

SALES TAXATION

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PREFACE

Sales tax is an important member of the tax family of almost every country. It originated in ancient Greek City-States in a rudimentary form and appeared with refined but complicated forms in modern times. Sales tax had to face many critical situations during its life time and was severely criticised as regressive tax mainly from the eighteenth century to the early part of the twentieth century. Its use was almost abandoned during this period. However, financial crisis created by World War I revived the tax and the general attitude towards sales tax changed drastically because of its fiscal sufficiency. So, the use of the tax had continued to expand rapidly year after year and the tax attracted the attention of not only fiscal authorities but also the academicians, politicians and even common people. Nowadays, sales tax is considered an important source of government revenue especially in developing countries and occupies a respectable position in the modern tax structure. Considering the growing importance of sales tax, this study is designed to discuss various forms of sales taxes particularly from the point of view of their practical usefulness in developing countries, to trace out the historical development of sales tax, to

examine its relative importance and to analyse its incidence.

Keeping in view these objectives, the study is divided into four chapters. Chapter I briefly discusses different types of commodity taxes so that it is possible to draw a demarcation line between sales tax and other commodity taxes. This chapter also attempts to define sales tax and identifies various forms of sales taxes. Here, our attention is focussed on the practical usefulness of different types of sales taxes in developing countries. Chapter II traces the historical background of sales tax and examines its relative importance in the modern tax structure. Here, the analysis is based on the Nepalese and Indian experiences. Chapter III analyses the shifting and incidence in order to find out the burden of sales tax. This chapter seeks first to review the theoretical development of the concepts and then examines some empirical studies conducted in this field in India. Chapter IV summarises the main findings of the study.

In the course of the study, I have benefited from discussions with a number of people.

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CHAPTER I

DEFINITION AND FORMS OF SALES TAX

Sales tax is one of the important members of the tax family. It belongs to that type of taxation which is known as "commodity taxation". This chapter seeks first to introduce the concept of commodity taxation with a brief discussion of various types of commodity taxes. Then, we enter into a detailed discussion of sales taxation. Here, we will first define general sales tax, which is known in general as sales tax. Then an attempt will be made to illustrate different forms of sales taxes. Here, we shall go over the classifications of sales tax given by some economists. We shall also try to identify major forms of sales taxes and point out their advantages and disadvantages. During the course of discussion of various types of sales taxes, attention will be focussed on their practical usefulness in developing countries.

1.1 Introduction

The term 'tax' is as familiar as the term 'government' to the common man. It is well known that tax is the money paid by citizens to the government for financing its activities. The Shorter Oxford English Dictionary defines tax as a compulsory contribution to the support of government, levied on persons, property, income, commodities etc.. Here

the last term commodity refers to both goods and services. Taxes upon goods and services are known as 'commodity taxes'.

Commodity taxes may be levied at different stages from production of a commodity to its final consumption. They can be imposed upon production, importation, exportation, sales, purchases or uses of the commodities. If the tax is imposed upon the domestic production of commodities for sales or consumption within the country, the tax is called an excise duty. In contrast to excise duties, levied on native goods, customs duties are imposed when goods leave or enter a country. A tax imposed upon goods leaving a country is called an export duty whereas an import duty is levied upon goods arriving in a country. Another important type of commodity tax is sales tax which is imposed upon the sale of both goods and services. On the other hand, purchase tax applies to the purchases by dealers rather than sales by them. Value-added tax (VAT) is a recent innovation in the field of commodity taxation. It is included in the sales tax family but from an analytical point of view it is better to remember that VAT is essentially different from sales tax because the legal tax base of VAT (i.e. value-added at each stage) is different from the base of sales tax (i.e. total sale value). Since it is customary to include VAT in the sales tax system, this study also follows the same tradition. Gross receipts business tax and use tax are the other two varieties of commodity taxation which are

not so popular in developing countries. The former tax, generally charged at less than one per cent, is regarded as a charge for the privilege of carrying business activities and intended to place burden upon business¹ while the latter tax is a levy imposed upon commodities bought elsewhere and used and stored in the state. The rationale behind the latter tax is that in a federal system consumers do avoid a sales tax if they are in a position to buy similar commodities free of tax from neighbouring states or by mail. The states are restricted in their power to impose sales tax upon goods and services involved in inter-state trade. So, use tax is imposed as supplementary to the general sales tax to avoid inter-state evasion of sales tax. Octroi duty is another member of commodity tax family. This is imposed by local bodies (municipalities in towns etc.) on goods leaving or entering the city gates. Generally, the tax is levied upon the goods that enter into the local area for consumption. Other commodity taxes are motor vehicles tax, taxes on passengers and goods, entertainment tax and electricity duties. For the purpose of assessment, commodity taxes may be specific (rates are based on physical units) or ad valorem (rates are based on prices).

Nowadays commodity taxes are considered very important especially in developing countries. Governments in these countries are unable to raise required revenue by means of income and property taxes because of mass poverty. Moreover, these taxes require an adequate and efficient system of

tax administration because of their complicated valuation methods. But developing countries generally lack a well equipped tax administration. In contrast, commodity taxes are broad-based, productive and comparatively easy to administer. They are important sources of government revenue. For example, they provide more than three fourth of the total tax revenue in Nepal and India.²

Besides the revenue purpose, commodity taxes also help to achieve a number of socio-economic objectives. For example, import duties are levied to protect domestic industries against competition from abroad. Heavy import duties on final goods and exemption or nominal rates on raw materials, machines and equipments help to increase domestic production. Excise duties also help to stimulate production in desired sectors by means of tax rebate or tax credit.

Excise duties are also imposed to reduce the consumption of goods, such as alcohol and tobacco, involving socially undesirable effects. Until recently health was the prime concern in this regard. But now negative externalities are being taken seriously.³ Because consumption of tobacco and alcohol imposes costs on individuals other than those who consume them. "... (It) is unpleasant to sit in the same cinema as cigarette smokers or to be endangered by drunken drivers on the way home."⁴

Both excises and sales taxes are used to reduce the consumption of luxuries by means of higher rates on them.

Similarly, high import duties are intended to restrict the consumption of imported luxuries.

Customs duties are used to improve the balance of payment situation by restricting imports and encouraging exports. Excises and sales taxes also help to achieve this objective curtailing domestic consumption and exempting exports from tax net.

Commodity taxes divert resources to desired sectors which plays crucial role in the development of developing countries. Resources can be diverted from consumption goods industries to investment goods industries through heavy taxation on luxuries and exemption of capital goods. Similarly resources can be diverted from imports to domestic products through import duties. Thus, commodity taxes are assigned to play an important role in the development process, especially in a developing country.

However, commodity taxes are considered as regressive taxes. There is still the presumption that a large part of commodity taxes is shifted forward to the consumer. They apply to all spending irrespective of its volume. They do not provide minimum taxable limit as do income taxes. Moreover, they do not take into account the part of incomes saved, the size of families, the number of taxpayer's dependents. In addition, they tax all consumers at the same rate irrespective of their wealth and incomes.⁵

Commodity taxes are considered inequitable even if they are not shifted. Because they are based on production, imports, sales or purchases of the commodities irrespective of profits, losses, indebtedness, and other factors affecting the condition of the business of the taxed vendors where one cannot find out the actual tax paying capacity of different vendors.⁶

Thus, on the one hand while commodity taxes are very important taxes especially for developing countries, they are at the same time regressive. Hence, attempts should be made to make the commodity tax system more efficient and also to minimise their regressiveness.

To ensure efficiency, tax should be imposed on the final goods alone and not on intermediate goods, because commodity taxes are ultimately paid by consumers. Tax on producers goods does not reduce the tax burden in any way rather it increases the tax burden. An input tax stimulates producers to change their choices of inputs to avoid taxes which leads to less efficient choice of inputs.⁷ It means inefficiencies in production.

Then, the question arises as to how the tax burden ought to be distributed among final goods? From the point of view of administrative convenience and economic efficiency, a uniform and universal commodity tax system is preferable. It is easier to administer in the sense that there is no necessity to classify commodities into taxed and untaxed groups

and taxed commodities according to their rates. It also reduces the burden on the part of businessmen since there is no need to keep separate records. It is easier for tax assessment and difficult for tax avoidance. Moreover, the universal nature of tax eliminates the distortion of consumer's choice between different commodities which, in other words, means minimisation of welfare losses.

However, such a tax "will have a disincentive effect on the choice between work and leisure, since the proceeds of work cannot be spent without liability to the tax."⁸

Moreover, a uniform and universal tax ignores the equity aspect. It does not take into account the source of tax revenue, importance of diversion of resources to desired sectors and regulatory and promotional role of commodity taxation.

Basic necessities such as food, coarse cloth etc. should be exempted and luxuries should be taxed heavily in order to minimise the regressiveness of commodity taxation. That is why now a days high rates on luxuries and low rates on goods of common consumption are widely accepted as rules.⁹

However, a highly selective and differential tax system erodes the tax base. It makes tax administration more complicated. It increases cost of collection. It also gives incentive for tax evasion which further brings erosion in the tax base. Hence, such a tax system results in considerable revenue loss.

Similarly, a highly selective and differential tax system causes welfare loss because of distortion. Distortion, in other way, means economic inefficiency because it changes consumption pattern away from optimality.¹⁰

Hence, there should be a good trade-off between equity and efficiency and an ideal system of commodity taxation should minimise both ^{the} efficiency and inequity and should maximise revenue yield. With this brief background of commodity taxation, we will switch over to a discussion of sales tax.

1.2. Definition of Sales Tax

In general sales tax is readily understandable. As the name suggests, sales tax is a levy imposed upon the sales of both goods and services. But it is quite difficult to define the term precisely. Because excises, purchase tax, gross receipts business taxes are quite close to sales tax in their structures and probable economic effects. That is why many economists fail to draw a clear cut demarcation line between sales tax and other commodity taxes though it could be done on the basis of their respective tax bases.

According to A. G. Buehler, "A general sales tax is really a system of sales taxes on a great number of commodities at more or less uniform rates and with more or less uniform exemptions, deductions, and other provisions. Different members of the general commodity tax family have been described as general sales taxes."¹¹

This definition first indicates the general nature of sales tax which applies to a great number of commodities. Then it points out the structure of sales tax. It carries practical importance in the sense that it takes into account different aspects of sales taxes such as rates, exemptions, deductions which are associated with almost all sales tax systems existing in different countries. However, it fails to mention explicitly the base of sales tax. In this connection the definition given by Pogue and Sgontz seems to be more satisfactory because they have explicitly pointed out the tax base of sales tax. They say : "Sales taxes are levied on sales of products and services, with the tax typically being collected from the seller. They may be general, applying to all sales or selective, applying to the sales of only specified commodities ... Sales taxes are, therefore, taxes on income uses, in contrast with income taxes, which are on income sources."¹²

According to John F. Due, "A sales tax is a levy imposed upon the sales, or elements incidental to the sales, such as receipts from them, of all or a wide range of commodities, excluding taxes imposed at fractional rates upon gross receipts in the form of business occupation or licence taxes."¹³

This is the most clear, wide and satisfactory definition of sales tax. Because it first clearly points out the

base of sales tax as sale value by which we are able to distinguish sales tax from customs duties, excises and purchase tax. Then it indicates the general nature of sales tax which distinguishes sales tax from other commodity taxes of limited coverage as use tax and other commodity taxes on particular services. Finally, it specifically excludes gross receipts business tax from the purview of sales tax. However, it must be said that unlike the preceding definition, this definition fails to mention that sales tax is a levy on income uses in contrast with income taxes, imposed on income sources.

John F. Due adds another feature of sales tax describing it as a levy imposed, "usually with the legislative expectation that the tax will be shifted forward to the consumer".¹⁴ However, this description applies to other commodity taxes also.

Now we can briefly say that sales tax is a levy on income uses in contrast with income taxes, levied on income sources. Sales tax is generally imposed upon the sales of wide range of commodities. Hence, legal tax base of sales tax is sale value of taxable goods and services. The value of sales depends upon the cash expenditure by consumers on consumption goods and services and by manufacturers on producers goods. Thus, expenditure both by consumers and manufacturers constitutes the potential tax base of sales tax. Moreover, it is desirable to consider the potential expenditure on

necessities and luxuries separately in order to have a better idea of the potential tax base.

1.3 Forms of Sales Taxes

There are different forms of sales tax existing in different parts of the world. They vary in nature, scope, methods of collection, rates and even regarding effects and burden to some extent. So it is quite difficult to classify these taxes on a single basis. Even though economists try to classify sales taxes on different grounds, they fail to give satisfactory classification of sales tax.

National Industrial Conference Board¹⁵ (hereinafter NICB) classifies sales tax mainly into three groups as following:

1. Multiple turnover tax
 - 1.1 General turnover tax
 - 1.2 Commodity transfer tax
2. Single turnover tax
 - 2.1 Production tax
 - 2.2 Retail tax
3. Luxury turnover tax

This classification is neither a purely stagewise nor a purely commoditywise classification. It mixes both. It is confusing because it classifies sales tax, at the same time, on the basis of stages as well as of types of commodities. If the tax applies to all stages in production and distribution

process, it is said to be multiple turnover tax and if it is limited to one stage it is said to be single turnover tax. But the above classification also includes luxury turnover tax, tax on the sale of luxury articles and on the performance of services of luxury, as a third variety of sales tax which makes this classification unacceptable.

Furthermore, multiple turnover tax is further divided into two groups according to the scope of the tax. A general turnover tax applies to the sale or transfer of tangible materials and commodities, commercial or professional services, immovable properties or other particular categories of transfer or services. On the other hand commodity transfer tax is limited to the sale or transfer of tangible material and commodities.

As multiple turnover tax, single turnover tax is also further divided into two groups, viz. production tax and retail sales tax. This classification is made according to the transaction that gives rise to the tax liability. Production tax is imposed upon the sale of a producer while retail sales tax liability rests upon the sale to final consumers.

This classification is not a complete classification because it does not include wholesale sales tax which is an important member of sales tax family. Moreover, it is not necessary to consider luxury tax as a separate branch of

sales tax. It was adopted by different countries simply as a supplementary tax to other forms of sales tax.

C. V. Oster¹⁶ classifies sales taxes according to scope, legal basis, turnover and coverage as following:

1. According to scope
 - 1.1 Selective sales tax
 - 1.2 General sales tax
2. According to legal basis
 - 2.1 Tax legally on the seller
 - 2.2 Tax legally on the buyer
3. According to turnover
 - 3.1 Multiple turnover tax
 - 3.1.1 General turnover tax
 - 3.1.2 Commodity transfer tax
 - 3.2 Single turnover tax
 - 3.2.1 Manufacturers sales tax
 - 3.2.2 Wholesalers sales tax
 - 3.2.3 Retail sales tax
4. According to coverage
 - 4.1 Retail sales tax
 - 4.2 General sales tax
 - 4.3 Gross receipts tax
 - 4.4 Gross income tax

This is a detailed classification which includes all possible types of sales tax. However, it includes gross

receipts tax and gross income tax under the purview of sales tax. According to Oster gross receipts tax covers retail, wholesale, extractive and manufacturers sales plus personal and professional services. In addition to this, gross income tax includes receipts from non-business activities as wages and salaries. We have already distinguished sales tax and gross receipts tax and the inclusion of gross income tax under sales tax seems to be improper. Furthermore, it would be better to separate purchase tax, the tax that is legally imposed on the buyer, from sales tax because their legal tax bases are different. The present study follows this line of thinking.

Most satisfactory classification of sales tax is given by John F. Due.¹⁷ According to him sales taxes can be classified into three groups as following:

- 1) Multiple stage tax
- 2) Single stage tax
- 3) Value-added tax

Single stage tax can be further divided into three categories.

- a) Manufacturers' tax
- b) Wholesale tax
- c) Retail tax

This classification is superior to preceding types of classification. It is a clearcut classification. It neither

involves unnecessary classification nor does it exclude any important type of sales tax from the purview of sales tax. As mentioned above, the classification given by the NICB fails to include wholesale tax while unnecessarily classifies luxury turnover tax as a separate form of sales tax. Oster's classification includes gross receipts tax, gross income tax and purchase tax under the purview of general sales tax. Classification given by John F. Due does not suffer from such problems and as such it is the most popular classification. We shall also follow this classification for the purpose of our analysis.

1.3.1 Multiple Stage Tax

Multiple stage tax is also known by the name of turnover tax, cascade tax or transaction tax. The modern turnover tax was essentially a German development and adopted by many other countries during the early part of twentieth century.

The multiple stage tax, in its pure form, applies to all sales at all stages of production and distribution. In other words, a complete multiple stage tax applies "to all transaction through which commodities pass on the way from initial production of materials to final sale to the consumer, and often to many services." Thus, the tax is imposed upon the sale by manufacturer to wholesaler, wholesaler to retailer and retailer to consumer. Moreover, principally the tax is characterised by a low and uniform tax rate and no sale of

goods or services is exempted from taxation in its pure form. Thus the tax is very comprehensive in nature.

However, in practice, none of the multiple stage taxes is complete and uniform. For example, Germany was the country which had used multiple stage tax to the greatest extent, even though, German Umsatzsteuer imposed a low rate to wholesalers.¹⁸ Similarly, Belgian¹⁹ and Italian²⁰ sales taxes did not cover sales by the retailers in their scope while Norwegian²¹ sales tax did not include sales by the manufacturer in its scope. Similarly, many countries do exempt some goods and services from the tax net. Thus, in practice we do not find multiple stage tax in its complete and uniform form.

