Editorial

24 July, 2000

THE HINDU **BUSINESS LINE**

Tax on subsidy: An impractical move?

Uttam Gupta

WHILE administrative and judicial bodies are expected to aid the process of economic reforms, they sometimes tend to obstruct the smooth conduct of normal business. A case in point is the issue of sales tax on subsidy given by the Government to fertiliser producers and refineries.

The sales tax authorities in Tamil Nadu, Andhra Pradesh and Kerala, who assess sales turnover without taking into account the subsidy element, suddenly decided, in 1988, to raise the demand for a tax on subsidy for past period; for instance, in Tamil Nadu for 1982-83 to 1987-88. This started a long legal battle.

Significantly, in the first half of 1990, various High Courts in Andhra Pradesh, Kerala and Uttar Pradesh held that demand for sales tax on subsidy was untenable. The judgments were upheld by the Supreme Court. However, in an order dated August 3, 1998 the Tamil Nadu Taxation Special Tribunal (TNTST) ruled that subsidy was liable to levy of tax. In a similar order, in the case of Madras Refineries Limited (MRL), it held that the subsidy received from the Oil Pool Account (OPA) was taxable.

From here on, the matter went to the Chennai High Court, which directed producers to deposit 50 per cent of demand. Unable to arrange the required cash, the latter approached the Supreme Court, seeking stay against action ordered by former. However, in its order of June 9, 2000, the apex court refused to intervene. It would perhaps wait until the Chennai High Court gives its final verdict.

Sales tax is leviable only on the price at which material is sold. In refinery products and fertilisers, the price is controlled by the Government. Subsidy is only a reimbursement of the excess production cost over this, to prevent loss to producers and ensure viable operations.

The payment of subsidy by the Government to the producer has nothing to do with actual sale to consumer. This is clear from the fact that subsidy is paid on despatch from the factory. The relevant price for levy of sales tax is the selling price. Hence, subsidy cannot justifiably form part of sale proceeds.

The current selling price of urea to dealers is Rs. 4,400 per tonne. If the ex-factory is Rs. 8,000 per tonne, the subsidy is Rs. 3,600 per tonne. Now, if a sales tax of, say, 25 per cent is charged on subsidy as well, the tax amount will be Rs. 400 per tonne (Rs. 8,000 x 0.05). This translates to an effective rate of 9.09 per cent (400/4,400) on selling price. Being higher than 5 per cent, this is untenable.

While insisting on tax on subsidy, the powers-that-be seem unmindful of the serious practical problems that could ensue. The liability for sales tax is on the consumer. In view of this, and since the demand is from 1982-83 to 1987-88, it would be virtually impossible to chase them! All along, consumers paid a uniform price, irrespective of source of supply. However, due to varying production cost, subsidies received by various units under RPS differed. Now, if sales tax is payable on subsidy as well, farmers would end up paying different amounts of tax, depending on the unit whose product was bought. This defies logic and is violative of the FCO. In initial stages of RPS, in several units, the selling price was higher than the retention price (RP) (difference was credited to the Pool Account). In such cases, tax was rightfully paid on the selling price. Now, if the contrary view is accepted, only the lower RP should be taxed and, logically, excess tax collected would have to be refunded to consumers. This, again, is impossible!

The State governments need to understand plain logic. The Government gives subsidies on fertilisers/petroleum products primarily to reduce their cost to farmers/poor consumers. By levying tax on subsidy, this objective will be defeated. Why, then, are the authorities bent on following such a course? And why do Courts allow such untenable demands to drag on?

(The author is chief economist, the Fertiliser Association of India.)