REPORT ON
REFORM OF INTER-STATE TAXATION IN INDIA

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Preface

Almost no country taxes its exports to other countries. Similarly, in most federations there is no taxation of inter-jurisdictional transactions. But, states in India collect taxes on sales to other states in the form of Central Sales Tax or CST. CST acts as a barrier to trade within the country. It creates an anomalous situation where an Indian in Bhagalpur can bring in goods from Brussels or Bikrampur without paying any taxes to the Belgian or Bangladesh Government, but has to pay taxes to. for example, the Maharashtra Government if it brings the same goods from Belgaum. Furthermore, CST violates the principle of `no taxation without representation'.

The compelling arguments for abolition of CST become even more pressing in the context of the November 16, 1999 decision of the Chief Ministers and Finance Ministers of all the States/Union Territories to introduce the Value Added Tax (VAT) in place of sales tax from April 1, 2001. VAT will involve providing set off for all input taxes. To be consistent with VAT, states will find it difficult to provide credit for taxes paid on inputs bought from other states without some complicated clearing house mechanism, which even the European Union has found it difficult to implement.

Abolition of CST. however, involves two difficulties. First, the states are in fiscal distress, particularly after the implementation of revised pay scales from 1996. Revenue loss, if any, on account of CST abolition will complicate the management of state finances. Second, there is the question of tax evasion. Without any tax on inter-state sale, there will be added incentive to pass off even intra-state sale as an inter-state one. The issue of CST, furthermore, is inextricably linked with the question of consignment tax and declared goods, and for revenue reasons, also with service tax and other measures.

In the Conference of Chief Ministers and Finance Ministers of all the States/Union Territories held on November 16, 1999, it was unanimously decided that rationalisation of CST needs further technical study as it is linked with widening of tax base of states and with service tax, consignment tax and declared goods. In pursuance of this Resolution, the Government of India entrusted a study of Inter-State Sales Taxation in India. This study report is the outcome of this assignment. The Governing Body of the Institute does not bear any responsibility for the contents and views expressed in the study.

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Reform of Inter-State Sales Taxation in India

1. Introduction

The taxation of inter-state trade in the form of CST is inconsistent with the principle of VAT. It is an economically irrational and harmful tax as (a) it acts as a barrier to trade; (b) it leads to cascading and escalation of costs; (c) being based on the origin principle it leads to tax exportation from one state to the other states and (d) it leads to economic distortions such as vertical integration.

2. Evolution of Tax on Inter-State Sales

Historically, the 1950 Constitution empowered states to levy "taxes on the sale or purchase of goods other than newspapers[1]". It did not provide for the levy of tax on inter-state sales[2] and placed the regulation of inter-state trade and commerce in the hands of the Union government[3]. Article 286, as originally provided, read as follows:

> "(1) No law of a state shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place –
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> (a) outside the state; or
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> (b) in the course of the import of the goods into, or export of the goods out of, the territory of India.
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> *Explanation:*
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> For the purpose of sub-clause (a), a sale or purchase shall be deemed to have taken place in the state in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of consumption in that state, notwithstanding the fact that under the general

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1. Government of India (1999), *The Constitution of India*, Entry 54 of List II, Ministry of Law, Justice and Company Affairs, New Delhi.
2. It was not provided in the Government of India Act 1935 as well.
3. Government of India (1999), *The Constitution of India*, *op.cit*, Seventh Schedule, Union List, item 42.

law relating to the sale of goods the property in the goods has by reason of such sale or purchase passed in another state.

(2) Except in so far as Parliament may by law otherwise provide. no law of a state shall impose, or otherwise authorise the imposition of, a tax on the sale or purchase of any goods where such sale or purchase takes place in the course of inter-state trade or commerce. Provided that the President may by order direct that any tax on the sale or purchase of goods which was being lawfully levied by the government of any state immediately before the commencement of this Constitution shall, notwithstanding that the imposition of such tax is contrary to the provisions of this clause, continue to be levied until the 31st day of March, 1951.

(3) No law made by the Legislature of a state imposing, or authorising the imposition of, a tax on the sale or purchase of any such goods as have been declared by Parliament by law to be essential for the life of the community shall have effect unless it has been reserved for the consideration of the President and has received his assent".

The meaning and the import of the above article was not in itself absolutely clear. The *Explanation* attached to Article 286(1) as well as clause (2) came for decision by the Supreme Court in *State of Bombay Vs. United Motors*[4]. On March 30, 1953 the court held that the *Explanation* provided that the state in which the goods sold or purchased and actually delivered for consumption therein is the state in which the sale or purchase is to be considered to have taken place notwithstanding the fact that the property in such goods passed in another state. According to the *Explanation,* if the goods are actually delivered in the taxing state. as a direct result of a sale or purchase, for the purpose of consumption therein, then such sale or purchase shall be deemed to have taken place inside the state and outside all other states. The latter are prohibited from taxing such sale or purchase; the former alone is left free to do so.

The above judicial interpretation of the *Explanation* attached to Article 286 led to certain difficulties for trade and to the assessment and collection of tax

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[4] State of Bombay vs. United Motors (I) Limited (1953), SCR 1069 (SC).

from non-resident dealers. The taxing authorities of the State in which the goods were delivered for consumption started calling upon the non-resident dealers to file returns, produce accounts, get themselves registered and comply with the demands of tax. Dealers in Calcutta, for example, were summoned to produce their accounts before the taxing authorities in different states and be subject to the provisions of the sales tax laws of Maharashtra, Tamil Nadu, Kerala and other states.

In view of the problems faced by the dealers in different states and the uncertainty about which state should tax a given transaction, the matter was referred to the Taxation Enquiry Commission (TEC). The TEC (1953-54) in this context, pointed out that the Constitution, as originally framed, implied that the sales tax should be levied by the consuming state[5]. The sales tax in its view was a destination-based tax on consumption to be levied by the state where consumption takes place. The TEC, however, differed from this view and expressed the opinion that the exporting state could claim a small share of the tax. which should be determined by the Union government. Hence the TEC suggested amendment of the Constitution to enable the Union government to impose sales tax on inter-state trade. It recommended that the proposed central legislation would specify the (maximum) rate at which tax on inter-state sale should be levied. The intention of the TEC in permitting the levy of sales tax on inter-state trade was to ensure that some revenue accrues to the exporting states. At the same time it should not unduly burden the consumers in the importing state.

The TEC had expressed the view that while the exporting state could claim a small share of tax on the commodity exported to another state, the prime tax space should be occupied by the state where consumption takes place. The TEC, therefore, suggested a maximum rate of one percent on inter-state sales. In addition, it prescribed specific conditions for the levy of tax on goods of special importance in inter-state trade (namely one stage taxation by exporting state and no further taxation on it by importing state) and recommended a maximum of 1½ percent tax on all such goods[6].

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5 Government of India (1953-54). *Taxation Enquiry Commission, Vol. III*, New Delhi. Ch. 4, p. 49.

6 *Ibid*, Vol. III, Chap. 4, p. 59.

The view of the TEC that the exporting state could claim a share of the tax on a commodity is in conflict with the modern theory of taxation for common markets. The view adopted by the fathers of the Constitution, on the contrary, is consistent with the modern view. However, it is important to note that the TEC did stress the need to limit the rate of inter-state sales tax to one percent.

On September 6, 1955 the Supreme Court in a majority decision in *Bengal Immunity Co. Ltd. Vs The State of Bihar*[7], over-ruled its earlier decision in the *United Motors case.* According to the majority opinion (it was held that)

> "Until Parliament by law made in exercise of the powers vested in it by clause (2) provides otherwise, no State can impose or authorise the imposition of any tax on sales or purchases of goods when such sales or purchases take place in the course of inter-state trade or commerce."

