CHAPTER II
EVOLUTION OF TAX SYSTEM IN INDIA

The prime objective of Public Finance is to maximise the welfare of the society, by ensuring rational allocation of resources in conformity with the economy’s priorities. The development of a nation to a large extent depends upon the mobilization of revenue and its spending. India is a federation. A salient characteristic of a federal government is legislative autonomy and financial independence. This principle has enshrined in the constitution of India.

Historical background plays an important role in the financial settlements of governments. A close observation of financial settlements in the past will help us to understand the present system.

The Regularity Act of 1773 and Character Act of 1833 were the beginning of financial settlements in unified India. Thereafter, steps towards the separation of tax resources between the centre and the provinces were taken on the recommendations of Mr. Montague, the then Secretary of State for India in 1919.

CONSTITUTIONAL ASPECTS OF INDIAN TAXES

The Constitution of India, 1950, had clearly demarcated the financial avenues between the centre and states. Articles 268 to 300 of the Constitution of India deal with financial matters. Article 246 of the Constitution, lays down that Parliament has exclusive power to make laws
with respect to any matter enumerated in Union List (List I of schedule VII). The states have complete power to make laws with respect to any matter enumerated in the State List (List II of schedule VII) and both Parliament and State Legislature have power to make laws with respect to any matter enumerated in the Concurrent List (List III of schedule VII).

The constitution of India under Article 265 clearly states that no taxes shall be levied or collected except by the authority of law. Entries 82 to 92B of List I of the VII Schedule describe the taxation powers of the Union Government. Entries 45 to 63 of List II of the VII Schedule specify the taxation powers of the state governments. List III does not contain any head of taxation which means the Union and the states have no concurrent powers of taxation. This provision has been made in the constitution so as to avoid duplication in tax administration, and to minimize tax rivalry between the Union and States; and among the States.

Local governments do not have a provision of taxing powers on subjects. However, Article 276, implies that, taxes on professions, trades, callings or employment, are for the benefits of a state, or of a municipality, district board or any other local authority. Besides this, the states may assign any of the taxes to the local governments from the state list. Generally, local governments are provided with property taxes, Octroi and taxes on vehicles. There are constitutional guarantees to avoid overlapping of tax powers between the union and states. The propriety of the centre is exempted from
state taxation under Article 285(1). Similarly, the propriety of the states is exempted from union taxes (Article 289(1)). As far as union territories are concerned, the union government has the power to impose any tax from the state list. The taxing powers of the state which is clearly demarcated by the Constitution of India are taxes within the Jurisdiction of the states enumerated in List II in the Seventh Schedule of the Constitution of India.²

**TABLE II-1**

**TAXATION POWERS OF THE STATES**

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Entry No. in List II</th>
<th>Nomenclature of tax / duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>45</td>
<td>Land Revenue</td>
</tr>
<tr>
<td>2.</td>
<td>46</td>
<td>Taxes on agricultural income</td>
</tr>
<tr>
<td>3.</td>
<td>47</td>
<td>Duties in respect of succession to agricultural land.</td>
</tr>
<tr>
<td>4.</td>
<td>48</td>
<td>Estate duty in respect of agricultural land</td>
</tr>
<tr>
<td>5.</td>
<td>49</td>
<td>Taxes on land and buildings</td>
</tr>
<tr>
<td>6.</td>
<td>50</td>
<td>Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.</td>
</tr>
<tr>
<td>7.</td>
<td>51</td>
<td>Duties of excise on alcoholic liquors and narcotics manufactured or produced in the state but not including medicinal and toilet preparations containing alcohol.</td>
</tr>
<tr>
<td>8.</td>
<td>52</td>
<td>Taxes on entry of goods into local area for consumption, use or sale therein.</td>
</tr>
<tr>
<td>9.</td>
<td>53</td>
<td>Taxes on the consumption or sale of electricity.</td>
</tr>
<tr>
<td>10.</td>
<td>54</td>
<td>Taxes on the sale or purchase of goods other than newspapers subject to the provisions of Entry 92A of List I</td>
</tr>
<tr>
<td>11.</td>
<td>55</td>
<td>Taxes on advertisements other than advertisements published in the newspapers (and advertisements broadcast by radio or television)</td>
</tr>
<tr>
<td>12.</td>
<td>56</td>
<td>Taxes on goods and passengers carried by road or on inland waterways</td>
</tr>
<tr>
<td>13.</td>
<td>57</td>
<td>Taxes on vehicles, whether mechanically propelled or not suitable for use on roads, including tram-cars subject to the provisions of Entry 35 of List III.</td>
</tr>
</tbody>
</table>
Though, the taxation powers allocated to the Union and the states as per Constitution of India are mutually exclusive, all the taxes assigned for the Union are meant for the purpose of Union. As the state governments are undertaking most of the expansive and expensive developmental activities, the revenue needs of the states are growing by leaps and bounds. To supplement the revenues of the states in accordance with their needs, specific provisions were made to set apart a portion of central revenues for the benefit of states.

