



## CHAPTER-I

### NATURE, HISTORY AND THEORY OF STATE EXCISES

#### Section-I

##### 1.1 Nature of And Reasons for the Study :

The State Governments obtain revenue from a variety of taxes. Of these, State excise is one of the important sources of revenue. Moreover, the revenue from State excises has shown a relatively faster rate of growth in the recent years.

The nexus between State excises and prohibition policy also makes the study of State excises exciting intellectually but at the same time slippery in a non-economic context.

The period covered under this study is a period of gradual relaxation of prohibition policy. In the last decade every State in India relaxed the prohibition policy - dose by dose - which makes the formal study of State excises interesting and meaningful.

The objectives of or the reasons for the study are mainly to study trends in various aspects of State excises with special reference to Maharashtra. More precisely this study attempts to analyse the changes and trends in -

- a) Revenue from State Excises.
- b) Revenue significance of State Excises.
- c) Level of State Excises.
- d) Per capita burden of State Excises.

- e) Cost of collection of State Excises.
- f) Buoyancy and income elasticity of State Excises.
- g) Developmental significance of State Excises.

The study also makes a brief review of history and economics of prohibition policy coupled with economics of State excises.

## 1.2 Methods of Study :

The period under study covers a span of 20 years. This is a sufficiently long period to get meaningful conclusions regarding the changes in revenue significance and other aspects of State excises. In all these aspects, the particular case of Maharashtra is compared with the All-States model. This comparison is static as well as dynamic because the comparison is for each year of the period under study. This study depends mainly on the secondary data available in official records relating to financial affairs to the State Governments, particularly budgetary documents, Combined Finance and Revenue Accounts (Government of India), Finance Accounts (Government of Maharashtra), the publications of the Planning Commission, the Reserve Bank of India and of the Central Statistical Organisation, the Directorates of Economics and Statistics of different State Governments and other publications pertaining to the subject matter of this study. For this purpose, use of simple tools of statistical analysis i.e. % changes, ratios, growth rates etc. is made.

## Section-II

### 1.3 Meaning of State Excises :

Ordinarily excise means a tax or duty on home produced goods either at some stage of production or before their sale to home consumers. The present concept of excise which has evolved over a period of years, has been described as follows<sup>1</sup> :

Firstly, excise means any duty, toll or tax.

Secondly, an inland duty levied upon the manufacturer, sale or consumption of commodities within the country.

Thirdly, excise means a tax upon certain sports, trades or occupations, usually taking in this case the form of exactions for licenses. Originally, the excise means the tax on commodities (which is generally an indirect tax, of which the burden falls on the consumer), but now it is to be applied to duties or fees levied upon makers, of, or deals in, exciseable commodities.

Lastly, excise means various taxes levied for permission to practice or conduct certain sports, trades, occupations etc.

An excise duty may be levied upon raw materials or at an intermediate stage of their production. Similarly an excise can be levied at the stage when the commodities are ready for consumption. If the excise duty is levied at the raw material stage, it becomes disadvantageous to producers.

The Government tries to strike balance by imposing the tax taking into consideration the average duration of the production process.

Taxation at the raw material stage may help in avoiding a part of the tax burden. In this case producers try to improve the production process in order to increase the income per unit of the raw material so that per unit burden of excises is reduced.

It is generally maintained that taxes should be levied in accordance with the canon of convenience. From this point of view, an excise tax should be levied at an intermediate stage of production or on the finished product. If the taxes are levied at an intermediate stage, the legislators get in opportunity to take quality of the commodity into consideration so that they can impose higher rates on better qualities. It also facilitates collection of the tax.

According to De Viti de Macro,<sup>2</sup> an excise tax imposed on raw material, is inequitable because products of different values are obtained from the same raw material and the poor tax payer is forced to pay a relatively larger tax. So it is always suggested that an excise tax should be imposed on finished products in order to make it more equitable in all its effects. Such an excise tax is more convenient for collection because it avoids the necessity of close and continuous supervision of the production process.

