

VAT AND CENTRAL SALES TAX

12.1 CENTRAL SALES TAX

India has a federal structure and the present State-Level value added tax is designed on individual State basis i.e. each State will impose value added tax on the sale/purchase transactions taking place within the State. So far as the trade between various States of India is concerned, the same has been governed by the Central Sales-tax (CST) Act, 1956 which is administered by the State sales-tax departments and the revenue is retained by the State Governments.

The Central Sales Tax Act, 1956 is an Act of the Parliament to formulate the principles for determining when sale or purchase of goods takes place in the course of inter-State trade or commerce. It provides for levy and collection of tax on such inter-State sales of goods. It also formulates principles for determining when a sales or purchase of goods takes place outside a State or in the course of import into or export from India. It also specifies and declares certain goods to be of special importance in inter-State trade and commerce and specifies in relation to them the restrictions and conditions to which the State sales tax laws shall be subject.

A dealer, registered under CST Act, effecting an inter-State-purchase of goods, either for resale, or for use in manufacture or processing of goods, or for mining, or for use in generation and distribution of power or for use in packing for sale/resale can issue form C for availing of the benefit of purchasing at a concession rate (2%) of tax. This form is obtained by the purchasing registered dealer from the concerned sales tax officer.

12.2 CST LEADS TO CASCADING OF TAXES

India has a purely unbalanced State wise economy as only some of the States are manufacturing States while majority of them are consumer states. Manufacturing States generate considerable revenues from CST.

A lot of goods come into the consuming States with CST imposed on them. When these goods are resold in these States, the tax liability of non-manufacturing States becomes

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very high on account of VAT and CST. For example, States that do not produce plastic granules (raw material) have to pay 2% CST (against 'C' Form) on import of plastic granules and on value-addition (finished products) it attracts 12.5% tax, the set-off of tax being nil as CST is not vatable (the concept of CST being non-vatable is explained in para 12.3). Thus, the total tax liability is 14.5% but the States where the raw material (plastic granules) is available the total tax liability would be only 12.5%. This shows that VAT with CST leads to cascading effect.

Trade will be uncompetitive for the States that are net importers, because in those States consumer prices will be high, while the very objective of the VAT system is the lowering of prices for the consumers. Since, CST is an origin-based tax collected by the exporting State whereas VAT is a destination based consumption tax, both cannot go together.

12.3 CST IS NOT VATABLE

The inter-state purchases liable to CST are not eligible for input tax credit. However, the liability for CST can be set off against the input tax credit earned on other eligible purchases.

Let us try to understand this with the help of an example and see why CST is not vatable. A dealer of Karnataka purchases goods from another dealer of Maharashtra. The Maharashtra dealer charges CST @ 2% on this sale against the C-form produced by the dealer of Karnataka. The tax is deposited in the treasury of Maharashtra and thus forms part of Maharashtra's revenue. Though its name is central sales tax but the Central Government does not get any part of this revenue and it is totally a revenue receipt of the selling state. The Karnataka dealer later sells these goods in the State of Karnataka to any other dealer or consumer and collects VAT on the same. Now the question arises whether the Karnataka dealer can claim input tax credit of the CST paid by him against his VAT liability. The answer is no as Karnataka (purchasing State) would not allow set off of a tax paid in Maharashtra (another State) against the tax levied by it as it would result in revenue loss for the Karnataka (purchasing State). This is the main reason why CST is not vatable or why it cannot be made vatable.

However, when liability of CST arises on a inter-state sale, the input tax credit can be used for set off as the revenue in this case the revenue does not go to any other State.

12.4 CST AFTER INTRODUCTION OF VAT

As per the national consensus, the inter-State transactions of purchase and sale will continue to be governed by the CST Act at least for some time till the State-Level Value Added Tax is settled and an alternative system as envisaged in the White Paper is implemented.

A decision has been taken by the Empowered Committee for duly phasing out of inter-State sales-tax or CST. The White Paper in this regard states that:

"There is also a need, after introduction of VAT, for phasing out of CST. However, the States are now collecting nearly Rs.15,000 crores every year from CST. There is accordingly a need for compensation from the Government of India for this loss of revenue as CST is phased out. Moreover, while CST is phased out, there is also a critical need for putting in place a regulatory frame-work in terms of Taxation Information Exchange System to give a comprehensive picture of inter-State trade of all commodities. As already mentioned, this process of setting up of Taxation Information Exchange System has already been started by the Empowered Committee, and is expected to be completed within one year. The position regarding CST will be reviewed by the Empowered Committee during 2005-06, and suitable decision on the phasing out of CST will be taken."

Consequently, in pursuance of the agreement for phasing out VAT entered into between the Central Government and the Empowered Committee of States for implementation of VAT, the rate of CST was reduced from 4% to 3% with effect from 01.04.2007. The rate of CST has been further reduced to 2% with effect from 01.06.2008.

12.5 AMENDMENTS IN CST ACT TO FACILITATE INTRODUCTION OF VAT

12.5.1 Amendment in section 15

Finance Act, 2002 had amended section 15(a) of the CST so as to empower States to impose tax at more than one stage in respect of declared goods defined under section 14 of the CST Act. This amendment is basically in response to the suggestions of the Empowered Committee on VAT asking for amendment in the CST Act so as to facilitate smooth introduction of VAT. It is hoped that CST rate for sale against 'C' form would be gradually reduced from 4% to 0%. Once it becomes so, sales-tax will be levied only by the destination State.

12.5.2 Amendment in section 8

With effect from 01.04.2007, the Taxation Laws (Amendment) Act, 2007 has amended section 8(1) of the CST Act to provide that the rate of tax payable by a dealer shall be 3% of his turnover or the State sales tax/VAT rate, whichever is lower. Further, the Central Government has been empowered to reduce this rate of 3% by issuing a notification. Consequently, the rate of 3% has been reduced to 2% with effect from 01.06.2008.

Self-examination questions

1. What is central sales tax? On which kind of sale is it levied?
2. Explain with the help of an example why CST is not vatable.

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3. Discuss the amendments made in the CST Act in order to ensure smooth introduction of VAT.
4. Explain how the CST in the VAT regime leads to cascading effect of taxes.
5. Briefly explain the policy laid down in the White Paper regarding the phasing out of the CST.

