TAXES ON THE ENTRY OF GOODS INTO A LOCAL AREA: AN ASSESSMENT

SHYAM NATH
AMARESH BAGCHI
SHEKHAR MEHTA

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NATIONAL INSTITUTE OF PUBLIC FINANCE AND POLICY
18/2, SATSANG VIHAR MARG
SPECIAL INSTITUTIONAL AREA
NEW DELHI 110 067

FOREWORD

The National Institute of Public Finance and Policy is an autonomous non-profit organisation established for carrying out research, undertaking consultancy work and imparting training in the field of public finance and policy.

The present study was undertaken at the instance of the Ministry of Finance, Government of India to examine (i) the existing practices in the States levying entry tax; (ii) to what extent these are in conformity with sound principles of taxation; (iii) to evolve principles for determining the structure of entry taxes to minimise adverse effects of inter-State trade and commerce; and (iv) to lay down norms for utilisation of tax proceeds to avoid State-local fiscal conflict.

Work on the study commenced in June 1989 and the draft report was submitted in March 1990. The study was conducted mainly by Shyam Nath with the help of Shekhar Mehta. Most of the chapters were drafted by Shyam Nath. Chapter 5 was drafted by A Bagchi.

The Governing Body of the Institute does not take any responsibility for the views expressed in this report. This responsibility belongs to the Director and Staff of the Institute, and more particularly to the authors of the report.

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DIRECTOR

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The Authors

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1. INTRODUCTION AND TERMS OF REFERENCE

1.1 Entry tax is a levy on entry of goods into a local area for consumption, use or sale therein. Commonly, it is assessed on the basis of returns filed by sales tax dealers indicating their purchases outside the "local area", supported by accounts and documents. Currently entry tax is in operation in three States, viz., Madhya Pradesh, Karnataka and Andhra Pradesh. In Madhya Pradesh and Karnataka entry tax succeeded octroi, a checkpost levy collected by local authorities in most States on goods entering a local jurisdiction for consumption, use or sale within the said area. It was felt that assessment and collection at octroi checkposts was obstructing the free flow of goods and breeding corruption. Entry tax, being an account-based levy, was felt to be an appropriate substitute. In Andhra Pradesh, however, entry tax was a new impost as the State did not have octroi earlier. Octroi, however, continues to be levied in several other States.

1.2 While the case for moving away from a checkpost-based levy like octroi towards an account-based impost like entry tax is generally acknowledged, practices regarding the structure of entry tax, assessment procedure and appropriation of its proceeds vary from State to State. The coverage of this tax ranges from only the items subject to additional excise duty in Andhra Pradesh to almost all commodities in Madhya Pradesh. The rates vary from 1 per cent in Karnataka to 7.75 per cent in Madhya Pradesh. As regards appropriation of the proceeds of entry tax, Madhya Pradesh and Karnataka have set up compensatory grants mechanism to protect local bodies from the revenue loss entailed by the elimination of octroi. Rural local bodies also receive such grants even though they did not levy octroi earlier. In Andhra Pradesh, however, local bodies were not given any share in the proceeds from entry tax. Inadequacy of compensation has been a major grievance of local bodies in several States and underlies their opposition to any proposal to abolish octroi.

1.3 Of late, some States have sought to safeguard their sales tax revenue by using the entry tax to check diversion of trade away from their territories caused by undercutting in the rates of sales tax by neighbouring States. For instance, Madhya Pradesh, Maharashtra and Rajasthan have used entry tax to counter the adverse effects of differential sales tax rates on motor vehicles in neighbouring States/UTs on their revenues. Out-of-State purchases of motor vehicles are made liable to an entry tax equivalent to States' sales tax at the time of their registration anywhere in the respective States. In this form, entry tax serves to contain diversion of trade caused by sales tax rate differential. However, this form of taxation has wide ramification as it seems to be a tax on inter-State trade. Tamil Nadu also was reported to be contemplating such a move and other States may follow suit. Another trend noticed of late in entry taxation has a bearing on inter-State trade. In the budget speech for 1987-88, the State Finance Minister of Kerala announced that Kerala intended to levy a tax on entry of crude oil into Cochin Refinery which is located in the Cochin municipal area. This amounts to taxing raw material on the basis of entry into a local area to be used in the production of goods that are intended to be distributed all over the country. States having a dominant position in the production or distribution of essential commodities or vital raw materials may resort to this device to realise taxes from citizens residing outside their boundaries.

1.4 While under the Constitution the States are fully empowered to levy entry tax in any form they like and a switch from octroi to entry tax is widely considered desirable, to the extent it distorts the flow of inter-State trade and commerce, and raises the level of taxation of inputs or enables some States to export their taxes to others, the consequences of the levy of entry tax are a matter of concern to country as a whole. The possible adverse impact on the local finances resulting from the levy of entry tax by the State governments instead of by the local governments also calls for attention. It was therefore felt necessary to examine the entry tax systems, and formulate the lines on which the entry tax could be devised so that the national economy is not harmed and the canon of equity is honoured. It would also be useful to examine how the local governments, for which the tax was apparently meant under the Constitution, can be compensated for the loss of revenue when octroi is abolished. The present study was commissioned by the Ministry of Finance to undertake this task. The following were the terms of reference of the study:

i. To examine the existing practices in the States levying entry tax in regard to mode of assessment, coverage, and rate and also manner of utilisation of the proceeds;

ii. To examine to what extent the existing practices are in conformity with sound principles of taxation, with special reference to possible impact on the free flow of inter-State trade and commerce; and

iii. To evolve principles for determining the structure of the tax in order to minimise the adverse effects on inter-State trade and commerce and lay down norms for utilisation of tax proceeds to avoid State-local fiscal conflict.

1.5 The study covers entry tax systems of States levying the tax at present in different forms. The report is divided into six chapters, apart from this introductory one. Chapter 2 presents a brief survey of the various forms of entry tax, mode of assessment and coverage. Chapter 3 examines the impact of entry tax on inter-State price differentials and trade flows, while Chapter 4 goes into its constitutional validity. Chapter 5 contains an evaluation of the entry tax as an alternative to octroi. In this chapter an attempt is also made to formulate principles which should govern the structure of the tax to minimise the adverse effects of inter-State trade and commerce. Chapter 6 profiles possible approaches to the design of entry tax rate structure. Chapter 7 discusses the arrangements for compensating the local bodies for the abolition of octroi.

1.6 The work on the project commenced in the first week of June, 1989.

2. FORMS OF ENTRY TAX

2.1 Introduction

2.1.1 The power to levy octroi or entry tax is derived from Entry 52 of the State list in the Indian Constitution which reads "Taxes on the entry of goods into a local area for consumption, use or sale therein". There are two other entries in the Constitution which also authorise the levy of taxes which fall essentially on the movement of tradables within the country,viz., Entry 56 of the State list and entry 89 of the Union list. Entry 56 of the State list empowers the State to levy "taxes on goods and passengers carried by road or inland waterways", while entry 89 of the Union list contemplates the levy of "terminal taxes on goods or passengers carried by railway sea or air, taxes on railway fares and freights". The tax on railway passenger fare was first levied in 1957 but merged with railway fares in 1961 with assurance of compensation to the States as the revenue was assigned to the States. It was reimposed briefly in 1971 but withdrawn in 1973. The taxes on passengers and goods carried by road are levied and collected by the States rather than local authorities and in several States, have been merged with the taxes on motor vehicles. The Union Territory of Delhi has a "Terminal Tax" which is somewhat of a hybrid between an octroi and a terminal tax since it extends only to goods carried by surface transport (vide Rao et al., 1986). Thus the taxes on the movement of goods in the country effectively in operation are octroi and entry tax. Sales tax is no doubt a tax on trade but its levy is occasioned not by movement of goods but through the transaction of sale while the taxable event for octroi or entry tax is the entry of goods into a specified area. The distinguishing feature of the latter is that it is account-based while octroi is operated through checkposts.

2.1.2 Generally in the case of octroi, the powers conferred under Entry 52 are delegated by State governments to their local governments. In contrast, entry tax has developed as a State levy. Also, barring a few exceptions, entry tax is levied in urban areas only.[1]

2.1.3 Though authorised by the Constitution, not all States/UTs make use of these taxes for their municipal finances. In fact, several States/UTs never had any octroi/entry tax/terminal tax at all while some have abolished it in recent years (See Chart 2.1). Among the large States, eight, namely, Punjab, Haryana, Maharashtra, Gujarat, Orissa, Rajasthan, Uttar Pradesh and West Bengal[2] continue to levy octroi, while two, namely, Karnataka and Madhya Pradesh have replaced octroi by entry tax. Andhra Pradesh did not have octroi except in Telangana region upto 1966. However, since 1987, an entry tax is levied on the three additional excise duty items, namely, textiles, sugar and tobacco. Assam, Bihar, Kerala[3] and Tamil Nadu never had any octroi/entry tax. Recently octroi was abolished in Jammu and Kashmir and as a compensatory device, the rates of existing toll taxes both on imports into and exports from the State have been revised upwards. Himachal Pradesh abolished octroi in 1982 without explicitly devising any substitute. Among the Union Territories, terminal tax is levied in Delhi,[4] Pondicherry and Andaman and Nicobar Islands while there is no such tax in Chandigarh, Dadra and Nagar Haveli, Lakshadweep and Daman and Diu.

2.1.4 Very recently Entry 52 of the State List has been invoked to check diversion of trade caused by sales tax rate differentials. Madhya Pradesh initiated the move in 1986 in respect of motor vehicles within the framework of the existing entry tax system. Maharashtra and Rajasthan followed in 1987 and 1988 respectively with separate enactments. The tax is collected at the time of registration on the basis of the entry of motor vehicles from outside the State into a local area for use or sale therein. In Madhya Pradesh, entry into a local area from within the State also constitutes a tax event. Entry tax is seen as a check on the loss of sales tax legitimately due to a State which suffers because of artificial diversion of trade resulting from undercutting in sales tax by its neighbours.

2.2 Variants of Octroi/Entry Tax

2.2.1 While there are variations in the operational form of taxes under Entry 52, essentially these constitute a levy on entry of goods into a local jurisdiction for sale, consumption or use. Under an octroi/entry tax regime, a trading firm or an individual would be liable to pay octroi/entry tax on goods brought into a local area (i) to be consumed by itself or sold to consumers directly or (ii) for sale to dealers who in turn sell the goods to consumers within the given area irrespective of whether the consumers bought them for use within the said area or outside[5].

2.2.2 Although octroi and terminal taxes are taken to be synonymous, there is a significant difference. Octroi is leviable on goods brought into an area only for consumption, use or sale. Goods in transit to other areas or goods meant for export outside the area are exempt either directly or through refund to the extent of outflow of goods within a specified period of time. Terminal taxes, on the other hand, can be levied without regard to the purpose for which the goods are brought into an area. However, for octroi or entry tax, entry should be related to some activity within the local area, i.e., the entry for the purpose of consumption or use in some form. Further, import into a local area also implies incorporating and mixing of goods in the mass of property in the local area, that is, in the sense of accretion. As a corollary, `export´ would imply decretion to the mass of property, rather than merely `taking out´. It would not ordinarily apply to goods in transit, i.e., brought into the area for the purpose of being transported out of it. Thus terminal taxes can be imposed both on the entry of goods into a local area (except when in transit) and also on goods for which destination and consumption happen to be outside the local area.[6]

2.3 Mode of Assessment

2.3.1 Octroi/terminal tax is collected at the local border checkposts on the basis of documents carried by goods and passenger carriers. As it is not possible to unload all vehicles for physical verification, assessment is done largely on trust, permitting no scope for subsequent cross-check. A checkpost-based tax has been found easy to administer.

2.3.2 Wherever levied, the coverage of octroi/terminal tax is usually fairly wide. Almost all goods entering into a local area are subject to tax. However, exceptions are made depending upon the capacity of local administration. The coverage of goods that attract tax is generally delineated in two principal ways. The first method consists of taxing all goods entering into a locality excepting those specified in a list of exemptions. This is the most common method of determining the coverage. For example, in Gujarat goods exempt from octroi are bonafide personal baggage, personal effects of a public servant on duty, raw materials used in the manufacture of goods by Khadi and Village Industries and Cottage Industries, goods imported by organisations providing relief for persons affected by natural calamities or goods imported for free distribution by organisations such as Red Cross Society and the UNICEF. The second method is to enumerate goods for tax purposes, leaving all others outside the purview of the tax. The Municipal Corporation of Greater Bombay, for instance, has listed 60 items for tax purposes.

2.3.3 The tax base for octroi/terminal tax usually is gross value or weight or number of goods that enter into a local jurisdiction. This makes tax rates either specific or ad valorem. Until recently, octroi rates were mostly specific, i.e., rate per unit of goods or according to weight. However, with growing expenditure of urban local bodies and the subsequent need for increased revenue, the rates for octroi/terminal tax have gradually been made ad valorem. The current status of octroi rates is that in general it is a combination of specific and ad valorem rates, the mix varying from one locality to another, with a few exceptions such as Bombay where all the rates are ad valorem. Rates vary quite widely from one State to another. They also vary not only among municipalities but also among municipal corporations within a State.

2.4 West Bengal Entry Tax/Octroi

2.4.1 In West Bengal what is essentially an octroi is called entry tax. It is checkpost-operated and has all the ingredients of octroi. One distinguishing feature of the octroi/entry tax in West Bengal is that the tax is levied and collected by the State government but devolved to local bodies.[7] The levy is confined to Calcutta Metropolitan Area (CMA) only. It was first introduced in 1955. In 1962, the West Bengal Taxes on Entry of Goods into Local Areas Act (TEGLA) replaced the earlier Act. The purview of TEGLA is confined to a few commodities, viz., fruits, tea, tobacco, cigarettes and jute. In 1970, the Taxes on Entry of Goods into Calcutta Metropolitan Area Act was passed to levy taxes on entry of a larger number of specified goods, (excluding those covered under the 1962 Act), into CMA for consumption, use and sale therein. This act was later replaced with another, namely, Taxes on Entry of Goods into Calcutta Metropolitan Area Act, 1972 (TEGMA). West Bengal entry tax is administered by the Director of Entry Tax at the State level. For entry tax purposes, the CMA is divided into five zones: Calcutta, Hooghly, Howrah, 24 Parganas (North) and 24 Parganas (South).

2.4.2 All vehicles and other forms of transport entering the CMA are required to report at the nearest checkpost for inspection by the assessing officers. In respect of any vehicle carrying specified goods, the dealer concerned or his agent has to provide the assessing authority with a declaration form (under TEGCMA) and/or a bill of entry (under TEGLA), as the case may be. After due verification of the relevant document, the assessing officers assess the tax liability and collect the tax from the dealer or his agent. There is a provision for advance deposit of tax. A dealer may make a deposit equivalent to his expected total tax liability for a stipulated period against which the tax assessed on individual consignments may be adjusted.

2.4.3 As mentioned earlier, the entry tax proceeds under TEGLA are appropriated by the State government. The net proceeds of the tax collections under TEGMA however are distributed among the municipalities and other authorities in the following proportions:

Local bodies	Percentage
Calcutta Metropolitan Development Authority	50
Calcutta Corporation	25
Other municipal bodies in Calcutta Metropolitan District	17
Other municipal bodies in the State	8

2.5 Entry Tax in Lieu of Octroi

2.5.1 As noted already, two States, namely, Madhya Pradesh and Karnataka have abolished and replaced checkpost octroi with account-based entry tax.[8] This is considered an improvement in the tax system as checkposts were associated with harassment, corruption and obstruction to the flow of goods. Entry tax is payable by sales tax dealers along with sales tax. Registered dealers are required to submit to the sales tax department on account of the value of goods imported into a locality from outside including imports from other States. On the taxable value of imports into a locality, entry tax is assessed on the pattern of sales tax. In this way, entry tax is a companion tax to sales tax. Andhra Pradesh, which did not have octroi earlier, has introduced entry tax only on additional excise duty items, namely, textiles, tobacco and sugar. The entry tax systems now in operation in the three of the large States are discussed in some more detail in the paragraphs to follow.

a. Madhya Pradesh

Coverage

2.5.2 There are three schedules in the Entry Tax Act (Madhya Pradesh Sthaniya Khsetra Me Mal Ke Pravesh Par Kar Adhiniyam, 1976). Schedule I enumerates tax-exempt goods and includes more or less the same set of goods which are exempt under the Madhya Pradesh General Sales Tax Act, 1958. Sugar, cotton textile and tobacco are not included here as these three commodities are covered by additional excise duties in lieu of sales tax. Schedule II mainly consists of goods which have been declared as goods of special importance and are taxed at the rate of 4 per cent or less. For entry tax purposes, sugar, textiles and tobacco are included in this schedule. Entry tax becomes payable on goods covered under Schedule II, when they enter into a local area for consumption, use and sale therein. Schedule III includes residuary goods not included in the other two schedules. This schedule includes most of the items included in Schedule II of the State General Sales Tax Act. In respect of these goods, entry tax becomes payable when goods enter into a local area only for consumption or use of such goods as raw materials or goods used as packing material or in the execution of a works contract.

Rate structure

2.5.3 Goods under Schedule II are taxed at rates varying from 0.5 to 3 per cent. For Schedule III goods the tax rates range between 0.25 per cent for cotton (0.50 per cent for oil seeds, jute and cotton yarn) and 7.75 per cent for foreign and Indian made liquor. The State government is empowered to increase the rates upto 20 per cent by notification. Recently, there has been a steep hike in the rates on motor vehicles, which now vary from 3 per cent for trucks, buses, chassis, jeeps and tractors to 14.5 per cent for motorcycles, motor scooters and motors. However, a concessional rate of 0.5 per cent applies to goods meant for consumption or use as raw materials. If the full entry tax has been collected on an item at the time of import, rebate is given to subsequent registered dealer. However, certain inputs such as iron ore, coking coal and bauxite entering into Bhilai and Korba Industrial Special Development Areas are taxed at 5 and 10 per cent respectively.

Base and point of levy

2.5.4 The base of entry tax is "taxable purchase value" in the hands of the importer. It is arrived at by adding to the actual purchase price, excise duty/or additional excise duty, cost of transportation, packing, forwarding and handling charges, commission, insurance and the like. In cases where goods have been acquired by ways other than purchase, estimated market value becomes the tax base. From the gross purchase price, the value of goods purchased or received from outside the local area but subsequently sent outside the local area (not by sale) is deducted (provided goods are transported out of the State within 6 months from the date of entry of said goods).

2.5.5 When entry tax replaced octroi in Madhya Pradesh on May 1, 1976, it was conceived as a multi-point tax payable at the point of each entry, of goods into a local area by every dealer liable to pay tax under the Sales Tax Act. Further, whereas Schedule II goods were subject to tax when they entered into a local area for consumption, use or sale therein, in respect of Schedule III goods the tax was payable on entry into a local area only for consumption or use and not for sale therein. This is because the sale or purchase of Schedule III goods was subjected to a turnover tax in addition to sales tax (surcharge and additional tax subsequently). The intention was to exclude goods bearing turnover tax (or surcharge or additional tax) from entry tax. However, from September 1, 1976 when the Entry Tax Act came in operation, the proposed multi-point levy in respect of Schedule II items was converted into a single-point tax leviable on the entry of goods into a local area for the first time only. Further, since entry tax is leviable on all items under Schedule III, additional sales tax was abolished in August, 1982.

