HISTORY
OF INDIRECT TAXES

ISSUE 03 | AUGUST 2021

Indians, both ancient and modern, are not new to taxation. Tax was collected as a source of revenue since the times of Chandragupta Maurya and has been a part of the country in one way or another. However, the indirect tax system that India adopted since Independence is a legacy of the British, who introduced the modern Customs duty & Excise duty levied on merchants trading in India and goods produced in India.

In late Nineteenth century, the highest tax that was collected was land tax followed by taxes on opium and salt which together constituted over 75% of the tax revenue to the British. Then, the British introduced machine made fabrics and textiles due to the industrial revolution and had to choose a well populated market such as India to sell the goods and bolster their revenues. But, in order to sell these they had to first make the local Khadi industry un-attractive and thus, introduced taxes on the textiles manufactured in India to increase the prices of the Khadi textiles and bring it on par to their machine-made cotton fabrics. Thus, this act by the British contributed towards the Swadeshi movement and gained momentum around 1905 with the partition of Bengal.

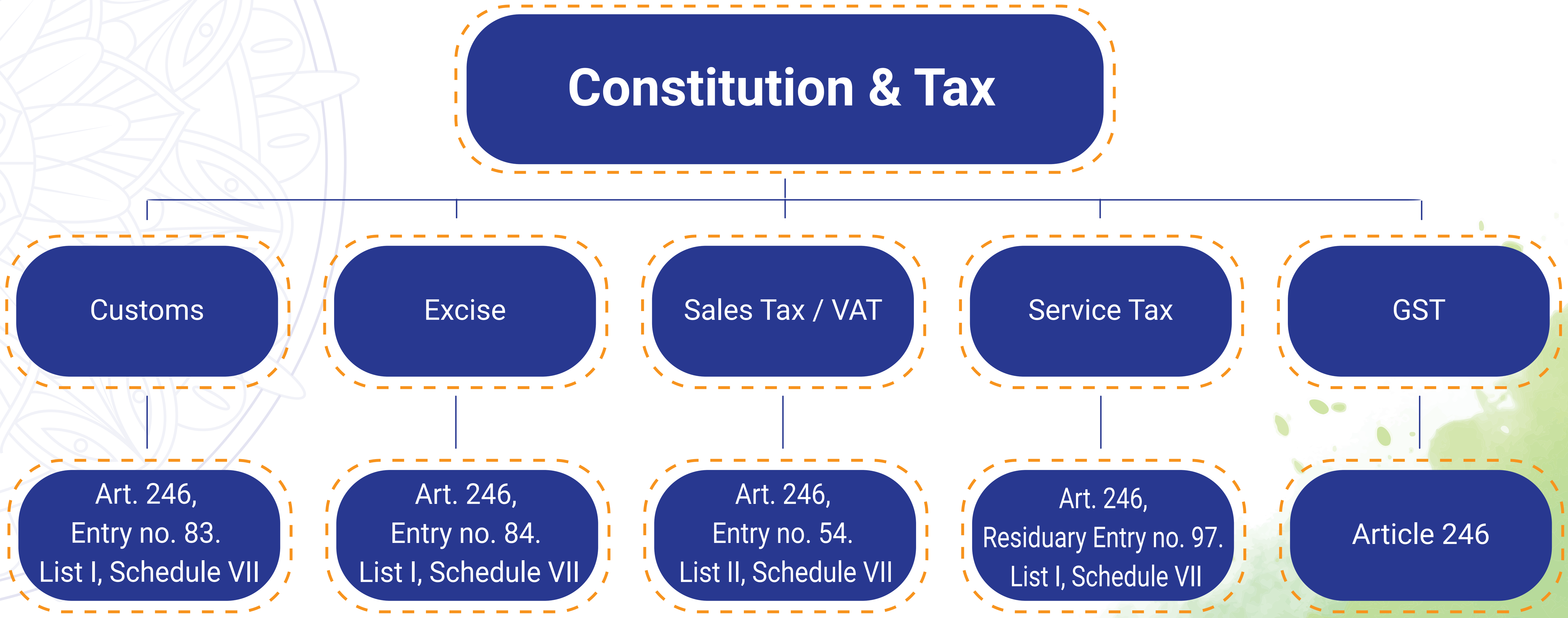
Regardless, taxation has played an important role in contributing to economic growth and is the major source of revenue to the government.