This decision had the effect of invalidating assessments made by sales tax authorities in respect of sales that took place in the course of inter-state trade, following the earlier decision in the *United Motors case,* requiring refund of taxes so collected. To get over the effect of this decision and with a view to bringing about economic stability in the states, the President promulgated on January 30, 1956, the Sales Tax Laws Validation Ordinance 1956[8]. The effect of the Ordinance was to legalise the taxes collected by the various states during the period April 1, 1951 to September 6, 1955. The validity of the Ordinance and the Validation Act was challenged and eventually the Supreme Court gave an authoritative interpretation[9]. The net resultant position was that while intra-state sales could all along be taxed under the relevant state law, inter-state sales made only up to 6th September, 1955 could be so taxed by the state of delivery-cum-consumption. Inter-state sales made after that date could neither be taxed by the state of dispatch nor by the state of delivery, "till Parliament may by law otherwise provide".

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7 (1995) 2, SCR, 603.

8 Ordinance No. 3 of 1956, whose provisions were later enacted in the Sales Tax Laws Validation Act, 1956 (Central Act No. 7 of 1956). This received the assent of the President on March 21, 1956.

9 Vide Sundararamier & Co. and others vs. The State of Andhra Pradesh and another (1958 S.C.R. 1422, 1958 S.C.J. 459 = A.I.R. 1958 S.C. 488 = 1958 S.C.A. 492 = 1 M.L.J. (S.C.) 179 = 9 S.T.C.

In this context, keeping in view the recommendations of TEC for certain modifications in the provisions of the Constitution, the Constitution (Sixth Amendment) Act, 1956[10] was enacted. As a result:

i. A new entry, No. 92A, was inserted in the Union List, bestowing upon the Union the powers to levy "taxes on sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-state trade and commerce".

ii. Entry 54 in the state list was modified and the states' power was confined to levy "taxes on the sale or purchase of goods other than newspapers subject to the provisions of entry 92A of List I."

iii. A new Sub-Clause (g) was inserted in clause (1) of Article 269 empowering the Government of India to levy and collect (to be assigned to the states in accordance with clause (2) of the Article) "taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-state trade or commerce".

iv. A new clause (3) was inserted in Article 269 whereby "Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in the course of inter-state trade or commerce".

v. Article 286 was amended so as to read as follows:

"Restriction as to imposition of tax on the sale or purchase of goods:

(1) No law of state shall impose, or authorise the imposition, of a tax on the sale or purchase of goods where such sale or purchase takes place:

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[10] Government of India (1954), Report of the *Taxation Enquiry Commission, 1953-54*, Vol. III, pp. 54-55.

(a) Outside the state; or

(b) In the course of the import of goods into or export of goods out of the territory of India[11].

(2) Parliament may by law formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in Clause (1).

(3) Any law of a state shall, in so far as it imposes, or authorises the imposition of a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-state trade or commerce, be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify".

The effect of these diverse changes made by the Constitution (Sixth Amendment) Act, 1956, was to invest Parliament with exclusive authority to enact laws imposing tax on sale or purchase of goods where such sale or purchase takes place in the course of inter-state trade or commerce. In exercise of the authority so conferred, Parliament enacted the Central Sales Tax Act, 1956 (Act 70 of 1956).

2.1 The Central Sales Tax Act, 1956

In exercise of the authority conferred by the amended Article 286, Parliament enacted Central Sales Tax (CST) Act, 1956. The CST Act deals with the problems of taxing inter-State sales and multiple taxation of goods of "special importance" entering into inter-state trade and export and import transactions. It aims at:

Devising a system of taxation of inter-state sales so as to check discrimination against intra-state trade while providing a small share of tax space to the exporting state and avoiding multiple taxation of goods of special importance.

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11 *Explanation* to Clause 1 was omitted by the Constitution (Sixth Amendment) Act 1956, S. 4.

The CST Act determines the *situs* of a sale (in which the different ingredients of a sale take place in more than one state) with reference to the principles contained in Section 4 of the CST Act. The key factor taken into account for determining the place of sale, is the location of goods at a particular time. For the specific or ascertained goods, this particular time is the time the contract of sale is made and for the unascertained or future goods it is the time when their appropriation to the contract of sale takes place.

The CST Act defines an inter-state sale under Section 3 as one which occasions the movement of goods from one state to another, or is effected by a transfer of documents of title to the goods during their movement from one state to another.

Although it is plausible that the flow of inter-state commerce would be at its maximum if it were immune from taxation, it is possible that the consumers could get out-of-state goods cheaper (without tax) than the local goods subject to tax and local dealers would suffer a competitive disadvantage as compared to outside dealers. More importantly, no tax would be collected on such transactions. In addition, absence of taxation causes some economic waste in transportation by encouraging persons to make their purchases out-of-state tax-free[12]

Keeping these aspects in view, the inter-state sales tax has been fashioned to serve three objectives: (i) maintaining competitive conditions between local dealers and out of state dealers; (ii) ensuring that the exporting states get a small part of the total tax that is leviable on a given commodity and (iii) regulating and monitoring inter-state trade. Accordingly, the CST Act originally prescribed two different rates of tax:

(i) one percent on inter-state sales to registered dealers; and
(ii) 10 percent on inter-state sales to unregistered dealers.

The higher rate is chargeable on sales to unregistered dealers because the state sales tax is charged on the sales made by registered dealers in the

[12] Indian Law Institute (1962), *Inter-State Trade Barriers and Sales Tax Laws in India*, N. M. Tripathi Private Ltd., Bombay.

consuming state but no tax is charged by that state on sales made by unregistered dealers[13]. The higher rate of tax on the unregistered dealer prevents him from entering into inter-state trade for any competitive advantage. By the same logic, the low rate (of one percent) is to be charged from registered dealers because the same commodity is taxed by the importing state also. The rate differential brings about equity of treatment of registered and unregistered dealers.

As noted earlier, the TEC has expressed the view that the exporting state should claim only a small share of tax on a commodity exported and the prime tax space should be occupied by the state where consumption takes place. In disregard of this view, the Central government raised the level of the rate of CST from one percent in 1956 to two percent in 1963, and to three percent in 1966. It was further increased to four percent in 1975. This enabled the exporting states to pre-empt a larger tax space before the consuming states could levy any tax on these commodities. This exercise was made presumably on the basis of a misconceived notion that raising the rate of the inter-state sales tax would help all states to raise more revenue which otherwise they could not do.[14]

Since the Constitution permitted the levy of sales tax only on the sales of goods, state governments complained that the tax on inter-state transactions was being avoided or eroded to a substantial extent through consignment transfers. In order to enable the Central government to levy a tax on the inter-state transfer of goods, a proposal to levy a tax on consignment transfers was mooted in 1982. To give effect to this proposal, the Constitution 46th Amendment Act was enacted, introducing a new entry 92B in the Union List providing for a tax on the consignment of goods in the course of inter-state trade[15]. However, as explained

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13 If the local sales tax rate in the exporting state is higher than 10 percent, the unregistered dealer in importing state has to pay the higher rate.

14 It could be shown through an illustration that this assumption is not correct. Assume that commodity 'X' is taxed locally at 12 percent both in states 'A' and 'B'. State 'A' alone produces 'X'. Its residents consume part of the output and the rest is exported to state 'B'. If an inter-state sales tax at 4 percent is introduced, total sales tax revenue is raised because consumers in state 'B' will be paying 16.48 percent effective rate of tax. Consumers in state 'A' however will continue to pay 12 percent tax. If state 'B' wishes to maintain the burden of the tax on its consumers at the original level, it would have to reduce its tax rate by approximately 4.3 percent. Thus, by raising the inter-state sales tax, the Central government allowed the exporting states to occupy larger tax space at the expense of consuming states, if the total tax burden of the importing and exporting state has to be the same.

