

The Existing Commodity Sales Tax System and the Proposed Indian GST: An Analysis Using Mclure's Ideal Sales Tax System

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Abstract

A sound tax system plays a vital role in the development of public finances of any country. So, each country tries to achieve it with the help of various reforms, which take place according to its economic, political, and financial considerations. The GST (Goods and Services Tax) has been proposed for implementation in India. Since its announcement, it has attracted a great debate on why we need GST if we have CENVAT (Central Value Added Tax) and State VAT (Value Added Tax). This paper presents an analysis of both - the existing commodity sales tax system and the proposed GST with the help of Mclure's ideal sales tax system and finds that the proposed GST fulfills most of the principles of Mclure's ideal sales tax system in comparison to the existing commodity sales tax system, which lacks all principles. The findings from this study favor the implementation of the proposed GST for India.

Keywords: taxation, tax reforms, sales tax, VAT, goods and services tax (GST)

JEL Classification: H20, H71, K35

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Taxation plays an important role in the advancement and growth of a country. Objectives of the tax policy of a country should be familiar with its general economic policy. The Government gets most of its revenue from taxes and uses it for the growth, development, and progress of the country. A sound tax system plays a vital role in the development of public finance of any country (Pandey, 2006). Tax reforms are made to achieve four main objectives of taxation such as revenue, redistribution, repricing, and representation. In India, most of reforms have been implemented to achieve the revenue objective. In India, the commodity tax is working under various taxes and laws. India being a federal country, its States have the independence of levying taxes. The Indian constitution has given this right to the Centre and State governments under Section 7 of Article 265 of the Indian constitution. The current structure of the Indian commodity tax system is at the Centre and State level such as - service tax, excise duty, custom duty, and so forth; state VAT, luxury tax, and entertainment tax, and so forth at the Centre and State level respectively. CST (central sales tax) is also levied by the Central government.

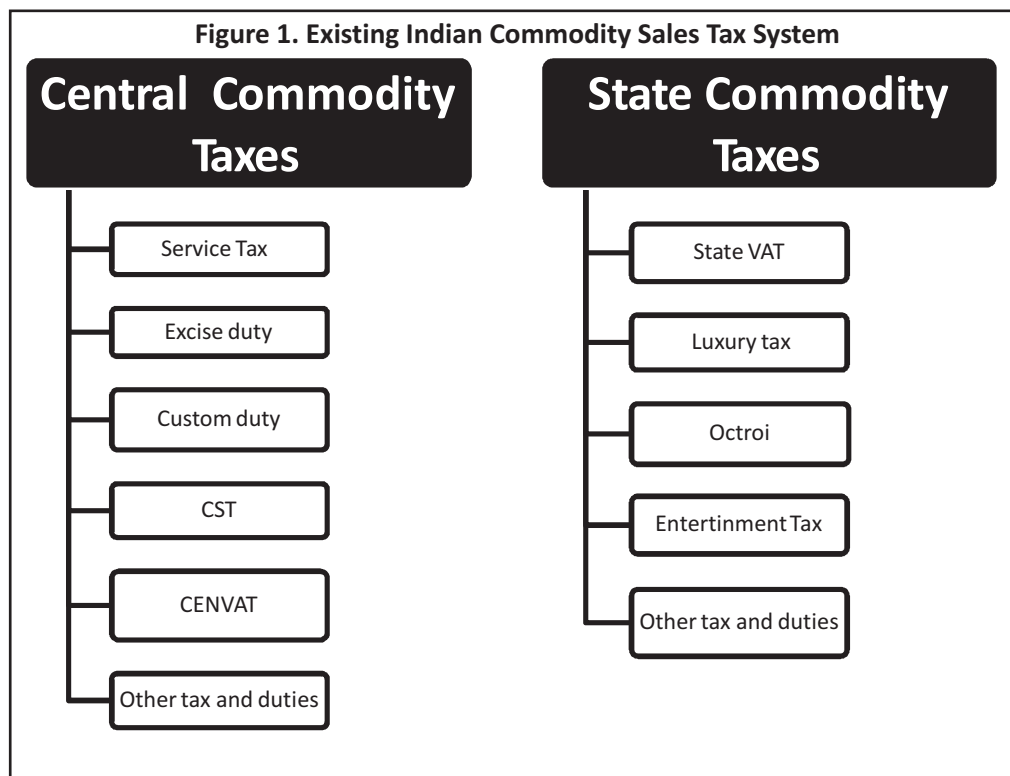
The existing system has a lot of deficiencies such as cascading effect, high administration and compliance cost, complexity, and no harmonization between the Centre and State governments. The former Finance Minister, Mr. P. Chidambaram proposed the GST (Goods and Services Tax) in 2009. The GST is a dual tax system named CGST (Central Goods and Services Tax) and SGST (State Goods and Services Tax). IGST (Integrated Goods and Services Tax) was also proposed in it. Being a burning topic in the Indian taxation field now, the most frequently asked question is - why do we need GST if we already have State VAT and CENVAT? The present paper contributes to the existing literature by comparing both kinds of systems, that is, the existing commodity tax system and the proposed GST with Mclure's ideal sales tax system. Mclure has been a great contributor in this field and he has suggested six principles of an ideal sales tax system. Firstly, this paper analyzes the existing commodity sales tax system with this criteria and then analyzes whether the proposed GST would be (or would not be) a better sales tax system for our country.

