

6. REFORM OF THE STRUCTURE OF SALES TAX—I

1. Introduction

Against the background of the discussion of the existing structure of sales tax in Delhi and the problems caused by it, we may outline the basic considerations that should govern the reform of the structure of the tax. In the preceding chapter, we have outlined our general approach to reform. The first and foremost consideration, apart from revenue yield, is the economic impact of the tax. In this connection, it is necessary to keep in view, as already mentioned, the special nature of Delhi's economy, i.e., it is a centre of entrepot trade and small-scale manufacturing activity. Hence the sales tax in Delhi cannot be largely a tax on producers with cascading impact and hindrance to entrepot trade; it has in essence to be a tax on consumption. Also in respect of industries where small-scale manufacturers predominate, there would be an advantage in collecting the tax at a stage later than manufacturing.

It is generally agreed that a tax should be appraised from the equity, economic and administrative points of view. From the second, namely, the economic point of view, the tax should not cause distortions in the pattern of production or in the relative factor prices or lead to cascading. If the tax is to be considered to be largely or primarily a revenue raiser, it should be as neutral as possible. It could be argued that a tax system for a local government like that of Delhi Administration should have mainly the role of raising resources; the objectives of re-distribution of income and wealth and of re-allocation of resources may be left to higher level governments. From this angle a single-rate value-added tax or a single rate retail sales tax may be the ideal tax for Delhi. However, it is generally considered desirable to introduce an element of progression in the indirect tax structure. In any case, since the commodities consumed largely by the poor cannot be taxed at a high rate, if there is to be a single rate, it has to be low.

With a low single rate, enough revenue cannot be raised. Hence it becomes necessary to have more than one rate; but the aim should be to keep the number of rates limited, as that would make administration much easier.

If the tax is to be made progressive through the differentiation of rates, it is necessary to be able to control the incidence and, if possible, to measure it empirically. Controlling of incidence is more easily possible with a retail sales tax or a value-added tax.

It is, however, widely felt that it is not easy to administer the value-added tax at the present time because the tax administration at the State level is not yet in a position to handle a more sophisticated system than the simple sales tax. The operation of a value-added tax involves the setting off of the tax paid at each stage against that payable at the next stage. This requires more information to be maintained by the dealers. It is felt that account keeping by the majority of resellers and the small manufacturers is far from adequate for the purpose of implementing a value-added tax. Thus, the Indirect Taxation Enquiry Committee (1978), while recommending the gradual conversion of the Union excise duty into a value-added tax at the manufacturing stage, did not make a similar recommendation in regard to the sales tax. Instead the Committee suggested that the local sales taxes of the States should be converted into a consumption tax in the form of a last-point tax. What the Committee had in view was a retail sales tax which would not interfere with the production processes [Government of India (1978), *Report of the Indirect Taxation Committee*, Delhi, p. 220]. A number of developing countries such as Brazil, Argentina, Peru, Chile, Guatemala and Korea have adopted the system of value-added tax and have been administering them for quite some time now; and, of course, all the member countries of EEC have made it their basic commodity tax, thereby freeing their exports of domestic tax burden. It cannot therefore be argued that a value-added tax cannot be at all administered. But in some countries opposition to its introduction has been voiced by both business and administration. For example, the recommendation for the adoption of the value-added tax in Australia by the Asprey Commission was opposed by the business community and ultimately rejected by the

Government. The tax did not receive support in New Zealand also [Due, J.F. (1983), "The Wholesale Sales Tax in Australia and New Zealand," *Canadian Tax Journal*, Vol. 31, No. 2, March-April, p. 225-226].

2. Resolution of the Present System

When sales taxation was introduced in Delhi in 1951 through the adoption of the Bengal Finance (Sales Tax) Act, 1941, the tax was predominantly a last-point one; at that point in time only eight commodities were subjected to tax at the first-point, namely, (i) vegetable ghee, (ii) coal, (iii) motor spirit, (iv) medicines and pharmaceutical preparations, (v) cement, (vi) all kinds of tyres and tubes, (vii) kitchen gas, and (viii) ice. Thus it seemed that Delhi had adopted a form of sales tax that is normally considered the most suitable and desirable from the economic and equity points of view.¹ But when the Bengal Finance (Sales Tax) Act was replaced by the Delhi Sales Tax Act, 1975 (which came into force on 20.10.1975), as many as 45 commodities began to be taxed at the first-point (Table A.6.1). Since then there have been many changes in the lists of commodities subject to the first- and last-point levies. These changes were effected presumably in response to representations received from trade interests and pressures exercised from different quarters. Moreover, the stand taken by the Administration has not always been consistent: some commodities have been shifted back and forth from one list to the other at intervals. Thus, silk fabrics and kerosene which were subject to the last-point levy from 1.4.1975 were shifted to the first-point levy from 1.11.1975 to 31.1.1978, and they were shifted again to the last-point levy on 1.2.1978, to be shifted back to the first-point levy with effect from 1.7.1978. Similarly, candles which were subject to tax at the last-point from 1.4.1975 were shifted to the first-point levy from 1.11.1975, and were shifted to the last-point levy on 28.2.1977, to be shifted again to the first-point levy with effect from 21.1.1980. Table 6.1 shows the number of times the points

1. A last-point sales tax with provision for exemption from tax of all inputs used by manufacturers is equivalent to a retail sales tax.

of levy changed for certain commodities during the period 1975 to 1982.