Section-III

**1.4 Constitutional Provisions  
Regarding State Excises :**

Indirect taxation constitutes the main constituent of tax revenue in India. The Central Government and State Governments are imposing excise duties on various commodities. Entry 51 of the List II (State List) enumerates the State excise duties.<sup>3</sup> State Governments can impose excise duties on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India. These goods are -

- a) alcoholic liquors for human consumption,
- b) opium, Indian hemp and other narcotic drugs and narcotics.

Some goods are excluded from State excise duties, i.e. the medicinal and toilet preparations containing alcohol. The Central Government is empowered to levy taxes on these goods. But these taxes are collected and appropriated by the States. The Central Government has authority to impose excise duties according to Entry 84 of the List-I (Union List). It is clear from the nature of goods included in the list, subject to State excises that excises at the States' level are more of a sumptuary nature aiming at curbing the production and/or consumption of such goods which are presumably social bads in nature.

According to Entry 84 of the List-I (Union List) the Central Government has wide powers of excise taxation with some exceptions which are subject to State excises. On the other hand, State Governments have relatively less powers of excise taxation. However, the State Governments have similar wide powers to impose taxes on sales and purchase of goods.

#### Section-IV

##### 1.5 Historical Review of State Excises in India :

The rates of excise duties vary from State to State. During the British rule, the aim was to raise maximum revenue from the excise duties while trying to maintain consumption and/or production at as low a level as possible.

No restrictions can be imposed on inter-State trade as per the provisions of article 301 of the Indian Constitution. State can enforce prohibition or other reasonable restrictions on the freedom of trade. The liquors and intoxicating drugs are strictly regulated even in wet areas. They can be imported only under a permit issued by the Excise Commissioner of the importing state. The liquors and intoxicating drugs are allowed to be exported only after the issue of a permit by the Excise Commissioners. Small quantities of about 1 to 3 litres of foreign liquor, whether imported or Indian made, can be carried to wet areas from one State to another without a permit.

The Indian National Congress was committed to a restriction of the consumption of liquor mainly because of Gandhiji's influence. He strongly pressed for the implementation of prohibition programme as early as possible. Congress Ministries were set-up in various States after the inauguration of Provincial Autonomy. Madras was the first province to enforce prohibition and extended it to four districts. Later on, other States, having Congress Ministries gradually adopted prohibition. But there was a great increase in cases of illicit distillation and Government was being deprived of significantly large revenue.

As an anti-inflationary measure, the Government of India advised the provincial Governments in 1948, that they should not extend, and if possible slow down, their prohibition schemes.<sup>4</sup> The Government of India also intimated that no financial assistance would be provided to compensate for the loss of revenue resulting from prohibition. Complete prohibition was enforced in the State of Madras (including Andhra) from October 2, 1948, in the State of Bombay (now Gujarat and Maharashtra) from April 6, 1950 and in Sourashtra from 1950. Other State introduced prohibition in selected areas or districts.

In India, prohibition is important not only from a social or moral point of view, but it is also an attempt to rectify the regressive burden of the taxation. Most of the excise revenue is derived from taxation of country spirit,



opium and other drugs. Excise duties are not only a taxation measure but they also aim at controlling and regulating the consumption of alcoholic liquors and toxicating drugs. However, since independence the prohibition has led to illicit distillation and inter-State smuggling of liquor from wet to dry areas. This has increased the incidence of corruption amongst officials. Naturally the State loses economically on two accounts - (i) loss of revenue because of corruption and (ii) the increasing public expenditure entailed by preventive and regulatory administration.

Prohibition is an alive issue mainly because, almost invariably, in all the States which experimented with prohibition, in all the States which experimented with prohibition, it has failed, whereas socially it must succeed and economically it cannot. Shri D.P. Misra, Chief Minister of Madhya Pradesh, expressed his personal opinion at Raipur on February 20, 1966 that prohibition has not been successful though he was not against it and accepted its utility.<sup>5</sup> In 1963-64, Uttar Pradesh also removed prohibition from 11 districts where it was in force and introduced 57 dry days throughout the State.

