

Sales Tax Efforts of States : Some Empirical Findings and Policy Issues

Jose Sebastian

This paper raises some methodological issues involved in the measurement of sales tax potential and efforts of States. The existing studies on sales tax efforts of States have used State Domestic Product or its various components as the potential base of sales tax. The methodological limitations of this approach are outlined and the suitability of total consumer expenditure as an alternative base are examined. Sales tax potential and efforts of 14 major States are estimated using State Domestic Product approach and consumer expenditure approach for five points in time. Statistical tests are carried out to bring out the superiority of the latter approach.

The importance of sales tax to the finances of Indian States need not be reiterated. Contributing more than 60 per cent of State's own tax revenue, the performance of sales tax is a major factor determining the overall tax performance of States, which the Finance Commission and Planning Commission take note of in determining the volume of federal transfers to States. Though a few studies have been undertaken on sales tax efforts of States, there is further scope for improving upon the methodology. This paper raises certain methodological issues and attempts to offer some improvements over the existing methodology.

The growing fiscal centralization in Indian fiscal federalism has considerably increased the dependence of States on sales tax to meet their additional revenue requirements. Assuming that a thorough restructuring of the existing Centre - State relations does not take place in the near future, the States are left with no alternative other than strengthening their tax effort. The growing urbanization and commercialization of both rural and urban economics have definitely widened the scope of sales taxation: It is doubtful to what extent this potential has been tapped. It appears that at the policy level a thorough understanding of the sales tax potential is inherently lacking in most Indian States. At the same time the fact cannot be overlooked that any scientific