CASCADING EFFECT OF TAX IN INDIA

Mahadev.R

The purpose of this article is to throw light on the cascading effect of taxation present in India and its impact and the possible remedy for the issues arising from the same. The main objective of any taxation in any part of the world is obviously not to levy tax on taxes or in simple words to avoid cascading effect. Cascading effect of tax is one of the major distortions that had crept into Indian taxation. In India, taxes are multi-layered as the central Government levies taxes like excise duty, service tax and central sales tax and State governments levies taxes like VAT/sales tax, entry tax, state excise, octroi etc. However, the fact that Indian Government is now moving towards eradicating this problem by adopting GST in a few years time cannot be overlooked. Some major developments took place in this regard in India in the recent past. Some of them are introduction of Value Added Tax in states by phasing out sales tax, decision taken to reduce the central sales tax over a period of time and phase out the tax by the year 2010 and most importantly the proposition made by the Finance Minister while presenting the budget 2006 to introduce Goods and Service tax with effect from April 2010. It is expected that this date may not be practicable and may have to be extended by a few years.

Tax principles resulting in cascading effect of taxes

India has variety in its culture, religion, places, and languages. Another item which should be added to this list is taxes. Some of the types of taxes which are levied by Central and State Governments are as follows:

CENTRAL GOVERNMENT	**STATE GOVERNMENT**
Direct Taxes • Tax on corporate income • Capital gains tax • Personal income tax • Wealth tax	• State sales tax/VAT • Entry tax • Octroi • State excise

Indirect taxes • Central Excise duty • Service tax • Customs duty • Central Sales tax • Securities transaction tax	• Property tax • Agricultural income tax

Apart from these there are many other taxes like luxury tax, entertainment tax etc. Among these taxes some of the tax principles which are leading to cascading effect of taxes are discussed under following heads.

SALES TAX ON CENVAT

Cenvat is a duty on the activity of manufacturing whereas sales tax is levied on transfer of property in goods. Under the present sales tax provisions which could be of either Central Sales Tax or State Value Added Tax, the sales tax shall be payable on aggregate of the sale prices received and receivable by a dealer in respect of sales made. By virtue of this, the cenvat/excise duty tax shall be includible in the assessable value for charging sales tax. This in turn results in paying sales tax on cenvat levied earlier.

Illustration: Manufacturer 'A' removes Electric Control Panels to 'B' from Bangalore to Mumbai. The value of goods is Rs.250000/-. On this 'A' has to charge cenvat of 10.30% which works out to Rs. 25750/- and on the total amount which is 275750/-, CST at the rate of 2% which is Rs.5515/- is payable. Out of Rs.5515/-, Rs.515/- is a tax on cenvat Rs.25750/-

SALES TAX ON CENTRAL SALES TAX (CST)

In the present VAT system prevailing in various states of the country, the dealer can claim the credit of tax paid on inputs/capital goods purchased within the State. However, credit of Central sales tax paid on inputs/capital goods purchased from other states would not be available. Even though it seems discriminatory, it has to be accepted. This in turn, leads to tax on CST.

Illustration: A dealer from Karnataka State purchases tools worth Rs.85000-from Kerala on payment of CST 2% Rs.1700/-. When the dealer sells the same tools within the State, his cost would be 86700/- on which adding his margin, tax would be charged. If credit of CST was allowed, then the cost would have been reduced by Rs.1700/-.

ENTRY TAX ON SALES TAX

In some of the states of India like Karnataka, Tamil Nadu, the entry tax on goods shall be paid by the dealer causing entry of goods from one municipal area to another. This levy has been held to be compensatory since the entry tax paid was found to be diverted to urban local bodies to provide various services and infrastructure facilities to trader community to carry on their business activities. Under these provisions, the dealer causing entry of specified goods shall be liable to pay entry tax at specified rate which generally ranges from 1 to 12.5%. The tax shall be payable on total invoice value including any taxes paid.

