CHAPTER II - NATURE, SIGNIFICANCE AND FORMS OF SALES TAX
2.1 The Concept of Sales Tax

A sales tax is a tax on sales of commodities. It is levied on the occasion of the sale of goods and is charged on the proceeds thereof, whether taken individually or collectively. Usually it is calculated in the form of a percentage on the gross receipts of a dealer. It is, therefore, sometimes called 'turnover tax'.

"A sales tax is a levy imposed upon the sales, or elements incidental to the sales, such as receipts from them, of all or a wide range of commodities, excluding taxes imposed at fractional rates upon gross receipts, in the form of business occupation or license taxes." 1

The sales tax is a levy imposed upon the sales of commodities or services. 2

The sales tax, as generally understood, refers to any tax, which includes, within its scope, all business sales of tangible personal property, at either the retailing, wholesaling or manufacturing stage with exceptions noted in the taxing law. 3

Professor Flank has defined sales tax as a tax upon the sale or exchange of goods or services which is proportioned to the value or quantity of the things transferred. 4

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According to Neil H. Jacoby, all sales taxes are recognized to have two common properties:

(i) They are levied upon the process of sale or exchange of goods or services, and

(ii) the amount of the tax payable is produced by a constant rate applied to the volume or value of the commodities transferred or exchanged.\(^5\)

Sales tax is therefore, a tax on the sale of goods as clearly mentioned in the preambles to the various Acts and in the relevant charging Sections. It cannot be considered a tax on the goods themselves.\(^6\)

Thus the concept of sales tax has been defined by different authors differently. For the purpose of levying sales tax in a state, the government is concerned only with the collection of tax due in respect of the sale, and the only fact which it has to satisfy itself is whether the sale took place within the state.

The sales tax is a tax levied on the sale price of goods on the occasion of sales made within the state. It is to be noted here that such a tax is levied only on sale of a commodity. Gifts and presents do not come within the ambit of 'sales' and so they are out of bounds to the Sales Tax Acts of our States in this country. Similarly,


\(^6\) Tata Aircraft, Ltd. Vs. Board of Revenue, 13 S.T.C. 388 (Calcutta).
receipts on account of services rendered by a person, professional or for works contract, e.g. fees received by an architect, doctor or lawyer, printing charges of a handbill, pamphlet, or bulletin, charges for repairing machineries do not come under sales and as such are not subject to tax.

2.2 Nomenclature

2.2(1) Although this species of taxation is of ancient origin and has an important place in the tax system of most of the countries, there is not complete awareness of its possibilities and limitations; on the other hand there is confusion in the terminology applied to it. Two descriptive terms, practically synonymous and interchangeable, have developed 'turnover tax' and 'general sales tax'. Both these terms are sufficiently broad to cover all of the special types of taxes in the general species. It would seem desirable to accept the two expressions 'turnover tax' and 'general sales tax' as synonymous and applying to all taxes based on the sale, exchange, or transfer of commodities, properties or services. 7

The general sales or turnover taxes that have been levied in the United States and abroad may be classified as follows: 8

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7 General Sales or Turnover Taxation (National Industrial Conference Board, Inc., New York), 1929, pp. 4-5.
8 Ibid., p. 6.
Multiple Turnover Taxes

(a) General Turnover tax
(b) Commodity transfer tax

Single Turnover Taxes

(a) Production tax
(b) Retail sales tax

Luxury turnover tax

The primary basis of classification for turnover taxes is according to whether the tax is imposed on several or all transfers or stages in the economic progress of a commodity or service, or whether it is imposed once, and once only on each individual commodity or service. General sales or turnover taxes in the first category may be called multiple-turnover taxes. Those in the second category are single-turnover taxes.

The class of multiple-turnover taxes may be subdivided according to the scope of the tax. If the tax is limited to the sale or transfer of tangible materials and commodities, the tax is a commodity transfer tax. If commercial or professional services, the sale or transfer of immovable properties, or other particular categories of transfers or services come within the scope of the tax, it may be called a general turnover tax.  

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9 ibid., p. 5.
10 ibid., p. 6.
Single turnover taxes are to be classified according to the transaction that gives rise to tax liability. If the tax is imposed primarily on the sales made by producers or manufacturers, it goes by the name of production tax. If that which gives rise to the tax liability is the sale to the ultimate consuming purchaser, the tax is called a retail sales tax.

Finally, a general sales or turnover tax, single or multiple in character, may be restricted in its scope to the sales of articles and to the performance of services of a 'luxury' character. Taxes of this sort, known as luxury turnover taxes are generally levied as supplements to one or another of the broader forms of general sales or turnover taxation mentioned above.

Thus there is great diversity in nomenclature. This diversity has been prevalent since long. The general sales tax is therefore known by different names in different countries. It was 'Alcabala' in the fourteenth century Spain, a Turnover Tax in France, Germany, and the Soviet Union, a General Payments Tax in Peru, and a Producers Tax in Australia, a Purchase Tax in the United Kingdom, and the Business Transaction Tax in Argentina. Elsewhere, it is known variously as a transfer tax, a

11 ibid.
12 ibid.
transaction tax, a manufacturers' tax, a merchants tax, industrial tax, and a general stamp tax. Its name varies with the methods of its levy. Imposed on retailers only, it is known as retailers sales tax, and imposed on sales by producers, wholesalers and retailers alike, it gains the name of General Sales Tax or Turnover Tax. Imposed on selected articles, it becomes a selective sales tax, as Gasoline or Tobacco Tax, or Motor Spirit Sales Taxation or Intoxicants Sales Taxation. Imposed on the sale of professional or other services of real property, or intangible property, such as the receipts of interest, dividends, rental payments, wages and salaries, it is known as the Gross Receipts Tax. The name thus differs according to its scope, as much as the method of the application. Inspite of this wide diversity in its nomenclature, fundamentally, it is a tax on consumption everywhere.

