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A STUDY ON THE TREND AND COMPOSITION OF INDIRECT TAXES OF UNION BUDGET OF INDIA IN THE POST LIBERALISATION PERIOD

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ABSTRACT

By direct taxes meant any of those taxes which were levied immediately upon the "product net." There alone, they argued, could be the fund out of which taxes could be paid. To levy taxes anywhere else was indirect, because the burden would be shifted from one to another until it rested there. Taxation policy has always been an important instrument for augmenting revenue, especially in developing countries, where it is the major source of domestic revenue. It is also an important instrument for attaining a proper pattern of resource allocation, income distribution, and economic stability, in order that the benefits of economic development are evenly distributed. The study discuss the trend and composition of major components of Indirect Taxes of Union Budget of India in the Post Liberalisation Period. An important aspect from the viewpoint of efficiency in resource allocation is the continued cascading of the tax on petroleum products. These are kept outside the CenVAT system. They are also not a part of the VAT system in states. These contribute to over 40 percent of the revenues of both the taxes. Considering the use of these items for intermediate consumption, the extent of cascading and relative price distortion will continue to be high.

KEYWORDS;Trend and Composition of Indirect Taxes, resource allocation, income distribution, and economic stability, in order that the benefits of economic development are evenly distributed.

INTRODUCTION

Taxation has continued to be one of the most important sources of revenue for both the Central and the State Governments in India. Further, both the layers of Government have depended more on indirect taxation, especially in view of the low per capita income of the masses. The cost consideration also prohibit the collection of direct taxes from majority of the people. Under such a' situation increase in revenue is more in case of indirect taxes in India. In this context, it may be pointed out that direct taxes constituted 2.31 percent of the G. D. P. in 1951-52, while indirect taxes formed 4.68 percent of the G. D. P. Indirect taxes have continued to predominate in India's tax structure, the percentage share of indirect taxes in 2000-01 stood at 11.47 percent as against 3.46 percent in the case of direct taxes.

Perhaps the most common distinction is that made between direct and indirect taxes. This distinction first obtained theoretical importance in the writings of the Physiocrats. By direct taxes they meant any of those taxes which were levied immediately upon the "product net." There alone, they argued, could be the fund out of which taxes could be paid. To levy taxes anywhere else was indirect, because the burden would be shifted from one to another until it rested there. The assignment of any particular tax to one or the other of these categories was with them a mark of approval or condemnation. With the recognition that other economic processes besides those which added to the material property of the world created wealth, this peculiar theory of taxation drifted into abeyance. The same terms, however, have been widely used by officials and writers and have such prevalence that recognition of them cannot be avoided.

LITERATURE REVIEW

C. P. Chandrasekhar and Jayati Ghosh(2008) The increase in Central Government tax revenues has been described as a victory for the Laffer curve in India. In the edition of Macroscan, C. P. Chandrasekhar and Jayati Ghosh examine the real reasons behind the recent increase in the tax-GDP ratio, in particular the change in income distribution and higher profitability of companies. The major positive feature of the recently announced fiscal measures is the evidence of increased Central Government tax revenues and an increase in the tax-GDP ratio. For the Centre, the gross tax-GDP ratio, after rising from 9.2 per cent in 2003-04 to 9.8 per cent in 2004-05, has increased further to 10.5 per cent in 2005-06 (RE), and is estimated to go up to 11.2 per cent in 2006-07. Coming after more than 15 years of decline, this is clearly a positive sign. It is even more noteworthy because, as part of the process of import liberalisation, the Government has been reducing peak and weighted-average import tariffs.

SukumarMukhopadhyay (2006) Which Way for Indirect Taxes? Reforms of indirect taxes in the budget amount to almost nothing. Customs tariffs have remained about the same while the number of exemptions have increased. In the case of CENVAT, rules remain complicated and the claim that rates have gravitated towards 16 per cent is not true. Service tax needs to be aligned with CENVAT to create a goods and services tax at the central level. Two parallel GSTs at the state and central levels, rather than a national GST, must be introduced.