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The Existing Commodity Tax, Proposed GST, and Mclure's System

➤ **The Existing Commodity Sales Tax System** : The existing commodity tax system in India is quite complex and is multi-layered at both levels, that is, at the Central and State levels. The Central government imposes various taxes on goods and services. It levies custom duty on goods at the point of import, excise duty at the manufacturing of goods, CST on inter-state sale of goods, and service tax on providing services. The State governments are not far behind the Central government as they also impose various taxes subject to the power provided to them under the Schedule 7 of the constitution. State VAT is levied on sale of goods within the state, entry tax is levied on entry of goods into the respective states, and entertainment tax is levied on providing entertainment in the state(s), and so forth are the examples of taxes imposed by the State governments (KPMG, n.d.). Sales tax is governed by two types of acts: CENVAT and State VAT. CST is also levied by the Central government on inter- state sales. The Figure 1 presents the existing commodity sales tax structure of India, which is multilayered.



A brief detail of these taxes is as follows:

➤ **Service Tax** : It is a tax levied on services given by the service provider. It is same as excise duty, but the difference is that excise duty is levied on manufactured goods, but service tax is levied on services. It is payable by the provider of services who takes it from the consumer.

➤ **CENVAT**: According to this act, a manufacturer or producer of final products and provider of output services is allowed to take credit of excise duty paid on special mentioned inputs and capital goods that will be used in the manufacturing of specified goods.

➤ **CST**: It is imposed only on goods sold from one state to another state, which particularly takes into account that the buyer and the seller need to be in two different states. In its chargeability, it is state specific.

➡ **Excise Duty** : It is a duty levied on excisable goods that are manufactured in India and are used for domestic consumption. It is levied under the Central Excise Act, 1944 and the Central Excise Tariff Act, 1985. Some other taxes are levied under it. They are:

- ➡ Basic excise duty,
- ➡ Special excise duty,
- ➡ Additional duty of excise.

➡ **Custom Duty** : It is levied on imported commodities in India under the Customs Tariff Act, 1975. Its rates are mentioned in this act and are revised through the annual finance act or various notifications time to time. If such imported goods are re-exported or are used in manufacturing for export, it is again taxed. Some other taxes are levied under it. They are:

- ➡ Basic duty,
- ➡ Additional countervailing duty,
- ➡ Additional duty to compensate duty on input used by Indian manufacturers,
- ➡ Anti-dumping duty,
- ➡ Duty on bound fed articles,
- ➡ Export duty,
- ➡ National calamity contingent duty.

➡ **State VAT** : Each State or union territory has its own methods to assess the tax liability and collection methods from the dealers who fall under the preview of VAT. Each State has its own exemption list of goods and rates.

➡ **Entertainment Tax** : It is levied on entertainment to which persons are admitted on payment. It is levied under the State legislation. It is made of 20-35% of charges collected by way of subscription or installation or any other charge for entertainment. 10% additional surcharge is also levied.

➡ **Luxury Tax** : It is a tax levied by certain State governments on specified goods. This tax is levied under State legislation.