In the last decade the Government of Maharashtra has relaxed the prohibition policy to a great extent by adopting a new revised permit system, which largely increased the number of liquor permits. The Karnataka Government has also introduced free sale of intoxicants of 3.5% of alcoholic content. The

The policy of the Mysore State was widely supported. A permit could be issued only in case of those who were above 30 years of age. Shri Ramakrishna Hedge, Karnataka's former prohibition minister, declared that relaxation of prohibition was not due to revenue considerations but was due to the inability of the Government to enforce the prohibition law. The Government was convinced that the extension of prohibition was impossible due to impracticability of enforcing prohibition through legislation. Shri Hedge also declared that prohibition cannot succeed unless it is applied throughout the State and the country.<sup>6</sup> Haryana, Kerala and Andhra Pradesh scrapped prohibition due to impracticability of enforcing prohibition through legislation.

The Tekchand Committee recommended the introduction of prohibition throughout the country through a phased programme spread over a period of 12 years, so that by 1975-76 the wet States should be ready to come in line with dry States and the final phase after this should consist of the introduction of complete prohibition.<sup>7</sup> However, the social reforms cannot be enforced through legislation. For this purpose, the Government should try to prepare and educate the people in the sociology and economics of prohibition. Most States accepted the Tek Chand Committees' report at least in principle.

Section-V

**1.6 Theoretical Analysis of State Excises :**

**1.6.1 Base of the Tax :**

There are four major types of excise taxation.<sup>8</sup>

(1) Taking the expenditures on the consumption of particular articles. Such excises on the consumption of particular articles are known as luxury excises.

(2) Excise taxation can be used to deliberately reduce the consumption of a particular type of commodities. These are commodities whose production and/or consumption entail costs to society over and above those incurred in their production. The main purpose of such an excise is to penalise the consumers and/or producers of such commodities. These excises are known as sumptuary excises. The usage of the term 'sumptuary' can be explained in two ways. The technical usage of the term 'sumptuary' refers to the regulation or control of private expenditure. In public finance usage, term 'sumptuary' represents all extra revenue objectives of taxation. The practice of Governments of imposing high consumption taxes upon liquor and tobacco can be partially explained by a desire to reduce their use.

(3) Some excises are based upon benefit. In this case, it is expected that excises allocate the burden of the tax in

relation to benefits received. Such a tax assumes that there is a close relationship between the benefits received from a particular public activity and the consumption of a certain commodity.

(4) Excises may be used as a rationing device. In this use, the excise duty may be used as a device to reduce consumption of scarce articles instead of direct control measures.

We can sum-up in the following manner :

- i) An excise tax is mainly related to expenditure as the base of the tax.
- ii) Excise are mainly of four types i.e. (a) luxury, excises, (b) sumptuary excise, (c) benefit excises and (d) diversionary excises.

#### 1.6.2 Nature of the Tax :

Excise duties in India and other countries are levied both in 'specific' as well as 'ad valorem' terms.<sup>9</sup> Excise on such items as petroleum products, tobacco (excluding cigarettes in case of India) and alcoholic preparations (excepting in India where this is a State tax under the constitution) are specific duties in all countries and India. Generally, specific duties are suitable in the case of commodities for which classifications and sub-classifications are not numerous. These

specific duties are levied mainly with a view to checking further increases in consumption. Ad valorem duties are suitable to levy where the values are different for different varieties of the commodity.

However, there are several deviations in actual practice. For example, in the case of items like cotton textiles and tobacco the price differentials could be significant for the same varieties but the duties on these commodities under our excise system are specific. On the other hand, on an item like sugar the duty imposed is ad valorem at present. Actually, sugar does not have many specifications. Specific duty may be said to be superior to ad valorem in this case. But the duty is levied upon sugar on an ad valorem basis at present. Comparatively, specific duties are more convenient than ad valorem duties from the administrative point of view. However, specific duties are inferior to ad valorem duties in respect of revenue elasticity. In a developing country revenue productivity becomes a major requisite of a tax or the tax system as a whole. Naturally, a tax of the excise type which provides substantial revenue to the Central Government and a significantly large revenue to the State Governments, must be, as far as possible, ad-valorem in nature.