2.2 (ii) Sales Tax and Turnover Tax

A turnover tax is the description of a tax usually calculated in the form of a percentage on the gross receipts of wholesalers or retailers or of both and in some countries, also in respect of receipts of services. It is, however, sometimes included under the more general name of sales tax, and it is evident from the various modern writers who have dealt with the subject -- that the latter expression is often used as a convenient name for a number of taxes ranging from turnover taxes to taxes on the
retail sale of specified classes of goods. 13

Neither 'turnover tax' nor 'sales tax' has achieved a recognised and certain meaning. In fact, the matter is still in a loose state and as the terms of taxation vary from one country to another, the nomenclature seems more to be a matter of chance between a turnover tax and sales tax than of science. Comstock in his book on 'Taxation in the Modern State', at page 113 observes: "The scope of sales and turnover taxes has varied greatly, some extended to all transactions, both wholesale and retail and others to wholesale transactions only. The first of these are usually called turnover taxes. Certain taxes include both goods and services while others include only goods. The German Turnover Tax is an example of a tax which includes nearly every type of transaction in the line of goods and services."

Findlay Shirras in his book 'Science of Public Finance' (Third Edition, 1936, at page 613) observes: - 'The Tax' (i.e. the sales, or the turnover tax) may be general as in France, and Germany or retail transaction may be included therein as in Belgium. It may be, as is common in the States of American Union, confined to retail transactions. It may be imposed as in Canada and Australia, as a producers'

or manufacturers' tax and it may be on classified industries or trades only. It may be levied nearly on all goods and services, as in Germany. It may exempt certain sales as in France, where the sales of farmers are exempted unless carrying on manufacture as well as agriculture.

2.3 Economists and the Sales Tax

It would be interesting to examine the opinions of well known economists on sales taxation as a whole.

Economists have not been kind to the sales tax.

Prof. Bastable has condemned sales taxation in the following words:-

"Taxes on all commodities, on transfers of goods, and on different forms of production would be extremely prejudicial to the development of industry, irksome and inconvenient to the payers, and very costly in collection. Financial history affords abundant examples of these evils." 14

According to Seligman, 15 the general sales tax is a sort of inverted income-tax and constitutes the last resort of countries which find themselves in such fiscal difficulties that they must subordinate all other principles of taxation to the one principle of adequacy. The general sales tax is a discredited remnant of an outworn system.


It is essentially undemocratic in its nature, and it would, if enacted, exaggerate rather than attenuate, the present inequalities of wealth and opportunity."

Carl Shoup and Robert Murray Haig who have made an extensive study of the sales taxes in the United States, are of the opinion that the sales tax marks an unnecessary retrograde and backward step in taxation. 16

The Committee on Taxation of the 20th Century Fund 17 conducted a survey of taxation in the United States in 1937 and recommended a programme for the future. The Committee recommended that the sales tax should be repealed in U.S.A. except in those states where pressing fiscal needs make such a step absolutely impracticable. Similar was the view expressed by the Committee on National Debt and Taxation (1927) in U.K., since Great Britain depended to a great extent on foreign trade, particularly exports, for its economic prosperity. The Committee felt that a general sales tax at each stage would be harmful to the industry in as much as it would raise costs, and would adversely affect the competitive capacity of British export goods. 18

As for a retail sales tax within the country, the Colwyn


Committee was confident that the British tax-payers would be more willing to pay direct taxes like taxes on Income which, unlike the general sales tax can be graduated according to the ability to pay. After a comprehensive survey of State and Local finance in the United States, Professor Elwin Hansen and Dr. Harvey Perloff also came to the conclusion that as the yields of other and more desirable taxes in the state are increased and developed, abolition or reduction of sales taxes should take place.  

Of all the economists, Professor Lutz alone has given unqualified support to the sales tax. His argument is that so far as the subordinate layers of Government are concerned the superiority of the sales tax over the individual income tax from the revenue point of view in America is more than proved. Prof. Lutz feels that in as much as no State can finance all the expenditure solely through taxes on incomes, and in as much as indirect taxation is inevitable in a fiscal system, the sales tax like the other indirect taxes has to be accepted as a necessary and profitable fiscal measure for intermediate layers of Government like the States under a federal community.

2.4 Sales Tax - Whether A Direct Tax or An Indirect Tax

2.4 (1) The primary liability to pay the sales tax, so far

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as the state is concerned, is laid down by the law on the seller. Some of the state laws have made provisions for collection of sales tax to be made by registered dealers only and have made such act of collecting by the unregistered persons to be an offence. From the point of view of an economist and as an economic theory, sales tax may be an indirect tax on the consumer but legally it need not be so.\(^{20}\) In fact, there can be a sales tax though the primary liability for it is put upon a person without giving him any power to recoup the amount of the tax payable from any other party.\(^{21}\) In other words, a tax can be sales tax, though the primary liability is placed upon the dealer without giving him an opportunity to recoup the same from the consumer.\(^{22}\) In this sense, sales tax is a direct tax.

2.4 (ii) Passing on the Tax to the Buyer

Doubtless the legislature must have been aware that sales tax, like every other tax, would be passed on to the consumer, if possible.\(^{23}\) According to accepted notions, a sales tax is intended to be passed on to the buyer, and provisions authorizing and regulating the collection of


\(^{22}\) S. Ramnath Shenoy and Co. Vs. S.T.C. 14 S.T.C. 231 (Kerala).

\(^{23}\) See Bates Shoe Co., Ltd. Vs. Member, Board of Revenue, 1 S.T.C. 193 (Calcutta) = 53 C.W.N. 278.
sales tax by the sellers from the purchasers are a usual feature of sales tax legislation. But it is not an essential characteristic of sales tax that the seller must have the right to pass it on to the consumer, nor is the power of the legislature to impose a tax on sales conditional on its making a provision for seller to collect the tax from the purchasers.\textsuperscript{24} Even if there are enabling provisions, in any form, in the statute concerned, for passing on the tax to the purchaser, the existence thereof does not mean, that it is incompetent to the legislature enacting legislation, pursuant to Entry 54 in List II, by suitable provisions, to make the tax paid by the purchaser to the selling dealer, together with the sale price, in consideration of the goods sold, a part of the turnover of the dealer; nor does it mean that the tax as imposed by government is a tax on the buyer so that the tax must always remain outside the sale price. The facility to pass on the tax liability to the purchasers is not a necessary condition precedent to the validity of a sales tax law.\textsuperscript{25} When the seller passes on the tax and the buyer agrees to pay sales tax in addition to the price, the tax is really a part of the entire consideration and the distinction between

\textsuperscript{24} J.K. Jute Mills Co., Ltd. Vs the State of Uttar Pradesh, 12 S.T.C. 429 (S.C.).