TABLE 6.1
Frequency of Shifts in the Points of Levy for Selected
Commodities Since 1975

| <i>Commodity</i> | <i>Period</i> | <i>Point of Levy</i> |
|---|---------------------|----------------------|
| 1. Silk fabrics | 1-4-75 to 31-10-75 | Last point |
| | 1-11-75 to 31-1-78 | First point |
| | 1-2-78 to 30-6-78 | Last point |
| | 1-7-78 till date | First point |
| 2. Matches | 1-4-75 to 31-10-75 | Last point |
| | 1-11-75 till date | First point |
| 3. Cement | 1-4-75 till date | First point |
| 4. Medicines, drugs and pharmaceutical preparations | 1-4-75 till date | First point |
| 5. Tyres and tubes of all kinds | 1-4-75 till date | First point |
| 6. Vegetable ghee | 1-4-75 till date | First point |
| 7. Liquified petroleum gas | 1-4-75 till date | First point |
| 8. Ice | 1-4-75 to 31-10-75 | Last point |
| | 1-11-75 till date | First point |
| | 1-4-75 till date | First point |
| | 1-4-75 to 23-10-75 | Last point |
| 9. Petroleum products 9a. Kerosene | 24-10-75 to 31-1-78 | First point |
| | 1-2-78 to 30-6-78 | Last point |
| | 1-7-78 till date | First point |
| | 1-4-75 to 31-10-85 | Last point |
| 10. Fireworks including coloured matches | 1-11-75 till date | First point |
| | 1-4-75 to 31-1-75 | Last point |
| 11. Bicycles | 1-11-75 till date | First point |
| | 1-4-75 to 31-10-75 | Last point |
| 12. Bricks, firebricks, etc. | 1-11-75 till date | First point |
| | 1-4-75 to 31-10-75 | Last point |
| 13. Butter, cream and khoya | 1-11-75 till date | First point |
| | 1-4-75 to 31-10-75 | Last point |
| 14. Ice-cream of all kinds | 1-11-75 till date | First point |
| | 1-4-75 to 31-10-75 | Last point |
| 15. Candles | 1-11-75 till date | First point |
| | 1-4-75 to 31-10-75 | Last point |
| | 1-11-75 to 27-2-77 | First point |
| | 28-2-77 to 20-10-80 | Last point |
| 16. Coal including coke | 21-10-80 till date | First point |
| | 1-4-75 till date | First point |
| 17. Butter oil | 1-4-75 to 31-1-78 | Last point |
| | 1-2-78 till date | First point |

TABLE 6.1 (Contd.)

| | | |
|--------------------------|-------------------|-------------|
| 19. Refined rapeseed oil | 1-4-75 to 31-1-78 | Last point |
| | 1-2-78 till date | First point |
| 20. Refined coconut oil | 1-4-75 to 31-1-78 | Last point |
| | 1-2-78 till date | First point |

Sources: 1. Sethi, B.R. and Bagai, Anoop (1980). *Chronological References—Goods Taxable at First Point, Delhi Sales Tax Act, 1975*, Bagai Printers, New Delhi.

2. Office of the Commissioner of Sales Tax, Delhi.

In 1978, there was a definite shift back to the last-point levy—the number of commodities subject to the first-point levy was brought down from 45 to 20 (Table A.6.2). Later, silk fabrics, candles, refined rapeseed oil and clocks, time pieces, watches, etc. were added to the list of first-point goods and the tax on three commodities, namely, (i) black-lead pencils and coloured pencils, (ii) fountain pens, ball point pencils and pro-pelling pencils, and (iii) sewing machines, their stands and covers, was shifted to the last-point. But the item clock, watches, etc. was shifted back to the list of last-point goods in 1982-83. Thus, as on 26th March 1983, there were only 20 commodities subject to the first-point of levy, as shown in Table 6.1.

While, as we have pointed out, the retail sales tax is the ideal one (next to VAT) from the economic point of view, it seems clear from the above description of continuing changes that the various parties involved are not really satisfied with it. A definite opinion on this question of point of levy has not yet been arrived at. Hence under one of our terms of reference we have been asked to study and give our opinion on the “distribution of items between the first-point and the last-point levy of the tax and the considerations which should govern the selection of items or levy at the first-point.”

3. Kanwarlal Gupta Committee

In this connection we note that a Committee headed by Shri Kanwarlal Gupta examined the question of the choice of point of levy in 1978. They came to the broad conclusion that the tax should continue to be largely a retail sales tax but that

there was a case for bringing some commodities under the first-point levy. For selecting the goods to be subjected to the first-point levy, the Committee adopted the criteria put forward by a High Level Trade Consultative Committee, namely,

- “(i) the selected commodity should not be a raw material but should be a finished product.
- (ii) if manufactured locally the selected commodity should be manufactured by a comparatively small number of well established concerns of repute.
- (iii) if the selected commodity is brought into the State the import channels should be few and well canalised.
- (iv) the commodity is not exported in any significant quantity.
- (v) the local manufacturers of the selected commodities should directly sell their products in other States.
- (vi) the selected commodity should be one in which considerable evasion of sales under the last-point levy system appears to exist.
- (vii) the item should be clearly identifiable and there should be no doubt about the scope.
- (viii) the item should not be capable of use as packing material, and
- (ix) the difference between the wholesale and retail prices of the goods should not be substantial. Some difference in these prices has to be there but the loss of revenue which may be caused by levy of tax on lower sale price at the first-point should be more than offset by larger revenue accruing from the curbing of evasion and administrative advantage.”

These criteria, which were implicitly approved by the Kanwarlal Gupta Committee, were aimed at preserving, as far as possible, the economic advantages of the last-point tax and ensuring that the pre-eminent position which Delhi enjoyed as a centre of entrepot trade was not jeopardised. Both Committees had in fact considered the last-point levy to be the most desirable form of tax and the best suited to Delhi, but were prepared to let some commodities be shifted to the first-point for administrative reasons. The last-point tax was, by and large,

favoured on the grounds that it enabled the government to capture value-added at all stages, that manufacturing and exports were least affected by it and that even administratively, it was easier to collect the tax with less evasion if it was levied at the last-point unless the import channels "were few and well-established or the manufacturers were limited in number, fairly large and were of repute." However, if it was clear that evasion of the last-point tax on particular commodities was large and could not be checked, then the tax on it could be shifted to the first-point. The Committee had not attached much weight to the traders' complaints about the last-point levy.

Presumably applying the above mentioned criteria, the Kanwarlal Gupta Committee recommended the levy of the tax at the first-point on the following 12 commodities:

1. Cement
2. Medicines, drugs and pharmaceutical preparations
3. Denatured spirit
4. Tyres and tubes of all kinds including those of motor scooters, motorettes, cycles and animal driven vehicles
5. Vegetable ghee (hydrogenated vegetable oil)
6. Liquefied petroleum gas
7. Ice
8. Motor spirit, aviation spirit, high speed diesel oil, light diesel oil, kerosene and bitumen (asphalt)
9. Fireworks including coloured matches
10. Bricks, fire bricks, brick-bats and brick ballast
11. Butter, cream and khoya
12. Coal including coke in all its form.

