## II Structure of Domestic Trade Taxes and Customs Duties

### A brief overview

In India domestic trade taxes are levied by the central, state as well as local governments, and have a highly complex structure. The major domestic trade taxes include: union excise duties (UED) and central sales tax (CST) levied by the centre; general sales tax (GST), entry tax and electricity duty levied by the States; and octroi levied by the local governments. Octroi is currently levied in six states, namely, Gujarat, Haryana, Himachal Pradesh, Maharashtra, Punjab, and Rajasthan, while entry tax prevails in two of the non-octroi states, namely, Karnataka and Madhya Pradesh.

UED covers all domestic products manufactured by the medium and large producers. These duties fall on final goods as well as on raw materials and intermediate products. With effect from 1986-87, a set off for the UED paid on inputs is available in regard to most goods, under the MODVAT scheme.

Sales tax comprises GST levied as well as retained by the States and CST levied by the centre and collected and retained by the States. GST is levied at one or more stages in the process of production and distribution of goods. In most of the states, GST is levied mainly on the first sale or purchase in the state by an importer or a manufacturer or any other dealer. It is levied on the tax base inclusive of customs and UED, if any. Inputs are accorded concessional treatment in all states. Also, the States have resorted to additional levies in the form of surcharge (SC) or turnover tax (TT). Five states, namely, Andhra Pradesh, Bihar, Gujarat, Kerala and West Bengal charge SC as well as TT. In addition to these five states, another six states, namely, Goa, Haryana, Jammu and Kashmir, Orissa, Punjab, and Uttar Pradesh levy SC, and three states, namely, Karnataka, Tamil Nadu and Tripura levy TT. Further, inter-state sales are subject to CST. In general, each State has sought to develop its own tax structure to maximise its revenue without serious concern about its economic effects.

Octroi is charged at the point of entry of goods into a local area for consumption, use, or sale in that area. It is generally applicable to goods entering into urban areas, i.e., areas serviced by municipalities or corporations. It is a check-post-based levy collected by local tax administration and has a broad tax base covering all goods brought into a local jurisdiction for consumption, use, or sale. Entry tax is levied on the sale of goods brought into a municipal area from other jurisdictions. It is an account-based levy collected by sales tax administration for the local governments and is applicable to goods sold by sales tax dealers only. Octroi or entry tax, as the case may be, is applicable to foreign as well as domestic goods, with no set off provisions.

UED, CST, GST and octroi may apply more than once to a domestic product depending on the process of its production and distribution, whereas a foreign product may altogether escape or bear a lower burden of these taxes, depending on the process of its procurement by its user. For example, in order to neutralise the disadvantage to domestic industries stemming from UED, goods imported from abroad are subject additionally to countervailing duties (CVD) of customs. To achieve this objective fully, the CVD, in principle, should equal the excise duty levied on a given product.[3] However, this is not always the case. Similarly, while goods imported and sold through registered dealers in India are subject to GST, CST and associated surcharges and turnover taxes, goods imported directly by the end-user (such as a registered manufacturer) are not.

It is clear that domestic trade taxes in India involve taxation of goods at multiple levels without adequate set off for the taxes paid on purchases/inputs. This results in substantial input taxation adding to production costs of domestic industry. This asymmetry can be a source of serious handicap for the domestic producers particularly as most imported products before leaving the country of origin, for example those from the European Union, are relieved of the burden of all taxes. While customs duties on imported products provide a counterbalance to these discriminatory taxes in the domestic market, the limitations imposed on Indian exports may be considerable. The MODVAT and duty drawback schemes seek to remove the burden of domestic taxation on Indian exports but do not fully relieve the

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[3] This assumes that import duty is just sufficient to match cost disadvantages other than tax disadvantages of domestic producers.

goods of the burden of customs duties, excise duty and sales tax, and no relief is available in respect of octroi.

Some details of the structure of customs duties and major domestic trade taxes (namely, UED, GST, CST, and octroi) in India, in respect of the year 1998-99, are briefly discussed below.

**Customs duties**

Customs duties, which are charged on all imported goods, comprised basic customs duty (BCD), special duty (SD),[4] additional duty (popularly known as countervailing duty: CVD), and a special additional duty (SAD). BCD is charged with a view to protecting domestic industry from international competition, SD as a revenue measure, and CVD to neutralise the disadvantage to domestic industries stemming from excise duty chargeable on domestic production. Because of its motivation, the rate of CVD for a commodity generally equals the excise duty applicable to that commodity, but the two rates differ in a large number of cases owing to exemptions and concessions granted. SAD was imposed through the Union Budget of 1998-99 to provide a level playing field with respect to the burden of state and local taxes on domestic and imported goods.

