1. INTRODUCTION:

The process of manufacturing and selling operations involve a number of stages, during each of which operations some value is added, but at the same time some taxes are also imposed and collected. By the time a commodity or service reaches the final consumer who would no longer bring it into any further commercial transaction, a series of taxes would have been collected. Such taxes are collected at each stage, not only on the incremental value of the commodity or service, but also on taxes paid earlier and include in the mark-up-price. This is known as the 'cascading effect' (or compounding effect) of input taxation. The French call this 'taxes en cascade' (like a waterfall) because it rebounds from rock to rock all along its descent.

2. IMPACT OF CASCADING TAX SYSTEM:

Various inequities and anomalies arise, the degree accentuating with the number of intermediary transactions between the first and the final taxable commercial transaction. The final burden of the tax is thus dependent upon the number of transaction to which the cycle of production gives rise to.

The main inequities and anomalies of a cascading input
(i) It promotes vertical integration, which leads to economic concentration, and also raises production cost and prices, thereby reducing international competitiveness and adversely affecting export performance. Thus, for example out of two identical cars, one may be manufactured by a company having its captive iron ore and coal mines body manufacturing plant, tyre and battery units, etc., and the other may purchase most of the inputs from outside. The latter will have to pay more taxes than the former and its production cost would be higher. On grounds of equity, such differential tax treatment is undesirable. The avoid multiple taxes, there will be an attempt towards vertical integration.

(ii) Vertical integration results in misallocation of resources, and discourages production of commodities with large value added at earlier stages.

(iii) Small scale and ancillary developments are particularly affected.

(iv) The relative changes in costs of different inputs and also of the same input at different times results in wrong factor/input combinations.

(v) Encourages tax evasion, as large amounts are involved at various stages.
It is felt that a value added tax could resolve such problems arising out of multi-point non-refundable differential rate system to input taxation. This is what the indirect Taxation Enquiry Committee (Jha Committee, 1978) also strongly felt.

5. **DEFINITION OF 'VAT'**

Value added is the difference between the actual/presumed money of sales and the money value of inputs. The tax base is incremental value, acquired since the last taxable transaction.

VAT appears like a cascade tax but its revenue implications are that of a last-point sales tax. It is like a multi-stage cascade tax on consumption in the sense that it is collected fractionally at each stage of commercial transaction. But the total amount collected is what would have been collected under a last-point sales tax.

4. **SALES TAX AND 'VAT'**

Basically VAT has been contemplated and introduced to replace the turnover or sales tax. Let us examine some of the economic and technical aspects of a VAT.

(a) **Economic Aspects**

(i) **Mechanism of Tax Collection**:

Under VAT, traders first pay tax to their suppliers who
pay to revenue authorities and then get it deducted from the tax due on their own sales, i.e. trader gets tax credit to be adjusted against his tax liability. Under sales taxation, no tax is to be paid by trader if he sells to a registered trader (sales tax to be paid only when sales made to an unregistered dealer). Therefore, no tax credit arises. From economic point of view, there is no difference in the amount of revenue collection between a VAT and a last-point sales tax. Only the method or agency of tax collection varies.

(ii) Tax Shifting:

Though theoretically, both VAT and sales tax can be fully shifted, in practice 100 per cent forward shifting to consumer prices is unlikely. Ultimately, shifting and supply depend not on the mechanism of tax collection.

Some suggest that VAT is more likely to be fully shifted forward as traders would wish to recoup the tax paid on these purchases. Others suggest that VAT is less likely to be fully shifted forward as traders are aware of the tax and of the interest in reducing their cost of production, as cost of production has a bearing on the tax base under VAT.

(b) Technical Aspects

(i) Revenue Security VAT is superior to a sales tax because:

(1) Only buyers at final stage have interest in under-
valuation of their purchases as the deduction system assures that all buyers at earlier stages get a VAT refund on their purchases. Therefore, revenue loss due to under-valuation is confined to valuation at last stage. But under sales tax, all in the process (producer, wholesaler, retailer) have mutual interest in under-declaration of actual purchase price.

(2) Under VAT, if tax is avoided at one stage, it can be picked up at later stage, and, at least the tax is collected upto the stages when it is evaded. If evasion is at last stage, the revenue loss is minimal. Under sales tax all tax due on the product is lost under a last point system.