One of the important advantages of multiple stage tax is that it is highly productive. A substantial amount of revenue can be collected with a relatively low rate of tax. For example, Germany collected around 40 per cent of national revenue from this tax.²²

Because of the low rate of tax, tax payers find it less burdensome. So there is very little urge towards tax evasion. Even if there is evasion at one stage, it may not be possible to do so at other stages. So the revenue loss will be much less in this system.

However, multiple stage tax suffers from many disadvantages. It discriminates non-integrated firms in favour of integrated firms and gives incentive to integration. Since

it is levied at all stages of production and distribution, integrated firms are able to avoid a part of tax. Here, the tax provides an incentive to the firms to produce their own materials and parts used in production instead of purchasing from independent suppliers. Moreover, they will try to sell their products directly to retailers or sometimes even to the consumers. So the wholesale level, sometimes even the retail level, might be forced out of existence. The tax puts those firms which do not want to change their method of doing business and also the small dealers who cannot get themselves integrated, at a disadvantage. "It is claimed in both France and Germany that the turnover tax has artificially favoured integration, and that the integrated establishments have secured important competitive advantages. It is very difficult to determine to what extent integration has resulted from the turnover tax, but its influence in that direction is no doubt felt. The higher the tax rate, the greater will be the tendency to integrate."²³ Integration is an unintended effect of taxation which brings unnecessary changes in the methods of doing business. It therefore represents inefficiency in taxation.

Non-uniformity of consumer burden is another disadvantage of this form of tax. As noted above, tax burden depends upon the number of stages in the production and distribution process through which a taxed commodity passes. Hence, "... commodities which passed through a short chain of transfers in the process of manufacturer and distribution bore less tax

than similar goods passing through a large chain."²⁴ It has two implications : "One result is discrimination among consumers on the basis of their relative preferences, another is potential distortion of resource allocation away from optimum."²⁵ This is because, those consumers who prefer commodities which change many hands during the production and distribution process and thus taxed many times have to bear greater burden in comparison with other consumers who buy commodities which pass only few stages. Hence, tax tends to increase prices of different commodities differently depending upon their number of transaction during production and distribution process. It affects relative prices which causes a reallocation of consumer expenditures. There is disincentive to consume relatively heavily taxed commodities. Thus because of differences in tax burden, consumer has to shift from a preferred commodity to less preferred one which causes "excess burden".

There is a greater possibility of pyramiding of tax in this form of sales tax. Pyramiding of tax arises because of the application of percentage mark-ups to purchase prices which include tax. Hence tax is imposed upon tax. It can be shown that consumers have to bear burden by amounts in excess of the tax. An implication of pyramiding is that there is a substantial difference between nominal rate of the tax and its effective rate. For example, "... on pulses, a multipoint tax rate of 4 per cent works out to be as high as 16 per cent on the consumer."²⁶ Thus, consumers have to pay three four times

higher prices than normal tax rates. Though competition eliminates such pyramiding tendency, it works very slowly and imperfectly.²⁷

Thus, the tax is not neutral. It causes distortions i.e. brings unnecessary and unintended changes in relative prices and methods of doing business, as mentioned earlier. So it cannot be used as an effective fiscal instrument to achieve desired objectives.

Exports are generally exempted from sales tax. So sales tax borne by exports is to be refunded to the exporters. But it is quite difficult to calculate the exact amount of tax levied on exports in this system of sales tax. Due to the integration effect, tax on the same commodity produced and exported by different firms may be different, depending upon the stages of transactions. The cascading element further aggravates the problem. Hence, the actual amount of sales tax paid on exported commodities cannot be ascertained.

Under this system, imported goods are often favoured over domestically produced goods because generally the number of times that imported goods change hands is fewer than the case of domestically produced goods.

This tax puts the small dealers at a disadvantage. As stated above, they cannot take the advantage of integration. Moreover, they cannot maintain records and are often harassed by tax authorities.

Finally, a broad-based sales tax with uniform rate is regressive. If attempts are made to exempt necessities and to introduce rate differential in order to remove regressive element, the tax gives rise to administrative complications. Because of all these disadvantages, the use of multiple stage tax has been decreasing gradually.

1.3.2 Single Stage Tax

Single stage tax is imposed at any one stage in production and distribution process. It may be imposed at the manufacturers' level or wholesalers' level or at the retail level. Let us discuss these different forms of single stage tax imposed at different levels separately.

1.3.2.1 Manufacturers' Tax

Manufacturers' tax is essentially a Canadian innovation and later adopted by other countries. It is imposed on the sale by manufacturer of finished products. "The intention of a manufacturers' tax is to make the charge at that point by reference to the "factory door" price."²⁸ Hence manufacturers' tax and excise duties seems to be identical since they both are imposed on manufacturer or producer. However, as mentioned elsewhere, excises are levied upon production not on sales while manufacturers sales tax is imposed upon the sale made by producers or manufacturers. Thus, excises are collected from manufacturers on his production irrespective of sales of

his products while sales taxes are collected only when goods are sold.

The rationale behind this tax is that it can be administered more easily than any other type of sales tax because of smaller number of manufacturers. Moreover, since manufacturers are more organised and large, their book keeping system is adequate. This makes checking and cross-checking more possible. Therefore at this stage tax payers are less inclined towards direct evasion of tax.²⁹

This tax attracts special attention in a developing country where tax administration is not efficient and retailers are very small and scattered, retailing is non-commercial in character or is conducted by individuals or families to a large extent, who are mostly illiterate and do not keep even elementary records and where retailing is often seasonal and without a fixed place.

There are many disadvantages of manufacturers' tax. As with turnover tax, pyramiding effect is associated with manufacturers' tax. Because of the application of percentage mark-ups, manufacturers' tax tends to pyramid on the way to the final consumers where consumers have to bear burden by amount in excess of the tax. However, now price is pyramided to a lesser extent than is the case with multiple stage tax.

This form of tax "unduly influence the economic development of industry by discouraging manufacturers from

integrating forward, or may even encourage them to leave to wholesalers certain functions such as transport, warranty and installation which might often be more satisfactorily undertaken by the manufacturers."³⁰ Here, the firms that do not change their distribution process will be penalised.³¹

Manufacturers' tax requires a higher rate of tax to provide required amount of revenue. It is said that a manufacturers' tax may require a rate of 8 to 10 per cent to produce the same revenue as a retail sales tax of 5 per cent, in a situation where same exemptions are provided in both tax systems.³² This is because of the difference in their coverage. Manufacturers' tax is imposed upon manufacturers' sales price. In addition to this, retail sales tax covers value-added at wholesale and retail stages. Hence, the tax base of manufacturers' tax is the narrowest. So, it requires a higher rate of tax in order to provide the required amount of revenue. Higher rates give incentive for tax evasion which may result in considerable loss of revenue.

1.3.2.2 Wholesale Tax

Wholesale tax is imposed on the last wholesale transaction. In other words, it applies to the sales by the wholesaler to the retailer. This tax was first introduced by Australia, followed by New Zealand, Switzerland and other countries.

One of the important advantages of this form of tax

is that it can be regulated and administered more easily than retail tax because the number of wholesalers is smaller. Moreover, wholesalers are more organised than retailers. So, they do keep better records than retailers which facilitates tax administration.

Wholesale tax is superior to manufacturers' tax in the sense that it is more neutral than manufacturers' tax because it is imposed at one stage nearer to the point of final consumption. As a result "it causes less price-pyramiding". Moreover, a lower tax rate can produce the required revenue because of broader tax base resulting from the inclusion of value-added at the wholesale level.

However, it is difficult to define wholesale dealers and wholesale transactions. Generally, second sales i.e. sales after the sales by producers, manufacturers or importers are considered as wholesale sales. However, to locate this stage of sale is extremely difficult especially in the case of unorganised manufacturing and production and also in the case of direct imports by the consumers.

Like multiple stage tax and manufacturers' tax, wholesale tax also causes price-pyramiding to some extent. Similarly, this tax is also not neutral because businessmen can avoid tax liability through reorganisation of their business. In order to avoid tax, manufacturers directly sell to retailers keeping the wholesale stage out of existence.

In developing countries much wholesaling is conducted on a small scale basis where wholesalers do not keep adequate records. So, it is difficult to control and administer this tax. Nepal has had a bitter experience with this form of sales tax.³³ Furthermore, the tax base of wholesale tax is narrower when compared to that of the retail tax. Hence, higher rates are required as compared to the retail tax in order to provide the required amount of tax revenue.

1.3.2.3 Retail Tax

Retail sales tax is imposed on the final sale to the consumer. It is widely used in American states, Canadian provinces and other countries.

Retail sales tax is considered as the most satisfactory form of single point tax on many grounds. Firstly, this tax is more neutral than other types of sales taxes. Like other taxes, it does not stimulate the firms to change their production and distribution systems. Since the tax is levied on the actual selling price to consumer, tax liability will be the same regardless of the systems of production and distribution. Thus, unlike other forms of sales taxes, it does not bring undesired and unnecessary changes in the methods of doing business.

Uniformity of consumer burden is another advantage of retail tax. Since the tax is imposed at the last point, it is shifted to the final consumer by the exact amount of the tax. It avoids discrimination between individuals on the basis of

relative preferences for various goods and also avoids the potential distortion of optimum allocation of resources.

As stated above, since the retail sales tax is imposed at the last point, it is shifted to the consumer by the exact amount. It does not enter into the purchase price of the dealer. So there is no possibility of the application of percentage mark-ups to tax amount. Hence, the possibility of pyramiding is avoided and the incidence can be kept under control to a great extent.

Since the tax base is broader, a lower rate can provide a given revenue yield. This lower rate lessens the incentive toward evasion.

Under the retail tax system, tax can be quoted separately which increases the consciousness of the consumers.

Thus, retail tax is the most satisfactory form of sales tax because it is more neutral since it does not bring unintended and unnecessary changes in relative prices and methods of doing business. It also eliminates the cascading effects and produces greater yield with relatively small tax rate.

However, retail tax is also not free from limitations. The first limitation is the large number of small retailers brought under the tax net. According to one study the number of tax payers under this system will be 8 to 15 times as great as the number of tax payers under a tax at the manufacturing or wholesale stage.³⁴ As mentioned elsewhere, developing countries generally lack an adequate and efficient system of

tax administration which could administer effectively such large number of retailers.

The tax can be successfully operated only in those countries where retail trade is handled by medium or large commercial establishments that keep proper records.³⁵ However, the tax creates problems and encourages large scale evasion in a developing country where a large part of retailing is non-commercial in character, retailers are small, scattered, seasonal, illiterate and do not keep even elementary records. The problem becomes more serious in the case of differential rates. Many retailers sell a number of commodities and cannot apply properly the different rates to various goods they sell.³⁶

To solve the problem of small vendors, economists recommend that they be excluded from compulsory registration. Here, a tax on sales by large retailers to consumers and to small unregistered retailers is advised.³⁷ But it is difficult to draw a demarcation line between the firms that must register and those that are excluded. The larger firms will be divided into several smaller units to escape liability for registration and there will be a revenue loss. To check it some sort of incentives should be given to the firms to get themselves registered. For example, in India, Jha Committee³⁸ recommended not only a raise in the limit for compulsory registration to a turnover of 2.5 lakhs but also recommended voluntary registration of dealers whose turnover is less than 2.5 lakhs.

This recommendation was made in order to enable small dealers, whose turnover is less than 2.5 lakhs, "to purchase inputs free of tax and supply them to manufacturer", which would reduce evasion.

1.3.3 Value-Added Tax

Value-added tax (VAT) is the most recent innovation in the field of sales tax. France led the way and many other European and Latin American countries followed the footsteps of France. This form of tax was considered as the standard form of sales tax for the European Common Market countries. The tax was considered in great depth even in the United States of America, Canada, Japan and also in some countries of Latin America.

As the name suggests, VAT is a levy imposed on the value-added by each firm through its production and distribution activity. Value-added for a firm is nothing more than its gross receipts from sales minus all expenditures for goods and services purchased from other firms. This very value-added is the legal tax base of VAT.

VAT is descended as a hybrid of multiple stage tax and retail sales tax. It is similar to the multiple stage tax in the sense that both of these taxes are imposed at each stage in the chain of production and distribution. It is similar to retail tax because their tax bases become identical. This will be shown by an illustration at the end of this

paragraph. However, VAT differs from multiple stage tax because the latter is imposed on total value at each stage while the former is imposed only on value-added at that stage. Similarly, VAT differs from retail tax in the sense that the former is imposed at each stage of production and distribution while the latter is imposed only at one stage, the final stage.

To make matters clear an illustration would prove to be illuminating. Consider the case of a manufacturer who buys cotton from a farmer at Rs. 100. He converts cotton into shirt and sells to wholesaler at Rs. 200, wholesaler sells to retailer at Rs. 250 and finally retailer sells to consumer at Rs. 300. Suppose tax rate is 5 per cent in both VAT and retail tax. In the case of VAT, tax base is value-added at each stage which is Rs. 300 (i.e. $100 + 100 + 50 + 50$) and in the case of retail tax, tax base is retail sale price which is also Rs. 300. The same amount of tax revenue will be collected in both the systems. The only difference is that in the case of retail tax, retailer will pay Rs. 15 while in the case of VAT this amount will be collected at different stages, i.e. Rs. 5 from the farmer, Rs. 5 from the manufacturer, Rs. 2.50 from the wholesaler and Rs. 2.50 from the retailer, (according to their respective value-added) which finally comes to Rs. 15. On the other hand, multiple stage tax will be imposed on Rs. 850 (i.e. $100 + 200 + 250 + 300$) and if tax rate is the same, Rs. 42.50 will be collected as tax revenue in this system of sales tax.

There are three types of VAT : the consumption type, the income type and the gross national product type. Under the consumption type VAT all capital goods purchased from other firms, in the year of purchase, are excluded from the tax net. Hence the tax applies only to the consumer goods. The base of this tax becomes identical to the base of retail sales tax on consumer goods and services. On the other hand both income type and gross product type of value-added taxes do include the purchase of capital goods from other firms under their tax net. The difference between these two types of VAT is that the former tax does exclude the depreciation on capital goods employed from the tax base while the latter tax does not do so.³⁹

Tax liability can be calculated by different methods. The subtraction and addition methods and the tax credit method. Under the subtraction method value-added is ascertained as net turnover which is obtained by subtracting cost of materials from sales proceeds while in case of the addition method, the same tax base is obtained by adding the incomes produced by the firm (i.e. the sum of profits, salaries, wages etc.). Tax credit method is also known as invoice method. Under this method the tax applies to the total value of sales and the tax payers are permitted to deduct from their gross tax liability the taxes already paid by their suppliers and passed on to them. This method is used in countries of the EEC.⁴⁰

VAT is considered to be more neutral. Since it is

imposed only on value-added at each stage of production and distribution, tax liability will be the same regardless of the systems of production and distribution. This further results in the same proportion of the tax in the final price of any particular product irrespective of the number of hands that commodity changes. Here it avoids the major disadvantages of turnover tax viz., discrimination against non-integrated firms and uneven burden on various commodities.

VAT has wide coverage : "... the direct impact of the tax is spread out over a much wider range of taxpayers than is the case with the single stage taxes, and much of the tax is collected from large firms at stages prior to retailing."⁴¹ In this system, tax evasion will be more difficult and minimum. Since the tax is levied at different stages, it spread out over a large number of tax payers. Hence, each tax payer has to pay relatively a small fraction of the tax. So there will be less incentive for tax evasion in comparison with the single stage tax system. Moreover, tax evasion is quite difficult at pre-retail stage because of the cross-checking method. For example, under tax credit method "the amounts shown on invoices are important for the calculation of the tax liability of both the seller and the buyer and they are regarded as identifiable items by both of them. Also, it is in the interest of a taxable person to insist on his suppliers collecting the tax and furnishing an invoice, as otherwise he would not be able to claim tax credit."⁴² If retailers do evade, there will be not

much loss in revenue because a large part of the tax has been already collected prior to the retail level.

This tax is more attractive from the point of view of foreign trade considerations. "... since it does not raise costs through input taxation and since under it exports could be fully relieved of internal indirect taxation, the VAT helps a country to maintain the collective competitiveness of its industries in the world market."⁴³

However, this tax is more cumbersome because it requires more extensive records, which are not possible in a developing country having large number of small unorganised and uneducated vendors. Since a large number of tax payers are brought under the purview of the tax, it increases administrative complexity. Though it has a cross-audit feature, it is not an automatic one. It requires proper record system and frequent checks. Otherwise, there is a possibility of great tax evasion.

Thus no system of sales tax is perfect. There are certain advantages and disadvantages of each system. For example, retail tax and VAT are most neutral and productive but are difficult to handle in a country having inefficient tax administration and also an unorganised business sector. VAT is one step ahead of retail tax in this matter. Other taxes are distortive, since they bring unintended and unnecessary changes in relative prices and methods of doing business. Moreover, successful operation of any type of sales tax depends upon economic conditions, institutional(business) set up and administrative condition of a particular country at a particular stage.

Footnotes

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CHAPTER II

DEVELOPMENT AND RELATIVE IMPORTANCE OF SALES TAX

The history of sales tax is as old as the history of organised states. Sales tax was imposed even in ancient Greek City-States. However, its history is not smooth and continuous, rather it is tumultuous. This chapter seeks first to trace out its historical development from its ancient rudimentary form to the present day refined but complicated forms. While doing so, an attempt will be made to trace out briefly the historical development of sales tax in general. Then we will come to developing countries where the case of Nepal and of India will be presented.