NEED FOR THE STUDY

After independence, in order to raise revenues excise duty waslevied on selected goods. Over the years, as the revenue requirementincreased, the list of commodities subject to tax was expanded. In doingso, in the initial years the emphasis was to include raw materials andintermediate goods rather than final consumer goods for reasons ofadministrative convenience (India, 1977). However, in later years withgreater pressure to raise revenues final consumer goods were included.

In 1975-76, the tax was extended to all manufactured goods.The structure of excise duties by the middle of 1970s wascomplex and highly distortionary. Some commodities were subject tospecific duties and others to ad valorem taxes, and on the latter alonethere were 24 different rates varying from 2 to 100 percent (excludingtobacco and petroleum products which were taxed at higher rates). Theprocess of conversion of specific duties was more or less completed by1993-94; however, this did not imply a decrease in the number of rates.This led to several classification disputes. In effect, this was amanufacturers' sales tax administered on the basis of goods clearedfrom the godowns. "Cascading" from the tax resulted not merely from itspre-retail nature but also because it was levied on inputs, capital goodsas well as final consumer goods. The tax system was complex andopaque and the detailed analysis by Ahmad and Stern (1983) showedsignificant variation in the effective rates.

STATEMENT OF THE PROBLEM

Taxation policy has always been an important instrument for augmenting revenue,especially in developing countries, where it is the major source of domestic revenue.It is also an important instrument for attaining a proper pattern of resource allocation,income distribution, and economic stability, in order that the benefits of economicdevelopment are evenly distributed. Increased revenues are desired for many otherpurposes including expanding socially desired government current expenditures, oreven on pragmatic grounds, as to impress foreign aid donors with evidence of thenation's 'effort' to develop on the basis of domestic resources.

OBJECTIVE OF THE STUDY

- To study the trend and composition of major components of Indirect Taxes of Union Budget of India in the Post Liberalisation Period

DATA SOURCES

The study is based on secondary data, i.e., data published by economic survey. For, the data of total tax revenue and major heads of revenue is collected from the RBI website. In our study the data is used from1990-1991 to 2006-07 for the first two objectives and the third objective related to service tax which was introduced only in the year 1994-95, so data is used from the fiscal year 1995-96 to 2006-07 .

ANALYSIS AND DISCUSSION

Trend and composition of major components of Indirect Taxes of Union Budget of India in the Post Liberalisation Period;

TABLE -1

INDIRECT TAXES AND ITS COMPONENTS TO TOTAL REVENUE AND GDP

(IN PERCENTAGE)

year	indirect tax as % of total revenue	excise as% of total revenue	customs as % of total revenue	service as % of total revenue	indirect tax to GDP	excise tax to GDP	customs tax to GDP	Service tax to GDP
1990-91	78.4	42.6	35.9	NA	8.4	4.6	3.9	NA
1992-93	75.5	41.7	33	NA	8.3	4.6	3.6	NA
1993-94	73.7	41.3	31.9	NA	7.8	4.4	3.4	NA
1994-95	71	41.4	29.3	NA	6.9	4	2.9	NA
1995-96	69.1	42.6	32.1	0.8	6.5	3.4	3	0.1
1996-97	69.1	36.1	33.3	1	6.5	3.3	3.2	0.1
1997-98	64.5	35	28.9	1.2	5.9	3.2	2.7	0.1
1998-99	66.8	34.5	28.6	1.4	5.5	3	2.3	0.1
1999-00	65.5	37	28.2	1.2	5.8	3.2	2.5	0.1
2000-01	62.9	36	25.3	1.4	5.7	3.3	2.3	0.1
2001-02	61.8	36.3	24.2	1.8	6.1	3.6	2.4	0.1
2002-03	60.7	38.1	20.7	1.9	5.3	3.4	1.8	0.2
2003-04	57.9	35.7	19.1	3.1	5.3	3.3	1.8	0.3
2004-05	56.1	32.5	18.9	4.7	5.4	3.1	1.8	0.5
2005-06	54.4	30.4	17.8	6.3	5.6	3.1	1.8	0.6