(3) VAT enables the revenue authority to monitor taxes on business before profits, as a trader has to show his purchase invoices, which provide business income and profits to the sellers.

(4) It is possible, however, to produce fake invoices by quasi-purchasers, to obtain deduction of tax on non-existent purchases. Also, staff limitations may make proper cross-audit and monitoring difficult. Finally, small traders, not subject to tax, are often the major tax evaders.

(ii) Administrative Work

Traders have to keep more records than under sales tax, as under a last point sales tax, traders upto the final trader
do not have to keep records for sales purposes and at the last stage, the earlier has to declare only his sales, not his purchases.

5. **METHOD OF COMPUTATION**

There are three methods of computation of VAT -

(i) Direct subtractive method (DSM);
(ii) Indirect subtractive method (ISM);
(iii) The additive method (AM) also known as the cost or accounting method.

Under the Direct Subtractive Method, value added is computed by deducting from total sales income or output, the cost of all inputs (such as raw materials, stores, power and fuel etc.) and services (transport, insurance, royalty, publicity, etc.). In other words value added is identified with sales. This method is operationally most suitable at a single rate.

The Indirect Subtractive Method is the generally used method, also known as the 'Invoicing' or 'Credit' Method. This is an improved variant of DSM. Value added is not calculated directly. The tax contents of inputs and outputs are shown in each invoice and tax payments of a firm is equal to tax collected from customers less the tax paid to suppliers. This is the method adopted in the EEC countries and in several developing countries.
Under the additive method, value added is computed by taking the sum of taxes and payments made to various factors of production in the form of salaries and wages, management remuneration, rent, interest depreciation and profits before tax. This method identified the tax as an imposition on payroll and profits rather than on sales. This method is advantageous where inputs and outputs are difficult to measure as in banking and finance industries.

6. REVENUE TO INDIA

(a) Plus Points: Economists feel that the operational problems of the present system of input taxation may be resolved by a VAT. Among the plus points of VAT are:

(i) It is simple: low-single rate with universal applicability.

(ii) Discourages wasteful expenditure and encourages economics in consumption of raw materials, stores, and services, economics in wages and salaries, maintenance cost, etc. for these would increase the tax base. Economics in expenditure would be the best way to reduce tax base and tax liability under a VAT system. Present tax system encourages such expenditure as more than one half of such expenses are borne by the exchequer.

(iii) Will increase net capital formation by releasing investible resources towards efficient or more efficient sectors.
(iv) Neutral in effect on allocation of resources and use of production techniques.

(v) More efficient use of capital and human resources a point emphasised by Jha Committee also.

(vi) Promoters development of small-scale and ancilliary industries, with their obvious benefits to employment generation.

(vii) Discourages tax evasion as tax collections are made in small fractions and not in lump-sum. Even if some tax evasion occurs at one stage, the amount involved would be less. Incidence determination at each stage would be facilitated. In fact, there is a built-in-check on evasion because tax paid by one company is reported as a deduction by the subsequent company which buys from the first company. "Cross Audit", which is thus possible, contributes towards a more efficient tax administration system and a better evasion regulatory device.

(viii) Export competitiveness improves because of lower domestic price.

(ix) If a VAT is to replace profits taxation, then profit making and efficient companies are not discriminated against, because under profits as tax base, loss making companies have no tax liability.
(x) The community would not know the real tax burden on each product.

(b) Minus Points :

(i) The need to bring in progressivity in tax structure would necessarily result in multiple rates. Inequity arises if the same tax rate is applicable to all commodities and services irrespective of whether they are mass goods or luxury goods. Operationally, it is found that only Uruguay has a single rate system. Differential in tax rates can be incorporated at the statutory tax rate level through multi rates or at the effective tax rate level, through special credit, exemptions and percentage deductions. Rate structure, therefore, need not necessarily be simple nor need the tax rate be low, as is generally hoped for under a VAT system.

(ii) Administrative problems would arise at the level of taxpayers as well as tax assessor. Detailed accounts would have to be maintained in order to obtain full credit; he would also have to maintain all the necessary tax vouchers etc. At the tax assessment and collection level the man-power requirements will increase substantially due to requirements will increase likely to take place in the number of assessees registration of VAT payers, filing of return assessment of returns and collection of tax would increase the collection cost.

