

REFORM OF CENTRAL EXCISES³⁶

A1.1 Introduction

Discussions of the present system of domestic trade taxes presented in Chapter 2 bring out several problems with the Union excises that persist despite reforms carried out in recent years. The basic problems are:

- . Definition of manufacturing
- . Determination of assessable value
- . Restrictive application of MODVAT
- . High level and multiplicity of rates
- . Too many exemptions

The only effective remedy for the structural deficiencies arising from problems in defining manufacturing and valuation lies in extending the tax base to trade levels beyond manufacturing. However, if, for reasons mentioned in Chapter 6 that is ruled out, then efforts have to be directed towards finding ways to strengthen the present system and rationalise it as best as possible.

Taking note of the various problems in excise taxation, the Tax Reforms Committee (TRC) made wide ranging recommendations for the restructuring of the Central excises. The key recommendations are:

- . Extension of MODVAT by stages to cover most manufactured goods except petroleum and tobacco products and matches.
- . Gradual reduction in the number of rates moving towards a three rate regime (10, 15 and 20 per cent).
- . Levy of non-rebatable selective excises on a few non-essential commodities at 30, 40 or 50 percent.
- . Extension of MODVAT credit to all inputs except items like office equipment, accessories and furniture, building material and a few others and granting rebate for

taxes paid on capital goods over a period of years.

- . Bringing selected services under taxation.
- . Extension of reformed Central Excises, to the wholesale stage, (wholesalers being defined as traders whose turnover exceeds a specified level, say Rs 50 lakh or 1 crore), - the tax at the wholesale stage to be administered and the revenue retained by the States.

Drawing on the recommendations of the TRC and the discussion contained in this study, an alternate set of proposals which can be implemented in the course of one or two years is put forward below. The main components of the proposals are:

1. Technical improvements in the method of valuation for more effective taxation at manufacturer level.
2. Extension and generalisation of MODVAT to transform Central excises into a manufacturers' value added tax as envisaged by the Indirect Taxation Enquiry Committee of 1976-77 (Jha Committee).
3. Rate rationalisation on the lines suggested by TRC.
4. Provision of full and immediate credit for tax on inputs including equipment for exclusive use in taxable manufacturing.
5. Broadening the base of excises by withdrawal of exemptions and extension to selected services.
6. Cessation of tax-rental agreement between the Centre and the States in regard to levy of sales tax on textiles, tobacco and sugar.
7. Sharing of additional customs duty (countervailing duty) between the Centre and the States.
8. Levy of countervailing custom duty equal to State VAT on baggage and goods imported for personal consumption.

36. As indicated in the text, the scheme of reform of Central excises proposed here was drawn up before the Union Budget for 1994-95 was unveiled.

A1.1.1 Improvement in the Methods of Valuation

As noted in Chapter 2, valuation has been a subject of numerous disputes in central excises and despite changes in the law and many court rulings, the problems do not seem to have been fully resolved. The problems arise essentially from the attempt on the part of manufacturers to depress the base of excise taxes by setting up sister concerns or artificial markets and/or by pushing some of the cost of production forward to the so-called "post manufacturing" stages. However, under the law as it stands now, the value for excise tax can be determined on the basis of price at which the goods can sell at arms length transactions. There is reason to suppose that the scope for manipulation can be reduced substantially if the tax authorities can establish conclusively the price at which a given product is traded in the wholesale market.

As a general rule, unless there is reason to suspect manipulation, the invoice price should form the basis for valuation. This was the thrust of TRC's recommendations too. For some commodities like sugar and cement, Tariff value may be fixed. In the case of goods covered by the Standards of Weights and Measures (Packaged Commodities) Rules, the TRC recommended that the maximum retail price (MRP) be taken as the basis for deciding the measure for levy of excise duty and a fair abatement be given for various taxes and other items not normally included in the assessable value. These prescriptions are eminently sensible and have been endorsed by the Committee for Common Code for Customs and Central Excise (Rukhi Committee), which submitted its report last year. However the Rekhi Committee favoured a more cautious approach in relying on invoice value.

While the problems inherent in taxing the manufacture of goods to the exclusion of services cannot all be removed, the judicial rulings allow considerable latitude to tax authorities in determining assessable value. It is now well settled that the price of a product in the wholesale market can be taken as a valid base for excise taxation after allowing for reasonable margin for trading profit and

transport charges. What is needed to check manipulation of exciseable value is to create a data base for the wholesale prices of goods. Excise authorities would do well to strengthen its machinery for gathering market intelligence regularly in systematic manner. A reliable data base is also needed for fixing tariff values.