Definition of dealer for assessment purposes

2.5.6 The liability of this tax falls on all sales tax dealers whose turnover exceeds Rs 10,000 in the case of importers, Rs 20,000 in respect of manufacturers and Rs 50,000 for all other dealers. It may be clarified here that entry tax is payable only by the first dealer liable to pay sales tax who effects the entry of any goods into a local area. In other words, no entry tax is payable if the entry of any goods into a local area is effected by a dealer not liable to pay sales tax or any other person. Similarly, if goods are purchased by a dealer who is liable to pay sales tax, the entry is deemed to have been effected by the latter who is also liable to pay entry tax.

2.5.7 If a particular import of goods into a local area has escaped assessment, the assessing authority can take up such cases any time within a period of five years from the relevant assessment year. Since this tax is administered by the State Sales Tax Department, the system of penalty, appeal, refund etc., follows the same pattern as for sales tax.

System of compensatory grant to local bodies

2.5.8 When octroi was abolished, the aggregate revenue from the levy to the States was about Rs 18 crore. As entry tax was supposed to bring in revenue directly to the State exchequer, a system of compensation grant to local bodies was introduced. During May 1976 - March 1977, each local body which levied octroi on the day of its abolition, received a grant equivalent to its octroi revenue in 1975-76. From the financial 1977-78, the compensation was allowed to grow at a rate of 10 per cent per annum, except during 1983-84 when no growth was allowed for. For those local bodies which either did not impose octroi or came into existence after May 1, 1976, compensation is worked out on the following basis, using 1971 population, and is payable in monthly instalments through bank draft.

Local bodies	Population	Rupees per capita (per annum)
I	50,000 +	29.00
II	20,000 - 50,000	25.00
III	less than 20,000	22.00

b. Karnataka

2.5.9 As in Madhya Pradesh, an entry tax is levied on the entry of scheduled goods into any local area for consumption, use or sale therein. It seems the Government of Karnataka faced difficulties in getting clearance from the Government of India quickly and also had to contend with dealers who took the matter to court. Thus tax could be introduced only in the latter half of 1980-81. The rate of 2 per cent proposed initially was reduced to 1 per cent when this tax was levied for the first time. In view of its multi-point nature, the rate of 2 per cent was considered too high.

<u>Registration of dealers and assessment for tax</u>

2.5.10 All sales tax dealers in scheduled goods, irrespective of whether their place of business falls within a local area or outside, are subject to compulsory registration for purposes of entry tax. However, the tax is payable only by dealers in the scheduled goods doing business in specified area. They are supposed to file a return indicating the import of taxable goods under the entry tax every month along with the tax payable in advance. Assessments are finalised at the end of the year. If in a particular case, import of goods into the local area has escaped assessment, the assessing authority can take up such cases any time within a period of 5 years from the relevant assessment year. Since the tax is administered by the State Sales Tax Department, provisions regarding penalty, appeal, refund etc., are the same as for sales tax. A person who is not a dealer is not liable to entry tax.

2.5.11 No exemption limit was set initially for the levy of this tax. However, with a view to exempting the petty dealers doing business in scheduled goods in rural areas, the levy of this tax is confined only to corporations and municipal cities/towns.

Thus, village/town panchayats are excluded from its purview. With effect from April 1, 1984, a turnover limit of Rs 40,000 has been set for dealers to become liable to pay entry tax. In determining the turnover liable to tax, the value of goods purchased or received from outside the local area but subsequently sent outside (not by sale), is deducted provided the goods are sent out of the local area within a period of six months from the date of entry.

Coverage and tax rate

2.5.12 The commodity coverage has been changed from time to time. It covered three items during 1979-80, 16 groups of commodities during 1982-83, 10 groups during 1983-84 and covers only 8 groups since 1984. The final basket of taxed commodities comprises additional excise duty items, declared goods, raw materials and inputs. The rates are 1 and 2 per cent.[9]

Formula for compensatory grants to local bodies

2.5.13 As in Madhya Pradesh, compensatory grants to local bodies do not have any relation to the amount of actual entry tax collections, but depend on the octroi collections in earlier years with an allowance, however, for some growth. The base year figure was allowed to grow at a rate of 5 per cent upto 1981-82. Thereafter, a 10 per cent growth rate was allowed. The State Government seems to be of the view that this growth rate along with some saving on account of cost of collection should be able to neutralise the loss of octroi revenue. In respect of local bodies which were not collecting any octroi as on April 1, 1979 (27 out of 227 municipalities), compensation grant is paid at the rate of Rs 6.83 per capita per annum as per 1971 census. Compensation is paid to local bodies quarterly.

c. Andhra Pradesh

2.5.14 Andhra Pradesh introduced an entry tax in 1987 only on three commodities, namely, textiles, sugar and tobacco. The tax is levied at the rates of 1, 2 and 4 per cent respectively and is administered by the Sales Tax Department. Since Andhra Pradesh did not have octroi earlier, there was no question of entry tax replacing octroi. However, it is not an entry tax in lieu of sales tax (which will be discussed presently) either, but a tax on entry of goods into an urban local area, on the pattern of Karnataka entry tax, without any stipulation regarding compensation to local bodies.

2.5.15 It may be pointed out that the three commodities, namely, sugar, textiles and tobacco were taken out of States' sales tax net in 1957 through general consensus in an attempt to protect these goods from inter-State tax competition and also to ensure uniformity in the incidence of tax.

2.6 Entry Tax in Lieu of Sales Tax

2.6.1 In recent years, Entry 52 of the State List has been used by some State governments to counter the adverse effect of sales tax rates undercutting on the free flow of trade. Several States and Union Territories have of late reduced drastically their sales tax rates on motor vehicles and chassis. Such reduction in rates by neighbouring States resulted in diversion of trade away from States having a higher rate to low-tax States with consequent loss of sales tax revenue. In an attempt to counter the loss, some of the adversely affected States decided to levy a tax on entry of motor vehicles purchased outside the State and brought into their territory for use or sale therein and required to be registered under the Indian Motor Vehicles Tax, 1939. The purpose is to contain the flight of business induced by sales tax rate differential. No tax is levied on motor vehicles which are already registered in any other State or Union Territory for a period of 15 months or more from the date on which they are liable to be registered in the State in question. The two States which have enacted such a legislation are Maharashtra and Rajasthan, through Maharashtra Tax on Entry of Motor Vehicles into Local Areas Act, 1987 and Rajasthan Tax on Entry of Motor Vehicles into Local Areas Act, 1988 respectively. Even earlier, as discussed, Madhya Pradesh raised the rates of entry tax in lieu of octroi on motor vehicles in the year 1986 to accomplish the same objective.

2.6.2 This tax becomes payable on the entry of all kinds of vehicles except tractors into a local area from a place outside the State but not being a place outside the territory of the Union of India for use or sale therein. In Madhya Pradesh, the entry of motor vehicles from other localities within a State is also taxed, if no sales tax has been paid on the earlier transaction. The tax is collected by the Sales Tax Department at the point where vehicles are brought for registration. The tax base is the purchase value of a motor vehicle, as ascertained from the original invoice and includes the value of accessories fitted to the vehicle, insurance, excise duties, countervailing duties, sales tax, transport fee, freight charges and other charges incidentally acquired or obtained other than by way of purchase. Estimated market value is used as the purchase price.

2.6.3 The rates of the entry tax in lieu of sales tax are 15 per cent of the purchase price in Maharashtra and Rajasthan and between 3 per cent and 14.5 per cent in Madhya Pradesh. These are equivalent to their sales tax rates. The tax is in addition to the tax levied and collected as octroi by a local authority within its local area in Maharashtra and Rajasthan. The effective tax rate is reduced in these States to the extent of sales tax paid in the other State or Union Territory by an importer who not being a dealer registered under the sales tax, has purchased the motor vehicle in that State for his own use. In Madhya Pradesh, however, the tax liability is not reduced to the extent of sales tax paid outside the State. To this extent, the liability of entry tax in lieu of sales tax is in addition to sales tax paid outside the State. The tax is administered by the State Sales Tax Department in all the three States. Sales tax rules regarding appeal, penalty, non-payment are applicable to entry tax in lieu of sales tax also. The tax is collected and the proceeds retained by the State Government in both Maharashtra and Rajasthan. The local bodies do not get any share of this tax. In Madhya Pradesh, however, collections under this head constitute the entry tax revenue and hence devolved to local bodies.

2.7 A Resume

2.7.1 It will be seen from the preceding description that use of Entry 52 of the State List by the States has led to three different forms of taxation, namely, octroi, entry tax in lieu of octroi and entry tax in lieu of sales tax. Octroi and entry taxes are the more common forms of tax on entry of goods into a local area. Essentially similar in character, these taxes are levied and collected as a source of finance of local bodies. West Bengal entry tax is nothing but an octroi but for two basic differences. First, it applies once for all only to entry of goods into CMA, and second, it is collected by the State government though the total proceeds net of cost of collection are passed on to CMDA, Calcutta Municipal Corporation and other municipalities.

2.7.2 Entry tax like octroi is a tax on entry of goods into a local area for consumption, use or sale therein. However, entry tax is different from octroi in the following respects. First, it is not collected at the checkpost, being payable by sales tax dealers by furnishing returns of their purchases from outside the local area. Thus entry tax is less costly to administer and avoids the harassment to taxpayers associated with octroi. Secondly, it is imposed as an ad valorem tax as against octroi which is generally a combination of specific and ad valorem levies. Thirdly, entry tax is a State-level levy while octroi is a local levy. Entry tax revenue, however, is treated as local revenue except in Andhra Pradesh and is passed on to local bodies to compensate them for the loss of octroi revenue. Thus entry tax is a revenue substitute of octroi by virtue of the compensatory grant. Finally, it is restrictive in application as only selected commodities transacted by registered dealers are subjected to entry tax. The commodities covered by entry tax are generally those which either fall outside the sales tax legislation, namely, goods subjected to additional excise duties in lieu of sales tax or goods subject to tax rate limitation applicable to the category of declared goods. Only recently the coverage of the entry tax has been extended to commodities other than those coming under this category of additional excise duty items and non-declared goods. Despite recent attempts to increase the number of goods under entry tax, the commodity coverage continues to be restricted and narrower than that of octroi. The exemption limits for the registration of dealers for entry tax also exclude a portion of the transactions of even taxable goods.

2.7.3 There are three principal systems of entry tax in lieu of octroi: Madhya Pradesh, Karnataka and Andhra Pradesh. Madhya Pradesh and Karnataka entry taxes are different in two respects. First, Madhya Pradesh entry tax is applicable to all local areas in the entire State. However, Karnataka entry tax applies only to entry of goods into urban local areas. Secondly, whereas the Madhya Pradesh entry tax is levied only on the first entry, the Karnataka entry tax is multi-point. Thus, in Madhya Pradesh, any first entry of goods into a local area from within and outside the State but not outside the Union of Indian is taxed. So there is no built-in bias for or against movement of goods between local areas. Under the Karnataka variety of entry tax, when goods move from an urban area to a rural area, there is no tax but when there is a reverse movement, goods attract tax. Similarly, if goods move from a place outside the State to any rural locality within the State, no tax is attracted as only entry into urban localities is taxed. The Andhra Pradesh type of entry tax is basically a Karnataka variety but covering only three commodities, namely, textiles, sugar and tobacco. Since the State did not have octroi before the introduction of entry tax, the proceeds from entry tax are not shared with or devolved to local bodies.

2.7.4 In respect of entry tax in lieu of sales tax, the Maharashtra and Rajasthan systems are identical. Entry tax is levied on motor vehicles purchased outside the State and brought into the State for use or sale therein and required to be registered under the Indian Motor Vehicles Act, 1939. It seeks mainly to compensate for the loss of sales tax revenue that can be attributed to inter-State rate differential. Further, this does not interfere with the octroi/entry tax in lieu of octroi which continues to be collected on motor vehicles. The proceeds of this tax are not shared with or devolved to local bodies for this simple reason. However, this tax measure, though devised within the framework of entry tax enactment in Madhya Pradesh to achieve the same objective of compensating for the loss of legitimate sales tax revenue as in Maharashtra and Rajasthan, has some additional implications. Since the entry tax on motor vehicles is levied under the existing entry tax enactment (in Maharashtra and Rajasthan, it is done by a separate enactment), entry tax in lieu of sales tax and entry tax in lieu of octroi get mixed up. Although the revenue from the entry tax on motor vehicles goes into the consolidated fund of the Government of Madhya Pradesh, it is shared with local bodies. As against this, entry taxes on motor vehicles in Maharashtra and Rajasthan are collected and retained by the State Government.

NOTES

1. In Maharashtra, for instance, octroi is levied by village panchayatas also.

2. Entry tax is collected on entry of goods into Calcutta Metropolitan Area only, like an octroi.

3. Timber tax exists on entry of timber into Trivandrum municipal corporation area. Recently, there is a proposal (Budget speech of the State Finance Minister for the year 1987-88) to levy an entry tax only on crude oil entering Cochin municipal corporation for refining purposes.

4. The net proceeds of terminal tax in Delhi are distributed over the three local bodies of the Union Territory of Delhi, namely, Municipal Corporation of Delhi, New Delhi Municipal Committee and Delhi Cantonment Board. For more details about terminal tax in Delhi, see Rao, V.G. et al. (1986).

5. AIR 1963 SC 906 Burmah Shell Oil Storage and Distributing Company Limited Vs. Belgaum Borough Municipality.

6. Taxation Enquiry Commission (1953), Vol.. III, p. 403.

7. See Gopalakrishnan (1987).

8. Introduction of entry tax was attempted in Gujarat and Maharashtra recently. It could not be implemented due to resistance from traders in Gujarat and from municipal employees in Maharashtra. Entry tax was also under active consideration in Rajasthan. (See Rao, M.G., 1984 for Gujarat and Rao et al. 1986 for Rajasthan). For limitations of entry tax and other alternatives to octroi (see, Nath, 1987, Nath and Sen, 1989).

9. There is a proposal to change the multi-point levy to a single-point levy on the first entry only. The tax rates are also proposed to be revised upwards to 4 per cent.

CHART 2.1

OCTROI STATUS OF STATES AND UNION TERRITORIES

Octroi States	Non-octroi States	
	Non-octroi	Entry Tax
Punjab	Andhra Pradesh[1]	Karnataka
Haryana	Assam	Madhya Pradesh
Himachal Pradesh[2]		
Jammu & Kashmir[3]	Bihar	
Maharashtra		
Gujarat		
Orissa	Nagaland	
Rajasthan	Sikkim	
Uttar Pradesh[3]	Tamil Nadu	
West Bengal[4]	Tripura	
	Manipur	
	Meghalaya	
	Mizoram	
	Arunachal Pradesh	
	Goa	

Octroi/Terminal Tax Union Territories	Non-octroi/Non-Terminal Tax Union Territories
Delhi[5]	Chandigarh
Pondicherry	Dadra & Nagar Haveli
Andaman & Nicobar Islands	Lakshadweep
	Daman & Diu

1. Entry tax introduced w.e.f. June 1987.
2. Abolished in 1982.
3. Abolished recently.
4. Collected at the checkpost under the name of entry tax.
5. A variant of octroi, namely, terminal tax.

3. IMPACT OF ENTRY TAX ON INTER-STATE PRICE DIFFERENTIALS AND TRADE FLOWS

3.1 Entry Tax in Lieu of Octroi and Relative Prices

3.1.1 It is evident that entry tax in lieu of octroi does not discriminate between goods manufactured within a State and those produced outside because every entry into a local area is taxable.[1] Thus entry tax in lieu of octroi does not discriminate between home produced goods and imports from outside the State and hence causes no relative price distortion. However, inter-State variations in octroi/entry tax rates and coverage can influence trade by distorting the relative prices. It is extremely difficult to isolate the impact of entry tax rate differential on inter-State trade from the other factors that affect product prices. However, on the basis of available data, an attempt is made to quantify the impact of entry tax rate differences on product prices and pattern of trade.

Exercise 1

3.1.2 To test the impact of entry tax on product price, let us take the case of commodities whose producers intend to achieve uniformity of price throughout the country. A few examples of such commodities are cement, fertilisers, iron, steel, coal and motor vehicles. Table 3.1 presents State-wise cement data on FOR (Free-on-Rail) price, incidental charges, sales and entry taxes, (latter in the form of a dummy) for the year 1985 (December). FOR price is same across all States. Incidental charges and sales taxes, differing from one State to another, introduce wide variations in cement price. Coefficient of standard deviation (a statistical measure of dispersion) of cement prices across States is 2.22 when incidental charges and sales taxes are taken into account, compared to zero initially for identical prices across all States. When price inclusive of entry tax/octroi, the latter ranging from zero tax to widely different rates varying between 1 and 4 per cent, is analysed, the coefficient of dispersion goes up from 2.22 to 2.59. However, coefficient of dispersion remains constant at 2.22 if identical entry tax/octroi rates are employed. Thus inter-State variations in entry tax do interfere with inter-State price structure and the policy of uniform cement pricing.

Exercise 2

3.1.3 Now the important question is, whether entry taxes influence direction of trade via their impact on relative price. An attempt was made to quantify the impact of entry tax on the direction of trade utilising the data on despatches of cement by manufacturers/wholesellers to different States, in order to ascertain whether presence or absence of octroi/entry tax has any impact on despatches. We postulate that despatches (DS) to a particular State would depend on its final price (P), size of the market (M) and presence/absence of octroi/entry tax (D). Price of a commodity for a State is equal to FOR price plus incidental charges plus sales tax but excludes entry tax/octroi. Size of the market for cement is approximated by the share of construction sector in the State domestic product. A dummy for the presence and absence of octroi/entry tax on cement has been used. D=1 denotes presence of octroi and D=0 otherwise. We further assume that trade margins in cement trade are the same in all States.

3.1.4 To isolate the differential impact of these variables on the despatches of cement, regression technique is employed. Results based on log linear estimate of regression equation in a cross- section of 15 States are presented below:

$$\log DS = -15.4456 + 1.9762 \log P + 0.8549 \log M - 0.1789 D$$
$$\qquad\qquad (0.4205) \qquad (+5.5513) \qquad (-1.0033)$$

$$\bar{R}^2 = 0.7331; \; DW = 2.1690$$

These results show that barring the coefficient associated with the size of the market, other coefficients are not statistically significant. In other words, despatches do not appear to be sensitive to price and presence and absence of octroi/entry tax. But this may be peculiar to cement.

3.1.5 Different results may be obtained in respect of commodities whose State-wise despatches are sensitive to their price. Due to non-availability of relevant data, similar exercises could not be carried out for other commodities. However, results obtained from the exercises carried out here seem to confirm that the existing entry taxes may have enhanced inter-State price differentials and, depending on the response to price changes, may be causing, at the margin, trade diversion as a consequence.

