CHAPTER VII

REPLACEMENT OF SALES TAX BY ADDITIONAL DUTIES OF EXCISE

In December 1957, Parliament passed the Additional Duties of Excise (Goods of Special Importance) Act, 1957, to replace sales tax on sugar, tobacco and textiles (cotton fabrics, rayon or artificial silk fabrics, and woolen fabrics) by additional duties of excise. Recently these duties have replaced sales tax on silk fabrics.[1] Sales tax from its inception in India has been a constant source of harassment and inconvenience to businessmen. Though the incidence of the tax falls on the consumer yet it is incumbent on the dealer to comply with the law. The majority of the dealers in India are small tradesmen without much education. The difficulties of maintaining complicated accounts, assessment of liability on the basis of those accounts, understanding the statute and keeping pace with the frequent amendments of the statute and the rules thereunder present difficulties which are often more burdensome than the tax itself. Further, the administration of tax collection equally with that of checking of tax evasion has been a problem for the government. From the angle of interstate trade, diversity in the tax rates on the same commodity in the central and state tax laws tends to cause unnecessary movement of goods from one state to another. The multiple taxation of the same commodity under different tax laws and diversity in the rates of tax may also give rise to the problem of interstate trade barriers.[2] Because of the difference in rates, the incidence of the tax on consumers varies from place to place. Further, when there is a great divergence in rates, particularly in contiguous states, there is danger of smuggling of goods from one state to another.[3]

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1. See sec. 15 of the Finance Act, 1961.
2. See *supra*, Chap. IV.
3. This was also pointed out in some of the replies to the Institute's enquiries. Dr. Lokanathan in his report on the Simplification and

To avoid all these difficulties, the National Development Council in December, 1956 recommended that on the three commodities mentioned above, sales tax should be replaced by the additional duties of excise by the Centre, provided that the previous income of the states from this source was assured to them. Parliament has power to impose excise duties under Art. 272 of the Constitution but it cannot by its mandate ask the states to give up sales tax revenue on a particular commodity or generally. However, it can give grant-in-aid to the states on the condition precedent that the states do not impose sales tax on particular commodities. Therefore, sales tax is to be given up by the states only on the basis of agreement between them and the Centre. On 22nd May, 1957, the Government of India referred the matter to the Second Finance Commission to make recommendations "as to the principles which should govern the distribution of the net proceeds of this additional duty among the States and the amounts which should be assured to the States as the income now derived by them from the levy of sales tax on these commodities."[4] The Commission adopted consumption as the main basis for the distribution of the proceeds, but since there was considerable margin of error in the figures of consumption, it also used population as a corrective in arriving at the figures for distribution of the proceeds among the states.

In accordance with the above principles and recommendations of the Finance Commission the Additional Duties of Excise Act was passed by Parliament. States were to give sales tax on sugar, tobacco and textiles in lieu of the share in the proceeds of additional excise duties on these commodities.

Improvement of the Sales Tax System in Madras, 1957, observes at p. 6: "In the case of sugar, it is estimated, the actual revenues were only about 50% of what should have been received. Clearly the leakage was large. The main reason for this leakage is said to be large-scale evasion encouraged by the sizeable differential between the Madras rate and the rates in neighbouring States. It is known that there was (and still is) widespread smuggling along the State borders which the Commercial Tax officials are unable to check."

4. *Finance Commission Report*, 1957, p. 2.

In order to make the states amenable to the scheme, the three commodities were designed to be declared goods[5] so that states' power to levy tax on their sales was limited to a maximum of 2 per cent.

The rates of excise duties are fixed on a sort of weighted average of the sales tax rates of all the states.

All the states have now accepted the scheme. Three main advantages have flowed from it. From the point of view of trade, the measure has been very welcome for it has eliminated considerable inconvenience experienced by the commercial community previously. The states are actually getting more revenue than before since evasion occurring under sales tax laws has now been checked. Thus the Central Government is said to have collected the additional excise duties of Rs. 42.12 crores on these three commodities in 1958-59, as against only Rs. 32.50 crores collected by the states as sales tax on them in the previous year.[6] Further by doing away with sales tax the scheme has been beneficial from the point of view of interstate trade and commerce.

In spite of the substantial gain from the scheme, a general extension of it to other commodities does not appear to be feasible. One obvious limitation is that administratively speaking excise is difficult to collect when there are inumerable producers with small units of production. When the excise is levied on the mass of commodities, administrative problems are no less than under the sales tax. Excise has advantage over sales tax only when the production is on a large scale and concentrated in a few hands. Apart from its limited usefulness from the point of view of administration, there is the difficulty that the states will lose the advantage of flexibility which sales tax gives them. Under sales tax, the states can change the rates to suit the changing fiscal and trade con-

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5. Section 7 of the Act. The section has now been repealed by the Central Sales Tax (Second Amendment) Act, 1958, and section 14 of the latter puts these commodities in the category of declared goods. With the imposition of additional excise duty on silk fabrics, this commodity has also been put in the category of declared goods, see sec. 14 of the Finance Act, 1961.

6. *The Hindustan Times*, September 3, 1959, p. 12, col. 6.

ditions in their respective areas. Such adjustments are not possible when the Central Government is levying additional excise duty in lieu of sales tax, for the Central Government will need to have the consent of all the states, and then a change in the rate of excise will affect not only that state which desires the change but also other states. Sales tax can also be varied in relation to different grades of consumers in accordance with the needs of a particular state, but this is not possible in the case of an excise levy by the Central Government.

If additional duties of excise were substituted in place of sales tax the states' dependence on the Centre for revenue would increase to a very great extent. In the course of Lok Sabha debate on the Additional Duties of Excise Bill, it was suggested that the Act be extended to other commodities. The then Finance Minister, Mr. T. T. Krishnamachari observed: "It (the Bill) detracts from the responsibility of the States to their own people to some extent, because they can always say that the Centre has done it. If tomorrow something goes wrong, say, in regard to any particular provision in this particular Bill, it is easy for the people to say, well, it is the Centre that has done it, and we are not responsible. Even in the Taxation Enquiry Commission. . . . I did mention this fact that the centralization of sales tax altogether would not be a correct thing because if the power of taxation is shifted to the Centre, there is no responsibility left so far as the States are concerned. So, we have also to keep the number of commodities that will come within the purview of Central taxation, however, beneficial it might be, to be restricted rather than enlarged, though, I do not, for one moment, say that there is no room for enlarging the present list."[7]

Therefore, extension of additional duties of excise does not seem a feasible device for use on a general scale. However, the Centre in agreement with the states may consider the desirability of extending it to a few more commodities, like cement and iron and steel.

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7. *Lok Sabha Debates*, 2nd Series Vol. X (1957) p. 6215. A meeting of the State Ministers was held in New Delhi on 29th July, 1960 to consider the extension of additional duties of excise on silk fabrics, match, paper and vegetable products. Agreement could reach only with regard to silk fabrics to be covered by the scheme.