CHAPTER-IV

INDIRECT CENTRAL TAXES: A CASE OF UNION EXCISE DUTY

Introduction

As we have already seen that the total tax revenue so generated by the two tiers of government, is unequally distributed; 67% is raised through the taxes assigned to the Centre and 33% through the taxes allotted to the States (2003-04). Some of the important taxes with the Centre yielding substantial revenue are union excise duty (yielding of the total combine revenue of the Centre and States), customs duty, corporation tax and personal income tax. The States have sales tax, State excise and taxes on vehicle as the important taxes. For our analysis we’ve taken into consideration union excise duty and sales tax as important commodity taxes for Centre and States respectively and a detailed study is done on both these taxes.

In this Chapter, a detailed analysis is done of the Excise taxes: one of the most important taxes assigned to the Central government. First of all a study is done of the meaning, and brief history of excise taxes. Then the principles, on which the taxes are based and their objectives are taken into account.

In the next section, an effort has been made to examine and analyse the excise duties in Indian context. Along with the Constitutional provisions, a detailed historical account of the excise taxes including changes in the rate structure, policy formulations etc. are examined. The different types of excise duties and their administrative structure are also discussed. A further step has been taken to highlight the fiscal importance of the excise taxes. Then, the major problems affecting the growth of excise revenue are also discussed. Various efforts are made by the government to overcome these problems and they have succeeded also, to certain extent by converting excise taxes into CenVAT. Finally, a brief outline of the present structure is also done.

Meaning of An Excise Tax:

The Chambers 20th Century Dictionary defines excise as a ‘tax on certain home commodities and on licenses for certain trades.’ The Webster’s Dictionary gives a more detailed description of excise as any duty, toll or tax; an inland duty which is
imposed or levied on the manufacture, sale or consumption of commodities within the
country and includes a tax upon a pursuit or a trade or occupation.¹

Originally, the term 'excise' was used only as the tax on commodities (which
is generally an indirect tax, of which the burden falls on the consumer); but it latter
came to be applied to duties or fees levied upon makers of or dealers in excisable
commodities and finally to various taxes levied for permission to practice or conduct
certain sports, trades, occupations etc.

An excise duty may be levied on raw materials or at an intermediate stage of
their production or when the articles are ready for consumption. An excise tax at the
initial stage is disadvantageous to producers since it is collected at the beginning of
the production process often long before the goods are sold. A solution to this
problem includes granting of tax credits by the government, of the production process.
However, taxation at the raw material stage may be beneficial too, since the
manufacturer may be driven to improve the productive process in order to increase the
yield per unit of raw material and thus escape a part of tax burden. If the finished
product is exported, the tax on raw material is refunded on the basis that in such cases
a more efficient producer gets back more than he actually paid.

Professor Sherias maintains that taxes should be levied in accordance with the
canon of convenience. From this point of view an excise tax should be levied at an
intermediate stage of production or on the finished product. The advantage of this
type of levy is that the period for which the manufacturer advances the tax is
considerably shortened. It also gives tax collector an opportunity to check the quality
of the commodity and impose higher rates on better quality products. Also tax
collection is convenient to administer, in case. According to some economist excise
taxes are also equitable in their effects.

The history of the development of excise taxation in the countries of Europe
and in the United States of America reveals that the two main features responsible for
the introduction of the system of taxation had been (i) the urgent necessity of revenue,
mainly to finance wars which were so common during that period of European history
and (ii) the existence of suitable conditions consequent upon the growth of the trading
and commercial class. Modern system of excise taxation was first introduced into
Holland in the 16th century, which was the leading financial and trading nation of
Europe.
Principles of Excise Taxation

The system of Excise taxes has passed through various phases, shifting from one principle to another before taking the present form. The various principles and the problems associated with those principles are as follows:

a) In the earlier times excises were levied on all goods of consumption, justifying on the ground of equity. It was thought that, “maximization of equity demanded nothing less than this comprehensive procedure” (Singh 1977). According to Dutch theorists, the greater the number of taxed articles the more perfect is the method or system of taxation. But, however, “popular sentiments by no means agreed with this idea of theorists and statesmen”, observes Bastable (1905).

The system of ‘general excise’ became very unpopular. It is said that a system of general excises is proportional to the total income of the taxpayers. But for a number of reasons the system of general excise is not proportional to the total income of the taxpayer. Most of the expenditure of the rich class on personal services like those of servants, drivers, cooks etc. is not taxed. Also, there is a problem of double taxation where raw material and finished goods are simultaneously taxed. Thirdly, there is administrative difficulty in supervision and collection of all goods spreading over a wide geographical area.

b) In view of the above a general system of excise taxation came, in course of time, to be confined only to a few levies like those on liquor, wine, beer and tobacco products. But since increased rates on few classified products cannot yield revenue on a scale required by the developing countries, the need is felt for the extension of the list of dutiable products. This extension is desirable both from the point of view of productiveness and equity. However, a judicious selection of the goods has to be made before bringing them under excise tax net to secure a fair distribution of the charge in accordance with the general principle adopted as a guide.

Traditionally, goods are classified into necessities, comforts and luxuries and the question that arises is which class of goods is best suited for excise tax. The general consumer does not favor taxation of necessities, as it will greatly affect the
maximum poor population. The other view is the taxation of luxury goods consumed only or mainly by the rich. Though, from the point of view of equity, taxation of luxury goods is most desirable but it is not so from the view of revenue productivity. The burden of such taxation falls predominantly on the rich consumers and their income forms a small part of the total national income. So the revenue, thus generated from this source is not quite significant.

The final option therefore left bears the main burden of excise taxation i.e. "on the intermediate class of goods that forms the staples of consumption" (Surya 1988). In other words the commodities to be taxed requires the characteristics of both a necessity and a luxury good, that is they must combine the quality of wide use and that of a certain degree of dispensability simultaneously. In case of such commodities revenue generation is quite large and elastic and less burden on the consumer. Some example of these commodities includes tobacco, liquor, tea, coffee, sugar etc. As the standard of living of people improves the tendency grows to restrict the taxes to the very few but lucrative goods of consumption. Like in all developed economies of the world at present, liquor and tobacco are the two most important sources of excise revenue followed by petroleum or gasoline excise. But, since in developing countries three fourths of the population consumes no luxuries, imposing excise duties on commodities of mass consumption can only generate revenue.

**Impact of Excise Taxation:**

Excise duties have come to acquire a prominent role in the tax structure of any country. The impact of excise duties can be analysed in two ways - its direct effect and the indirect effect on the economy. Excise taxes directly influence the pattern and direction of production and consumption. As the excise taxes are raised on the commodities, the prices of the goods and commodities also increase simultaneously. At higher prices consumption of these goods reduces (unless they are necessity goods) and due to lower demand the production of these goods also goes down.