A1.1.2 Removing the Limitations of MODVAT

It must be acknowledged that the MODVAT has been a major step towards mitigating the cascading effect of input taxation in the country. In principle, it now covers roughly 80 per cent of the industrial products. The proportion of MODVAT credit to the gross tax due on final products still remains only at 22 per cent whereas the revenue accruing from inputs forms over 40 per cent of the total excise revenue. This is partly because a good proportion of inputs is used in the unorganised sector. Partly this is also due to limited coverage and narrow interpretation of the scope of MODVAT that tend to nullify to a considerable extent the intended benefits. Some of the recurring problems are highlighted below.

Inputs Eligible for MODVAT Credit

The most serious limitation of the MODVAT scheme stems from its restrictive scope. The notification (of 1 March 1986) which authorizes the grant of credit paid on inputs refers to "*input used in or in relation to the manufacture of the final product*". An explanation below the relevant rule under which the notification was issued³⁷ stipulates that inputs do not include "machines, machinery, plant, equipments, apparatus, tools or appliances used for producing or processing of any goods". There is a further stipulation that a manufacturer intending to avail of the MODVAT benefit must file a declaration regarding the inputs in respect of which duty credit is sought to be claimed. Interpretation of what constitutes eligible input in a given situation has been a source of disputes and audit objections, tending to defeat the objective underlying the scheme.

37. Rule 57A of the Central Excise Rules, 1944.

MODVAT credit procedures

Another set of disputes and audit objections centre around the question whether the inputs in respect of which credit is claimed were duly declared in advance. Such declaration has to be detailed and specific and not in broad terms since the proforma prescribed for the purpose provides specific columns for the description and subheadings of the inputs and the final products.

Lack of relief for excess credits

Since excises are levied at disparate rates, there is sometimes an excess of the credit over what can be effectively rebated. The excess or surplus however is not allowed to be carried forward or set off against other products even in a multi-product firm, where combined MODVAT account is maintained.

Denial of Credit to Exempt Producers

The law does not allow input tax credits where the final product is exempt, even in cases where the manufacturer of the final product wants to come within the tax net. Initially, such an option was allowed to the taxpayers but this was considered inadmissible in law. As a result of the bar on the grant of MODVAT credit for duty on inputs used in exempt products, even 100 per cent Export Oriented Units cannot avail of MODVAT benefits, as their products are exempt from excise duty. Goods brought into a 100 per cent export oriented unit in connection with manufacture and packing of articles have, however, been exempted from excise duty.

The problems in the working of the input duty relief mechanism operating through the MODVAT scheme narrated above underline the limitations of a system of VAT operating with too many restrictions and the urgency of going in for a fullfledged value added tax with rebate allowed for the tax paid on all inputs and appliances including capital goods. Other measures needed to expand and rationalise the operation of MODVAT as and when the rate structure is rationalised are set out in Section A1.1.5 below.

A1.1.3 Rate Rationalisation

The TRC has recommended a drastically revised rate structure for many commodities and the structure is contained in the Committee's Final Report (Part II, Appendix XI.1). Basically, the recommendation is for a general rate reduction and a three tier structure of 10, 15 and 20% (with high rates of 30, 40 or 50% in the case of non-essential commodities). The TRC had acknowledged that such a rate structure can be achieved only over a period of time. This is obvious because there are constraints in reforming an existing tax structure which has evolved over a period of time. What could be attempted immediately would therefore not be as scientific as TRC's recommendations. Small adjustments in the tax rates, generally in the direction pointed by the TRC, can be made in such a way that, by and large, the rate adjustments are revenue neutral. A rate structure with such modifications has been attempted and set out in Table A1.1.

It would be necessary to retain for the time being the present incidence on a number of commodities where the duty is specific and the revenue yield is substantial. Such commodities include petroleum products, cigarettes and man-made fibres and yarn. There are a few commodities, carrying a very high rates of excise duty and yielding significant amounts of revenue. The duty on these commodities could be brought down to the maximum rate of 20%. These will include tyres and cement. In the case of these two commodities, however, special excise may be levied in order to reduce the adverse impact on revenue, purely as an interim measure, as these commodities do not fall in the category of goods on which special excise could be considered in the normal course.

Table A1.1 also indicates the revenue impact of the changes suggested in regard to commodities yielding 90% of the total revenue. As for the remaining commodities contributing in all about 10% of revenue, it is assumed that it would be possible to make suitable rate rationalisation without any significant impact on revenue.

It should be mentioned that the rates indicated in the table - existing and proposed reflect average incidence on the commodity/commodity group as a whole. There are at present a number of rates within the same commodity group. These rate differentials should eventually go.