15 Simultaneously, sub-section 3 of Article 286 was substituted to read as follows:

later in the Report, due to changed economic conditions this decision has not been implemented so far.

The main objectives in introducing the tax on inter-state sales were two fold: the first was to regulate the flow of inter-state sales in order to minimise tax evasion through which both the exporting and importing states might lose, and the second was to enable the exporting state to gain a small share of the total tax that would be/could be levied on a commodity. In the absence of a law regulating the flow of goods across state borders, it was feared that cross-border sales to consumers and unregistered dealers might take place without any check.

Keeping these objectives in view, the CST Act, 1956, provided that inter-state transactions between registered dealers would be subject to a maximum rate of tax of one per cent and that inter-state sales to unregistered dealers would be subject to a rate of 10 per cent or the local rate of tax on the commodity, whichever is higher.

3. Assessment of the Existing System of CST

This distinction made by the CST Act implies that only inter-state sales to registered dealers will be recognised as genuine inter-state sales eligible for the concessional rate prescribed. If the sales are to unregistered dealers, the commodities concerned will be subject to a high rate of 10 per cent or more so that the exporting state will gain in the absence of any tax on those commodities by the importing state. The rate differential could be said to have brought about equity of treatment between registered and unregistered dealers.

While the CST has served the purpose of regulating the flow of inter-state movement of goods within the country, as it has evolved, it causes several deleterious effects on the economy and inter-state equity.

"(3) Any law of a State shall, in so far as it imposes, or authorises the imposition of,

(a) a tax on the sale or purchase of goods declared by Parliament by law to be of special importance in inter-State trade or commerce; or

(b) a tax on the sale or purchase of goods, being a tax of the nature referred to in sub-clause (b), sub-clause (c) or sub-clause (d) of clause (29A) of article 366

be subject to such restrictions and conditions in regard to the system of levy, rates and other incidents of the tax as Parliament may by law specify."

3.1 *Obstacles to the Formation of a Common Market*

The high rate of CST acts as a significant obstacle to the formation of a common market within the Indian federation because, as is well known, any such tax on the movement of goods across state borders within the federation is a barrier to trade. Unless the demand for a particular commodity is totally inelastic (which is very unlikely) the imposition of tax on inter-state sale will result in the reduction in the volume or value of such sales (by the same token the entire tax will not be shifted forward). This happens in respect of all inter-state sales throughout the economy. The effect of CST is cumulated as a commodity in the course of production and distribution moves from state to state. The total effect is to significantly affect the size of the market which means less economies of scale being reaped by individual enterprises. The high rate of inter-state sales tax could also lead to distortions in the location of production of different commodities since such a tax acts also as a protective duty.

From what has been said above, it would be clear that taxation of inter-state sales within a federation goes against the principle of forming large Free Trade Areas. For example, if a SAARC Free Trade Area is formed, an anomalous situation will be created by which goods from the other SAARC countries could come out free into different states of India but goods from one state to another within India would be subject to tax. The Indian producers would be at a disadvantage and would be induced to locate their production units in the nearby SAARC states. It is obvious that any tax on inter-state sales is inconsistent with the policy of maintaining a fairly open economy (even if SAARC Free Trade Area is not formed).

3.2 *Cascading Effect*

The CST levied on the total price including the cost of inputs and the taxes on inputs, if any, leads to cascading. Further, it is to be noted that the CST levied by the exporting state will not be given any tax credit in the importing state and hence the costs of an input imported from another state goes up and causes further cascading. If, in the process of the production of the commodity, the good moves from state to state at various stages of production cascading is multiplied. This leads to increasing competitive disadvantage in export markets as well as against imported goods. The existing system of a combination of a first point tax without full input tax credit for manufacturers and the CST leads to considerable escalation of costs. Although the CST Act, 1956, provides for exemption of tax on exports[16], the exemption is available provided the last sale takes place after and is for the purpose of complying with the agreement, or order for, or in relation to such exports. In practice, it is difficult for the exporters to purchase commodities against confirmed orders. Purchasers made in anticipation do not qualify for exemption. Such conditions give rise to disputes as to whether a given sale can be regarded as a penultimate sale.

Introduction of VAT in respect of local sales tax will remove one cause of cascading but the cascading caused by the CST will remain.

3.3 Violation of Inter-jurisdictional Equity

Any tax on inter-state trade, which is not rebated in subsequent transactions, would lead to some tax exportation to the importing states and through this also outside the national jurisdiction (See Table 1). The example considers a case where different stages in the production of a good are located in different states. Each time the inputs cross a state border, the transaction is subjected to CST. If the good is to be consumed in state 4, the final price of the good includes taxes paid to three other states. In other words, three of the states are practising tax exportation.

Such tax exportation conflicts with the principle of inter-jurisdictional equity according to which people should pay taxes to the government of the jurisdiction in which they live because it is that government which provides them the public services and is answerable to them. That is why it is generally agreed that indirect taxes levied by the constituent units in a federation should be based on the principle of destination. Data in Table 2 presenting the distribution of the yield of CST and GST indicate that four high income states namely Maharashtra, Gujarat, Punjab and Haryana collect the bulk of CST revenue (43.7 per cent) in 1997-98. They accounted for 20.05 per cent of the total population of 14 major

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16 The export sale itself as well as the immediately preceding sale are to be exempted.

states. On the other hand, five low income states, namely, Bihar, Madhya Pradesh, Orissa, Uttar Pradesh and Rajasthan collected only 18.2 per cent of CST, while accounting for 46.95 per cent of the population.

3.4 Distortion of Resource Allocation

The fourth major adverse effect produced by the CST is that it leads to distortion in the allocation of resources. Such distortion takes the form of vertical integration of the process of production: either concentrating the entire production process in one state instead of in more than one state as may be dictated by economic considerations and the starting of production units in large consuming states induced by the protection guaranteed through the levying of the CST.

In view of these deleterious effects caused by the levy of the CST, particularly levy at a high rate of four per cent, there is imperative need to reform the system of the taxation of inter-state sales. The very purpose of introducing VAT at the state level in replacement of the existing sales taxes is to eliminate cascading, minimise escalation in costs, avoid economic distortions and introduce transparency in tax incidence. These objectives cannot be fully achieved unless inter-state sales are effectively free of taxation. At the same time, it has to be ensured that there is a mechanism for regulating the flow of inter-state trade and to prevent evasion of local sales tax.

4. International Experience in the Tax Treatment of Inter-jurisdictional Sales

4.1 Canadian Model

Before we consider the lines on which the existing system of inter-state taxation in India should be reformed, it may be useful to consider the manner in which some other federal formations have tried to deal with this question. In the Canadian Federation, all provinces except Alberta[17] levy a tax on the sale of tangible personal property, i.e., a sales tax. While different forms of sales tax exist in the various provinces, it is ensured that no tax is levied on inter-provincial

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17 Alberta does not levy such a tax apparently because it gets considerable revenue from gasoline.

sales. Five provinces namely, British Columbia, Ontario, Manitoba, Prince Edward Island and Saskatchewan levy a retail sales tax. This tax applies only to retail sales to consumers or unregistered dealers and does not fall on inter-provincial exports. In three provinces, namely, Newfoundland, Nova Scotia and New Brunswick, what is called a system of harmonised sales tax (HST) exists. HST is a VAT legislated and administered by the federal government consisting of two components: the federal component of GST which is a comprehensive VAT on goods and services at seven per cent and the provincial VAT component at eight per cent. The total of 15 per cent tax is collected by the federal government and the yield from the provincial component is distributed among the three states. The province of Quebec levies its own provincial VAT and also collects the federal GST on behalf of the federal government.