3.2 Entry Tax in Lieu of Sales Tax and Diversion of Trade

3.2.1 Let us now take an entry tax which is levied in lieu of sales tax, using the event of entry of motor vehicles into a local area. Prior to the advent of this form of entry tax, there existed a situation in which due to sales tax rate differential, local business in motor vehicles tended to fly to zero or low sales tax States. This situation can be described by a tax system in which only local sales of motor vehicles could be taxed and imports went untaxed. Thus entry tax in lieu of sales tax can be regarded as a tax intervention to correct an existing distortion in the form of diversion of trade and consequent loss of sales tax on the motor vehicles supposedly purchased outside the State for use in the State.

3.2.2 An attempt is made in this section to show the effect of entry tax in lieu of sales tax on inter-State trade of motor vehicles. Analysis has been carried out with the help of data on diesel vehicles manufactured by TELCO. Before examining the trade effects, it would, however, be instructive to present a brief description of the inter-State variations in the sales tax rates on motor vehicles and discuss the operational parts of inter-State trade in such goods.

a. Sales Tax Rates on Motor Vehicles

3.2.3 The system of sales taxation of motor vehicles varies from one State to another (Table 3.2). In most States, rates vary according to category of the vehicle, namely, motor cars, jeeps and pick-ups, scooters and motorcycles and motor chassis. But in some States such as Maharashtra and Rajasthan, a single rate is prescribed for all categories. A look at the sales tax rate schedule pertaining to motor vehicles in selected States would reveal that inter-State variations are sharp and the rates range from 3 per cent to 15 per cent. However, due to inter-State tax competition, in recent years the rates have generally tended to decline. In 1975-76, except Gujarat, in most of the States included in the table, the tax rate was 12 per cent for all categories of vehicles. In 1985-86, the rates declined in most cases to 3 to 5 per cent. This trend has persisted in most States except in Maharashtra, Madhya Pradesh (a few vehicle categories) and Rajasthan where the rates have in fact gone up.

3.2.4 The role of inter-State tax differential as a source of diversion of trade in motor vehicles can be better appreciated if the sales tax rates on motor cars prevailing within a group of neighbouring States are compared. Let us take for illustration the rates applicable to motor cars in Maharashtra, Gujarat, Rajasthan, Daman and Silvasa in 1986-87, the year of introduction of entry tax in lieu of sales tax. The respective rates were 12 per cent, 4 per cent, 12 per cent, 3 per cent and nil (tax exemption was granted to assembly units under industrial policy of the Union Territory of Dadra and Nagar Haveli). The extent of differential in tax rates is evidently large enough to induce trade diversion from high-tax States to low-tax territories.

3.2.5 Often the diversion occurs merely on paper. For instance, one of the biggest manufacturers of diesel vehicles in Maharashtra employs local dealers in low tax territories to sell its products to consumers all over the country. However, where the tax rates differ widely in adjoining States, dealers located in low-tax territories act as agents for purchasers from the State with high tax rate. The vehicles do not move physically but the sales are shown as having taken place outside the high-tax State. The tax payable in the State where the vehicle is finally used is evaded. The price of a vehicle is thus reduced to the extent of sales tax saved due to rate difference between the State where original bookings are made and the States/UTs from where actual deliveries take place.[2] Sometimes the place of booking and the place of delivery are the same, but the transaction is shown as "inter-State" only. For instance, bookings are made in Bombay and vehicles are also delivered there, but transactions are shown to have taken place in Vapi, Daman or Silvasa.[3]

3.2.6 It was reported to us by a local dealer of the manufacturers that before 1984-85, most of the local demand in Indore was met through the dealers in Silvasa where the manufacturing company had an assembly unit which got exemption from sales tax on its products under the provisions of the UT's industrial policy. Motor vehicle parts were taken to Silvasa from the manufacturing points only for assembly purposes to avail of the tax concession. Similar is the case with the products of another car manufacturer located near Delhi. The local demand of the consumers of the car in Bombay is met by the stockyards of the manufacturer in Daman, Vapi and Silvasa. Motor vehicles which should have been despatched to Bombay against local bookings there were transported to Daman, Vapi or Silvasa to take the tax advantage.

b. <u>Entry Tax Intervention and Correction of Trade Diversion</u>

3.2.7 The preceding discussions bring out the distortions which are caused by inter-State tax rate differential and the revenue loss suffered by the States having relatively high rates of tax. The trade diversion also deprives local bodies of octroi because of artificial diversion of trade in motor vehicles and resulting out-of-State vehicle registration. This is possible because a vehicle registered in any State can ply in another State without fresh registration for a period of time, such as 15 months from the date of registration. Besides loss of tax revenue to the State and local governments, such route diversion also causes waste of fuel and time for which no estimate is available.

3.2.8 However, some idea of the extent of trade diversion and its impact on State and local exchequer caused by tax differential can be obtained from the following indicators before and after such differentials were introduced:

1. Number of vehicles delivered
2. Transacted value of motor vehicles
3. Sales tax collection from motor vehicles
4. Octroi collection from motor vehicles

3.2.9 For the present exercise, two States, namely, Maharashtra and Madhya Pradesh were chosen. Information on the number and transacted value of only diesel-driven vehicles readily available from a leading manufacturer for the State of Maharashtra as a whole and Indore in Madhya Pradesh was used. The data were collected from the respective governments.

3.2.10 Table 3.3 furnishes data on delivery of diesel vehicles by the company in Indore. It is assumed that income changes do not affect demand for motor vehicles significantly in the short run. A sharp decline in the number of delivery from 806 in 1981-83 to 532 in 1983-84 is noticed which can therefore be attributed to the introduction of a tax concession in Silvasa. This can be taken to be an indicator of the effect of sales tax rate differential on business in motor vehicles. To counter this flight of business, sales tax rate on diesel vehicles in Madhya Pradesh was reduced from 10 per cent to 6 per cent and further to 3 per cent. This brought about a sharp rise in the number of delivery in Indore from 532 in 1983-84 to 1227 in 1985-86. Thus trade in motor vehicles which was lost to Silvasa was restored to Indore. Convinced by the efficacy of this move, the Government of Madhya Pradesh continued to resort to undercutting of sales tax rates on motor vehicles. The same objective was later achieved by introducing an equivalent entry tax in May, 1986. In the absence of data on sales tax and entry tax collected from motor vehicles for Indore (not available for even a single category of vehicles), revenue impact of this tax measure cannot be quantified with precision. However, the spurt noticed in transactions in motor vehicles in Indore may be taken to be an indicator of the additional tax collection on this account.

3.2.11 The Maharashtra experience confirms these trends. Table 3.4 gives information on sales value of diesel vehicles sold by the manufacturer in Maharashtra along with sales tax rates. As a result of diversion of business to low sales tax areas, value of motor vehicles sold in Maharashtra dropped from Rs 14.43 crore in 1983-84 to Rs 2.83 crore in 1985-86. This trend appears to have been reversed with the introduction of entry tax in September, 1987. During 1987-88, the sales value of motor vehicles attained a level of Rs 46.30 crore. The following year witnessed a small reduction in sales value which, however, can be attributed to the hike in sales tax rate on motor vehicles from 12 to 15 per cent in Maharashtra, which restored relative gains of transactions in Vapi, Daman or Silvasa to some extent.

3.2.12 These trade diversions had their impact also on the collections of sales tax, entry tax in lieu of sales tax and octroi. Tax gain to the exchequer of Maharashtra which is also a measure of diversion of runaway business in motor vehicles back to Maharashtra is reflected in the sudden spurt in sales tax collections plus entry tax collection in lieu of sales tax and revenue from octroi. Figures set out in Table 3.5 show that sales tax collection from motor vehicles business increased substantially, particularly in the case of four-wheelers, after the introduction of entry tax in lieu of sales tax. Aggregate tax collections from motor vehicles increased from Rs 23.45 crore in 1985-86 to Rs 46.77 crore in 1987-88 (Rs 41 crore from sales tax and Rs 4.87 crore from entry tax in lieu of sales tax) to Rs 68.53 crore in 1988-89 (Rs 55.62 crore from sales tax and Rs 12.91 crore from entry tax in lieu of sales tax). Further, the benefits of direct transportation of vehicles to destination market, for instance Bombay, consequent upon neutralisation of tax differential, are also reflected in octroi collections from motor vehicles in Bombay (Table 3.6). Annual percentage variation which was 10 per cent during 1985-87 increased to 17 per cent during 1987-89.

3.2.13 It is instructive to compare the experiences of the two States in this regard. Two important results are worth noting. First, since in Madhya Pradesh entry tax is a composite tax embracing both entry tax in lieu of sales tax and entry tax in lieu of octroi, the tax gain is reflected in one figure, i.e., entry tax collection. In Maharashtra, however, because of the separate identity of the two taxes, the tax gain is distinct. Second, whereas entry tax in lieu of sales tax has played an identical role in the two States, sales tax structures have been different. It has been noted earlier that Madhya Pradesh started with sales tax reduction on motor vehicles which was complemented later by entry tax. But in Maharashtra, sales tax rates were not lowered, instead they were raised along with the introduction of entry tax in lieu of sales tax.

3.2.14 A confirmation of the second result, i.e., the impact of differences in the two sales tax policies during the period of experimentation with the entry tax in lieu of sales tax, is obtained when the impact of the two taxes on deliveries of motor vehicles or annual sales values, are quantified by using the regression technique. Dependent variables in the regression equations are annual deliveries of diesel vehicles in Madhya Pradesh (DI) and annual sales value of motor vehicles in Maharashtra (SMH). Explanatory variables in both the equations are sales tax rates (STMP and STMH) respectively for Madhya Pradesh and Maharashtra and entry tax dummies (D=0 in year with no entry tax in lieu of sales tax and D=1 for its presence). It is postulated that both the taxes would have opposite signs if they were instrumental in diverting the flight of business in motor vehicles. The results of the exercise are presented below:

$$DI = 1956.8103 - \underset{(-3.0246)}{109.8377}\ STMP + \underset{(+1.4216)}{408.7028}\ D$$

$$R^{-2} = 0.8734; \quad DW = 2.6845$$

$$SMH = -6.6780 + \underset{(+1.0310)}{11.9330}\ STMH + \underset{(+2.6985)}{108.0154}\ D$$

$$R^{-2} = 0.8456; \quad DW = 0.8456$$

3.2.5 The `t' ratios reported in parentheses indicate that all coefficients except the one associated with sales tax in Maharashtra (STMH) are significant. Deliveries of vehicles in Indore went up with the imposition of entry tax and decline in sales tax rate. But in Maharashtra, annual sales value of motor vehicles not only increased with the coming of entry tax but also when sales tax rate was enhanced. Although the latter impact is not statistically significant, its positive sign is not quite unexpected. The present exercise thus shows that entry tax in lieu of sales tax has proved to be an effective instrument of controlling the flight of business in motor vehicles from Madhya Pradesh and Maharashtra to zero or low sales tax States/Union Territories.

3.3 Tax Exporting

3.3.1 One of the undesirable features of entry/octroi taxation as practised in India has been that in some localities they embrace not merely articles of final consumption but also raw materials and other inputs of production. For instance, Government of Madhya Pradesh imposed in 1978 an entry tax on iron ore and coking coal and bauxite respectively used by Bhilai-Durg and Korba special development projects at rates ranging between 7 per cent and 10 per cent. These raw materials are brought into "the local area" of the projects from their captive mines located outside the local area. The motivation underlying this measure presumably stems from the consideration that whereas these projects use facilities provided by the State and local governments, they do not contribute to the State and local exchequers commensurately. Most of their products are exported on consignment transfers to other States which do not attract Central sales tax. In the absence of local sale of most of their output, they are not liable to local sales tax either. Another example is the levy of octroi on crude oil. Crude oil can flow into a local area from offshore oil rigs, inland oil resources or from outside the country. There is a proposal to levy an entry tax on entry of crude oil into the Cochin municipal corporation area for refining purposes at a rate of one paisa per litre on crude oil received by Cochin Refineries. This measure was expected to yield Rs 2.2 crore per annum. Similar instances can be identified even in octroi regimes. For instance, Bombay Municipal Corporation collects octroi at the rate of 1 per cent ad valorem on crude oil entering Bombay. The Central government undertakings, namely, Hindustan Petroleum, ONGC and Indian Oil Corporation paid about Rs 18 crore to the Bombay Municipal Corporation in octroi on crude oil during 1988-89 (Table 3.7).

3.3.2 Ordinarily, such taxes should not give rise to any cause for concern so long as their incidence falls entirely on the residents of the respective States or localities. This indeed would be the case if the entry taxes were framed on the principle of destination which falls on goods consumed by the residents of a local area. But this is not generally the case.

3.3.3 Entry taxes on inputs usually form part of the cost of production. Any tax on sale to other States can be taken to be passed on to consumers in the importing State if the demand for the product in the State in question is price-inelastic. By the same logic, any tax that goes into the sale price of a product in inter-State trade is also likely to be passed on to consumers of the importing State. This provides certain States a convenient way of exporting taxes to the rest of the country. It thus amounts to taxation of consumers of the importing State by the exporting State.

3.3.4 The rationale for taxation of raw materials and inputs at the point of entry seems to be to recover from the users of public services a part of the cost of supply. Going by the benefit principle of taxation, if a part of the government expenditure is deployed for the supply of public services that reduce the cost of private output, it should be charged to the producer of the product. If the product happens to be exported, such taxes should be paid by the consumers in the importing State who in fact become the beneficiary of the service. However, this argument is a little tenuous inasmuch as the exporting State also benefits from the stimulus provided to its economy by exports.

3.3.5 On a priori reasoning, it seems that application of the benefit principle would result in a fair allocation of the cost of public service among individuals residing in various States and in turn equitable division of tax base among the States. It also seems that benefit taxation would not disturb relative prices and free flow of commodities between States. But application of the benefit principle to taxation of goods in inter-State trade cannot be justified because in principle States have the right to tax only their own residents. In fact, it is because of these considerations that the Central sales tax law was enacted in 1956 to restrict the powers of the States to levy tax on sale and purchase of commodities by putting a ceiling on the tax that can be charged on inter-State sales and limiting the rate of tax on certain goods declared to be of importance to inter-State trade and commerce. State and local taxes to recover the cost of public services provided in a particular State from the residents of other States cannot be sustained in a federal set-up.

3.4 Summary

3.4.1 On the basis of the preceding analysis, the following observations can be made. One, entry tax in lieu of octroi does not discriminate between goods produced within a State and those brought from outside. However, inter-State variations in tax rates are found to be interfering with relative prices across States.

This may affect the free flow of goods from one State to another. Two, one of the relieving features of entry tax in lieu of sales tax is that it is capable of eliminating local distortions attributable to `rate war´ in sales taxation. Flight of business in motor vehicles from high-tax States to zero-or low-tax States (the latter created only as tax havens) has been checked by such taxes. State and local exchequers continue to get their legitimate sales tax and octroi revenues respectively. In the absence of such a tax, the attempts by the States to tax items like motor vehicles at a relatively high rate are frustrated entailing loss of legitimate State and local tax revenues. Finally, entry taxes have been used to export taxes to the residents of other States by taxing raw materials, particularly vital inputs such as crude oil which are used in the production of goods of country-wide importance. The pros and cons of these and other related taxes are considered at some more length in a subsequent chapter.

NOTES

1. Entry taxes of a locality do discriminate between its local producers and producers outside the locality and, for that matter, out-of-State producers. The consequences of this are however not gone into here as there is no apparent discrimination against producers outside the State boundary.

2. The prices of non-deluxe and deluxe models exclusive of sales tax are Rs 93,000 and Rs 1,40,000 respectively. A consumer in Bombay may bring down the price of Maruti vehicles by one-fifth (in absolute terms, Rs 17,000 on the purchase of non-deluxe Maruti and Rs 26,000 on deluxe Maruti by transacting in Daman). This is possible because the present rate of sales tax including turnover tax and surcharge in Maharashtra is 18.05 per cent and also including octroi it is 22.77 per cent. The rate of sales tax in Daman is 3 per cent. The difference between the two tax rates is a gross saving if the vehicle is bought in Daman. Cost of bringing the vehicle including driver's charges is reported to be generally not more than Rs 1,000.

3. It was learnt that a dealer in Maruti vehicles located in Vapi (a town of Gujarat 10 km away from Daman and 167 km away from Bombay) accepts money for delivery of Maruti vehicles to customers in his Bombay office. He performs all the formalities in Vapi but final delivery of vehicle is made from his stockyard in Daman.

TABLE 3.1

Statewise Cement Statistics (December, 1985)

(Rupees per tonne)

State	FOR price of cement	Incidental charges	Price col.2+3	Sales tax	Price col.4+5	Octroi/ entry tax	Price col.6+7	Price when octroi levied at uniform rate (2%)	FOR price to octroi
1	2	3	4	5	6	7	8	9	10
Andhra Pradesh	885.12	38.00	923.12	120.56	1043.68	0.00(0)	1043.68	1064.55	885.12
Assam	885.12	39.50	924.62	92.46	1017.08	0.00(0)	1017.08	1037.42	885.12
Bihar	885.12	34.30	919.42	102.17	1021.59	0.00(0)	1021.59	1042.02	885.12
Gujarat	885.12	68.50	953.62	125.87	1079.49	21.59(2)	1101.08	1101.08	902.82
Haryana	885.12	56.00	941.12	80.00	1021.12	20.42(2)	1041.54	1041.59	902.82
Jammu & Kashmir	885.12	38.00	923.12	77.54	1000.66	20.01(2)	1020.67	1020.67	902.82
Karnataka	885.12	30.00	915.12	150.99	1066.11	21.32(2)	1087.43	1087.43	902.82
Kerala	885.12	20.00	905.12	108.61	1013.73	0.00(0)	1013.73	1034.84	885.12
Madhya Pradesh	885.12	47.17	932.29	102.55	1034.84	31.05(3)	1065.89	1055.54	911.67
Maharashtra	885.12	55.00	940.12	75.21	1015.33	30.45(3)	1045.78	1035.64	911.67
Punjab	885.12	44.40	929.52	66.37	995.89	29.88(3)	1025.77	1015.81	911.67
Orissa	885.12	35.00	920.12	73.98	994.10	29.82(3)	1023.92	1013.98	911.67
Rajasthan	885.12	30.00	915.12	125.63	1040.75	41.63(4)	1082.38	1061.57	920.52
Tamil Nadu	885.12	33.31	918.43	115.72	1034.15	0.00(0)	1034.15	1054.83	885.12
Uttar Pradesh	885.12	55.00	940.12	75.21	1015.33	40.62(4)	1055.95	1034.64	920.52
West Bengal	885.12	75.00	960.12	76.81	1036.93	41.48(4)	1078.41	1057.67	920.52
Average	885.12		928.82		1026.92		1447.44	1047.46	902.82
Standard deviation(SD)	0.00		14.37		22.80		27.11	23.26	13.28
Coefficient of dispersion (SD/X)	0.00		1.55		2.22		2.59	2.22	1.47

Notes: 1. Incidental charges consist of charges on local transport and retailer profit margin, etc.