Since, the distribution of tax powers is biased towards the Union government and to meet the resulting revenue imbalance between the Union and the states, four dynamic balancing devices,

a) Revenue sharing

b) Revenue Distribution

c) Revenue Assignment and

d) Grants-in-aid
have been adopted. In respect of revenue sharing, the states share the proceeds of the taxes on income (other than corporate tax) and of Union excise duties. Regarding revenue distribution, the entire proceeds of some of the taxes in the Union List are distributed among the states. These taxes include succession and estate duties, terminal taxes on passengers and goods carried by railway, sea or air, taxes on railway fares and freights, taxes on the sale and purchase of newspapers, sale and purchase tax on inter-state trade and additional duties of excise in lieu of sales taxes. The revenue assignment relates to the taxes in the Union List whose revenue has been assigned to the state governments. These taxes are levied by the Union but the proceeds are collected and retained by the states for their use. Such taxes are stamp duties and excise duties on medicine and toilet preparations containing alcohol. Finally, the Constitution provides for a system of grants which may be conditional or in aid of general revenue. Thus, all these taken together along with the financial powers under the state List, form the total financial resources of the state governments. Therefore the main sources of revenue of the states are:

a) Tax Revenue
b) Non-Tax Revenue
c) Revenue sharing
d) Grants-in-aid
The salient features of the true federal system warrants legislative
and financial autonomy. But in practice, most of the elastic and higher
revenue taxes are vested with the Union and the states are left with majority
of the developmental activities and fewer elastic taxes in its armoury. As a
result states are endowed with legislative autonomy and financial
dependence. This is the prime characteristics of Indian federation. This
feature, over a period of time developed due to the mis-matching of revenue
and expenditure and as time passes this becomes the source of confrontation
between the Union and state governments. Under these circumstances, the
sales tax assumes an important place in the fiscal armoury of the states,
particularly as an instrument of a much sought fiscal autonomy.

EVOLUTION OF SALES TAX

As the governments at various stages need finance to undertake
developmental activities, it is imperative to impose a tax on the movement of
goods and services from production to consumption. This is the cause for the
origin of sales tax. Sales tax is a tax which is levied by the government on the
sale of a commodity either at the last point or at the first point of sale. Haig
has defined sales tax as a “tax which includes within the scope all business of
sales of tangible personal property, either retailing or wholesaling or
manufacturing stage with the exceptions noted in the taxing law”.4

John F. Due defines sales tax as a “levy imposed upon the sales or
elements incidental to sales such as receipts from them, on all or a wide range
of commodities excluding taxes imposed at fractional rates upon gross receipts in the form of business occupation or licence taxes. A sales tax is imposed upon all transactions through which commodities pass or upon one or on small number of stages only. The tax is confined only to physical commodities or it may apply to some or all services rendered by commercial enterprises, professions etc., but not services rendered by workers to their employers.\textsuperscript{5}

A.G. Buchler defines sales tax as, “a tax imposed upon the sales of numerous commodities and the use of personal services at uniform rates”.\textsuperscript{6} According to Plank, sales tax is, “a tax upon the sales or exchange of goods or services which is proportional to the values or quantities of the things transferred”.\textsuperscript{7}

Sales tax has been defined by different authors differently. Such a variety of definitions resulted from the efforts taken by the experts to incorporate as much characteristics of sales tax as possible in a capsule form. Though, the attempts in this regard are a continuous one, we can list out the basic characteristics of sales tax. They are

i) In rem taxes (in rem is a Latin expression meaning on things)

ii) Imposed on activities or objects.

iii) Imposed either on household side or firm side of the transaction.

iv) In rem taxes are inferior to well-defined personal taxes.
Being an ad valorem levy imposed on the seller with reference to the transaction of sale, sales tax is as old as human civilization. As, “taxes are the price of civilization”, a look back on its origin and economic history give an idea about the various stages of development to its present form. Being an old source of revenue, there were references about sales tax, on the slaves market of Athens during the fourth and fifth centuries. Actually, sales tax was imposed on the slave transactions in Athens. Sales tax in ancient Rome at the rate of 1 per cent on the sale of movable goods and 2 per cent on the sale of slaves was imposed by Emperor Augustus. Spain administered a national tax in 1342 similar to general sales tax and this tax continued up to 1845. The rate of tax charged was as much as 15 per cent. France introduced a general sales tax during fourteenth century but later discontinued it.