Thus, there are three systems of sales tax in operation in the provinces of Canada. As already mentioned, the retail sales tax does not apply to inter-provincial sales. Quebec which levies its own VAT known as QST applies zero-rating to inter-provincial sales as well as exports. In the provinces having HST, the three provinces are treated as one block, where all inter-state transactions are also treated as intra-state transactions. As regards transactions taking place between an HST province and provinces outside the HST system, they are zero-rated under the provincial component of HST. Distribution of the net collections between the HST provinces is on the basis of consumption statistics, ensuring the destination principle. In sum, in the Canadian federation there is no tax on inter-provincial transactions and input taxes collected are refunded.

4.2 Clearing House Mechanism of European Union

In the European Union VAT is levied by the member states of the Union. Indeed one of the conditions required as a pre-requisite for a country to enter into the European Union is the introduction of VAT in replacement of other domestic trade taxes. Since one of the main objectives of forming the European Union is the creation of a common market, the member states cannot levy any tax on inter-member country sales based on the principle of origin. The VAT levied by the member states should be on the basis of destination and should not be a barrier to trade.

The above objectives can be achieved either through a system of clearing house mechanism or through zero-rating of inter-member country sales. The original designers of VAT in the European Union had envisaged the adoption of a clearing house mechanism. Under this system VAT would be levied on the basis of the origin principle with no distinction between intra member country and inter member country sales. The importing dealer in a member country would claim set-off for the tax he has paid to the exporter in another member country. However, in order to preserve the destination principle, a clearing house mechanism would be set up through which all the taxes collected on inter member country sales would be pooled and each member would get what is due to it on its imports. This system is more easily operated if the tax base in different jurisdictions is the same and the rates are identical, because each member country would have to submit its net claim to the clearing house on the basis of a statement giving its sales to, and purchases from, each of the other member countries together with the taxes collected and the amount of set-off given. Since in practice the rates of VAT on different commodities differ from one member country to another and the VAT base is also not uniform, working such a clearing house mechanism is extremely difficult to operate. Hence this system has not yet been adopted by the European Union.

Instead, from the very beginning, inter-member country sales are subject to zero-rating, under which a zero rate of tax is formally charged on such sales and the taxes paid on inputs by the exporter are refunded to him. The importing member country is then free to tax that commodity. Thus, the destination principle is implemented. For claiming zero-rating, the supplier in one member country who sends goods to other EU member countries will need to obtain the VAT registration number of the overseas customers and quote that number with his own VAT number in the invoices.

Sales to unregistered dealers across state borders are taxed as intra-state sales.

This system which is called the transitional regime, was originally planned to apply only until 1997. However, there has since been no consensus among the member countries about shifting to the clearing house system. Therefore, the transitional regime continues to operate.

4.3 Brazilian System

In the Brazilian federation also, the constituent states levy a value added tax known as ICMS (*Imposto Sobre Operacoes Relatives a Circulacao De Mercadorias E Servicos)*. Under this VAT, inter-state transactions are taxed by the exporting states and the importing states extend credit for the tax paid by the importer to the exporting states but the rate of inter-state tax varies depending upon the destination, i.e., the region to which goods are exported. The rate of tax is 12 per cent on goods going to the north-east or the central-west regions and seven per cent on goods going to the poorer states in the south-east regions. Under the Brazilian system while tax cascading is avoided and the inter-state tax does not act as a barrier to inter-regional trade, the principle of destination is violated; also the attempt to use the inter-state trade tax for purposes of redistribution violates the principle of neutrality and also introduces complications into the system. Side by side, there is a federal VAT at the manufacturing stage on industrial products, with several exemptions.

The Brazilian system is considered quite an unsatisfactory model by most fiscal economists. Recognising the extent of complexity in this system of taxation, the central government in Brazil is proposing reforms whereby, the existing system of commodity taxes would be replaced by a central VAT supplemented by a retail sales tax at the municipal level. These reforms are awaiting presidential assent.

4.3.1 The Varsano Model

Ricardo Varsano of Brazil has proposed a dual system of VAT in a federation in order to deal satisfactorily with the problems of inter-state tax under VAT.[18] His system can only be introduced where both the federal government and the state governments are levying VAT covering all stages of production and distribution. To put it briefly, under the Varsona system, the state tax on an inter-state transactions is collected by the federal government along with its own federal tax and then it gives credit for that tax to the importer against the tax

[18] Varsano, Ricardo (1995), *A Tributacao do comercio Interestadual: ICMS Atual versus CMs Partilhado, Instituto de Pesquisa Economica Aplicada*, Rio de Janerio.

payable by him to it as federal VAT. In this way inter-state trade is fully regulated and evasion of tax on inter-state transactions is prevented. This system cannot be applied to India because the central government, under our Constitution, cannot levy a trade tax except at the stage of manufacturing

5. Reform of the System of CST

The relevant features of VAT levied by the constituent units of federal formations discussed above indicate that in all cases care is taken to ensure that there is no effective taxation of inter-state sales so that there is no cascading and escalation of costs, the principle of destination is fulfilled (except in Brazil now) and there is no barrier to inter-regional trade. In the USA, where VAT is not levied either by the federal government or by the states, the states levy only retail sales taxes and they are prohibited from levying any tax on inter-state trade and commerce. There is no alternative to India adopting a similar system of domestic trade taxation which would exclude any element of effective tax on inter-state sales.

Given the Constitutional provisions only two alternative solutions to the problem of inter-state taxation can be considered: the first is zero-rating of inter-state sales and the second is some kind of clearing house mechanism as envisaged by the European Union. In both cases, the exporting state would have to give credit to the exporters for the input taxes paid by them. Under zero rating, the rate of tax on inter-state sales will be zero; under the clearing house mechanism, the rate of tax can be the same as for local sales.

One advantage of the clearing house mechanism is that the rate of taxes for all transactions, intra-state as well as inter-state, will be the same for any given state. Thus, there will be no need to differentiate between inter-state transactions and other transactions. As such the possibility of evasion is much reduced (if the rates of taxes in the different states are close to one another, the advantage of exporting goods to unregistered entities will also be reduced considerably). The major problem with the clearing house mechanism is that effectively the tax collected by the exporting states would have to be transferred to the importing states. In order to do this, the exporting states would have to transfer, month by month, the amounts of tax they have collected on inter-state transactions to the central pool and the central pool will have to distribute these amounts to all the states according to their respective imports. If the rates of tax vary among the states, this job would require elaborate account keeping because the central pool office will have to keep records of commoditywise exports to each of the states. The job would be made somewhat simpler if inter-state transactions are differentiated and one single rate of tax is levied on them as in India today. Even then while commoditywise export figures need not be maintained, total statewise export and import figures would have to be recorded. This itself would be a stupendous job. This is simply not possible given the present state of information coverage and stage of computerisation. Besides the importing state will have to give set off as soon as the import takes place and will get it back only after a delay of a month or so. Fear is also expressed that given the sorry state of state finances today, the states exporting goods may not find it possible to fulfil their commitment to transfer the tax amounts promptly to the central pool.

All these considerations lead us to the conclusion that zero-rating is the only possible solution in the Indian context. However, one cannot move to zero rating in ~~one single step because~~ many states in the Union as shown earlier are now deriving a considerable amount of revenue from the CST. One has to give some time to the state for making the necessary adjustments.

To initiate the process of reform, as suggested by the Conference of Finance Ministers (1998), the central government should reduce the maximum rate of CST to three per cent with effect from April, 2001. Theoretically this should mean a fall to the extent of 25 per cent in revenue from CST to each of the states. In fact, however, the loss would be less than 25 per cent because the prevailing rate of CST on several commodities in many states is less than four per cent. (see Table 3). The rates are less than four per cent either because the corresponding rates for local sales are lower than four per cent or because the states have consciously reduced the rates in order to boost inter-state trade.