Excise duties (as a part of taxation policy) indirectly help in achieving a number of economic objectives also. These objectives include not only economic growth, but also full employment, stable prices, efficient allocation of resources, a satisfactory distribution of income and a proper balance of payment.
Acceleration of Growth

To achieve a higher per capita income the rate of national growth product must exceed the rate of growth of population. However, tax policy affects only the rate of growth of national product and not the population. In this context Due’s development model of effects of taxation on the attainment of a higher rate of national product is used. According to this model the rate of economic growth in terms of an annual increase in per capita real income \((Y/N)\) is a function of: a) the rate of capital formation i.e. annual increase in total capital stock \((k)\); \(DK= I\) (Investment), b) the incremental capital output ratio \(DK/DY\), 3) the rate of technological change \((t)\), c) the rate of increase in quality and quantity of natural resources labor and entrepreneurial ability\((r)\), d) modification in the institutional environment \((v)\).

Taxation plays an important role in effecting these determinants of growth thereby economic development. It also permits the financing of the government expenditure without the ill effects of other methods of financing. Excise taxes enter into the development model in the form of higher prices for consumption goods relative to the prices paid to the factors.

Distribution of income

As far as income redistribution is concerned, indirect taxes like excise whose incidence is generally regressive will have less impact upon after tax pattern than highly progressive income taxation. Excises, if administered reasonably well, may in fact be more equitable than direct taxes that are poorly enforced.

Resource allocation

Indirect taxes, in comparison with the direct taxes, exert more influence on the allocation of resources into priority uses. Selective use of excise taxes with high rate of taxation may reduce the production of goods not essential for development. On the other hand exemption from excise duty or low duty may encourage production of goods considered essential for development.

Taxation and Stability

There are contradictory statements whether excise taxes are inflationary or anti inflationary. Some theorists view that excise taxes cannot check inflation since they raise price and are hence inflationary. But it is improbable because in such price rise
the government absorbs the proceeds where as in the inflationary price rise they accrue to the producers.

It is however often said that excise taxes have greater anti inflationary potential than income taxes because the former being regressive reduce consumption more than the latter. It is so because rich class consumes proportionately less of their income than those in the lower class.

It is also said that excise taxes provide a special anti-inflationary advantage since they discourage consumption expenditure and promote savings. Consumer can escape these taxes by declining consumption of the taxed commodities.

Excise taxes also affect wage rates. As excise taxes raise the price of commodities, trade union may demand higher wages. A wage price spiral situation may arise which reduces the anti-inflationary effects of excise taxes and while aggravating inflationary pressure.

**Excise Duties in India**

Constitutional Provisions

By virtue of the taxation powers vested in the Constitution under Entry No. 84 of List I of the Seventh Schedule, the Central Government is authorized to impose, "duties of excise on tobacco and other goods manufactured or produced in India except (a) alcoholic liquors for human consumption; (b) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included in sub paragraph (b) of this entry." (for details refer to Annexure A.4.1)

**Historical Account of Excise Taxes**

The system of excise taxation was in existence, though in an undeveloped form in the period even before *Arthashastra* of Kautilya (4th century B.C.). Among the items subject to excise duty were gold, medicinal roots and herbs, honey, meat, grass, firewood and even cattle. The system of taxation developed in the Arthashastra continued and was built upon, right through the Mughal times. Excise duties on such items as dairy products, cloth, sugar, salt, indigo, tobacco, leather etc. were levied during the Mughal period and under early British rule. The excise on salt was important source of revenue throughout the period of British rule.
The beginning of the modern excise system taxation in India is generally said to have been made in 1894, with the levy of a duty at the rate of 5 percent *ad valorem* on cotton yarn of above 20 counts and the extension in 1896 to fine cloth. These measures were aimed at protecting the imported British cloth. The levy was opposed strongly by the Indians and it gave a momentum to the *Swadeshi* movement, resulting in the boycott of foreign cloth. The duty on cloth was abolished in 1926 but reimposed only after independence in 1949.

The year 1934 is considered to be a landmark in the development of central excise duties since, in that year; they took a definite shape in the fiscal system of the country. Duties were levied on sugar, matches, mechanical lighters and steel ingots. They were imposed mainly as a revenue measure to check the decline in the revenue of the Government of India because of the Great Depression.

The First Five-year Plan started in 1951 and additional revenue was needed to achieve the investment targets and meet the expenditure on social welfare schemes. Therefore, a high-powered Taxation Enquiry commission (TEC) was appointed under the chairmanship of Dr. John Matthai (1953-54).

Consequent upon the recommendations of the TEC, the history of excise taxation in India since 1954 is one of the increasing commodity coverage. Cement, footwear, paints and varnishes, paper, refined diesel oils, motorcars etc. were brought under the excise net. By the beginning of 1954, only 19 commodities were subject to excise duties and between 1954-56, the number of products subject to excise had more than doubled.

The budget of 1957-58 would be remembered for introducing additional excise duties in lieu of sales tax on tobacco and its products, textiles and sugar under the *Additional Duties of Excise (Goods of Special Importance)* Act, 1957. The proceeds are paid to the States.

In 1963, selective surcharges were levied on the central excise duty with a view to raise revenue exclusively for the Centre, which was then engaged in a major military build up as a result of the Chinese invasion. The surcharge or special excise duties were levied at varying rates of 10%, 20% and 33 1/2% on most items except sugar, cycle parts, cotton fabrics, footwear, matches, some iron and steel items and patent and proprietary medicines.
The process of covering more and more items under the excise system reached its height when Tariff Item No.68 was introduced in 1975-76. In 1978, the Jha Committee gave its recommendations including need for avoiding the cascade effect of duties, expansion of the area of sales tax reforms and abolition of octroi levies.

In 1984, V.P. Singh as the finance minister announced a Long-term Fiscal Policy. Other major developments include reduction of direct taxes on individuals and corporations, introduction of MODVAT from 1st March 1986. MODVAT ushered in a new era in the system of excise taxation as it permitted instant credit to manufacturers on the duty paid on bought out inputs and intermediates and thereby affected the rising incidence of the cascade effect of excise and countervailing duties on the final products. In the budget 1987-88, MODVAT was extended to most excisable commodities. The underlying objective of MODVAT was to minimize the cascade effect and at the same time achieve revenue neutrality. To avoid a fall in revenue following MODVAT, the rates had been suitably adjusted upwards in 1986-87 budget and more rates were adjusted and raised in 1987-88.