In the course of our discussion, an attempt will also be made to point out the specific reasons for the imposition of sales tax in a particular country. Here, the attention will be focussed mainly on Nepal and India. We shall also try, wherever possible, to mention some major changes in the sales tax systems of these two countries.

Then, we shall examine the relative importance of sales tax, especially among other commodity taxes in terms of coverage and in quantitative terms with reference to India and Nepal. The reason for showing relative importance of sales tax among commodity taxes is that these taxes are most

important taxes which provide around 80 per cent of total tax revenue in both these countries.

2.1 Development of Sales Tax

2.1.1 Historical Background

The history of sales tax is very long. If we try to trace out its history, we reach the ancient Greek City-States (404-354 B.C.) where "heavy transfer taxes were levied on the sales of wholesale merchants" in order to provide funds for the protection of commerce, which was an important function of Greek City-States.¹ It was also imposed in ancient Egypt and Rome.²

Taxes on sale of particular commodities and especially upon necessities of life were common in Europe throughout the Middle Ages. For example, taxes on beverages and salt known as aides and gabelle, respectively were common in France.³

After the twelfth century, turnover taxes became common in Italian, French, German and Spanish commercial cities.⁴

In France, King Philip the Fair introduced the turnover tax at national level in the year 1292.⁵ But the tax was opposed, abandoned and reintroduced at different periods till the out-break of French Revolution, which ultimately abolished this tax.⁶

Spain was the only country where sales tax was levied permanently. The tax, which was started in the early middle

ages in the communes, was introduced as a national tax by the name alcabala, in the year 1342. The tax included virtually all articles⁷ and was levied on every stage of the production and distribution process. The rate reached 10 per cent over the years.⁸ Slowly, it became a burden on industry, trade and commerce as well as on the consumer.⁹ So the tax was severely opposed. Some attempts were made to reform the tax system in 1785. As a result, the tax was made applicable only to the initial transfer of goods and different tax rates were fixed. However, since it was not popular, it was finally abolished in 1819.¹⁰

Alcabala was highly condemned by many economists. Adam Smith condemned it as a major factor in the decay of Spain.¹¹ According to Seligman "The alcabala in short, has been notorious as an example of misdirected zeal in public finance."¹² While John F. Due considers it as "...a discredited and hated word in the field of taxation".¹³

Sales tax became most unpopular during eighteenth and nineteenth centuries because of the unpopularity of Spanish alcabala, development of the ability to pay principle and emergence of democratic governments and the concept of welfare. Sales tax was therefore confined to two countries, Mexico and the Philippines before the outbreak of World War I.

2.1.2 Development of Sales Tax During Present Century

Sales tax has been viewed from different angles since

World War I. It was first introduced by different countries as a temporary measure in order to solve financial problems created by World War I. Germany and France took pioneering steps in this direction. Germany levied a stamp tax upon the sale of commodities and their transfer in 1916.¹⁴ Since the yield was disappointing, the tax was converted into a more general turnover tax known as Umsatzsteuer, in 1918.¹⁵ The tax was applicable to the sales of commodities and services. This tax was accompanied by a retail sales tax on luxuries.¹⁶

France was one step ahead of Germany in this direction having already introduced a stamp tax on the sales of larger retailer in 1914.¹⁷ However, with some exceptions, she introduced general sales tax on sales of all ordinary articles and personal services in 1920. As in Germany, the tax was supported by a retail sales tax on luxuries.¹⁸

Similarly, Italy also adopted a retail sales tax in 1919¹⁹ while Czechoslovakia adopted multiple stage tax in the same year.²⁰

In order to eliminate the deficit and retire war debt, Canada introduced a turnover tax as new source of revenue in 1920 which was replaced by manufactures' tax in 1923.²¹

Sales tax movement attracted many countries in the year 1921. Belgium,²² Hungary,²³ Rumania,²⁴ USSR,²⁵ Yugoslavia²⁶ and West Virginia,²⁷ an American State, introduced sales tax in their tax structure in that year. In 1922, sales tax was introduced by three countries, namely Brazil,²⁸ Cuba²⁹ and

Luxembourg.³⁰ Austria,³¹ Bolivia,³² and Poland³³ included sales tax in their tax structure in 1923 while Equador and Turkey³⁴ introduced it in 1925 and Uruguay in 1928.

Thus, more than 20 countries adopted sales tax during the period of World War I to the beginning of the Great Depression of the Thirties. As mentioned above, the main reason for the introduction of sales tax was to solve the financial difficulties created by World War I. Sales tax movement gathered momentum in the beginning of the twenties while it became slack during late twenties. However, depression of thirties revived the trend of sales tax development. Many countries adopted sales taxes in order to meet deficit resulting from the depression. Other countries, which were already adopting sales taxes, brought changes in their sales tax system in order to raise their revenue.

Australia introduced wholesale tax to offset the decline in revenues from customs duties, resulting from depression, in 1930.³⁵ The Argentine Republic entered the sales tax field in 1931 with multiple stage tax³⁶ while China adopted commodity tax in the same year.³⁷ Netherlands³⁸ and New Zealand³⁹ also adopted sales tax in order to eliminate deficits arising out of depression condition in 1933. Norway entered the sales tax field in 1935.⁴⁰

The great depression also stimulated many American states to adopt sales taxes. During the depression, public

expenditure increased heavily but the required revenue could not be raised from existing sources. So most of the states adopted general sales taxes as emergency measures. During the period from 1933 to 1937, retail sales taxes were introduced by 29 states.⁴¹

World War II was further responsible for the development of sales tax. Though most of the countries involved in the war had already adopted sales tax, World War II further increased the importance of sales tax as an effective instrument of resource mobilisation. The war forced some of the countries to adopt sales tax and bring about changes in the sales tax system in others already having the sales tax.

United Kingdom preferred to impose purchase tax in 1940. The tax was levied mainly to raise additional revenue for war purposes and to check inflationary process.⁴² Similarly, Finland⁴³ introduced sales tax in order to bolster war revenue and Switzerland⁴⁴ adopted it to meet the sharply increased defence spending in 1941. Sweden introduced sales tax in 1940⁴⁵ while Chile entered the sales tax field in 1943.⁴⁶

2.1.3 Development of Sales Tax in Developing Countries

Thus, World War I gave rise to sales tax movement, and Depression of the Thirties and World War II accelerated its pace. The trend continued after World War II also. Since then, sales tax spread mainly over developing countries. Developing

countries adopted sales tax in order to generate revenue for financing their enormous developmental activities. Countries, already using sales tax, brought a number of reforms in their sales tax system.

Most of the developing countries started planned development since fifties. Hence, the governments were burdened with a number of responsibilities. A huge amount of revenue was required to finance developmental activities. So they looked for new sources of revenue. The experience of developed countries had already shown sales tax as highly productive source of revenue. So developing countries adopted it one after another. Besides being used for revenue purpose, sales tax is also used as a fiscal weapon for channelising resources to the desired sectors through differential tax rates. It is used to control the potential increase in consumption. Hence, sales tax became popular in developing countries particularly after World War II. For example, most of the Indian states adopted sales tax during the forties. Pakistan⁴⁷ (1948), Indonesia⁴⁸ (1950), Sri Lanka⁴⁹ (1962), Malaysia⁵⁰ (1965), Nepal⁵¹ (1965), The Republic of Korea,⁵² Thailand,⁵³ Vietnam⁵⁴ adopted sales tax one after another. Similarly, Ghana, Algeria, Tanzania, Madagascar, Uganda, Rhodesia, South Africa, Ivory Cost, Portugal, Hunduras, Nicaragua, Bolivia, Peru, Venezuela, Colombia and Guatemala adopted sales tax in different years.⁵⁵ We shall not go into the development of sales tax in all these

countries but shall concentrate on its development in India and Nepal.

2.1.3.1 Development of Sales Tax in India

In India, sales tax movement started during the thirties. The Government of India Act, 1935, gave power to the provinces to levy "taxes on the sales of goods and advertisements".⁵⁶ At first, Bombay Province introduced selective sales tax on the sales of tobacco within certain limited urban and suburban areas in 1938.⁵⁷ In the same year, Madhya Pradesh imposed sales tax on retail sales of motor fuel and lubricants.⁵⁸ However, it was Madras, which led the movement of general sales tax in India as Madras was the first state which introduced multiple stage general sales tax in the year 1939.⁵⁹ Then many other states followed Madras during the forties. The trend continued at a rapid pace till the beginning of the fifties. By that time, almost all the states had introduced sales tax in their tax structure.⁶⁰

In India, sales tax is mainly a state concern. States have full freedom to tax all internal sales and purchases within their territories. States were also imposing taxes on inter-state sales of goods prior to the enactment of the constitution in 1950. Under this system "a single inter-state transaction was taxed by more than one state imposing a heavy and unregulated burden both on the consumer and the trade."⁶¹ To remove this undesirable situation, the constitution

restricted the power of the states in levying tax on the sale or purchase of goods outside the state. Central Government was empowered to levy taxes on the sale or purchase of goods in the course of inter-state trade or commerce.

Moreover, states are also restricted in their power, to levy tax or to increase rates on articles of special importance without the permission of the Central Government.⁶² Essential Goods Act, 1952, declared a large number of goods as "essential goods". These goods were to be excluded from the purview of state's tax power. States governments criticised this Act because they felt that it unduly restricted their powers of taxation.⁶³ Later on according to the recommendation of Taxation Enquiry Commission,⁶⁴ state's tax power was restricted only in relation to commodities of special importance in inter-state commerce.⁶⁵ Furthermore, constitution also has restricted state's power from taxing sales in the course of exports out of the country.⁶⁶

Sales tax, however, is mainly the state concern. Taxes on inter-state sales are also collected by states according to the rules of Central Sales Tax Act. The revenue thus collected is accordingly appropriated by them. Each state has its own Sales Tax Act formulated according to the condition of particular state. Hence, the nature of the tax in different states may vary depending upon the Sales Tax Act of these states. Consequently, sales tax systems in different states vary widely

in their nature and structure. Some states adopted multi-stage tax while others some sort of single stage tax. In addition to this, some other states preferred to have a mixed types of sales taxes combining some features of both multi-stage and single stage taxes. Similarly, they differ widely regarding rates, exemptions, turnover limits and so on. Moreover, many states thought of suitable and effective forms of sales tax over the years and brought changes accordingly.

2.1.3.2 Development of Sales Tax in Nepal

Sales tax in Nepal was introduced first in the fiscal year 1965-66 according to the provision of "Aarthik Ain 2022" and codified in 1966 as the "Sales Tax Act, 1966". The tax was basically a general sales tax at retail level. However, in the case of non-registered vendors, it was imposed at whole-sale-import level. Moreover, in the case of sales of manufactured jute goods, tobacco products, stainless steel goods, alcoholic beverage and matches, the tax was collected at source i.e. manufacturing-import level.⁶⁷ However, retail sales tax system brought a number of problems both in respect of tax collection and tax payment. Tax Department, which was established only in 1959, was in the stage of infancy. There was a lack of experienced, trained and efficient personnel. Moreover, the department had to look after a number of taxes, such as : income tax, urban house and land tax, vehicle tax, air flight tax, entertainment tax and contract tax. There was not

even separate sales tax wing under tax department which could concentrate on the problem of sales tax. On the other hand, there was a large number of small retailers scattered all over the Himalayan Kingdom. Many of them were seasonal without even permanent place for doing business. Moreover, most of them were illiterate and so small that they could not maintain even preliminary records. There was no information about the number of dealers and their way of doing business. Problem of under billing was serious and tax evasion large. Because of these problems retail sales tax was substituted by wholesale sales tax in 1968. Now the tax was applicable to the sale by wholesalers of both domestically produced and imported goods. But in the case of direct imports by retailers and other unregistered dealers, the tax was collected at the time of importation at customs points. Wholesale tax was expected to be more effective on the presumption that the number of wholesalers would be small which could be controlled more effectively. However, the above mentioned problems remained as they were, in respect of both tax administration and tax payers. Rather, the problem of under billing and evasion became acute. Traders began to import goods through non-existing imaginary firms. So, mainly to check tax evasion and to reduce administrative problems and cost of collection, a manufacturing-import level tax system was imposed in place of wholesale tax system in 1974. Under this system, legal tax liability was placed on importer, in the case

of importation and on manufacturers, in the case of domestic production. Since then, tax has been collected at the time of collecting customs duties in the case of importation, and in the case of domestically produced goods tax has been collected on the basis of returns submitted by manufacturers. Since the country is industrially backward, it has to import most of the goods from outside world. Domestically produced goods form a small proportion of the total goods sold. Hence, more than three-fourth of total sales tax revenue is collected from importation, the sale of domestically produced goods constituting less than one fourth of the total sales tax revenue.⁶⁸

Sales tax was introduced mainly for revenue purposes both in India and Nepal. In India, it was initially imposed to cover the loss of revenue resulting from the policy of prohibition and abolition of internal customs and also to meet the increasing expenditure on economic development of the states.⁶⁹ Nepal adopted sales tax to bridge the increasing gap between revenue and expenditure. In Nepal, developmental activities, which involved heavy expenditure, were started since the mid fifties which required a huge amount of revenue. But, existing sources of revenue were not sufficient to meet even regular expenditure till 1962-63.⁷⁰ So, it became virtually necessary to turn to alternative sources of revenue which could mobilise a significant amount of internal resources. In this connection, sales tax was considered to be a highly productive source of revenue. So, the tax was introduced in 1965 in Nepal.

Sales taxes were also used as fiscal weapons which could perform some distributional functions such as cutting down the consumption of luxuries and diverting resources to desired sectors. This explains why essential goods such as food stuffs, coarse cloths etc. are exempted and luxuries are taxed with higher rates both in Nepal and India.

2.2 Relative Importance of Sales Tax

Sales tax, in its modern form, is relatively a new phenomenon in modern tax system. But it possesses a key position in the tax family of different countries. This tax is broadest in base, covers largest number of goods and services and provides a significant portion of revenue. Furthermore, it deserves special attention in a federal set up in order to provide autonomy to the states in mobilising their internal resources.

2.2.1 Relative Importance of Sales Tax in Terms of Coverage

Commodity taxes, as mentioned earlier, are considered very important especially in developing countries. Among commodity taxes, customs duties, excises and sales tax are important taxes. Most of the other commodity taxes are narrow in their bases and do not provide much revenue as their big brothers (i.e. customs duties, excises and sales tax). Though

the gross receipts business tax can have a base of a similar magnitude as the general sales tax, it is generally levied at the rate of less than one per cent and is not popular in developing countries. The use of purchase tax is also limited in some countries and in some goods. As in India, purchase tax is applicable only to few commodities such as foodgrains, gur, oilseeds, deshighee etc.⁷¹ Use taxes are limited only to imported commodities from other states while octroi duties are imposed only by local authorities. Similarly, other taxes on services are also very limited in their bases and provide relatively less revenue.

As mentioned elsewhere, customs duties are imposed upon the commodities which either leave or enter the country and excises are limited on the production of native commodities. On the other hand, sales tax covers all commodities, domestically produced as well as imported from the outside world. In an industrially less developed country customs duties have a broad base as compared to excises because the country has to import a large number of commodities including necessities of daily use. As the country proceeds further on the path of industrial development, more and more commodities are produced domestically. Hence, the base of excises increases and that of customs duties decreases relatively. On the other hand, the overall importance of sales tax remains the same since it includes both the sets of commodities, those produced domestically and those imported or exported.

The relative importance of excise duties increases with development. However, they are generally selective taxes. Though theoretically excises may be general, in practice it is difficult to make them very broad-based in scope. It is not desirable to extend excises to unorganised industrial units and agricultural sector because it not only becomes difficult but also uneconomic to administer the tax. On the other hand, sales tax is more general in nature covering a large number of commodities. "True, on administrative considerations, very small shopkeepers are also exempted from sales tax, but then the tax is collected at the earlier stage on the same products."⁷² Thus, sales tax covers largest number of commodities under tax net where a relatively lower rate can provide the required amount of revenue.

Even if we assume that both sales tax and excises cover the same number of commodities, their scope would be similar only in relation to the number of taxable commodities. But the story does not end here. Excises are collected upon manufacturer or producer on his production. While sales taxes are collected at retail stage. Hence, excises cannot cover the increase in value which takes place between the ex-factory stage and the point at which it reaches the final consumer. This portion of value-added is the result of the cost of transport and distribution as well as the profits of wholesalers and retailers, which can be covered by sales tax. Though

sometimes, sales tax can be imposed at manufacturing stage in order to collect tax most cheaply and conveniently there is always a tendency to get down to the retail level in order to take real advantages of sales tax. Thus, it would not be an exaggeration to say that sales tax has the broadest base in relation to both commodity and value.

2.2.2 Relative Importance of Sales Tax in Quantitative Terms

Though sales tax is comparatively a new element in the modern tax structure of different countries, it has been successful in providing substantial amount of revenue within a short period. The modern history of sales tax started as a temporary measure in order to provide additional revenue to solve the financial crisis created by either war or depression. Initially, the tax was opposed and condemned on the equity ground. But as the tax proved to be highly productive, the need for fiscal adequacy became stronger than the requirement of justice. Then, the tax became not only permanent but a distinguished member of tax family in different countries. Now it is considered as an important source of revenue especially in developing countries. We present below India and Nepal as typical examples.