2. Figures in parentheses are rate of entry tax/octroi. Zero rate indicates that particular State does not have this tax.

Source: Cement Data Book (1985), Government of India, Ministry of Industry, Office of the Development Commissioner for Cement Industries, New Delhi-110008.

TABLE 3.2

Changes in Rates of Sales Tax on Motor Vehicles in Selected States

(%)

	1975-76	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Motor Car											
AP	12	6	8	8	8	8	8	5	5	5	5
TN	-	7	7	7	9	9	9	9	5	5	5
Maharashtra	12	12	12	12	12	12	12	12	12	15	15
MP	-	8.5	8.5	8.5	8.5	8.5	8.5	8.5	10	10	10
Orissa[1]	12	13,7	13,7	12,6	12,6	10,6	10,6	10,6	10,6	10,6	10,6
Pondicherry	-	-	-	-	-	-	4	4	4	3	3
Daman	12	6	7.50	12	12	3	3	3	3	3	3
Gujarat	9	9	12	12	12	5.50	2.70	4	4	4	4
Rajasthan	-	10	10	10	10	10	10	10	10	12	12
Jeeps & Pick-ups											
AP	12	12	12	8	8	8	8	8	8	8	8
TN	-	-	-	-	12	12	8	5	5	5	5
Maharashtra	12	12	12	12	12	12	12	12	12	15	15
MP	-	8.5	8.5	8.5	8.5	8.5	8.5	8.5	10	10	10
Orissa	12	13	13	12	12	10	10	10	10	10	10
Pondicherry	-	-	-	-	-	-	4	4	4	4	
Daman	12	6	7.50	12	12	3	3	3	3	3	3
Gujarat	9	9	12	12	12	5.50	2.70	4	4	4	4
Rajasthan	-	-	-	-	10	-	-	-	-	-	12
Scooters, Motor cycles											
AP	12	12	10	10	10	8	8	8	8	8	8
TN	-	15	15	15	15	15	15	15	8,4	4[2]	4
Maharashtra	12	12	12	12	12	12	12	12	12	15	15
MP	-	13.5	13.5	13.5	13.5	13.5	13.5	13.5	16	10	10
Orissa	12	13	13	12	12	10	10	10	10	10	10
Pondicherry	-	-	-	-	-	-	7	7	7	3	
Daman	12	6	7.50	12	12	3	3	3	3	3	3
Rajasthan	-	-	-	-	10	-	-	-	-	-	12
Motor Chassis											
AP	12	12	10	10	8	5	5	5	5	5	5
TN	-	15	15	15	9	6	6	6	6	6	6
Maharashtra	12	12	12	12	12	12	12	12	12	15	15
MP	-	10.5	10.5	10.5	10.5	6	2	2	3	3	3
Orissa	12	13	13	12	12	10	10	10	10	10	10
Pondicherry	-	-	-	-	-	3	3	3	-	-	-
Daman	12	6	7.50	12	12	3	3	3	3	3	3
Rajasthan	-	10	10	10	10	10	10	10	10	12	12

Notes: 1. 7 per cent on motor car; later, 6 per cent was levied on 1000cc car.
2. 4 per cent on moped.
\- Not available

Source: Sales Tax Departments of States concerned.

TABLE 3.3

Delivery of Diesel Motor Vehicles in Indore by a Leading Manufacturer and Sales Tax Rates in Madhya Pradesh

(per cent)

Year	Sales tax rate	Entry tax rate in lieu of sales tax	Delivery of vehicles (Number)	Annual per cent change
1980-81	-	10	834	-
1981-82	-	10	808	-3
1982-83	-	10	806	-1
1983-84	-	10	532[1]	-52
1984-85	-	6	1227	131
1985-86	3[2]	3	1417	15
1986-87	3	3	1783	25
1987-88	3	3	2289	28

Notes: 1. Such a decline in delivery of diesel motor vehicles is reported to be the result of around 400 motor vehicles delivered from Silvasa. In the following year some vehicles were delivered from Daman also.

2. Introduced on May 14, 1986.

Source: Data on delivery of diesel motor vehicles were obtained from a local dealer in Indore, and sales tax rates from the Commercial Tax Department, Indore, Government of Madhya Pradesh.

TABLE 3.4

Sales Value of Motor Vehicles and Sales Tax Rate in Maharashtra

(Rs. crore)

Year	Sales value of motor vehicles[1]		Sales tax rate (%)	Entry tax rate in lieu of sales tax (%)
	One leading manufacturer	All		
1983-84	14.43	150.00	12	-
1984-85	10.12	113.54	12	-
1985-86	2.83	174.48	12	-
1986-87	16.06	191.70	12	-
1987-88	46.30	285.22	12	12[2]
1988-89	38.06	308.14	15	15

Notes: 1. Derived by dividing sales tax revenue by sales tax rate on motor vehicles.

2. Introduced on September 13, 1987.

Source: Office of the Commissioneer of Sales Tax, Bombay, Government of Maharashtra.

TABLE 3.5

Sales Tax Revenue from Motor Vehicles in Maharashtra

(Rs. crore)

Year	Four-wheeler	Two/three-wheeler	Total	Entry tax in lieu of sales tax
1983-84	15.03	5.12	20.15	-
1984-85	8.43	6.85	15.28	-
1985-86	14.85	8.60	23.45	-
1986-87	18.27	9.89	28.16	-
1987-88	31.20	10.70	41.90	4.87*
1988-89	32.45	23.17	55.62	12.91
1989-90	-	-	-	1.82**

* October, 1987 to March, 1988

** April to June, 1989

Source: As for Table 3.2.

TABLE 3.6

Octroi Collection on Motor Vehicles in Bombay

Year	Amount (Rs. lakh)	Annual per cent variation
1984-85	283.71	-
1985-86	314.98	11.09
1986-87	343.82	9.16
1987-88	402.74	17.13
1988-89	473.88	17.66

Source: Office of Assessor and Collector, Municipal Corporation of Greater Bombay, Government of Maharashtra.

TABLE 3.7

Octroi Collection from Crude Oil from Central Government Undertakings in Bombay

(Rs. crore)

Year	Undertakings*			
	Hindustan Petroleum	ONGC	Indian Oil Corporation	Total
1985-86	-	9.85	0.68	10.53**
1986-87	2.15	12.46	0.48	15.09
1987-88	4.24	13.70	0.25	18.19
1988-89	3.98	13.45	1.10	18.53

* No collection is reported from Bharat Petroleum.

** Excludes Hindustan Petroleum.

Source: Office of the Assessor & Collector Bombay Municipal Corporation.

4. CONSTITUTIONAL VALIDITY OF ENTRY TAXES

4.1 Entry Tax in Lieu of Octroi

4.1.1 It has been argued time and again that the levy of octroi (and entry tax in lieu of octroi) violates the freedom of trade and commerce guaranteed by Article 301 of the Constitution. Article 301 states that subject to the other provisions of this part, trade and commerce throughout the territory of India shall be free. It has been argued that the maintenance of checkposts for the collection of octroi adversely affects free movement of goods. Judicial rulings on the subject have tended to focus on the following two issues. One, whether the levy of octroi per se constitutes an infringement of the freedom of trade and commerce guaranteed by Article 301 and two, if not, whether the tax is reasonable and in public interest as required by Article 304(b) which provides that the State can impose such restriction on the freedom of trade, commerce or intercourse as may be required in the public interest.

4.1.2 Courts in general have not objected to barriers in the form of checkposts and the collection of octroi tax and for that matter, to the levy of entry tax. In a series of cases, (See Balachandran, 1977, 72-9 for court cases), courts have ruled that regulatory measures imposing compensatory taxes for the use of trading facilities do not come within the purview of the restrictions contemplated by Article 301. Octroi/entry tax was taken as an instrument to recover the cost of providing facilities to trade. A rational nexus could be found between the levy of octroi and the provision of facilities to trade and commerce within the municipal limits.

4.1.3 It seems, however, that in this context courts did not go into the implications of Article 304(a) which stipulates that States may impose on goods imported from other States or Union Territories, any tax to which similar goods manufactured or produced in that State are subject, so as not to discriminate between goods so imported and goods so manufactured or produced in the State. This Article clearly indicates that goods imported from other States can be put to any tax which is also levied on the goods produced in the State. Since under an octroi/entry tax regime, entry of goods into a locality both from outside the locality and also from outside the State are subject to the same tax, this levy would appear to be within the constitutional parameters. If, however, one looks at imports of goods into a locality from outside the State, it would appear that an octroi tax on imported goods with no corresponding tax on products of the importing locality. Viewed thus, Article 304(a) would seem to be violated. Since however no State or local authority levies octroi or entry tax in a form which might on the face of it look discriminatory against imports from other States - it is always the entry of goods into a local area which occasions the tax - questions have not been raised about the constitutional validity of octroi or entry taxes on this ground.

4.2 Entry Tax in Lieu of Sales Tax

4.2.1 As regards the constitutional validity of the entry tax in lieu of sales tax, it appears meet to the requirements postulated by Article 304(a). Goods imported into a locality from another State are subjected to tax at the same rate as charged under on goods purchased in the importing State. Although goods imported into a locality from another locality in the same State do not attract entry tax in Maharashtra and Rajasthan (in Madhya Pradesh inter-locality movements are also taxed, if sales tax has not been paid earlier), in terms of tax treatment, there is no discrimination. Entry of motor vehicle into a locality can be effected either by a dealer or an individual. As a dealer, he would be taxed in the form of sales tax when a sale takes place. As an individual, he would have already paid sales tax in the locality where he bought the vehicle. So in each case, tax happens to be paid either as sales tax or entry tax in lieu of sales tax. So the contention (see Balasubramaniam, 1989) that this tax exclusively falls on goods coming from outside the State and hence violates the prohibition in Article 304(b) of the Constitution does not seem to be tenable.

4.2.2 Similarly, it is difficult to accept the contention that merely because a neighbouring State is levying lower taxes, a discriminatory tax on goods imported from that State cannot be justified. It has been further argued that entry tax is a sales tax on sale outside the State. What in fact happens is that sales take place outside the State to meet the demand of motor vehicles within the State, as represented by the bookings for motor vehicles in a particular locality. In many a case what actually happens is that the locale of booking and that of delivery are identical but on paper the transactions are shown to have taken place outside the State, clearly evidencing an intention to evade sales tax. Thus entry tax in lieu of sales tax falls only on those motor vehicles of which the sale should normally have taken place in the State where they are registered but is contrived to have taken place outside.

4.3 Additional Evidence

4.3.1 The preceding discussion suggests that entry tax in lieu of sales tax does not discriminate between imports and locally produced goods provided both sales and entry taxes together constitute the tax liability in respect of motor vehicles brought for registration in a given State. It may be argued that as this tax measure has been designed in an attempt to prevent tax avoidance in motor vehicles trade, ancillary measures to check avoidance should originate in Entry 54 of the State List which is the source of sales tax. In other words, taxes originating in two different entries of the Constitution cannot be complementary to each other, and so entry tax in lieu of sales tax is unconstitutional. Another possible argument is that this tax can be held as violative of the provisions of entries 92A and 92B of the Union List which lay down that only Parliament is competent to tax inter-State sale or purchase or consignment of goods.

4.3.2 The question whether the contention put forward above is valid has to await a verdict of the judicial authorities. However, it may be relevant here to examine the logic of the court decisions in the United States in respect of a similar tax known as "use tax". Like entry tax in lieu of sales tax on motor vehicles, use taxes have been adopted by sales tax jurisdictions in the United States, both to safeguard their revenues and to protect local merchants against the diversion of purchases by local residents or businesses to low sales tax jurisdictions. US Supreme Court was faced with the question whether these taxes were invalid as levies discriminating against inter-State trade and commerce particularly in view of the fact that motor vehicles purchased within the States typically are not subject to the tax. The court held the view that use tax, viewed in the background of the sales tax it complemented, was designed to put out-of-State and in-State purchases on a level of equality (See Hellerstein, 1977, 113-37). The court rejected the argument that this tax was equivalent to a protective tariff. Instead, it found that the States levy this tax with the objective of keeping local and out-of-State sales on parity in order to prevent flight of purchases from local traders to dealers outside and the consequent loss of tax revenues.

4.3.3 Any attempt by the States, however, to charge higher use taxes on out-of-State purchases in comparison to what would have been payable as sales tax on in-State purchases, has not been upheld by the courts in USA. The States' contention that additional administrative burdens are imposed in collecting the tax directly from the users has failed to persuade judicial authorities to permit higher taxation of out-of-State purchases. Two cases may be cited as illustration. In one case, a Pennsylvania buyer who purchased an automobile in New Jersey was assessed for use tax in Pennsylvania on the full purchase price whereas if it would have been bought in Pennsylvania, the sales tax would have been payable only on the net price paid after deduction for the trade-in-allowance for the old car. In another case, the State of Louisiana was stopped from introducing a sales tax-use tax differential in the case of equipment manufactured by a Louisiana taxpayer outside the State, i.e., in Oklahoma, for use in Louisiana in its own business. The collector assessed a use tax on the value of the cost of articles purchased plus labour and shop overheads. If it had purchased the material in Louisiana and had produced the equipment in that State it would have been subjected to a sales tax only on the cost of the articles purchased, excluding labour and shop overheads.

4.3.4 The ground on which the US courts upheld use taxes on goods purchased outside a given State and transported to the buyer within the State is that they are imposed on intra-State use - the buyer's taking the goods into his possession or his acquiring title to them. It is not easy to see how delivery of goods or transfer of title takes place in intra-State trade, even though that event occurs simultaneously with the termination of inter-State movement. However, the stand implicit in the US court decision that use tax is on intra-State use of commodities has been appreciated for it largely puts an end to the immunity of inter-State sales from State sales and use taxes in the importing

State. As States seldom tax or tax at lower rates sale of goods transported to other States, these decisions were found to be greatly reducing the unjustified competitive advantage, dealers in inter-State trade enjoyed of not being obliged to collect or pay sales taxes or use taxes in any State. To take the example of entry tax in lieu of sales tax, dealers in Bombay may show the transactions as taking place in Silvasa where vehicle assembly is exempt from sales tax and also not pay any sales or entry tax in Bombay as these vehicles are duly registered in Silvasa. There is no tax on inter-State consignment of motor vehicles either. This business scenario is completely changed when entry tax in lieu of sales tax (or use tax) is introduced which restores to the State governments the revenues siphoned off from their treasuries through artifacts.

4.3.5 The use of entry tax in lieu of sales tax, however, does not invalidate the collection of sales tax on the same commodity again in the State of entry. From the court rulings in the United States, it is clear that any sale by a local merchant to an out-of-State purchaser (including a business purchaser) who receives delivery of goods in the State for immediate transportation by him outside the State constitutes an inter-State sale that is taxable in the State of purchase (See Hellerstein, 1977, footnote 53, 131). This is because the taxable event is the transaction which is separate from transportation and inter-State trade. Thus even in the presence of a sales tax by the out-of-the State government, an entry tax in lieu of sales tax (or use tax) is justified by the importing State to accord equal treatment to home purchases and purchases from outside. As regards a credit for the sales taxes paid to the States in which goods were purchased, as it exists in Maharashtra and Rajasthan but not in Madhya Pradesh, some lessons can be drawn from the US court decisions.

Courts in USA have taken the view that it was not mandatory that there should be an allowance for taxes paid to other governments (See Hellerstein, 1977 footnote 49, 131).

4.4 Summary

4.4.1 With an entry tax, if one considers imports into a locality in a State from a locality of another State, there would appear to be an octroi/entry tax on imported goods with no corresponding tax on home produce of that locality. In this way, it does put out-of-State goods to a disadvantageous position. However, Courts in general have not found anything objectionable in checkposts and the collection of octroi tax or for that matter entry tax in lieu of octroi as barriers to trade. In several cases, courts have ruled that regulatory measures or measures imposing compensatory taxes for the use of trading facilities did not come within the purview of the restrictions contemplated in the Constitution. Since in an octroi/entry tax regime, entry of goods into a locality from outside the locality are subject to the same tax, which may be from outside the State or within, its constitutionally validity has not been questioned.

4.4.2 As regards the constitutional validity of entry tax in lieu of sales tax, it seems to meet the requirements laid down by the Constitution in that goods imported into a locality from another State are taxed at the same rate which is charged on the goods purchased within the importing State. The only auxiliary requirement to meet this general condition is that the tax liability on the commodity should be computed with reference to sales tax and entry tax in lieu of sales tax. The latter is justified because it puts out-of-State purchases and in-State purchases on equal footing. **This tax falls** on sales of only those goods which in effect take place within the State where they come to be used. Such a levy greatly reduces the unjustified competitive advantage enjoyed by inter-State traders who are not obliged to collect or pay sales tax in any State, and secondly, it restores back to the States their legitimate revenues siphoned off by the neighbouring States through rate cutting.

5. ENTRY TAX AS AN ALTERNATIVE TO OCTROI - PROS AND CONS

5.1 Introduction

5.1.1 The survey of taxes levied in exercise of the powers conferred under Entry 52 of the State List in the Constitution ("taxes on the entry of goods into a local area for consumption, use or sale therein") shows that these have taken two forms, viz., octroi and entry tax, the distinguishing feature of the latter being that it is accounts-based and not operated through checkposts. Sometimes, the entry tax is also checkpost-based such as in West Bengal but such an entry tax comes essentially within the category of octroi. The terminal taxes envisaged under Entry 56 of the State List and under Entry 89 of the Union List belong essentially to the same genre. In fact, at one time, the terminal taxes were thought to be possible candidates as replacement for octroi, as they had certain advantages over octroi such as avoiding the need for exemption or refunds in respect of goods in transit and also afforded a wider base since goods going out of the locality and also passengers could be brought under taxation. However, as noted in Chapter 2 the terminal taxes have either been abolished or merged in the motor vehicles tax or are operated like octroi, as in Delhi, without however the exemptions or refunds associated with a tax for local sale., consumption or use. Thus octroi has continued to be levied in large parts of the country and it is only in recent years that entry tax has been receiving attention as a substitute.

5.1.2 While octroi has been a very ancient mode of collecting tax in India dating from the Mughal period and, in its present form, from the East India Company days, it has been regarded almost universally as an undesirable impost and attempts have been made since long to find a suitable alternative, as may be seen from the following observations of the Taxation Enquiry Commission of 1953-54:

> ".....Octroi and terminal taxes, as a form of levy by local bodies, have been the subject of much criticism from many quarters and at different times. In the last century as well as this, unsuccessful attempts were from time to time made to render these duties as harmless as possible by adopting various devices to localise their incidence and to rid them of their administrative defects. Some of these efforts were made by the Government of India. It was sought, firstly to restrict the tax to a few articles of local consumption and secondly, to moderate the rate on necessaries of life. A rule was at one time laid down that articles liable to customs duties and the property of Government should be exempt from taxation. To prevent octroi operating as a terminal tax at higher rates, the municipalities were required to provide warehouses and other conveniences for the storage of goods in transit. In 1877, Government prescribed a standard of yearly consumption of dutiable goods per head of municipal population by reference to which the excess of the amount paid as octroi over the amount properly payable could be calculated, the excess being taken as the measure of the extent to which octroi had become a transit duty. All these devices achieved little that was tangible in the way of elimination of these duties from the scheme of local taxation...."