[Delhi Administration, Sales Tax Department (1977)
Report (Interim) of the Sales Tax Committee for Delhi,
Delhi.]

and the shifting of the tax from the first-point to the last-point on four commodities, namely,

1. Black-lead pencils including coloured matches
2. Fountain pens, ball point pencils and propelling pencils
3. Light diesel oil and lubricants, and
4. Sewing machines, their stands and covers.

[Delhi Administration, Sales Tax Department (1978)
Report of the Sales Tax Committee for Delhi, Delhi]

It is not clear on the basis of what empirical evidence the Committee decided on the shifting of particular commodities to the first-point levy. We did not consider it useful at this point in time to examine the merits of their recommendations in relation to particular commodities in the two lists above. It is more important to note that they decidedly favoured the last-point tax *except* in cases where there was large-scale evasion of the last-point tax. In addition, they were agreeable to the shifting of some commodities to the first-point levy, for administrative convenience, if evasion would not increase and the value-added after the first-point was not relatively large. The last suggestion represented the Committee's concession to the traders' pleas.

We agree with the view underlying the recommendations of the Kanwarlal Gupta Committee that the major advantages of the retail sales tax should not be lightly thrown away in the name of administrative simplicity. Often, the question of the first-point levy vs. the last-point of levy is considered and discussed purely in administrative terms with little or no importance attached to economic effects. Thus it must be said to the credit of the Kanwarlal Gupta Committee that, unlike some other Committees constituted to study sales taxation in different States, they clearly perceived the merits of the last-point tax and refused to be swept off their feet by the trend in other States to move towards the first-stage regardless of economic consequences.

4. Basic Considerations

Yet, as indicated earlier in the chapter, the question of stage of levy is still a matter of controversy and we need to consider the matter in some greater detail. Our approach would be to find an alternative which, while avoiding the administrative disadvantages of the retail sales tax, would enable us to retain its major economic merits. Also, one could consider a combination of the two systems.

The two major arguments advanced against a predominantly last-stage levy in Delhi are (a) that evasion is in fact

rampant and cannot be checked or tackled so long as the tax is at the last-point and (b) that the means by which it is enforced, namely, through the use of the security-pointed ST—1 form has led to harassment and corruption. It is further argued that the last-point levy brings into the tax net an unnecessarily large number of dealers, most of whom are bound to be relatively small. On the one hand, this leads to harassment of the traders and often the placing of an unduly high cost of compliance on the small man; and on the other, it overburdens the tax administration because the tax has to be collected from a large number of small dealers, instead of from a smaller number of larger dealers as under the first-point levy. Traders, who have become vocal in this matter, look upon the adoption of the first-point tax as a way of freeing themselves of the obligation to deal with the tax department and of reducing the scope for corruption.

Of the 24 associations and two individuals who responded to our question on the point of levy, as many as 24 favoured the single-point levy, a majority (90 per cent) favoured the first-stage levy. Those who argued for the single-point levy at the first stage that the last-point system had resulted in harassment to the dealers (members of the associations) and the same result could be expected of the multi-point system as small dealers would come under such a system. It was their view that if the first-point levy was introduced, one could dispense with the statutory ST—1 form, which was a major source of corruption and harassment. Those who favoured the multi-point tax also stated that the existed system had resulted in great harassment. They were of the opinion "that the concepts of first-point and last-point are not intelligible to all and rather susceptible to misinterpretation and in the interest of simplicity and easy understandability sales tax on all commodities should be charged at a uniform rate of 1 per cent of value at every point of sale. By this, sales would be duly accounted for by all dealers ungrudgingly and the parallel market that is now rampant would be reduced considerably."

The majority of associations and individuals who responded to our questionnaire and those who gave evidence before us have argued against the last-point levy mainly on the grounds of hardship to the small re-sellers and of the trouble caused by

the ST—1 form. Several of them also gave large-scale evasion under the present system as an additional point against it. These arguments by the taxpayers should indeed be given due weight, but the economic and equity considerations, which we have outlined earlier, have to be given equal, if not more, weight.

5. Views of Other Committees and Commissions

The question of what are the proper form and structure of sales tax under Indian conditions has been a matter of debate in almost all the States which impose the tax. Many of the major States have had the question examined by a committee or commission. Most of these committees did not at all consider the desirability or feasibility of introducing the value-added tax in lieu of the existing sales taxes. It is to be presumed that they ruled out such a tax as being too sophisticated for the States as well as the dealers to handle. The choice therefore lay among the multi-point levy (without set-off), the first-stage levy and the last-stage levy (or the retail sales tax). Some of the States, such as the Southern States, started with the multi-point levy, while several others in the North and North-East originally adopted the Bengal pattern of the last-point levy. But in course of time, there was a gradual shift towards the first-point levy, though except perhaps in Maharashtra, everywhere mixed systems operate.

This move towards the first-point levy has taken place largely in response, on the one hand, to the strong pressure from traders (re-sellers) urging that they be freed from “the troublesome” obligations imposed by the Sales Tax Acts, and, on the other hand, to the desire of the administrators to confine the tasks of surveillance and collection to a limited number of large dealers. Experts and scholars who have studied the subject, or chaired (or participated in) the Committees set up by the various States to study this problem have favoured the move away from the multi-point tax. For example, NCAER teams which studied the sales tax system in Tamil Nadu and Andhra Pradesh, favoured a noticeable shift towards the first-point tax, though a mixed system was ultimately recommended as a compromise. [NCAER (1965). *Sales Tax System in Madras*, Delhi, NCAER (1971); *Review of Sales Tax in Andhra Pradesh*,

Delhi]

The Committee on Commodity Taxation, Kerala (1976) as well as the Karnataka Taxation Review Committee (1982)—both chaired by Prof. I S Gulati—favoured the single-point tax mostly to be levied at the first stage as against the multi-point levy. The Sales Tax Enquiry Committee of Maharashtra (1975-76) also argued against the multi-point, double-point and the last-point levies in favour of the first-point levy.

