressing Uttar Pradesh; and J.K. Godha, The Working and

<u>Administration of Sales Tax in Bombay/Maharashtra, Ph.D. dissertation, University of Poona, 1969.</u>

3/ A published study of the National Institute of Public Finance and Policy by M.G. Rao and G. Pradhan, "Excise Duty Evasion", op.cit., footnote 2) examines the evasion arising out of the attempts of the government to encourage small-scale textile production by exempting the types of cotton yarn used by handlooms and the application of different rates to various types of textiles. There is substantial misclassification of textiles to obtain the lower rates, use of exempt cotton for powerlooms, and reporting powerloom production as handloom production. The conclusion is reached that through misclassification of yarns and cloth produced in the composite mill sector, the revenue loss is about 28 per cent of what should be collected from the textile sector, in addition to the loss from reporting of powerlooms as handlooms.

4/ Purohit, "Structure of Sales Taxes," op.cit., footnote 1, p.1366.

5/ Rao and Tulasidhar, "Sales Taxation", op.cit., footnote 2, Table 5.

6/ Bagchi, <u>West Bengal</u>, op.cit., footnote 1, pp. 27-28.

7/ Information provided by Dr. M.C. Purohit, NIPFP.

8/ Rao and Tulasidhar, "Sales Taxation", op.cit., footnote 2, p.7,

9/ Bagchi, <u>West Bengal</u>, op.cit., footnote 1, p.42.

10/ Bagchi, <u>ibid</u>., pp.25-39

11/ Chelliah, <u>Sales Tax Reform</u>, op.cit., footnote 2, pp. 8-12.

12/ <u>Report of Indirect Taxation Enquiry Committee</u>, op.cit., footnote 1.

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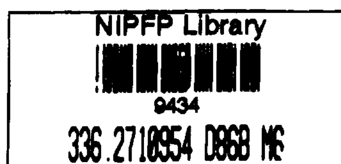
13/ Rao and Tulasidhar, Sales Taxation, op.cit., footnote 2, p.10; E. Ahmed and N. Stern, "Indirect Taxes and Prices in India", Discussion Paper 14, Development Economics Research Centre, University of Warwick, 1982.

14/ Ibid., p.2 and Table 2.

15/ John F. Due, "Some Observations on Five Sales Taxes - Sudan, Guyana, Bolivia, Mexico, Brazil", Bulletin for International Fiscal Documentation, Vol.31, (Nov.1977), pp. 507-512; Michele Guerard, "The Brazilian State Value Added Tax," International Monetary Fund Staff Papers, Vol. 20, (March 1973), pp.118-69.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