Certain measures to be taken in regard to three groups of commodities yielding substantial amounts of revenue are indicated below along with their revenue impact. (The revenue effect has been worked out with reference to the year 1991-92. However, the directions of change and broad dimensions should hold good for subsequent years).

(a) *Petroleum products*

It is being suggested separately below (Section A1.1.5) that MODVAT be extended to petroleum products. In the context of this suggestion and keeping in view the revenue needs of the Centre, it is proposed that the duty on petroleum products be restructured as follows:

1. The Central VAT on petroleum products should be levied at a flat rate of 5 per cent on all petroleum products. [An exception may have to be made in the case of Low Sulphur Heavy Stock (LSHS) for power generation, as there is no excise duty on electricity.] Assuming the total value of petroleum products to be of the order of Rs 25000 crore, this would yield about Rs 1250 crore. (In 1991- 92, the total value of those products was about Rs 22000 crore).
2. Special excises at rates differentiated among products of the group may be levied. Differentiation would take account of distributional considerations. These will be sumptuary excises and will be retained entirely by the Centre.
3. Revenue may also be obtained through a compounded levy worked out on a tonnage basis on the crude throughput of the refineries. If an amount of Rs 500 is charged per tonne of crude - indigenous and imported -, the realisation will be of the order of Rs 2500 crores. (At

present cess is charged at the rate of Rs 900 on indigenous crude and the yield is Rs 2466 crore). This amount could be levied as special excise, accruing entirely to the Centre.

The whole structure can be so worked out that the total revenue realisation from the petroleum products remain more or less what is derived at present, and the rate rationalisation does not necessitate any sharp variation in the administered prices fixed by the Government.

A possible rate structure for the major petroleum products is set out in Table A1.2.

(b) *Tobacco products*

In 1991-92 the revenue from cigarettes and biris which are the most important among tobacco products was as follows:

(Rs crore)		
Commodity	Basic duty	Addi. duty in lieu of sales tax
Cigarettes	1638	973
Biris	144	53

The duty on cigarettes which is expressed as a single rate on specific basis is distributed between excise duty and additional duty in lieu of sales tax in the ratio of 65:35. As an interim measure, the existing levies of specific duty to which the consumers and manufacturers are accustomed, may continue subject to indexation of the specific rates, where required. It has been suggested later in this paper that MODVAT be extended to tobacco products. The revenue implication of such a measure will be minimal.

(c) *Textiles*

The structure of excise duties on textiles is highly complicated and calls for drastic rate rationalisation. Some of the measures that could be considered are:

1. In the case of spurn yarn i.e., cotton and cellulosic spun yarn and blended yarn the Central VAT should be 10% ad valorem. For these items, which undergo frequent price fluctuations, it would be necessary to fix tariff values, so that valuation does not pose any problem.
2. The duty on fabrics should be so adjusted that the total yield from cotton yarn and fabrics does not undergo any appreciable change and rate rationalisation does not push up the prices of fabrics.
3. The current level of polyester fibre duty may continue. In the long-run, the rate should be 10 per cent ad valorem.
4. In the case of man made filament yarn, which yielded revenue of over Rs.1600 crore during 1991-92, there is a clear case for reduction of duty and this has been recommended by the TRC. This may have to be done in stages, considering the revenue implications. It has been separately recommended that the additional duty on textile and textile articles, which is 15 per cent of the basic duty be abolished. The current incidence on filament yarn is of the order of 60 to 70 per cent. The abolition of additional duty on textile and textile articles itself will bring down the duty by about 10 percentage points. There could be a further reduction of 10 per cent of the basic duty in the first instance, so that the incidence comes down to about 50 per cent which is the maximum rate recommended by the TRC for any commodity.

The revenue implication of the measures suggested above will be such that broadly the revenue accruing from the commodity groups will remain the same. There could be a decrease in the yield from polyester filament yarn to the extent of Rs.163 crore. With the extension of MODVAT to textiles, there should be a basic duty on fabrics. In the case of synthetic fabrics, excise duty is reported to be widely evaded. It will be very difficult to estimate the likely revenue yield from the duty on synthetic fabrics. However, it can be

said that this amount is not likely to be less than the drop in revenue from polyester filament yarn that may occur with rate reduction.

A1.1.4 Special Excises

The TRC had recommended reduction of the multiplicity of rates of excise duties to two or three viz. 10, 15 or 20 per cent. The Committee suggested that in addition, there could be selective excise duties on non-essential commodities or commodities injurious to health. The maximum rate on a commodity should not exceed 50 per cent with a few exceptions like cigarettes.