MODVAT Scheme: Features

MODVAT scheme provides for instant and complete reimbursement of excise duty and additional duty of customs (countervailing duty) paid on the components and raw materials when used in the manufacture of the final products. Articles, which were not used as inputs in the manufacturing process, were not eligible for credit under this scheme. Where the same input was used for different finished products, some of which were not dutiable, the credit of duty was allowed only for that part attributable to inputs that are used for the manufacture of dutiable finished products. MODVAT scheme was claimed to have the following advantages:

a) It aims at making levies transparent so that the effective rates of taxation on a particular commodity can be known. This information will be helpful in undertaking meaningful studies of excise incidence, which may be used to control excise burden on different commodities. It also seeks to avoid cascading effects associated with a traditional turnover tax.

b) MODVAT scheme not only encourages the small-scale sector but also exports by making them more competitive in the international market. MODVAT scheme was claimed to encourage indigenisation because full set off was available when
indigenous inputs were used. However, no credit of basic and auxiliary customs duties was permissible on imported materials and components. It was also claimed that MODVAT would check excise evasion because credit of input duty cannot be claimed unless actual production was declared to the excise authorities. MODVAT scheme would also help to reduce number of disputes, arising on account of classifications requiring lower or higher rates of duty, because the duty element on a large number of components would become irrelevant for manufactures in view of set-off.

The year 1986 was a landmark in the evolution of excise taxation in India. In that year, a new internationally accepted harmonized system of commodity classification was introduced in place of the then existing antiquated system introduced by the British.5

In the 1996-97 Budget, it was proposed that the Excise structure which had 11 ad-valorem rates ranging 0-50% should be reduced to 4: 0, lower rate on mass consumption, single normal rate and higher rate on luxury items. This promise was, however, fulfilled in the 1997-98 Budget when three new rates were introduced: 8%, 13%, and 18%. Also, Maximum Retail Price (MRP) based excise levy was introduced in this budget.

The objective of the 1998-99 Budget was to introduce greater transparency in the excise system through a significant rationalization of rates. The ultimate objective was to move towards a Central Value Added Tax (CenVAT) system, which can then be merged with a generalized VAT.

To rationalize the rate structure, a new 3-rate structure was proposed in the Budget 1999-2000, a central rate of 16%, merit rate of 8% and demerit rate of 24%. To establish a single rate Central VAT (CenVAT) at the Centre, the three rates 8%, 16%, 24% converge to 16% CenVAT in the 2000-01 budget. MODVAT scheme would now be known as CenVAT scheme.

In the budget 2000-01, certain measures were also proposed for streamlining and simplification of the excise system. From 1st July 2000, all statutory records in excise would be dispensed with and excise department would rely upon the manufacturers’ records. From 1st April 2000, excise assesses would be allowed to pay the excise duties in fortnightly installments and it was further liberalized to pay duty
at the end of the month in the 2003-04 budget. To make the valuation mechanism simple, it was proposed to replace the existing section 4 of Central Excise Act, which was based on the concept of 'normal price' by a new section based on 'transaction value' for assessment.

**Various Types of Excise Duties**

There are various types of excise duties imposed by the Union Government under different Acts of Parliament as given in the Constitution. See also Annexure I. The important duties in operation were the following:

1. **Basic Excise Duty**: Central excise duty is levied under Section 3 of the Central Excises and Salt Act, 1944. The duty levied under this is known as basic excise duty. The basic excise duty may be fixed with reference to the value, weight, volume, unit, length or area of the excisable goods. These details are given in the Schedule of the Central Excise Tariff Act, 1985.

2. **Additional Duties in Lieu of Sales Tax**: These duties are imposed under the Additional Duties of Excises (Goods of Special Importance) Act, 1957, which provides for the levy and collection of additional duties on sugar, tobacco, cotton fabrics, rayon or artificial silk fabrics produced or manufactured in India. These duties are in addition to the duties payable under the Central Excises and Salt Act, 1944, and replace, by agreement with State Governments, the sales tax levied by them on those commodities. The proceeds of these additional duties of excise are distributed among the states in accordance with the principles of distribution formulated and the recommendations made by the Finance Commission from time to time.

3. **Cesses**: These are levied under separate enactments on certain commodities and the revenue is used for specific purposes. For example, handloom cess is levied on fabrics to raise funds for developing khadi and other handloom industries and for promoting the sale of khadi other handloom cloth. Cesses are also levied under various Acts on tea, jute, indigenous crude oil, paper, sugar, bidis, automobiles, vegetables oils and television sets.

Duties on different commodities are levied under the Central Excises and Salt Act, 1944. Under Section 37 of this Act, a set of rules known as the Central Excise Rules, 1944, has been framed to implement the provisions of the Act. Another set of rules under the same section deals exclusively with the valuation of the excisable...
commodities and is known as Central Excise (Valuation) Rules, 1975. The Act and the Rules are amended from time to time. Broadly speaking, the Act embodies substantive law, and the Rules contain both substantive law and procedural matters.

Although the Central Government is empowered to levy duties on agricultural products also, but it has avoided doing so in view of the administrative difficulties involved. Therefore, the excise system has remained confined mostly to the products of the industrial sector with the exceptions of tea and coffee.

**Administration of Excise Taxation**

There is elaborate administrative machinery for the collection of excise duties. At the apex level is the Central Board of Excise and Customs (CBEC), which is a statutory board forming part of the Department of Revenue in the Ministry of Finance. The Board, consisting of a chairman and five members works under the control and direction of the Union Finance Minister.

At the field level, under the CBEC there are 34 Commissionerates of Central excise and each of the Commissionerate is headed by a Commissioner of Central excise that is assisted by a number of Additional Commissioners and Deputy Commissioners. They are in turn assisted by a Superintendent of Central Excise and a number of Inspectors who are in fact responsible for the proper assessment of central excise duties, generation of the statistical information and ensure that the laws and procedures are properly followed.

There are different procedures to assess and collect excise duties. For details refer to Annexure A.4.2.