6. Multi-point Tax

Public finance theorists would readily agree that a turnover tax of the cascading type generally known in India as the multi-point levy is to be avoided on economic and equity grounds, although it might be a relatively simple system to administer and to comply with. There might be on the whole less incentive to evade tax under the multi-point system than under the single-point one, since it is collected from a large number of sellers each paying a relatively small amount. Also the nominal rate can be kept low, which is psychologically advantageous. But the arguments against the multi-point levy are quite strong. First, under it, there will be cascading of tax and unintended changes in the relative prices of inputs; second, there will be increases in the costs of production; third, there will be a tendency towards vertical integration; fourth, it would be difficult to control the incidence of the tax on various commodities so as to achieve the desired pattern of incidence and progression, since there will be varying degrees of divergence between the nominal and effective (cumulative) rates as the result of the tax falling on the successive stages; and fifth, since the multi-point tax is to be realised from dealers at all stages, the number of taxpayers to be dealt with could be much larger than under the single-point levy. Citing the experiences of the different States which had introduced and tried to administer the multi-point tax, the Maharashtra Sales Tax Enquiry Committee (1975-76) said:

“The States where the multi-point system was introduced, found out that though the system of multi-point was easy to understand and administer, articles sold from the first stage of sale to the last could not be traced and fraudulent

suppression of sales at the middle or the last stage of sales became common for obvious reasons. The other defect of such a system was that the turnover limits for registration had to be fixed at a comparatively low figure and so a large number of small traders were brought within the ambit of taxation under this system. Apart from the cascading effect such a system had on the sale in the course of inter-State trade or commerce or in export, the intermediate links like commission agents between manufacturers and wholesalers or semi-wholesalers tended to be eliminated under this system. While, on the one hand, the tax rates had to be increased to meet the growing revenue needs of the State, on the other, it became necessary to provide relief to manufacturers and commission agents. Further the States found it necessary to levy a single-point tax at the first stage on the sales of certain items which were consumed by the affluent sections of the society. All this led to complication in tax law." [Government of Maharashtra (1976), *Report of the Sales Tax Enquiry Committee, 1975-76*, Bombay, p. 8]

Several other expert committees and bodies also voiced the same opinion about the multi-point levy and the opinion has been unanimous in rejecting it as the main form of sales taxation. But some of the Committees did not mind recommending a multi-point levy on a few selected commodities along with a single-point tax.

7. First-point Levy

Unlike the multi-point tax, the single-point levy at the first-point can be collected from a much smaller number of dealers—the importers and manufacturers, who, it is said, will represent relatively large establishments. If a single-point system is adopted assessment and collection would be made easier for the above reason and efficiency can be imparted because the point or stage at which the tax is leviable can be decided upon, taking into account both the channels of trade peculiar to each commodity and the efficiency with which the administration can enforce the tax laws. [Government of Kerala (1976), *Report of the Committee on Commodity Taxation*, Trivandrum, p. 32.] Also, the rate can be fixed for each commodity with

much greater certainty about the incidence on consumers. But the first-point levy suffers from some of the disadvantages of the multi-point levy, even though to a somewhat lesser extent, as will be shown below.

In any case we must rule out the adoption of the multi-point system by Delhi. That would indeed be a retrograde step. As noted above, in several of the States the tendency has been to move towards the first-point levy. Should this be the path of reform in Delhi?

Let us reiterate the advantages claimed on behalf of the first-point tax:

- (a) Administration is easier because the number of dealers involved will be smaller.
- (b) Evasion may be less because the tax is collected, so to speak, at the source.
- (c) It is collected from the class of dealers who can afford the organisational set-up needed to maintain the requisite records and accounts.
- (d) Consumers will generally not be aware of the rates of tax being levied and therefore there will be less opposition from them if rates are raised; and
- (e) Unlike under the multi-point tax, there will be no significant cascading effect.

It will be noticed that most of the above arguments are administrative. While not underplaying the importance of administrative aspects, we have throughout emphasised the importance of economic considerations, because the ultimate goal of national policy is to increase production through greater investment and efficiency. Moreover, some of the arguments given above can only be accepted with qualification. Thus, take the argument that under the first-point tax, the tax administration will have to deal with a much smaller number of dealers. As the Gujarat Taxation Enquiry Commission points out,

“It is a mistaken notion that the number of dealers to be checked and kept under surveillance would be different and considerably smaller under the first-point tax. Given the exemption level, of those with turnover above that level

will have to get themselves registered and submit returns. This includes the majority of importers and manufacturers because in their case the exemption level is lower. The number of registered dealers will be exactly the same under the two types of levies and even under the first-point levy the returns of all the registered dealers will have to be checked against declaration forms or cash memos issued by sellers at earlier stages." [Government of Gujarat (1980) *Report of the Taxation Enquiry Commission*, Gandhinagar, p. 73.]

It also does not seem to be correct to say that evasion would definitely be less under the first-point levy. To the extent that the entire burden is concentrated at one point and the rates need to be higher than under the last-point levy, there is greater inducement to evasion. The experience of Tamil Nadu and Maharashtra shows that 'bill trading' can flourish under the first-point levy also. This method of evasion consists in showing goods on which tax has not been paid as goods already subjected to tax through obtaining bills from certain registered dealers who issue them without transacting any business. The latter are not genuine dealers and they disappear after doing this type of business. A method of avoidance adopted by several dealers under the first-point tax is to under-invoice the price on the first sale and get related dealers at the subsequent stage to raise the price. If the Tax Department contests the price, the dealers concerned often go to court and litigation ensues, that may be ultimately loss of revenue.

As for the economic aspects, the belief that the first-stage levy does not entail much cascading is not correct, because this levy falls on the same product as it passes through successive stages of production until it leaves the manufacturing sector. Such cascading can be avoided only if complete set-off or relief is provided in respect of the tax falling on all inputs. But giving such a relief would in effect mean moving the stage of levy forward—the tax burden will arise only when a good leaves the manufacturing sector.