\textsuperscript{25} The State of Mysore Vs H. Ibrahim Saheb and Sons, 15 S.T.C. 273 (Mysore).
the two amounts--tax and price--looses all significance from the point of view of legislative competence.26

2.4 (iii) Selling Dealer not an Agent of State to Collect the Tax

It is not correct to say that the registered selling dealer, collecting tax on the sales from his customer, even though the State Sales Tax Law might contain a provision for such collection to be made by registered dealers only--does so as an agent of the State. The Sales Tax Act in a way ignores the customer altogether. The charging section makes a dealer liable to the payment of the tax on the sales of the turnover. There is no provision in the Act which says that the customer will have to pay a sales tax at such and such rate. There is not even a direct provision to the effect that the dealer shall charge this amount from his customer. Wherever the law so provides, that a registered dealer alone can charge tax from his customer, the provision itself is not giving the registered dealer any such authority but is only providing a ban to any one not registered not to collect any tax. The authority through which a selling dealer charges his customer the amount of tax payable by him is a general authority of a dealer to charge what he likes from his customer. It is

only when he realises the tax as a tax, that he has to comply with the other requirement of the provision, namely to pay over to the state all such tax so realised.  

2.5 Motive of Sales Taxation

The emergence of sales tax in modern times may be ascribed to the following:-

(1) Why Sales Tax - War

Before the First World War, the sales tax was not of great significance. Most of the leading European nations adopted the sales tax during the years 1919 to 1923, especially as an aid to the fiscal system, wrecked by the drain of war and post-war expenditures and uncontrolled inflation. The close connection between the sales tax and the world war is indicated by the fact that the tax has been adopted by none of the European countries which remained neutral and by all the European belligerents except Great Britain. Once adopted, the sales tax tends to remain.  

The economy of many European countries was shattered by war. Their reconstruction became an urgent and fair task. Devastated towns, cities and villages had to be rebuilt. Industries and trade had to be reorganised. Disrupted communication

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27 Sales Tax Commissioner Vs Sada Sukh Vyapar Mandal, 10 S.T.C. 57 at p. 65 (Allahabad).

28 Haig and Shoup, op.cit., pp. 5-6.
systems had to be re-established. The monster of inflation had to be fought. All these problems cried for more and more money, and the sales tax came in handy. It was to save the country from alarming situation that the sales tax was resorted to.

(2) Depression of the Thirties

In the U.S.A. the States sales taxes originated as a means of eliminating deficits which arose from the depression of the thirties and of meeting the demand for lower property tax rates. The depression reduced revenue from other State taxes and increased expenditures, for relief and public works, while the State Governments sought increased State aid and urged the States to free property taxes for their sole use. Potential yields from State income taxes and other possible sources were limited.

(3) Political Ideologies

Political ideologies also indirectly contributed to its emergence. The Congress Party which had assumed office in the former British India Provinces, in 1937, under the Government of India Act, 1935, was irrevocably wedded to a policy of prohibition, and at the earliest opportunity, it wished to implement it. That, of course, meant a serious loss of revenue obtained from excise on intoxicants and narcotics, which ranked second next only to land revenue in state finance. So, in 1938, Madras State sought to make good the loss of excise revenue by introducing sales tax in 1939.
(4) **Equity**

Considerations of equity in taxation played their part in the introduction of sales tax in recent times. Most of the public expenditure is incurred with a view to help the poor and hence it is only fair that the poor also pay a little towards meeting such expenditure.

(5) **Welfare Concept**

The financial needs of modern governments are ever growing. Sales tax has offered a fruitful and elastic source of revenue in all nations. In the context of planned economic development, the states have exploited this fertile source of revenue. Many States in India adopted sales tax to meet the growing developmental expenditure of the five year plans.

2.6 **Rationale of Sales Taxation**

The sales tax has been introduced as a measure designed to raise large sums of money quickly under the pressure of financial emergency. The sales tax has been justified on the following grounds and not because it necessarily conforms to certain accepted standards of tax policy.

The arguments advanced for the use of sales tax are:

(1) Being a consumption-expenditure-based tax, the adverse effects on economic incentives are avoided which an income-tax, particularly a high progressive one, creates.

(2) One of the primary arguments for the use of the sales
tax in preference to both income taxes and spending taxes is the greater ease of administration. This is because the sales tax is collected from a relatively small number of business firms, instead of large number of individuals and thus control is easier and less expensive. Moreover the tax is collected on the basis of figures of total sales, which are much easier to ascertain and subject to less interpretative questions, than net earnings, which must be calculated for the portion of the income tax applying to any type of business activity. In a country with large number of persons in the lower income groups, an income tax with reasonable exemptions is likely to reach only a small proportion of the population; if the remainder are to make some contribution to tax revenue, the sales tax may be only feasible basis.\(^{29}\)

The argument of administrative effectiveness has played a particularly important role in the development of sales taxation in countries in which standards of tax administration, tax compliance, and literacy are relatively low. In such countries effective collection of income tax is almost impossible, and reliance upon sales taxation becomes imperative. This is a partial explanation of the dominance of commodity taxation in many countries, two or three centuries ago, and of its continued importance in some

\(^{29}\) John F. Due, _op.cit._, p. 34.
countries down to the present time.  

(3) Though it is widely accepted that the tax should conform to equity considerations and income tax conforms most closely with accepted standards of equity, it is, however, contended that the supplementary use of the sales tax can increase the overall equity of the tax structure. The sales tax insures some payment from persons, who legally or illegally, are able to escape adequate payment under the income tax. Furthermore, the income tax does not differentiate between various forms of income, on the basis of differences in spending power, in any satisfactory way. The sales tax provides the differentiation because it applies only to the actual amount spent.

(4) Support for sales tax also comes from groups who wish to see a greater proportion of total governmental cost imposed upon the lower income group than that which result from the usual income tax. It was once argued by these persons that the sales tax is a more efficient way of reaching the low income groups than the income tax is.