(iii) Operationally VAT is more effective and easier to
administer in an unitary set up. Except for West Germany and Brazil, VAT has been introduced only in unitary forms of Governments. In India, to be effective there has to be a common assessing authority for all input taxation; as such it would be desirable to shift the sales tax from the State list to the Central list. This is politically a difficult proposition to implement but not impossible.

(iv) VAT will have to be a centrally administered tax and if it aims to replace the sales tax, it may not be readily accepted at the State level. A constitutional amendment would also be required. The whole question would revolve around the trade-off between efficiency and political acceptability.

There is a need for a cautious approach. The Jha Committee recommendation of introducing MANVAT on selected industries at manufacturing stages seems appropriate; they suggested for an experiment, automobile and diesel industries which have highly pronounced cascading effects. Initially, VAT could be applied to only manufactures in lieu of excise, with full credit facility for the taxes paid on inputs at earlier stages. In the transitionary period before full scale VAT is operational at all stages, it would be desirable to first convert sales tax from multi point to single point rationalise all input taxation, introduce a single authority for all input taxation and then extend VAT to wholesale and retail trades. It would be necessary to have different effective VAT rates
through reliefs and incentives, the finance commission could examine the allocation of VAT proceeds among the States.

The replacement of input taxation by VAT needs to be a gradual process spread over 8 to 10 years. In the U.K. the Richardson Committee recommended VAT in 1964, and it was finally introduced only in April 1973.

However, the relative utility of the four types of VAT like production income, wages, and consumption remains to be examined.

The Federation of Indian Chambers of Commerce and Industry has supported a system of parallel Central and State value-added taxes (VAT's) to replace the present MODVAT scheme, if the introduction of a comprehensive VAT is not feasible under the given situation in India.

Representatives of FICCI have explained the feasibility of introduction of the system of parallel Central and State VATs at a recent meeting of the working group set up by the Central Government to review the MODVAT scheme in India.

The scheme proposed by FICCI envisages levying Central VAT on the base of manufacture and imports and the simultaneous operation of parallel State VAT to replace numerous cascade taxes presently levied by the State Governments. Under the scheme the
VAT liability is assessed in the usual way. The revenue is either collected by a Central agency and the State's share is re-apportioned from Centre to State Governments.

For instance, a commodity X is leviable to 15% Central VAT and 12% State VAT, the Central VAT administration can either collect 27% and re-apportion between the Centre and the State. Alternatively the VAT assessee can file returns separately for Centre and State VATs.

Operation of the parallel VAT the FICCI says presupposes harmonization of rates, structure and coverage. Lack of uniformity in the rate and structure would mean that tax credit on each invoice would be different for identical goods if they had originated in different States with differing tax rates. However, the minor variations in the structure and rate may not create a major problem. For instance if a State is buying different VAT rates, it will opt to buy from the State which has lower VAT. This will induce other States to reduce the VAT rate over a period of time.

To ensure harmonization of rates the FICCI feels that the minor taxes like octroi, levied by local bodies should be abolished. A share from the State VAT revenue can be re-apportioned to the bodies to compensate them for the revenue loss.

Ideally, the FICCI feels that the VAT administration,
whether it is comprehensive or parallel, should be with the Central ensure a uniformity of decision-making and equal treatment to all assesses. This would lead to greater specialisation in the VAT administration. Also there will be administrative advantages in having centralized records accounting and financial control.

In an industrially underdeveloped State like Assam the base of a potential value added tax may have to be narrowed further for practical reasons. For instance it would be difficult to incorporate the numerous small retailers that do not keep adequate accounts in a value added tax. Similar problems arise with the handicraft and small scale manufacturing sectors that may account for as much as half of total industrial output. Agricultural activities would also have to be exempted, as would most services because of the small size of many firms and the nature of their activities. These exclusions would in effect mean that the tax would extend only through the wholesale or manufacturing stage.