It may not be necessary to levy sumptuary excises in every case on an ad valorem basis. There could be specific duties particularly when the commodity is a finished product not entering the production process. The existing duties on motor vehicles, plastics, refrigerators and air-conditioners, cosmetics, ceramic products and aerated waters could bear special excises so that the incidence does not fall steeply (see Table A1.1). On the other hand, commodities like cigarettes and man-made filament yarn could continue to be subjected to a cumulative duty which need not be split into Central VAT and special excise to avoid any adverse impact on the devolution of proceeds from excise duties to the States. As an interim measure, it may be necessary to levy special excises on tyres and cement, as suggested earlier.

The base for application of special excise when expressed in ad valorem terms should in principle be the assessable value for Central VAT plus the Central VAT. However for the sake of simplicity, it is suggested that the assessable value for special excise may be the same as for Central VAT.

A1.1.5 Extension of MODVAT

The main drawback of the existing MODVAT system arises from the limitations in its application described earlier. The excluded items like petroleum, textiles and tobacco products yield substantial amounts of revenue. At present, as much as 40 per cent of excise revenue is derived from non-MODVAT commodities. To the extent

that MODVAT is not applicable to these items, the cascading effect of excise duties in the economy continues.

Another anomaly arises from the specific duty applied in the case of a number of commodities. Currently nearly 70 per cent of the Central excise revenue is derived from commodities on which specific duties are leviable. Apart from petroleum, textile and tobacco products (to which MODVAT is not extended), these include sugar, paper, cement, tyres, aerated water and consumer durables such as air-conditioners and TVs. A specific duty in the case of a finished product will mean a constantly changing incidence of duty in an inflationary situation. One of the unfinished tasks of excise reform is to convert the specific duties on commodities for which MODVAT credit is available into ad valorem.

Exemption from Central Excise duty is yet another area which has complicated the operation of MODVAT. There are some products such as tractors, some of which are exempted on the basis of specifications. The parts required for the exempted and dutiable varieties are purchased together by the manufacturer and to maintain account on the basis of whether the finished product is exempt or not will be extremely difficult. The TRC has recommended withdrawal of the exemptions to the maximum extent possible and when this is implemented the problem will be eased to a large extent.

It should be possible to extend the MODVAT system to the excluded commodities, namely, petroleum products, tobacco products, textiles, cinematographic films and matches. There could be marginal variation in the rates of duties on the final products in order to provide for MODVAT credit without significant adverse impact on revenue. Extension of MODVAT to tobacco products may not present any problem as the revenue impact of such a measure is not likely to be very significant. In the case of petroleum products, it has been suggested there should be an ad valorem component of duty and this should be permitted as credit when a product is used as an input.

As regards textiles, MODVAT may be extended in stages as recommended by the

TRC. The first stage of the reform would consist of introducing MODVAT till the yarn stage in all sectors and provide for input duty relief in the case of cotton textiles, without subjecting grey fabrics to the levy. The input duty relief in the case of independent processors will be on a notional basis whereas integrated mills will follow the regular MODVAT procedure. The same system may be applied later to synthetic and blended fabrics other than those for fabrics made of filament yarn. The duty on filament yarn would have to be progressively lowered so that within three to five years the level of duty on filament yarn is at the same level as the other commodities. At that stage, it should be possible to extend VAT to fabrics made of filament yarn.

In 1991-92, the total yield from additional duty in lieu of sales tax from synthetic fabrics including fabrics of man-made staple fibres was about Rs. 600 crore. A levy of about 25 per cent of the current incidence of additional duty on these fabrics as basic excise duty or Central VAT, it is estimated, would yield adequate revenue to make up for the loss arising out of the proposed duty reduction on filament yarn. (At this stage, there will not be any MODVAT in the case of fabrics made of filament yarn).

The TRC had envisaged that at a future date powerloom factories may be permitted to avail of the small scale exemption applicable in the case of other commodities. It appears that there are practical difficulties in implementing the TRC's recommendation, given the existing threshold for exemption for small scale units. The current threshold level of Rs 30 lakh per year would cover even units having 10 powerlooms. It is reported that a substantial number of powerloom factories in the country are in units with less than 10 powerlooms. So, with an exemption level of Rs 30 lakh of turn over, it would not be possible to derive any significant revenue from the powerloom sector.

The TRC has recommended extension of MODVAT to machinery, permitting credit of duty paid not fully at the time of purchase but in instalments during a subsequent period of years to be laid down in the law. One of the

considerations underlying this suggestion is the likely adverse impact on revenue. Granting credit in instalments may however present administrative problems. In a consumption type VAT, it is necessary to grant the credit of duty as soon as the machinery is brought into the factory for installation. No doubt, this may entail revenue loss of the order of Rs.700 crore on account of MODVAT credit in central excise duty and Rs.600 crore on account of MODVAT credit in countervailing duty. To contain revenue loss, it may be provided that excess credits will only be carried forward and not refunded, except in the case of those whose sales consist mainly of exports.