(5) The sales tax as compared to excise has three major advantages. In the first place, because of its greater coverage, a lower rate is possible for the raising of a given sum. The lower the rate, the less is the incentive given, to the evasion, and the less serious are the

30 ibid.
objectionable results of the tax, other features being the same. Secondly, the sales tax avoids the inevitable discrimination created by the excise taxes against those persons who have relatively high preferences for the taxed articles. A sales tax, if properly designed, is uniform, on all consumption expenditures. Finally, the excise taxes will lead to reallocation of consumer demand and thus a reallocation of resources; a uniform sales tax will not cause reallocation of resources.

(6) When a rapid rate of economic growth is desired to raise standards of living, it is obvious that high income taxes will lessen the potential rate of capital formation by reducing significantly the overall propensity to save. A sales tax compels a temporary reduction in consumption and insures that the savings of the higher income groups will be available for capital formation. This is more important in the case of underdeveloped countries.

(7) In countries with Federal governmental structures, to insure autonomous revenue to one of the levels of government, particularly the State governments, sales tax is essential and very useful.

(8) The sales tax is an instrument of anti-inflationary fiscal policy. Sales taxes have rarely been used as deliberate instruments of fiscal policy, the chief exception being, the British purchase tax. But during the World War II and Korean War periods, considerable attention was
given to the use of the tax for inflation control purposes.\footnote{ibid., p. 42.}

A sales tax, particularly if it is regarded as temporary, is likely to be more effective, per dollar of revenue, than that an income tax in checking inflationary pressures and less injurious to incentives to work. But if the tax gives rise to general wage increases, as is very possible, it may prove, in practice, to be much less satisfactory. The success of the sales tax, as a weapon of inflation control, thus depends largely upon three factors:-

1. The extent to which consumers believe the tax to be temporary.

2. The extent to which the tax element can be dissociated from the cost of living, and thus general wage increases induced by the tax prevented.

3. The general acceptability of the tax as an equitable means of inflation control.\footnote{ibid., p. 46.}

2.7 Objections to Sales Taxation

The primary objection to sales taxation is that it is regressive in nature. The distribution of burden is not in conformity with accepted principles of equity in taxation. If all expenditures are subject to tax, a substantial burden is placed on the lower income groups, despite the fact that
they have little taxing ability; in the sense that they acquire their entire incomes for a bare subsistence level of living. Even if the tax is confined to tangible commodities, the burden on the poor is substantial. Furthermore, since the percentage of income saved is greater at high levels, the overall distribution of burden is regressive.

Evaluation of the regressivity argument is a complicated task. Primary reliance upon regressive taxes is obviously contrary to accepted standards of equity in distribution of burden. On the other hand, the regressiveness of one particular tax is not a conclusive argument against its use in a tax structure which contains highly progressive elements. Apart from the question of regressiveness, the absolute burden placed upon the poor may be regarded as undesirable. The argument of regressiveness has had substantial political significance in uniting lower income groups against the use of sales taxes.\textsuperscript{33} The use of regressive taxes prevented the introduction of a Federal Sales Tax in the United States during World War II.\textsuperscript{34}

As a consequence, certain modifications have been introduced into many of the taxes to lessen regressiveness, and burden on the poor. Food is exempted which does lessen

\textsuperscript{33} In both the United States and Canada, labour unions have traditionally been the chief opponents of sales taxation.

\textsuperscript{34} Quoted by John F. Due, Government Finance: An Economic Analysis, Richard D. Irwin, Inc., Homewood, Illinois, 1954, Chapter 17, p. 320.
the regressivity of burden, and removes a large portion of the burden on the poor. In other cases, government have sought to introduce some degree of progression by applying higher rates to a number of commodities regarded as 'luxuries'.

Sales tax results in a distribution of tax burden contrary to that generally accepted as equitable. It discriminates against those groups in the economy whose circumstances compel them to spend relatively large amounts to maintain certain levels of living and it discriminates somewhat on the basis of preferences since all expenditures cannot be made taxable.

The basic and the most widely accepted objection centres around the distribution of the burden of the tax by income group, under the assumption that the tax is shifted forward to the final consumers of the products. The tax tends to place a relatively heavy burden on all persons whose expenditures on taxable goods constitute relatively high percentages of their incomes. It is argued that relatively heavy burden is in many cases inflicted on persons ill able to pay it, with consequent inequity.35

2.8 Sales Tax and Excise

Sales tax and Excise are different in as much as one

35 John F. Due, *op.cit.*, p. 36.
is a tax on transactions while the other is a tax on commodity. They are quite separate and distinct imposts. By 'Excise' is ordinarily meant a tax or duty on home produced goods either in the process of their manufacture on or before their sales to customer, specially on spirits, beverages, gasoline, sugar and tobacco.  

A duty of excise is a duty on production levied on a producer and grounded on the fact of production while a sales tax is a tax levied on a dealer on the occasion of sale. In other words, the first is levied upon a person qua manufacturer and the second qua seller. The distinction between the scope of sales tax and excise duty has been pointedly enunciated by the Federal Court in the famous case of Province of Madras Vs Boddu Paidanna and Sons. Their Lordships of the Federal Court thus observed:

"The duties of excise which the Constitution Act assigns exclusively to the Central Legislature are according to the Central Provinces Case, duties levied upon the manufacturer or producer in respect of the production or manufacture of commodity taxed."

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38 Tata Iron and Steel Co., Ltd., Vs State of Bihar, 7 S.T.C. 158 (Patna).
39 1 S.T.C. 104 at pp. 120-121, 1942 F.C.R. 90.
The tax on the sale of goods which the Act assigns exclusively to the Provincial legislature, is a tax levied on the occasion of the sale of goods. Plainly a tax levied on the first sale in the nature of things is a tax on the sale by the manufacturer or producer, but it is levied upon him qua seller and not qua manufacturer.

The power to make laws in respect of sales tax was given to the Provinces in the Government of India Act 1935, while that to make laws with respect to duty of excise was given to the Federal or Central Legislature. There is no prohibition in the Constitution of India against the imposition at one and the same time of a excise duty and a sales tax.