The first stage suffers from certain other disadvantages which are often ignored. First, the proportions of value-added at the earlier and later stages in the process of production vary from commodity to commodity. Any tax which encompasses

value-added only at the earlier stage introduces a bias in favour of commodities in whose cases the proportion of value-added is larger at the later stages. Good examples are consumer durables. Second, under the first-point levy the taxable base would be lower than under the last-point of levy and hence the tax rate would have to be higher for getting the same amount of revenue. Correspondingly, there could be greater incentive for evasion. Third, the type of first-point tax obtaining in Maharashtra and Karnataka, for example, where no systematic set-off is provided for the tax paid on inputs, would promote vertical integration and strike at ancillary industries. As Professor S. Crossen has observed:

“The wholesale tax is slowly but surely becoming an anachronism. Because retail margins are not taxed, effective tax rates will not be uniform and competitive commissions are distorted. Excess burdens attributable to the tax tend to grow exponentially as rates are increased for revenue purposes—I am inclined to favour the retail tax because of its higher feasibility and greater built-in resistance to pressures to increase rates for revenue.” (*Bulletin for Fiscal Documentation*, 1983, p. 147)

A word may be added on the phenomenon of cascading. Technically, the term cascading does not refer to the mere cumulation of tax burden as a ‘good’ passes through the successive stages of production. It refers to the fact that under the first-point and multi-point levies, the ultimate price increase (and hence the burden on the consumer) is greater than the revenue accruing to the government. This phenomenon arises because (i) the cost of holding inventories goes up (hence higher interest charges) as a result of the tax being levied at the early stage of production and (ii) the profit margin is applied to a cost base that includes taxes paid at the earlier stages. The cost of production is raised unnecessarily to the extent of cascading. This consideration does not seem to have been kept in view, or given due weight, by those committees which have endorsed the first-point levy without set-off of tax paid on inputs, purely on administrative grounds.

8. Last-point Levy in Practice

We have already indicated the merits of the last-point levy. From the economic point of view and from the point of view of Delhi's own interests, what Delhi now has is the ideal structure. The trouble is that this ideal structure has not been actualised. The administration has not been, and is not, able to cope with the tax. Under the existing system, the payment of the tax is postponed to the last stage. This postponement is achieved through a system of issue of certificates by the purchasing dealers to the effect that they are registered dealers and are purchasing the goods for re-sale or for use in manufacture. In such cases, the selling dealers do not have to collect tax and pay it to the Government. The tax is to be collected only when the sale is to someone who cannot furnish the certificate, i.e., a consumer or a non-registered dealer. It was found by the administration that the system was being increasingly misused. The certificates were being issued by bogus dealers who obtained registration by showing a single act of import or export, sometimes in collusion with the officials. Obviously the selling dealers who obtained these certificates to escape tax liability were in league with the bogus dealers issuing the certificates. No wonder that when attempts were made to check the genuineness of the certificates, it was often found that the dealers issuing them had vanished without a trace. In order to minimise evasion of tax through this means, the Department introduced a rule to the effect that sellers could sell without collecting tax only if a registered dealer submits his declaration in a security-printed form which is to be obtained from the Department itself. This is the ST—1 form which is considered to be a source of corruption and harassment by the representatives of trade and industry.

The procedures according to which the ST—1 form is issued and the conditions attached to the use of form by the dealers have created tremendous opposition on the part of the trading and business community to the method of enforcement of the last-point levy and to the levy itself. All the representatives of associations and businessmen who appeared before us and all those who submitted memoranda to us have strongly complained against the trouble and harassment to which they are put because of the ST—1 form. According to them, they do not get

the forms in the required quantities; the officials invariably give them much fewer than what is demanded and even then much trouble has to be undergone to obtain the forms. Often palms have to be greased. The limitation of the total amount of sales that can be entered in a form to a fairly low value also creates problems. Those who do large business are put to the necessity of obtaining hundreds of forms in a year. Again, since frequently the intending sellers are unable to obtain the required number of forms, they promise the sellers that they would give the forms later, and the selling dealers have to pursue the purchasers to get ST—1 forms before they submit their returns.

It is also generally argued that the institution of the ST—1 form has given rise to a considerable volume of corruption. Unscrupulous officials collude with some dealers and issue copies of the ST—1 forms to be later on sold in the market. Senior officials of the Department admit that this kind of fraudulent business is going on.

Another argument against the continuance of the form is that in spite of its existence, evasion is rampant. Since thousands of forms are issued each month, it is hardly possible to check them carefully and see if they are genuine. The dealers have pointed out—and this is confirmed by our investigation—that the checking of the sales against the ST—1 form takes place only at the time of assessment. As of now assessments are lagging behind by about four years. By the time assessments are taken up, it is too late to check the genuineness of the dealers who issued the forms : an appreciable number of them would not be traceable.

On the other hand, while admitting that the ST—1 form has created many problems and difficulties, the Departmental officials hold the view that evasion would become even larger in case the ST—1 form is done away with. Now some care is taken to ensure that only genuine registered dealers are able to buy without paying tax. Of course, to the extent that a certain proportion of forms is issued clandestinely, this objective is thwarted. Apart from that, there is the possibility of checking the accounts or files of the issuing dealers to see whether they have paid tax on the sale of goods bought on the basis of the form.

We are thus in a dilemma. The ST—1 form creates problems by its presence as well as by its absence. The administrators tend to think that it is better to abolish the last-point levy than to have it without the requirements of the use of ST—1 form. One final argument is adduced against the continuance of the last-point levy. It is stated that consumers are generally willing to buy a variety of goods without getting a voucher or bill if they can avoid paying the tax. As the rates range upto 8-10 per cent, there is temptation to take the risk arising from not getting a record of sale in order to save tax. Again, several unscrupulous dealers collect the tax from the consumers, but do not pay it to the government. They go undetected even if they have issued ST—1 forms because they are small; often they get part of their goods off the record but collect the tax on them, just to enrich themselves at the expense of the customers.