**Fiscal Significance of Excise Taxes**

India is one of those developing countries where indirect taxation occupies a dominant position in the overall tax structure of the country. In the sphere of Central Government only two indirect taxes are of significance from revenue point of view i.e. union excises and customs. Table 4.1 shows that if we compare both direct and indirect taxes, the share of indirect taxes in total tax revenue of the Central government is substantially higher as shown in Chapter I also. In 1970-71, the share of direct taxes was just 5.04b out of 24.5b and that of indirect taxes 19.5b. In 2003-04, this share for direct taxes reached 1034b.
### Table 4.1 Relative Growth of Union Excise Duties vis-à-vis other Taxes of the Central Government of India - Selected Years

<table>
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</thead>
<tbody>
<tr>
<td>A+B Total tax collections</td>
<td>24.51</td>
<td>60.1</td>
<td>93.88</td>
<td>211.8</td>
<td>430.42</td>
<td>819.39</td>
<td>1366.58</td>
<td>1336.6</td>
<td>1594.25</td>
<td>1869.82</td>
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<tr>
<td>A. Direct taxes of which</td>
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<td>(i) Corporation tax</td>
<td>5.04</td>
<td>14.62</td>
<td>19.83</td>
<td>37.55</td>
<td>69.09</td>
<td>222.91</td>
<td>496.51</td>
<td>477.07</td>
<td>830.9</td>
<td>1050.91</td>
</tr>
<tr>
<td>(ii) Income tax</td>
<td>1.14</td>
<td>4.8</td>
<td>5.04</td>
<td>6.63</td>
<td>12.56</td>
<td>43.18</td>
<td>237.66</td>
<td>221.06</td>
<td>368.65</td>
<td>413.87</td>
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<tr>
<td>B. Indirect taxes of which</td>
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<tr>
<td>(i) Custom duties</td>
<td>19.47</td>
<td>45.47</td>
<td>74.04</td>
<td>174.24</td>
<td>361.32</td>
<td>596.48</td>
<td>872.64</td>
<td>865.11</td>
<td>1331.75</td>
<td>1331.16</td>
</tr>
<tr>
<td>(ii) Union excise duties</td>
<td>5.24</td>
<td>14.19</td>
<td>34.09</td>
<td>95.25</td>
<td>206.44</td>
<td>357.57</td>
<td>341.63</td>
<td>283.4</td>
<td>448.51</td>
<td>486.3</td>
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<td></td>
<td>13.68</td>
<td>29.88</td>
<td>37.22</td>
<td>73.3</td>
<td>141</td>
<td>221.76</td>
<td>497.58</td>
<td>544.7</td>
<td>823.1</td>
<td>907.7</td>
</tr>
</tbody>
</table>

Source: Government of India, Ministry of Finance, Indian Economic Statistics (Various Issues)

Table 4.2 presents the growth of excise revenue (%) to the total tax revenue of the Central government. The share of excise taxes in 1970-71 was 56%. This share however, reduced and was just 27% in 1995-96. Then, there is a increase in the share and in 2003-04 it reached to 49%.

<table>
<thead>
<tr>
<th>Year</th>
<th>Central Excise Revenue (Net Receipt)</th>
<th>Total Net Tax Revenue of the Central Govt.</th>
<th>(2) as % of (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>13.69</td>
<td>24.51</td>
<td>55.85</td>
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<tr>
<td>1975-76</td>
<td>29.88</td>
<td>60.1</td>
<td>49.72</td>
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<tr>
<td>1980-81</td>
<td>37.23</td>
<td>93.88</td>
<td>39.66</td>
</tr>
<tr>
<td>1985-86</td>
<td>73.3</td>
<td>211.8</td>
<td>34.61</td>
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<tr>
<td>1990-91</td>
<td>141</td>
<td>430.42</td>
<td>32.76</td>
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<tr>
<td>1995-96</td>
<td>221.76</td>
<td>819.39</td>
<td>27.06</td>
</tr>
<tr>
<td>2000-01</td>
<td>497.58</td>
<td>1366.6</td>
<td>36.41</td>
</tr>
<tr>
<td>2001-02</td>
<td>544.69</td>
<td>1336.62</td>
<td>40.75</td>
</tr>
<tr>
<td>2002-03</td>
<td>823.1</td>
<td>1594.25</td>
<td>51.63</td>
</tr>
<tr>
<td>2003-04</td>
<td>907.2</td>
<td>1869.82</td>
<td>48.54</td>
</tr>
</tbody>
</table>

Source: Same as in table 4.1

A comparison is also done of the two important central taxes i.e excises and customs in the Table 4.3. The table shows the changing pattern of the two indirect
taxes. In 1970-71 the share of excise revenue in the total indirect tax revenue of the Central government was as high as 56%. Since then, however, this tax has lost its importance and its share has reduced to 27% in 1995-96. On the other hand, customs have emerged as the most important single source of revenue of the Central government with its share increasing from 27% to 60% in the same period. During this period customs occupied major position as a source of revenue and excise lagged far behind. However, a reverse trend is seen in the later years when the share of customs revenue reduced to 33% in 2000-01 and the share of excises is raised to 63%. In the year 2003-04, there was a rise in the share of both union excises and customs revenue to 68% and 38%.

The same trend is seen when we compare both the taxes with the total net tax revenue of the central government. In 1970-71, excise duties accounted for a 56% of the total Central tax collections: Rs 13.68 b out of Rs. 24.51 b and the share of customs duties was a modest 21%; Rs. 5.24 b. Within a span of 25 years, the proportionate share of customs shot up to Rs. 357.57 b in 1995-96 out of Rs. 819.39 b (44%) and that of excises was just Rs. 221.8 b (27%). But by 2000-01 onwards the situation changed and again the share of excise revenue (45%) was more than the customs revenue (25%) in the year 2004-05.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total net tax revenue of the central govt. (Rs.b)</th>
<th>Total Indirect Taxes (net receipts) (Rs.b)</th>
<th>Customs (net receipts) (Rs.b)</th>
<th>Union Excises (net receipts) (Rs.b)</th>
<th>(4) as % of (2)</th>
<th>(4) as % of (3)</th>
<th>(5) as % of (2)</th>
<th>(5) as % of (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>24.51</td>
<td>19.47</td>
<td>5.24</td>
<td>13.69</td>
<td>21.38</td>
<td>26.91</td>
<td>55.85</td>
<td>70.31</td>
</tr>
<tr>
<td>1975-76</td>
<td>60.1</td>
<td>45.47</td>
<td>14.19</td>
<td>29.88</td>
<td>23.61</td>
<td>31.2</td>
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<td>65.71</td>
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<td>1980-81</td>
<td>93.88</td>
<td>74.05</td>
<td>34.09</td>
<td>37.22</td>
<td>36.31</td>
<td>46</td>
<td>39.66</td>
<td>50.27</td>
</tr>
<tr>
<td>1985-86</td>
<td>211.8</td>
<td>174.24</td>
<td>95.25</td>
<td>73.3</td>
<td>44.97</td>
<td>54.67</td>
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<td>361.33</td>
<td>206.44</td>
<td>141</td>
<td>47.96</td>
<td>57.13</td>
<td>32.76</td>
<td>39.02</td>
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<td>1995-96</td>
<td>819.39</td>
<td>596.48</td>
<td>357.57</td>
<td>221.76</td>
<td>43.64</td>
<td>59.94</td>
<td>27.06</td>
<td>37.17</td>
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<td>1366.6</td>
<td>872.64</td>
<td>341.63</td>
<td>497.57</td>
<td>25</td>
<td>39.14</td>
<td>36.41</td>
<td>57.02</td>
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<tr>
<td>2001-02</td>
<td>1336.62</td>
<td>865.11</td>
<td>283.4</td>
<td>544.69</td>
<td>21.2</td>
<td>32.75</td>
<td>40.75</td>
<td>62.96</td>
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<td>2002-03</td>
<td>1594.25</td>
<td>1331.76</td>
<td>448.51</td>
<td>823.1</td>
<td>28.13</td>
<td>33.68</td>
<td>51.63</td>
<td>61.8</td>
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<tr>
<td>2003-04</td>
<td>1869.82</td>
<td>1331.16</td>
<td>486.29</td>
<td>907.2</td>
<td>26</td>
<td>36.53</td>
<td>48.54</td>
<td>68.15</td>
</tr>
<tr>
<td>2004-05(R.E)</td>
<td>2258.04</td>
<td>1492.57</td>
<td>562.5</td>
<td>1007.2</td>
<td>24.91</td>
<td>37.69</td>
<td>44.6</td>
<td>67.48</td>
</tr>
</tbody>
</table>