2006-07 RE	51.2	24.9	18.3	8	5.8	2.8	2.1	0.9
2007-08 BE	50.9	23.8	18	9.2	5.9	2.8	2.1	1.1

Source ; computed

INDIRECT TAX

Under revenue receipts of total receipts tax revenue contributes a solid proportion. In tax revenue, indirect taxes play a key role for union government. Major components of indirect taxes are excise duty and customs duty. A sound diagnosis of the causes of the low tax / GDP ratio and of poor tax buoyancy particularly in case of excise, is a necessary precondition for emerging market economics. Indirect taxes are worth expressed in terms of percentage growth to GDP, as a percentage to total receipts, as a percent to tax revenues and as a percentage to annual growth. There is a wide variation in annual growth of indirect taxes. This is felt due to fluctuations in excise and customs duties. Indirect taxes to GDP unlike direct taxes has gradually reduced from 7 per cent in 1990-91to 4.5 per cent in 2004-05. Indirect taxes to total receipts have also come down as indirect taxes are with percentage to GDP. The contribution of indirect taxes was 38.5 per cent in 1990-91 and it has comedown to 26.2 per cent in 2004-05. The buoyancy of indirect taxes is lost for the fifteen years. Production of marketing goods has been on the increase for the past fifteen years but the proportional increase of excises and customs duty has been decreasing in spite of the actual growth is felt in both the taxes. There is a dramatic change in the contribution of customs and excise duties from 1990-91 to 2004-05. In the year 1990-91 customs duty was 57.2 per cent while excise duty was 39.1 per cent. later the share of customs duty started declining to 38.9 per cent in 2000-01 and declined further to 29.4 per cent in 2004-05 as the share of excise duty started increasing to 56.7 per cent and then to 63.8 per cent in 2004-05 to indirect taxes. The reasons for declining trend of indirect taxes to GDP are reduction in customs duty and less buoyancy in excise duty after 2000-01. As part of continuous process of bringing about a moderate, rational and simplified tax structure and to align them with ASEAN levels as per pre-announced commitments, the peak rate of customs duty on non-agricultural products was reduced from 15 per cent to 12.5 per cent in 2006-07 with a few exceptions Commodity taxes have been important instruments for management of prices, neutralising the disadvantages to domestic industry because of domestic taxes, removing anomalies in duty structure and strengthening competitiveness of domestic industry. Extension of countervailing duties(CVD) on all imported goods; reduction induty of metals and other intermediate products; and withdrawal of exemptions tolend simplicity to the tax laws, were some of the important measures taken in Budget2006-07. The structural shift of the taxes in favour of direct taxes was in line with the policy of removal of price distortions.

The current year has been characterised by inflationary pressures,initially upon, primary articles and fuels, but subsequently also on manufactured products.The moderation in inflation in the fuel group,with a reduction in international oil prices,from 7-9 per cent up to September 2, 2006to 3.7 per cent in January 2007, was morethan neutralised by the acceleration in inflation in primary articles and manufactured products. Along with the administrative measures, fiscal measures to combat inflation have included duty reduction in some of the items under heavy inflationary pressures. Customs duty of wheat and pulses were reduced to zero in June 2006.Duty on edible oils, particularly the palmgroup of oils was reduced by 10 percentage points each in August 2006 and January2007. Duty on portland cement and metals was also reduced in January 2007.

Performance of revenues from exciseduty, which had been quite disappointing withgrowth of such revenues declining steadily from 13.4 per cent in 2002-03 to 10.3 percent and 9.2 per cent in the two subsequent years, revived somewhat to 12.8 per cent in2005-06. Among others, three factors, which have had - and continue to have - a major bearing on excise duty collection, are: area based excise duty exemptions, small-scale industries' (SSI) excise duty exemption scheme, and the low rates on selected products. Budget 2006-07, while projecting a modest growth in excise duty revenues of 6.3 per cent, took some important steps inredressing these root causes. Share of indirect taxes declined substantially from 78.4 per cent in 1990-91 to66.8 per cent in 1998-99 and is expected to marginally fall to 65.9 per cent in 1999-2000. The share of excise revenues in gross revenues has declined from 42.6 per centin 1990-91 to 36.9 per cent in 1998-99, and is estimated at 36.1 per cent in1999-2000.

