

Sales tax on fertiliser subsidies

Illogical and untenable

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IN A recent judgment, the Tamil Nadu Taxation Special Tribunal (TNTST) upheld the decision of the sales tax authorities in the State to levy sales tax on subsidies received by fertiliser manufacturers from the Government under the retention pricing scheme (RPS).

The Government maintains the selling price of fertilisers at low levels to induce an increase in consumption which, in turn, helps increase cost-effective food-grains production and, thus, the achievement of food security. However, the cost of production being higher, the Government assures, under RPS, a fair ex-factory/retention price (RP) including reasonable return, which is based on prescribed efficiency norms for capacity utilisation and consumption of raw materials. The difference between RP and net back from selling at controlled prices is reimbursed as subsidy.

The subsidy is thus an instrument of macro-economic policy which seeks to compensate manufacturers for any losses from selling fertilisers at low prices. Though there is no nexus between the selling price and the subsidy, sales tax authorities have unjustifiably sought to club the two. They maintain that a subsidy constitutes a part of total realisation from sales and is, hence, liable for tax levy. Ironically, this view has been upheld by the TNTST.

In this context, it may be pertinent to recall that the Andhra Pradesh and Kerala high courts held that subsidy received from the Centre cannot be deemed to be a part of sales realisation and therefore, is not liable to be taxed. Surprisingly, TNTST has pronounced the view despite full knowledge of the AP and Kerala High Court judgments.

In Gujarat, in the late 1980s, when sales tax authorities initiated proceed-

ings against manufacturers with a view to collect tax on the subsidy portion, the State government had directed them not to enforce such demands.

The TNTST may have its reasons to justify the levy of tax on subsidy. However, an analysis of the facts reveals that this is not only contrary to the law, but also works against the macro-economic objective of promoting the food security, in the furtherance of which the Government provides the subsidy.

Tax is payable on the sale price which, in this case, is the statutorily notified selling price. Currently, this is Rs. 3,530 per tonne urea on sale through private channel. This, together with the distribution margin of Rs. 130 per tonne (also controlled by the Government) translates to price of Rs. 3,660 per tonne. This is, in fact, the price mentioned on the invoice at which the sale takes place, that is, the material is offered and paid for by the buyer. The subsidy received by the manufacturer from the Government has nothing to do with this transaction and levying taxes on it is illogical.

That the collection of taxes on subsidies is unsustainable under the law may be seen from another angle. Assuming it could be levied, we need to know the subsidy amount to determine the tax. This relevant RP for the manufacturer of, say, Rs. 7,500 per tonne minus Rs. 3,530 per tonne which works out to Rs. 3,970 per tonne. Let the rate of tax be computed at three per cent. Given these, the amount of tax on subsidy works out to Rs. 119.10 per tonne. Add to this, the tax on sale price, that is, Rs. 105.90 per tonne. In other words, Rs. 225 has to be paid as tax for every tonne of urea sold. As a percentage of sale price, this will translate to 6.37 per cent. As this is higher than the prescribed rate of 3 per cent, collecting tax on subsidy will tantamount to violating the Act itself.

(Rs./tonne)

| | Weighted average retention price | Farmgate price |
|---------|----------------------------------|----------------|
| 1991-92 | 4,332 | 3,300 |
| 1992-93 | 4,929 | 2,760 |
| 1993-94 | 5,098 | 2,760 |
| 1994-95 | 5,297 | 3,320 |
| 1995-96 | 5,369 | 3,320 |
| 1996-97 | 5,584 | 3,660 |
| 1997-98 | 6,826 | 3,660 |

Source: Hanumantha Rao Committee Report

Levying tax on subsidy would lead to further distortions and even make a mockery of the legislation on pricing of fertilisers. To gauge this, we need to take note of the fundamental relationship between tax and price. If tax has to be in relation to the total realisation, that is, notified consumer price plus subsidy or Rs. 7,500 per tonne — then as argued by TNTST — and by inference, the selling price must be Rs. 7,500 per tonne. This is the RP of the unit concerned.

As RPS is unit specific, there are as many RPs as there are urea producing units. Consequently, taking the argument of tax on subsidy to its logical limits would tantamount to having multiple selling prices. This will be contrary to the Fertiliser Control Order, under which urea is required to be sold at a uniform price throughout the country irrespective of the source of supply.

That charging of tax on subsidy is illogical and inconsistent may be analysed from yet another angle. Consider a reverse situation in which RP is lower than the selling price. In fact, this was the scenario in the early 1980s, with respect to some plants, such as GSFC, Baroda, JFFCO, Kalol and HFC, Namrup.

Against this backdrop, were the units'

effective realisation (selling price minus amount returned to the Government) taxed, the relevant price should have been the RP. This is totally illogical. In such cases, the sales tax authorities charge tax only on the selling price, and rightly so.

The practical side of tax on subsidy cannot also be wished away. Sales tax is essentially borne by the buyer. The manufacturer is only a conduit for collecting it and depositing it with the concerned authorities. As the demand for tax is retrospective — covering past several years, even if the additional tax on subsidy had to be paid, it is virtually impossible (even, unthinkable) to expect manufacturers to chase consumers who bought material and paid tax on the lower selling price.

Either way, the demand for levy of sales tax on subsidy received from the Government is unwarranted, unjustified, illogical and legally untenable. It violates the State Sales Tax Act and will be termed untenable even in the view of central legislation.

Besides, the levy of tax on subsidy works against the macro-economic objective of keeping fertiliser prices low and achieving food security. In fact, when viewed from this angle, the tax on notified selling price itself does not make sense. Indeed, some States — Punjab, Maharashtra and Haryana — do not levy it. Levying tax on subsidies as well will make a mockery of laudable objectives.

The TNTST judgment is bound to give rise to further litigation. To prevent this and save manufacturers from attendant problems, the State government should see reason and avoid proceeding with the levy of tax on subsidies received by manufacturers from the Centre.

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