Sales tax was introduced in many nations during and after World War I. Though, there was severe opposition for the indiscriminate use of sales tax during the early stages of its origin, governments continued to impose this tax as it is a stable yield even in the face of declining business activity. Similarly, Canada switched over to the system of sales taxation in 1920, Cuba in 1922, Brazil in 1924, Ecuador in 1925, Uruguay in 1928, Argentina in 1931 and Mexico in 1932. During and after World War II, nations faced with severe inflationary pressure and scarcity of essentials. To overcome this situation, sales tax was introduced in Great Britain in 1940 and Finland and Switzerland switched over to the system of sales tax in 1941 and Chile in 1943. World War
II also promoted the use of the tax still further and led to widespread rate increase.

During and after, World War I, sales tax was adopted in European countries, as a system to finance projects related to war, reconstruction of economies devastated by war and settlement of soldiers. Germany adopted the system of sales tax in 1918, France in 1920, Italy and Czechoslavakia in 1919, Hungary, Russia, Rumania, Belgium and Yugoslavia in 1921, Luxemberg in 1922, and Poland and Austria in 1923, Netherlands in 1933.11

Sales taxes in India are as old as human civilization. There were references about sales tax in Kautilya’s ‘Arthasastra’. Kautilya states that, sales tax was levied to the extent of 1/10th on the goods sold by weight and 1/11th on goods sold by counting.12 Sales tax was widely prevalent during Mauriyana rule also. During that period, a general sales tax or tax percentage ad valorem on the sale price of all articles was found and any malpractice in the payment of tax was liable for punishment.13 Sales tax also existed during the regime of Firoz Shaw, Sher-shaw-Suri and during Akbar’s time. During Akbar’s time Hasil-i-Bazar (market dues on the sale of commodities) was abolished but the rate of sales tax was determined on the basis of religion. The rates of sales tax were 5 and 2.5 per cent for Hindus and Muslim dealers respectively. Jahangir wanted to do away with sales tax, but it prevailed during the time of Shah Jegan and Aurangazib.14
The origin of modern general sales tax is traceable to the Government of India Act, 1935. Fifteen various committees such as Indian Statutory Commission 1930, Peal Committee 1932, and Joint Parliamentary Committee 1933-36, etc. discussed the problems of provinces and were of the opinion to equip the provincial governments with greater financial resources. Following this, Sir Otto Nie Mayer in 1936, recommended that, 50% of net proceeds of income tax should be assigned to the provinces on the basis of revenue and population.

The jurisdiction of levying sales tax with states continued from the adoption of this Constitution of India since 1950. But, it was the Supreme Court Judgement in 1955, which led to a constitutional review in 1956, clearly demarcated the imposition of sales tax. As a result the sale or purchase of goods in the course of inter-state trade or commerce was brought within the purview of the legislative jurisdiction of the Parliament. Thus, the Central Sales Tax Act, 1956 came into existence through the Sixth Constitutional Amendment which introduced entry 92A in List I of schedule VII. This authorizes the Parliament to levy tax on the sale or purchase of goods in the course of inter-state trade. However, the entire proceeds from this tax are assigned to the states by amending Article 269 of the Constitution. Section 15 of the Central Sales Tax Act laid down certain restrictions with respect to the levy of sales tax on goods of intra-state transactions as declared goods of special importance. The restrictions are:
a) The rate of sales tax should not exceed 4\% and

b) The tax cannot be levied at more than one stage. The tax on inter-state transaction has already been levied and if such goods are later sold in inter-state trade, the state sales tax is refunded.

In 1957, the Union government entered into an agreement with the states regarding the abolition of sales tax (Goods of special importance) on textiles, sugar and tobacco including manufactured tobacco. As per this arrangement, the Union government levies Additional Excise duty in lieu of Sales tax (AEDILST) on these three commodities. Entire proceeds from these commodities through AEDILST are assigned to the states. However, the states are empowered to cancel this arrangement whenever they desired so and impose sales tax on these commodities. But the rights of the states to levy sales tax on these commodities are restricted under the list of ‘Goods of special importance’ and rate of sales tax on these commodities cannot exceed the rate of Central Sales Tax.\(^{16}\)

**STRUCTURE OF SALES TAXES IN INDIA**

There is total uniformity among the states for the continuous levy of sales tax, since it is a resourceful source of revenue. However, the structure of sales tax among Indian States is neither homogeneous nor uniform. The reason behind this situation is, that the union government didn’t take any step to maintain uniformity in sales tax structure among the states during the early
stages of its adoption. A close scrutiny of the introduction of the system of sales taxation and the rate structure among Indian States will testify this issue.

Though the system of sales taxation followed by the Indian States is divergent in nature, they can be classified on the basis of certain commonalities. These commonalities are scope or coverage of sales tax regime, legal characteristics and turn-over.