The share of indirect taxes as a per cent of GDP declined from 8.4 per cent in 1990-91 to 5.5 per cent in 1998-99 and is budgeted to increase to about6.0 per cent in 1999-2000.

CHART 1

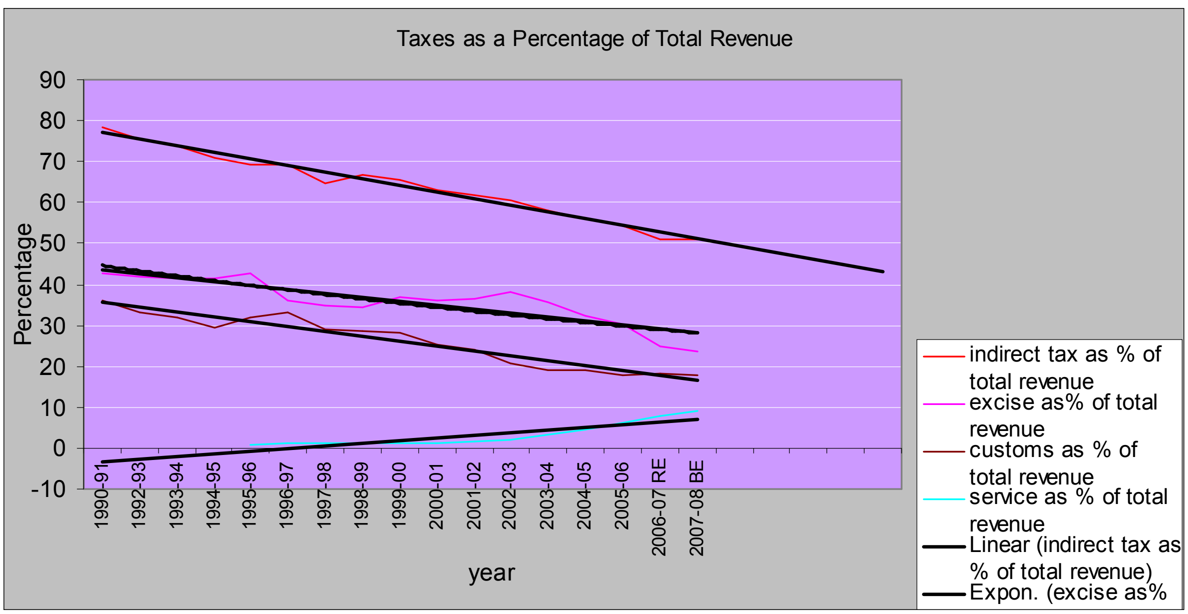
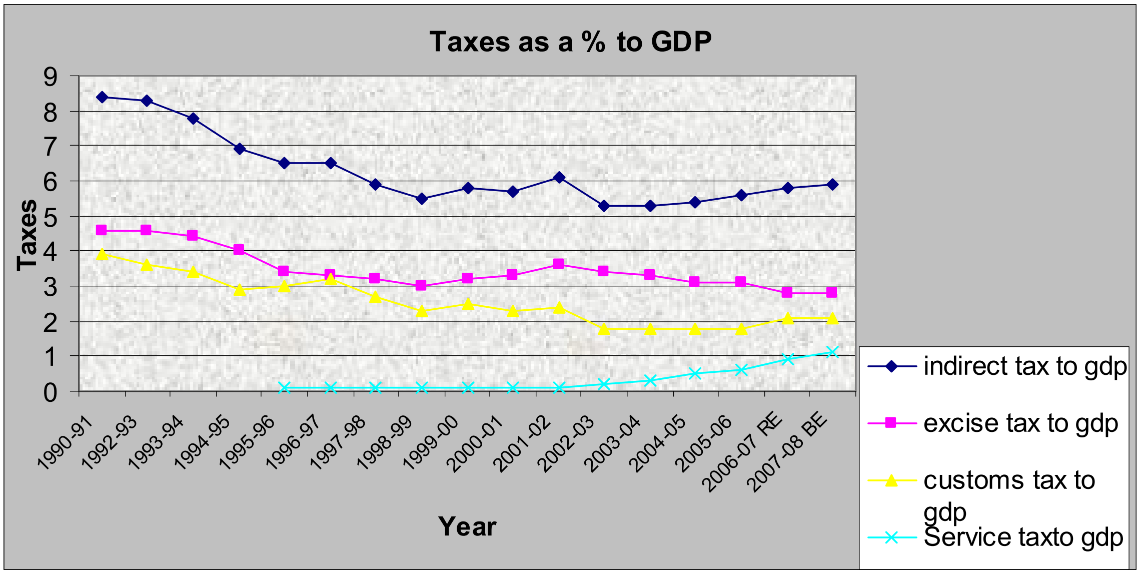