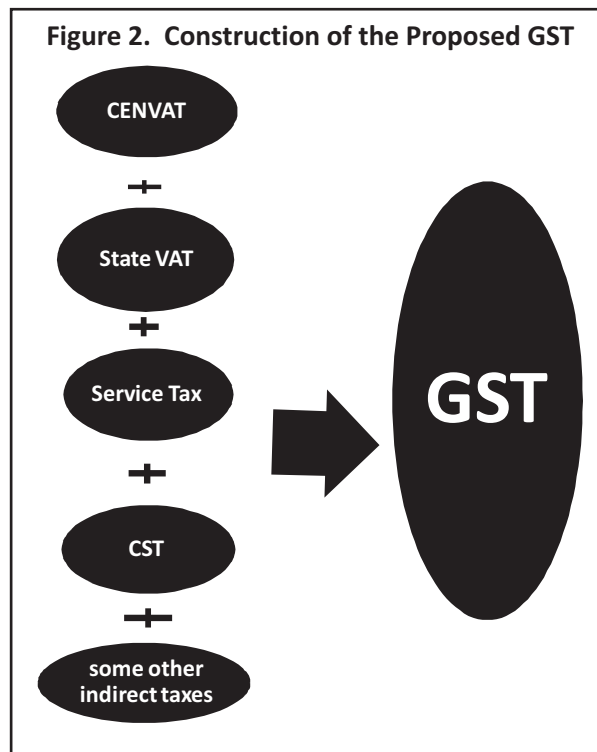
➡ **Octroi** : It is levied when a good enters into a municipality or any other specified jurisdiction for use, consumption, or sale. This is levied on the goods whether the same have been already sold, used, or consumed or not. Currently, this is levied by Maharashtra only (Naik, 2013).

➡ **Cess and Surcharges** : The Central government levies various cess and surcharges on excise and custom duties. Education cess of 2% and 1% for higher and secondary education is levied on both excise duty and custom duty aggregate amount.

The Proposed Indian GST

It is a dual tax system that has been proposed both for the Centre and State level named as CGST and SGST respectively. IGST would be levied on interstate -sale of goods and services. Separate accounts will be needed for both levels by businesses. Input tax credit will be given to respective tax only such that CGST input tax can be credited from CGST output tax, and SGST input tax can be credited from SGST output without any cross utilization. It will be a multi-stage tax imposed on both goods and services. It will be administered concurrently by Centre and State governments. A PAN-linked identification number will be allotted to the taxpayer (The Empowered Committee of State Finance Ministers, 2009). It would make India a single market in which all goods and services would flow independently. The Figure 2 shows the construction of the GST.

➡ **CGST**: It would be a tax levied by the Central government. In it, various taxes currently levied by the Central



government would be subsumed. They are service tax, excise duty, custom duty, and various additional duties on excise and customs, and so forth.

➡ **SGST:** It would be a tax levied by the State governments. In it, various taxes currently levied by the Central government would be subsumed. They are state VAT, luxury tax, octroi, entertainment tax, and so forth.

➡ **IGST:** It would be a tax levied on interstate sale of goods. It would be levied by the Central government. In it, raw materials and capital goods would account for input tax credit. This credit would not only be given to IGST, but also to (both) CGST and SGST.

Mclure's Ideal Sales Tax System

According to Mclure Jr. (n.d.), an ideal sales tax system should have five features, out of which three are economic, one is administrative, and one is political. They are:

- ➡ Single rate taxes should be levied on all sales to consumers,
- ➡ There should be an exception for all sales to businesses,
- ➡ Taxes should be levied on the destination base,
- ➡ The Governments should have the power to set their own rate of structure,
- ➡ Undue cost of compliance and administration should not be increased,
- ➡ There should be harmonization between State and Central governments,
- ➡ There should be conformity for tax base between both levels of governments.

The question arises: Is the existing commodity tax system fulfilling all conditions? To answer this question, the paper analyzes (step by step) the existing commodity sales tax system according to Mclure's ideal sales tax system.

