VAT and CST: A Critical Study of the Problem

Central Sales Tax is a major issue connected with the implementation of Value Added Tax in our country and there were many twists and turns regarding this basic and important issue before introduction of VAT in most of the country in the month of April 2005. Haryana had introduced it in 2003 itself. But the states of Rajasthan, Gujarat, Madhya Pradesh, Chhattisgarh and Jharkhand have refrained themselves from introducing it on certain grounds, including the phasing out of CST and its ultimate abolishment. These states are demanding a clear roadmap for phasing out and ultimate abolishment of CST. Two other important states, UP and Tamilnadu, have also opted out from VAT for their own local and economical reasons.

Sudhir Halakhandi

In our country we have federal system of governance and sales tax is a state subject. Central Sales Tax, by whatever name it is called it is collected by the selling states and also it is the part of state revenue. Central Sales Tax was introduced in our country in 1957 specially to monitor the movement of goods from one state to another in the course of Interstate sales.

The rate of CST at present is 4% against C-form. But this rate was not the original or initially introduced rate. Let us have a look at the rates of CST varied from it's inception in the table given below:

Year	Of Tax CST Rate	Year	Of Tax CST Rate
1957	1%	1963	2%
1966	3%	1975	4%

Why CST Is Not Vatable

Let us try to understand with the help of an example and see why CST is not vatable: -

A dealer of Karnataka purchased goods from another dealer of Maharashtra. The Maharashtra dealer will charge CST 4% on this sale and will get the C-form from the Dealer of Karnataka. The tax will be deposited in the state of Maharashtra and it will form part of Maharashtra revenue. Though it's name is central sales tax but the Central Government will not get any part of this revenue and it is totally a revenue receipt of the selling state.

Since the dealer of Karnataka has paid CST to the Maharashtra Dealer and the same has been deposited and formed part of Maharashtra revenue and now the Karnataka dealer sells goods in the state of Karnataka to any other dealer or consumer and collect vat on the same. Now the reason why CST is not vatable or why it cannot be made vatable is that if CST is made vatable then he will get input credit of CST paid by him to the Maharashtra Dealer and after deducting the same he will deposit the balance of tax to the Karnataka exchequer. No purchasing state can accept this eventuality and give the credit of tax paid in another state and this is the reason why CST is not vatable.

CST And Vat Implementation

The last whole decade specially the year 2002-2003 was very much important relating to the process of

The author is the Member of the Institute. He can be reached at sudhir@halakhandi.com

introduction of VAT and lot of work has been done for the introduction of VAT in our country during this period. During this whole period the problem of CST and its effect of value added tax has been studied very carefully but since the matter is very delicate considering federal system of economy in our country, no suitable solution was found. The problem was further complicated with the fact that we have a purely unbalanced state wise economy in which some of the states are manufacturing states having considerable revenue from the CST but majority of states are consumer states. Hence the conflict regarding CST was inevitable. The problem was so delicate and complicated so it has confused the lawmakers also. Let us see the history how this issue was handled at different period of time and in different situations:

In his budget speech of Budget 2003-04 the erstwhile Finance Minister Mr. Jaswant Singh has declared the following on the floor of house:

"135.With the introduction of VAT, there is need to now phased out the CST, and move to a completely destination –based system. This cannot be done in one step. We must let stabilize VAT; but also recognize that these two – VAT and CST – cannot remain in tandem, in perpetuity. Therefore, in the first instance, the ceiling rate of CST for the inter-state sale between registered dealers will be reduced to 2 percent during 2033-2004, with effect from date to be notified. The government of India will compensate the states for loss of revenue from this reduction of the CST. This will be done, as all these steps have been undertaken, only after arriving at a consensus with the Empowered Committee of state Finance Ministers."

But in the year 2003 vat was postponed and once again when the process of it's implementation was started in the mid of year 2004 the problem of CST was crept up in it's new form. Let us see the statement of Shri Ramesh Chandra, Member secretary of Empowered committee of state finance ministers on VAT at a conference organized by FICCI in the Month of November 2004 regarding this:

"We have been saying from very beginning that CST and VAT are not compatible. CST have been introduced years ago due to certain reasons and those reasons persist even now .So merely making CST 4 % in to zero percent was not the solution. Empowered committee felt that time has not come to do anything on the sales tax front. Also the states had collected Rs. 1 lakh crores as the sales tax. This constitutes 80 percent of the revenue. So CST would continue from April 2005 and the position would be reviewed in October 2005."

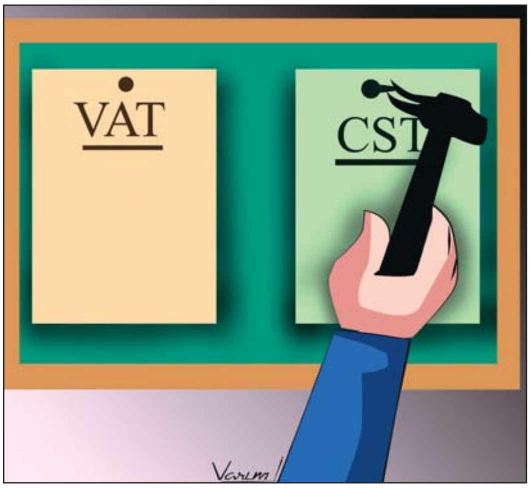
(Source The Hindu, chennai dated 7.11.2004)

Finally in white paper it was declared that initially there would be no change in CST and VAT will be introduced without any change in CST and according to this VAT was introduced as such in the month of April 2005 by 20 states along with the CST without any change.