A1.1.6 Withdrawal of exemptions

A system of VAT or MODVAT cannot function effectively if there are large areas of duty exemption in the system. As the TRC has pointed out, in a scheme of value added tax, exempting a few products means exemption only in respect of value added at the final stage since no credit is available for the duty paid on inputs. It is true that in a number of cases, exemption from excise duty has been given to inputs based on end-use. These end-use based exemptions have complicated and distorted the tariff causing difficulties in administration, opening up avenues for evasion. To widen the tax base, it is necessary to withdraw many of the exemptions which are currently in force. The exemptions which have been identified by the TRC are given in paragraph 9.6 of the Interim Report of the Committee. In addition, there are several other exemptions relating to individual products. An attempt has been made for this paper to estimate the gross value added in the major exempted sectors from the National Accounts. Revenue likely to be derived by subjecting these commodities presently exempt to a 10 per cent VAT would be of the order of Rs.2500 crore as estimated in Table A1.3. Needless to mention, the revenue so generated will be shareable between the Centre and the States.

A1.1.7 Tax on Services

The TRC has recommended that the tax base for indirect taxes should be broadened *inter alia* by covering many, if not most, of

the services and a beginning could be made with the taxation of a few services. As argued elsewhere in this study, taxation of services is necessary for broadening the Tax Base.

The TRC had favoured levying of a tax on the following services by the Central Government:

1. Advertising services;
2. Services of stock brokers;
3. Services of automobile insurance;
4. Service of insurance of residential property, personal effects and jewellery; and
5. Residential telephone service.

The pros and cons of taxation of services are examined in Chapter 7. In conclusion, it is suggested that services should be taxed selectively at least for the present and those for which location of consumption is difficult to determine should be taxed by the Centre. By and large, the services recommended for Central taxation by the TRC fall in that category. On the basis of available information, it is estimated that an amount of Rs.1300/- crore should accrue from a tax on the services contemplated by the TRC (other than advertisements), vide Table A1.4. (It has not been possible to estimate the possible revenue yield from advertisement services).

As there is little difference between taxation of commodities and that of services, it is only proper that the revenue accruing from the service tax is also shared between the Centre and the States. However, in view of the fact that the Centre's revenues in the next couple of years may be adversely affected because of the rationalisation and lowering of Customs duties, it is proposed that for the time being, the yield from the Central tax on services may be retained by the Centre, until the entire revenue needs of the Centre and the States are assessed by the Finance Commission.

A1.1.8 Abolition of additional duty in lieu of sales tax

The scheme of levying additional excise duty in lieu of sales tax was implemented through an Act of 1957 in the case of sugar, tobacco and textiles.

There have been persistent demands from many States that they be permitted to levy sales tax on these commodities. An examination of the measures taken to ensure that the promised targets fixed in the case of additional duty in lieu of sale tax were reached shows that these have resulted in a number of complications in central excise tariff.

With the reform of the trade taxes and move towards a harmonised system of consumption tax, the States should be free to levy State VAT on the items of consumption. viz. sugar, tobacco and textiles. Such an arrangement would however be possible only after State VATs get implemented and the tax systems in the States are harmonised and rationalised. Until then, the additional duty in lieu of sales tax may continue to be collected as at present.

A1.1.9 Additional Duty of Customs (Countervailing Duty)

In terms of Section 3 of the Customs Tariff Act, an additional duty of customs equal to the excise duty on a like article manufactured in India is leviable on imported goods. The amount of countervailing duty (CV duty) collected during the last five years is shown below:

(Rs. crore)			
Year	Customs duty (Basic+ auxiliary)	Additional Customs duty (CV duty)	CV duty as % of total collection
1988-89	13879	2140	13.36
1989-90	16033	2293	12.51
1990-91	17990	2972	14.18
1991-92	18320	3519	16.11
1992-93	20613	3575	14.78

At present, the revenue from this duty being in the nature of customs duty is retained entirely by the Centre. However, in the case of inputs, the countervailing duty is adjusted against excise duty payable on finished products. Thus the CV duty retained by the Centre goes to reduce the yield from the excise duty which is shareable between the Centre and the States. In equity, the yield

from CV duty should be shareable between the Centre and the States. No doubt, only part of the CV duty collected would get adjusted as MODVAT credit, because CV duty falls also on finished products and to some extent the goods may be used as input by the sector exempted from excise duty. There is no estimate of the CV duty which is adjusted as MODVAT credit. It is only after adequate data are collected to make such an estimate, that an appropriate formula for sharing CV duty can be evolved. Till then, the entire amount of CV duty collected may be shared with the States. Sharing of CV duties would also compensate the States for the 'loss' arising out of the introduction of non-shareable special excise duties.