Table 1. Difference in VAT Rates of Various States than the Agreed Rate of 4%

STATES	GENERAL VAT RATE (%)
Andhra Pradesh	5.00
Assam	5.00
Arunachal Pradesh	4.00
Bihar	5.00
Chhattisgarh	5.00
Dadra and Nagar Haveli	4.00
Daman and Diu	4.00
Delhi	5.00
Gujarat	4.00
Goa	5.00
Haryana	5.00
Himachal Pradesh	5.00
Jammu and Kashmir	5.00
Jharkhand	5.00
Karnataka	5.00
Kerala	4.00
Maharashtra	5.00
Madhya Pradesh	5.00
Manipur	4.00
Meghalaya	4.00
Mizoram	4.00
Nagaland	4.75
Orissa	4.00
Punjab	5.00
Puducherry	4.00
Rajasthan	5.00
Sikkim	4.00
Tamil Nadu	5.00
Tripura	5.00
Uttar Pradesh	4.00
Uttaranchal	4.00
West Bengal	4.00

Source : N. Kothari (2011). GST and development of single national market. Retrieved from <http://www.iica.in/images/GST%20Single%20National%20Market.pdf>

Comparison of the Systems

Existing Commodity Sales Tax System and Mclure's Ideal Sales Tax System

➤ **Single Rate for all Sales to Consumers :** According to this principle, there should be a single rate for all sales to consumers. But in India, VAT is applicable at the Central and State level named as CENVAT and State VAT. CENVAT has different rate of tax than State VAT. Rate of VAT is different in every state. Exemptions of various goods are also different in different States. The Table 1 presents a list of VAT rates in different States in India. It can be observed from the Table 1 that there is no single rate of taxes applicable in India. State VAT has three rates applicable. 12.5% is the standard rate and 4% is applied on essential items and industrial goods, and 1% is

applicable on precious metals and stones. Each State has its own rate structure. Instead of uniformity, each tax law applicable has its own rates and exemptions. Thus, in our country, McLure's first principle is being violated.

➤ **Exception of all Sales to Businesses :** This principle says that all sales to business houses for business purposes should be tax free. The reason for this is that by doing so, the business houses are saved from the burden of taxes and this reduces their production cost, which is beneficial for the consumers as well as for the economy. Though in India, CENVAT and State VAT have input tax credit system, but the input credit is given to the businessmen after charging tax on goods in relation of these taxes only, and not for others. There are various taxes levied on goods and input tax credit of such taxes is not allowed for deduction. Thus, the second principle is partially satisfied.

As the first two principles are not fulfilled, so the tax base of the State and Central governments differs. According to McLure Jr. (n.d.), violation of the first two principles of a good sales tax design is primarily a matter of poor state tax policy, and is not an administrative necessity.

➤ **Destination Base :** CST is a tax that is not levied on destination, but it is levied on the goods from where it is manufactured, that is, it is origin based. The origin state has the liability to collect taxes on the goods for sale. It does not give input tax credit to the exporters, so the burden is not passed onto the final consumer. Thus, McLure's third principle is also not satisfied.

➤ **Harmonization Between State and Central Taxes :** This principle says that there should be harmonization between both levels of the government. This is the most important principle on which success of all principles is based. Each tax law has its own registration procedure, return filing procedure, and its exemption list of goods. Each State defines various goods by its own definition of taxes, which leads to conflict among States for CST. Hence, there is lack of harmonization between the States and the Centre.

➤ **Compliance and Administration Costs :** Central and State level's VAT includes cost of administration at both levels with many forms. Services are not included in the State VAT structure. It has three rate structures, which increases complexity, and which is ultimately added into the compliance cost. Thus, it has high cost of compliance and administration. There are various exemptions given to goods/services in each tax law. This philanthropy of exemption leads to an increase in the compliance cost. Thus, it will not satisfy the fourth condition. The threshold exemption limit for small businessmen is ₹ 1.5 crore.

➤ **Conformity for Tax Base Between Both Levels of the Government :** As mentioned earlier, there are a lot of taxes that have been implemented under the present commodity tax system. Each one has its own threshold limit. In State VAT, it is ₹ 5 lakh, in excise duty, it is ₹ 1.5 crore, and for service tax, it is ₹ 10 lakh. Hence, there is a lot of difference in the tax base of various taxes. Hence, this principle of McLure is also not satisfied.

The Proposed GST and McLure's Ideal Sales Tax System

➤ **Single Rate for all Sales to Consumers :** In the proposed GST, three rates of taxes are proposed. Yet, a single rate of taxes is proposed for all goods and services for CGST and SGST separately. It is a consumption based tax system and gives credit for raw material and capital goods both. Hence, the proposed GST partially fulfills this principle.