In India, commodity taxes provided around sixty per cent of total tax revenue in 1950-51. Their contribution to total tax revenue increased to 81.35 per cent in 1980-81.⁷³ Among commodity taxes, customs was the largest source of tax

revenue during the fifties. Next to customs were central excises and sales tax, in that order. Later on, central excises took first position and sales tax not only approached customs but eventually surpassed customs duties. So, at present sales tax is only second to central excise, among commodity taxes, in terms of the revenue yield. This can be clearly seen from Table 2.1.

The relative position of sales tax remains the same even if we looked at the whole tax structure of India. Sales tax maintained its position as second largest source of tax revenue in 1980-81. Table 2.2 shows the relative strength of sales tax in the tax structure of India.

Since sales tax revenue has been increasing continuously and substantially, its contribution to total tax revenue and commodity tax revenue has been rising accordingly. Sales tax constituted 9.29 per cent of total tax revenue and 15.80 per cent of commodity tax revenue in 1950-51 while this share reached 20.47 and 25.17 per cent respectively by 1980-81.⁷⁴

The relative importance of sales tax is more prominent in the state tax structure. Sales tax revenue accounts for more revenue than all other state taxes combined. In other words, it constitutes more than 50 per cent of state's own tax revenue. It contributed more than 65 per cent of state's own commodity tax revenue and 59 per cent of state's own tax revenue in 1980-81.

Table 2.1 : Changes in Relative Importance of Commodity Taxes in India
(1950-51 - 1980-81)

Types of commodity taxes	Percentage of contribution to total commodity tax revenue						
	1950-51	1955-56	1960-61	1965-66	1970-71	1975-76	1980-81
1. Customs	42.67	34.90	18.87	25.64	14.52	16.79	21.17
2. Union excise duties	18.34	30.41	46.20	42.72	48.73	45.47	40.35
3. State excise duties	13.53	9.45	6.09	4.77	5.58	5.41	5.41
4. General sales tax	15.80	17.08	18.19	18.15	21.79	23.45	25.17
5. Taxes on vehicles	2.11	3.16	3.79	2.91	3.11	2.47	2.62
6. Taxes on goods and passengers	0.03	0.73	0.62	1.60	1.62	2.20	1.80
7. Others	7.52	4.27	6.23	4.2	4.64	4.2	3.48
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

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Source : See Appendix Table 1.

Table 2.2 : Relative Importance of Various Taxes in India
(1980-81)

Types of taxes	Revenue yield (Rs. in crores)	Percentage of total tax revenue
<u>A. Tax on income and expenditure</u>		
1. Corporation tax	1310.8	6.62
2. Taxes on income other than corporation tax	1507.4	7.62
3. Taxes on agricultural income	46.4	0.23
4. Other taxes on income and expenditure	151.6	0.77
<u>Sub-Total</u>	3016.2	15.24
<u>B. Taxes on Property and capital transactions</u>		
5. Land revenue	145.8	0.74
6. Stamps & registration fees	434.7	2.19
7. Estate duty	15.6	0.08
8. Taxes on wealth	67.4	0.34
9. Gift tax	6.5	0.03
10. Taxes on immovable property other than agricultural land	5.7	0.03
<u>Sub-Total</u>	675.7	3.41
<u>C. Taxes on commodities and services</u>		
11. Customs	3409.3	17.23
12. Union excise duties	6497.2	32.83
13. State excise duties	870.3	4.4
14. Sales tax	4052.4	20.47
15. Taxes on vehicles	421.2	2.13
16. Taxes on goods and passengers	289.7	1.46
17. Other taxes and duties on commodities and services	561.0	2.83
<u>Sub-Total</u>	16101.1	81.35
<u>Grand Total</u>	19793.0	100.0

Source : RBI Bulletins, August 1982, pp. 566-67 and
September 1982, p. 684.

Table 2.3 : Contribution of Sales Tax in Different States - 1980-81

State	Sales tax as percentage of			
	State's own tax revenue	State's tax revenue including share in central taxes	State's own commodity tax revenue	State's commodity tax revenue including share in union excise duties
1. Andhra Pradesh	48.49	32.15	54.95	38.79
2. Assam	47.87	19.19	71.85	26.99
3. Bihar	70.06	27.66	77.29	33.47
4. Gujarat	66.63	49.02	73.68	58.07
5. Haryana	45.32	35.91	50.09	41.81
6. Himachal Pradesh	39.96	24.37	43.03	28.70
7. Jammu and Kashmir	47.30	26.78	50.97	32.39
8. Karnataka	50.00	35.30	56.45	42.15
9. Kerala	60.60	41.80	68.95	50.08
10. Madhya Pradesh	51.83	29.04	56.97	34.50
11. Maharashtra	66.32	51.11	72.10	59.30
12. Manipur	52.94	13.41	61.64	17.26
13. Meghalaya	47.43	19.15	51.91	23.43
14. Nagaland	43.19	23.88	47.95	28.55
15. Orissa	58.02	26.24	65.06	31.91
16. Punjab	44.70	36.17	50.20	42.74
17. Rajasthan	63.98	36.40	71.67	43.85
18. Sikkim	19.23	16.83	20.75	19.92
19. Tamil Nadu	71.92	49.38	77.89	57.39
20. Tripura	51.58	12.46	70.76	16.20
21. Uttar Pradesh	54.38	27.47	63.40	34.04
22. West Bengal	58.27	36.35	64.46	43.31
Total	58.76	37.36	65.54	44.66

Source : See Appendix Table 3.

The relative importance of sales tax in the state tax structure varies from state to state. The contribution of sales tax to state's own tax revenue is highest in Bihar ^{Tamil Nadu} (71.92) ^{71.92} while it is lowest in Sikkim (19.23). ^{Similarly,} ~~But~~ the share of sales tax in state's own commodity tax revenue is highest in Tamil Nadu (77.89) ^{and lowest in Sikkim (20.75)}. The overall contribution of sales tax to states' own total tax revenue is 59 per cent for all the states in 1980-81. The share of sales tax is higher than the average for all states in Tamil Nadu (71.92), Bihar (70.06), Gujarat (66.63), Maharashtra (66.32), Rajasthan (63.98) and Kerala (60.60) while it is lower in rest of the states.

Even if we take into account state's share in central taxes, the role of sales tax remains significant. In 1980-81, sales tax provided 44.66 per cent of total commodity tax revenue (including share in union excise duties) and 37.36 per cent of total tax revenue (including share in income tax, estate duty and union excise duties) of all the states added together.

Relative importance of sales tax in the Nepalese tax structure is easily noted. Sales tax contributed 3.54 per cent of total tax revenue in the very first year (i.e. 1965-66) of its imposition. In that year, customs duties, land revenue, excises, income tax and sales tax were in descending order in relation to their revenue yield. However, sales tax revenue surpassed income tax revenue in the second year of its

imposition, excise revenue in third year, and in 1972-73 it also superseded land revenue.⁷⁵ Thus, sales tax is the second largest source of revenue, second to customs duties. Its relative importance among commodity taxes is shown in Table 2.4 while its relative strength in the whole tax structure is given in Table 2.5. These tables show that sales tax is important among both commodity taxes and the whole tax structure of the Himalayan Kingdom. Since sales tax revenue has been increasing rapidly, its contribution to commodity tax revenue and total tax revenue also has been increasing continuously. The contribution of sales tax revenue to commodity tax revenue and total tax revenue was 3.54 and 5.13 per cent respectively in 1965-66 while it reached 27.01 and 32.58 per cent respectively in 1981-82.⁷⁶

The ratio of sales tax revenue to national income has been increasing continuously both in India and Nepal. It was 0.60 per cent in 1950-51 which reached 3.89 per cent in 1980-81, in India. In Nepal, this ratio was found to be 1.96 per cent in 1980-81 against 0.09 per cent in 1965-66. Tables 2.6 and 2.7 show the increasing trend of the ratio of sales tax revenue to national income in India and Nepal respectively.

Increase in tax revenue may be the result of two factors. Firstly, it may be automatic growth, which is associated with the increase in national income. Besides this, tax revenue may increase because of budget proposals. In

Table 2.4 : Relative Importance of Various Commodity Taxes in Nepal (1965-66 - 1983-84)

Fiscal year	Customs duties	Sales tax	Excises	Contract tax	Hotel tax	Entertainment tax	Air flight tax	Road cess	Vehicle tax	Total
1965-66	76.74	5.13	16.46	0.30	-	1.16	0.21	-	-	100.00
1966-67	77.21	7.70	12.66	1.09	-	1.20	0.13	-	-	100.00
1967-68	71.40	14.81	11.82	0.80	0.07	0.94	0.15	-	-	100.00
1968-69	69.40	18.16	10.60	0.86	0.10	0.72	0.15	-	-	100.00
1969-70	67.25	17.75	13.25	0.61	0.18	0.78	0.18	-	-	100.00
1970-71	55.56	22.13	20.08	0.90	0.25	0.87	0.21	-	-	100.00
1971-72	58.07	20.20	18.59	0.94	0.27	0.81	0.16	0.95	-	100.00
1972-73	59.19	19.84	16.84	1.00	0.38	0.93	0.32	1.38	0.12	100.00
1973-74	59.27	20.41	16.04	1.00	0.45	1.03	0.27	1.29	0.24	100.00
1974-75	49.32	28.61	17.97	1.12	0.43	0.88	0.35	1.04	0.28	100.00
1975-76	52.36	23.64	19.28	1.38	0.51	1.02	0.40	1.10	0.30	100.00
1976-77	47.09	27.07	20.25	1.44	0.59	1.06	0.58	1.77	0.14	100.00
1977-78	48.01	28.58	17.20	1.35	1.07	1.03	0.87	1.65	0.24	100.00
1978-79	50.40	28.69	14.49	1.34	1.12	0.79	0.57	1.39	0.21	100.00
1979-80	47.61	31.42	16.85	1.45	1.10	0.74	0.68	-	0.15	100.00
1980-81	48.44	31.92	14.38	2.19	1.03	0.71	1.22	-	0.11	100.00
1981-82	45.0	32.58	16.70	2.34	1.26	0.82	1.19	-	0.13	100.00
1982-83	39.40	36.09	17.53	2.98	1.44	0.79	1.11	0.12	0.53	100.00
1983-84	38.77	36.18	16.71	2.58	1.85	0.87	1.29	1.29	0.46	100.00

Note : Figure show the percentage of total commodity tax revenue.

Source : See Appendix Table 4.

Table 2.5 : Relative Importance of Various Taxes in Nepal
(1981-82)

Types of taxes	Revenue yield (Rs. in thou- sands)	Percentage of total tax revenue
1. Customs	8,25,144	37.31
2. Sales tax	5,97,377	27.01
3. Excises	3,05,679	13.82
4. Income tax	1,89,759	8.58
5. House and land registration	88,312	3.99
6. Land revenue	81,746	3.70
7. Contract tax	42,963	1.94
8. Hotel tax	23,137	1.05
9. Air flight tax	21,867	0.99
10. Entertainment tax	15,165	0.69
11. Urban house and land tax	9,273	0.42
12. Taxes on interest	5,712	0.26
13. Vehicle tax	2,357	0.11
14. Panchayat development and land tax	2,282	0.10
15. House rent tax	472	0.02
16. Local development tax	120	0.01
Total	22,11,365	100.00

Source : See Appendix Table 4.

Table 2.6 : Sales Tax Revenue as Percentage of National Income in India (1950-51 - 1980-81)

(Rs. in crores)			
Fiscal year	National income at current prices	Sales tax revenue	Col.3 as percentage of Col.2
(1)	(2)	(3)	(4)
1950-51	9,530	58	0.60
1960-61	13,263	164	1.24
1970-71	34,476	786	2.28
1980-81	1,04,201	4,052	3.89

Source : Jha Committee Report, p.54, V.G.Rao, The Responsiveness of Tax System in India, Allied Publishers P.Ltd., India, 1979, p.42 and Reserve Bank of India, Reports on Currency and Finance, 1981-82, Vol.I, p.6.

Table 2.7 : Sales Tax Revenue as Percentage of National Income in Nepal (1965-66 - 1980-81)

(Rs. in million)			
Fiscal year	Gross domestic product at current prices	Sales tax revenue	Col.3 as percentage of Col.2
(1)	(2)	(3)	(4)
1965-66	6,909	6	0.09
1970-71	10,010	62	0.62
1975-76	17,394	162	0.93
1980-81	27,452	538	1.96

Source : Central Bureau of Statistics and Budget Speeches.

other words, tax revenue may also increase because of discretionary changes (i.e. changes in rates, bases, imposition of new taxes and improvement in tax administration). The automatic growth is measured by income elasticity while discretionary change along with automatic change is measured by buoyancy. The elasticity coefficient, shows the average percentage change in tax revenue that has accompanied a one per cent change in national income after effect of discretionary changes is taken out. When this coefficient is one or more than one, it means that the tax revenue grows automatically in proportion to or in greater proportion than the growth of national income. Such an automatic growth may be regarded as desirable. When we take into account discretionary effects as well, the coefficient becomes buoyancy coefficient which measures total responsiveness of the tax system or a particular tax. Now it is obvious that divergence between buoyancy and elasticity coefficients is the indication of responsiveness to additional tax efforts put in by a government in order to raise tax revenue.

Sales tax is found to be most elastic and buoyant, both in India and Nepal. The results of some of the studies for India are given in Table 2.8 and for Nepal in Table 2.9. Sales tax is found to be satisfactorily responsive in most of the Indian states.⁷⁷

A lot of discretionary changes were brought in the

Table 2.8 : Elasticity and Buoyancy Estimates of Taxes in India

Description	Total tax		Direct tax		Indirect tax		Selected indirect taxes					
							Sales tax		Customs duties		Union Excise duties	
	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy
Lakdawala & Nambiar (1960-61 - 1969-70)	.63	1.19	.53	.77	.68	1.33	1.16	1.55	-	-	.61	1.32
V.G.Rao (1960-61 - 1973-74)	.83	1.23	.64	.91	.90	1.35	1.46	1.61	.52	1.11	.80	1.37
Jha Committee (1963-64 - 1974-75)	-	-	-	-	-	-	1.15	1.43	.54	.86	.75	1.31

Sources : D.T.Lakdawala and K.V. Nambiar, Commodity Taxation in India, Sardar Patel Institute of Economics and Social Research, Ahmedabad, India, 1972, p.29, V.G.Rao, op.cit., pp. 76-96 and Jha Committee Report, pp. 390-452.

Table 2.9 : Elasticity and Buoyancy Estimates of Taxes in Nepal

Description	Sales tax		Customs duties		Excise duties	
	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy
Govind Ram Agrawal (1967-68 - 1975-76)	1.74	2.20	0.86	1.18	1.28	2.24
Bhavani Dhungana (1964-65 - 1977-78)	2.17	3.09	0.55	1.37	0.88	2.17

Source : Govind Ram Agrawal, Resource Mobilisation in Nepal, Centre for Economic Development and Administration, Nepal, 1980, p.89 and Bhavani Dhungana, Indirect Taxation in Nepal, Centre for Economic Development and Administration, Nepal, 1980, pp. 78-98.

field of sales tax over the years, both in India and Nepal. They are briefly mentioned below.

In the beginning, tax rates were very low in both the countries. For example, in Uttar Pradesh, in India, the minimum and maximum rates were 0.25 per cent and 7 per cent respectively in 1960-61 while in 1972-73 they reached one per cent and 12 per cent, respectively.⁷⁸ Similarly, rates were stepped up by different states in different times. Originally, maximum rates were fixed at one per cent for both

goods of special importance in inter-state trade and goods involved in inter-state trade. However, they reached 4 per cent by 1975.⁷⁹ In the case of Nepal, minimum rates were fixed at 5 per cent and maximum at 20 per cent by 1983-84 from the original flat rate of two per cent.⁸⁰

Besides tax rates, tax bases also have been increasing in both the countries. Size of the tax base is related to its coverage viz. number of commodities covered, volume of production and consumption and the prices of related commodities. In India, as noted elsewhere, since the power of states is restricted only in relation to commodities of special importance in inter-state commerce, many states shifted several goods from exempted list to the list of taxable goods. For example, Uttar Pradesh Government brought foodgrains, cereals, gur, matches etc. under the tax net.⁸¹ More than 75 per cent of sales tax revenue comes from imports in Nepal⁸² where number of imported goods and the volume of imports⁸³ have been increasing substantially in recent years, which helped widening the sales tax base.

Moreover, in both the countries, volume of production, real transaction or consumption also have been increasing because of industrialisation, urbanisation, economic development and increase in population. Similarly, both the countries are no exception to worldwide inflationary trend. Since sales tax rates are ad valorem, increases in price automatically

increases tax base. Thus, all these factors are responsible for the increase in tax base over the years.

In addition to tax rates and bases, administrative efficiencies also may be responsible for increase in sales tax revenues. As sales tax administrations are becoming mature, we can presume some positive correlation between administrative maturity and efficiency.

Because of all the above factors, sales tax revenues have been increasing continuously and enormously resulting in rapid increase in relative importance of sales tax among the tax family. The tax is equally important for all other developing countries mainly for mobilising resources required for their enormous developmental activities.