However, in the context of present socioeconomic condition of India particularly underdeveloped State like Assam where most of the traders have no basic knowledge of accounting, the introduction of system of value added tax may not be worth while. Jha Committee also has not favoured a total substitution of sales tax by value added tax system. It has also recommended that sales taxation is to be continued with such
modification as may remove the weakness which render the present system of taxation unpopular and also detrimental to the interest of trade and industry.
SALES TAX VERSUS EXCISE DUTY

One of the proposals that has found favour particularly with trade and industry recently is the abolition of Entry 54 in the Seventh Schedule to the Constitution empowering the States to levy "taxes or the sale or purchase of goods other than newspapers ..." and the replacement of the existing sales taxes by an enhancement of the rates of excise duty so as continuance of sales taxation. This is generally referred to as the merger of the sales tax with excise duties. Since, industry has found it difficult and costly to deal with more than one tax authority in respect of commodity tax laws and since both trade and industry seem to experience hardships in coping with the heterogeneous provisions of sales taxation in different States, they have urged that they should be asked to deal with one tax authority in respect of indirect taxation. If sales taxes (and octroi) are done away with, then internal commodity taxation would be leviable only at the stage of production, and a large number of dealers would be freed of the botheration of dealing with problems of commodity taxation, except when they happen to be importers or dealers who are specially required to be registered with excise tax authorities.

The proposal to merge the sales tax with excise has been put forward by some as a desired end-result of reform and by others merely as an intermediary step in the transition towards a comprehensive system of value added taxation. Under the latter version, the initial merging of the sales tax with excise would
be followed in due course by a centrally administered value added tax extending from the manufacturing to the retail stage. We shall here consider mainly the former type of proposal which envisages taxation confined to the production level with no taxes at all at the wholesale and retail stages.

The proposal that commodity taxation should be confined to the production level has certain inherent economic demerits. Nor is it to be assumed that if only we could do away with taxation at retail and wholesale stages, we would automatically have a rational system of internal commodity taxation. However, the merger of the sales tax with excise would result in certain advantages which are listed below.

1. As already stated, the merger would mean that trade and industry would no longer have to deal with State Governments on commodity taxation matters; by the same token there would be uniformity of tax burden on any given exciseable product throughout the country.

2. As inter-State sales tax would also be abolished, and important hindrance to the free flow of trade across State borders would be eliminated. Inter-State inequities in taxation would be eliminated since the proceeds of the excise duties can be shared on a basis considered equitable by the States.

3. Distortions caused by the sales taxation of inputs would be eliminated.

4. Since manufactured products would be subject only in excise, it would be easier to work out the amounts of
duty drawback to be given to different kinds of exports.

5. Since commodity taxation would be concentrated at the hands of the Centre, there would not be any artificial diversion of industrial investment due to differential taxation, except when the Central Government decides that such diversion in particular cases would be desirable in the national interest as can be readily seen, the gains that would follow from the abolition of the sales tax are substantial. But the merger would leave several major problems unresolved and, for reasons given below, could not be considered a satisfactory long-term solution to the problems caused by the existing systems of excises and sales taxes.

1. Obviously, the mere abolition of sales taxes and a compensating upward revision of excise tax rates would in no way mitigate the cascading and distorting effects of excise arising from the subjection of inputs to excises. Indeed to the extent that sales taxes on inputs are loaded on to excise, there might be a worsening of the situation because at present some of the States are quite liberal in their treatment of raw materials and intermediates.

2. A major drawback of this proposal is that several commodities will be freed from taxation without any justifiable economic reasons. Excise taxation is levied at the point of production. In India, in practice, mostly industrial production is covered. While legally speaking, excise could be imposed also on agricultural products. Even within the sphere of industry, the production that takes place in numerous units in the
unorganized sector are, and would have to be, left out of the excise net for administrative reasons. This is where the general sales tax plays a useful role, because through this tax it becomes possible to cover agricultural commodities and other goods that cannot be taxed at the stage of production. It is easy to see that by shifting the tax to the wholesale or retail stage we are able to tax several goods through a tax on a single seller.

2. The scheme of levy of additional excise duty in lieu of sales tax applicable to sugar, tobacco and textiles was implemented through the additional duties of Excise (Goods of special importance) Act 1957, in pursuance of the decision of the National Development Council. The proceeds of the Additional Excise Duty are distributed among the States in accordance with the principles of distribution laid down by the Finance Commission from time to time.

The States are not happy with the scheme, as in their opinion sales tax revenue have shown a much higher rate of growth than the yield from additional excise duty.