Thus while Constitutionally excise and sales tax levies have been distinguished and differently allocated, there is a similarity in their incidence. This has not only led to conflict of financial interests, between the Union and the States but has led also in certain cases to dispute regarding the constitutional validity of one or the other of the levies. It has been held by judicial authorities that the real nature 'the pith and substance' and not merely the form or phraseology, of a taxing statute should determine its validity. The line of demarcation evolved is that only when the tax is payable by the producer or manufacturer on goods, it is an excise duty. An excise duty is thus a tax on goods produced or manufactured and
not on their sales or proceeds of sales which is a sales tax.

Though Central Excise is a duty levied on goods produced and manufactured, assessment is based on value at the time of sale. This, by itself, and more so, when a collection is made at the point of sale, makes the levy a disguised form of sales tax which is essentially within the province of state governments.

If the tax payer who pays a sales tax is also a manufacturer or producer of commodities subject to a central duty of excise there may no doubt be an overlapping in one sense, but there is no overlapping in law. The two taxes which he is called upon to pay are economically two separate and distinct imposts. There is in theory nothing to prevent from imposing a duty of excise on a commodity as soon as it comes into existence, no matter what happens to it afterwards, whether it be sold, consumed, destroyed or given away. It is the fact of the manufacturer which attracts the duty, even though it may be collected later. We may draw attention to the Sugar Excise Act in which it is specially provided that the duty is payable not only in respect of sugar which is issued from the factory but also in respect of sugar which is consumed within the factory. In the case of a sales tax, the liability to tax arises on the occasion of a sale, and a sale has no necessary connection with manufacture or
production. The manufacturer or producer cannot of course sell his commodity unless he has first manufactured or produced it. But he is liable, if at all, to a sales tax because he sells and not because he manufactures or produces, and he would be free from liability if he chose to give away everything which comes from his factory.

Thus excise duty is primarily a duty levied upon a manufacturer or a producer in respect of the commodity manufactured or produced. It is collected from the manufacturer on his production even if there is no sale, whereas the sales tax is collected only when the manufactured goods are sold. It is a tax upon the goods and not upon sales or the proceeds of sale of goods. Excise duties usually have proximity to the points of production. Moreover, for very good reasons, excise duties are necessarily selective, and therefore, the rates of duty are normally high, whereas the sales tax operates at different points of the trade channel, over a large number of commodities and in varying degrees of proximity to the final consumption and can, therefore, be levied comparatively at low rates. It also follows that the sales tax can be varied in relation to the different grades of consumers in a manner which is not generally open to excise. In other words, sales tax can take cognizance of the varying degrees of specialisation and differentiation which occur in the goods as they leave the stages of production and
and primary processing with which excise is concerned.\footnote{40}

The merits of the sales tax as a major source of revenue lies in the fact that it is dispersed over a large number of goods and of dealers, and substantial revenue can be collected by a comparatively low rate of tax, whereas by definition, custom and excise apply only to a strictly limited portion of the industrial output that is sold within the country.

2.9 Sales Tax and Purchase Tax

In ordinary parlance, it can easily be said that a sales tax is a tax levied on the occasion of a sale while a purchase tax is a tax levied on the occasion of a purchase. But a transaction which involves a sale by somebody must involve a purchase by somebody else. In other words, sale and purchase are merely different ways of looking at the same transaction from the angle of the person concerned. But a proper distinction can be drawn between the two parties to it; one is the seller, and the other the buyer. The sales tax is a tax, which, with reference to transaction of sale cum-purchase, is levied on the seller, whereas the purchase tax is a tax, which with reference to the same transaction, is levied on the buyer.

\footnote{40} Government of India (Ministry of Finance), Report of the Taxation Enquiry Commission, Vol. III, pp. 43-44.
In Syed Mohammed and Co. vs State of Madras, 41 the validity of the Sales Tax Act was challenged on the ground that item 48 of the Provincial List of the Government of India Act, 1935, relates only to sales and not to purchases and a Sales tax law in so far as it imposes a tax on purchases is ultra-vires the powers of the Provincial Legislature. This contention was negatived by the Madras High Court. The Court held that a power to tax sale of goods is in reality, a power to tax the transaction which carries with it the power to tax either party thereto. Entry No. 48 in the Provincial Legislative List in the Government of India Act, 1935, is of sufficient amplitude to authorise the levy of a tax on purchases and that therefore the Madras General Sales Tax Act (IX of 1939) is not ultra vires the Madras Legislature on the ground that it imposed a tax on purchases.

2.10 Income Tax and Sales Tax

Two important points of distinction between sales tax and income tax are—

Firstly, income tax is a tax assessed on the income of the previous year called the accounting year. Sales tax on the other hand becomes liable to be paid immediately after each sale is effected though for the facility of

consumption and payment of tax, provision is generally made for the filling of returns at the expiry of each quarter. Secondly, rates of income tax vary in accordance with the amount of income whereas the amount of sales tax does not vary on the amount of taxable turnover. The result is that no one can be certain of what income tax he has to pay at least until the accounting year expires. But a dealer can always be certain of what sales tax he has to pay as soon as he effects the sale.

2.1.1 Principles of Sales Tax

Like all taxes, sales tax, must conform to the principles of general taxation. They are:

(1) The sales tax must not produce undesirable repercussions in the economy. Since the taxes are collected from business firms, there is a danger that methods of carrying on production and merchandising of commodities may be altered. When a sales tax is applied to each sale through which a commodity passes, integration of business will be encouraged, and small independent merchants will be driven out of business. If the tax is levied on the sales by manufacturers, some of whom sell to wholesalers, while the others sell to final consumers at substantially higher prices, the direct sales will be discouraged. Any taxation of goods used in production will tend to distort production techniques, since some methods will be subject
to greater tax than others.

(2) An attempt must be made to distribute the burden of the tax as nearly in conformity with accepted standards of equity as is possible in terms of the general objectives of the tax. The coverage of the tax should be broader so that there will be less discrimination against those persons who concentrate their expenditures on commodities which are subject to the tax. Exemptions should be few. The tax should reach all persons giving less scope to some people to make particular use of the non-taxed items.