Thus, "Roundly condemned as regressive and ruinous burdens on the poor and on honest sellers of merchandise, they have been, on a few unfortunate occasions, been factors in bitter rebellions against governments. From this unlikely background, they have now grown to respectable and influential old age."⁸⁴ Furthermore, "... a tax which essentially crept in by the back door in periods of crisis, and was apologetically justified by governments as a temporary measure has gained a high degree of respectability."⁸⁵

Footnotes

1. NICB, op.cit., p. 163 and also C.V.Oster, op.cit., p.8.
2. E.R.A. Seligman, Studies in Public Finance, The MacMillan Company, New York, 1925, pp. 124-25, NICB, op.cit., p. 164 and C.V.Oster, op.cit., p.8.
3. E.R.A. Seligman, Studies in Public Finance, op.cit., p.125.
4. NICB, op.cit., p. 164.
5. Ibid., p. 164.
6. E.R.A. Seligman, Studies in Public Finance, op.cit., p. 126.
7. Ibid., p. 126.
8. Ibid., p. 126.
9. C.V. Oster, op.cit., p. 9.
10. NICB, op.cit., p. 165.
11. Adam Smith, The Wealth of Nations, Random House Inc., New York, 1937, pp. 850-51.
12. E.R.A. Seligman, Studies in Public Finance, op. cit., p. 127.
13. John F. Due, Sales Taxation, op.cit., p. 51.
14. Alfred G. Buehler, Recent Development of the General Sales Tax, op.cit., p. 83.
15. John F. Due, Sales Taxation, op.cit., p. 52.
16. Ibid., p. 52.
17. C.V. Oster, op.cit., p. 10.
18. Alfred G. Buehler, Recent Development of the General Sales Tax, op.cit., p. 84.

19. John F. Due, Sales Taxation, op.cit., p. 100.
20. Ibid., p. 346.
21. Ibid., pp. 147-48.
22. NICB, op.cit., p. 175.
23. Ibid., p. 181.
24. John F. Due, Sales Taxation, op.cit., p. 347.
25. NICB, op.cit., pp. 183-84.
26. John F. Due, Sales Taxation, op.cit., p. 347.
27. C. V. Oster, op.cit., p. 23.
28. NICB, op.cit., p. 185.
29. John F. Due, The Evolution of Sales Taxation, 1915-1972, op.cit., p. 336.
30. John F. Due, Sales Taxation, op.cit., p. 81.
31. Ibid., p. 74.
32. NICB, op.cit., p. 185.
33. Ibid., p. 182.
34. Ibid., p. 183.
35. John F. Due, Sales Taxation, op.cit., pp. 184-85.
36. Ibid., pp. 341-42.
37. P. D. Ojha and G.E. Lent, Sales Taxes in Countries of the Far East, IMF Staff Papers, November 1969, p. 534.
38. John F. Due, Sales Taxation, op.cit., pp. 83-84.
39. Ibid., pp. 195-200.
40. Ibid., pp. 261-62.
41. Ibid., p. 292.
42. Ibid., pp. 202-5.

43. Ibid., pp. 166-67.
44. Ibid., p. 174.
45. John F. Due, The Evolution of Sales Taxation, 1915-1972, op.cit., p. 328.
46. John F. Due, Sales Taxation, p. 343.
47. P.D. Ojha and G.E. Lent, op.cit., p. 538.
48. John F. Due, Sales Taxation, op.cit., p. 339.
49. P.D. Ojha and G.E. Lent, op.cit., pp. 541-42.
50. Ibid., p. 544.
51. Aarthik Ain, 2022.
52. U.N. Department of Economic and Social Affairs, op.cit., p. 13.
53. John F. Due, The Evolution of Sales Taxation, 1915-1972, op.cit., p. 338.
54. P.+D. Ojha and G. E. Lent, op.cit., p. 541.
55. John F. Due, The Evolution of Sales Taxation, 1915-1972, op.cit., pp. 337-38 and also U.N. Department of Economic and Social Affairs, op.cit., pp. 5-19.
56. Jha Committee Report, p. 59.
57. Walter R. Mahler, op.cit., p. 149.
58. Harvard Law School, World Tax Series, Taxation in India, N.M.Tripathi Private Limited, Bombay, 1960, p. 434.
59. Ibid., p. 434.
60. Jha Committee Report, p. 59.
61. Ibid., p. 59.
62. Uttar Pradesh Taxation Enquiry Committee Report, 1974, Finance Department, Uttar Pradesh, p. 211.
63. Jha Committee Report, p. 63.

64. Hereinafter referred to as TEC.
65. Uttar Pradesh Taxation Enquiry Committee Report, op.cit., p. 211.
66. Jha Committee Report, p. 65.
67. Aarthik Ain, 2023.
68. See Appendix Table 7.
69. P.D. Ojha and G.E. Lent, op.cit., pp. 544-45 and also Uttar Pradesh Taxation Enquiry Committee Report, 1974, op.cit., p. 205.
70. See Appendix Table 9.
71. Uttar Pradesh Taxation Enquiry Committee Report 1974, op.cit., p. 206.
72. Jha Committee Report, p. 210.
73. See Appendix Table 1.
74. See Appendix Table 2.
75. See Appendix Table 4.
76. See Appendix Table 6.
77. See Appendix Table 11.
78. Uttar Pradesh Taxation Enquiry Committee Report 1974, op.cit., pp. 239-40.
79. Jha Committee Report, pp. 64-65.
80. See Appendix Table 8.
81. Uttar Pradesh Taxation Enquiry Committee Report 1974, op.cit., p. 211.
82. See Appendix Table 7.
83. See Appendix Table 10.
84. Earl R. Ralph and George F. Break, Public Finance, op.cit., p. 272.
85. John F. Due, Sales Taxation, op.cit., p. 2.

CHAPTER III

SHIFTING AND INCIDENCE OF SALES TAX

Shifting and incidence has attracted the attention of economists, fiscal authorities as well as political leaders and common people. Detailed analysis of shifting and incidence is required in order to make a tax system equitable and justifiable and to achieve the desired objective of a particular tax. "Without a correct analysis of the incidence of a tax, no proper opinion can be formed as to its actual effect or its justice."¹ While levying a tax, the government does not simply collect revenue but aims at collecting tax from those sections of people who can best bear the tax. And it is not possible for the government to attain this objective without a proper understanding of shifting and incidence since a tax can create many economic distortions.

Considering the importance of shifting and incidence, this chapter seeks first to define these terms briefly. Then an attempt will be made to analyse the shifting and incidence of sales tax. Here we shall try to present a brief sketch of the development in the theory of sales tax incidence. Finally, an attempt will be made to review a few empirical studies in this field conducted in India.

3.1 Definition of Impact, Shifting and Incidence

Impact is initial burden of tax borne by the legal tax payer. Shifting is a process of transfer of the tax which may be forward, from sellers to buyers, or backward from buyers to sellers or partly forward from producers to consumers and partly backward from producers to factor owners. Incidence is the point where tax burden settles finally. So it is the ultimate burden of the tax. Here an example is in order. Suppose a retail sales tax is levied. Initially, retailers pay tax. So they bear the impact. But they collect tax from consumers by means of increased prices. This process of passing tax from retailers to consumers is shifting. Consumers are the ultimate payers of tax. So they bear the incidence. Sometimes, impact and incidence may coincide. "In such cases, there is no shifting; bearer and payer are identical."²

Ursula Hicks³ classifies incidence into two categories: formal and effective incidence. Formal incidence is the proportion of people's incomes paid to government for financing collective satisfactions while effective incidence is the economic consequences resulting from the imposition of a tax which is nothing more than the difference between pre and post economic set up (distribution of consumers' wants and incomes and allocation of factors).

This is a simple way of defining incidence and

economists do agree with this general definition. But they have not been able to reach the same conclusion regarding the operational definition of incidence. Because it is not easy to answer the question: Who actually pays any particular tax? This has been a controversial issue in recent years. We do not intend to go over this controversy. We shall limit ourselves to a review of analysis of sales tax incidence found in the literature. Against the background of this review we shall turn to some empirical studies relating to sales tax incidence conducted in India.

3.2 Shifting and Incidence of Sales Tax

3.2.1 Review of Theoretical Studies of Sales Tax Incidence

According to the traditional version, sales tax is shifted, if not completely, at least to a large extent to the consumer. Sales tax tends to be shifted to the consumers in the form of higher prices. So the burden of tax is borne in relation to consumer spending. This version assumes a situation of perfect competition. In this situation, an imposition of tax leads to an increase in cost. But sellers cannot adjust price immediately in relation to cost, as they are simply price takers. But, they can adjust supply. They will reduce supply. Some weak firms will leave the taxed industry. As a result,

price will increase. Reduction in supply will take place until new equilibrium is obtained where normal profits are earned. Thus readjustment takes place through reduction in output. In the new situation, "The amount produced and consumed is less and the price is higher than before the tax was imposed."⁴

Moreover, retailers do state sales tax separately from the price of the commodity which undoubtedly facilitates shifting.⁵ "In addition, many legislatures place the legal incidence of the tax on the consumer and impose fines on any retailer who advertises that he absorbs the tax burden himself."⁶ However, "it may be clear that the wording of the law cannot itself control the economic effects of the tax, nor does a separate listing of the tax imply that the sales price is higher than it otherwise would have been by that amount."⁷

Furthermore, the traditional theory has been severely criticised since thirties mainly on the ground that it assumes a situation of competitive pricing throughout the taxed industry; but this situation is hardly realistic to assume. Moreover, this theory does not take into account the effects on the rest of the economic system of the shift of resources out of the taxed industries.⁸

Actually, the traditional theory oversimplifies the analysis just by saying that sales taxes are shifted forward to a great extent, through increased prices. But

the matter is not so simple. Shifting and incidence of sales tax depend upon a number of factors and hence, the above generalisation cannot be blindly accepted. So a number of questions are raised about the validity of traditional theory.

H. G. Brown⁹ challenged the traditional version in 1939. Earl R. Rolph¹⁰ accepted Brown's conclusions and extended them to excise taxes in 1952. They assumed a situation of perfectly competitive factor as well as commodity markets, perfectly inelastic factor supply and given public expenditure. In such situation an imposition of general and uniform sales tax raises the cost of production by the amount of tax. But given the total money demand for commodities, prices of output will not rise. Now there will be a reduction in money earnings of each firm. So each firm reduces output. It further reduces factor demand which results in reduction in factor prices. Reduction in factor prices will continue until the entire amount of the tax is absorbed in factor price reductions where full employment will be reattained. The conclusion is that sales tax leaves the composition of output and product prices unchanged and reduces the money incomes of resource owners proportionately as does proportional income tax. Thus, tax burden rests not upon consumers but upon the factor owners in proportion to their incomes.

However, Brown-Rolph analysis is based on

unrealistic assumptions. In real world, there is neither perfect competition nor perfectly inelastic supply of resources. But the assumption of perfect competition is not crucial to Rolph. He finds almost similar results even in imperfect competition, as with the case of perfectly competitive market. As he says, "The pattern of results is virtually indistinguishable from that found for perfect competition. The same possible shifting through interrelations of the demands for products may occur under conditions of monopolistic pricing."¹¹

Their assumption of given public expenditure is also not satisfactory. Why should a government hold the proceeds of tax idle? Holding the proceeds idle as treasury cash is merely a rare possibility. Other possible uses of tax proceeds, are debt redemption, deposits with the central banks and government spending. "Sales taxes are usually enacted to finance increases in expenditures or to avoid curtailment of governmental budgets."¹² Hence, the likely result is not as analysed by Brown and Rolph. It is "merely one in a wide range of possible cases".¹³ If we relax any one assumption, their analysis does not hold true. For example, if we recognise some elasticity in the factor supplies, "it is obvious that burden will no longer rest in proportion to factor incomes and commodity price adjustment will occur."¹⁴ In a typical commodity market, which is not perfectly competitive, firms make

immediate price adjustments when sales tax is imposed. Moreover, it is common practice among sellers to quote price and then to add the tax in order to obtain final sales price which undoubtedly facilitates forward shifting of the tax.

John F. Due condemns existing writings mainly on the ground that they neglect the significance of public expenditure and use partial equilibrium theory to explain essentially general equilibrium phenomena in the theory of sales tax incidence.¹⁵ He thinks that existing theory could not explain the effects of the tax upon aggregate demand and subsequent adjustments in employment and factor prices.¹⁶ His outlook is broad regarding incidence of sales tax. The following is an attempt to summarise his ideas briefly.

In the case of perfect competition, as stated earlier, imposition of sales tax increases cost of production and adjustment takes place through reduction in production. But public expenditure may counter reduction in output. If government revenue is spent sufficiently upon the particular product, its demand will increase which will offset the effects of the higher cost and allow the sale of the original volume of output at higher prices. If the demand of a particular product is affected slightly or not at all, then its output is bound to reduce and some resources will be displaced. These displaced resources "are utilised in part in the production of the goods for which

the demand increases significantly as a result of the government expenditures, and in part by the government itself in rendering services."¹⁷ Hence, aggregate real factor demand is unaffected. Reduction in factor demand because of the tax is exactly offset by increase in factor purchasing resulting from governmental expenditure out of the tax revenue. So there is no question of reduction in factor prices after the imposition of a tax. But if the factors can be used only in particular industry whose output falls after tax and if public expenditure creates no demand for them - such factors will bear a portion of the tax burden after reduction in their prices. However, it is not a general case. In a general case, prices will rise by roughly the amount of the tax and tax burden is likely to be distributed in proportion to expenditure on taxable goods.

Monopoly case deviates from the above analysis mainly on the ground that on the one hand a monopolist can increase price immediately as soon as tax is imposed and on the other hand he can bear a portion of tax even over a long run period out of his monopoly profit.

In the case of monopolistic competition and oligopoly, price increases immediately after the imposition of tax because tax increases the cost of each firm where, "each seller is likely to suspect that other firms, known to be affected in like manner, will raise prices provided

this firm does so."¹⁸ Thus, in the case of imperfect competition "... the firms can and will directly raise prices as soon as the tax is levied. This will result in some unemployment of the factors of production. But the factors that are thus thrown out of private industries may be absorbed in public sector when the tax revenue is spent. Thus, the final result is the same under imperfect competition as under perfect competition except that part of the tax may be absorbed in excess profits."¹⁹

Thus, according to John F. Due sales taxes are generally shifted forward and tax burden is likely to be distributed in proportion to the expenditure on taxable goods. The general belief is also similar to this conclusion. Main stream of thought still believes that by and large sales tax is shifted forward to the consumer. However, it becomes not only difficult but quite impossible, at least in a developing country, to measure sales tax incidence according to Due's line of thinking. It is not possible to measure the benefits derived from public expenditure in developing countries because of lack of information. So most of the empirical studies make crude assumption that full amount of sales tax is shifted forward to consumers. They also neglect the benefits derived from public expenditures in their analysis. Thus, empirical studies resemble traditional theory of sales tax incidence.

For example, all studies, conducted in this field in India are based on such assumptions.

3.2.2 Review of Empirical Studies of Sales Tax Incidence

A number of attempts have been made in India in order to estimate the incidence of taxation. The first systematic and comprehensive study of incidence of indirect taxation in India was made by Taxation Enquiry Commission, 1953-54 (TEC).²⁰ This study was based on the fourth round National Sample Survey (NSS) data which were collected for the period April-September 1952. They were assumed to hold good for 1953-54 and the analysis was made for the same year.

The study was based upon the assumption that indirect taxes are passed on entirely to the consumer. The analysis was confined only to the formal incidence. Secondly, the benefits of public expenditure were not taken into consideration. The burden of indirect taxes was estimated in terms of percentages of expenditure in different monthly household expenditure (rural-urban) groups. Ministry of Finance (Government of India) carried out two similar type of studies²¹ for the years 1958-59 and 1963-64. As earlier study, these studies were also based on NSS data collected in 13th and 18th rounds, respectively and their approaches were similar to the previous study.

Main findings of these studies are given in

Table 3.1. All these studies take account of the tax as per cent of consumer expenditure. In 1953-54, in average, indirect tax constituted 3.6 per cent of the total consumer expenditure. This share of indirect tax to the total consumer expenditure reached 5.7 per cent and 10.1 per cent in 1958-59 and 1963-64, respectively. Thus, there was an increase in the tax element in the consumer expenditure. It was true of both rural and urban households. This increase in incidence is mainly due to the increase in coverage and rates of tax. For example, excise duties were extended to new commodities and foodgrains were also brought under the purview of sales tax in some states, over the years. Similarly rates were stepped up many times.

Another reason for the increase in the incidence of indirect taxation may be the increase in the proportion of cash expenditure to total expenditure. The distribution of burden of indirect taxes depends upon consumption pattern. Total consumption expenditure include cash expenditure as well as noncash expenditure. Non-cash expenditure is nothing more than the value of home-produce consumed by households which escapes all indirect taxes. Thus, only cash expenditure attracts tax. There has been a decline in non-cash expenditure over the years. For example, in 1953-54, the share of home-product consumed by households was 37 per cent of consumer expenditure while it came down to 32 per cent

Table 3.1 : Tax as Per Cent of Consumer Expenditure

Monthly household expenditure groups (Rs.)	1953-54			1958-59			1963-64		
	Rural	Urban	All India	Rural	Urban	All India	Rural	Urban	All India
0 - 50	2.2	3.6	2.4	2.5	5.8	3.1	5.8	11.1	6.5
51 - 100	2.4	4.5	2.7	3.6	7.1	4.3	6.1	11.6	7.0
101 - 150	2.6	5.1	3.1	4.1	8.0	5.1	6.8	12.6	8.0
151 - 300	2.8	5.1	3.3	4.8	9.0	5.9	8.8	14.0	10.1
301 and above	4.1	8.2	5.5	6.9	13.8	9.3	11.9	24.6	16.6
All households	2.9	5.9	3.6	4.4	9.3	5.7	8.0	16.6	10.1

Source : Government of India, Incidence of Indirect Taxation, 1963-64, op.cit., p. 9.

in 1958-59.²² Thus, this reduction in non-monetized consumption led to increase in the incidence of indirect taxation.