In several states the maximum rate of four per cent is applied to most commodities. Therefore, although the reduction in revenue from CST would be somewhat less than 25 per cent for all states taken together it will be necessary for the central government to compensate the state governments to the extent of

25 per cent of the present revenue from CST at least for the first two years, i.e., 2001 – 2003. This will be taken as a period of adjustments. The compensation will cease at the end of 2002-03. Meanwhile changes in the tax system should be brought about to augment the tax revenue of the state governments. The estimated amount of compensation per year works out to roughly Rs 1250 crore[19].

As indicated above, compensation from the central government is only a temporary measure. As the reform proceeds, the state governments should be encouraged and enabled to raise more revenues from their respective residents instead of collecting a substantial portion of the revenues from the residents of other states. It is to be understood that reduction and phasing out of CST does not mean reduction in the taxable capacity of the states but only a shift from raising part of the revenues through tax exportation to raising most of the revenues from the taxation of residents.

While the long term objective should be to bring the rate of CST down to zero per cent with full set off for input taxes paid by the exporter of a commodity to the other states, the medium term objective could be to bring down the rate of CST to one per cent along with rebate of input taxes paid (this might mean in several cases refund of a part of the inputs taxes). The target date for bringing down the CST to one per cent should be the beginning of the year 2003.

In the intervening period, the system should be so reformed as to enable the states to augment their revenues. Some of the measures have already been implemented and have started giving results: (1) the adoption of floor rates agreed upon by the Conference of Chief Ministers and Finance Ministers on November 16, 1999 by almost all states would serve to increase revenue from local sales taxes considerably because of the elimination of rate competition. Similarly, phasing out of sales tax incentives to industries would soon lead to a substantial increase ~~in revenue to most states.~~ (2) The adoption of floor rates and VAT would also mean a reduction in the number of exempted items[20]. This step

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19 If some of the steps indicated later, such as returning some at least of Additional Excise Duty goods to the states for the levy of VAT, could be carried out immediately, then there will be no need for central compensation of this magnitude or may be for any compensation.

20 With the introduction of VAT, exemption from tax of a particular commodity would only mean exemption from tax of a very small part of value added at that particular stage.

increases the neutrality of the tax system as well as serves to increase the revenue. (3) The adoption of VAT would mean that the base of the tax would include not merely value at the manufacturing stage as under the first point tax but the entire value added of commodities, right down to retail level. Hence, VAT would yield in the medium term much higher revenue than the first point tax. This is also because with the introduction of VAT undervaluation at the manufacturing stage would come down considerably.

Apart from the above, the states should strengthen the administration of sales tax through computerisation and other measures. It has been suggested that in the medium term the central government should undertake/promote measures that would enable the state governments to raise more revenues through an enhancement of the tax space available to them.

On the understanding that the rate of CST would be reduced to one per cent by 2003, the central government should take action that would serve to enhance the revenue of the state governments to compensate for the loss of revenue from the reduction of the rate of CST. There is general agreement that the following measures should be considered.[21]

1. The central government should at the earliest amend the CST Act to the effect that the declared goods could be taxed at more than one stage by those states that provide for full set-off for taxes on all goods used as inputs and on purchases for resale, i.e., the states which have adopted a full system of VAT. Without the amendment. a state VAT cannot be implemented satisfactorily.

2. The central government should amend the CST Act to remove the provision that a C Form is not required for a sale to be recognised as an inter-state sale, if the rate of tax is lower than four per cent. Since under a full fledged VAT, an exporter to another state will be entitled to refund of input taxes paid by him, it is necessary to

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Moreover, every exemption creates a break in the chain of VAT credit and, therefore. puts the concerned dealers to disadvantage (as those who purchase the exempted commodity from them would not be able to claim input tax in their tax return).

21 These have been considered at several conferences of the State Chief Ministers and Finance Ministers held to discuss sales tax reform.

ensure that he is selling to a registered dealer in another state. This amendment should also be brought about early.

3. Under an agreement entered into by the centre and the states in 1956, an additional excise duty in lieu of sales tax (AEDILST) was levied on sugar, textiles and tobacco by the centre in 1957 and the states have since then desisted from levying sales tax on these items. The net proceeds of AEDILST are distributed among the states according to the distribution formulae recommended by the successive Finance Commissions. These three goods have been brought under the list of declared goods under the CST Act. A state is free to opt out of the agreement, but then it can tax any of the three goods only at the maximum rate of four per cent and at only one stage and it would lose its share of AEDILST. All the states have adhered to the agreement, but they have been arguing that they would be raising more revenues from sales taxes on these goods as shown by the fact that the general sales tax revenue has been more buoyant than the yield of AEDILST.

Although there were proposals from time to time that the list of goods subject to AEDILST should be extended, in view of the understandable opposition from the states these proposals were not accepted nor implemented.

A case can be made out for the centre imposing uniform rates of duty on certain important goods the incidence of taxes on which need to be controlled, in the context of various types of sales taxes being levied by the different states and at widely differing rates. Once the states have adopted uniform floor rates as well as a VAT on goods, there would be no ground for the centre levying AEDILST on behalf of the states. It is recommended that simultaneously with the reduction of the maximum rate of CST to one per cent the AEDILST be abolished so that the states would be free to levy VAT on these goods.

It may be noted here that sugar, textiles and tobacco have not been brought into the list of goods for which floor rates have been agreed upon. Besides, tobacco is a "sin" good on which high rates of tax are levied. Before the states are "given back" these goods for levy of VAT, two steps must be taken. First, floor rates should be agreed upon for textile products and sugar. Second, there must be an agreement between the centre and the states on the maximum rate of tax that each level of government would be permitted to levy. In the absence of such an agreement the total combined burden of taxation on tobacco and its products might (would probably) become too high resulting in a drastic fall in demand and high evasion. Although the harmful heath effects of tobacco is fully recognised, any such large and sudden increase must be avoided in order not to cause severe hardship to tobacco farmers. It is in the interest of those farmers and in the national interest that the total burden of tax on tobacco is regulated.

Once these steps have been taken, these three goods, namely, sugar, textiles and tobacco can be removed from the list of declared goods under sections 14 and 15 of the CST Act.

4. Since the devolution formula has been changed by the 89th Constitutional amendment, the revenue from the central tax on services also becomes shareable and as the centre extends the scope of the service tax, the states will receive correspondingly additional revenue.

At present services in general are excluded from the purview of state taxation as per the Constitution. Only a few services are taxable by the states under certain specific provisions of the Constitution, namely, taxes on goods and passengers carried by road and inland waterways, taxes on luxuries including amusements and taxes on betting and gambling. Under the Constitution, the centre has been given the power to levy taxes only on railway fares and freights and on airway services. However, by virtue of Entry 97 of Union List (the residuary clause) the centre has levied taxes on a number of services such as on foreign travel, telephone services, services of stockbrokers, non-life insurance and advertising. The service tax has not been merged with CENVAT. That is, the service tax levied by the centre is a cascading type of tax.

The NIPFP (1994) Report on *Reform of Domestic Trade Taxes in India: Issues and Options* had suggested that some services integral or incidental to the supply of goods such as works contract and some localised services could be given to the states for taxation.

It seems entirely proper that as VAT is adopted by the states, the centre should delegate the power to collect the tax on a number of localised services to the state governments which would retain the proceeds. In other words, the central government would legislate and levy the tax on those services prescribing a uniform rate while the states should collect the tax. In course of time, the tax on services at the central level as well as at the state level should be merged with the VAT on goods at the respective levels so that the country would have a comprehensive dual VAT on goods and services. Tentative calculations of revenue that could be raised by the states from a tax on selected services show that substantial amounts could be raised through that method (see. Table 5).