#### 1.6.3 Objectives of the Tax :

The main objectives of State excises are discussed below :

The main object of the levy of an excise duty has always been revenue. Whenever, the Government faces a sudden need for increased public expenditure (for instance in times of war) duties of excise become handy and just by increasing the rates on articles currently subject to the tax or increasing the number of articles subject to excises, Government can increase the revenue very conveniently. On the other hand, in a developing country, public expenditure both non-developmental and developmental, tends to increase at a rapid rate. However, because of low levels of per capita income and a large non-monetised sector, the growth of revenue tends to be sluggish. In such a situation, duties of excise remain the only easy avenue for rapidly increasing revenue.

A significantly large number of people have a variety habits, of which some are aptly described as addictions (e.g. tobacco, liquor, opium, ganja etc.) The consumption of these goods is injurious to the health both individually and socially. Individually, it weakens the persons mental and physical capacities and disturbs the psychological peace and economic security of the family. Socially, it creates problems of law and order. In short, most of these articles are social bads. Therefore, it becomes necessary for the Government to curb the production and/or consumption of such articles. Thus curbing of socially and some times economically undesirable activity becomes a responsibility of the Government. Excise duties can be used for this purpose. In an inflationary

situation, particularly if it is due to excessive demand conditions, excise duties can be effectively used to restrict the demand vis-a-vis a particular commodity or even in a general manner, if a general excise duty is made applicable. Sometimes, scarcity or shortage of a particular commodity may create problems of stability as well as availability of the commodity to priority sectors. In this situation also excise duties become useful and effective. Thus excise duties can be effectively used to attain singly or collectively, the objectives of revenue productivity, sumptuary taxation and demand restriction and/or efficient allocation of a scarce commodity.

#### 1.6.4 Shifting, Incidence and Effects of Excise Duties :

Excise duties are basically an indirect tax. Naturally shifting of the burden of the excise duty will be certain and in a significant quantum. The incidence of excise duties will depend on the nature of the commodity, mainly price elasticity of its demand and supply conditions. These aspects will at the same time determine the nature of shifting, full or partial, forward, backward or lateral etc. If the supply conditions are given, larger will be the incidence on the seller of the excisable commodity, the greater is its price elasticity of demand and vice-versa. Similarly, if demand conditions are given, larger will be the incidence on the buyer, the greater

is the price-elasticity of its supply. We can look at the excise duty as a case of a single price. In case of a particular excise duty, the incidence will be proportional to the excise duty. If we consider a general excise duty, then the incidence will be proportional to the income of the consumers. Of course, this will be more particularly true in case of advalorem excises. To the extent proportionality is acceptable as an indicator of relative equality of tax burden, this type of excise duty can be said to subserve the objective of equity. However, if we accept the proposition that income itself is subject to the law of diminishing marginal utility, then a simple advalorem excise at a flat rate will be certainly regressive in incidence.

Because in that case loss of utility due to excise duties in case of poorer consumers will be greater even if the direct money burden remains the same. But with greater knowledge of the market situations, patterns of consumer expenditure, and technical advances in the management of tax systems, it has now become possible to introduce a certain degree of progressivity in the composition and rate structure of the excise duties. For instance, if the excise tax is levied at higher rates on luxury goods and if the excise tax is levied at low rates on essential goods, the rich persons pay more tax and poor persons pay less tax. The luxury commodities are consumed by rich persons. If the excise duty



is imposed at high rates on luxury commodities, automatically the burden of the excise tax falls on the rich persons. On the other hand, the necessary goods or commodities consumed by poor persons can be exempted from excise taxation.

However, in case of State excises, this analysis requires some significant qualifications. State excises cover mainly the commodities which form either a minor but a lasting habit or a strong addiction. Consequently, the demand for such commodities (tobacco, liquor and other intoxicants) becomes almost price-inelastic. But at the same time, this demand is income-elastic. Naturally, the incidence of the State excises will be mostly on the consumers. The regressivity of this incidence will depend mainly on the proportion of income spent by the consumers on these terms. If it can be assumed that with increasing income levels, this proportion decreases then State excises will be certainly regressive.

The long run effects of State excises, in particular, on production, employment etc. may not be adverse at all. This again is due to price-inelastic and income elastic nature of the demand for goods subject to State excises.

R E F E R E N C E S

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