BCD and SD are charged on c.i.f. value of imports (that is, imports valued at cost including freight). CVD is charged on value of imports inclusive of BCD and SD, and SAD is payable on value of imports inclusive of BCD, SD and CVD. The duty inclusive value of a commodity is given by

$$V\,(1+t_{bcd}+t_{sd})(1+t_{cvd})(1+t_{sad}), \qquad (2.1)$$

where the c.i.f. value of import of the commodity is V, and $t_{bcd}$, $t_{sd}$, $t_{cvd}$ and $t_{sad}$ denote the rates of BCD, SD, CVD and SAD, respectively.

[4] SD has been abolished through the Union Budget 1999-2000.

### Rates

Rates of BCD specified in the *Customs Duty Act*, are basically ceiling rates, and are referred to as standard rates. Standard rates of BCD and CVD vary across commodities, while those of SD and SAD remain unchanged. As tax concessions are announced through notifications appearing from time to time, it becomes difficult to keep track of the rates of customs duty applicable at different points of time.

In the year 1998-99, there were 8 *ad valorem* rates of BCD: 3, 5, 10, 20, 25, 30, 35, and 40 per cent, with some exceptions. Some goods were subject to higher rates of duty (beyond 40 per cent). In addition, specific[5] and *ad valorem* plus (less) specific duties[6] applied to a few commodities. The rate of SD was 5 per cent for most commodities and 2 per cent or *nil* for some others.

There were 11 *ad valorem* rates of CVD: 5, 8, 10, 12, 13, 15, 18, 25, 30, 32 and 40 per cent. It may be noted that only a few commodities were subject to high rates of CVD at 30, 32, or 40 per cent. The rate of SAD has been 4 per cent for all products excepting some fully exempted goods.

### Exemptions

Various exemptions and concessions have been available under the system of customs duties. These include: general, area specific (country of origin) and end-use exemptions and concessions. Generally, some of the products or their specific uses are exempted from a combination of BCD, SD, CVD, and SAD, or taxed at a concessional rate. For example, in 1998-99, tanks and other armoured fighting vehicles were exempt of BCD, SD, CVD as well as SAD. Specified goods required for setting up crude petroleum refinery were exempt of BCD, SD and SAD, and CVD was only 10 per cent as against UED of 13 to 18 per cent. Goods exempt from BCD and CVD included hospital equipment, specified goods required in connection with petroleum operations undertaken under specified

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[5] Specific duty rates are applicable to all sorts of almonds.

[6] *Ad valorem* plus specific duty rates are applicable to all sorts of ball or roller bearings and bearing housings (incorporating ball or roller bearings), while preferential duty on tea and coffee is *ad valorem* less specific.

contracts, specified goods required for construction of national highways and video/audio cassettes of predominantly educational character.

Traders registered for the purposes of sales tax have been exempt of SAD to avoid levy of SAD on a commodity that is, in any case, subject to sales tax in the process of its distribution. The other items exempt of SAD during 1998-99 were:

- gold and silver;
- goods which are exempt from basic customs duty as well as CVD;
- newsprint, glazed newsprint and light weight coated paper up to 51 gms imported by actual users for magazines;
- crude petroleum;
- goods imported under advance licensing scheme;
- goods required for fertiliser projects;
- goods required for coal mining projects;
- goods required for power generation projects;
- specified goods imported for setting up of a crude petroleum refinery;
- specified telecom equipment; and
- goods subjected to additional excise duty (in lieu of sales tax);

**Union excise duties**

UED is levied on nearly all goods manufactured by medium and large manufacturers. These comprise basic excise duties and additional duties of excise in lieu of sales tax. Additional duties of excise in lieu of sales tax are levied on textiles, tobacco and sugar as a substitute for the sales tax foregone by states on these commodities. These duties are collected and transferred, in full, to the states. Moreover, there are additional duties and cesses on several commodities including textile, and textile articles.[7] The base for charging additional duties and cesses is the basic UED. As these duties are collected and transferred, in full, to the

[7] The Department of Revenue administers the cesses on fabrics, sugar, tea, biris, paper, jute manufactures, automobiles, indigenous crude oil, cotton, vegetable oils and television sets. Other departments administer those on coal and coke, rubber, salt, iron ore, limestone and dolomite, mica, cine workers, research and development, and water.

relevant ministries for development of the paying industries, in true sense of the term, these duties and cesses are not UED.