Source: Same as in 4.1
**Nature of The Excise Revenue Growth**

A number of factors are responsible for a change in relative importance of the excise taxes. Excise being a tax on production requires the existence of indigenous industries. Before independence indigenous industries were not so developed and therefore the excise revenue was not important. There were two main factors mainly held responsible for the spread of modern tax system from the 16\(^{th}\) to 18\(^{th}\) century's i.e. (i) urgent necessity of revenue mainly to finance wars (ii) the existence of ripe conditions due to the growth of trading and commercial classes.

Later on, with the policy of rapid industrialization followed under the five-year plans since 1951-52, increase in excise revenue came about due to

1) extension of commodity coverage
2) changes in rate structure and
3) increase in the production of excisable goods

Simultaneously, a large number of new and important industries began to develop and it was accompanied by import substitution and drastic curtailment of imports of luxury and semi-luxury goods. These factors provided both the base on which new excise taxes could be levied and the necessity to tap this source fully to finance the ever-increasing plan expenditures. Meanwhile, the fundamental change in the nature of our foreign trade made the growth of customs revenue more difficult.

**Buoyancy & Elasticity of Union Excise**

The next step is to examine the growth of excise revenue in relation to the growth of national income. The growth of revenue from any tax may be viewed in two ways. One is the increase in tax receipts as a result of every increase in national income without any change either in the tax rates or in its coverage. It is called built-in flexibility of the tax. In the second case, changes in tax rates and coverage of the tax, which are also discretionary changes, are also taken into consideration. In this case the growth in the tax revenue is the result of a process of both widening and deepening of the tax. Changes in the tax yield flowing from the combined effects of automatic responses as well as discretionary changes, which when linked to every increase in national income, is known as the buoyancy of the tax. It is computed by dividing percentage change in actual tax yield by percentage change in national income.
With tax parameters held constant (i.e. discretionary changes being removed), automatic or built-in changes in the tax yield resulting from variations in the national income measure the elasticity or built-in flexibility of a tax or a tax system. It is the ratio of percentage change in tax revenues (adjusted for discretionary changes) to percentage change in national income.

Buoyancy coefficient compares the actual growth of tax revenue with the growth in national income. It helps in assessing the overall success of government measures to increase tax revenues. The elasticity coefficient, on the other hand, indicates the inherent responsiveness of a tax system to changes in national income. It reflects how far the revenue potential of a given tax system has been realized.

Before imposing a tax, the selection of tax base and their rate structure needs to be so designed as to impart reasonable degree of elasticity to the tax system. This is so because in case of weak elasticity attribute of the tax system, government may have to resort to frequent changes in tax laws, which in turn may cause legal complications, reduce administrative efficiency and prove to be politically inexpedient.

The reason for relating tax yield to national income is the fact that most taxes are either based on or in some ways related to production, income, expenditure, wealth or transactions which all tend to increase with the growth in national income (Bretherton 1937). However, taxes should be so devised as to grow automatically with increases in national income. It is more appropriate and informative if tax yield is related to precise approximate bases upon which the tax yield is levied along with national income.

Table 4.4 shows the buoyancy and growth rates of excise duties calculated by the above mentioned procedure for the different periods. Firstly, a broad period of 1970-2004 is taken to analyse the overall situation of excise duties in India. Then, decadal periods are taken into consideration starting from 1970-80, then 1980-90, 1990-2000, and 2000-04. Another classification is done on the basis of the broad reform measures initiated by the government during the period 1970-2004. MODVAT (modified value added tax) system introduced from 1st March 1986, ushered in a new era in the system of excise taxation. MODVAT was initiated to minimize the cascading effect of the excise duties and also to generate revenue. So the period is divided as Pre-MODVAT and Post-MODVAT.
Table 4.4 Bouyancy and Growth rate of Union Excise Duties of different periods

<table>
<thead>
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<tr>
<td>Buoyancy</td>
<td>0.89</td>
<td>1.07</td>
<td>1.04</td>
<td>0.67</td>
<td>2.44</td>
<td>1.07</td>
<td>0.94</td>
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<td>Growth Rate</td>
<td>12.3</td>
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<td>14.7</td>
<td>9.8</td>
<td>25.5</td>
<td>12.8</td>
<td>13.5</td>
</tr>
</tbody>
</table>

Source: Same as in table 4.1 (Fore details see Annexure A.4.3)

As far as the buoyancy rates are concerned, the overall period of 1970-2004 shows a buoyancy of less than 1 (0.89). If we see the decadal periods we get the true picture which shows that the except the period of 1990-2000 when the rate is 0.67, in all other periods rate was more than 1. Even in the pre-MODVAT period the rate of buoyancy is greater than 1 but in the post-MODVAT period it is 0.93 i.e less than 1.

The study of growth rate also exhibits the same situation. In the period 1990-2000 (9.8) the growth rate is lower comparatively to other periods (12.8, 14.7, 25.47). This analysis shows that generally the buoyancy and growth rate are moving simultaneously i.e. if one is increasing the other is also increasing and vice-versa. But this has not happened when pre-MODVAT and post-MODVAT periods are considered. The buoyancy rate has declined from pre-MODVAT period to Post-MODVAT period from 1.07 to 0.94. But in case of growth rate there is actually increase in the growth from 12.82% to 13.46%.