CHART 2



EXCISE DUTY

The union list in constitution of India empowers the Central Government to levy duties of excise on goods manufactured or produced in India. Therefore Central Government is empowered to levy tax on production of goods and not on consumption of goods. Accordingly the union excise duty is a tax applicable only on the manufacture of goods with in the country. The value addition in post manufacturing stage, being in the nature of services, is excluded from the tax base. Over the years, the excise duty of centre has been fine-tuned for various objectives including social considerations and revenue considerations. It is replete with exemptions and incentives. Excise duty reform began in 1986, but its progress has been relatively slow. The tax structure has improved considerably since the beginning of the 1990's. Unlike in the early 80's when the excise duty was levied at specific rates, it is now mostly levied on ad veloram Basis. It is on the basis of value and their values are determined based on transaction value and maximum retail price. VAT is introduced to limit cascading effect of duty incidence on a number of excisable goods used as inputs. Excise duty comes under indirect taxes of union budget. It can be expressed as a percentage of GDP, as a percentage to total receipts, as a percentage to indirect taxes and as a annual growth. The excise duty as a percentage to GDP has come down from 2.8 per cent in 1990-91 to 1.9 per cent in 1998-99. But after 1999-00 again the contribution of excise duty towards GDP started increasing and contributed 3 per cent of GDP in 2004-05. Like contribution of excise on GDP, its contribution on total receipts also shows the same trend fluctuation by constituting about 15 per cent in 1990-91 to 10.2 per cent in 1998-99 and again to 16.7 per cent in 2004-05 from 11.8 per cent in 1999-00.

In total tax revenue the excise duty constitute about more than 30 per cent on an average for the past fifteen years. The buoyancy of excise duty to total tax revenue was reducing from 1990-91 to 1998-99 and then till 2004-05 from 1999-00, its buoyancy has increased. Its percentage to indirect taxes has overcome customs duty share and from 2000-01 onwards excise duty constitute more than fifty percentage to indirect taxes.

CUSTOMS DUTY

Customs duty is also a part of revenue receipts under receipts of union budget. It is a kind of indirect taxes like excise duty. Customs duty is levied on imports of goods into India. During nineties, significant improvements have been made in the structure of customs tariff. The number of customs tariff rates has reduced significantly from 22 major basic duty rates in 1990-91 to 4 rates in 2003-04. The weighted average tariff rate has reduced from 55 per cent at the beginning, to around 20 per cent by the end of the fiscal year 2003-04. These changes in the structure of customs tariffs that, resulted in reducing the number of customs classification, have in turn lead to greater transparency and made customs administration much simpler. Recent surveys have shown significant decline in the dwell time of imports even though they continue to be substantially higher than the international standards. Customs duty influencing in reducing fiscal deficit can be expressed as a percentage to GDP, as a percentage to total receipts, as a percentage to tax revenue, as a percentage to indirect taxes and as a percentage to annual growth rate.