3. The "Jha Commission"\(^\text{24}\) in its report also observed "a strong plea has been made to us by representatives of trade and industry as well as others for abolishing the sales tax as a separate entity and making appropriate enhancement in the excise

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\(^{24}\) Indirect Taxation Enquiry Committee Part II. 1978
levies, the proceeds of which could be earmarked for the States. In support of this view it has been argued that if a number of separate authorities independently levy tax on the same products, there can be no rationalisation of the tax structure which is the main aim of the taxes on a particular product, it can take into account all relevant considerations - the burden on the consumer as well as impact on production and investment in the industry. Such a Central levy would be easy to rebate when exports take place. There would be considerable saving in the cost of collection. The diversion of trade as well as production centres from one State to another, which differential rates of sales tax lead to, would be eliminated. The harassment caused by the requirements to comply with the laws, procedures and forms of different States, which make life difficult for small traders as well as manufacturers who buy their raw materials and components from different States and also sell their products in different States, will be removed.

State Governments, on other hand, have emphatically argued against such a course. In part they seem to be afraid that no matter with assurance are given their revenues will suffer as a result of the change. They have some unhappy memories of the way in which, after they agreed to replace the sales tax on textiles, tobacco and sugar by additional excise duty, their revenue from these items remained virtually frozen, though the Centre got higher revenue from them by raising the basic excise duty while keeping the additional
excise duty unchanged. Perhaps they are influenced by the consideration that in each plan, States are expected to step up their own level of resource mobilisation and they do not for this purpose get any credit for what they receive by way of a share of Central taxes. Further, more important than mere revenue considerations, State Governments feel that any reduction in the powers of the State to tax its own people and having to depend on Central subventions instead would erode their autonomy. Finally, when a State has to mount its own tax effort for which it has to seek the support of the State legislature, it has a greater sense of responsibility and explores every possibility of economising on expenditure. The increasing dependence of States on Central subventions tends to undermine financial discipline".

While there is a considerable amount of truth in the criticisms levelled against the existing system of sales taxation by trade and industry, the proposal to completely abolish sales taxation and to confine commodity taxation to the points of production may itself be criticised on a number of grounds. The popular belief that excise duty and sales taxes fall on the same base, though levied by two different authorities, is not altogether correct. Estimates made by the National Institute of Public Finance and policy indicate that nearly Rs. 500 crore of sales tax are being currently collected on goods not subject to excise duties. This is not a contribution to revenue from taxes on goods such as agricultural products and output of small manufacturers as well articles of
Jewellery which, for administrative and other reasons, central excises do not reach. Further, even when the same product is subject to both excise duties and sales taxes the area of overlap is not total. The increase in value which takes place between the ex-factory stage and the point at which it reaches the ultimate consumer due to costs of transport and distribution as well as the profits of wholesalers and retailers cannot be taxed through excise duties. The levy of sales tax can cover this part of value added. From the purely economic point of view, confining taxation to the point of production suffers from the disadvantage that it comes at an early stage in the chain of transactions and, therefore, leads to a certain degree of cascading. In any case, the consequence of a simple abolition of sales tax from the angle of resource mobilisation would be a substantial loss of revenue to compensate for which something like a 50 per cent increase in excise duties on the average would be necessary, given the present base of excise taxation.

4. According to Jha Committee's suggestion, in respect of some essential goods like Cement, Medicine, Paper, Vanaspati, Petroleum products, it might be desirable to consider the question of additional excise duty in lieu of sales tax.

In the conference of the Chief Ministers it was decided that an Expert Committee should be appointed to go into the financial implication to the proposal for inclusion in the list of declared goods and for levy of additional excise duty in lieu of sales tax and vanaspati, drugs and medicines, cement, paper
and paper board, and petroleum products and the manner in which the financial interest of the States could be safeguarded. Accordingly, the Expert Committee under the Chairmanship of Late Kamalapati Tripati, had submitted its report in January, 1983.

However, almost all the States including Assam opposed the proposal tooth and nail on the plea that any move to replace sales tax would hamper the building up of major source of revenue (Assam earns one third of its sales tax revenue from the petroleum products) for the State and virtually amount to crunch of revenue and erosion of rights. The issues involved are both political and constitutional regarding state autonomy and its impact on the financial relationship between the Centre and the States.