9. Reform

In discussing a better alternative to the existing system, a few important considerations need to be kept in mind. Delhi has a sound structure of sales tax, its most important merits being that (i) there is no interference with the processes of production or trade, (ii) there is no cascading, and (iii) value-added at all stages is covered. If for administrative reasons we have to depart from this model, we must ensure that at least the essence or the major part of these merits is preserved. The first-point levy, as it is generally understood and applied, e.g., in Maharashtra or Tamil Nadu, is defective precisely because it does not possess the abovementioned merits. What we need, therefore, is a *via media*. We need a variant of the first-point levy in which the disadvantages of the traditional form of that levy is minimised and which could be made to have some of the major advantages of the last-point levy. In particular,

- (a) The tax should not fall on inputs at all; i.e., the tax should not be, in effect, at the first-point as such, but should be deferred to the point where the good leaves the manufacturing sector. This can be achieved through a system of set-off or by enabling the manufacturer to buy all inputs free of tax.
- (b) Entrepot trade should not be affected, i.e., a dealer will

buys some goods from a manufacturer or importer and then exports them outside Delhi, should be given refund of tax or should be able buy those goods free of tax.

- (c) To make the task of administration easy and to reap the benefits of shifting the tax to an earlier stage, the exemption level should be raised; and
- (d) Some method should be found to spread the burden and cover value-added at all stages.

The basic features of the system that we recommend are spelt out below:

1. There would be a variant of the first-point tax on most goods; the tax will be payable by importers, by manufacturers who sell to non-manufacturers internally and by registered dealers who have bought goods from unregistered dealers and sell to non-manufacturers. Alternatively, all manufacturers (and those who have bought from unregistered dealers) may be required to collect and pay tax, but complete set-off should be granted in respect of tax paid by manufacturers on all goods used in manufacture as well as packaging. The only exception should be in respect of inputs used to produce tax-free goods.
2. The level of rates of the first-point levy should be kept moderate. It could then be supplemented by a low-rate levy at the last-point, say, at 1.5 per cent so that the burden of tax is spread over the two stages and value-added at post-manufacturing stages would be covered. This latter levy will apply only to the first-point goods.
3. On a relatively small number of commodities, the tax should be levied at the last-point only. These are commodities in respect of which value-added is quite substantial at later stages, and those which are manufactured in a large number of small units. If the goods are generally sold in fairly large establishments, that would be additional point in favour of putting the commodity under the last-point tax—Table 6.2 contains a tentative list of goods which should be kept under the

last-point levy. To this may be added a few others which are predominantly manufactured in small units but which are sold through well-established channels. The goods which are subject to the basic last-point levy will not be liable to the supplementary levy of 1.5 per cent.

TABLE 6.2

A Suggested List of Last-Point Goods

1. Refrigerators, their accessories, components and spare parts
 2. Television sets and their components, accessories and spare parts
 3. Lifts whether operated by electricity or hydraulic power
 4. Electrical meters
 5. X-ray apparatus
 6. Motor vehicles
 7. Motor cycles, and their combinations
 8. Motor scooters, and motorettes
 9. Tractors and trailers
 10. Diamonds
 11. Ivory articles
 12. Helmets
 13. Typewriters
 14. Computers, tabulating, calculating, cash registering, cash punching, franking and addressing machines and their components, accessories and spare parts
 15. Telephones and their components, spare parts and accessories
 16. Teleprinters and their components and spare parts
 17. Dictaphones, tape-recorders and other similar apparatus for recording sound and their components, spare parts and accessories
 18. Sound transmitting equipment, like loud-speakers and their accessories, components and spare parts
 19. Duplicating machines and their components and spare parts
 20. Wireless reception instruments and apparatus, radios, radio-gramophones, loud-speakers
 21. Gramophones, record players and record changers and their components, accessories and spare parts, records and needles
 22. Bullion and Specie
 23. Gold and Silver ornaments
 24. All arms including rifles, revolvers, pistols and ammunition for the same and component parts, spare parts and accessories thereof.
4. The list of the last-point goods should be kept relatively short.

5. In regard to the first-point levy, a system of set-off should be preferable to that under which tax-free purchases are allowed to manufacturers. This is because under the system of set-off, there is less risk of loss of revenue. Additionally, the set-off would not be applicable if the goods are sent out on a consignment basis; under the tax-free purchases system, it would become necessary to recover tax from the dealer concerned.
6. The exemption level for compulsory registration should be simultaneously raised to Rs 3 lakh for re-sellers, to Rs 1 lakh for manufacturers and Rs 50,000 for importers. The existing exemption levels for resellers, manufacturers and importers were fixed in 1975, and are Rs 1 lakh, Rs 30,000 and Rs nil, respectively. Between 1976 and now the value of the rupee has gone down considerably. The wholesale price index of all commodities (base 1970-71 = 100) moved up from 173.0 in 1976 to 288.3 in 1983. If the goods exempted from DST are excluded, the index has moved up from 176.6 to 302.5. The mere increase in the prices of the commodities alone would justify a substantial increase in the exemption level for registration. Apart from that, if the full benefits of the reform are to be reaped, the number of dealers to be kept under scrutiny should be substantially reduced. As we pointed out earlier, in a sense, all registered dealers create work for the Department and have to be given some attention, since they will all be filing returns. If the exemption level is raised, we shall get rid of those who can now be considered small dealers. Thereby we will also be reducing the scope for harassment.

The raising of the exemption level would not mean any significant loss of revenue. Since the tax on most of the commodities would be at the stage of import and manufacture, the raising of the exemption level for resellers will not have any impact on revenue. The only possibility of leakage of revenue in this case (i.e., the first-point levy) would be through small manufacturers and importers selling directly to small retailers. This can happen only on a small-scale and would not there-

fore lead to a more than negligible loss of revenue. As regards the last-point levy, the raising of the exemption level would only mean that the tax would be collected at an earlier stage. Correspondingly, some part of value-added representing the profit margin of the newly excluded dealers would escape taxation. Again the amount will not be significant.

On balance, there is likely to be a net gain. We have noted earlier that the number of registered dealers with a turnover of Rs 5 lakh and below now constitute 66 per cent of the dealers but contribute only 9.8 per cent of the total revenue. The proportionate contribution of those with a turnover below Rs 3 lakh is likely to be less than 5 per cent. When the tax on most commodities is shifted to the first-point, this share would further fall. Revenue would be a gain if the administration could be freed of the task of looking after so many small dealers so that it would be possible to concentrate on the bigger dealers. In fact, we would recommend that after a year of experimentation with the adoption of the exemption levels suggested by us, if every thing goes well, the exemption level for resellers should be raised to Rs 4 lakh and that for importers to Rs 1 lakh.

