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The enigma of differential sales tax

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The UP government maintained until 8 July 1997, a regime of differential sales tax on gas. Until 31 May 1994, whereas tax on gas used for producing urea sold within UP was 5 per cent, on gas used for quantities sold outside it was 10 per cent. With effect from (wef) 1 June 94, these rates were reduced to 2.5 per cent/5.0 per cent for quantities sold within/outside.

Assuming sales outside UP to be 50 per cent, differential levy would result in an overall effective rate of 7.5 per cent up to 31 May 94 and 3.75 per cent wef 1 June 94 as against 5 per cent/2.5 per cent if, uniform rate were to be charged on the entire sales. In turn, this has led to significantly higher cost of producing urea. Other industries using gas are similarly affected.

Under a free market scenario, producers would have correspondingly raised the selling price. The additional burden of hike would be on entire sales and not just on product sold outside UP. Thus, even as the UP government realised extra revenue, a part of this would have been paid for by farmers located in its own state.

The state government seems to have deduced a clever policy stance. Now, urea is covered by the retention pricing scheme (RPS) under which even as GOI controls selling price at a low level, the excess of reasonable production cost over net-back from sales is reimbursed as subsidy to producers. Consequently, burden of differential tax would eventually be met by the Centre.

In view of above, there could be reason for state government to be happy. It gets money at no extra cost to its farmers. At the same time, producers' health is also not affected as GOI is expected to reimburse him for differential tax. It would appear to be a win win for all. But, the situation is not all that simple. The GOI does not reimburse to producer additional sales tax in respect of material sold outside the state (in fact, on this account, two urea majors have an uncovered cost of about Rs 100 crore). It has so far taken the stand that being inequitable and discriminatory, states should not levy such taxes.

On the face of it, UP Sales Tax Act provides an escape route from this problem. The unit can avoid payment of differential tax if, it undertakes outside sales as interstate transaction. But, then, this would attract CST @ 4 per cent. Ironically, this cannot be recovered from farmers. The remedy is worse than the disease.

Wef 9 July 97, UP Sales Tax Act was amended to provide for uniform tax rate of 5 per cent on entire quantities of natural gas consumed. Here again, the state government chose the higher rate. Instead of fixing uniform rate at lower end of earlier differential regime, i.e., 2.5 per cent, it was put at the higher level of 5 per cent. On naphtha, the differential tax system continues.

In view of above, GOI has no reason to deny reimbursement of sales tax on gas in full. Consequently, there is relief for the producers for the future even though the problem for the past period remains. The exchequer on the other hand is saddled with a higher burden of subsidy. This is because as against a weighted average rate of 3.75 per cent earlier, it will now have to recompense @ 5 per cent.

While, some of us are quick to lambaste the increasing fertiliser subsidy, little attention is paid to factors that lead to it. The various taxes on gas royalty @ 10 per cent on producer price, CST @ 4.0 per cent on producer price plus royalty and sales tax @ 5.0 per cent on consumer price plus royalty plus CST plus transport charge add up to a total of about Rs 600 per thousand cubic metre. This increases cost of producing urea by about Rs 400 per tonne.

There are eight plants using gas supplied from HBJ pipeline, five of these located in UP, two in MP and one in Rajasthan. At optimum load, these produce about 6.0 million tonnes urea per annum. The taxes on gas, thus, lead to an extra burden of about Rs 250 crore per annum on the exchequer. Remove these and you save that much money by way of subsidy outgo.

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