A1.1.10 Countervailing duty equal to State VAT

If the imports are to be taxed on the same footing as domestic products, there has to be a levy of countervailing customs duty equal to the State VAT on domestically produced commodities. However, in the case of imports by registered dealers there would be little point in applying the countervailing duty because the duty would be allowed to be set-off against State VAT, when the goods are sold in the domestic market. This will not be true of imports by unregistered dealers and high-seas sales. There would, therefore, be a case for levying countervailing duty on such imports. This duty can be equal to the maximum of the standard rate prescribed for State VATs. Similarly there should be a State VAT countervailing duty on baggage and other imports for personal consumption.

Assuming imports by unregistered dealers and high-sea sales to be 5 per cent, each of the total imports (Rs.47850 crore in 1991-92) and also providing for a small amount to accrue from personal importations, it is estimated that the yield from such a countervailing duty would be of the order of Rs.500 crore at 1991-92 level of importation. Considering the nature of this levy, it will have to be pooled and shared among the States on a formula to be decided by the Finance Commission. However, levy of such a countervailing duty will have to be considered only after the indirect taxes in the States have been rationalised and harmonised.

A1.1.11 Abolition of Cesses

In addition to excise duties, Central Government levies cesses on certain commodities and these are also administered by the Department of Revenue. (There are certain other cesses which are collected by Ministries/Departments other than Revenue Department).

Several Committees have felt that cesses in general should be abolished and support for particular activities of the Government be provided directly from the budget. In the context of rationalisation of the excise duties, cesses should be abolished and budget support where necessary should be provided from the Consolidated Fund of India. This would result in decrease in the Centre's revenue to the extent of Rs.246 crore at 1991-92 level of collections.

For the same reason, additional duty levied on textiles and textile articles under the Additional Duties of Excise (Textile and Textile Articles) Act, 1978 to finance Janata Cloth Scheme, also should be withdrawn. The revenue to the Centre from these duties was Rs.348 crore in 1991-92.

A1.1.12 Revenue impact of the suggested interim measures of reform

The revenue impact of all the above proposed interim measures is given in Table A1.5. The calculations have been made on the

basis of actual collections in 1991-92. It will be seen that overall, the suggested measures will result in additional revenue to the extent of Rs.1113 crore to the Centre and of Rs.160 crore to the States, at 1991-92 level of collections. The increase in the revenue of the Centre would partly neutralise the 'loss' due to reduction in the level of Customs Tariff and enable the Centre to help some of the States to move over to the VAT system.

A1.1.13 Modification of the rate structure over a period of time

The rate structure suggested for Central VAT and special excise is such that the changes from the existing incidence are not too abrupt. The level of duty suggested for a particular commodity/commodity group is based on certain assumptions. It would be necessary to allow the recommended rate structure to work for a year or two and watch the revenue yield and the credit availed of in the case of commodities to which MODVAT is proposed to be extended. Modification can then be made in the rates through a process of iteration to correct any anomaly that might come to notice because of extension of MODVAT. The goal should however be to help move the system towards a true VAT at the Centre.

Table A1.1

Statement Showing Current Yield & Proposed Yield of
Central Excise Revenue from Major Commodities