The adoption of the kind of first-point levy suggested by us and the simultaneous raising of the exemption level would considerably reduce the opposition to the sales tax on the part of the business community. The harassment of the really small dealers would come to an end. The number of bogus registrations also would be cut down.

7. As regards the first-point levy, the present practice of accepting the declarations of the selling dealers in their own vouchers must be continued. No security-printed form should be introduced. ST—1 form may be used, at least for some time, in respect of *some* of the goods taxed at the last-point. The use of the form should be prescribed only if it is found that evasion was taking place in respect of particular commodities.
8. In order to encourage entrepot trade, it is now provid-

ed that if a commodity is imported (paying CST to another State) and is then re-exported, CST will be charged only at half the prescribed rate. When the general shift to the first-point levy is made, it should be provided further that if a dealer having bought a good on payment of tax (internally) exports the good to another State, the tax he has paid would be set-off against the CST payable by him and that any excess payment would be refunded. If he exports the good outside India, the entire tax paid should be refunded to him. This is anyhow required by Central law.

9. Delhi has two levels of Government, Delhi Administration and the Municipal Administrations. In several countries, the local authorities levy a sales tax, which is in addition to the levy by the provincial or State authorities. The 1.5 per cent last-stage levy that we have recommended in respect of all commodities subject to the first-point levy may be looked upon as a separate tax. With the raising of the exemption level, its administration should not pose any problem. Although it can be looked upon as a separate tax, it will be levied by the Delhi Administration, but the proceeds could be distributed to the municipal bodies. The terminal tax could then be abolished. We may add that this tax should also be administered *without* the use of the ST—1 form. Since the rate is low, consumers would be more inclined to pay the tax and take a bill, and evasion is not likely to be large.

We would like to reiterate, in conclusion, that the shift to the first-point tax should be made only if the provisions we have recommended for minimising cascading and avoiding hindrance to entrepot trade are made part and parcel of the scheme. Unlike some committees and experts, we would not recommend a first-point levy which falls on inputs without relief. If the administration feels that a set-off system or tax-free purchase system in respect of inputs cannot be implemented, then it is better to stick to the last-point levy with a higher exemption level. Except for the recommendation regarding the second-stage levy at 1.5 per cent, all other recommendations are put forward as a package. They must be implemented together.

TABLE 6.1
First-Point Goods

(at the time of introduction of the Delhi Sales Tax Act, 1975)

1. Silk Fabrics
2. Matches
3. Black-lead pencils and coloured pencils
4. Cement
5. Medicines, drugs and pharmaceutical preparations
6. Tyres and tubes of all kinds including those of motor vehicles, motor cycles, motor scooters, motorettes, cycles and animal-driven vehicles
7. Vegetable Ghee (Hydrogenated Vegetable Oil)
8. Liquefied petroleum gas (kitchen gas)
9. Ice
10. All electronic and electrical goods (within the meaning of entry 15 of the First Schedule appended to the Delhi Sales Tax Act, 1975 (excluding those falling in any other entry of the said Schedule)¹
- [11.]²
12. China-ware including crockery.
13. All types of sanitary goods and fittings
14. Petroleum products including motor spirit, aviation-spirit, high speed diesel oil, light diesel oil, furnace oil, mineral turpentine oil, solvent oil, kerosene lubricants and bitumen (asphalt)³
15. (a) Hair-oils, hair-creams, hair-fixers, hair-dyes, hair-darkeners, hair-tonics, shampoos, hair-lotions, brilliantine, pomade, vaseline, and hair-spray;
- (b) Tooth-pastes, tooth-powder and other dentifrices and tooth-brushes;
- (c) Lipsticks, nail-polish, mascara, beauty-boxes (sringar-boxes) talcum and other powders for face and skin, snows and creams, perfumery, depilatories, blemish-removers, beauty-milk and cleansing milk, eye-tex, eye-brow pencils, eye-liners, rouge, eau-de-cologne, solid-colognes and lavender-water;

1. Inserted w.e.f. 27.11.75 vide Ibid.

2. Entry No. 11 which read as "Electricity storage cells and batteries" was deleted w.e.f. 28.2.1977 vide Notification No. F. 4/47/76-Fin. (G) dated 28.2.1977.

3. Substituted for "14. Petroleum products including motor spirit, aviation spirit, high speed diesel oil, light diesel oil, solvent oil and lubricants, but excluding kerosene." w.e.f. 27.11.1975 vide Notification No. F. 4/73/74-Fin. (G) dated 27.11.1975. Prior to substitution of entry No. 14, Kerosene was taxable at the first-point from 24.10.1975 vide Notification No. F. 4/70/75-Fin. (G) dated 24.10.1975.

TABLE A.6.1

- (d) Shaving sets, safety-razors, razor-blades, shaving blades, shaving-brushes, shaving soaps and creams, and after-shave lotions and creams;
- (e) Soap other than washing soaps
- 16. Fireworks including coloured matches
- 17. All types of glazed and vitrum tiles, mosaic tiles, laminated sheets like sunmica, formica, etc.
- 18. Cotton as defined in section 14 of the Central Sales Tax Act, 1956 (74 of 1956)
- [19.]⁴
- {20.}⁵
- [21.]⁶
- {22.}⁷
- {23.}⁸
- 24. Bicycles, tricycles, perambulators and cycle-rickshaws
- 25. Bricks, fire-bricks, brick-bats and brick-ballast
- 26. Butter, cream and khoya
- 27. Fountain pens, ball-point pencils and propelling pencils
- 28. Pesticides and insecticides, but not including pesticides for plant protection
- 29. Milk powder, condensed milk, baby milk, and baby foods
- 30. [(a)]⁹
 - [b] All kinds of paints, including distempers, cement colours or paints, powder-paints, stiff paste paints, powder-paints, enamels and liquid paints, whether ready for use or not