Extra revenues could be raised also through a better exploitation of the revenue resources available to the centre and the states under the Constitution. For example, as far as the central government is concerned, one important service that the centre has been given the power to tax is that of railways. However, the central government long ago withdrew the tax on railway fares whose proceeds are assigned to the states. (The states are given a grant in lieu of railway fares.) A comprehensive VAT at the central level would require the taxation of railway fares and freights and the integration of that tax into CENVAT. The net proceeds of the tax on railway fares (that is the gross collection minus input credit given to the railways) should be distributed among the states. As far as the states are concerned one important way of making the VAT buoyant is to extend its base. As of now, the agreement among the states permits as many as 47 items to be exempted from the state VAT. Such a large number of exemptions create problems in the administration of VAT because the chain of tax credit is broken at several places and secondly the size of the base is reduced. Efforts should be made by the state governments to arrive at a consensus to confine exemptions to a handful of necessities and sales of raw proceeds by agriculturists.

In regard to local sales taxation, Finance Ministers of States agreed to adhere to a limited number of floor rates for agreed groups of commodities. However, each State is free to levy a higher rate on any commodity. In this way, the States have been given a certain degree of flexibility in deciding upon rates of tax on individual commodities. In the case of CST, the central government has fixed the maximum rate at which CST can be collected by a State, namely 4 per cent. The States enjoy the freedom to fix a rate less than 4 per cent, on any one commodity according to the prevailing circumstances. Hence, in this area also the States enjoy a degree of flexibility in rate fixation.

A question has been raised whether, as in the case of the local sales tax, a floor rate should be agreed upon among the States for CST also. Fixing any floor rate for CST would cut down the degree of flexibility that the States now enjoy in this respect. Besides, the accepted goal is to phase out CST, as early as it is practicable; the fixing of a floor rate would be contrary to this objective. If reducing the CST rate is desirable in itself, there would be no justification in preventing any one State from moving to this goal at a faster rate.

6. Consignment Transfers

As mentioned earlier in the Report, it had been decided to consider the introduction of a tax on consignment transfers across state borders in order to minimise what was regarded as the avoidance of inter-state sales tax. A tax on consignments was not favoured by some states, which were mainly consuming states and a number of fiscal experts who argued that the possibility of making genuine inter-firm transfers across state borders helped preserve to some extent the character of a common market within India. Nevertheless, the Constitution was amended to enable the central government to impose a tax on such consignment transfers, but a Bill for imposing such a tax could not be brought before the Parliament for several reasons. First, the major central public enterprises which were dealing in basic essential raw materials such as coal, steel, petroleum and aluminium were opposed to such a tax because they would not be able to distribute these essential products throughout the country paying only the local sales taxes. They argued that the prices of these basic raw materials would be pushed up which is undesirable. Second, there was no agreement between the centre and the state governments, particularly the state governments of the more advanced states, on whether the centre or the state should be vested with the power of determining exemptions from the consignment tax. The centre wished to have that power presumably because it wanted to have the power to determine which essential goods should be exempted, whereas the states argued that under the CST Act they had been given the power to decide on exemptions and that precedent should be followed. Third, many of the smaller states such as those in the North-East and the net importing states were opposed to the consignment tax because the prices of consumer goods which they were importing in large quantities from the industrially more advanced states would go up. Lastly, some economists pointed out that the CST itself was an undesirable tax and the real solution was to phase it out rather than to impose a consignment tax, which would further fragment the Indian economy. In this connection, it may be mentioned that the Indirect Taxation Enquiry Committee (1978), otherwise known as the Jha Committee, had recommended in its Report that the rate of CST should be gradually brought down to one per cent as originally recommended by 1953-54 Taxation Enquiry Committee.

With the inauguration of comprehensive economic reforms in July, 1991, it was decided by the Government of India that along with other aspects of the existing system, the tax system should also be reformed and made economically more rational so that cost of production will come down. In this context, the then proposal to levy a tax on consignment transfers was not pursued. Instead then Finance Minister, Dr. Manmohan Singh, requested the National Institute of Public Finance and Policy to study the question of the reform of state sales taxes and put forward proposals in that regard.

If, as recommended in this Report, the rate of tax on inter-state sales is gradually brought down and if such sales are finally zero-rated, consignment transfers currently being made to avoid CST would come to an end. (This may happen even as soon as the rate of CST is brought down to one per cent and refund is made on input taxes paid by the exporters.)

Once the states have started zero-rating inter-state sales, they can extend the same treatment to consignment transfers. For this purpose, it should be required that the transferee outside the state should obtain a form like the 'C' form, say, an 'E' form from the VAT department of the state in which the transferee is located and send it to the transferor. On submission of this form, the transferor could be made eligible for zero-rating, i.e., he would be refunded the tax paid on inputs. The requirement to submit such forms would serve to curb possible evasion of tax.

7. Conclusion

The Taxation Enquiry Commission (1953-54) recommended in its report that the central government should levy a low rate of central sales tax at one per cent on inter-state sales. This recommendation was based on the reasoning that there must be a means for monitoring and regulating the flow of inter-state trade and that the producing states could be given a small share of the total tax that would be/could be levied on any given commodity. Subsequently, the qualifying condition mentioned by the Taxation Enquiry Commission while recommending the levy of CST, namely, that it should be at a very low rate, was not heeded and the rate of CST was raised by stages to four per cent. At this level CST began to create distortions, acted as a barrier to trade and led to large enterprises including most important manufacturing public enterprises sending their goods on consignment transfers to their respective stockyards in different states to avoid CST. A CST would have created much greater harm to the economy if it had been a relatively open one. Within the closed economy framework with quantitative restrictions on imports as well as high tariff rates, escalation of costs and the fragmentation of the market caused by the CST were not made visible. Industries were protected, but high costs and inefficiency were the inevitable results.

In the last 30/40 years the character of the world economy has changed and along with it the theory and practice of taxation, particularly taxation of commodities and services. In several parts of the world, attempts have been successfully made to create large free trade areas or common markets so that firms could produce on a large scale reaping economies of scale and having the benefit of a large market for their products without any trade barriers. In the context of liberalisation India has also proceeded to make its economy much more open than before. The advantages of a large market are now fully realised and the countries of South Asia are moving towards the formation of a South Asia Free Trade Area (SAFTA). Obviously, the existence of tax barriers at the borders of the states within the Indian Union would be inconsistent with SAFTA under which there will be no tax barriers across borders of the South Asian countries.

Apart from the likely formation of SAFTA, there will be an imperative need to make Indian products competitive in the world markets and against imports. It has been shown in this report that the CST leads to escalation of costs, economic distortions and fragmentation of the Indian common market. There is, therefore, no doubt that CST should be phased out, but enough time should be given to the states and the central government to readjust the tax structure. In this way, the states are also enabled to collect more from their respective residents and less from the residents of the other states. In addition, the centre should make available additional tax space to the state governments, as suggested earlier in the Report.