**TABLE II-2**

**GENERAL SALES TAX AMONG INDIAN STATES, SYSTEM AND CHRONOLOGY**

<table>
<thead>
<tr>
<th>S.No.</th>
<th>State</th>
<th>Year of Introduction &amp; Revision</th>
<th>Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Tamil Nadu</td>
<td>1939</td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Multi point sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1959</td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Multi point sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>First stage purchase tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Last stage purchase tax</td>
</tr>
<tr>
<td>2.</td>
<td>Punjab</td>
<td>1941-Amended in 1942</td>
<td>Single Point last stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1948-Amended in 1949</td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Last stage purchase tax</td>
</tr>
<tr>
<td>3.</td>
<td>West Bengal</td>
<td>1941-42</td>
<td>Single point last stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td>4.</td>
<td>Bihar</td>
<td>1944</td>
<td>Multi point cum single point sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point last stage sales tax</td>
</tr>
<tr>
<td>5.</td>
<td>Maharashtra</td>
<td>1946</td>
<td>Multi point cum single point sales tax</td>
</tr>
<tr>
<td>6.</td>
<td>Orissa</td>
<td>1947</td>
<td>Single point last stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Purchase tax</td>
</tr>
<tr>
<td></td>
<td>State</td>
<td>Year</td>
<td>Tax Structure</td>
</tr>
<tr>
<td>---</td>
<td>------------------</td>
<td>-------</td>
<td>---------------------------------------------------</td>
</tr>
<tr>
<td>7</td>
<td>Madhya Pradesh</td>
<td>1947</td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point last stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Purchase tax</td>
</tr>
<tr>
<td>8</td>
<td>Assam</td>
<td>1947</td>
<td>Single point last stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td>9</td>
<td>Uttar Pradesh</td>
<td>1948</td>
<td>Multi point sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point last stage sales tax/ Purchase tax</td>
</tr>
<tr>
<td>10</td>
<td>Karnataka</td>
<td>1948</td>
<td>Multi point sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1957</td>
<td>Multi point sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td>11</td>
<td>Rajasthan</td>
<td>1954</td>
<td>First/Last stage purchase tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point First/Last stage sales tax</td>
</tr>
<tr>
<td>12</td>
<td>Andhra Pradesh</td>
<td>1957</td>
<td>Multi point sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point first / last stage purchase tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point first stage sales tax</td>
</tr>
<tr>
<td>13</td>
<td>Gujarat</td>
<td>1959</td>
<td>Single point first/last stage sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Double point sales tax</td>
</tr>
<tr>
<td>14</td>
<td>Jammu &amp; Kashmir</td>
<td>1962</td>
<td>Single point first/last stage sales tax</td>
</tr>
<tr>
<td>15</td>
<td>Kerala</td>
<td>1963</td>
<td>Multi point sales tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Single point first/last stage sales tax</td>
</tr>
</tbody>
</table>

**i) SALES TAXATION ON THE BASIS OF SCOPE**

On the basis of scope or coverage, sales tax in India can be classified into General Sales Tax (GST) and Selective Sales Tax (SST). General Sales Tax can again be classified into single point; double point and multi point sales tax.
Under the General Sales Tax, the tax is levied on almost all commodities excepting those which are excluded or exempted under the law. Under the Selective Sales tax, a few commodities are singled out for the purpose of taxation. In other words, General Sales tax means a tax characterized by its broad base or measure, which commonly includes sale of most of the tangible personal commodities and certain specified services (i.e) its application is all inclusive, of course, subject to legal exemptions. Selective sales tax means a tax levied on selected commodities and aims at singling out one or more products for distinct treatment.18

The single point sales tax (the first stage or the last stage) is a tax which is collected from only one of the dealers who are inter-connected in the process of exchange of goods. In this case, the impact of sales tax may take place either at a point where an importer or manufacturer makes the first sale of goods (Single Point First Stage Sales Tax (SPFSST)) or at a point where a retailer sells (if he is a dealer) his goods to the consumer (Single Point – Last Stage Sales Tax (SPLSST)). In single point (first stage/last stage) sales tax system, the liability of the tax is restricted to one single occasion, irrespective
of the multiplicity of sales in succession and the law is so framed as to prevent double taxation.

The double point sales tax provides for the taxation of commodities at both the points (i.e.) when they enter the segment of registered dealers and when they go out of it. The volume of tax which the government intends to levy on particular goods is split up between two points, the first point and the last point in the chain of sales. A specified proportion of tax is collected at the point of entry and the balance at the point of exit.

The multi-point sales tax system has a provision for taxation at each stage of a sale. The goods are sold by an importer or manufacturer to his sole-selling agent, who sells them to a wholesaler and the wholesaler to a semi-wholesaler or retailer by whom they are finally sold to the consumers. Sales tax is imposed at each of these transactions. The prices of goods are thus necessarily inflated at each stage in this chain of sales.