### Rates

Standard rates of excise duty, like standard rates of customs duties, are basically ceiling rates. Several exemptions or concessions are given through numerous notifications issued by the revenue department. The duty rates vary by commodity, by type of manufacturer and by end use of a given commodity. The duty rates prescribed are generally *ad valorem*, but specific or *ad valorem* plus specific rates apply to a few commodities.[8] Though the duty rates are not many, the system of granting concessional rates of duty through notifications throughout the year makes it difficult to keep track of the rates of UED applicable at any time. During 1998-99, there were 11 *ad valorem* rates of basic excise duty varying from 5 to 40 per cent though there were some exceptions. Besides 5 and 40 per cent, the other standard rates of basic excise duty were 8, 10, 12, 13, 15, 18, 25, 30 and 32 per cent. A few commodities were subject to higher or lower duty rates or specific duties or *ad valorem* cum specific duties.[9]

### Exemptions

Exemptions and concessions from UED include: general, on goods produced without aid of power, on goods produced in the small scale industry (SSI) and on the basis of end-use of the product. Goods produced in SSI are exempt upto a certain limit and a concessional duty is levied on the value of goods in excess of the specified limit. During 1998-99, the manufacturers having value of goods not exceeding Rs.30 million were eligible for the benefits of SSI. There was *nil* UED on goods worth Rs.5 million and the balance value of goods was taxed at a concessional rate. Generally, raw agricultural products (such as cereals), and energy saving and pollution control devices are exempt and necessities (goods supposed

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[8] Specific duties are applicable to (i) tubes, tyres and some other rubber products, (ii) waste of filament and man- made fibres, (iii) marble slabs and tiles, and (iv) cement clinkers.

[9] The Union Budget 1999-2000 reduced the 11 *ad valorem* rates of excise duty to 3 *ad valorem* rates, namely, 8, 16 and 24 per cent. However, a special additional duty has been imposed at the rates of 6, 8 and 16 per cent on the goods which were subject to high rates of excise duty, namely, 30, 32 and 40 per cent, respectively.

to be consumed mainly by the common man such as bicycles, and many agro-products, such as, pickles and jams) are either exempt or taxed at low rates.

### MODVAT scheme

Inputs are relieved of the burden of UED through the modified value added tax (MODVAT) scheme that operates on the principle of value added tax (VAT). This scheme was introduced in 1985-86 and made applicable to some of the commodities. Over time, its scope has been enlarged. Some of the commodities are still not covered by this scheme denying benefit of tax relief to their users. Currently, the excise duty collected from the commodities covered by the MODVAT scheme account for about 90 per cent of the total excise duty. With effect from 1998-99, a provision was made to disallow MODVAT credit to the extent of 5 per cent. But, full MODVAT credit has been restored with the 1999-2000 budget.

The MODVAT scheme is applicable to all commodities except tobacco (other than cut tobacco used in manufacturing of cigarettes), matches, cinematographic films, petroleum products used largely for final consumption (including motor spirit and high speed diesel oil), textiles (excluding specified textiles and yarns other than specified spun yarns) and office equipment (excluding specified equipment such as that used for quality control, testing and pollution control).

SSI enterprises are given the option to pay normal UED in place of concessional duty if they wish to be covered under the MODVAT scheme. This provision benefits those SSI enterprises that hope to attract taxable manufacturers to buy their products and claim MODVAT credit in turn.

### Sales tax

The state sales tax can be levied on the sale of all commodities except newspaper; and there are special taxes in the nature of sales tax on selective services, such as, transportation (road and inland water ways) and entertainment. As discussed earlier, sales tax comprises GST, CST and additional tax (AT). In some of the states, GST on certain commodities, such as sugarcane is levied in the form of a purchase tax because of the convenience in collection of the tax from a few major purchasers rather than thousands of sellers (farmers).[10] Additional tax is charged as surcharge (SC) on GST and/or as turnover tax (TT).

Goods on which additional excise duty is levied in lieu of sales tax, such as sugar, textiles and tobacco, are not subject to GST. In principle, a state can treat these goods as "declared goods" and tax them under GST, but a state opting for this choice has to forego its share in additional duties of excise in lieu of sales tax.[11] Goods covered under this category are listed at Annexure 1. The state of origin can not charge its GST on inter-state sales to registered dealers, and on consignment or branch transfers. Some specified goods are considered to be of importance in inter-state trade, commonly referred to as <u>declared goods</u>. A list of these goods is given in Annexure 2. On these goods, the rate of GST can not exceed 4 per cent. Further these goods can not be taxed more than once under the *GST Act* implying that multi-point taxation of these goods is ruled out.

In most of the states, GST is levied mainly at the first sale or purchase in the state by the importer or manufacturer or any other dealer. Only a few commodities are subject to a multi-point tax in the two Indian states of Karnataka and Kerala. Similarly, some commodities are subject to a double point tax in Gujarat and Kerala.