Table 1

Effect of CST on Prices with Manufacturing Activity spread over 4 States[22]

(Rupees)

	Rate of CST			
	4%	3%	2%	0%
State 1				
Raw materials	100.00	100.00	100.00	100.00
Value Added	50.00	50.00	50.00	50.00
Value of Output (Good 1)	150.00	150.00	150.00	150.00
CST collected	6.00	4.50	3.00	0
Exported to State 2				
Value of Inputs	156.00	154.50	153.00	150.00
Value Added	75.00	75.00	75.00	75.00
Value of Output (Good 2)	231.00	229.50	228.00	225.00
CST Collected	9.24	6.89	4.56	0
Exported to State 3				
Value of inputs	240.24	236.39	232.56	225.00
Value added	112.50	112.50	112.50	112.50
Value of Output	352.74	348.89	345.06	337.50
CST Collected	14.11	10.47	6.90	0
Exported to State 4				
Value of inputs	366.85	359.35	351.96	337.50
Value added	168.75	168.75	168.75	168.75
Value of Output	535.60	528.10	520.71	506.25
Total Tax Collected	29.35	21.85	14.46	0
As per cent of value of good	0.058	0.043	0.029	0

Note: It is assumed that the entire tax is shifted forward. This may not be so if demand is elastic to some extent. The latter will be the more realistic assumption. For simplicity of presentation the assumption of zero elasticity is made here.

22 Given the provision in the law allowing purchase of goods at the rate of 4 per cent from other states, no state can afford to charge a tax on the sale of goods used as inputs in manufacturing, at a rate higher than 4 per cent. However, since the tax structure in most of the states is a first-point tax, this replicates the problems discussed here.

Table 2: Trends of Sales Tax Revenue in Selected States

(Rs Crore)

State/Year	1995-96 GST	1995-96 CST	1996-97 GST	1996-97 CST	1997-98 GST	1997-98 CST	1998-99 (RE) GST	1998-99 (RE) CST	1999-2000 (BE) GST	1999-2000 (BE) CST
High Income States (HIS)										
1. Maharashtra	5690.19	1154.13	6045.01	1244.99	6547.2	1278.28	7048.06	1360	8183	1520
	(83.14)	(23.84)	(82.92)	(23.15)	(83.67)	(20.52)	(83.83)	(15.89)	(84.33)	(17.53)
2.Gujarat	3038.1	555.26	3428.54	597.15	3724.46	677.93	4422	778	4870	880
	(84.55)	(11.47)	(85.17)	(11.11)	(84.60)	(10.88)	(85.01)	(9.09)	(84.70)	(10.15)
3. Haryana	604.19	451.22	981.11	398.96	1061.04	491.65	1113.3	676.7	1236.63	768.17
	(57.25)	(9.32)	(71.09)	(7.42)	(68.34)	(7.89)	(62.20)	(7.90)	(61.68)	(8.86)
4. Punjab	982.08	201.33	1011.44	253.06	1124.83	276.31	1161.04	324.38	1626.97	373.03
	(82.99)	(4.16)	(79.99)	(4.71)	(80.28)	(4.44)	(78.16)	(3.79)	(81.35)	(4.30)
Total HIS	10314.56	2361.94	11466.10	2494.16	12457.53	2724.17	13744.40	3139.08	15916.60	3541.20
(Share in Total Collections)	(33.19)	(48.79)	(32.18)	(46.39)	(31.66)	(43.74)	(30.82)	(41.22)	(31.16)	(40.84)
Middle Income States(MIS)										
5. Andhra Pradesh	2433.97	520.54	2981.17	544.45	4105.11	623.24	4997.8	676.2	5415.3	757.34
	(82.38)	(10.75)	(84.56)	(10.13)	(86.82)	(10.01)	(88.08)	(7.90)	(87.73)	(8.73)
6. Karnataka	2713.8	240.65	3370.9	139.29	3615.61	213.17	3775.44	694.37	4457.47	740.8
	(91.85)	(4.97)	(96.03)	(2.59)	(94.43)	(3.42)	(84.47)	(8.11)	(85.75)	(8.54)
7.Kerala	2119.07	166.89	2602.72	169.56	2920.96	163.13	3315.22	194.88	3936.4	207.7
	(92.70)	(3.45)	(93.88)	(3.15)	(94.71)	(2.62)	(94.45)	(2.28)	(94.99)	(2.40)
8.West Bengal	2021.22	426.01	2272.28	431.88	2512.22	332.09	2687.65	531.42	3051.6	585.95
	(82.59)	(8.80)	(84.03)	(8.03)	(88.32)	(5.33)	(83.49)	(6.21)	(83.89)	(6.76)
9.Tamil Nadu	3987.93	701.34	4673.59	667.48	4569.21	1034.58	5369.93	730.07	5897.88	934.12
	(85.04)	(14.49)	(87.50)	(12.41)	(81.54)	(16.61)	(88.03)	(8.53)	(86.33)	(10.77)
Total MIS	13275.99	2055.43	15900.66	1952.66	17723.11	2366.21	20146.04	2826.94	22758.65	3225.91
(Share in Total Collections)	(42.72)	(42.46)	(44.63)	(36.32)	(45.04)	(37.99)	(45.18)	(37.12)	(44.55)	(37.20)
Low Income States(LIS)										
10. Bihar	1310	0	1169.41	326.99	1213.98	353.66	1574.58	467.42	1858.34	421.66
	(100.00)	0.00	(78.15)	(6.08)	(77.44)	(5.68)	(77.11)	(5.46)	(81.51)	(4.86)
11.Madhya Pradesh	1177.66	341.94	1368.13	363.12	1623.77	432.42	1882.67	459.33	1977.53	597.47
	(77.50)	(7.06)	(79.03)	(6.75)	(78.97)	(6.94)	(80.39)	(5.37)	(76.80)	(6.89)
12.Orissa	716.1	0	893.51	0	925.08	0	944.81	303.19	955	310
	(100.00)	0.00	(100.00)	0.00	(100.00)	0.00	0.00	(14.58)	(75.49)	(3.58)
13.Uttar Pradesh	Na	Na	3331.2	141.98	3697.88	237.06	4330	290	5335	425
			(95.91)	(2.64)	(93.98)	(3.81)	(93.72)	(3.39)	(92.62)	(1.90)
14. Rajasthan	1317.76	81.9	1500.97	97.88	1711.37	115.17	1970	130	2280	150
	(94.15)	(1.69)	(93.88)	(1.82)	(93.69)	(1.85)	(93.81)	(1.52)	(93.83)	(1.73)
Total LIS	4521.52	423.84	8263.22	929.97	9172.08	1138.31	10702.06	1649.94	12405.87	1904.13
(Share in Total Collections)	(14.55)	(8.75)	(23.19)	(17.30)	(23.31)	(18.28)	(24.00)	(21.66)	(24.29)	(21.96)
Total Collections : 14 states	31078.88	4841.21	35629.98	5376.79	39352.72	6228.69	44592.50	7615.96	51081.12	8671.24
	(86.52)		(86.89)		(86.34)		(85.41)		(85.49)	

Source: For 1995-96 to 1997-98, Reserve Bank of India, *RBI Bulletin*, Chapter on State Finances (various issues) and for later years RBI, *State Finances*, Bombay, 1999 and 2000..

Note: Break-up of total tax revenue into GST and CST is not available for Orissa (1995-96, 1996-97, 1997-97), Bihar(1995-96).
Figures within parenthesis for GST indicate percent to the total sales tax revenue of the State, and those for CST indicate percent to total CST revenue.