(3) The tax should provide specific exemptions for certain major categories of expenditures in order to alter the over-all distribution of burden. The exemption of food brings the distribution of burden more in line with generally accepted principles of equity.

(4) Since the tax is intended to be and probably it is typically born by the final consumer there is some merit in insuring that the consumer is aware of the burden, rather than allowing the tax element to become part buried in the prices of the goods purchased.

(5) While taxing commodities different rates should be levied. It would secure both a restriction of consumption of nonessential items and a diversion of productive resources from taxed goods to other goods. The generally practised methods of taxing luxuries and exempting capital goods are attempts in this direction. Luxuries should be
highly taxed and articles of necessitates should either be exempted or low taxed.

(6) The compliance costs on the part of the tax paying firms and the administrative costs to the government are minimised. This consideration suggests that the tax be applied prior to the retail level, in order to minimise the number of tax paying firms. This result is in conflict with considerations of equity and economic consequences which dictate application of the tax to the retail sale.

2.12 Federal and State Levy

A sales tax may be centrally levied and appropriated or centrally levied and distributed among constituent states on some agreed basis, or it may be levied and administered and the proceeds utilised by the State Governments. In Pakistan the entire proceeds, less collection charges are turned over to Provincial Governments. The Soviet Union makes grants out of the collections to specific purposes. A pre-determined percentage of the collection goes to the Federating units in Germany, France and some other continental countries. The U.S.A. and India are among the important countries where sales tax figures as a state tax. The efforts to make it a federal tax in the United States of America did not succeed. Under the scheme of Provincial autonomy of 1935, the right to impose sales tax was granted to Provinces in India and the same system continues. The
State Governments enjoy the right to levy the sales tax on all commodities and services except (a) the articles declared to be essential for the life of the community and (b) articles of special importance in the inter-state trade or commerce.

It may be added that the proceeds of the Central Sales Tax when levied on inter-state trade are given to the States after deducting administration expenses. It is obvious that these two exceptions have been made in the interest of public welfare and the smooth flow of inter-state commerce.

2.13 **Forms of Sales Tax**

Sales tax has assumed different forms in different countries. Broadly, the two main forms of sales tax are:-(1) Multi-point or Multiple-stage or turnover tax, and (2) single-point sales tax either at retail, wholesale or manufacturing stage or at two or more stages.

2.14 **Multi-point Sales Tax or Turnover Tax**

The multiple-stage or turnover tax, which, in its pure form, applies at a uniform rate to all sales at all stages in production and distribution channels, has, in a somewhat modified form, dominated the sales tax picture of West-Central Europe for three decades. The principle of taxing all sales at all levels is, of course, a very
simple one, and modern use of it finds antecedents in ancient Rome, in Fourteenth century France, and in medieval Spain, in which this form of levy first attained the status of a major continuing revenue source. The 'alcabala' first imposed on a national scale in 1342, was the multi-point tax levied at the rate of 10 per cent on all sales. The modern general multiple stage sales tax is basically a German invention: the German Umsatzsteuer, introduced during World War I, was the model for the sales taxes introduced in a number of other European countries during the decade of the twenties. 42

The underlying objective of the system is to make the tax applicable to a majority of consumption articles, to levy it on a large number of dealers, and to adopt a very low rate. Under this system, there is no definite sector with reference to tax collection. The dealers of course are registered but each pays tax irrespective of whether it has already been collected once, or is to be collected again. Maintenance of accounts is relatively simple under this system, since everybody pays the tax. Exemptions are generally few. The number of registered dealers under this are more than that under the single point system since the turnover limit for registration is kept lower and the tax rate is also much lower under the

42 John F. Due, op.cit., p. 51.
other system. In short, under a multi-point tax, a tax is levied on all sales or purchases of a dealer irrespective of whether the goods involved have borne tax at a previous stage or stages of sale or purchase or will bear the tax at a subsequent stage or stages of sale or purchase.

Thus the multi-point system provides for taxation at each incidence of sale. When goods are sold by an importer or manufacturer to its sole selling agent, by the sole selling agent to a wholesaler, by the wholesaler to a semi-wholesaler, by the semi-wholesaler to a retailer, by the retailer to a consumer, a sales tax is attracted on each of these five transactions; and the price of the goods is necessarily inflated by five times the rate of tax in this chain of series of sales. 43

2.15 Single-point or Single stage Sales Tax

The single point tax is adopted to make the tax applicable to large number of articles. It is collected from a limited number of registered dealers through whom the taxable articles are expected to pass. A relatively high tax rate can be levied and it is possible to provide an adequate range of exemptions.

The single-point system seeks to ensure the collection of the tax at only one point in the series of sale trans-
-actions of a commodity which may take place from the first stage of production till it reaches the final consumer.

The basic rationale of single stage collection is the desire to avoid the complications and unnecessary duplication of effort created by multiple-stage collection by striking each commodity but once as it passes through production and distribution channels.44

There are three primary levels at which a single stage may be levied; the sale by the manufacturer, the sale to the retailer and the sale by the retailer. The tax levied at the stage of the first sale or purchase of goods inside a State after their production or manufacture in or import into the State, has the following advantages.

The single-point system is an incidence controlled system. In this system the total tax charged in the passage of the article from the first dealer to the last in what may be a whole chain of dealers, is not left to be decided by the intermediate number of links which may exist in the chain, but is collected only at one of the number of sales which may be involved. Thus the incidence of sales tax levy may either be when an importer or manufacturer makes the first sale of goods (and then it may be termed as a first-point tax), (but not tax at source in all cases), or when there is the last sale from a retailer (if he is

44 John F. Due, op.cit., p. 358.
a 'dealer') to the consumer (and in that case it is said to be a last point tax). In this system, the liability to tax is restricted to a single occasion irrespective of the multiplicity of sales in succession and the law is so framed as to prevent a second levy.\(^4\)\(^5\) In this system the rate of tax is generally high, but a large number of essential commodities are made exempt from taxation.

2.16 **Single-point Vs Multi-point**

The single-point and multi-point taxes differ in conception and design.

