

5. OUR APPROACH TO SALES TAX REFORM

1. Introduction

In the preceding three chapters we have presented a broad review of the growth and composition of tax revenue in Delhi and the place of sales tax revenue in the tax armoury of Delhi. Before we proceed to discuss the structure and operations of sales tax and to make our recommendations thereon we would like to outline briefly our approach to the task of sales tax reform in Delhi.

Our terms of reference require us, among other things: (*a*) to examine the structure of sales tax in Delhi with reference to the distribution of items between the first-point and the last-point levy of tax and the considerations which should govern the selection of items for levy at the first point; (*b*) to examine the factors which should be taken into account in determining the rate structure of sales tax in Delhi and to consider whether any changes are needed in the existing rate structure; (*c*) to examine the implementation of the sales tax law with particular reference to assessments and the introduction of a viable system of summary assessment; (*d*) to examine the working of the enforcement branch of the Sales Tax Department, its desirable strength, methods and procedures of operation and the optimum selection of enforcement activities; (*e*) to consider the yardsticks for staffing the Department taking into account reasonable cost of collection and desirable norms of work of assessing and other authorities and (*f*) to examine the adequacy of the existing system of collecting and compiling statistical data with particular reference to the collection of commodity-wise and other information of use in the formulation of policy.

2. Criteria for Reform of the Sales Tax System

The terms of reference quoted above require us to keep in view not only the generally applicable criteria for a good sales

tax system but also the special features of Delhi and its economy.

In our approach to the reform of the sales tax, we shall keep in mind, *inter alia*, considerations of revenue productivity, equity, economic efficiency and administrative ease. In discussing the aspect of economic merit, it would be necessary to keep in mind the importance of the growth of industry and entrepot trade for the gainful employment of the rapidly growing population of Delhi. The openness of Delhi's economy must also be taken into account. The basic characteristics that a reformed system should possess are briefly mentioned below:

(i) The system must be productive of sufficient revenue and be elastic with respect to the base and income. An income-elasticity clearly greater than one is needed to produce a fast enough growth in revenue to match the growth of expenditures.

(ii) The tax must fulfill the criterion of equity. This criterion may be interpreted to mean that the burden should be progressively distributed, i.e., proportionately larger burdens should be cast on the better-off sections of the population. However, this criterion is difficult to fulfill within a small State or Territory. High or stiff rates would divert business away from the city. Besides, widely differing rates lead to many complications in the actual operations. However, it is clear that regressivity must be avoided and mild progression with respect to expenditure could be aimed at.

(iii) A relatively simple, broad-based tax with moderate rates is preferable to one with high rates combined with loopholes and exemptions. The tax legislation must be clear, simple and unambiguous.

(ix) The tax must not lead to cascading or to distortions in the allocation of resources. Significant cascading is not only not in the national interest, but would also adversely affect the competitiveness of Delhi's products in the domestic and international markets.

(v) Any tax that one can think of will be avoided/evaded to a greater or lesser extent. If the tax is so fashioned as to make it easily administrable, and if the rates are moderate, then to that extent, the tendency to evade and avoid would be reduced.

(vi) In taxation, particularly in the context of a developing economy, the crux of the matter lies in administration. From the economic point of view, the basic structure of sales tax is a sound one—tax at the last-point without interfering with the process of production, almost complete relief from taxation for inputs, and generally moderate rates—but the administration of the tax is in a sorry state. There is evidence of considerable evasion; there is also corruption and harassment of the taxpayers. Our approach has to be two-pronged; first, while keeping the economic principles in mind, a system must be devised which can be easily administered; second, ways must be found to improve the administrative structure and practices. Since the existing system is not being administered properly, some may wish to switch over to an economically undesirable system which may be simple to operate. Our approach is rather to find a *via media* and at the same time to make attempts to improve the administration.

(vii) The interests of the taxpayers should be safeguarded. The procedural formalities should be reduced to the minimum and it must be recognised that speedy assessments are as important as satisfactory assessments. Ultimately, the system must be based on self-assessment with provision for thorough sample checks and rigorous punishment if found guilty of evasion. The concentration must be on the larger dealers.

(viii) The yardsticks/norms for staffing the Department must be such as would promote efficiency in administration and push up the morale of the administrative machinery.

(ix) A proper information system is a *sine qua non* of a good tax system—it is essential for both efficient administration and sound policy formulation.

(x) Lastly, the tax system must be in consonance with the objectives of national tax policy and should be consistent, to the extent possible and necessary, with the structures of sales tax in the neighbouring States.