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- 4. Entry No. 19 which read as "Iron and steel as defined in section 14 of the Central Sales Tax Act, 1956 (74 of 1956)" was deleted w.e.f. 29.9.1976 vide Notification No. F. 4/47/76-Fin. (G) dated 29.9.1976.
 - 5. Entry No. 20 which read as "Jute as defined in section 14 of the Central Sales Tax Act, 1956 (74 of 1956)" was deleted w.e.f. 29.9.76 vide Ibid.
 - 6. Entry No 21 which read as "Oil seeds as defined in section 14 of the Central Sales Tax Act, 1956 (74 of 1956)" was deleted w.e.f. 29.9.1976 vide Ibid.
 - 7. Entry No. 22 which read as "Hides and skins, whether in a raw or dressed state" was deleted w.e.f. 28.2.1977 vide Notification No. F4/47/76-Fin. (G) dated 28.2.1977.
 - 8. Entry No. 23 which read as "Cotton yarn as defined in section 14 of the Central Sales Tax Act, 1956 (74 of 1956) and cotton thread" was deleted w.e.f. 28.2.1977 vide Ibid.
 - 9. Entry No. 30(a) which read as "Dry colours and pigments" was deleted w.e.f. 29.9.1976 vide Notification No. F. 4/47/76-Fin. (G) dated 29.9.1976.

TABLE A.6.1 (Contd.)

| | |
|--|-----|
| [(c) |]10 |
| [(d) |]11 |
| (e) Acrylic and plastic emulsion paints. | |
| [(f) |]12 |
| (g) |]13 |
| [31. |]14 |
| 32. Sewing machines | |
| [33. |]15 |
| 33. Ice-cream of all kinds including ice candy | |
| 35. Ice-cream mixes and powders | |
| 36. Locks of all kinds, their keys and parts | |
| [37. |]16 |
| [38. |]17 |
| [39. |]18 |

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10. Entry No. 30(c) which read as "Varnishes, vegetable turpentine, paint-removers and stainers of all kinds" was deleted w.e.f. 29.9.1976 vide Ibid.
 11. Entry No. 30(d) which read as "All kinds of vehicles, dilutents and thinners, including natural and synthetic drying and semi-drying oils such as double boiled linseed oil, blown linseed oil, stand oil, sulphurised linseed oil, perille oil, whale oil, tung oil and white oil" was deleted w.e.f. 29.9.1976 vide Ibid.
 12. Entry No. 30(f) which read as "All types of laquers" was deleted w.e.f. 29.9.1976 vide Ibid.
 13. Entry No. 30(g) which read as "Glue and polishes of all descriptions and varieties, paint-brushes and sand papers" was deleted w.e.f. 29.9.1976 vide Ibid.
 14. Entry No. 31 which read as "Paper of all kinds including hand-made paper, whether meant for writing, printing, copying, packing or for any other purpose" was deleted w.e.f. 28.2.1977 vide Notification No. F. 4/47/76-Fin. (G) dated 28.2.1977.
 15. Entry No. 33 which read as "Coffee, chicory, coco and tea, in leaf or powder" was deleted w.e.f. 28.2.1977 vide Ibid.
 16. Entry No. 37 which read as "Wood and Timber of all kinds and of all trees, of whatever species, including fuel wood" was deleted w.e.f. 29.9.1976 vide Notification No. F. 4/47/76. Fin. (G) dt. 28.2.1977.
 17. Entry No. 38 which read as "Paraffin wax and candles" was deleted w.e.f. 28.2.1977 vide Notification No. F. 4/47/76-Fin. (G) 28.2.1977.
 18. Entry No. 39 which read as "Dry fruits, canned, preserved, dried or dehydrated fruit" was deleted w.e.f. 29.9.1976 vide Notification

TABLE A.6.1 (Contd.)

40. Vegetables (green or dried) when sold in sealed containers
41. Desi Ghee
42. Footwear, attache case, vanity boxes and brief cases whether made of leather or synthetic materials
- [43.]¹⁹
44. Boot polish and boot cream
- [45. Coal including coke in all its forms]²⁰

No. F. 4/47/76-Fin. (G) dt. 29.9.1976. This item was restored at the table of first point goods again w.e.f. 19.10.1976 vide Notification No. F. 4(47)/76-Fin. (G) dt. 19.10.1976. This entry was again deleted from the table of first point goods w.e.f. 28.2.1977 vide Notification No. F. 4/47/76-Fin. (G) dt. 28.2.1977.

19. Entry No. 43 which read as "Knitting wool" was deleted w.e.f. 29.9.1976 vide Notification No. F. 4/47/76-Fin. (G) dt. 29.9.1976.
20. This item was brought on the above table by giving it No. 45 w.e.f. 27.11.1975 vide Notification No. F. 4/73/74-Fin. (G) dt. 27.11.1975 by cancelling the Notification No. F. 4/70/75-Fin. (G) dt. 31.10.1975 whereunder this item was taxable at the first point w.e.f. 1.11.1975.

TABLE A.6.2
List of Goods Subjected to First-Point Levy on 1.2.1978

1. Bicycles
2. Black-lead pencils and coloured pencils
3. Brick, fire bricks, brick-bats and brick-ballast
4. Butter, creams and khoya
5. Butter oil
6. Cement
7. Coal including coke in all its forms
8. Denatured spirit
9. Fireworks including coloured matches
10. Fountain pens, ball-point pencils and propelling pencils
11. Ice
12. Ice-cream of all kinds including ice-candy
13. Liquefied petroleum gas (kitchen gas)
14. Medicines, drugs and pharmaceutical preparations
15. Matches
16. Petroleum products including motor spirit, aviation spirit, high speed diesel oil, furnace oil, mineral turpentine oil, solvent oil, kerosene and bitumen (asphalt)
17. Refined coconut oil
18. Sewing machines, their stands and covers
19. Tyres and tubes of all kinds including those of motor vehicles, motor-cycles, motor scooters, motorettes, cycles and animal-driven vehicles.
20. Vegetable ghee (hydrogenated vegetable oil).

Source: Gupta, S.N. (1982), *Delhi Sales Tax Manual*, A Taxmann Publication, p. 22.