Sl. No.	Commodity	1991-92 (Actuals)	Current estimated incidence (Rs crore/ %age)	Proposed incidence		Proposed Total Yield		
		Basic duty		Central VAT (Rs crore/ %age)	Special Excise (Rs crore/ %age)	Central VAT	Special Excise	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1.	Petroleum products	2796	2796	1336	1460	1336	1460	2796
	a. Motor spirit	1245						
	b. Refined Diesel Oil	703						
	c. All others in Chapter 27	433						
	d. Kerosene	246						
	e. Petroleum gases etc.	72						
	f. Furnace oil	57						
	g. Diesel oil NES	40						
2.	Cigarettes	1638	1638	1638		1638		1638
3.	Man-made Fibres & Filament Yarn	2075	2075	1912		1912		1912
4.	Motor vehicles	1805	40%	20%	20%	903	903	1805
5.	Iron and Steel	1431	10%	10%		1431		1431
6.	Rubber products	992	35%	20%	200	567	200	767
	a. Tyres, tubes	811						
	b. Others	181						
7.	Cement	1281	30%	20%	200	854	200	1054
8.	Chemicals	1397	15%	15%		1397		1397
9.	Machinery	1416	15%	15%		1416		1416
10.	Elec. machinery	1368	15%	15%		1368		1368
11.	Non-ferrous Metals	812	10%	10%		812		812
	a. Aluminum	653						
	b. Copper	78						
	c. Zinc	53						
	d. Others	28						
12.	Man-made fabrics	0	0	163		163		163
13.	Sugar	393	8%	10%		491		491
14.	Plastics	792	35%	20%	15%	453	339	792
15.	Pharmaceutical products	426	15%	15%		426		426
16.	Paper and paperboard	388	30%	20%		259		259
17.	Cotton yarn & fabrics	191	4%	10%		478		478
18.	Paints and dyes	343	25%	20%		274		274
19.	Soap and detergents	375	20%	20%		375		375
20.	Refrigerators & Airconditioners	271	40%	20%	20%	136	136	271
21.	Cosmetics	263	75%	20%	30%	70	105	175
22.	Wireless Receiving Sets	232	20%	20%		232		232
23.	Ceramic products	228	40%	20%	20%	114	114	228
24.	Glass & glassware	235	30%	20%		157		157
25.	Wires & cables	271	15%	15%		271		271
26.	Biris	144	144	144		144		144
27.	Articles of base metals	110	15%	15%		110		110
28.	Aerated waters	135	40%	20%	20%	68	68	135
29.	Vegetable products	49	10%	10%		49		49
30.	Matches & explosives	92	8%	10%		115		115
31.	Tea	75	5%	10%		150		150
32.	Wood and wood articles	75	10%	10%		75		75
33.	Elect. Stampings & Laminations	59	15%	15%		59		59
Total		22158	22158			18301	3524	21825
Other Commodities		1399	1399	1399		1399		1399
Gross Revenue		23557	23557			19700	3524	23224
Refunds and Drawbacks		465	465			465		465
Net Excise Revenue		23092	23092			19235	3524	22759

Note: In columns 4 to 6, tax yield is reported for goods subjected to specific duty while tax rates are given for goods subjected to ad valorem duty.

Table A1.2

Statement Showing Existing and Proposed Incidence of Duty on Petroleum Products

Sl. No.	Commodity	Price (Rs/KL)	Basic Rate of duty	Price exct. of duty	Duty incidence	Proposed Incidence			Diff. in duty	Price incl. duty	Diff. in price	Revenue 1991-92	Rev. Central VAT	Rev. Spl. Ex.
						Cen. VAT	Spl. Ex.	Amount of duty						
1.	Motor spirit	14564	2481	12083	20.5	5	1875	2479.24	-1.76	14562.24	-1.76	1245	304	941
2.	Diesel oil	5606	352	5254	6.7	5	100	362.19	19.19	5616.19	10.19	703	503	200
3.	Kerosene											246		
	(a) Industrial	5515	375	5140	7.3	5	125	381.67	6.67	5521.67	6.67			
	(b) Domestic	2201	335	1866	18.0	5	250	342.90	7.90	2208.90	7.90		81	165
4.	Furnace oil											57		
	(a) Fert. feedstock	2812	0	2812	0.0	5	0	133.90	133.90	2945.90	133.90			
	(b) Fert. fuel	4999	75	4924	1.5	5	0	238.05	163.05	5162.05	163.05			
	(c) For bunkering coastal vessels	4999	11	4988	0.2	5	0	238.05	227.05	5226.05	227.05			
	(d) Other feedstock	4999	110	4889	2.2	5	0	238.05	128.05	5127.05	128.05		57	0
5.	Naphtha for													
	(a) fertilizer	3723	5.5	3718	0.1	5	0	177.29	171.79	3894.79	171.79			
	(b) gas turbine	6075	660	5415	12.2	5	400	670.24	10.24	6085.24	10.24			
	(c) petrochemicals	6075	66	6009	1.1	5	0	289.29	223.29	6298.29	223.29			
6.	LSHS													
	(a) Power generation	2851	0	2851	0.0	0	0	0.00	0.00	2851.00	0.00			
	(b) Other than power generation	4804	175	4629	3.8	5	0	228.76	53.76	4857.76	53.76			
7.	Gases & Diesel N.E.S.											112	80	32
8.	All others (40)											433	310	123
Total												1336	1460	

- Notes:
- The rate of special excise duty has been so worked out as to keep the incidence close to the existing levels.
 - The Central VAT has been applied on the current price minus proposed special excise.
 - The Central VAT on furnace oil and naphtha used in the manufacture of fertilizer will be available as input credit.
 - In the case of kerosene the likely revenue yield has been calculated on an approximate basis assuming the average special excise duty to be Rs.225.
 - The likely yield in the case of sl.no. (7) and (8) from Central VAT and special excise has been estimated in the same ratio as in Diesel Oil.