Sales tax on Motor Spirit Tax (MST) and Purchase Tax on commodities like sugarcane, paddy and jute are examples of selective sales tax. From the Sixties onwards there is a trend to merge the MST with the GST (General Sales Tax). Kerala merged MST with GST in 1965-66, Andhra Pradesh in 1968-69, Karnataka in 1970-71, Madhya Pradesh in 1973-74, Bihar in 1976-77, Tamil Nadu in 1980-81 and Orissa in 1981-82.
ii) THE LEGAL BASIS OF SALES TAX

Legally, sales tax is levied on dealers, either on those who sell the commodities or on who purchase them. Therefore, sales tax is known as sales tax or purchase tax.

Actually, the nature of the commodity decides whether it is subject to sales tax or purchase tax. Certain commodities have been isolated for the levy of purchase tax. For example, in Rajasthan, cumin seeds are subject to first point purchase tax, in Tamil Nadu, rubber is liable for last point purchase tax, in Assam, paddy is subject to first point purchase tax and in some other states sugarcane is liable to first point purchase tax.

iii) SALES TAX–ACCORDING TO TURN-OVER

Turn-over means the aggregate amount at which goods are supplied or distributed by way of sales or sold by a dealer either directly or through another one on own account or on account of others. Taxable turn-over is again classified into

- Multiple turn-over tax
- Single turn-over tax

Multiple turn-over taxes are imposed more than once in the production-distribution processes whereas single turn-over taxes are levied only once. The taxable quantum of turn-over is different among different states. In some states different types of taxable quantum are prescribed for
different type of dealers. Generally, there are two distinct limits, one for importers and manufacturers and another for all other dealers.

There is no minimum turn-over in regard to dealers registered under the Central Sales Tax Act. In most of the states, a dealer registered under the Central Sales Tax Act is liable to pay tax on all sales irrespective of the quantum of his turn-over. Casual traders are also required to pay tax on all their sales irrespective of their turn-over. However, there is persistent demand among the trading community for the periodical revision of turn-over limit. If the turn-over limit is raised, consequent to a rise in prices, the revenue elasticity of sales tax would be lost. As sales tax is assessed on turn-over and as the value of turn-over depends on prices and production, any upward revision of turn-over would remove the built-in-response of the sales tax to the increased turn-over.

**EXEMPTIONS GRANTED UNDER SALES TAX ACT**

Exemption from sales tax means, freeing the commodities from the clutches of tax. The equity principle of Fiscal Economics demands that people with income to contain the bare necessities of life should not be indiscriminately taxed. This policy can be achieved by exempting certain commodities of consumption from the purview of sales tax. This exemption also makes the sales tax system less regressive. Exemptions are being granted on the basis of any one or all aspects of the following norms.
a) Necessities
b) Goods for production
c) Goods sold to or by social or economic institutions
d) Goods taxed under separate law
e) Administrative exemptions

Granting exemptions to a group of commodities from sales tax also has justification on the basis of Engel’s law of consumption. It states that, a poor man’s family budget is a budget of such consumption goods as are of basic necessity over which a major portion of his income is expended. On the other hand, in the case of a rich man’s budget items of luxury goods according to their social standard do find an important place in it. It is due to this economic disparity, it is pleaded that the poor man’s consumable goods should be either taxed at a lower rate or totally exempt them from tax, so that he may not move to lower indifference curve by changing his consumption pattern due to taxation. To maintain the standard of living of the lower strata of society at certain level, exemptions are justified.

Though there are justifications for exemption, it is a known fact that exemptions of large scale deprive the state of heavy amount of revenue. Fiscal experts persistently demand the abolition of exemptions granted on certain commodities. Despite this, the system of grating exemption and subsidy to industrial sector continues.
DEMAND FOR ABOLITION OF SALES TAX

Sales tax is the only major source of revenue for states, but there is diversity in rate structure, base of taxable goods and taxable turn-over limit. In spite of the fact that there are diversities in sales tax system, its enforcement in some states put up maximum difficulties and harassment to traders and businessmen who in turn demand the abolition of sales tax. Lack of uniformity in sales tax among states, and deficiency in the administration of the system can be rectified through a central enactment. But, the demand for the abolition of sales tax will not solve the problem rather it deprives the states fiscal autonomy and make them totally surrender to the Union government for revenue requirements.

The question of levying additional excise duties in lieu of sales taxation was first raised before the Taxation Enquiry Committee (1953-54). The committee observed that the sales tax must continue to be a tax of the state. The abolition of sales tax was again discussed in the National Development Council in 1956. The Federation of Chambers of Commerce and Industry in 1960, suggested that the power to levy and collect sales tax should be vested with the Central Government and the proceeds obtained should be distributed to the states, similar to the provisions of Article 269 of the Constitution. Keeping all these facts in mind, the Government of India constituted a committee under the chairmanship of Dr. B.C. Roy. The committee opined that the additional excise duty should not be extended for more commodities. In 1963, the idea of extension of additional excise duties in
lieu of sales tax was disfavoured by the state finance ministers. The matter of substitution was again considered in National Development Council meeting in 1970, where the state finance ministers demanded the abolition of Additional Excise Duty in lieu of sales tax on sugar, cloth, tobacco and silk fabrics. The FCCI presented again a memorandum to the Jha Committee (1977) regarding the abolition of sales tax. However, the committee had not have incorporated the idea into its business. The Janatha Government in its election manifesto in 1977 had promised the businessmen to replace sales tax by additional excise duty. The Jha committee in its report mentioned that the merger of sales tax with union excise may pose several problems apart from the question of state autonomy. The advantage of substitution of sales tax can be had only at the cost of losing the autonomy of the states as well as their income. As all other sources of state income are going down, they have to depend on sales tax more and more for resource mobilization to meet the expanding needs of finance. Therefore, any argument for the abolition of sales tax is irrelevant in the context of increasing financial requirements of the states.