However, the feasibility of this sound public finance principles deserves close scrutiny and careful acceptance keeping uppermost in mind the State's financial interest. No legislation has yet been made in this regard and the scheme is yet to be implemented.
REVIEW OF THE STATE TAXATION SYSTEM IN ASSAM

The tax system of the State of Assam has undergone perceptible changes over time, in terms of the absolute and relative contributions of different sources of revenue to the State Exchequor. The Sales Tax group consisting of the general Sales tax, the Central Sales Tax, Sales Tax on Motor Spirit and Purchase tax, has remained the most significant source of revenue and its relative contribution has increased significantly of the total State Tax revenue. The share of Agricultural Income Tax is also maintaining an increasing trend. It would still be true to say that the sales tax group occupies the Central place in the overall tax structure of the State.

As regards other State taxes, some have more or less maintained their proportionate contribution, while the rest have significantly declined in fiscal significance. Taxes in the former category are the profession tax and Stamp Duty and Registration fees among direct taxes, and the Passengers and Goods Tax, Motor Vehicles Tax, Entertainment Tax and Electricity Duty among indirect taxes.

Among the individual taxes in Assam, the general Sales tax and the Central Sales Tax, Electricity Duty and the Entertainment Tax were highly buoyant. All but the last were elastic. The buoyancy and elasticity of Assam's Sales Taxes are higher than those in West Bengal, Bihar and Orissa.

It is a fact that about 70 per cent of the total
population of the State is below the poverty line. Hence, State taxation can cover only a small portion of the total population, thus resulting in the tax base to be very narrow.

Though a comparatively recent origin Sales Tax have come to occupy a very important place in the fiscal structure of Assam. Alongwith the tremendous growth in absolute terms, the relative importance of the tax has also increased over the years. However, if allowance is made for differences in per capita income and the degree of urbanisation, Assam is shown to make more or less average tax effort, whereas such states as Karnataka, Kerala and Tamilnadu are shown to be making tax effort significantly above the average. It would be fair to conclude that there is scope for further utilisation of the taxable capacity of the State. The lower tax ratio in Assam can be explained by the lower per capita income and the lower degree of urbanisation. But even if allowances are made for these two factors, the performance of Assam is not significantly above average. The task of tax reform in Assam has to be based on the premises that the level of taxation in Assam can be significantly increased and that there is urgent need to increase the income elasticity of the system.

It can be expected that as industrialisation proceeds and brings in a greater degree of urbanisation, the elasticity of the tax system would improve. At the same time structural changes in the tax system and administrative improvements are also needed to improve tax performance. In a relatively under
developed state, such as Assam the way to raise revenue in the long run is to promote industrial development and to refashion the structure of taxation so that it can capture automatically a sizable proportion of the additional income generation in the course of development. It would be counter-productive to raise rates without the regard to economic considerations an attempt to maximise short term revenue.

The tax system of State is a sub-system in the sense that if covers only a part of the territory of the nation. In building a tax system within region, the possibility of diversion of trade and investment has to be kept in view. Such as possibility acts as a constraint and to some extent one is forced to fall in line with the average behaviour of the neighbouring state. Recently Assam Govt. had to reduce the rate of tax on motor vehicles from 12 per cent to 7 per cent since the rate of tax on motor vehicles in West Bengal is 7 per cent.

The aim of a State Government would naturally be to maximise the flow of revenue to itself, but in attempts to do so it is necessary to keep in mind broad national objectives, inter-dependence of the different parts of the country and inter-State equity. At the same time a State Government has to safeguard its own interests and would be justified in adjusting its tax structure so as to extract contributions from the major sectors of economic activity within its borders.

The basic objective of tax reforms have been conceived to
be to evolve a structure of taxation for Assam which is (i) income-elastic (ii) equitable (iii) conductive to rapid economic development (iv) in consonance with the tax structures of the neighbouring states and (v) is conformity with national guidelines.

If the Sales tax system of the State of Assam is to subserve broad social and economic objectives and if it is to be a flexible instrument in the hands of the State, it is imperative that the separate enactments levying different sales taxes be unified into a single integrated Act. The consolidation of the different Acts into a single Act may be seen to be the prerequisite for steps that need to be taken towards the rationalisation of the sales tax system and improvement of its administration in Assam.