After independence too, the Central Government has been pressing the States to abolish octroi and compensate the local bodies adequately (vide, for instance, the Budget Speech of the Union Finance Minister for the budget for 1978-79). Progress towards its abolition has however been slow and halting, mainly because an acceptable alternative is yet to be found.

5.2 Entry Tax as an Alternative to Octroi

5.2.1 Among the several alternatives considered as eligible substitutes for octroi, the one most discussed in recent years is the entry tax (vide, for instance, the Report of the Gujarat Taxation Enquiry Commission of 1980 and the Report of the

Committee on Substitution of Octroi set up by the Government of Maharashtra in 1987). After considering the possible alternatives to octroi, the Gujarat Taxation Enquiry Commission recommended the abolition of octroi throughout the State except in four municipal corporations where it could be continued on a limited scale. The Commission recommended introduction of entry tax in all other local areas, with a guarantee from the State Government of the revenue collected by the municipal bodies to compensate for the loss of octroi with an assured annual growth of 9 per cent. The more recent Maharashtra Committee also felt that entry tax is very close to octroi in terms of both commodity coverage and incidence and yet much less vexatious as it can be collected on the basis of accounts instead of through checkposts. The Committee felt that the entry tax was quite capable of being administered by the local bodies and that on a gross basis at a rate of about 2.5 per cent on the taxable turnover would suffice to raise the required revenues for the local bodies in Maharashtra. Despite these recommendations neither the Government of Gujarat nor, until now, that of Maharashtra have found it feasible to replace octroi by entry tax. Very recently the Maharashtra Government has drawn up a bill proposing a "General Entry Tax" but the proposals have evoked a sharp protest from trade and industry (vide Economic Times, 21 February, 1990). The Mayor of Bombay had also strongly opposed the abolition of octroi primarily on the ground that there is no better alternative source of steady cash flow to the municipal corporation of Bombay. Initially, Maharashtra had levied an entry tax for an altogether different purpose, namely, to counter the revenue loss caused by rate-cutting by neighbouring States/territories. However, entry tax has been in force in Madhya Pradesh and Karnataka for several years now and it is the example of these two States which is often cited in support of arguments in favour of entry tax as a replacement for octroi.

5.2.2 It is somewhat ironical that levy of a tax which has been considered to be the best possible alternative to octroi has given rise to reservations and controversies after it has been in operation in at least two States for some time and a bill to introduce it is moved in the legislature of another. Since the abolition of octroi is to a great extent contingent on the acceptability of entry tax as an alternative, the factors which underlie the doubts and reservations about its suitability need to be gone into objectively and the lines on which entry tax can be levied without giving any cause for concern need to be explored. In the paragraphs to follow, an attempt is made to set out the attributes of a good tax especially in the context of a local government and identify in that light the objectionable features of the entry tax as it has evolved in India in recent years, especially those which are of national concern and could therefore call for Central regulation, if not by law at least by way of guidelines, and suggest principles on the basis of which such guidelines could be formulated.

5.3 Characteristics of a Good Tax System in the Context of Local Government

5.3.1 The time-honoured canons of taxation have been equity, efficiency, ease of administration and certainty. Equity demands that taxes should be levied according to ability to pay. This in turn implies that the burden of taxation should fall equally on persons in similar economic circumstance. Commonly it is also taken as axiomatic that equitable taxation calls for casting a higher burden on the rich than on the poor, that is, taxes should have a measure of "progressivity". Progressivity is also felt to be a desirable attribute of a tax as a way of redistributing purchasing power from the rich to the poor.

5.3.2 Efficiency implies minimising the distortions caused by taxation in the pattern of consumption and production in the economy. Concern for efficiency arises from the fact that most taxes have their impact on relative prices and thereby affect the choice of consumers and producers as between different products. While some of these "distortions" might be caused deliberately to influence the allocation of resources in the economy, unless carefully devised, taxes often tend to distort the pattern of production and consumption in unintended ways with a detrimental effect on the growth of the economy as also on equity. Often these distortions are not immediately apparent and take their toll over the years without quantification or even detection. Unfortunately a tax which scores high on equity grounds may not be very good from the efficiency angle (e.g., a highly progressive income tax). On the other hand, a tax which satisfies the efficiency canon well, might not be easy to administer and may give rise to evils of evasion and corruption.

5.3.3 To help administration as well as compliance - which also is required of a good tax - the tax should have the quality of "certainty", that is, its base should be well defined and not capable of manipulation because of ambiguity. It is difficult to think of a tax in the real world especially in the context of a developing economy which could satisfy all these criteria simultaneously. Some trade-offs are unavoidable. In the context of a levy meant for financing local government expenditure in particular, it is neither possible nor necessary to pursue all the aims which higher level governments alone can meet. Nevertheless, it is useful to keep the four canons in view as broad parameters to be followed with suitable adaptation to meet the constraints of a given situation, such as a local or State government has to face.

a. Equity

5.3.4 While fairness is unquestionably the prime attribute of a tax, it is irrational and unrealistic to expect a tax levied at the sub-national levels in a country to aim at a high degree of progressivity. The simple reason that steep progression in the taxes cannot be maintained or enforced in a locality or one part of the country in isolation because of the possibility of migration of capital and labour, as is amply demonstrated by the phenomenon of rate-cutting among States in sales tax in India and the consequent flight of trade from high-tax territories to low-tax neighbouring areas. For similar reasons, the task of redistribution of purchasing power is better left to higher levels of government. Maintaining stability in the economy is also a responsibility of the national government. The tasks of a local or State tax therefore would thus appear to be relatively simple, namely, to raise revenue in a way which the administration can handle and without causing undue hardship or damaging the economy and without violating the canon of equity in a broad sense. That is to say, any tax, whether levied by the Central or a sub-Central-level government, has to be equitable, easy to administer while satisfying the criterion of efficiency.

5.3.5 In the context of a State or local-level tax in a federal country, equity would in the first place require a broad adherence to the principle of taxation according to some clearly defined principle such as ability to pay or according to benefits received. This implies that the tax should have an easily identifiable or unambiguously defined base so that the scope for evasion is minimised and there is no discrimination against any particular class of people or region. Equity would also require some graduation in the burden of taxation as between the rich and the poor. The fact that the benefit of local services provided by local governments is enjoyed more by the rich argues for a measure of progression in local taxes, even though potential mobility of people and capital does not permit carrying the principle of progressivity in local taxation very far (vide Rao, 1984). A broad degree of progressivity as is achieved by taxing luxuries at a higher rate than essentials would help to meet the requirements of equity to a considerable extent.

5.3.6 Another dimension of equity in taxation which assumes special importance in the context of a tax levied by a sub-national-level government stems from the need to respect the principle of taxation by destination, which implies that each unit of sub-national government should as far as possible, tax only its own residents and refrain from trying to raise revenue by levying taxes, the incidence of which spills over (beyond) into other jurisdictions and thereby affects people living in other territories and their economy.

5.3.7 It needs pointing out that the compulsion to follow the principle of destination in taxation is predicated not by any moral or ethical consideration but arises simply from the fact that in the absence of a convention whereby each government avoids taxing residents of other States, retaliation may follow leading to a chaotic situation. The result often is that relatively strong or better placed governments or jurisdictions gain at the expense of weaker or economically less developed countries/regions and create disharmony in inter-governmental relations which, if allowed to continue, can lead to a crisis in international relations or, in a federal country, in inter-State harmony. These considerations have induced even independent countries to enter into tax treaties to avoid conflict of jurisdictions and double taxation. Failure to respect this principle in a federal country weakens the federal fabric and can even destroy the federal structure. Allocation of powers of taxation between the national and sub-national governments should and usually do take cognizance of the requirement of delineating the powers of taxation of the federating units in such a way that there is no overlap of jurisdictions and each State/unit raises revenue from its own residents. Where the constitutional provisions prove inadequate to prevent spillover of taxes levied by one jurisdiction into another - "tax exporting", in the federal finance jargon - some action at the national level becomes necessary.

b. Efficiency, certainty and administrative ease

5.3.8 "Efficiency" as an attribute of a good tax derives its rationale from the fact that most taxes, barring possibly the poll tax, are distortionary and therefore detrimental to growth and economic welfare. However, as is well recognised, even in predominantly free enterprise economies the allocation of resources which would otherwise take place because of the operation of market forces may not always be acceptable because of the inherent inability of the markets to cater to certain requirements of the community (such as the provision of 'public good') or compensate for externalities such as pollution caused by industries. In such situations intervention by the State may be called for. Even so, economic logic suggests that taxes should avoid unintended distortions and minimise the costs associated with the adjustments which people are induced to make in response to taxes. Modern theory of taxation predicates that this is best ensured by lumpsum taxes and where lumpsum taxation is not feasible, as they tend to be regressive or because of legal constraints, taxes should fall on articles of final consumption, sparing inputs. Modern theory also indicates that commodity taxes can be efficient and equitable if levied on final products with a broad differentiation between necessaries and luxuries. However, economists universally stress that taxation of inputs is undesirable.

5.3.9 The criterion of efficiency has another important connotation in the context of commodity taxes when they are levied on trade (as distinguished from production). If levied at the point of entry or exit between two jurisdictions, a trade tax can have very detrimental effect on economic growth by impeding the play of competitive forces. The strength of a free market economy, it is generally accepted, lies in promoting efficient use of scarce resources through competition. Anything which interferes with competition leads to inefficiency and is thus harmful for growth. The move towards a unified market in Europe by 1992 by removal of fiscal frontiers between independent countries rests on the recognition of the merit of competition and free markets as promoters of efficiency and economic growth.

5.3.10 Of course, "free trade" too can be detrimental to the underdeveloped economies in a world where levels of economic development sharply differ. Hence the justification for tariff to protect infant or growing industries in developing countries. Similar justification can be adduced in favour of taxes (such as octroi or entry tax) which serve to foster growth of industries in a backward State or locality within a country. However, even for such purposes, a protective tax is undesirable as it acts as a drag on economic growth and the realisation of the full potential of a large common market which ultimately benefits all regions of the country by allowing the development of each region according to its potential and comparative advantage derived from its resource endowments. Where growth is stalled because of lack of infrastructure, protective taxation can be of no avail and the remedy would lie in investment for creating the necessary infrastructure. In the long run, trade barriers, whether physical or tax-based are harmful for all economies from the national, regional and local angles. For all these reasons, it is now universally agreed that fiscal frontiers are bad for growth, and undesirable between countries and more so within a given country.

5.3.11 Another reason why such frontiers are considered undesirable is that the checks required for enforcing any tax on movement of goods between countries or regions invariably lead to waste of time and resources. They are vexatious and breed corruption. The losses caused by hold up of traffic at checkposts are substantial. Checkpost-based tax is also undesirable because of the problem it creates in administration and compliance and also lack of certainty in the base when levied on an ad valorem basis. Specific levies, on the other hand, can be inequitous and anomalous as is the case with the Delhi terminal tax whereby gold and iron are taxed by weight, both at the same rate. It is these considerations which have brought octroi into disrepute and led to the research for an account-based substitute which the entry tax essentially is. But even entry tax is economically harmful if it discriminates between local production and goods coming from outside the locality and thereby interferes with the play of competitive forces.

5.4 Evaluation of Entry Taxes and Policy Implications

5.4.1 Viewed in the light of the principles discussed above, it will be seen that, although they appear to be an improvement on octroi from the administrative and compliance angle, entry taxes too violate both equity and efficiency, barring only those which are designed to equalise the level of sales tax on goods domestically produced and those coming in from across the border of the given State or territory and thereby counter the diversion of trade induced by effective tax rate differential. In particular, the entry taxes falling on inputs or universal intermediates are borne by consumers of products using them anywhere in the country. Thus, the tax on entry of crude oil for refineries as also that on the entry of iron ore or coal into a "local area" for use in production of steel are clear instances of the attempt on the part of the sub-national governments to "export" their tax and raise revenue at the cost of residents of other States/territories. These taxes also violate the efficiency norm as they lead to distortions and escalation of costs of industrial production, the dimensions and directions of which remain unknown. For all these reasons, entry tax in any form is a bad tax and could be justified only in a primitive or a backward economy where industrial production is at a low level and import of goods provides a convenient point for the levy of taxes.

5.4.2 Entry taxes which raise the level of taxation on consumer goods like textiles, tobacco and sugar, even though borne entirely by residents of the jurisdiction levying them, go against efficiency, though not equity, in that they discriminate in favour of local production and discourage imports from outside the local area. Such discrimination can be overlooked so long as the tax is levied by a relatively small locality or municipality having very little industrial production of its own but not in municipal bodies of large industrial towns.

5.4.3 An additional objection on efficiency ground to entry taxes levied in an industrially advanced municipal area could be that by raising the prices of goods coming from outside, these taxes tend to hinder dispersion in the location of industries and aggravate concentration. Where, however, the tax is levied on inputs, it may serve to encourage industrial dispersion. The net effect is difficult to predict in a given situation. Whether, and if so to what extent, the entry taxes in Bombay or Calcutta regions have contributed to the concentration of industries in these metropolitan areas remains to be tested empirically. A priori, there is every reason to think that entry taxes when imposed by large industrial town authorities run counter to the policy of wider dispersal of industries and development of backward regions.

5.4.4 One argument which can be and is often advanced in favour of octroi or entry tax is that, as benefits of public services in local areas are reaped largely by the urban consumers it would be fair to make them pay. In fact, an important principle at the local level is the benefit principle. Octroi and entry taxes are useful devices to realise revenue from citizens of municipalities meant for financing services provided by them. However, as pointed out in the earlier paragraphs, the harm done by the octroi and entry taxes outweighs their merit as an instrument of local taxation, more so when they are used for taxing citizens of other territories.

5.4.5 Use of entry tax (or for that matter, octroi) to circumvent the limitations imposed by the Central Sales Tax Act on the powers of the States to levy sales tax on certain commodities (that is, those declared to be of importance to inter-State trade and commerce) is also objectionable in that it undermines the efficacy of the CST Act in enforcing a certain discipline in the matter of sales taxation which was felt to be necessary and was brought about by legislation, by Parliament, by common consent of the country as a whole. Similar objections could hold good for the attempt to get round the tax rental arrangement agreed upon by all States whereby sales tax on three commodities, viz., textiles, tobacco and sugar is substituted by additional excise levied by the Union Government. If these limitations on the powers of sales taxation are thought to be undesirable and found no longer acceptable, the right course would be to remove or relax them in the CST Act rather than allow a situation where these are flouted by States through whatever means available at their disposal.

5.4.6 Understandably, policy-makers at the State or local level are not inclined to take cognisance of the spillover effects of their fiscal actions or losses in terms of lower economic growth caused by such action unless the consequences are visibly and immediately inimical to their own interest. However, informed policy-making calls for a consideration of the economic consequences of taxation, the externalities involved and the extent to which they can recoil on themselves. The case for harmonisation in the matter of taxation between different jurisdictions thus rests not on any abstract principles but on a recognition of the manifold benefits of co-operation and co-ordination between two localities, regions and countries. Ultimately it is these which provide the sanction for a higher level organisation such as the Central government to lay down the ground rules for tax practices at the sub-national levels or a superior organisation of the independent countries like the EEC in Europe.

5.5 Policy Implications

5.5.1 In sum, Central action to impose a measure of restriction or regulation even in a field of taxation which lies within the constitutional powers of the States would be justified if the levy of a tax by a State government has an appreciable spillover effect, that is, affects other States and/or interferes with free flow of trade within the country or discriminates between local production and imports. For, in such situations, inter-State relations are involved and can lead to actions and counteractions which do no good to any one. Clearly, tax exporting gives rise to such a situation.

5.5.2 Anything which affects free flow of goods within the country, whether inter-State or intra-State, can also be a matter for national concern, and so Central intervention, because of its adverse effect on the economy. Part XIII of the Constitution which assures freedom of trade and commerce within the Indian Union reflects a recognition of the need to permit free flow of goods without hindrance. It is heartening to find that judicial authorities in India have generally frowned upon any legislation which constitutes an impediment to free flow of trade, commerce and intercourse within the Indian Union. But the constitutional provisions are found to be increasingly inadequate to cope with attempts to interfere with free trade in the country and the practice of tax exporting, except in very glaring instances. Thus, certain forms of taxation at the sub-national level have come into vogue and their area is expanding, which is clearly against the principles of equity, efficiency and the need among sub-national units for respecting each other's jurisdiction. If these principles are to be adhered to, the following maxims ought to be respected:

i. No octroi or entry tax should be levied on inputs or intermediates whether these are used for industrial production within the taxing jurisdiction or re-exported after some processing or refining. For, any tax which has the effect of tax exporting, that is, impinges on residents across the borders of the authority levying the tax, such as a tax on inputs used in the manufacture of goods which eventually move out of the "local area", is objectionable and bad. This principle is implicit in the terms of Entry 52 with their reference to consumption, use or sale in a local area. The recent verdict of the Supreme Court against the levy of octroi by the Bangalore Municipal Corporation on Horlicks powder brought into the city for bottling and export outside the city reflects judicial approval of this principle and the reasoning advanced by the court that bottling did not mean "use or consumption" makes sound economic sense. [(HMM Ltd. Vs. Bangalore City Corporation JT (1989) 4 SC147)]. Taxation of inputs brought into a given locality, even when used in manufacturing, is detrimental to the economy of the locality.

ii. No octroi/entry tax should be levied if they result in discrimination between local products and imports, even if the commodities concerned are meant for final consumption.

5.5.3 It follows that the only form of octroi or entry tax which cannot be objected to is the one which serves to equalise the level of sales tax on goods purchased by the residents of the taxing jurisdiction, whether locally made or bought outside (e.g., the entry tax in lieu of sales tax imposed by Maharashtra and Rajasthan). All other forms of entry tax, whether checkpost-operated or accounts-based, are detrimental to the growth of the national economy and subversive of the federal political structure. Any action to have these taxes removed would therefore be amply justified. Unfortunately the powers of the Centre to intervene in the matter are rather limited.

5.6 Impediments to Rationalisation of Entry Taxes

5.6.1 The powers to levy tax on entry of goods into a local area conferred under Entry 52 of the State List rest entirely on the States or the local authorities concerned (where these powers are delegated to them by the States) and it is difficult for the Centre to intervene so long as the States, to all appearances, keep within the parameters of the law, even when the taxes levied in exercise of the said powers transgress the requirements of equity and efficiency in effect.

5.6.2 Moreover, for many years now, several States have been levying octroi or entry taxes which violate inter-State equity as their incidence clearly goes beyond their respective borders and inhibit economic growth (e.g., the octroi on crude oil in Maharashtra, on yarn in Gujarat and jute in West Bengal; and on other declared goods in Madhya Pradesh and Karnataka). Presumably the consent of the Centre was obtained before these taxes were levied. Given this background, it would appear to be discriminatory on the part of the Centre to stop others now from introducing such taxes in their jurisdictions.