Table 3

Concessional Rate Under CST in States

States	Commodities	Rates
Goa	Chemical. Ore Pallets, Mining machinery spares. Electronic weighing scale. Photographic product, Electronic medical equipment, Betel nut. Cashew nut, Iron & steel. Raw cashew nut.	2%
Himachal Pradesh	Goods manufactured by Industrial units(other than these manufactured by breweries, distilleries. non-fruit/ vegetable based wineries and bottling plants (both of country liquor and Indian made foreign liquor).	1%
	Cereals like paddy, rice. wheat, jowar. bajra, maize, ragi, kodon etc.	1%
	All types of yarn.	1%
Kerala	Beaten rice and purchased rice	1%
	Bullion and spices	1%
	Kerosene stove	1%
	Arecanut	0
	Chloroquine Tablets	0
	Caprolactum	2%
	Coconut Oil	0
	Coconut Oil Cake	2%
	Cotton Yarn	0
	Declared goods other than Coconut (i.e. Cocos-Nucifera) or copra specified in schedule II to the KGST Act, 1963 (15 of 1963).	0
	Desiccated Coconut	2%
	Fibre foam	2%
	Ginger (Green or dried)	0
	Granite slab and Granite Tiles	2%
	News Print	2%
	Pepper (Garbled or ungarbled)	0
	Power Tiller	2%
	Pushbutton Telephone(*SRO. 304/99 GO (P) No. 63/99/TD dt.31.3.99)	2%
	Rubber (SRO 215/97)	0
Karnataka	Cotton yarn	2%
	KST suffered silk fabrics	0
	KST suffered Arecanut	0
	KST suffered Coffee beans and Coffee seeds	0
	KST suffered Dry chillies	0
	KST suffered Horsrgram and Halasande	0
	KST suffered Tamarind and Tamarind seeds	0
	Bicycles	2%
	Copra	2%
	Computers, Computer peripherals etc	0.25%
	Cotton seeds	2%
	Dessicated coconut	2%
	Edible oil refined and non-refined	2%
	Groundnuts and their seeds, safflower seeds and sun flower seeds	2%
	Khandasari sugar	2%
	Liquid glucose, dextrine etc	2%
	Medical diagnostic imaging equipments	2%
	Washed cotton seed oil	2%
	Bullion and specie	0.5%
	Earth moving equipments-hydraulic excavator etc	2%
	Rechargeable lanterns	2%
	Refrigerators, Washing machines, Microwave ovens and vaccum cleaners	2%
	Video cassette recorders, VCPs, audio and video CD players, radio, cassette recorders and radio cassette recorders	2%
	Pencils	0
	Kerosene wick stoves	0

Mizoram		0
Delhi	Sale of goods (other than the goods specified in the First Schedule of the DST Act 1975) in the course of inter-State trade or commerce by a dealer having his place of business in the territory of Delhi provided the sale is made to a registered dealer having his place of business outside the territory of Delhi and the goods are proved to have been imported into the territory of Delhi after being subjected to tax under the Central Act and then exported from the territory without undergoing any processing or change in identity.	2%
	Sale of goods (other than the goods specified in the First Schedule of the DST Act 1975) in the course of inter-State trade or commerce by a dealer having his place of business in the territory of Delhi provided the sale is made to a registered dealer having his place of business outside the territory of Delhi and the goods are proved to have been received by him in the territory of Delhi under the Central Sales Tax Act from his place of business in another State where he is registered under the sales tax law of the that State in respect of his such place of business or from the place of business of his Agent or Principal in another State where such agent or principal is registered under the Sales Tax Law of that State and in respect of which the importing dealer furnishes a certificate containing the declaration in the prescribed form that tax on the said goods has been paid or will be paid by him or his Agent or his Principal, as the case may be, under the Sales Tax Law of the State wherefrom the goods were received. and which are exported by the importing dealer from the said territory without under-going any processing or change in identity.	2%
	Dry Fruits	2%
	Tea	2%
	Sarson, toria, till or taramira oil (not being hydrogenated vegetable oil).	1%
Orissa	Television sets and electronic goods	1%
	Pig iron, gold and silver ornaments.	2%
Pondicherry	Milk powder, cotton yarn, cotton waste, technical grade pesticides, SSI products for 14 years after expiry of 5 years tax holiday.	1%
	Aluminium, art silk, and SSI products as stated above.	1.5%
	Photographic goods, cinamatographic goods, medicines. surgical equipments, oil and oil cakes, hydraulic excavators, electronic goods and computers.	2%
	Gensets, plastic goods, rubber goods, packing materials. chemicals, asbestos, cement sheets, food colours, footwear, iron and steel. ferrous and non-ferrous alloys, paper products.	3%
Sikkim	Cardamom, ginger and orange	3%
West Bengal	Gold	1
	Gold and silver ornaments, articles and filigree	1
	Mustard seed, Rape seed	1
	Poultry feed additives	1
	Silver	1
	All non-cotton yarn other than pure silk yarn made in India	2
	Edible rice bran oil	2
	Feed additives for cattle and pig	2
	Jute goods except specified elsewhere	2
	Mustard oil. rape oil and mixture thereof	2
	Precious stone including preal-real, artificial or cultured	2
	Rice and broken particles of rice	2
	Synthetic fibre such as, acrylic fibre or polyester fibre	2
	Wheat and broken particles of wheat	2
	Aluminium utensils	3

West Bengal Continued	Gas mantle	3
	Hawai Chappal, Chappal and Sandals made of plastic	3
	Hosiery goods excluding cotton, woolen	3
	Micro-cellular sheet, banawar sheet	3
	Parts, accs., comp. Of cycle-rickshaw	3
	Power tillers	3
	Readymade garments (excld. hosiery goods, garment of khadi)	3
	Umbrella and parts, comp. Thereof	3
	Mill-made cotton fabrics, rayon or artificial silk fabrics and wollen fabrics	0
	Tobacco, whether manufactured or not	0
	Sugar	0
	Newprint (for publishing newspaper)	0
	Betel leaves	1
	Condoms	0
	Bicycles	1
	Motor Vehicles for use as taxis	2
	Chloroquine phosphate tablets	0
	Interstate sale of locally purchased single point goods on which due tax has been paid in West Bengal.	0
	Non-ferrous metals-tubes, pipes, rods, sections, wires, and sheets	2
	Tea Purchased at Calcutta Tea Auction	2
	Tea Purchased at Siliguri Tea Auction	2
	Cycle-rickshaws and components thereof	1
	Iron and Steel	0
	Sale of motor cars:	
	i. Sales effected under Section 8(1)	2
	Television and Vanaspati	
	i. Sales effected under section 8(1)(b) of television..	1
	ii. Sales effected under section 8(1)(b) of Vanaspati	3
	Lottery tickets	0
	Sales by industrial units holding eligibility certificate	0
	Aluminium foil, aluminium foiled paper, and aluminium foil backed or inter-leaved with paper	2
	Electronic audio equipments	1
	Personal Computer and peripheral devices, Refrigerator, Washing machine, Vacuum cleaner, Microwave oven, Video cassette recorder, Video cassette player, radio, Transistor radio, Music systems.	1
	Sale of inverter, generator and laminated jute bags	2
	Drugs or medicines manufactured by the Small Scale Industrial Unit	0
	Sale of Trekker	2
	Coir mattress with or without foam and acrylic fibre	1

Source: information supplied by the Offices of the Commissioner of Commercial Taxes

Table 4

Revenue Estimates from the New Services Proposed to be Brought Under State VAT

Services to be Taxed	Number of Assesses	Total Value of Service (Rs. crores)	Revenue Estimated at the Rate of 5% (Rs. crores)
Works Contract	-	-	-
Leasing	-	-	-
Nursing Homes	9000	2700	135
Coaching Classes/ Institutes	1500	1500	75
Beauty Parlours	8000	800	40
Sports and Recreation Clubs	200	180	9
Film Production Services	100	200	10
Software Engineers/Consultants	700	5400	270
Lawyers, Advocates & Solicitors	150000	2000	100
Car/Automobile Service Stations/Motor Garages (other than two wheelers)	15000	1500	75
Real Estate Developers and Contractors	15000	22500	1125
Total	199500	36780	1839

Source: Government of India (1998), Report of the Expert Group on Service Tax. Department of Revenue, Ministry of Finance. New Delhi.