The tax incidence on the urban households is more than double than that on the rural households. The reasons for this might be the high percentage of cash expenditure in the total expenditure in urban sector because of monetised nature of the urban economy.

Table 3.1 also shows the progressive nature of indirect taxation which continued to remain progressive over the years. In 1953-54, the highest expenditure group was paying little more than two times the proportion paid by the lowest group. This progression was further increased in 1958-59. However, 1963-64 figures are more progressive in comparison of 1953-54 figure while less progressive as compared to 1958-59 figure.

The reasons for progressivity in indirect taxation may be that in the case of lower consumption expenditure group, the proportion of non-cash expenditure is higher and most of the expenditure is made on foods and other necessities which are generally exempted or lightly taxed. As consumer moves up the expenditure scale the share of cash expenditure increases and most expenditure is made on manufactured, luxury items which are generally taxed highly. These both factors increase the element of tax in higher expenditure groups.

Though the structure of indirect taxes is progressive with reference to expenditure, one should not forget that indirect taxes fall even on the poorest sections of society. Table 3.1 shows that the lowest income group had to pay 2.4 per cent, 3.1 per cent and 6.5 per cent of their total monthly expenditure as indirect taxes in 1953-54, 1958-59 and 1963-64, respectively. Had it been the case of income tax, the lowest income class would have been exempted from the tax.

Incidence of sales tax does not deviate from the abovementioned general trend of the incidence of indirect taxation. Tables 3.2 and 3.3 show the incidence of sales tax in 1953-54 and 1963-64 respectively.

As in the case of indirect taxes as a whole, there is marked disparity between the sales tax incidence on the urban and the rural sectors. This disparity exists throughout the entire range of expenditure groups. Table 3.2 shows more proportional nature of sales tax while Table 3.3 shows progressivity in the sales tax system. The proportion of sales tax to total expenditure had gone up in the case of higher income groups over the years. Sales tax burden had increased around three times within a decade i.e., between 1953-54 and 1963-64. The reasons for inter-regional disparity, progressivity, and increase in sales tax burden were, as discussed above, difference in consumption pattern between rural and urban households and also higher and lower expenditure groups, increase in coverage and rates of sales tax.

Table 3.2 : Incidence of Sales Tax (1953-54) (Tax as percentage of total expenditure)

Monthly household expenditure groups(Rs.)	Rural	Urban	Rural and urban combined
1 - 50	0.3	0.9	0.4
51 - 100	0.4	1.0	0.5
101 - 150	0.4	1.1	0.5
151 - 300	0.5	1.1	0.6
Above 300	0.5	1.3	0.7
All expenditure groups combined	0.4	1.1	0.6

Source : Government of India, Report of TEC, op.cit., p. 72.

Table 3.3 : Incidence of Sales Tax (1963-64) (Tax as percentage of total expenditure)

Monthly household expenditure groups(Rs.)	Rural	Urban	Rural and urban combined
1 - 50	0.94	2.49	1.16
51 - 100	0.99	2.78	1.28
101 - 150	1.07	2.90	1.45
151 - 300	1.25	3.07	1.72
301 - 500	1.51	3.24	2.08
501 & above	2.59	7.02	4.39
All households	1.24	3.67	1.88

Source : Government of India, Incidence of Indirect Taxation, 1963-64, op.cit., p. 33.

Another attempt was made by the Jha Committee.²³

The Committee attempted to measure the incidence of indirect taxation for the year 1973-74. The study was based on 28th round NSS data. The line of approach of this study was also similar to the earlier studies. But it had made some improvements over the previous studies. "... earlier studies used NSS data on the consumption expenditure according to household expenditure groups In the present study, households have been divided into monthly per capita expenditure groups because relative economic positions of different households are more accurately reflected by per capita expenditure levels."²⁴

Moreover, the earlier studies allocated entire taxes on machinery items to the consumers in the year in which they were collected. This study also assumed that taxes on items other than consumption goods and services are passed on ultimately to the consumer. But taxes on machinery items are not assumed to be shifted immediately. Such taxes raise the cost of purchase of machinery resulting in higher depreciation charges from year to year. This will raise prices to consumers who bear the taxes from year to year. So, in this study the average life of plant and machinery was taken to be 10 years and, accordingly one tenth of the taxes collected on machinery items in 1973-74 was assumed to be passed on to the consumer during that year.

Furthermore, this study had gone one step further regarding the treatment of purchases of taxable goods by government or public sector units. Public sector units can purchase taxable goods and if their services are not given free, they may pass taxes through higher prices to the public. Hence, departmental and non-departmental commercial undertakings in the public sector were excluded from the definition of government sector for this purpose and the indirect taxes paid by them were treated on par with those paid by private sector enterprises.

This study had also attempt^{ed} for the first time in India to measure the incidence of tax on major types of goods separately such as consumption goods, intermediate goods and capital goods.

Some of the findings of this study are given in Table 3.4. These results are not strictly comparable with those of the earlier studies because of the abovementioned differences between this study and the earlier ones. However, overall results, as to progressivity and to the difference in the tax burden between rural and urban consumers, were similar to those found in earlier studies.

Indirect tax burden as a proportion of expenditure kept on increasing with higher per capita expenditure groups. The difference in the tax burden between the highest and lowest per capita expenditure groups was more than 7 times.

Table 3.4 : Indirect Taxes as Percent of Total Expenditure and Total Cash Expenditure by Per Capita Expenditure Groups (1973-74)

Monthly per capita expenditure group (Rs.)	(Percentages)					
	Rural		Urban		All India	
	Tax as per-cent of total ex-penditure	Tax as per-cent of cash ex-penditure	Tax as per-cent of total ex-penditure	Tax as per-cent of cash ex-penditure	Tax as per-cent of total ex-penditure	Tax as per-cent of cash ex-penditure
0 - 15	2.91	4.55	3.63	4.44	2.96	4.56
15 - 28	3.33	5.25	6.31	6.79	3.63	5.46
28 - 43	4.45	7.27	7.36	7.93	4.89	7.41
43 - 55	6.18	10.32	9.66	10.31	6.85	10.31
55 - 75	6.71	11.40	11.86	12.70	7.92	11.82
75 - 100	10.02	16.43	14.80	15.85	11.40	16.21
100 & above	16.17	22.46	30.19	31.35	21.96	26.77
All house-holds	8.03	12.87	17.96	19.03	10.54	14.96

∞

Source : Jha Committee Report, p. 90.

This progressivity exists among rural and urban households taken separately. The reasons for this, as stated earlier, were the difference in consumption pattern between lower and higher per capita expenditure groups and between rural and urban households.

Above analysis does apply to sales tax incidence which is shown in Table 3.5.

Table 3.5 : Sales Tax as Per Cent of Consumer Expenditure by Per Capita Tax Expenditure Groups (1973-74)

Monthly per capita expenditure groups	Rural	Urban	Rural and urban combined
0 - 15	0.67	0.30	0.65
15 - 28	0.85	1.63	0.93
28 - 43	1.02	1.86	1.16
43 - 55	1.23	2.35	1.44
55 - 75	1.31	2.69	1.63
75 - 100	1.77	3.01	2.13
100 & above	2.60	4.51	3.39
All households	1.49	3.23	1.93

Source : Jha Committee Report, pp. 92-94.

National Council of Applied Economic Research (NCAER) had also made attempts to analyse the incidence of

taxation in Gujarat²⁵ and Mysore²⁶ States. Like earlier studies, these studies were also confined to the formal incidence and the benefits derived from public expenditures were not taken into consideration. Both studies were based on sample surveys. However, sample survey made for Gujarat was confined only to the urban sector while the survey conducted for Mysore was extended to rural areas. Former study relates to the year 1967-68 while the latter to the year 1968-69.

In the case of Gujarat, the selection of households for the survey was made through a three-stage stratified random sample design with towns as primary sample units, blocks in the towns as second stage units and households in the blocks as the final stage units. Number of selected towns, blocks and households were 5, 50 and 1000 respectively.

Similarly, in the case of Mysore, the households in the urban sector were selected through a three-stage stratified sample design as towns, blocks and households as primary, second and third stage units, respectively. The number of selected towns, blocks and households were 9, 24 and 480 respectively. In the case of rural sector two stage stratified sample design was used for the selection of households. Villages were considered as primary sample units and 16 villages were selected for the study.

Households within the selected villages were considered as second stage units and the number of households selected for the purpose of study was 320. Then, information was collected regarding family budget and incomes of households. They estimated the distribution of tax burden on households by income groups. Thus, tax incidence was estimated as proportion of households' income.

The main findings of the study conducted in Gujarat show that taxation system as a whole is progressive. As shown in Table 3.6, households in the lowest income group pay 8 per cent as taxes in contrast of the households in the highest income group who pay 22 per cent as taxes. Central income tax was pointed out as the main reason for progressivity of the tax system. The combined incidence of all other taxes was regressive.

In Mysore, as shown in Table 3.7, the average incidence of all taxes on households in the urban sector was 11.4 per cent against 6.7 per cent in the rural sector. Thus, like earlier studies, this study also shows inter-sectoral disparity of tax incidence which exists at all levels of income.

As in Gujarat, the tax system as a whole is progressive in the urban sector but regressive in the rural sector. The tax constituted 10 per cent of the lowest income group in contrast to 24 per cent of the highest income

Table 3.6 : Taxes as Percentage of Household Income

Taxes	Annual household income group (Rs.)						
	Upto 1,200	1,201- 2,400	2,401- 4,800	4,801- 12,000	12,001- 24,000	Above 24,000	All groups
Income tax ^a	-	-	0.002	2.25	7.26	17.1	2.84
Income tax (excluding agri- cultural households)	-	-	0.002	2.56	9.05	18.36	3.16
Union excise	6.13	4.37	3.89	3.31	3.97	3.66	3.85
Sales tax (including sales tax on motor spirit)	1.50	1.08	1.18	1.17	1.09	0.93	1.15
Motor vehicles tax	-	-	0.004	0.03	0.10	0.15	0.03
Tax on passengers (carried by road)	0.08	0.05	0.06	0.07	0.07	0.03	0.06
Entertainment tax	0.11	0.16	0.26	0.23	0.15	0.07	0.20
Electricity duty	0.11	0.10	0.13	0.15	0.15	0.15	0.13
Education cess	0.14	0.09	0.10	0.11	0.05	0.06	0.09
All taxes	8.07	5.85	5.63	7.32	13.04	22.06	8.35

a = This ratio of income tax to household income should be distributed from the proportion of income tax collected to income assessed. Household income includes non-taxable income of members of the family and also incomes which fall below the exemption limit.

Source : NCAER, Incidence of Taxation in Gujarat, op.cit., p. 83.

Table 3.7 : Taxes as Percentage of Household Income

Annual household income groups (Rs.)	Rural	Urban
Upto 1,200	9.02	10.07
1,201 - 2,400	6.54	8.99
2,401 - 4,800	6.56	8.85
4,801 - 9,000	7.00	9.33
9,001 - 18,000	7.09	10.32
18,001 - 36,000	5.69 (over 18,001)	14.13
Over 36,000	-	24.08
All groups	6.72	11.38

Source : NCAER, Incidence of Taxation in Mysore State, op.cit., pp. 52-53.

group, in urban sector while the case of rural sector was different where tax income ratio for the lowest and the highest income groups was 9 per cent and 5.7 per cent, respectively. The reasons found for such regressivity in the tax system in the rural area was the absence of progressive income tax like the one levied on urban income.

So far as the question of the incidence of sales tax is concerned, it was regressive in Gujarat. As Table 3.6 shows the incidence declined from 1.50 per cent in the

lowest income group to 0.93 per cent in the highest. However, the regressiveness was not continuous throughout the income range; rather there were fluctuations in the middle income groups. Similar trends were found in Mysore in the case of the rural sector where sales tax incidence came down from 1.37 per cent in the lowest income group to 1.05 per cent in the highest and there were some fluctuations in the middle groups. It is shown in Table 3.8. This table also shows the progressivity at the highest income level in the case of the urban sector. In the urban sector, incidence of sales

Table 3.8 : Incidence of Sales Tax (Including sales tax on motor spirit) (Tax as percent of income)

Annual household income groups (Rs.)	Rural	Urban
Upto 1,200	1.37	2.71
1,201 - 2,400	1.25	2.52
2,401 - 4,800	1.33	2.47
4,801 - 9,000	1.62	2.43
9,001 - 18,000	1.56	2.18
18,001 - 36,000	1.05 (over 18,001)	2.72
Over 36,000	-	3.11
All Groups	1.38	2.50

Source : NCAER, Incidence of Sales Taxation in Mysore State, op.cit., p. 20.

tax stepped up from 2.71 per cent in the lowest income group to 3.11 in the highest. However, fluctuations did exist in the middle income groups. The probable reason for this progression of the sales tax incidence at the highest income level was pointed out to be the higher per cent of expenditure, of this group, on the consumer durables, taxed heavily.

All above studies suffer from many limitations. They assume that full amount of the indirect tax is shifted to the final consumers. This is an arbitrary assumption. Because sometimes only a portion of tax is shifted while sometimes the amount passed on may exceed the tax, depending upon market conditions, nature of the tax and so on, as discussed above during the course of our discussion. Moreover, shifting of a tax depends upon the elasticity of demand and supply of a taxed item. Forward shifting is easier only when supply of taxed commodity is elastic and its demand is inelastic. But it is difficult to pass on tax burden forward to the consumer when supply is inelastic and demand is elastic.

All these studies neglect the benefit derived from public expenditure. They neglect the role of subsidies which help consumer to get things cheaper. Hence, the analysis is bound to overstate the burden of indirect taxation. This overstatement is likely to be prominent

particularly in the case of lower income/expenditure groups who generally are the beneficiaries of negative taxation (i.e. subsidies) in greater degrees.

However, these assumptions are necessary in order to facilitate the empirical studies. Otherwise, it becomes not only difficult but quite impossible to carry out empirical study, in a developing country like India, because of lack of information. However, even if we accept these assumptions, these studies suffer from several limitations.

Earlier studies were based on NSS data while the studies carried out by NCAER were based on sample surveys conducted in Gujarat and Mysore. Data collected by direct interview method, in a developing country like India, generally lack accuracy. Because, households cannot provide detailed and precise information on various items of expenditure and do not like to tell facts about their sources of incomes. Hence, these studies suffer from certain lack of precision.

Studies carried out by TEC and Ministry of Finance allocated entire taxes on capital goods to the consumers in the year in which they were collected. But in reality these taxes cannot be shifted immediately. Such taxes raise the cost of purchase of machinery resulting in higher depreciation charges from year to year. This will raise prices to consumers who bear the taxes from year to year.

However, the study carried out by Jha Committee does not suffer from this limitation. Because in this study the average life of plant and machinery was taken to be 10 years and accordingly, only one tenth of the taxes collected on machinery items in 1973-74 was assumed to be passed on to the consumer during that year.

Moreover, all other studies except those carried out by NCAER, measure the incidence of indirect taxation in relation to the consumer expenditures rather than incomes which tends to overstate the progression or understate regression of the taxation. This is because the consumer expenditure as a proportion of income tends to fall as one moves up the income scale. Hence, in the case of higher income groups, the incidence in relation to income would be lower as compared to incidence expressed in terms of consumer expenditure.²⁷

Moreover, NSS data, used by these studies, do not fully represent the expenditure of higher expenditure groups. For example, "Directors, executives and other high-paid employees often receive, in addition to salary, perquisites such as transport for leisure activities, home furnishing, restaurant meals, telephone calls, entertainment and even medical and school fees. None of this would appear in the NSS figures."²⁸ Thus, these types of business consumption are omitted from the analysis while indirect taxes

paid in the process of business consumption are included. It exaggerates the degree of consumption progression.²⁹

This may be the probable reason for the divergence between the findings of previous studies and the studies carried out by NCAER. As stated above, NCAER studies indicate more or less regressive nature of sales tax while other studies show progression in it.

All these studies are limited in their scope. Studies carried out by NCAER are limited to a particular state while other studies are limited to the incidence of indirect taxation. So they do not give the picture of the incidence of the tax structure in the country, as a whole.

Footnotes

1. E.R.A. Seligman, *The Shifting and Incidence of Taxation*, The MacMillan Company, London, 1902, p. 1.
2. Otto Von Mering, *The Shifting and Incidence of Taxation*, The Blakiston Company, Philadelphia, 1942, p. 3.
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CHAPTER IV

SUMMARY AND CONCLUSIONS

4.1 Sales Tax : Meaning and Types

The term 'tax' is as familiar as the term 'government' with the common man. It is well known that, tax is the money paid by citizens to the government for financing its activities. It can be imposed on persons, property, income, commodities etc. The tax imposed upon commodities is known as 'commodity taxation'. It can be imposed upon production, importation, exportation, purchases, uses or sales of commodities.

The tax levied on the sales of goods and services is called a 'sales tax'. It generally applies to the sales of a large number of commodities. The legal tax base of sales tax is the sale value of taxable goods and services. Sale value depends upon the cash expenditure by the consumer on consumption goods and the expenditure by the producer on production goods. Hence, cash expenditure by the producer and the consumer constitute the potential tax base of sales tax.