**Excise Tariff Structure**

Once the commodities for excise taxation are identified, the next step is to formulate a tariff structure for various commodities. The nature of excise tariff and the issues related to it are now described.

**Statutory and Effective Rates**

Rates of excise duty approved by the Parliament are termed as statutory or tariff rate. However, the Government enjoys the power to exempt, by notification, any excisable goods from the whole or any part of duty leviable on such goods. In exercise of this power the Government determines and notifies from time to time the effective rates of duty. The rationale for granting such powers to the executive is that during the period intervening two consecutive budgets, necessary adjustments might be made to regulate exports, consumption, and prices of different commodities.
However, the delegation of this power to the executive has led to frequent changes in excise rates, creating an unstable atmosphere for trade and industry and problems for the administration.

Moreover, since the notifications are technically not rules, there is no obligation to place them on the table of the House. Consequently, the Parliament does not always have the information on the variations made in the rates approved by it. The determination of the effective rates of duty by the executive leads to decline in the parliamentary control over the excise system. Duty changes should be discussed and legislated in sessions of Parliament, which are held regularly at short intervals.

Specific and Ad Valorem Duties

In the early days of the excise system of independent India, the emphasis was on specific rates due to administrative reasons. However, the emphasis shifted to ad valorem rates when the economy started experiencing frequent inflation rates. The 1970’s saw a big shift from specific rates of duty to ad valorem rates on cement, vegetable products, electric fans, paper, cotton fabrics, paints, varnishes etc.

However, beginning with the 1980’s, the tendency to shift to ad valorem rates not only stopped but also reversed due to the disputes over classification and valuation of goods for purposes of excise levies. As a measure to combat tax avoidance and evasion, the basis of duty was changed from ad valorem to ad valorem-cum-specific rate or specific rate on a number of commodities. Important commodities where the shifts took place and in the particular year were: flat glass, aluminium metal (1982), paper aerated waters, motor cars, cigarettes, sugar (1983), paper boards, tyres for buses and trucks (1984), gases, tubes and flaps of tyres and color television sets (1985).

The balance further tilted in favor of specific duties as the policy of conversion from ad valorem rates to specific rates continued right up to 1990-91. The Tax Reforms Committee, 1991, observed that the share of revenue from specific-rated items has increased from about 46 % of the total revenue in 1981-82 to 65% in 1986-87 and about 70% in 1990-91. The Committee examined the advantages and disadvantages of ad valorem and specific rates of duty and concluded, “the advantages of having ad valorem duties far outweigh the administrative benefits derived by switching over to specific duties. In a system of comprehensive taxation
with a wide coverage of MODVAT, it would be necessary to have by and large only
ad valorem duties in order to ensure a rational system of taxation.”(TRC, 1991)
Following the recommendations of the committee, a modest switch over to ad
valorem rates was made in the 1992-93 budget.

At present, important commodities, which bear only specific rates, are
cigarettes, coffee, tea, sugar, beverages, mineral fuels, mineral oils, silk man-made
staple fibres and iron and steel. Ad valorem rates of duty are imposed on organic
chemicals, pharmaceutical products, leather, footwear, ceramic products, tools and
implements, machinery and mechanical appliances, electrical machinery and
equipment, and miscellaneous manufactured articles. A few commodities like cotton
fabrics, paper and paper boards, are subject to ad valorem-cum-specific rates of duty.

Issues involved in the system of Excise Taxation

As already discussed in the earlier chapter, union excise duties, as a major
component of commodity taxes, suffered from various types of inefficiencies. These
inefficiencies had resulted from structural and administrative system followed by the
tax authorities. This had given rise to certain problems for the assesses and
inconsistencies in the policies and procedures. These problems were: -

i) The Extended System

The system was not integrated but an ‘extended’ one, wherein the taxes were
levied at the different stages of production. The final product, the inputs,
intermediates and raw materials, the packaging material etc were all subject to excise
duties. The duties had been raised on most occasions, but reduced only rarely. There
was no single levy as the “excise duty”; but there was the basic excise duty, the
special excise duty, the auxiliary duties of excise, the additional excise duties on
specified textiles, the additional duties of excise and customs in the case of the whole
range of P.O.L products, the various cesses and, of course, the additional duties of
excise in lieu of sales tax. These different levies made it inconvenient and time
consuming for the assesses to calculate the exact amount under each head and the
total duty payable. Also, most of the listed products bear at least two of these levies
and some, like the textiles, the P.O.L levies and products, 3 or 4 different levies and
cesses.
ii) Taxation at the Manufacturer level

Although the Constitution had distinctly defined excisable goods as goods manufactured or produced in India and sales tax as tax on sale or purchase of goods. But the two taxes had come to overlap as the sales tax were levied on manufacture and importers to avoid problems in administering taxes levied it at the retail level.

iii) Definitional Irregularities and Problem of Valuation

Excise taxation implied taxation at the manufacturer level, but the term “manufacturing” is quite difficult to define as goods might had undergone a change of form due to a variety of processing activities performed after their initial production or manufacturing.

In taxation at the manufacturer level, determination of manufacturing value also was equally troublesome. Manufacturers often sold their products through their own distributors or wholesalers and sometimes directly to the customers. In determining the value at the manufacturer level adjustments had to be made for trade margins at different trade levels. Then came the question whether costs of after-sale service, advertisement and selling, organization expenses come under manufacturing cost. The Supreme Court ruled in a leading case that the post manufacturing expenses to be added to the assessable value; only the durable and returnable containers were exempted and the value of all other packing was added (Union of India Vs Bombay Tyre International). Even after such rulings, determination of excisable value had continued to present acute problems.

iv) Multiplicity of Rates

The excise rate structure was provided by the Schedule of the Central Excise Tariff Act, 1985, which included goods ranging from toys to nuclear reactors. The Schedule was divided into 20 sections covering 96 chapters. Goods falling under each chapter were divided and sub-divided into numerous headings and sub-headings. The statutory rate of duty applicable in respect of each item was shown against the appropriate commodity heading / sub heading. These statutory rates were modified, if necessary, by Government notifications to determine effective rates of duty.

Prior to tax reforms initiated in 1991, excise taxation in India was an interesting example of the multiple of rates, which were subject to frequent revisions. Various considerations contributed to the complexity of excise rates.
Commodities such as sewing machines, water coolers and bicycles, though on the tariff list, were completely exempted from the payment of duty. However, a number of other commodities were subject to a wide range of excise rates. The rate of duty on necessities of life like food products (cheese, butter, vegetable oils), pharmaceutical products, and footwear ranged from 10 to 15 per cent *ad valorem*. Rates of excise duty on semi-luxuries like washing machines, tape recorders and refrigerators and colour televisions ranged from 25 per cent to 40 per cent *ad valorem*. Luxury items like cosmetics and air-conditioners suffered a high rate of duty ranging from 100 to 110 per cent.