Now again it is declared by Shri Ramesh Chandra at a conference organized by CII at New Delhi in the Month of April 2005.that CST will start phasing out from 2006 and will be completely abolished in forthcoming years:

"CST is a biggest barrier and the Empowered Committee of State Finance Ministers is working to remove it. We have determined that the rate of CST will come down to 2% from the April 1 2006, before being ultimately phased out from 1st April 2007."

(Source: Financial Express 7th April 2005)



CST And State Economy

What ever may be the differences within the states regarding Central Sales Tax and its role in VAT regime, one thing is clear that the solution is not easy. Since the importance of CST in different states is not the same hence differences are inevitable. Let us try to study the importance of CST in the economy of the different states.

As per budget estimates of 2004-2005 the total budgeted collection from the CST throughout the country is under: -

(Figures in Crores)

Total Local sales tax of the states	Total CST of all the states	% of CST to Local sales tax
88368.41	13655.57	15%

(Source: RBI)

Now let us see how this figure of 13655.57 shared by the different states. Only 8 states covered the 70% share of this nationwide collection of Rs.13655.57 crores: -

(Figures in Crores)

State	Total CST collection	% of National wide collection
Maharashtra	2180.00	16%
Gujarat	1525.00	11%
Tamil Nadu	1229.55	9%
Andhra Pradesh	1164.40	8%
Karnataka	1031.00	7%
Delhi	900.00	7%
Haryana	750.00	6%
Madhya Pradesh	750.00	6%

(Source: RBI)

For these states the CST is the major source of revenue. Let us see how the different states are collecting central sales tax in comparison of their own local sales tax: -

(Figures in Crores)

State	State sales tax	Central sales tax	% of CST on LST
Meghalaya	39.76	29.20	73%
Jharkhand	1254.95	527.52	42%
Chhattisgarh	1115.79	376.91	34%
Gujarat	4927.00	1525.00	31%
Madhya Pradesh	3209.66	750.00	23%
Delhi	3894.90	900.00	23%
Maharashtra	10200.00	2180.00	21%
Haryana	3500.00	750.00	21%
Uttranchal	397.24	67.10	17%
Karnataka	7078.02	1031.45	15%
West Bengal	5055.48	728.36	14%
Punjab	3544.50	445.00	13%
Tamil Nadu	10502.45	1229.55	12%
Andhra Pradesh	10060.48	1164.40	12%
Orisa	1758.28	199.72	11%
Kerala	6557.91	473.03	7%
Rajasthan	4211.23	271.51	6%
Bihar	2402.86	71.62	3%

(Source: RBI)

See barring some states all the states are touching the national average of 15% comparing to the local sales tax collection.

Government's Compensation

The formula of centre's compensation has been mentioned in white paper, according to which the Central Government will compensate the states for loss of revenue resulted from the introduction of vat. But the states have major revenue from the CST will not likely to be in a happy situation because in that case they will have to compromise with their self-reliance. Further the compensation is only for initial 3 years and after that states have to finance themselves. The center's compensation to the major CST collecting states will not practically solve the problem. The Haryana experience has shown that there will be considerable increase in the revenue hence there is a possibility that the comparatively developed states may handle the situation in this respect during the course of time.

Further the center is itself facing the deficit financing and in that case how the amount of compensation will be arranged is also a question. Self-reliance in this respect will only solve the problem.

The Alternate Solution

Phasing out and finally complete abolition of CST has been considered to be the best and ideal solution but if it is possible in present circumstances then vat would have been introduced with a process of phasing out of the CST at the initial stage itself. There are some inevitable problems attached with this issue though the same may or may not be accepted by the persons at the helm of affairs of vat. Some of the states have opted out of vat on the issue of CST. Hence if total abolishment of CST is not possible then a reduced rate of 2% CST and then further reduced rate of 1% can be made to make the balance at both the sides. 4% CST is not a standard rate and our system has the CST ranging from 1% to 4% as enumerated in the table above. Total abolishment will create practical problem also considering our present system of governance and economy and further there is a genuine need to monitor the interstate movement of goods also. Hence instead of total abolishment, a practical approach of reduced rate will a logical approach and also it can make some balanced situation, which in turn will enhance the acceptability of VAT.

The last whole decade specially the year 2002-2003 was very much important relating to the process of introduction of vat and lot of work has been done for the introduction of VAT in our country during this period. During this whole period the problem of CST and its effect of value added tax has been studied very carefully but since the matter is very delicate considering federal system of economy in our country, no suitable solution was found.

Taking some clues from the same type of economic set up and having successful implementation of VAT particularly from the nations like Canada, our law makers can have a acceptable solution in this respect to provide a smooth selling of value added tax which in turn enhance the chances of it's success. ■