Sales tax is mainly classified into three categories, viz. multiple stage tax, single stage tax and value-added tax. Single stage tax is further divided into

three classes - manufacturers' tax, wholesale tax and retail tax.

The multiple stage tax, in its complete form applies to all sales at all stages of production and distribution. Hence, the tax is imposed on the sale by manufacturer to wholesaler, wholesaler to retailer and retailer to consumer. On the other hand, single stage tax applies to the sale of any one of these three stages. If the tax is levied on the sale by manufacturer, the tax is called a manufacturers' tax while a tax levied on the sale by wholesaler is called a wholesale tax. Finally, the tax applicable to the sale by retailer to consumer is known as retail tax. VAT is descended as a hybrid of multiple stage tax and retail tax. As multiple stage tax, VAT is imposed at each stage in the chain of production and distribution but not on the sale value, as is the case with multiple stage tax, but only on value-added at each stage. Sum of the value-added at each stage becomes identical to the retail sale value, the tax base of retail tax.

Among all these taxes, multiple stage tax has the broadest base while manufacturers' tax has the narrowest. The implications are that former tax can produce a substantial amount of revenue with relatively low rate which reduces the tendency to evade taxes. Even if there is evasion at one stage, this may not be possible at other

stages. On the other hand, manufacturers' tax requires higher rates in order to provide same amount of revenue. Other types of sales taxes lie between these two extremes.

Multiple stage tax is most distortive in nature because it brings unnecessary and unintended changes in methods of doing business and relative prices. Since the tax is levied at each stage, it provides an incentive for vertical integration. To avoid taxation, firms seek to produce their own materials and parts used in production instead of purchasing from independent suppliers. Similarly, they sell their products directly to retailers or sometimes even to consumers. Thus, the tax brings changes in methods of both production and distribution. Hence, the tax puts those firms which do not want to change their method of doing business and also the small dealers who cannot get themselves integrated, at a disadvantage. This discriminatory effect of multiple stage tax is not limited to sellers but is extended to the consumers. Since tax burden depends on the number of transactions, the tax increases the prices of various commodities differently depending upon the respective number of transactions. It thus affects relative prices. Hence, consumers who prefer commodities which change many hands during the production and distribution process and thus taxed many times have to bear greater burden in comparison with other consumers who buy commodities

which pass only a few stages. It creates disincentive to consume relatively heavily taxed commodities. Thus, consumers reallocate their expenditures. They shift from a preferred commodity to less preferred one in response to taxation and this causes "excess burden".

Multiple stage tax is cascading by nature. Any tax below retail level, except tax on value-added, has cascading effect. Because tax enters into the purchase price of the dealers. Conventionally, they increase their sale price by some percentage mark-up in order to provide, inter alia, for profit. Hence, profit margin is also increased on the tax amount. It goes on cumulating till the retail level. The implication of such price pyramiding is the substantial rise in effective tax rate in comparison with the nominal rate - placing a burden on consumers by an amount in excess of the tax. Since, manufacturers' and wholesalers' taxes are imposed below retail level, they also cause price pyramiding, but to a lesser extent. Similarly, they also bring unintended change in the methods of doing business. A manufacturers' tax causes deliberate transfer of functions, such as transport, from manufacturers to wholesalers in order to free these activities from the tax net. On the other hand wholesale tax gives incentive for direct sale by manufacturer to retailer - keeping wholesale stage out of existence - to avoid taxation.

On the other hand, broad-based retail and value-added taxes are most neutral. They do not bring unnecessary and unintended changes in the system of production and distribution because, in these systems, tax liability remains the same irrespective of the process of production and distribution. Tax is levied on the actual selling price to consumer in the case of retail tax while in the case of VAT, it is imposed on the value-added at each stage. So, changes in the pattern of production and distribution process do not bring change in tax liability. This has two implications: It neither stimulates firms to change their production and distribution patterns nor brings many changes in relative prices. Hence, consumers also do not change their pattern of expenditures. Moreover, there is a tendency to shift the exact amount of tax to the consumer. These taxes do not enter into the purchase price of the dealers. So they are free from cascading effects. Furthermore, both retail tax and VAT have broader tax bases in comparison with manufacturers' and wholesale stage taxes. Broader tax base enables them to provide a substantial amount of revenue with relatively lower rate. This lower rate again reduces the possibility of tax evasion. Tax evasion is more difficult in case of VAT because of the possibility of cross-checking in its case.

It is customary to exempt exports from sales tax.

Hence, all tax entering into the cost of exported goods is refunded to exporters. But in the case of multiple tax so also manufacturers' and wholesale stage taxes, it is difficult to ascertain the sales tax element in the cost. So, there is a possibility of inclusion of tax element in export prices which could reduce the competitiveness of home industries in foreign markets. VAT is always favoured in this matter because it does not raise cost through input taxation. Hence export could be fully relieved of sales tax. This can be done under retail tax also, allowing all registered dealers concerned to make all purchases free of tax.

Thus, broad-based retail and value-added taxes have several advantages over other types of sales taxes. They are desirable both from administrative point of view as well as consumer's and producer's points of view. These taxes are desirable from administrative point of view on the ground that because of their broad base, a relatively low rate can provide required revenue. Lower rates further reduce the possibility of tax evasion. These taxes are preferred from consumer's side on the ground that they do not cause price pyramiding. Moreover, they do not cause price distortions. There is no urge for producers to change their methods of doing business in search of tax avoidance. Since, taxes do not enter into the production cost, exports can be

made free of tax which can maintain the relative competitiveness of products in world markets.

However, since taxes bring a large number of vendors under tax net, their administration becomes quite cumbersome. Moreover, these taxes cannot be successfully operated in a developing country where tax administration is relatively inefficient and a large part of business is non-commercial in character; several vendors are petty, small, illiterate, scattered, unorganised, seasonal and without a permanent place of doing business, and they do not keep even elementary records. VAT is more cumbersome because it requires more extensive records than retail tax. In such situation, a manufacturing-import level tax - which can be administered more easily and collected most cheaply and conveniently - is desirable pending the subsequent development of the trade sector and administrative efficiency.

4.2 Historical Review

Sales tax was born in ancient Greek City - States and arrived in the modern era with "respectable and influential oldage". However, it had to face many critical situations in course of its long march i.e., many times, it was adopted, strongly opposed, abandoned and revived as well. It was severely criticised during eighteenth and nineteenth centuries mainly because of the unpopularity of Spanish alcabala, the need for direct taxation to attain

equity and the emergence of democratic governments. So the tax was abandoned by many countries and was confined only to two countries, Mexico and the Philippines, before the outbreak of World War I. Thus, the "nineteenth century as well as the early part of twentieth was notable for an absence of sales tax".

However, financial crisis created by World War I led many countries to adopt sales tax as a new source of revenue. Germany launched pioneering step which was followed by many other countries. The Great Depression of the Thirties added fuel to the flame. Many countries introduced sales tax to offset loss of revenue due to depression while other countries, already having this tax, brought many reforms in order to raise more revenue. World War II added another chapter in the development of sales tax. The War forced some of the countries to adopt sales tax and bring about changes in the sales tax systems in others already having the sales tax. High productivity of sales tax urged many developing countries to adopt it in order to raise additional revenue for financing their enormous developmental activities. So since World War II, sales tax has been spreading mainly over developing countries. Many developing countries adopted it one after another mainly to generate revenue for development finance. For example, most of the Indian states introduced sales tax during

forties while Nepal adopted it in the year 1965. Both these countries introduced sales tax mainly for revenue purposes. In India, it was initially imposed to cover the loss of revenue resulting from the policy of prohibition and abolition of internal customs and also to meet the increasing expenditure on economic development of the states. On the other hand, Nepal adopted sales tax to bridge the increasing gap between revenue and expenditure resulting from rapid increase in development expenditure.

Thus, the extensive use of sales tax in modern states started only since the outbreak of World War I. However, the tax occupied a key position in modern tax structure within no time. This is because of its broader base and hence high productivity.

4.3 Relative Importance of Sales Tax

In developing countries commodity taxes are considered very important type of taxes. Among commodity taxes, customs duties, excises and sales taxes are more important - in terms of coverage and revenue yield. Among these three taxes, sales tax has the broadest base. Because, customs duties are imposed on the commodities which either leave or enter the country and excises are limited on the production of native commodities while sales tax covers all commodities, domestically produced as well as imported from outside world. In an industrially less

developed country, customs duties have a broad base as compared to excises because the country has to import a large number of commodities including necessities of daily use. But as the country proceeds further on the path of industrial development, the base of excises increases and that of customs duties decreases relatively. The base of sales tax increases in the course of economic development. It should thus be noted that whereas the relative importance of excise duties increases and that of customs duties decreases with development, the overall importance of sales tax need not be affected since it extends both to domestically produced goods and to those imported or exported. Moreover, excises are generally selective taxes. Though, theoretically excise tax may be general, it is difficult in practice to make it more universal in scope, at least for administrative considerations. It becomes very difficult and uneconomic to administer the excise tax on unorganised industrial units and agricultural sector. On the other hand, sales tax is more general in nature covering a large number of commodities. Even if we assume that both sales tax and excises cover the same number of commodities, their bases will not be similar. Because excise duties, levied on the production, cannot cover that part of value-added which takes place between ex-factory stage and the point at which it reaches the final consumer. On the other hand, sales

taxes, levied on sales value, do cover this portion of value-added in their scope.

The relative importance of sales tax is also very high in quantitative terms. The modern history of sales tax started as a temporary measure in order to provide additional revenue to solve the financial crisis created by war and depression. Initially, the tax was opposed and condemned on equity ground. But as the tax proved to be highly productive, fiscal adequacy became stronger than justice. Now, the tax is considered as an important source of revenue especially in developing countries. For example, sales tax is the second largest source of revenue both in India and Nepal. At present, sales tax is only second to central excise in India while in Nepal, it is second to customs duties, in relation to revenue yield. In India, sales tax provided 20.47 per cent of total tax revenue and 25.17 per cent of commodity tax revenue in 1980-81 while in Nepal the share of sales tax revenue in total tax revenue and commodity tax revenue was 27.01 and 32.58 per cent respectively in 1981-82. The relative importance of sales tax is more prominent in the tax structure of states in India. Sales tax contributed more than 65 per cent of state's own commodity tax revenue and 59 per cent of their own tax revenue in 1980-81.

4.4 Shifting and Incidence of Sales Tax

Thus, relative importance of sales tax has been increasing continuously. Hence, it is a matter of curiosity to know whether or not such a tax is equitable. The analysis of incidence gives us an idea of the equity aspect of the tax. Incidence analysis shows the distribution of burden among different groups of population - classified according to their economic strength. Unfortunately, there is no single opinion regarding shifting and incidence of sales tax.

According to traditional theory, sales tax is shifted forward to the consumer through higher prices and the burden is distributed in relation to consumer spending. Traditional theory assumes a situation of perfect competition where imposition of tax tends to increase cost. Since suppliers are simply price takers, they cannot directly adjust price in relation to cost. The only way is to reduce output and they do so till a new equilibrium is obtained where normal profit rates are earned. Thus, prices are increased through reduction in supply and tax burden is distributed in proportion to consumer expenditure. However, this theory has been severely criticised since the thirties mainly on the ground that it assumes a situation of perfect competition which is not found in the real world. Moreover,

it neglects the effects of the tax on the rest of the economic system other than the taxed industry.

H. G. Brown challenged the traditional version in 1939. Earl R. Rolph accepted Brown's conclusion in 1952. According to these economists burden of sales tax rests not on consumers but on the factor owners in proportion to their income. They assumed a situation of perfectly competitive factor as well as commodity markets, perfectly inelastic factor supply and given public expenditure. In such a situation, an imposition of general and uniform sales tax raises the cost by the amount of tax. But given total money demand for commodities, prices of output will not rise. Now there will be a reduction in money earnings of each firm. So each firm reduces output which further reduces factor demand and causes reduction in factor prices. Reduction in factor prices will continue until the entire amount of the tax is absorbed in factor price reductions where full employment will be reattained. Hence sales tax neither changes the composition of output nor product prices but reduces money incomes of resource owners proportionately as does proportional income tax.

However, the Brown-Rolph analysis has also been criticised in recent years. Their analysis is based on unrealistic assumptions such as perfectly competitive market, inelastic factor supply and given public expenditure. If

we relax any of these assumptions, their analysis does not hold true. So, it is "merely one in a wide range of possible cases". However, at this point we must say that the assumption of perfect competition is not crucial to Rolph. He finds almost similar results even in imperfect competition.

John F. Due's approach is wider and more realistic in this matter. Along with perfect competition he analyses the case of imperfect competition and takes into account the effect of public expenditure in the analysis of incidence. According to him, in case of perfectly competitive market, adjustments after tax take place through reduction in production or public expenditure. Imposition of tax increases cost and tends to reduce production. But public expenditure may counter the latter effect i.e., reduction in output. If government revenue is spent sufficiently upon a particular product, its demand will increase which will offset the effects of the higher cost and allow the sale of original volume of output at higher prices. If the demand for a particular product is affected slightly or not at all by public expenditure, then its output is bound to decrease and some resources will be displaced. Some of the displaced resources will be used in the production of the goods whose demand has increased sufficiently by public expenditure. Rest are utilised by government rendering services. Hence, aggregate factor demand is unaffected. But if the factors

can be used only in a particular industry whose output falls after tax and if public expenditure creates no demand for them, then such factors will bear a portion of tax burden after the reduction in their prices. However, this is not a likely case. So taxes are generally shifted forward and tax burden is likely to be distributed in proportion to expenditure on taxable goods. Final result is the same in case of imperfect competition except for that part of tax which can be absorbed in excess profits.

The general belief is also similar to that of John F. Due's conclusion. Main stream of thought still believes that by and large sales tax is shifted forward and tax burden is distributed in relation to consumer spending. Due, however, concludes in favour of forward shifting by taking into account the benefits of public expenditure. It becomes not only difficult but quite impossible, at least in developing countries to measure sales tax incidence empirically in tune with Due's theoretical analysis outlined above. It is not possible to measure the benefits derived from public expenditure in developing countries because of lack of information. All the same, most of the empirical studies make the assumption of forward shifting in full, for want of a better alternative. They also neglect the benefits derived from public expenditure in their analysis. Thus, empirical studies resemble traditional theory of sales tax

incidence. For example, all studies, conducted in India, are based on such assumptions.

Studies, carried out by TEC for the year 1953-54, by Ministry of Finance for the years 1958-59 and 1963-64 and by Jha Committee for the year 1973-74, tried to measure the incidence of tax in relation to the consumer expenditures while the studies conducted by NCAER in Gujarat (1967-68) and in Mysore (1968-69) attempted to measure incidence of tax according to income groups. TEC report shows almost proportional nature of sales tax while the studies carried out by Ministry of Finance and Jha Committee indicate progressivity in the sales tax system. All these studies show marked inter-sectoral disparity of the tax incidence which exists at all levels of expenditure groups. Moreover, a comparative study of these reports shows the increasing trend in tax burden over the years. The reasons for increasing tax incidence may be increase in coverage, in tax rates and in monetization of the economy. Reasons for inter-sectoral disparity and progressivity may be differences in consumption pattern between rural and urban households and as between lower and higher expenditure groups. Generally, rural and/or lower income groups spend more on food and other necessities which are commonly exempted or lightly taxed. Then again, the proportion of their non-cash expenditure, which bears no tax, is higher in total

expenditure. This causes a relatively lower tax burden on rural households and/or lower expenditure groups. Though the structure of sales taxes is progressive with reference to expenditure, one should not forget that sales tax falls on the poorest section of society. For example, lowest expenditure group was paying 0.4 per cent and 1.16 per cent of its expenditure in the form of sales tax in 1953-54 and 1963-64 respectively. Similar is the case for other years. Had it been the case of income tax, the lowest income class would have been relieved from tax burden. Moreover, studies except those carried out by NCAER measure incidence in relation to consumer expenditure which tends to over-state the progression or under-state regression of the tax system. This is because as one moves up the income scale, the consumer expenditure as a proportion of income tends to fall. Hence, the incidence in relation to income would be lower as compared to incidence expressed in terms of consumer expenditure, in case of higher income groups and vice versa for lower income groups. This may be a probable reason for findings of NCAER studies, which measures incidence of tax according to income groups and showed more or less regressive nature of sales tax.

Thus, sales tax is a levy imposed upon the sales of goods and services. Though its history is very long, it is considered the newest fiscal instrument in the modern tax

system. Financial crisis created by World War I revived the tax in the present century while Depression of the Thirties and World War II helped a lot in the further development of sales tax. This tax attracted attention of developing countries mainly because of its high revenue productivity and now-a-days it is considered as one of the important forms of tax in the tax structure of many countries. Theoretically, the tax is regressive because it applies to all consumers equally irrespective of their ability to pay the tax. But in practice, some element of progression can be introduced by means of exemption of absolute necessities and introduction of differential tax rate i.e., imposition of high rates on luxuries and low rates on comforts and some necessities. However, sharp rate differentiation would make tax administration more complicated. Hence, there is a great possibility of revenue loss either through increase in cost of collection or increase in evasion. Thus, the tax system tend to become inefficient if it is stretched far too much towards equity. So the policy makers have to think of an optimum trade-off between equity and efficiency to derive enough revenue with a reasonable degree of equity and efficiency.