Most capital goods like machine tools, cranes, agricultural, textile and printing machinery, etc were subject to duty ranging from 15 to 20 per cent *ad valorem*.

Tobacco items were and continue to be conspicuous by high rates of duty. Successive upward revision of excise duty on cigarettes had all along remained a notable feature of tobacco tariff in India. In the 1997-98 budget, excise duty on various categories of cigarettes was increased ranging from Rs 20 to Rs 70 per thousand.

Broadly speaking, necessities of life were either exempt or paid a low rate of duty, semi-luxuries were moderately taxed, and luxuries and tobacco products stood out distinctly as high-rated tariff items, capital goods were subject to a relatively low rate of duty.

v) Taxation of Inputs and Capital Goods

Input excises (raw materials, components and other intermediates) enhanced costs and profits and therefore increased the prices of goods much more than the amount of excise collected. Moreover, if excises were imposed on inputs as well as the finished goods for which these inputs were used, a gap emerges between the nominal rate of tax and the cumulative rate of tax. This phenomenon made the excise system complicated and hindered the proper evaluation, particularly on equity criterion.

Still further, excises on inputs may promote vertical integration in an industry, a trend that is harmful to the growth of small-scale sector. Lastly, input excises impose inequitable burden on different economic classes by not discriminating between essential and non-essential uses of a product.
It was generally argued that capital goods, being instruments of industrial production, should be available at the minimum possible prices. Every increase in the capital cost was reflected in the final prices of the manufactured product. Since the resources available for investment were rather limited, any levy on capital goods reduced the real investment to that extent. It also pushed the cost of investment and slowed down the process of modernization and technology upgradation.

vi) Exemptions and Concessions

As in other countries, exemptions and concessions were an integral part of the Indian excise system. Excise preferences and reliefs were given to promote a wide range of socio-economic objectives. If wisely used, such tax preferences could become an effective tool of economic change on desired lines.

Exemptions were necessary to ensure progressivity in the structure of commodity taxation. Excise preferences were justified to induced entrepreneurs to undertake activities, which they would have otherwise avoided, e.g. adopting labor-intensive techniques of production. Concessions were designed to promote enterprises considered vital by the society though it was controversial as to which activities were vital and required governmental support. Exemptions were also used as a corrective mechanism to stabilize demand, production, and profits of different industries. Excise rates were raised to cover the excess profits and downward to boost low demand for idle industries. Excise tariff was also used for export promotion, employment generation by providing concessions to the small scale industries.

However, excise exemptions narrowed the tax base and therefore reduced governmental revenue. They interfered with the designing of the excise system and led to complexities in the excise law, which in turn caused tax evasion and litigation. They also obscure the evaluation of excise system, particularly from equity angle. Excise concession to a particular industry resulted in similar demands by other industries, causing unsettling effects on producers, consumers, and the administration.

Some of the goods exempted from the excise duties were technical, educational and research institute, goods of welfare of defence personnel, goods donated to the National Defence Fund or to the Ministry of Defence etc.
vii) Controlled use of MODVAT System

To tackle the cascading effects of input taxation of excises, a modified system of value added tax (VAT) or MODVAT was introduced in 1986-87. At that time, a full fledged Value Added Tax (VAT) could not be adopted as the Indian excise system was quite complicated with large number of excise rates and any major change would affect the system drastically. Under the MODVAT scheme, credit of the excise duty and additional duty of customs (countervailing duty) was paid on inputs when used in the manufacture of the final products. However, there was restrictive use of MODVAT facility since the scope of the provisions of law was not readily accepted. Purchases, which from the economic angle clearly pertain to the manufacture of the commodities, were often denied MODVAT credit on technical grounds.

viii) Exclusion of Services

The excise taxes were levied on goods only, excluding the services from its base. Services form an integral part of manufacturing and the distinction between goods and services had minimized.

In response to these inefficiencies, the government, time and again initiated various reform measures. However, a detailed study of these reform measures is done in the Chapter VI. The result of these reform measures was implicit, in the shift from union excise duties to a Central VAT (CenVAT).

The prevailing structure includes (i) CenVAT (present name of excises), (ii) special excise duty, (iii) additional excise duty in lieu of sales tax, (iv) additional duty of excise on textiles and textile articles, and (v) cesses on specified commodities.

(a) CenVAT: CenVAT is levied on all goods manufactured or produced in the country. With effect from March 1, 1986 MODVAT was introduced under the union excise duty as a system of giving credit for excise duty on inputs. Initially, it was introduced for a selected number of commodities. The coverage was limited to 37 chapters out of a total of 91. Overtime, MODVAT was extended and finally replaced by CenVAT in the Budget 2000-01. CenVAT has in general a single rate of 16% with some variations for select commodities. This coverage of CenVAT has been extended to all commodities except high speed diesel, motor spirit and matches.
(b) **Special excise duty**: There are three rates of special excise duty of 8%, 16% and 24% on specified products. Most of the items under special excise duty are final products but some of the items also fall in the category of intermediate goods.

(c) **Additional excise duty in lieu of sales tax**: It is levied only on tobacco, textiles and sugar. As followed earlier, this is a tax rental arrangement between the Centre and the States with the difference that Eleventh Finance Commission has recommended its inclusion under the shareable taxes.

(d) Additional excise duty on textiles and textile articles and cess on specified commodities are primarily meant to raise resources for the development of concerned industries. The revenue department administers it but some other departments also contribute in this endeavour.

The structure and procedures under CenVAT as given above indicates that the new system results in transparency of the tax burden under union excise duty. In addition, it reduces cascading effect of input taxation as well as pyramiding effect of the tax. Also, it generates a mechanism to check evasion of tax through self-policing.

In addition, the reforms implemented under excises have simplified its structure especially through CenVAT. While previously there were large numbers of rates, over the years it has been brought down considerably and the general rate of CenVAT is 16%. Apart from rationalization of rate structure, exemption notifications have also been curtailed and the specific rates are converted into *ad valorem* rates. Further, the rate structure of CenVAT is linked to the Harmonized System of Nomenclature (HSN) present in a number of countries for providing help in international trade.

**Weaknesses of the System under CenVAT**

The existing structure of CenVAT and the procedures for its administration are characterized by the following weaknesses:

(a) The existing procedures for physical controls are outmoded. In the context of the liberalized economy the physical control system should be replaced by self-assessment procedure.