RECENT REFORMS IN SALES TAX STRUCTURE: APPROACH TOWARDS VALUE ADDED TAX (VAT) IN INDIA

The sales tax system operating in India is very old and it needs complete overhaul. Periodical review of sales tax system not only makes the system dynamic but also brings handsome revenue to the exchequer. The existing sales tax system in states is marked by several deficiencies such as
lack of uniformity, multiplicity of rates, cascading of taxes, pyramiding effects and revenue loss due to incentives. As time passes, and the system of sales taxation grows, inherent deficiencies noted above should be routed out. Instead, the system becomes more complicated. To overcome these deficiencies, experts prescribed a hybrid variety of taxation called Value Added Tax (VAT). Value Added Tax is a multi-stage sales tax levied as a proportion of the value added. (i.e., sales minus purchases which is equivalent to wages plus profit). Though the system of state-Value Added Tax has certain advantages such as simplification of the existing sales tax system, fewer rates and very few exemptions, less opportunity for tax evasion and total transparency in the operation of the system, it suffers from certain deficiencies.

This system will be efficient and resourceful in an economy which is characterized by high degree of monetization, efficient accounting procedure and above all consumer awareness.

A full-fledged VAT was first introduced in Brazil in 1960’s, then in European countries in 1970’s and subsequently introduced in about 130 countries. In Asia, it has been introduced in countries including China and Sri Lanka. In India, there has been a VAT in respect of Central Excise Duties. At the state level, the VAT system has been introduced in terms of Entry 54 of the State List of the Constitution. VAT came into operation in India at state level from 1 April 2005. Majority of the states in Indian Federation opted to it,
barring a few states, including Tamil Nadu on non-economic reasons. These states also joined with the mainstream subsequently and today Value Added Tax is being implemented in India at state level.

SALES TAXATION IN TAMIL NADU

Tamil Nadu state which accounts for 4 per cent of the land area and 7 per cent of the population in India was the first state in the country to introduce a general sales tax in its present form way back in 1939 and used to account for 62 per cent of sales tax collected in India in the early sixties. Tamil Nadu General Sales Tax being the first of its kind in India was a multi-point turn-over tax primarily to make up for the loss in revenue arising as a result of the introduction of prohibition. It was a multi-point tax levied at a very low rate of 0.5 per cent on all dealers with a turn-over in excess of Rs. 20000 were made liable to this tax. But there was also a provision for levying a slab rate of Rs. 5 per month on the dealers having turn-over between Rs. 10000 and Rs. 20000 per annum. This tax covered almost all the commodities, except agricultural and horticultural commodities sold by the producers. Other commodities exempted from the purview of the sales tax were, bullion and spices, cotton, cotton yarn and cloth woven on handlooms.

The general rate was reduced to 0.25 per cent and the slab rate to Rs. 4 per month in 1940. Again in 1943, the rate was increased to one per cent on turn-over in excess of Rs. 20000 and the slab rate to Rs. 8 per month for dealers having turn-over between Rs. 10000 and Rs. 15000 and to Rs. 12 per
month for dealers having turn-over in the range of Rs. 15000 and Rs. 20000 per annum. Prohibition was extended to the entire state in 1948 and the revenue loss expected was around 17 crores. To compensate this loss of revenue the slab rates were abolished and the general rate was increased to 1.56 per cent. Exemption given earlier to commodities such as cotton yarn, bullion and spices and handloom cloth were withdrawn and they were taxed at the rate of 0.25 to 0.50 per cent single point. The law was amended to permit taxation of works contract. But this was not maintainable till the enactment was included in the Constitution in 1982. The 46th Amendment to the Constitution enlarged the definition of the word “tax on sale or purchase of goods” under Article 366 (29A) (b) to include “a tax on transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract”