INCOME TAX (TDS) ON SERVICE TAX

As per Section 194 of Income tax Act 1961, any person who is responsible for making certain payments viz., to contractor or sub-contractor, payment made for professional or technical services, payment made as rent, commission or brokerage etc, shall deduct tax at source at specified percentage and deposit it to the Government. Here, the issue is whether the tax shall be deducted on the total value including service tax or total value net of service tax. The general opinion which is prevailing amongst us was that TDS should not be applied on service tax. However, many of the assessees still continue to deduct the tax on total value including service tax. Recently the CBDT has issued a circular (Circular No.4 dated 28th April 2008) to clarify that service tax component relating to rental income need not be subject to TDS u/s 194I. However, the ambiguity still continues relating to deduction of tax in case of payments other than rent. There remains a question mark on whether the Government clarifies this aspect in future so that the cascading effect can be avoided.

Impact of cascading taxation

It is a very big challenge for the Indian Government to overcome the problem of tax on taxes. The cascading effect has lot of disadvantages. Some of them are as follows:

- Tax burden from the stage of import to the stage of delivery has made the Indian products less competitive at international market. The purpose of Government to export goods and not taxes would not be met
- Assessee may try to escape/ evade the tax liabilities as in total they are very high.
- Assessees are finding it difficult to comply with various laws with multiple rates, basis, elaborate procedures where cost of compliance is very high.
- Extra tax burden would be on the ultimate consumer as the taxes are passed on at every stages to end with the final consumer.

Challenges for the Government

The Government cannot stop collecting taxes as the taxes are the main source of revenue to support any Government for mainly paying for its won running along with development/ defense requirements. But in order to achieve the high tax revenue, the Government cannot keep on introducing new tax provisions every time. Presently, the plethora of taxes has created and caused hurdles in the administration and implementation of various laws, complexities in the collection mechanism. It has also caused ignorance/ cynicism among the citizens regarding the existence of various laws and taxes. A normal businessman is unable to ascertain the impact caused by the present tax laws, on his day to day business.

Even though the Government has been successful in achieving the tax to GDP ratio of 12.8% for the financial year 2007-08 against 9.2%[now revised to about 6 % in the light of the slowdown] in the financial year 2008-09, still more revenue can be expected considering the continued growth of Indian economy in recent years. The measures should be taken however, to simplify and rationalize the tax laws. This would definitely lead to widening the tax base. It also encourages the assessee for voluntary compliance. Exemption to sectors like Textiles, molasses for political / other reasons are not prudent tax policies. Presently, due to the ambiguity in Indian tax laws the business man has to spend time on tax compliance rather than on his business. Even after orderly compliance, he is getting letters, show cause notices from the tax departments which is again due to differences in understanding of tax laws by the tax administrators and tax payers as well as more bias being shown towards revenue from the department's side than what is warranted.

Is Goods and Service tax the remedy?

Goods and Service tax is consumption based tax on goods and services collected at each stage of value added in the supply chain. The tax paid on inputs is available for setoff as input tax credit. The ultimate burden of tax would be on the final consumer. Under the GST system, there would not be different types of taxes like excise duty, sales tax/VAT etc. There can be only one or two uniform tax rates. In the present situation the rate of tax can be assumed to be around 15% considering the excise duty and sales tax rates. Since, the input credit is available at every stage, there would be no scope or rather limited scope for cascading taxation under this system.

However, there should be single unified GST in order to overcome the cascading effect. If there are dual GST at Central and State level, the cascading effect would continue as the Central GST might not be allowed for set off as input tax credit against State GST and vice versa. However ours is a federal set up and the States, which are powerful would not like to lose their right to collect such a large tax. Therefore only a dual GST regime would be practical. There is also a big question mark as to whether the local taxes like entry tax/octroi, property tax would be covered under the GST net. We should also focus on positive outcome of the GST which could be better tax administration, less litigation, more tax collection, and more competitiveness of Indian products abroad. These outcomes collectively should result in assisting India to become a developed nation. It is expected that the GST at Sate level and GST at centre would be the possible workable scheme of things to come.

Conclusion: With the introduction of GST it can be hoped that it will resolve substantially the long standing distortions which are continued in indirect taxation. This however would not be easy if multiple rates are sought. However, measures need to be taken to avoid cascading effect of tax in direct taxes also. Some of the provisions of direct taxes which need more focus of the government are with regard to fringe benefit tax, dividend distribution tax, tax collection at source and tax deducted at source etc.