Appendix Table 1 : Combined Tax Revenue Receipts of the Centre, States and Union Territories in India (1950-51 to 1980-81)

	(Rs. in crores)						
Description	1950-51	1955-56	1960-61	1965-66	1970-71	1975-76	1980-81
Total tax revenue	626.7	767.6	1350.4	2921.6	4752.4	11181.7	19793.0
1. Direct taxes	258.4	289.9	449.3	819.7	1144.0	2727.0	3691.9
2. Indirect taxes	368.3	477.7	901.1	2101.9	3608.4	8454.7	16101.1
i) Customs	157.2	166.7	170.0	539.0	524.0	1419.4	3409.3
ii) Union excise duties	67.5	145.2	416.3	897.9	1758.6	3844.8	6497.2
iii) State excise duties	49.8	45.2	54.9	100.2	201.4	457.5	870.3
iv) General sales tax	58.2	81.6	163.9	381.5	786.4	1982.5	4052.4
v) Taxes on vehicles	7.8	15.1	34.2	61.2	112.2	208.7	421.2
vi) Taxes on goods & passengers	0.1	3.5	5.6	33.7	58.4	185.8	289.7
vii) Others*	27.7	20.4	56.2	88.4	167.4	356.0	561.0

Note : * These include entertainment tax, terminal tax and betting tax in Delhi, tobacco duties, newspaper and advertisement tax, education cess, taxes on raw jute, electricity duties, taxes on purchases of sugarcane etc.

Source : Jha Committee Report, pp. 12-13 and RBI Bulletin, August 1982, pp. 566-67 and September 1982, p. 684.

Appendix Table 2 : Sales Tax as Percentage of Total Tax
and Commodity Tax Revenue in India
(1950-51 - 1980-81)

Fiscal year	Sales tax as percentage of total tax revenue	Sales tax as percentage of total commodity tax revenue
1950-51	9.29	15.80
1955-56	10.63	17.08
1960-61	12.14	18.19
1965-66	13.06	18.15
1970-71	16.55	21.79
1975-76	17.73	23.45
1980-81	20.47	25.17

Source : See Appendix Table 1.

Appendix Table 3 : Tax Revenue of Individual State in India - 1980-81

State	(Rs. in lakhs)					
	State's own tax revenue			State's own tax revenue and share in central excise		
	Total tax revenue	Commodity tax revenue	Sales tax revenue	Total tax revenue	Commodity tax revenue	Sales tax revenue
1. Andhra Pradesh	58,208	51,370	28,226	87,783	72,774	28,226
2. Assam	6,578	4,383	3,149	16,410	11,669	3,149
3. Bihar	27,654	25,068	19,376	70,039	57,893	19,376
4. Gujarat	53,102	48,025	35,385	72,069	60,931	35,385
5. Haryana	23,391	21,161	10,600	29,514	25,354	10,600
6. Himachal Pradesh	3,393	3,151	1,356	5,563	4,724	1,356
7. Jammu and Kashmir	3,780	3,508	1,788	6,677	5,521	1,788
8. Karnataka	47,468	42,045	23,736	67,241	56,311	23,736
9. Kerala	33,654	29,579	20,394	48,795	40,718	20,394
10. Madhya Pradesh	38,588	35,103	20,000	68,876	57,967	20,000
11. Maharashtra	1,13,034	1,03,962	74,959	1,46,674	1,26,403	74,959
12. Manipur	255	219	135	1,007	782	135
13. Meghalaya	487	445	231	1,206	986	231
14. Nagaland	433	390	187	783	655	187
15. Orissa	13,208	11,779	7,663	29,206	24,014	7,663
16. Punjab	34,884	31,059	15,593	43,105	36,486	15,593
17. Rajasthan	23,023	20,553	14,731	40,475	33,595	14,731
18. Sikkim	260	241	50	297	251	50
19. Tamil Nadu	63,911	59,010	45,963	93,087	80,085	45,963
20. Tripura	380	277	196	1,573	1,210	196
21. Uttar Pradesh	64,519	55,337	35,085	1,27,741	1,03,063	35,085
22. West Bengal	51,408	46,473	29,955	82,397	69,168	29,955
Total	6,61,618	5,93,138	3,88,758	10,40,518	8,70,560	3,88,758

Source : Reserve Bank of India Bulletin, September 1982, pp. 708-729.

Appendix Table 4 : Composition of Tax Revenue in Nepal (1965-66 - 1983-84)

(Rs. in thousands)

Fiscal year	Direct Taxes									Total
	Land revenue	House & land registration	Income tax	Urban house & land tax	House rent tax	Tax on loan	Tax on interest	PDLT	Others*	
1965-66	44,518	2,265	7,083	638	189	-	-	-	178	54,871
1966-67	56,646	2,350	7,729	394	466	-	-	-	279	67,864
1967-68	83,295	4,146	11,415	502	765	-	-	-	1,080	1,01,203
1968-69	79,352	5,722	16,731	403	692	-	-	-	161	1,03,061
1969-70	87,718	14,478	19,634	548	-	-	-	-	59	1,22,437
1970-71	76,397	14,511	21,169	587	-	-	-	-	-	1,12,664
1971-72	83,170	17,343	22,045	604	-	-	-	-	-	1,23,162
1972-73	74,452	18,642	23,375	945	-	-	-	-	-	1,17,414
1973-74	96,930	27,011	32,643	1,244	-	-	-	-	-	1,57,828
1974-75	90,899	36,014	46,995	1,734	97	-	-	-	-	1,75,739
1975-76	94,764	39,626	87,172	3,255	1,389	-	-	-	-	2,26,206
1976-77	97,935	42,684	1,33,300	4,124	1,970	-	-	-	-	2,80,013
1977-78	87,024	54,057	1,36,839	5,098	3,355	70	146	1,605	-	2,88,194
1978-79	54,619	55,655	1,03,026	6,123	2,789	5,279	1,092	4,689	-	2,33,272
1979-80	56,176	64,963	1,01,114	6,526	826	13,794	85	8,279	-	2,51,763
1980-81	1,00,747	77,825	1,43,958	6,552	1,111	210	13,189	4,151	3,620	3,51,363
1981-82	81,746	88,312	1,89,759	9,273	472	-	5,712	2,282	120	3,77,676
1982-83 R.E.	62,500	1,15,000	2,40,000	12,000	500	-	15,000	763	11	4,45,774
1983-84 E.	85,000	1,70,000	3,16,500	40,000	-	-	15,000	-	-	6,26,500

R.E. = Revised Estimate

E = Estimate

Note : * These include foreign investment tax, stamp duties, local development tax etc.

Source : Budget speeches.

Contd...

Appendix Table 4 : (Continued)

Fiscal year	(Rs. in thousands)									Grand Total	
	Customs	Sales tax	Excise	Contract tax	Hotel tax	Entertainment tax	Air flight tax	Road cess	Vehicle tax		Total
1965-66	93,515	6,255	20,062	365	-	1,411	253	-	-	1,21,861	1,76,732
1966-67	1,21,746	12,147	19,964	1,717	-	1,898	208	-	-	1,57,680	2,25,544
1967-68	1,29,733	26,918	21,479	1,451	131	1,716	270	-	-	1,81,698	2,82,901
1968-69	1,83,564	48,039	28,043	2,289	265	1,901	395	-	-	2,64,496	3,67,557
1969-70	1,93,512	51,090	38,124	1,755	506	2,243	521	-	-	2,87,751	4,10,188
1970-71	1,56,515	62,334	56,566	2,536	698	2,458	587	-	-	2,81,694	3,94,358
1971-72	1,98,598	69,080	63,591	3,208	911	2,785	560	3,262	-	3,41,995	4,65,157
1972-73	2,38,197	79,820	67,757	4,025	1,512	3,739	1,304	5,553	503	4,02,410	5,19,824
1973-74	2,86,212	98,548	77,429	4,856	2,180	4,988	1,286	6,214	1,140	4,82,853	6,40,681
1974-75	3,28,522	1,90,525	1,19,678	7,487	2,847	5,835	2,317	6,939	1,887	6,66,037	8,41,776
1975-76	3,58,496	1,61,875	1,32,034	9,473	3,471	6,966	2,722	7,562	2,054	6,84,653	9,10,859
1976-77	3,86,193	2,21,983	1,66,074	11,813	4,838	8,679	4,779	14,500	1,186	8,20,045	11,00,058
1977-78	4,58,780	2,73,095	1,64,361	12,925	10,257	9,864	8,271	15,756	2,292	9,55,601	12,43,795
1978-79	6,26,714	3,56,772	1,92,626	16,699	13,990	9,766	7,065	17,288	2,642	12,43,562	14,76,834
1979-80	6,08,013	4,01,190	2,15,180	18,503	14,020	9,486	8,632	-	1,932	12,76,956	15,28,719
1980-81	8,15,838	5,37,661	2,42,185	36,933	17,442	11,981	20,550	-	1,771	16,84,361	20,35,724
1981-82	8,25,144	5,97,377	3,05,679	42,963	23,137	15,165	21,867	-	2,357	18,33,689	22,11,365
1982-83 R.E.	8,18,671	7,50,000	3,64,370	62,000	30,000	16,500	23,000	2,500	11,000	20,78,041	25,23,815
1983-84 E.	10,50,000	9,80,000	4,52,500	70,000	50,000	23,500	35,000	35,000	12,500	27,08,500	33,35,000

Appendix Table 5 : Revenue Receipts in Nepal
(1965-66 - 1983-84)

(Rs. in thousands)				
Fiscal year	Total revenue	Total tax revenue	Total commodity tax rev.	Sales tax revenue
1965-66	2,16,498	1,76,732	1,21,861	6,255
1966-67	2,56,662	2,25,544	1,57,680	12,147
1967-68	3,25,979	2,82,901	1,81,698	26,918
1968-69	4,13,034	3,67,557	2,64,496	48,039
1969-70	4,64,031	4,10,188	2,87,751	51,090
1970-71	4,59,698	3,94,358	2,81,694	62,334
1971-72	5,53,429	4,65,157	3,41,995	69,080
1972-73	6,15,826	5,19,824	4,02,410	79,820
1973-74	7,66,435	6,40,681	4,82,853	98,548
1974-75	10,08,393	8,41,776	6,66,037	1,90,525
1975-76	11,15,624	9,10,859	6,84,653	1,61,875
1976-77	13,22,916	11,00,058	8,20,045	2,21,983
1977-78	15,82,020	12,43,795	9,55,601	2,73,095
1978-79	18,11,914	14,76,834	12,43,562	3,56,772
1979-80	18,80,000	15,28,719	12,76,956	4,01,190
1980-81	24,19,172	20,35,724	16,84,361	5,37,661
1981-82	26,79,540	22,11,365	18,33,689	5,97,377
1982-83 RE	30,55,555	25,23,815	20,78,041	7,50,000
1983-84 E	43,06,000	33,35,000	27,08,500	9,80,000

R.E. = Revised Estimate

E = Estimate

Source : Budget speeches.

Appendix Table 6 : Sales Tax as Percentage of Total Revenue, Tax Revenue and Commodity Tax Revenue in Nepal (1965-66 - 1983-84)

Fiscal year	Sales tax as percentage of		
	Total revenue	Tax revenue	Commodity tax revenue
1965-66	2.89	3.54	5.13
1966-67	4.73	5.39	7.70
1967-68	8.26	9.51	14.81
1968-69	11.63	13.07	18.16
1969-70	11.01	12.45	17.75
1970-71	13.56	15.81	22.13
1971-72	12.48	14.85	20.20
1972-73	12.96	15.35	19.84
1973-74	12.86	15.38	20.41
1974-75	18.89	22.63	28.61
1975-76	14.51	17.77	23.64
1976-77	14.03	20.18	27.07
1977-78	17.26	21.96	28.58
1978-79	19.69	24.16	28.69
1979-80	21.34	26.24	31.42
1980-81	22.22	26.41	31.92
1981-82	22.29	27.01	32.58
1982-83	24.54	23.67	36.09
1983-84	22.78	29.39	36.18

Source : See Appendix Table 5.

Appendix Table 7 : Departmentwise Collection of Sales Tax
in Nepal (1975-76 - 1981-82)

(Rs. in thousands)

Fiscal year	Total	Tax offices	Per-centage	Customs offices	Per-centage
1975-76	1,61,875	34,852	21.53	1,27,023	78.47
1976-77	2,21,983	52,987	23.87	1,68,996	76.13
1977-78	2,73,095	58,743	21.51	22,14,352	78.49
1978-79	3,56,772	64,219	18.00	2,92,553	82.00
1979-80	4,01,190	85,855	21.40	3,15,335	78.60
1980-81	5,37,661	1,16,296	21.63	4,21,365	78.37
1981-82	5,97,377	1,34,410	22.50	4,62,967	77.50

Source : Tax Department.

Appendix Table 8 Rates of Sales Tax in Nepal

Fiscal year	Rates				
	Percen- tage	Percen- tage	Percen- tage	Percen- tage	Percen- tage
1965-66	-	2	-	-	-
1966-67	-	3	4	-	-
1967-68	-	5	7	-	-
1968-69	-	5	7	-	-
1969-70	-	5	7	-	-
1970-71	-	5	9	-	-
1971-72	-	5	9	-	-
1972-73	-	5	9	-	-
1973-74	-	5	9	-	-
1974-75	-	5	9	-	-
1975-76	-	5	10	-	-
1976-77	-	8	12	-	-
1977-78	-	8	12	-	-
1978-79	-	8	12	-	-
1979-80	-	8	12	-	-
1980-81	-	5	10	15	-
1981-82	1	5	10	15	20
1982-83	1	5	10	15	20

Source : Tax Department.

Appendix Table 9 : Revenue and Expenditure of HMG/Nepal (1951-52 - 1979-80)

(Rs. in lakhs)

Time period	Total expenditure			Total revenue				Cash balance (surplus -)
	Regular	Development	Total	Revenue	Foreign aid	Foreign loan	Internal loan	
Before plan period (1951-52 - 1955-56)	3,287*	-	3,287	2,335	950	-	-	-
First plan period (1956-57 - 1960-61)	4,709	5,987	10,696	4,390	3,829	200	-	-
Interim period (1961-62)	1,154	1,889	3,043	1,172	1,288	-	-	-
Second plan period (1962-63 - 1964-65)	3,724	5,978	9,702	4,858	3,906	539	181	134
Third plan period (1965-66 - 1969-70)	9,108	16,391	25,499	16,762	9,053	146	578	-1,039
Fourth plan period (1970-71 - 1974-75)	20,350	33,569	53,819	34,037	11,984	3,107	3,300	1,392
Fifth plan period (1975-76 - 1979-80)	45,773	88,326	1,34,099	77,124	26,237	16,171	11,200	3,365

* Before 1956-57 development expenditure was nominal and included in regular expenditure.

Source : Rup Bahadur Khadka, Budgeting in Nepal, Rajaswa, The Nepalese Journal of Revenue Administration, Year 1, Vol.2, HMG/Ministry of Finance, Revenue Administration Training Centre, Kathmandu, Nepal, April, 1982, pp. 1-25.

Appendix Table 10 : Total Imports of Nepal
(1965-66 - 1979-80)

(Rs. in crores)	
Fiscal year	Total imports
1965-66	78.20
1966-67	49.93
1967-68	47.78
1968-69	74.79
1969-70	86.46
1970-71	69.91
1971-72	88.83
1972-73	98.38
1973-74	116.32
1974-75	181.46
1975-76	202.16
1976-77	204.54
1977-78	251.58
1978-79	291.24
1979-80	353.20

Source : Nepal Rastra Bank, Twenty Five Years, 2013-2038,
Nepal Rastra Bank, Central Office, Kathmandu,
Nepal, 2038, p. 44.

Appendix Table 11 : Statewise Elasticity and Buoyancy Estimates of Sales Tax in India

	Jha Committee (1963-64 - 1975-76)		V. G. Rao (1960-61 - 1973-74)		M. C. Purohit (1960-61 - 1970-71)	
	Elasticity	Buoyancy	Elasticity	Buoyancy	Elasticity	Buoyancy
Andhra Pradesh	1.26	1.42	1.37	1.41	1.55	1.63
Assam	1.52	1.61	*	*	1.35	1.56
Bihar	1.01	1.16	1.45	1.60	*	1.56
Gujarat	1.08	1.48	1.26	1.37	1.41	1.53
Karnataka	1.40	1.82	1.48	1.73	2.10	2.11
Kerala	0.99	1.22	1.00	1.17	1.85	1.24
Madhya Pradesh	1.12	1.40	1.23	1.59	1.49	1.79
Maharashtra	1.18	1.40	1.15	1.22	1.45	1.50
Orissa	1.08	1.25	0.84	0.98	1.09	1.15
Rajasthan	1.19	1.38	3.72	5.27	1.56	2.15
Tamil Nadu	1.40	1.67	0.82	1.34	1.57	1.68
Uttar Pradesh	1.46	1.70	1.37	1.45	1.40	1.45
West Bengal	0.85	1.33	0.95	1.04	1.23	1.43

* Not available.

Source : Jha Committee, p.443, V. G. Rao, The Responsiveness of Tax System in India, op.cit., p. 111 and M.C. Purohit, Buoyancy and Income Elasticity of State Taxes in India, in V.B.Ghughe (edt.) : States' Taxation in Indian Federation, Mehta Publishing House, Pune, p. 166.

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