In most states, when a commodity is used as input in the production of a taxable commodity, it is exempted or subjected to a concessional tax rate, or a refund given for the tax paid in excess of a specified ceiling. However, no such tax concession is allowed for inputs used in the distribution of goods.[12] Also, some states like Maharashtra do not give this concession in respect of machinery and equipment. In general, sales tax paid at an earlier stage becomes part of the tax base for the subsequent stages of tax. This results in substantial input taxation. At the rate structure of 1989-90, input taxation accounted for more than 30 per cent of the final incidence of sales tax on most commodities commodities or certain categories of dealers. During 1998-99, the

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[10] For a detailed description of the system of sales tax in India, *see* NIPFP(1994) or Purohit (1995).

[11] The definition of "declared goods" is given ahead.

[12] *See* NIPFP (1994), p.16.

(Aggarwal, 1998a).[13] Some states apply the principle of VAT on some principle of VAT was applicable in Maharashtra[14] to all dealers with turnover exceeding Rs.25 lakh, and in Andhra Pradesh, Kerala and West Bengal on only re-sales of some commodities.

**Rates**

Rates of GST vary widely across states, and in a state, across commodities. In general, raw materials and necessities are taxed at lower rates while luxuries are taxed at higher rates. Most of the states exempt raw foods of GST. A brief description of the rate structures of GST for different states is given in Annexure 3.

In a given state, the rate of CST for a commodity is the same as the rate of GST subject to a ceiling rate of 4 per cent if the sale is made to a registered dealer and a floor rate of 10 per cent if the sale is made to an unregistered person. However, in the case of sale of a declared good to an unregistered person, the CST rate is twice the GST rate in the exporting state.

In some states such as Maharashtra, the tax rate on inputs is higher when the manufactured commodity is sent out of the state on a consignment transfer (a transaction not subjected to CST) than when it is sold locally or sent out on an inter-state sale (that is subjected to CST).

**Exemptions**

Goods exported out of the country are not subject to GST. In fact, no sales tax is charged (or the tax refunded subsequently) on the sale of a good one stage prior its export, provided the commodity in question is purchased against confirmed export orders. However, no such relief is available in respect of CST (i.e., for inter-state purchases). Consignment or branch transfers of goods are outside the domain of CST.

Various tax incentives are allowed under the system of sales tax for achieving certain social objectives such as industrial growth and

[13] This result relates to the rate structure of sales tax for the year 1989-90. Since then, there has not been any major change in the pattern of input taxation under sales tax.
[14] In Maharashtra, the principle of VAT has been withdrawn with effect from 1999-2000.

development of less developed areas. New firms are allowed a deferral of tax or retention of sales tax as interest free loan for a specified period provided these are located in less developed areas or engaged in production of specified commodities.[15]

## Octroi

Octroi is a local tax that prevails in six states, namely, Gujarat, Haryana, Himachal Pradesh, Maharashtra, Punjab, and Rajasthan. Municipalities or municipal corporations levy it on entry of goods into an urban area for consumption, use, or sale. The goods just passing through a jurisdiction are not subject to octroi. However, it is applicable to foreign as well as domestic goods. Octroi is a check-post based levy. Each municipality determines its own rate structure depending on its revenue needs and administrative capacity, but the rates are subject to approval by the state in some way. In general, octroi rates vary across municipalities and across commodities within a municipality. Most of the commodities are taxed on the basis of value while some are taxed on the basis of weight or number of pieces/packets etc.

### Rates

In Maharashtra, the state covered in the present study, octroi is at present levied in 22 municipalities. Data on the rate structures of octroi are compiled for 4 municipalities, namely, Greater Mumbai, Kolhapur, Malegaon, and Mira Bhandar, and reported in Annexure 4.[16]

Commodities are classified into the following nine broad categories :

- articles of food and drinks;
- animals;
- articles used for fuel, lighting, washing etc.;
- articles used in construction and those made of wood or cane ;
- perfumes, toilet requisites, colours and household goods;
- tobacco and tobacco requisites;

[15] *See* NIPFP (1994), p. 28.

[16] We are grateful to Professor O. P. Mathur for his generous help in obtaining the relevant data from the municipalities.

- piece goods, cotton, yarn, starching and sizing materials, leather and rubber products;
- metals and articles thereof; and
- miscellaneous.

For most commodities, the rates are *ad valorem* and these vary from 0.50 to 7.00 per cent in Greater Mumbai, from 0.20 to 7 per cent in Kolhapur, from 0.25 to 4.00 per cent in Malegaon and from 0.05 to 5.25 per cent in Mira Bhandar. Generally, agricultural raw materials and inputs, life saving drugs, sports goods, and animals are exempt; lower rates apply to necessities and raw materials; and higher rates to luxuries.