5.6.3 Then again, tax exporting has been permitted, even under the Central law governing taxation of inter-State sales, viz., the CST Act whereby tax is allowed to be levied on inter-State sales, subject to a prescribed ceiling. The demand for the introduction of a consignment tax in order to plug the leakage of CST, seems to have found acceptance by the Centre and will constitute tacit approval of the practice of tax exporting in the country.

5.6.4 The levy of a tax on inter-State sales by the State of origin is sometimes justified on the ground that growth of manufacturing is helped by infrastructure set up by the State where the producing unit is located and so, realisation of the cost of providing these services through a tax on the consumers of the product, wherever located, is justified. This is a somewhat specious plea since the growth of manufacturing is beneficial to an economy in myriad ways which serve to raise the level of economic activity and augment the incomes of the exporting locality all round and thus its taxable capacity. That is why no country thinks of levying an export tax on its products except where it has a monopoly of the product in the international market, that is, as a measure to mop up the excess profits of the exporters. "Provider of infrastructure" argument can at best justify levying a mild tax on inter-State sales within a country where levels of industrial development vary widely between regions, but its possible ill effects outweigh the arguments in its favour.

5.6.5 Thus, from all viewpoints, octroi or entry taxes in any form (except as a countervailing measure to equalise the incidence of sales tax within a given jurisdiction) are bad and undesirable. Originally, octroi was envisaged as a purely local tax and as noted by the TEC, to which reference has been made earlier, attempts, though unsuccessful, were made in the past to make them as harmless as possible by localising their incidence. It bears repeating that the octroi was always supposed to be a local tax meant to fall on consumption or use in a local area. Its present use as a device for tax exporting could not have occurred in the olden days when it came into being. It is also pertinent to point out that terminal taxes were thought of as a possible replacement for octroi earlier only as a stop-gap towards the elimination of octroi by resorting to direct taxation like the property tax.

5.6.6 While referring to the possible alternatives to octroi, the TEC thought that one way would be to convert it into a terminal tax operated for conveniently grouped municipalities through the agency of a combined transport system (rail, road, etc.). The other alternative was its conversion into a surcharge on sales tax when the sales tax system was well established and efficiently administered in the generality of States. The TEC thought that these solutions were long-term ones though the latter possibility not so remote. In the four decades that have elapsed since the TEC made these observations, sales tax has struck firm roots in the country, yet no serious thought is given to the question of replacing octroi by a surcharge on sales tax. The very wise recommendation of TEC has thus been almost buried and instead, alternatives are looked for in entry tax in a form which far from localising the incidence serves to widen it to the maximum possible extent.

5.6.7 Ironically, the Centre has been a party to the use of the entry tax in this way by permitting its levy on declared goods and inputs. Entry tax was introduced in West Bengal when the State was under President's rule in the 1960s. It is too late in the day for the Central government now to raise a finger at States which are merely wanting to follow examples already blessed by the Centre.

5.6.8 However, just as two wrongs cannot make one right, it will not be correct to allow wrong practices to continue simply because these have been permitted in the past. Given the compulsions of a federal polity, it is necessary to take a view of the problem of all taxes having inter-State ramifications in their totality, both in terms of equity as also the possible impact on the growth of the economy and arrive at a national consensus. The right course would be to do away with all taxes on the movement of goods within the country, whether inter-State or intra-State, which means that octroi and entry taxes in any form should go except as a countervailing measure to complement sales tax. In principle, CST should also go but since it has already proved a source of sizeable revenue, no State will be willing to give it up. While this reality cannot be ignored, the aim should be to see that its incidence is not allowed to grow. The proposal to have a consignment tax along with CST at a rate of 4 per cent is a totally retrograde step. Though the need for a tax on consignment to plug loopholes in the CST which have been widely exploited, cannot be denied, it is necessary to keep the incidence of both CST and the consignment tax at a modest level.

5.6.9 As for removal of octroi/entry taxes, a prerequisite is a recognition that in either form it is an evil. Only when there is a firm conviction that these are primitive taxes and constitute a drag on development, serious effort will be made to find alternative sources to compensate the local bodies for their loss. A surcharge on sales tax suitably designed so that it falls only on the consumers residing in a local area can be a good substitute. More vigorous efforts towards improving the direct taxes within the competence of the local or State governments, such as the profession and property taxes, could also help bridge the revenue gap which abolition of octroi/entry taxes would cause. It would be an inducement for the removal of these evils if the Centre came forward to make up for a part of the likely revenue loss of the local bodies.

5.6.10 In the last analysis, where there is a will there is a way. It is thus important to build up the necessary will to abolish octroi and entry taxes. The matter is urgent enough to call for a discussion at the NDC or a suitable forum at a high level. Nothing short of that could undo the damage that this form of taxation is doing to the country with no gain to anyone in the long run.

5.6.11 It would however not be correct to ignore the fact that octroi fetches substantial amount of revenue for local authorities. (In Maharashtra, octroi revenue is now touching almost Rs 700 crore). However forceful, no argument is likely to persuade any State government to forgo such a revenue source unless an equally lucrative alternative source is identified. Similarly, sales tax may be objected to unless it is realised only from products consumed by the inhabitants of a given locality which is not simple to ensure. Moreover, any addition to sales tax would not find favour with the States as that would mean reducing their already strained potential further (as argued by Godbole and Valluri in their dissenting note to the Kasbekar Committee Report). One can think of other potential taxable areas like services and of piggy-backing on income tax, at least in big cities like Bombay, Calcutta and Delhi, to compensate for the abolition of octroi/entry taxes. Municipal financing can also turn more towards cost-recovery of services wherever it is possible. All these call for concerted effort by the Centre and the States and even constitutional amendment such as to enable the States to tax services. However, it has to be recognised that the only feasible alternative to octroi now is entry tax, although that is a second best alternative (a very poor second at that). Given this constraint, one has to think of ways in which the structures of entry taxes can be framed on rational lines and the arrangements which would need to be made for the devolution of the revenue from entry taxes if they come to replace octroi. These tasks are taken up in the two chapters that follow.

6. ON DESIGNING ENTRY TAX RATES

6.1 Introduction

6.1.1 There are two principal forms of entry tax - one in lieu of octroi and the other in lieu of sales tax - for which the structure of rates needs to be designed. Given the objective of neutralising inter-State sales tax differentials, the rates of entry tax in lieu of sales tax should be the same as for sales tax. Designing the rates of entry taxes in lieu of octroi constitutes an independent exercise. In this chapter, an attempt has been made to discuss the essential considerations having a bearing on the task of developing norms for fixing entry tax rates.

6.2 Commodity Coverage and Tax Considerations

6.2.1 Experience shows that the commodity coverage of entry tax has depended primarily on considerations of revenue and does not follow any rational principle. (For commodity coverage and rates of tax, see Annexures 1 and 2). Thus one finds a universal tendency to levy entry tax on:

1. Items yielding substantial revenue, such as raw materials and inputs; and
2. Items for which sales tax is precluded or the burden of the tax cannot go beyond a prescribed limit (commonly, 4 per cent).

Thus the commodity coverage of entry tax is different from that of sales tax. However, entry tax has developed on the pattern of sales tax and is administered along with the latter.

6.2.2 If the entry tax has to replace octroi, there being no other suitable alternative, keeping in view the criteria of a good tax discussed in the preceding chapter, it would be desirable to group the commodities under four bands: (i) Essential consumer goods, (ii) Non-essential consumer goods, (iii) Intermediate goods and (iv) Consumer durables. Items of common consumption can be grouped under "essential consumer goods". Category (ii), that is, non-essential consumer goods, would comprise commodities consumed largely by middle and high income classes while articles used in manufacturing and construction would come under "intermediate goods". Commodities which cannot be classified under any of these heads because of their multiple uses would come under the fourth category, that is, "consumer durable-cum-capital goods". Flowing from the general principles of commodity taxation recommended by modern tax theorists, in general, intermediate and capital goods should be either free of tax or taxed at rates lower than those on finished products. Consumer durables and non-essential consumer goods should be taxed at a higher rate than essential consumer goods with a differentially higher rate on consumer durables. This is the pattern of rates suggested in a study on Terminal Tax in Delhi done by the NIPFP (Rao et al., 1986). The only difference in the suggestions made here is that capital goods have been grouped with intermediates. Because of their usually high value and key role in industrialisation, there is no case for taxing capital goods at all.

6.2.3 It should be added, when a State government levies a tax on the commodity base both at the point of entry into a local area and at the point of purchase/sale, one has to look at the options available. If, for instance, retail and wholesale network in respect of a commodity is "informal", or not well organised, a tax on sale of final goods may not be feasible. In that case it would be advisable to tax such commodities at higher rates at the entry point, such as manufacturing or import, leaving subsequent stages tax-free. The same logic would support taxing at full rate the final goods on entering the local market where it is difficult to trace them later. If, however, taxation of final goods in the market is not a difficult proposition, entry taxes should be nominal or zero.[1]

6.2.4 Alignment between taxation of inputs and final goods should not however be undertaken from the viewpoint of a single locality or a State. In other words, taxation of inputs used in the production of goods for inter-State trade should be either avoided or kept at a low level.

6.2.5 Another important point relevant in the context of entry taxation relates to the treatment of declared goods which are subject to a rate limitation and goods subject to additional excise duty in lieu of sales tax. Since these commodities have continued to be taxed under octroi even after they were brought within the discipline of a ceiling on the admissible rate or the levy of additional excise, their additional taxation through entry taxes cannot possibly be objected to, though for reasons set out in the preceding chapter, continuance of this practice is not desirable. However, in view of the reason stated in the earlier chapters that entry taxes tend to distort and enhance inter-State variations in sales tax rates, uniformity in entry tax rates throughout the country has an obvious merit if these taxes are to be retained at all. This argument would apply more forcefully to declared goods and additional excise duty items.

6.2.6 To sum up, while designing entry tax rates it is essential to note that it should, if at all, be used as an instrument to tax articles of final consumption coming into a local area and not as a tax on "imports" into the area as such and that too commodities which are not produced in the local area. In any case the rates of entry tax cannot be set independent of sales tax rates. Further, if it is known that particular inputs are used in the production of goods mainly for exports to other States, taxation of such inputs should be either avoided or rates be kept low.

6.2.7 In designing the structure of entry tax rates, one has therefore to keep the following principles in mind:

1. It should be capable of yielding adequate revenue to compensate for the revenue loss due to octroi abolition, where it replaces octroi.

2. It should not obstruct free flow of trade either between localities or between States.

3. As this tax falls, at present, largely on raw materials and inputs whose taxation results in cascading and associated ill effects, the rates should be so designed as to minimise these costs. This implies concessional treatment of raw material and inputs or better still, their exemption.

4. As entry tax is a close associate of sales tax, it should conform to the principles underlying the latter. This objective can be achieved by entry tax rates that closely correspond to sales tax rate structure.

5. It should not interfere with the policy of having uniform and moderate taxation on declared goods and additional excise duty items. The attempt to use octroi or entry taxes to circumvent the limitations imposed by Parliament or accepted by the States by common consent is most objectionable.

6. It should be easy to administer.

6.2.8 NIPFP studies on octroi[2] in Gujarat (1984) and Rajasthan (1986) had suggested a classification of goods and rates of tax for entry tax purposes, as indicated below.

i. Items of common consumption and basic raw materials - 1%

ii. Other consumer goods, other inputs and capital goods - 2%

iii. Semi-durable goods and items of semi-luxury consumption - 3% and

iv. Durable consumer goods and items of conspicuous consumption - 4%

6.2.9 For revenue-neutral change-over to entry tax, according to estimates made for Maharashtra, it was noted that the rates would have to be 2%, 3%, 4% and 5% respectively (Godbole & Valluri, 1981).

Concluding Remarks

6.3.1 NIPFP studies revealed that the rates of octroi in operation (Terminal tax in the case of Delhi) did not follow any rational pattern. There was considerable scope for reform along the lines suggested above, though it may be reiterated that retention of entry tax is a poor second best answer to the ills of octroi. The right course would be to do away with all taxes which discriminate between local production and imports, whether the tax jurisdiction in question happens to be a country, or a region within a country or a local area.

NOTES

1. It has been shown that if consumption distortions arising from taxation of final goods are small, then optimal tax mix might contain very little import tax on inputs (Corden, 1980, 75-6).

2. Rao, M.Govinda (1984), Entry Tax as an Alternative to Octroi and Rao et al. (1985) Alternatives to Octroi in Rajasthan.

3. Godbole, M.D. & N. Valluri, "Note of dissent" in Report of the Committee on Substitution of Octroi, Government of Maharashtra, October 1987.

ANNEXURE 1 TO CHAPTER 6

Rates of Entry Tax in Karnataka (1989)

Sl. No.	Description of scheduled goods	Rate of tax (%)
(1)	(2)	(3)
1.	All varieties of textiles, namely, cotton, woollen or artificial silk including rayon or nylon and other man-made or synthetic fabrics, manufactured in mills or powerlooms, and hosiery cloth in lengths;	2
2.	All tobacco products like, beedies, cigarettes, cigars, cheroots, snuff, zarda, quimam etc;	2
3.	Sugar other than sugar candy, confectionery and the like;	2
4.	Industrial machinery & parts & accessories thereof;	2
5.	Industrial gases other than LPG;	2
6.	All petroleum products, that is to say, petrol, diesel, crude oil, lubricating oil, transformer oil, brake or clutch fluid, bitumin (asphalt), tar and others but excluding LPG, kerosene and naptha for use in the manufacture of fertilisers;	1
7.	Packing materials, namely,	
	i. Wrapping paper, fibre board cases, paper boxes, folding cartons, paper bags, carrier bags, cardboard boxes, corrugated board boxes and the like;	1
	ii. tin plate containers (cans and boxes), aluminium foil, collapsible tubes, steel and aluminium drums and crates, and the like;	1
	iii. plastic films, bottles, pots (excluding country-made earthen pots) jars, bags and cushioning material, and the like;	1

(1)	(2)	(3)
	iv. wooden boxes, crates, casks and containers and the like;	1
	v. gunny bags, bardan including batars, hessian cloth and the like;	1
	vi. glass bottles, jars and carboys, and the like;	1
8.	All raw materials, component parts and inputs which are used in the manufacture of an intermediate of finished products*;	1
	i. when brought into local area by an industrial unit, or	
	ii. when brought into local areas by any dealer who, after having so brought, sales or supplies the same to an industrial unit located either within the same local area or outside it.	
9.	Coffee	
10.	Tea	
11.	a. Raw cotton b. Cotton yarn, and blended yarn c. Man-made filament yarn, man-made fibre yarn, man-made fibre d. Raw wool, woollen yarn and woollen blended yarn.	

* Raw materials, component parts and any other inputs do not include Iron and Steel, that is to say -

i. pig iron and cast iron including ingot moulds, bottom plates, iron scrap, cast iron scrap, runner scrap and iron skull scrap,

ii. steel semis (ingots, slabs, blooms and billets of all qualities, shapes and sizes),

iii. skelp bars, tin bars, sheet bars, hoe bars and sleeper bars,

iv. steel bars (rounds, rods, squares, flats, octagons and hexagons, plain and ribbed or twisted in coil form as well as straight lengths),

v. steel structurals (angles, joints, channels, tees, sheet piling sections, Z sections or any other rolled sections,

vi. sheets, hoops, strips and skelp, both black and galvanised, hot and cold rolled, plain and corrugated, in all qualities in straight lengths and in coiled form as rolled and in rivetted condition,

vii. plates both plain and chequered in all qualities,

viii. discs, rings, forgings and steel castings,

ix. tool, alloy and special steels of any of the above categories,

x. steel melting scrap in all forms including steel skull, turnings and borings,

xi. steel tubes, both welded and seamless, of all diameters and lengths, including tube fittings,

xii. tin plates both hot dipped and electrolytic and tin free plates,

xiii. fish plate bars, bearing plate bars, crossing sleeper bars, fish plates, bearing plates crossing sleepers and pressed steel sleeper, rails, heavy and light crane rail,

xiv. wheels, tyres, axles and wheel sets,

xv. wire rods and wires-rolled, drawn, galvanised, aluminised, tinned or coated such as by copper,

xvi. defectives, rejects, cuttings or end pieces of any of the above categories.

ANNEXURE 2 TO CHAPTER 6

Rates of Entry Tax in Madhya Pradesh (1989)

Sl. No.	Description of goods	Rate of tax (%)
(1)	(2)	(3)
1.	Coal, including coke in all its forms but excluding charcoal	2.5
2.	Hides and skins whether in a raw or dressed state	0.5
3.	Iron and steel, that is to say -	2.5
	i. pig iron and cast iron including ingot moulds, bottom plates, iron scrap, cast iron scrap, runner scrap and iron skull scrap;	
	ii. steel semis (ingots, slabs, blooms and billets of all qualities, shapes and sizes);	
	iii. skelp bars, tin bars, sheet bars, hoe bars and sleeper bars;	
	iv. steel bars (rounds, rods, squares, flats, octagons and hexagons) plain and ribbed or twisted, in coil form as well as straight lengths;	
	v. steel structurals (angles, joists, channels, tees, sheet piling sections, Z sections or any other rolled sections);	
	vi. sheets, hoops, strips and skelp, both black and galvanised, hot and cold rolled, plain and corrugated in all qualities, in straight lengths and in coiled form, as rolled and in rivetted condition;	
	vii. plates, both plain and chequered in all qualities;	

(1)	(2)	(3)
	viii. discs, rings, forgings and steel castings;	
	ix. tool, alloy and special steels of any of the above categories;	
	x. steel melting scrap in all forms including steel skull, turnings and borings;	
	xi. steel tubes, both welded and seamless, of all diameters and lengths, including tube fittings;	
	xii. tin plates, both hot dipped and electrolytic and in free plates;	
	xiii. fish plate bars, bearing plate bars, crossing sleeper bars, fish plates, bearing plates, crossing sleepers and pressed steel sleepers, rails-heavy and light, crane rails;	
	xiv. wheels, tyres, axles and wheel sets;	
	xv. wire rods and wires-rolled, drawn, galvanised, aluminised, tinned or coated such as by copper;	
	xvi. defectives, cuttings or end pieces of any of the above categories.	
4.	Jute, that is to say, the fibre extracted from plants belonging to the species Corchorus Capsularies and Corchorus Olitoritus and the fibre known as Mesta or Bimli extracted from plants of the species Hibiscus cannabinus and Hibiscus Sabdarifa-Var altissima and fibre known as sunn or sunn hemp extracted from plants of the species Crotalaria Juncea whether baled or otherwise.	0.5
5.	Oilseeds, that is to say -	0.5