(b) The provision of registration of wholesalers has created number of loopholes since there was no distinction between a manufacturer, first stage, second
stage dealer and so on. This facility should be restricted to only the first-stage dealers.

(c) The coverage of CenVAT has not been extended to all the commodities.

(d) Misuse of CenVAT tax crediting provisions and widespread evasion also.

Excise duty Reform Measures

The CenVAT structure requires immediate reform measures to be initiated by the Central government. These measures are:

(a) The administrative reform of excises is the most important aspect of the reform policy.

(b) There is a strong case for carefully reviewing the large number of products, which enjoy complete exemption. Apart from loss of revenue, such exemptions affect the CenVAT chain, which provides the core value of VAT-type taxes. Many products need to restored to the CenVAT rate of 16%.

(c) Also, the role of special excise should be limited to few luxury consumer products such as cars, refrigerators etc. The rates of such duties should be in the range 5to 15%. Apart from raising much needed additional revenue, such taxes would counter the regressive nature of a uniform CenVAT.

(d) The service tax should be integrated with the CenVAT/excise structure.

Summary and Conclusion

The analysis on excise duties so far, reveals some important aspects. The excise system has witnessed certain far-reaching changes. At the Central level, at the time of Independence, India inherited a system of commodity taxation wherein union excise duties were levied on about a dozen articles yielding a small proportion of total tax revenue to the Centre. Following Independence, the rates were raised, the base was enlarged and more and more items were brought into its net, thereby, resulting in more revenues also. Excises were levied not only on finished goods, but also on raw materials, intermediate goods and capital goods.

Though there was decline in revenue accruing from excises during the decade of eighties and nineties. But situation improved and the share of excise duties into total tax revenue of the central government again increased. Excise duties have come to occupy a dominant position in the revenue growth of the Central government. The
calculated buoyancy and growth rate estimates of excises reveals the same scenario. The buoyancy and growth rate are moving simultaneously i.e if one is increasing, the other is also increasing and vice-versa. But when comparing the trend during the pre-MODVAT period with post-MODVAT period, buoyancy rate has declined from 1.07 to 0.94, i.e, from an income-buoyant source it has turned into a non-buoyant source.

But the growth rate has increased from 12.8% to 13.46%. It implies that the growth rate in GDP has been much faster than the growth rate of excises explaining fall in its income buoyancy. Except in the decadal period 1990-2000 and overall period 1970-2004, when both buoyancy and growth rates are lower, in other decadal periods buoyancy and growth rates are rising.

However, the overall weak revenue performance of central excises cannot be adequately explained by the reduction in rates. Other possible explanations include proliferation of exempted products, the wrong use of CenVAT tax crediting provisions and widespread evasion. Reforms of excise include administrative reforms, single CenVAT rate of 16%, limited number of special excises on consumer products and finally integrating service tax with the CenVAT.

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2 Excise duties on liquor and other narcotics are imposed by the State government under provisions of entry 51 of List II (State List) in the Seventh Schedule. The Centre under Article 268 levies duties of excise on medicinal and toilet preparations containing alcohol but they are collected and appropriated by the States within which they are leviable. These are levied by the Centre to ensure uniformity in their rate throughout the country. Apart from allocating taxation powers, the Constitution also provides for the sharing of certain taxes between the Centre and the States. Prior to the constitution (Eightieth Amendment) Act, 2000, excise duties belonged to the category of taxes, which may be divided between the Centre and the States. Prior to the constitution (Eightieth Amendment) Act, 2000, excise duties belonged to the category of taxes, which may be divided between the Centre, and the States (Article 272) and the subject matter of this division fell within the purview of the Finance Commission. [Article 280, 3 (a)]. The sharing of excise duties was permissive and therefore the States did not enjoy a constitutional right to claim a share out of the revenues from central excises. However successive Finance Commission took the view that permissive sharing, contemplated under article 272 was not only justified but also even necessary in view of the growing financial needs of the States. Therefore, ever since April 1, 1952, the states got a share of the proceeds of Central excises. However successive Finance Commission fixed this share at 47.5 percent for the quinquennium 1995-2000. The Tenth Finance Commission also fixed this share at 47.5 percent for the quinquennium 1995-2000. However the Constitution (Eightieth Amendment) Act, 2000 substituted a new Article for Article 270 which states are now given a percentage share of all central taxes and duties. However, the surcharge levied for purposes of the Union under Article 271 is excluded from the divisible pool. Moreover, Article 272 of the Constitution was omitted by the same amendment.


4 Tariff Item no. 68 was introduced in the budget for 1975-76 and encompassed all goods not elsewhere specified in the excise tariff. The rate of duty on this catch-all-item was 1 percent ad valorem in the year of introduction and the objective of duty was purely revenue in purpose. Subsequently, the rate of duty was raised to 2% in 1977-78, 5% in 1978-79 8% in 1980-81, 10% in 1983-84 and 12% in 1985-
86. This residual tariff item was abolished with the introduction of harmonized system of commodity classification introduced from February 28, 1986. The large assortment of commodities under this head got scattered under proper heads in the new nomenclature of excise tariff.

5 The history of excise tariff classification dates back to the year 1944 when the Central Excises and Salt Act was passed, combining separate laws for different goods. This Act of 1944 covered 11 tariff items, which were arranged in alphabetical order.

6 Physical production in case of specific duties and value (production \times price) in the case of ad valorem rates.

7 The formula for buoyancy is the same as for elasticity with the difference that tax revenue in the case of buoyancy is to be considered in aggregate while for elasticity it has to be interpreted as net of discretionary changes.

8 Excises are levied in specific and ad valorem forms. A specific or volumetric duty represents a fixed amount of tax on a unit of the physical quantity of the product. This type of duty is generally preferred for commodities the classifications and sub-classifications of which are not numerous i.e. the commodity is standardized, e.g. sugar. Specific duties are easy to apply and have the potential and psychological advantages of obscuring the actual ratio of the tax to the selling price. They are, however, price-neutral i.e. price changes, if any, in the product do not affect the revenue yield. Specific duties are quality-neutral also unless differential rates prescribed with reference to the quality of the product. Ad valorem duties are imposed as a fixed percentage of the price of the product taxed. They are preferred when a commodity has many classifications and sub-classifications, e.g. textiles. Ad valorem duties are responsive to price changes and thus help maintain the proportion of taxes in national income. The main problem in applying ad valorem rates is the determination of the tax base, i.e. valuation of production.

9 Indian Tax Foundation, Excise duties in India 1894-2001