1. The single-point system is incidence controlled. It ensures that no more than the specific amount of the tax is added to the price. This object is attained by collecting the tax at only one point in the chain of sales or purchases through which a commodity passes before it reaches the consumer. As against this the multi-point tax is not incidence controlled. The incidence of the tax in a multi-point tax is unequal, it tends to be more in the case of essential and popular articles which pass through more stages of sales than in the case of nonessential or occasionally used articles. It is contended that the multi-point tax system involves taxation at each stage

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\(^4\) Dy. Comr. of Agri. Incometax and Sales Tax Vs. Trivandrum Cooperative District Society Ltd., 14 S.T.C. 16 (Kerala).
at which an article changes hands and leads to taxing
an article many times over. To this is argued, that there
is nothing intrinsically wrong of at one stage only, so
long as the total incidence of the tax on the consumer is
not different under the two systems. Multiple taxation is
not double taxation. Whereas in the single-point system,
the total burden that an article is intended to bear is
imposed on it at one particular stage, under the multiple
tax system or the general turnover tax the total burden
is so divided that a part of it is borne whenever a com-
modity changes hands.

(2) In many ways the single stage tax is easier to admi-
nister than the typical multiple stage tax. Collection
is concentrated on one group of firms instead of being
spread over a wide variety. The single stage form avoids
the extensive differentiation of rates which is almost
imperative with the multiple stage form, and thus the deter-
mining problems are minimised, and compliance and inspection
made much simpler. As against this, the general turnover
tax brings in a much larger number of units in sales tax
administration, and therefore makes administration more
cumbersome and difficult. As against this, it is pointed
out that actual experience in working of the single-point
tax system has shown that the work devolving on the admi-
nistration has increased and that a greater burden has
been cast on dealers in the matter of maintenance of
accounts and submission of returns. It is said that the administration has to examine the accounts of all registered dealers and make references in several thousands that the tax has been realized at the previous stage. It is also said that smaller dealers have to maintain detailed accounts showing the sources from which the goods have been purchased and issue bills for their sales to enable the subsequent dealers obtain exemption. The actual number of dealers who will come within the operation of the general turnover tax will not be very much larger than under the single-point system.

(3) Under a single-point levy, the consumer is aware of the full incidence of the tax, and is able to resist any undue increase in the rate of levy. Under general turnover tax the consumer is not aware of the full incidence of the tax.

(4) It has been reckoned a merit of the single-point system that it would enable an article to be traced through various stages to the final consumer completely, because of the series of detailed accounts that the traders at all stages will have to submit and because of the necessity of claiming exemption by traders at all stages except the final stage of the sale of a commodity. Theoretically, the claim may be conceded, but practically it is difficult to check in detail the passage of the bulk of all commodities in this manner from hand to hand. If the check is complete the single
stage tax system may be able to operate perfectly. If the check is at all incomplete it encourages and leaves room for considerable evasion. Under the general turnover tax, the returns will not be as detailed and may not be as full as in the single-point system. On the other hand, their supply will tax the staff of the trader and the trader himself less, their scrutiny will prove less of a burden on the sales tax department and the temptation to evade by each individual trader be substantially less.

(5) Discrimination against non-integrated firms and incentive towards further integration are completely or at least largely eliminated, since the tax strikes but once, and the tax burden will be the same regardless of the nature of the circuit through which the commodity passes on the way from initial production to final consumption. On the other hand, there is incentive for integration under the multi-point system. The general turnover tax leads to a greater disturbance of the trading structure than the single point tax. But this is not true for the reason that any tax burden which is substantial and which impinges only at a particular point will lead to a greater disturbance in existing trade agreements than a tax burden which is slight and whose incidence is widespread. A small tax gives less incentive to evasion. A small tax also gives less incentive for bringing about actively, change in the type of trader or in the place of trading. Thus, on general
considerations, the turnover tax should lead to less of a disturbance in the existing trading structure than the single-point taxation.

(6) It is claimed that the adoption of a single-point levy would do away with small dealers problem, because a majority of them would be subsequent purchasers. This claim is partly true because a majority of the small and petty merchants would not fall into the tax net as their purchases have already suffered a tax at previous stage. But majority of small producers would be brought into the tax net. We cannot do away with the small dealer problem by just switching over to single point tax. When the small dealers become liable to single point tax, they have to maintain elaborate accounts and submit themselves to more thorough scrutiny.

(7) The single stage form of tax suffers from only one limitation; a higher tax rate is required to obtain a given sum of money, and the entire impact of the tax is centred upon one group of firms. It is this argument, virtually alone which causes several countries to retain the multiple stage form. In Germany, for example, it is frequently argued that a single stage tax is impossible and unworthy of consideration because of the rate which would be necessary.

Actually the evils of imposing a relatively high rate on a single class of firms are much less serious than is
argued, as demonstrated by the success of many countries with the single stage type. The experience of Canada, with its manufacturers' Sales tax, of Switzerland, Australia, and New Zealand with the wholesale tax, and of Norway, the American States and the Canadian provinces with the retail tax demonstrates clearly the feasibility of such taxes, and the much lesser degree of criticism against inequality, evasion, and adverse economic effect.

The merits of the general sales tax become all the more important when the yield from tax is to be increased without increasing the tax rate. The higher rate under single point tax will aggravate all the difficulties regarding passing on the tax to the consumer, regarding evasion, regarding differentiation between registered and unregistered dealers. Under the multi-point system, substantial revenue can be had from a low rate of tax, but whose incidence is universal.

2.17 Wholesale Sales Tax

The wholesale sales tax is imposed upon the last wholesale transaction, that is, upon the sale to the retailer, whether made by a manufacturer or wholesaler. Sales made directly by manufacturers or wholesalers to final consumers are of course included in the scope of the tax. Because of the importance in the present day economies of direct sales by manufacturers to retailers, in large measures the
tax paying firms under a wholesale tax are the same as those under a manufacturer's sales tax. But with the wholesale tax, the levy is collected from the wholesalers in these cases in which such firms participate in the distribution of the goods, and the basic value figure for tax purposes is the price paid by the retailer, rather than the price charged by the manufacturer. The wholesale form of tax has been used successfully for a number of years in Switzerland, Australia and New Zealand. The British purchase tax is likewise a form of wholesale sales tax.