The collection of customs duty has doubled in the end of the decade of 1990's from just Rs. 20644 cr in the early 1990's. But after that, till 2004-05 it has been declining. To encourage foreign investments and imports of capital goods, India reduced many duty rates and exempted commodities from the duty slab. As a consequence customs duty to GDP has come down to 1.4 per cent in 2004-05 from 4 per cent to GDP in 1990-91. The annual growth becomes negative in seven years of the total fifteen year period (from 1990-91 to 2004-05). Huge decline in growth rate is felt in the annual growth of customs duty in the year 1999-00 and 2000-01 at the rate of –34.14 per cent and –20.20 per cent respectively. If customs duty as a percentage to total receipts is taken it constitute lesser and lesser share as the years go by. In 1990-91 customs duty constitute about a quarter of the total receipts which has steadily fallen and came down to 7.5 per cent total receipts. As the contribution of other revenues to total receipts increasing, customs duty has been declining from 1990-91 to 2004-05. Its share to tax revenue and to indirect taxes has also reached to half of its contribution compared to its contribution in the year 1990-91. It should be apparent that even if the level of the rates of duty is low, a small difference in the rate applicable to inputs and final products has very large economic efficiency implications. Thus, on account of an exemption an imported item may be subjected to a lower duty than prescribed in the tariff. At times, the duty payable may even be nil.

CONCLUSION AND POLICY SUGGESTIONS

The present status of taxation under this tax is one of taxation with the provision of credit extended both for service tax paid by Cen VAT assessees and for CenVAT paid by servicetax assessees. Taxation of selected services however, means that the rest of the services are exempt from taxation. As suggested by the *Govinda Rao Committee*, it is important to consider comprehensive taxation of services with a small negative list. This would help in makinga transition to a comprehensive goods and services tax at the central level.

Apart from the exemptions discussed above, all the indirecttaxes excise and customs as well as service tax as discussedabove, have lists of commodities which are exempt from tax in general.In customs, there are exemptions provided to a class of goods used bythe IT/electronics industries as also for goods used for manufacture ofsteel intermediaries. Exemptions of these kinds had some value in aregime where the tariff rates were high and/or import quotas existed.

However given that the rates of tariff now are nominal, there is no casefor providing exemptions and concessions within customs barring itemsfor which India is committed to provide exemption as per the *InformationTechnology Agreement, 1996*.Similarly, within excises, there are selective exemptions e.g. forfood processing. A full scale study of tax cost of exemption should lookat all these. The estimate presented here should therefore be taken asbeing on the conservative side.

One of the most important reforms needed in indirect tax systemis to evolve a co-ordinated consumption tax system for the country. Thisis necessary to ensure fair distribution of the burden of taxation betweendifferent sectors and between goods and services, improve the revenueproductivity, minimise relative price distortions and above all, ensure acommon market in the country without placing any impediments on themovement of factors and products.

The above involves co-ordinated reforms at central, state, andlocal levels. At the centre, as mentioned above, the first step is to evolvea manufacturing stage VAT on goods and services. At the state level,the reform initiated in April, 2005, of introducing the VAT has to becompleted. The most important step involved in this is the extension ofinput tax credit mechanism not only to intra-state trade but also interstatetrade by introducing appropriate zero-rating mechanism. Thiswould require building up a proper information system on inter-statetransactions, which has been initiated. This will have to be adopted byall the states and union territories. Also, appropriate mechanisms willhave to be found for enabling the states to levy the tax on services andintegrating it with the VAT on goods, so as to arrive at a comprehensiveVAT. An important problem in this regard is devising a system fortaxation of services with an inter-state coverage, which would dependclosely on the mechanism chosen for zero-rating inter-state trade.

An important aspect from the viewpoint of efficiency in resourceallocation is the continued cascading of the tax on petroleum products.These are kept outside the CenVAT system. They are also not a part ofthe VAT system in states. These contribute to over 40 percent of therevenues of both the taxes. Considering the use of these items forintermediate consumption, the extent of cascading and relative pricedistortion will continue to be high.

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