➤ **Exception for all Sales to Businesses :** As all commodity taxes of the Centre are clubbed into CGST and all State commodity taxes are clubbed into SGST, so, if a businessman will pay CGST in the final stage, he will get input tax credit of CGST paid earlier and the same is the case with SGST. But a businessman cannot get input tax credit of CGST while paying SGST in this tax system. Hence, this principle is also partially satisfied.

➤ **Destination Base :** In the proposed GST, IGST is a tax which would be collected by the purchaser state. In it, the importer will be taxed and the exporter will be zero-rated. This makes shifting of tax base from producers to consumers. The revenue share will be given to the importer state. Thus, it is a destination based system. Hence, McLure's third principle is fulfilled.

➡ **Harmonization Between States and Central Taxes :** In the proposed GST, rates and rules are predefined. The Indian constitution gives power to the State and Central governments to levy taxes. In the proposed system, the State governments have to leave their right for levying taxes, which may be the reason for them opposing its implementation. Same rate and base attracts no conflict between the Centre and State governments. Standardization of these rates along with the return filing system and registration procedure are some points in the proposed GST that attracts harmonization between State and Central governments.

➡ **Compliance and Administration Costs :** In the proposed system, there is one return filing system. 12 digits identification number in which the first 10 digits numbers will be from the PAN number and the last two digits will be the State code will be allotted to the person willing to register. Rates will be less in comparison to the commodity tax. The exemption list would be common for all State and Central governments, which would lead to uniformity. Uniform threshold exemption limit, that is, ₹ 10 lakh is would be offered, benefiting the small businessmen.

➡ **Conformity for Tax Base Between Both Levels of the Government :** There is the same tax base for all goods and services being taxed under the proposed GST. It is proposed to be ₹ 10 lakh for goods and is higher for services. Though the threshold limit is not fixed, but it is certain that it will be same for all levels. Hence, this principle is also satisfied in the proposed GST.

Table 2. Summary of Fulfillment of Mclure's Ideal Sales Tax System by the Existing Commodity Tax and the Proposed GST

Mclure's Ideal Sales Tax System	Existing Commodity Sales Tax System	Proposed GST
Single rate for all sales to consumers	No	Partially
Exception for all business sales	Partially	Partially
Destination based	No	Yes
Harmonization between State and Central governments	Partially	Yes
Compliance and Administration Cost	No	Yes

The Table 2 shows a summary about the fulfillment of Mclure's ideal sales tax system by the existing commodity sales tax system and the proposed (GST) tax system. It can be inferred from the Table 2 that the Indian commodity sales tax system lacks three principles of Mclure's ideal sales tax system, and two principles are partially fulfilled. But the proposed GST fulfills most of the principles of Mclure's ideal sales tax system. Thus, India needs to adopt the proposed GST as soon as possible.

Conclusion

India is standing at the door step of a revolutionary taxation reform, that is, the proposed GST. It is often argued why we need it, though we have similar concepts such as CENVAT and State VAT. This paper tries to find out the answer to this question with the help of an ideal sales tax criterion given by Mclure in his paper. This paper found that the existing commodity tax system lacks all principles of this criterion. It means that at present, the Indian commodity tax system is not an ideal sales tax system. An ideal tax system is very important for the growth and development of a country. Each tax system tries to be ideal, but it is very difficult to achieve that state of perfection due to economic, political, and financial reasons.

Before CENVAT and State VAT, India's sale tax system was very poor, and with the implementation of both these taxes, our country has at least made some progress towards having a good sales tax system. It was implemented on the basis of this proverb - It is good to have something rather than nothing. However, now, a system having the content of an ideal sales tax system is the need of the hour. The proposed sales tax system named GST was proposed in the Parliament in 2009. Unfortunately, it was not passed in the Parliament. Settlement of revenue and lack of power considerations are the reasons due to which it has not been implemented and both are

necessary for harmonization among the Central and State governments (fourth principle of McLure's ideal sales tax system). Though the proposed GST is not an ideal sales tax system, but it is near to it. It has also been observed that India reforms its sales tax system gradually, and the proposed GST is the next step towards such reforms. This paper strongly recommends the implementation of the proposed GST in India.

Research Implications

India is at the doorstep of bringing in reforms in its sales tax system. After a hectic exercise, an amendment bill was placed in the Lok Sabha, which is still waiting for an approval. This paper can provide strong evidence in the discussion why India needs the approval and consequent implementation of the GST (goods and services tax).

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