(1)	(2)	(3)
	i. Groundnut or peanut (Arachis hypogaea);	
	ii. Seasamum or Til (Seasamum orientale);	
	iii. Cotton seed (Gassypium Spp);	
	iv. Soyabean (Glycine seja);	
	v. Rape seed and mustard -	
	- Toria (brassica Campestris Var Toria);	
	- Rai (Brassica Juncea);	
	- Jamba-Taramira (Eruca Satiya);	
	- Sarson, yellow and brown (Brassica Campestris Var arson);	
	- Banarsi Rai or true mustard (Brassica Nigra);	
	vi. Linseed (Linum Usitatissimum);	
	vii. Castor (Ricinus communis);	
	viii. Coconut (i.e. Copra excluding tender coconuts) (Cocos Nucifera);	
	ix. Sunflower (Helianthus Annus);	
	x. Nigar seed (Guizotia Abyssincia);	
	xi. Neem, Vepa (Azadirachta Indica);	
	xii. Mahua, Illupai, Ippe (Madhuca Indica M. Latifolia. Bassia. Latifolia and Madhuca Longifolia syn. Longifolia);	
	xiii. Karanja, Pongam, Honga (Pongamia Pinnata syn. P. Glabra);	
	xiv. Kusum (Schleichera Oleosa, syn. S. Trijuga);	
	xv. Punna, Undi (Calophyllum Inophyllum);	
	xvi. Kokum (Carcinia Indica);	
	xvii. Sal (Shorea Robusta);	
	xviii. Tung (Alcurites fordi and A. Montana);	
	xix. Red palm (Elacis guinenisis);	

(1)	(2)	(3)
6.	Cotton, that is to say, all kinds of cotton (indigenous or imported) in its unmanufactured state, whether ginned or unginned, baled, pressed or otherwise, but not including cotton waste.	0.25
7.	Cotton yarn but not including cotton yarn waste.	0.5
8.	Cotton fabrics as defined in item No. 19 of the First Schedule to the Central Excise and Salt Act, 1944.	2
9.	Silk fabrics as defined in item 20 and man-made fabrics as defined in item 22 of the First schedule to the Central Excise and Salt Act, 1944 (No. 1 of 1944).	2
10.	Woollen fabrics as defined in item No. 21 of the First schedule to the Central Excise and Salt Act, 1944	2
10-A	Durries other than those woven on handloom.	2.5
11.	Sugar as defined in item No. 1 of the First schedule to the Central Excise Act, 1944	2
12.	i. Cigrettes, cigars and cheroots	3
	ii. All kinds of Bidis, Snuffs and all other kinds of tobacco as defined in item No. 4 of the First schedule to the Central Excise and Salt Act, 1944	2.5
13.	Paddy Oryza Sativa L.)	2.5
14.	i. All kinds of whole pulses whether with or without husk	1
	ii. All kinds of separated pulses	1
15.	Crude oil as specified in clause (ii-c) of section 14 of the Central Sales Tax Act, 1956 (No. 74 of 1956)	2
16.	Fuel-efficient motor cars of engine capacity of 1000 cc or less	6

(1)	(2)	(3)
	i. Motor cars other than those specified in 1 above	9.5
	ii. Trucks and buses including their chassis	3
	iii. Minibuses, pickup vans including their chassis and bodies	11.5
	iv. Motor rickshaws	11
	v. Motorcycle and motor cycle combinations motor scooters, motorettes	14.5
	vi. Three-wheeler tempo	11
17.	Batteries excluding dry cells mentioned in entry 37 of Part III	1.5
18.	Motor cycles and motor cycle combinations, motor scooters, motorettes, autorichshaws and tyres, tubes, spare parts and accessories thereof	1.5
19.	Wireless reception instruments and apparatus, radios and radio gramophones, television, electrical valves, accumulators, amplifiers and loudspeakers and spare parts and accessories thereof	1.5
20.	Refrigerators, deep freezers, air-conditioning plants including air-conditioners, mechanical water coolers, air coolers and components, parts and accessories thereof	1.5
21.	Cinematographic equipment including cameras, projectors and sound recording and reproducing equipment, lenses, films and parts and accessories required for use therewith	1.5
22.	Photographic and other cameras and enlargers, lenses, films, plates, paper and cloth and other parts and accessories required for use thereof	1.5
23.	All arms including rifles, revolvers and pistols and ammunition for the same	1.5
24.	Cigrette cases, holders and lighters	1.5

(1)	(2)	(3)
25.	Dictaphone, tape-recorders including tape for use in connection therewith and other similar apparatus for recording sound and spare parts thereof	1.5
26.	Typewriters, tabulating, calculating, registering, indexing, card punching, franking, addressing and duplicating machines including duplicators and other apparatuses for obtaining duplicate copies, teleprinters and components, parts and accessories of any of them	1.5
27.	Sound transmitting equipment including telephones, microphones and loudspeakers and spare parts thereof	1.5
28.	Gramophones and components and parts thereof and records	1.5
29.	Binoculars, telescope, opera glasses and goggles	1.5
30.	Precious stones, namely, diamonds, emeralds, rubies, real/cultured pearls and sapphires, whether they are sold loose or as forming part of any article in which they are set	1.5
31.	Pile carpets including kalins and galichas	1.5
32.	Furs and skins (other than those of cattle, sheep and goats) and articles of personal or domestic use made therefrom	1.5
33.	Ivory, ivory products, carvings, paintings and curios	1.5
34.	Electroplated articles with gold or silver	1.5
35.	Dyes, paints, varnishes, lacquers, enamels, glue, paint brush, sand paper, turpentine oil and polish excluding dry colours, gulal and shoe polish	1.5
36.	Scents, perfumes, hair tonics, hair creams, hair shampoo, depilatories and cosmetics including face creams, snows, lipsticks, rouge and nail polish	1.5

(1)	(2)	(3)
37.	Saltpetre, gunpowder, potash, other explosives and fireworks including coloured matches	1.5
38.	Vacuum flasks of all kinds including thermos flasks [and parts thereof]	1.5
39.	Sheets, cushions, pillows, mattresses and other articles made of rubber, foam rubber, plastic foam or other synthetic foam or rubberised coir	1.5
40.	i. Petrol	1.5
	ii. Light diesel oil	1.5
	iii. High speed diesel oil	1.5
	iv. Motor spirit other than that mentioned in (i) to (iii) above, aviation spirit and aviation turbine fuel specified in entry 40 of this part and articles specified in entry 41 of this part, entry 33 of part III	1.5
41.	Marble and goods and wares made thereof excluding tiles specified in entry 28 of this Part	1.5
42.	Floor and wall tiles of marble and glazed and vitrum tiles	1.5
43.	Culinary and flavouring essences	1.5
44.	Art paper, lustra cote art paper, sun coat, art card, art board, [ivory card] chromocoated paper, cheque paper, imitation art paper, bible paper and silver coat art paper	1.5
45.	Laminated sheets such as sunmica, formica, etc.	1.5
46.	All clocks, timepieces, watches and parts thereof	1.5
47.	Timber	18
48.	Tendu leaves	1.5
49.	Foreign and Indian made foreign liquor	7.75
50.	Silver ornaments of personal wear	0.5

(1)	(2)	(3)
51.	Gold ornaments of personal wear	0.5
52.	Bullion and specie	0.25
53.	Iron ore[1]	11
54.	Coking coal[1]	5
55.	Bauxite[2]	10
56.	a. Caprolactum	5
	b. Denethyltwphthlate (DMT)	5
	c. Mono Mthylena Glycol (MEG)	5
	d. Titanium-Di-Oxide (TIO)	5
	e. Polyter chips	5
57.	Goods specified in schedule I of the Sales Tax Act, except textile, sugar and tobacco	0
58.	Goods not enumerated in schedules	1

1. In Bhilai-Durg special Industrial area
2. In Korba special Industrial area
3. In all local areas falling within the limits of Ujjain Municipal Corporation

7. DEVOLUTION OF ENTRY TAX PROCEEDS

7.1 Introduction

7.1.1 In the preceding chapters a strong plea has been made for doing away with any form of entry tax whether accounts-based or, as in the case of octroi, checkpost-operated, since these are indefensible legacies of the past. It is however unlikely that this logic will prevail with any State government, given the sizeable revenue which accrues from these taxes to the local authorities. In Maharashtra it fetches at present more than Rs 650 crores a year. Bombay alone gets about a crore every day. Hence, at the most, octroi may be replaced by entry tax. Abolition of octroi however has given rise to apprehensions among local bodies about their cash flow position in the absence of octroi. This explains the strong reservations expressed by the Mayor of Bombay to the recommendation of the majority of Kasbekar Committee for replacing octroi by entry tax in Maharashtra. Experience shows that these fears are not altogether unfounded. It is, therefore, necessary to examine how the local bodies can be compensated when octroi is abolished and entry tax is levied at the State level, as seems to be contemplated in several States.

7.2 Present Position

7.2.1 Commonly, as noted in a preceding chapter, octroi is levied, collected and retained by local bodies except in West Bengal where it is levied and collected by the State government but devolved to local bodies. However, entry tax in lieu of octroi, which has developed as a companion of sales tax in Madhya Pradesh and Karnataka, is levied and collected by the State government, but shared with or devolved to local bodies. Andhra Pradesh entry tax was not a replacement for octroi, hence it is not shared. Entry tax in lieu of sales tax, being a compensatory sales tax, is levied, collected and retained by the State governments.

7.2.2 Thus one finds that while recourse to Entry 52 of the State List has generated entry tax in different forms to serve different purposes, it has also created a fertile ground for State-local fiscal conflict. There is no clear pattern in the matter of the appropriation of the revenue from this tax with each State following the course it finds expedient. It would be helpful if some principles could be evolved in this regard which might be adopted by the States with such variations as might be felt necessary or desirable under the circumstances of each State.

7.3 Existing Devolution Practices

7.3.1 As mentioned already, in three States, viz., Madhya Pradesh, Karnataka, and West Bengal, entry tax in lieu of octroi is levied and collected by the State government but the proceeds are either shared or fully devolved to fiscal bodies. Both in Madhya Pradesh and Karnataka, the objective of devolution has been to compensate local bodies for the revenue lost by them with the abolition of octroi. The forgone octroi revenue is estimated by applying a growth rate to the actual octroi collected in the last year of its operation. The growth rate relied upon for this purpose is an average of the growth rates of past two or three years and growth at the rate of 10 per cent per annum is normally assumed. It was felt that compensation based on this growth rate along with some saving on account of cost of octroi collection would be able to neutralise the loss of octroi revenue. In respect of local bodies which did not have octroi or which came in being after octroi was abolished, compensation was prescribed on a per capita basis.

7.3.2 The adoption of a growth rate of 10 per cent per annum has been a matter of controversy. Some local governments have contended that the actual growth rates should be used in deciding the amount payable to each and not the notional 10 per cent. It is true that the growth rate adopted is generally lower than what was recorded in the past. In Madhya Pradesh growth rate of octroi revenue on a time trend worked out at 28.03 per cent per annum and for Karnataka 18.56 per cent per annum for the periods 1973-76 and 1970-79 respectively (Table 7.1). Data presented in Table 7.2 reveal that in both the States there is a big gap between what local bodies could have collected, i.e., octroi collectible and the compensation payable. It also turns out that entry tax collections never matched octroi collectible. It is, however, pertinent to note that collection of entry tax exceeded the amount of compensation payable to local bodies in Madhya Pradesh. This means that a part of the entry tax revenue is being appropriated by the State government. The picture is different in Karnataka where compensation worked out, exceeded the entry tax collections, indicating that the State government has shouldered the responsibility of compensating the local bodies from its own resources.

7.3.3 The policy governing devolution of entry tax in West Bengal is based on a different footing. Entry tax proceeds under TEGLA, which is about 8-10 per cent of the total entry tax collections is appropriated by the State government. The rest, collected under TEGMA, is devolved to local bodies. As noted in Chapter 2, the prescribed shares for constituent local governments and urban authorities are 50 per cent for CMDA, 25 per cent for Calcutta Municipal Corporation, 17 per cent for other municipalities in CMD and the remaining 8 per cent for other municipalities. These shares have been computed on the basis of the proportion of population of the constituent groups of local bodies in the total. Unlike Madhya Pradesh and Karnataka, in West

Bengal the devolution policy is not compensation-oriented, as entry tax was not a replacement for octroi therein. The other three States, namely, Andhra Pradesh, Maharashtra and Rajasthan do not share with their local bodies the proceeds of the entry tax they levy, the reason presumably being that in these States it was not a replacement for octroi.

7.3.4 To sum up, devolution practices pertaining to entry tax vary across States. It has been devolved to local bodies less than fully in Madhya Pradesh and West Bengal and more than fully in Karnataka. The basis of devolution has been derived from one of the following parameters:

1. Amount needed to compensate for the loss of octroi;
2. Per capita fixed grant;
3. Proportion of local population in the total population.

7.4 Devolution: Case For and Against

7.4.1 Inter-State variations in entry tax devolution policy have an important bearing on State-local fiscal relations. Absence of a devolution policy in some of the States has generated concern among local bodies which are experiencing severe resource crunch. In this background, the central issue is whether it would not be desirable to provide for devolution of entry tax proceeds to local bodies, particularly in Andhra Pradesh, Maharashtra and Rajasthan, where the tax was not a substitute for octroi.

7.4.2 Non-shareability or non-devolution of entry tax of Andhra Pradesh variety can be justified if octroi and entry tax co-exist, that is, entry 52 can serve as a source of both State and local government finance and both can levy entry tax or octroi regardless of overlap.

7.4.3 Also the revenue from entry tax can legitimately be retained wholly by the State government when it is realised from the items under additional excise duties, viz., textiles, tobacco and sugar as in the case of AP.

7.4.4 The rationale for not allowing any devolution of entry tax in Andhra Pradesh is the absence of octroi or any such levy earlier. Since both octroi and entry tax derive their constitutional sanction from Entry 52 of the State List, the pertinent question is, are the two mutually exclusive, i.e., does the levy of one preclude that of the other? Since both are levies on goods entering into a local area for consumption, use or sale therein, they cannot possibly exist together as this would amount to double taxation of the same tax base by a single taxing authority. Overlap of tax powers, i.e., use of a given tax base even by more than one taxing authority as far as possible has been avoided in the Constitution, though this is a moot point. (Supreme Court has held that the profession tax can be levied by both the State as well as local governments).

7.4.5 It has been argued by the State governments that entry tax has been introduced to counter the erosion of sales tax revenue due to Central government interference through additional excise duties and rate limitation on declared goods. It is also contended that the growth of additional excise duty in lieu of sales tax on sugar, textile and tobacco has not kept pace with the growth of sales tax or Union excise duty. The State governments would, perhaps, have raised more than what is being collected as additional excise duty had these commodities continued in the sales tax net. Similarly, several State governments feel that a ceiling rate of 4 per cent on declared goods has constrained the growth of their sales tax revenues. Opinions would of course differ about the validity of these arguments - for, as pointed out elsewhere in this report, if the tax rental arrangement agreed upon by the States, in respect of the three commodities in question, is not acceptable any longer, the right course would be to abrogate that agreement openly instead of flouting it by using the powers of entry tax. It is difficult to see the merit of the argument that entry tax realised from additional excise duty items can be treated as additional sales tax revenue to be appropriated by the State government and therefore does not call for any sharing with local authorities. Going by the history and the spirit of the constitutional provision which authorises the levy, it would appear that taxes levied under this head belong to the sphere of local governments and the proceeds ought to be devolved to them, no matter by which level of government the tax is collected.

7.4.6 Moreover, by and large, the State governments have assigned taxes like octroi to local bodies. Entry tax as a substitute for octroi is in vogue in Madhya Pradesh and Karnataka which apparently induced other States too, particularly Maharashtra and Gujarat, to think of it as a substitute for octroi. Most of the entry tax revenue has been used to compensate local bodies for the loss of octroi revenue. This goes to show that Entry 52 has been a source of local government finances and was not meant to serve as a revenue source for the State governments.

7.4.7 It follows that entry tax, so long as it is levied, whether in replacement of octroi or <u>ab initio</u> as a new tax as in Andhra Pradesh, is a tax which is a close variant of octroi and its proceeds should always be shared with or devolved to local bodies. One can evolve a sensible formula based on the needs of the local bodies determined normatively or simply on the basis of population. The devolution and sharing arrangements already in vogue in States like West Bengal can serve as a model.

7.5 Entry Tax in Lieu of Sales Tax

7.5.1 Let us now take up the question of devolution of entry tax in lieu of sales tax and assume that Entry 52 can be used by the State governments provided it does not constrain current and potential tax-raising capacity of local governments. One view can be that since sales tax rate differentials do influence trade flows, particularly flight of business to low sales tax areas, the State governments' objective of safeguarding their revenue can be achieved by minimising the tax rate differences. Rate differentials can be eliminated either by reducing sales tax rates to the levels prevailing in adjoining States or by introducing an equivalent entry tax in lieu of sales tax. Undercutting of sales tax rates to maintain parity with adjoining States seems to be one solution. But when the goods involved are items like motor vehicles, this strategy could be questioned as unsound and inequitous especially if commodities like foodgrains are subjected to sales tax. Further, in this solution, States would have to lose sizeable amount of revenue due to lower tax rates in other States. This is also likely to introduce an element of uncertainty in rates because of competitive rate cutting.

7.5.2 An alternative to the strategy of undercutting of tax rates is to introduce an equaliser, i.e., taxing out-of-State purchases at a rate applicable to in-State purchases. This precisely is what has been resorted to in Madhya Pradesh, Maharashtra and Rajasthan. This strategy can succeed especially in the case of automobiles since out-of-State purchases in the case of motor vehicles can be policed through automobile registration. Of the two methods, one would justify entry tax in lieu of sales tax on the ground that it does not involve undercutting of sales tax rate on motor vehicles and at the same time accomplishes the objective of checking diversion of business.

7.5.3 Again, it does not preclude the levy of octroi by local bodies. In Maharashtra and Rajasthan, even after the introduction of entry tax in lieu of sales tax, local bodies continue to collect octroi. Out-of-State purchases of automobiles entering into a local area for consumption, use or sale therein have to pay Central sales tax to the exporting State and octroi to the local body in the importing State along with the entry tax in lieu of sales tax equal to the difference between the tax which could be payable if bought locally and the tax paid to the State where the item is purchased.

7.5.4 In Madhya Pradesh, the picture is slightly different. As there is no octroi, there is no tax payable to local bodies separately because entry tax in lieu of octroi and entry tax in lieu of sales tax have got integrated and is governed by a single legislation. Thus entry tax in lieu of sales tax does not preclude the levy of octroi/entry tax in lieu of octroi.

7.5.5 The above discussion clearly brings out that entry taxes in lieu of sales tax as they operate at present are more in the nature of sales tax. Given this fact, there is no prima facie case for the proceeds of this tax to be shared with or devolved to local bodies.

7.5.6 In this context, it may be pertinent to note that the magnitude of funds to be devolved to local bodies in a State would depend on two things: (1) tax rental arrangement between local and State governments as, for instance, the system followed in the case of entry tax in lieu of octroi in Madhya Pradesh and Karnataka and (2) the State government's general tax devolution policy. In practice the latter may be found to be a more important source of flow of funds to local bodies. Depending on a particular State's devolution policy, even taxes which are not earmarked for local bodies with any tax rental arrangement such as entertainment tax in Andhra Pradesh, may be passed on to the extent of 90 per cent of collection. These practices differ from one State to another having a bearing on the devolution status of a tax. Thus entry tax in lieu of sales tax, though a State tax, goes into the divisible pool in Madhya Pradesh while it is not the case in the other States which levy such a tax.