As the turnover of hotels exceeded Rs. 25000, a tax of 2.34 per cent was levied in 1949. Similarly, 1949, was marked by the withdrawal of tax on cotton and it was subjected to a single point tax. The period between 1949 and 1953 didn’t have much change in the sales tax structure. In 1954, an additional tax at 7.8 per cent was levied on the first sale of superfine and fine varieties of cloth in the state. Similarly an additional first point tax at the rate of 3.125 per cent on precious stones was levied. In 1956, first sale of sugar was liable for an additional tax of 6.25 per cent and an additional tax of 7.81 per cent was levied on medium cloth also.
As time passed, trading community mounted pressure on the government for a change over to single point tax system. The rate of tax was fixed between 3 and 6 per cent. Commodities subjected to this change during 1957 were coffee, tea, cement, motor cars, refrigerators, kerosene, fertilizers and cane-jaggery (These commodities were switched over from multi-point to single point tax). Similarly, commodities such as coal and coke, iron and steel, jute and oil seeds were transferred from CST to state taxes. The rate of tax under multi-point system was increased from 1.56 per cent to 2 per cent in 1957.

Due to the development of trade and commerce over a period of time, the assessment, compliance and administration of sales tax system become complicated. To sort out the inherent deficiencies over the system and to suggest methods to improve it, the government appointed Dr. Loganathan (1957) to examine the system of sales taxation in Tamil Nadu. On the basis of the report submitted, the government enacted a new legislation now known as the Tamil Nadu General Sales Tax Act 1959 (TNGST). This system covered 63 commodities liable for single point tax. In 1965, the government again invited Dr. P.S. Loganathan to re-examine the system of sales taxation in Tamil Nadu. Further, to examine the structure and administration of sales tax in Tamil Nadu, Mr. S.P. Srinivasan was appointed as officer on Special Duty in 1974. Again to examine the administrative procedure relating to sales tax, a committee was appointed in 1979 under the Chairmanship of Mr.S.P. Kaiwar. As a result of the recommendations of the various committees and pressure
from the trade and commerce community, the number of commodities earmarked for single point taxation went on increasing.

**ADDITIONAL SALES TAX (1970)**

As the developmental and welfare measures undertaken by the government were on the rise, the government needed additional revenue to cope up with the situation. Two new enactments were incorporated into the statute book. They are:

i) The Tamil Nadu Additional Sales Tax Act 1970 and

ii) The Tamil Nadu Sales Tax Act, 1970 (AST (97))

The additional sales tax is a turn-over tax and the rate of taxation varies as per the slabs of turn-over. Those subjected to this tax are specifically prohibited from collecting the tax from the consumers. Goods under the first schedule of TNGST (Tamil Nadu General Sales Tax) Act are subject to a single point sales tax only. They are not taxable at any point other than the prescribed point. Therefore, dealers have to deduct the turn-over of these goods from their total turn-over for the purpose of determination of AST on the ground that those commodities were not taxable at these points.

**SURCHARGE ON SALES TAX (1971)**

The surcharge on sales tax is leviable in Chennai, Madurai, Coimbatore, Salem and Thiruchirapalli and their suburban areas and 38 municipalities. There was a proposal to levy this tax to the entire state for the sake of maintenance of uniformity. An additional surcharge levied within the
jurisdiction of Madras Corporation and suburban areas extending upto 32 kms, was also extended to Madurai and Coimbatore corporations and to their suburban areas extending upto 16 Kms.

SALES TAX ON MOTOR SPIRIT (MST)

To compensate the revenue loss resulted due to the introduction of prohibition, sales tax on Motor Spirit was first levied by the Government of Madras in 1939. This tax was commonly known as Tamil Nadu Motor Spirit Taxation Act, 1939 (MST Act). This was a single point tax on retail sales items such as petrol, aviation fuel and heavy and light diesel oil. Initially, it was a tax based on volume and later due to inconveniences; it has been made as ad valorem tax. The administration of this Act was initially, with the Excise Department in the non-prohibition areas and to the police department in the prohibition areas. Collection was entrusted to the revenue department. After the formation of the Department of Commercial taxes, this task was entrusted to the commercial taxes department. From 01.11.1980 onwards, MST was brought under the TNGST (Tamil Nadu General Sales Tax) Act 1959 and the rates are advalorem.

STRUCTURE OF SALES TAX IN TAMIL NADU – A GLANCE

“Tax structure refers to the mix and types of taxation used by governing bodies. It is a measure of the relative importance of various kinds and methods of taxation used. The tax structure observed at any point of time reflects a political equilibrium resulting from the historical evolution of institutions and the distribution of political power. Tax structure changes over
time as political and economic conditions change. Existing structure of sales taxes in the state is governed by the Tamil Nadu General Sales Tax Act 1959 (TNGST). Basically, it was a multi-point tax. Later, it has undergone several changes, and the number of commodities under multi-point receding and the number of commodities covered by single point fastly increasing. Some commodities are taxed at the first point whereas some other commodities are taxed at the last point. Those commodities, which were not classified so far, are subject to multi-point taxation. The share of revenue from multi-point commodities declined from 60 per cent in 1959-60 to 24 per cent in 1972-73 and 12 per cent in 1979-80.