Table A1.3

A Summary Statement of Likely Gains from Withdrawal of Central Excise Exemptions

Description	Rs. crore
I. GVA of Regd.Manufacturing in 1988-89 (Rs.crore)	41760
II. GVA of exempted goods in 1988-89 (SSI+large-scale) (Rs.crore)	14402
III. Less:GVA of exempted goods in 1988-89 (SSI below Rs. 30 lakh turnover per annum only) (Rs.crore)	2673
IV. GVA of large units in the production of exempted goods. (Rs.crore): Potential tax base in 1988-89	11729
V. Potential tax base as percentage of I	28.1
VI. GVA of Regd. Mfg.in 1991-92 (Rs.crore)*	60333
VII. Potential tax base in 1991-92 (Rs.crore)	16953
VIII. An estimate of potential revenue at a weighted average duty rate of 15% (Rs.crore)**	2543 or say 2500

Notes: GVA = Gross Value Added.
 * = As per White Paper, CSO; 1993.
 ** = The modern small scale industry considered above does not cover some products, namely coir, handicrafts, handlooms and powerlooms. Taking into account the contribution of these sectors to the tax base, it is possible that the revenue potential from withdrawal of exemptions is Rs.2500 crore even at a rate less than 15% say, at about 10%.

Table A1.4

An Estimate of Tax-base of Selected Services

Sl. No.	Items	Tax-base (Rs. crore)	Proposed tax rate (%)	Revenue (Rs. crore)
		(1)	(2)	(3)
1.	Brokerage on sale-purchase of stocks	3000	10	300
2.	Non-life insurance premia net of claims	4000	10	400
3.	Téléphone-telex-fax-pay phones etc.	6000	10	600
	Total	13000		1300

Table A1.5

**Impact of Interim Reforms in Central Excise on
Revenue Based on 1991-92 (Actuals)**

(Rs.crore)

Measure	Existing			Proposed			Difference	
	Centre's Share	States' Share	Total	Centre's Share	States' Share	Total	Centre's Share	States' Share
Rate rationalisation (excluding duty on petroleum products & capital goods eligible for MODVAT credit)	12151	9941	22092	10029	8206	18235	-2122	-1735
Extension of MODVAT to petroleum products (C.X duty)	165	135	300	0	0	0	-165	-135
Extension of MODVAT to capital goods (C.X. duty)	385	315	700	0	0	0	-385	-315
Special Excise	0	0	0	3524	0	3524	3524	0
Conversion of crude cess into Special Excise	2466	0	2466	2466	0	2466	0	0
Withdrawal of exemptions	0	0	0	1375	1125	2500	1375	1125
Tax on services	0	0	0	1300	0	1300	1300	0
Extension of MODVAT to capital goods (CV duty)	600	0	600	0	0	0	-600	0
Sharing of CV duty (other than on capital goods)	2712	0	2712	1492	1220	2712	-1220	1220
Abolition of Cess (other than on crude)	246	0	246	0	0	0	-246	0
Abolition of AD (T&TA)	348	0	348	0	0	0	-348	0
Total CX duty & CV duty	19073	10391	29464	20186	10551	30737	1113	160

Notes:

- From the proposed total yield of Central VAT an amount of Rs.1000 crore has been deducted, being the estimated MODVAT credit likely to be availed of in the case of petroleum products (Rs.300 crore) and capital goods (Rs.700 crore).
- Special excise and tax on services are treated as non-shareable.
- CV duty is assumed to be 15% of total collections from customs duty.
- The total customs revenue from machinery including project imports in 1991-92 was Rs.5820 crore. This includes Rs.1874 crore from project imports which did not carry any CV duty. Assuming 20% of the balance accounted for CV duty, the yield would have been Rs.800 crore. But this will include revenue from items which are not in the nature of capital goods, and items which were exempted from CV duty. Assuming that such items accounted for 25% of the revenue, CV duty from capital goods eligible for MODVAT credit will be about Rs.600 crore.
- The total central excise revenue from machinery (including electrical machinery) in 1991-92 was Rs.2784 crore. This included (a) machinery supplied to the non-duty paying sector and (b) machinery in the nature of finished goods and machinery components already availing of MODVAT credit. Assuming that (a) accounts for 50% of the revenue and (b) for 25%, the revenue from capital goods becoming eligible for MODVAT credit will be about Rs.700 crore.
- In the case of petroleum products, MODVAT credit will be available only when they are used as feed stock. Considering the fact that the excise duty for such uses is at concessional rates much lower than the standard rates and that motor spirit and 90% of diesel oil are used for transportation it is estimated that the amount of duty likely to be taken as MODVAT credit will be Rs.300 crore.