7.5.7 On balance it is fair to say that devolution of entry tax in lieu of sales tax may be discretionary on the part of the State governments. However, it should be obligatory on their part to devolve the proceeds of entry tax in lieu of octroi. This brings us to the question, how the proceeds from the tax should be devolved to local bodies so as to avoid State-local fiscal conflict.

7.6 Revenue from Entry Tax in Place of Octroi: Basis of Devolution

7.6.1 In general, there can be two approaches to distribution of the proceeds of a tax among local bodies; (i) return to a locality what is its due and (ii) use devolution policy as an instrument of reducing inter-locality fiscal disparities. In view of the fact that inter-locality fiscal disparities are glaring, the latter approach to devolution has an appeal on equity grounds. In this approach, in order to work out the share of each locality in total tax yield, an assessment of fiscal needs and fiscal capacity of each locality would be needed. This however calls for exercises for which the requirement of data would be daunting. For instance, it will require data on domestic products for each location and potential tax bases of important local taxes such as property tax. Information on these variables is not available and it is a stupendous task to estimate them.

7.6.2 `Return to a locality what is its due´ seems to be the only practicable alternative. This approach assumes greater significance particularly in a situation where one local level tax has been substituted by another tax levied by the State government. A locality's due out of a given tax can be approximated basically in two ways: (i) an amount which it would have collected had the old tax, e.g., octroi, continued to be levied, designated hereafter as local octroi collectible and (ii) an amount which the locality collects from the substitute tax, i.e., entry tax collection. The first, however, seems to be fairer. The latter may not prove to be revenue neutral, if entry tax in lieu of octroi is not equally productive.

7.6.3 Octroi collectible in a locality for any year can be determined by applying historical growth rate to the previous year's actual octroi collections. Growth rates can be determined either by time trend or the buoyancy measure of the tax with respect to a variable like per capita income. It has been noted earlier that both Madhya Pradesh and Karnataka employ growth rate based on time trend for determining octroi collectible. This method, however, suffers from two limitations. First, local shares in total tax yield are quite sensitive to numerical values of growth rate employed. The longer the period for which growth rates are computed, the more stable are their values. However, in practice, only two or three years´ collection figures are used to compute growth rate. Local shares are found to be constrained in some years by not allowing for any growth in collection. This trend has also been observed in respect of other taxes such as entertainment tax and motor vehicles tax which constituted the divisible pool in some States (See Government of Karnataka, 1985, 52-7). Hence past growth may not provide a fair basis for consumption or devolution.

7.6.4 Another point to note is that there is a tendency in taxes to stick where they are collected (Bahl and Nath, 1986, 405-18). State-local fiscal scene has witnessed disturbing trends in terms of a tussle between State and local governments for numerical value of growth rate to be used. Local authorities have invariably complained that lower growth rates have been adopted while determining octroi collectible. Studies have also substantiated this viewpoint (See for instance, Nath and Purohit, 1989, 56-70). The second limitation of time trend method is that there is an implicit assumption that tax collection is basically a function of time and there is no relationship between the growth rate in tax revenues and growth in economic activity which determines taxable capacity.

7.6.5 Recognising that revenue yield results from an application of given rates to some tax base and the tax base depends on the level of economic activity, represented by income level, using a buoyancy measure might be more rational. This method utilises the historical relationship between actual tax collections and income and the growth of income in the future. The projection, however, would involve the assumption that all discretionary tax changes, which occurred during the estimation period, would be replicated and would have the same effect over the period for which forecasting is contemplated.

7.6.6 Choosing between the two methods is not easy. Time trend growth method is widely used in short-term and medium-term forecasting. However, as income buoyancy method utilises the rate-base-income relationship in revenue forecasting, it seems to provide a superior basis. Coming to the validity of the assumption regarding the impact of discretionary tax changes in estimation period for the forecast period, it may be noted that the octroi structure did not undergo any drastic change during the decade preceding the year of its abolition. In the absence of locality-wise income (domestic product) estimates, the base of octroi, i.e., figures of assessment at the checkposts can be used to estimate buoyancy of octroi with respect to base. The use of the latter to determine growth rate would, however, require an additional assumption, that income changes are reflected in the base figures accurately and pari passu, i.e., if income changes by one per cent, base also changes by one per cent. In view of the fact that octroi records have not been maintained properly, this method also may not seem feasible in practice. Entry tax base figures, i.e., assessed taxable turnover of dealers on account of imports into a locality, as an alternative, may not be acceptable for the simple reason that commodity coverage of octroi used to be much larger than that of entry tax. The coverage of the latter is restricted mainly to additional excise duty items and declared goods comprising essential raw materials. The base of entry tax, therefore, cannot be taken to represent the totality of trade flows into a locality.

7.6.7 In the light of the above discussion, use of growth rates computed as time trend seems to be the only feasible alternative as the basis for devolution. However, growth rates should be calculated on the basis of at least 10 years' tax collection figures. It can be computed as compound growth rate which utilises all the observations and not only the base year and terminal year figures. For those localities which did not have octroi or which came into being after octroi was abolished, octroi collectible can be approximated by the share of local population in the total population of the State or part of the State which constitutes octroi jurisdiction, whichever is relevant.

7.6.8 For an entry tax of the kind levied in Andhra Pradesh, the method of devolution discussed above will not be feasible as there was no octroi in that State earlier. For that matter the above method will not be practicable in any other State where octroi has not been levied at all in the past. In such cases, devolution can be allowed on the basis of "collection", that is, each locality will get the tax collected from that locality. This basis can be justified on the ground that given the tax rate, the collections from goods specified in the tax legislation may represent the actual flow of taxable goods into the locality. To be specific, in Andhra Pradesh each locality would get its share in the proceeds of entry tax from textiles, sugar and tobacco, in proportion of what is collected in that locality. While using collections as the basis for devolution, it may be important to note that collection should be measured in terms of collection out of current demand only. Figures on collections generally show an erratic trend, depending on the speed of disposal of tax cases with the courts, etc. Current collections locality-wise, net of refunds on account of exports of goods imported into a locality, should thus constitute the basis of devolution.

7.6.9 In sum, except in cases where it is levied in lieu of sales tax, revenue from entry tax ought to be devolved to local bodies. Where the tax is used as a replacement for octroi, historical growth rates derived from a relatively long series should provide the basis for devolution. In other cases, it can be made on the basis of collection.

TABLE 7.1

Growth Rates of Octroi for Revenue Projection

Municipal Corporation/ State	Time trend (compound growth rate) per cent per annum	Buoyancy with respect to SDP
Madhya Pradesh	28.03 (73-76)	2.4874 (73-79)
Bhopal	27.22 (67-76)	
Indore	12.52 (60-76)	
Raipur	14.30 (67-76)	
Gwalior	16.61 (60-76)	
Jabalpur	10.28 (60-76)	
Ujjain	11.39 (60-76)	
Karnataka	18.56 (70-79)	1.2879 (70-79)
Bangalore	16.03 (60-79)	
Dharwar	16.34 (61-79)	

Note: Figures within parentheses indicate period.

Source: Nath & Purohit (1989), p. 71.

TABLE 7.2

Entry Tax, Octroi Collectible and Compensation to Local Bodies

(Rs. lakh)

Year	Madhya Pradesh			Karnataka		
	Entry tax	Octroi[1] collec-tible	Compen-sation	Entry tax	Octroi collec-tible	Compen sation
1976-77	891.00	2337.81	1506.70	-	-	-
1977-78	1148.00	2993.07	2143.96	-	-	-
1978-79	1643.00	3831.99	2262.70	-	-	-
1979-80	1889.00	4906.05	2488.97	6.00	2747.68	2433.49
1980-81	2396.00	6281.16	2780.00	42.00	3251.67	2555.08
1981-82	3090.00	8041.70	3001.95	518.87	3862.31	2682.83
1982-83	3657.00	10295.69	3790.76	1110.06	4579.18	2951.12
1983-84	4038.00	13181.45	3740.00	1116.34	5429.11	3246.23
1984-85	4907.00	16876.66	4114.00	1723.63	6436.78	3570.85
1985-86	6499.74	21606.22	4525.00	2681.00	7631.49	3927.94
1986-87	6740.21	27662.19	4977.94	3158.00	9047.95	4320.75

Notes: 1. Based on time trend growth.
2. Provisional.

Original Source: 1. State Sales Tax Departments.
2. Computed.

Source: Nath & Purohit (1989).

8. CONCLUSIONS AND RECOMMENDATIONS

8.1 Forms of Entry Tax

8.1.1 The power to levy octroi or entry tax is derived from entry 52 of the State List in the Indian Constitution, which reads "taxes on the entry of goods into a local area for consumption, use or sale therein". Two other entries in the Constitution authorise levy of taxes on the movement of tradeables within the country in the form of terminal tax (entry 56 of the State list and entry 89 of Union list). But the taxes on the movement of goods effectively in operation are octroi and entry tax.

8.1.2 Octroi and entry tax in lieu of octroi are the more common forms of tax on entry of goods into a local area. Both the taxes are similar in character, the main difference being that octroi is operated through checkposts while entry tax is assessed on the basis of accounts. Also, whereas octroi is levied and retained by the local bodies, entry tax in lieu of octroi is a State levy, administered and collected along with the State sales tax. But its proceeds are passed on to local bodies to compensate them for the loss of octroi where it happens to replace the latter.

8.1.3 There are three principal system of entry tax in lieu of octroi as illustrated by the entry taxes of Madhya Pradesh, Karnataka and Andhra Pradesh. In Madhya Pradesh, the tax is applicable to all local areas while in Karnataka it is applicable only to entry of goods into urban local areas. In M.P. entry tax is levied on fresh entry only, but in Karnataka it is a multipoint tax. Andhra Pradesh entry tax follows the Karnataka pattern but is confined to only three commodities, namely, textiles, tobacco and sugar.

8.1.4 Recently entry tax has been levied in lieu of sales tax (e.g., in Maharashtra and Rajasthan). So far it has been confined to motor vehicles purchased outside a given State and brought into the State for the use or sale therein and required to be registered under the Indian Motor Vehicles Act. It seeks mainly to compensate for the loss of sales tax revenue to a State caused by trade diversion attributable to inter-State rate differential in sales tax. This tax is levied independently of octroi/entry tax which is payable otherwise. Accordingly the proceeds of this tax are not shared with local bodies.

8.1.5 The structure of entry tax, commodity coverage and rates differ from State to State and so does the system of compensatory grant to local bodies where it has replaced octroi.

8.1.6 In Madhya Pradesh, the rates range from 0.25 per cent to over 14 per cent. Inputs are taxed at a concessional rate of 0.5 per cent but certain inputs like iron ore, coking coal and bauxite entering into Bhilai and Korba Industrial Special Development Area are taxed at 5 and 10 per cent rates respectively. Deduction is allowed for goods sent out of the State within six months.

8.1.7 In Karnataka, the commodity coverage of the entry tax has undergone changes from time to time. Commodities subject to tax comprise those bearing additional excise duty in lieu of sales tax, "declared goods", raw materials and inputs. The rates are 1 and 2 per cent.

8.1.8 In Andhra Pradesh, the tax is levied only on the three additional excise duty items at rates varying from 1 to 4 per cent.

8.1.9 As regards appropriation of proceeds, in Madhya Pradesh, the local bodies which used to levy octroi are compensated with a grant on the basis of their last collection (i.e., in 1975-76) with a growth factor of 10 per cent per annum. For others, compensation is given at a stipulated rate per capita for the population of each locality. The same basis in principle is followed in Karnataka. In Andhra Pradesh, where there was no octroi in the past, the revenue from entry tax is appropriated entirely by the State government.

8.2 Impact on Trade

8.2.1 Octroi/entry tax does not discriminate between goods produced in the State and those brought from outside. However, inter-State variation in the rates of entry tax in lieu of octroi can cause variations in prices across States, affecting thereby the flow of goods from one State to another. In the case of cement variations in entry tax are found to interfere with inter-State price structure and the policy of uniform cement pricing. However, cement despatches do not appear to be sensitive to price.

8.2.2 Entry tax in lieu of sales tax, however, serves to eliminate local distortions attributable to rate war in sales taxation. Flight of business in motor vehicles from high taxed States to zero or low taxed States has been checked by such taxes.

8.3 Constitutional Validity

8.3.1 Courts in general have not found anything objectionable in the operation of checkposts and the collection of octroi or for that matter entry tax in lieu of octroi as barriers to trade. Since in an octroi/ entry tax regime, entry of goods into a locality both from localities within the State and also from those outside is subject to the same tax, the levy appears to be within the constitutional parameters. As regards entry tax in lieu of sales tax, it also seems to meet the requirements laid down by the Constitution in that goods imported into a locality from another State are in effect taxed at the same rate which is charged on goods purchased within the imported State. Levy of a tax like this also does not appear to offend the spirit of constitutional provisions as it treats out-of State purchases and in-State purchases on equal footing. In fact, such a levy should be welcome as it serves as a check on the attempt by traders to secure undue advantage through arbitrage by exploiting inter-State variations in tax rates.

8.3.2 Judicial rulings in the United States upholding the validity of "use tax" levied by the States sales tax jurisdictions to counter diversion of trade and safeguard revenue lends support for this view.

8.4 Entry Tax as an Alternative to Octroi

8.4.1 Entry tax is often thought to be an acceptable alternative to octroi. Judged by the criteria of equity, efficiency and administrative ease, neither octroi nor entry tax can be regarded as good taxes. While local taxes cannot be expected to serve the objective of achieving vertical equity through progressive rates because of the likely flight of capital and labour, octroi and entry taxes offend equity by violating the principle of taxation by destination. They afford opportunities for tax exporting through taxation of vital inputs like crude oil and iron ore.

8.4.2 In a federal State, the compulsion to follow the principle of destination in taxation is predicated not by any moral or ethical consideration but arises simply from the fact that in the absence of a convention to avoid tax exporting, retaliation may follow leading to a chaotic situation and no gain to any State or accretion of revenue to relatively advanced States at the cost of backward ones, thereby affecting inter-State harmony. Attempts to export taxes by taxing inputs also affects the criterion of efficiency, which in any case is violated when goods imported into a locality suffer taxation while those produced within its borders are not required to pay it. Such a tax impedes growth by thwarting competition. The move towards a unified market in Europe by 1992 by removing fiscal frontiers between independent countries rests on the recognition of the merit of competition and free markets as a promoter of economic efficiency and growth. Entry tax levied in an industrially advanced municipal area also tends to hinder dispersion of industries by providing protection to industries located within that area. For less advanced localities such protection might have a beneficial effect but the key to the development of such areas lies in development of infrastructure rather than fiscal protection of local industries.

8.4.3 Considering its negative equity and efficiency features octroi or entry taxes in any form (except as a countervailing measure to equalise the incidence of sales tax within a given jurisidiction) cannot but be regarded as bad and undesirable. Octroi is supposed to be a local tax to fall on consumption or use in a local area and not meant to be used for "tax exporting". Given the manner in which octroi and entry taxes are being used, the right course would be to do away with both except as a countervailing measure to complement sales tax.

8.4.4 A surcharge on sales tax suitably designed so that it falls only on consumers residing in a local area can be a good substitute. More vigorous efforts towards improving taxes like the profession tax and property tax could help to compensate the local authorities for the revenue loss which might be caused by the abolition of octroi and entry taxes. The Centre should also come forward to make up for part of the revenue loss of the States or local bodies which might occur if octroi and entry taxes were abolished. Consideration may be given to widening the tax base to cover services and piggy backing on income tax at least in big cities like Bombay, Calcutta and Delhi. For this purpose, concerted effort by the Centre and the States and constitutional amendment would be needed. Municipal services financing can also move towards cost-recovery of services wherever possible. Pending radical reform, attempt should be made to rationalise the structure of entry tax which may be levied in lieu of octroi and evolve a suitable mechanism for devolution of the entry tax revenue from the State governments to local bodies.

8.5 Norms for Rate Structure of Entry Tax in Lieu of Octroi

8.5.1 Declared goods for which there is a ceiling leviable by the States and goods subject to additional excise duty in lieu of sales tax are often taxed under octroi. Therefore, levy of entry tax as these commodities cannot possibly be objected to. However, since levies such as octroi/entry tax tend to distort and enhance inter-State variations in the incidence of tax, there is a case for their elimination. If, however, they have to be retained at all, uniformity in their rates throughout the country and some moderation in their levels is desirable.

8.5.2 While designing entry tax rates, it should be borne in mind that it should, if at all, be used as an instrument to tax articles of final consumption coming into a local area and not as a tax on "imports" into the area as such and that too commodities which are not produced in the local area. In any case the rates of entry tax cannot be set independently of sales tax rates. Further, if it is known that particular inputs are used in the production of goods mainly for exports to other States, taxation of such inputs should be either avoided or their rates kept low. Raw materials and inputs should be treated preferentially or exempted altogether. Even neutrality can be achieved if the entry tax is levied at the following rates:

i. Items of commercial consumption and basic raw materials - 2 per cent

ii. Other consumer goods, other inputs and capital goods - 3 per cent

iii. Semi-durable goods and items of semi-luxury consumption - 4 per cent

iv. Durable consumer goods and items of conspicuous consumption - 5 per cent.

8.6 Devolution of Entry Tax Revenue

8.6.1 In general, there can be two approaches to distribution of the proceeds of a tax among local bodies; (i) returning to a locality what is its due and (ii) using devolution policy as an instrument of reducing inter-locality fiscal disparities. In view of the acute inter-locality fiscal disparities often observed, the latter approach has an appeal on equity grounds. This, however, calls for exercises for which the requirement of data would be difficult to meet. `Return to a locality what is its due´ thus seems to be the only practicable alternative. This approach assumes greater significance particularly in a situation where one local level tax has been substituted by another tax levied by the State government.

8.6.2 A locality´s due in a tax can be approximated basically in two ways: (i) by estimating the amount which it would have collected had the old tax, namely, octroi continued to be levied; and (ii) passing on to the local government what is collected out of the substitute i.e., entry tax from the locality in question. The first, however, seems to be the proper course, particularly when entry tax in lieu of octroi is not revenue netural.

8.6.3 For an entry tax of the kind levied in Andhra Pradesh where there was no octroi previously, devolution has to be allowed on the basis of "collection", that is, each locality will get what is collected in that locality. While using collection as a basis of devolution, it may be important to note that collection should be measured in terms of collection out of current demand only. Current collection locality-wise, net of refunds on account of exports of goods imported into a locality, should thus constitute the basis of devolution.

8.6.4 Entry tax in lieu of sales tax, though a State tax, goes into the divisible pool in Madhya Pradesh while it is not the case in other States which levy such a tax. Two different treatments create confusion. It would be advisable to adopt two separate legislations - one for entry tax in lieu of octroi and the other for entry tax in lieu of sales tax.

8.6.5 On balance it is fair to say that devolution of entry tax in lieu of sales tax may be discretionary on the part of the State governments. However, it should be obligatory on their part to devolve the proceeds of entry tax in lieu of octroi.

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