2.18 Two-Point Sales Tax System

This is a variant of the single-point system of tax. Under this system, the tax is levied both at the point of entry of an article into the stream of sales and purchase transactions, and also at the point of the exit therefrom. The total tax which the Government intends to collect is split between two points. Double-point system was adopted in the pre-reorganized Bombay State during the period 1-4-1954 to 31-12-1959.

Generally, the double-point system shares the advantages and disadvantages of a single-point tax. The criteria for its levy are also the same. But it has some advantageous features of its own:-

(1) It combines the advantages of a system of a single point tax levied at the first stage and of one levied at the last stage of sale or purchase.
(2) The system of tax is better than either of the two forms of a single-point tax from the standpoint of controlling evasion. By splitting the incidence of the tax into two parts, the two point system reduces the incentive for evasion, and the fact that an article is taxed at two stages of sale or purchase affords greater safeguard against evasion than if it were to be taxed only at one stage.

In the single-point system, goods are taxed either at the point when they enter into the sector of registered dealers, or at the time when they exit out of this sector, whereas in the double-point system, they are taxed not only at one but at both such points, namely when they enter into and when they exit out of the sector of registered dealers. In this system, the total tax which the government intends to levy on a particular article, is split up between the two points, the first and the last in the chain of sales, a specified fraction is collected at the point of entry and the balance collected at the point of exit.\(^6\)

The arrangements for exemption set off and refund, which are necessary feature of this system, have made it very cumbersome from the administrative point of view and very complicated from the standpoint of tax payers.

The tax payers have to bear a heavy burden of accounting and other work in order to comply with statutory requirements which is altogether disproportionate to the revenue.

derived from the tax.

It would bring in a number of retail merchants into the tax net as last purchasers and cross checking the claims that the goods have met tax at the previous stage would be necessary. The retail merchants would be exposed to harassment. A hundred per cent check of claims for exemption would be necessary.

2.19 **Value Added Tax**

The value added tax is the latest fiscal innovation of general scope. It has been brought in force recently and that too in a few jurisdictions (in France and in the United States, Michigan, and adopted in principle but not yet put into force, in Japan).

The tax on value added (TVA) is a single general tax payable each time when a product is sold from wholesale upto retail sales. The tax base is the value added by the manufacturers or the wholesaler. Since the tax already paid on the purchases is credited against the tax payable on sales, tax value added is not cumulative in effect.

The value added tax provided a means of avoiding the objectionable features of the multiple stage taxes without concentrating the impact of the tax as heavily on one group of firms as is necessary with a single stage tax. A value-added tax may be confined to one sector of the production and distribution stages, or it may extend to all. A value-added tax confined to the manufacturing sector is equi-
valent, in the overall distribution of burden by commodity, to manufacturers sales tax, and, with identical coverage, requires the same tax rate to raise a given sum of money. A value-added tax extended to all production and distribution sectors is equivalent to overall burden distribution by commodity to retail sales tax, and requires the same tax rate.47

The concept of the tax on value-added has been developed through two different approaches. Through one approach, the tax has been devised merely as a method of collecting a sales tax viewed as a tax on the value of a product collected from business enterprises selling it and expected to be forwarded to purchasers by means of an increase in prices equal to the amount of the tax. Through the other approach, the tax is expressly related to some version of the 'benefit' principle of taxation. In that case, the tax may or may not be regarded as a tax on ultimate purchasers of taxable products.

The basic intent of a value added tax is to tax each firm on the sum of the value which it has added in the manufacturing and distribution process - that is the difference between the cost of the materials and other physical objects purchased for use in production and the selling prices of the products. The value added is thus equal to the sum of wages and salaries, interest and rent paid, and profits made by the firm. Since the sums of the value added at the various stages in production and distribution

are equal to the selling prices of the final products to the ultimate consumers, a value added tax applying at all stages in production and distribution is basically the same with respect to final distribution of burden by commodity as a retail sales tax applying to all sales of consumer goods. A value added tax confined to the manufacturing sector is essentially the same, in net effect, as a manufacturers' sales tax confined to consumption goods.

The European Economic Community Council of Ministers, on February 8, 1968, announced agreement on a uniform Added Value Tax to be adopted in each of the six countries by 1st January 1970, with the following main provisions:—

(a) Tax will be levied at each stage in the production process on the value of sales less bought-in materials.

(b) The method of assessment will be that of 'tax from tax' i.e. the amount of tax payable by any given firm is that assessed on its sales less what it can show has already been paid on its purchases.

(c) The tax will be levied on the destination rather than the origin principle i.e. it will be levied on home output plus imports less exports.

(d) Countries are at liberty to adopt different rates of tax for the time being.

(e) There is a good deal of discretion with respect to exemptions e.g. various types of services, small firms retail stage transactions. It is open to community members
to substitute a sales tax of their own at the retail stage if they so wish. Agriculture is also exempt for the time being.

The turnover taxes at present in force in Italy, Belgium, Luxembourg, and the Netherlands (all of the 'cascade' type) will be replaced by a common system of tax on value added. France which already has a value added tax, and West Germany which is about to have one will have to adopt their systems to that approved by the European Economic Community. If the U.K. joins the European Economic Community, introducing the tax on value added will be part of the integration process.

2.20 Conclusion

It can be said that sales tax is not a modern invention in the armoury of states. This weapon of collecting taxes was known both to the Eastern as well as the Western administrators. It was used as and when found necessary to collect more taxes. The First World War and the Great Depression were primarily responsible for levy of sales tax by different countries in the world. The fact that it fulfills the canon of adequacy or productivity has made it very popular amongst the finance ministers of various countries. It has assumed different forms and has wide diversity in its name. However, the most important forms are the Multi-point or Turnover Tax and Single Point or Single-stage tax. The form of tax adopted differ from
country to country. In India, different States have adopted different forms or systems of sales tax. Moreover in some States the different systems have been combined. This has created difficulties and complexities in the administration. Further, the structures or the systems of sales tax have undergone frequent changes. Irrespective of these factors of diversity in nomenclature and in systems or forms of sales tax, it must be admitted that sales tax has become a permanent feature of fiscal structure of many countries in the world today.