In addition to the General Sales Tax, the TNGST (1959) provides for the levy of Additional Sales Tax (AST) under Tamil Nadu Additional Sales Tax Act (1970). AST is levied on the basis of turn-over as decided by the TNGST Act, 1959. The special feature of AST is that, it doesn’t permit the traders to shift the burden of AST on consumers. Despite, the AST, a surcharge is also leviable as per Tamil Nadu Sales Tax (Surcharge) Act, 1971. The rate of surcharge in Madras City and its suburban is 15 per cent and 5 per cent in Madurai, Salem, Coimbatore and Tiruchirapalli. An analysis of the trend of revenue from AST and surcharge with respect to GST shows that, the share of surcharge with GST is more or less constant (3 per cent); whereas the revenue from AST is gradually increasing over the years. The share of
AST with GST was 3.9 per cent in 1972-73, 10.15 per cent in 1979-80 and 14.5 per cent in 1995-96.

EXEMPTIONS UNDER TAMIL NADU GENERAL SALES TAX ACT

Exemptions are granted for a variety of reasons. They may be economical, political and social. Tax exemptions may be classified into five categories.

a) Exemptions of necessities
b) Exemption of goods for production
c) Exemption of goods sold to or by social or economic institutions
d) Exemption of goods taxed under separate law
e) Administrative exemptions

The direction and quantum of exemptions given in Tamil Nadu is comparable with any other state. Exemptions to certain commodities were granted partly due to the reason that they are perishable and partly due to the fact that they are not easily administrable. Such exemptions include common salt, khandsari sugar, paddy, rice, cholam, chambu, ragi, thinai, varagusamai, kudiraivali, rice products, millets and its products, water and milk. Apart from this, fresh fruits and vegetables, meat, fish and eggs are also exempted from the purview of sales tax.

To achieve certain social objectives and also to encourage the consumptions of certain goods exemptions were granted to certain non-food items, which include reading books and text books, students notebooks,
writing pencils, slates and slate pencils, educational films and film strips, electrical hearing aids, diagnostic X-ray photos, junnadi goods, honey and bee wax, Korai grass, coconut and coconut husk, bangles (not by any metals) firewood, hay, green grass, rice bran, wheat bran, husk, dust of pulses and grams, jaggery and gur, hurricane lights, non-pressure kerosene stoves, lawrel oil, bandage cloth and guaze and condoms.

Exemptions were also granted to promote the interests of certain institutions or certain type of activities. These include, sales by schools, colleges and the department of the regimental canteens and hostels, sales of drugs and scientific equipments in government hospitals and public health centres, goods produced by certain grama sevak sanghs and village handicraft industries, products of research and training centres, sales by co-operative societies, articles sold at service and welfare institutions sales by rehabilitation industries and centres, sales in between corporations and boards, articles for government use, stationery articles sold to educational institutions.

To fulfil obligations arising from inter-state or international agreements, exemptions were also granted to certain institutions. Such institutions in Tamil Nadu are:

a) High Commissioner of United Kingdom in Chennai
b) High Commissioner of Ceylon in Chennai.
c) Assistant High Commissioner for Malasia in Chennai
d) Sales made to World Health Organization and the United Nation’s Offices and agencies in India, Medical stores and equipments for AIIMS, New Delhi, UNICEF greeting cards and calendars.

Sales to the Royal Family of Bhutan and other government agencies and representatives are also exempted.

Certain agricultural inputs including producer goods used in agriculture were also exempted from the purview of sales tax in Tamil Nadu. Such items were; sheep, goats, cows, bulls, bullocks, pigs and such animals, primitive agricultural implements, sales of bacterial culture and bactericides for agricultural purposes, coconut thatches, screwpine fibre and broomstick.

Apart from those exemptions mentioned above, exemptions are granted to certain type of commodities which are governed by some other statutes. Such commodities are tobacco, sugar, cotton, fabrics, rayon or artificial silk fabrics and woolen fabrics as defined in the Additional Duties of Excise (Goods of special importance) Act 1957.

REPLACEMENT OF VAT AND OTHER TAXES BY GOODS AND SERVICES TAX (GST)

The Government of India, in the union budget 2009-10, reiterated its commitment for the introduction of a new tax system known as Goods and Services Tax (GST) by April 2010. Introduction of GST is a part of the ongoing tax reforms. Goods and Services Tax is the single most important tax reform since independence. This tax covers all goods and services. It replaces the
complex levy of goods and services at the centre and at the state levels. Goods and Services tax is a dual levy of Centre GST and State GST. Three Indian states namely, Tamil Nadu, Madhya Pradesh and Chattisgarh expressed their reservations for the introduction of GST from 1 April 2010. GST is at its introductory stage, a detailed blue print and a road map for its implementation is yet to be released by the Government of India.
REFERENCES

17. State