Taxation After Independence And The Indian Constitution's Role

Post-independence, India continued the tax systems and laws of the British with modifications where required. But, the adoption of the Constitution of India on 26th January 1950 meant that all the laws implemented in India have to be sub-ordinate to the constitution. Hence, the makers of the Constitution implemented Article 246 along with the Seventh Schedule which gave the elected governments the power to levy tax and this power was shared between the central Union government and States.

The Seventh Schedule to Article 246 contains three lists which state the areas under which the union and the State Governments have the authority to make laws.

List I - Union List which gives the Parliament of India the power to make laws
List II - State List which gives the State Legislature the power to make laws
List III - Concurrent list which gives both the Parliament and State the power to make laws



Customs - The First Modern Tax To Be Levied

India's tryst with modern taxation started with Customs Duty levied on merchants wanting to sell their wares in India. Customs duty was based on the 'customary levy' collected from merchants who sold their wares. Since the majority of trade was through the sea, the very first act for levying duty was the 'Sea Customs Act, 1878' which regulated the movement of goods through the sea. With the developments of the steam engine technology and the advent of railways, transportation of goods through railways started to become common and this resulted in the 'Land Customs Act, 1924'. Then, the World Wars brought rapid innovation and development of aircrafts which also began to be used for transportation of goods, thus resulting in the 'Indian Aircraft Act, 1934'.

Post-independence, India continued the use of these laws to regulate goods movement and levy of customs duty till 1962. The Customs Act, 1962 was notified on 1st February 1963 and superseded the earlier laws. The Central Board of Indirect Taxes and Customs (CBIC), a pan-India board for regulation and implementation of the central indirect taxes and customs, was also set-up shortly on 1st January 1964.

Thus, customs became a full-fledged law enacted to regulate and levy customs duty on import and export of goods outside India.

Excise - The Tax That Influenced The Indian Independence Movement

The Central Excises and Salt Act, 1944 was introduced on 24th February, 1944 to levy tax on manufacturing within India. The intention to levy tax on just manufacturing was criticized by many economists as being a burden to the people, while some justified the levy on sin goods such as alcohol and tobacco.

In India, some of the first goods to be levied with excise duty included salt, diesel, tobacco and also coffee & betel-nuts. In fact it was excise duty on salt that gave inspiration to Mahatma Gandhi to go on the Dandi March on 12th March 1930. Mahatma Gandhi protested against the huge levy of tax on making of salt and the monopoly the British and their agents had on salt production. The Dandi March became a pivotal event in the Indian freedom struggle and brought the world's attention to India's plight. It also had a profound impact on the taxation of salt even after independence. In fact, salt was taxed under the law but exempted by way of notifications in every Finance Act after independence. Thus, excise duty on salt manufacturing became one of the catalyst for the Indian Independence movement.

In the early days of Excise, a physical control system was put in place to monitor and levy excise. This involved an officer of the Central Excise supervising the clearance of goods from the factory premises. This was changed to self-assessment by the taxpayer in 1969 on gate-pass and on invoices from 1994.

Central & State Sales Tax - The Taxes With High Cascading Effect

The Constitution (Sixth Amendment) Act, 1956 was introduced to bring Central Sales tax on inter-state trade and commerce and restrict states from levying tax on the same. Further, various states brought in their own Sales Tax Acts to levy tax on intra-state trade & commerce.

In case of states, The Madras General Sales Tax Act, 1939 is said to be the first state tax law passed in India. And the Mysore Sales Tax Act, 1957 was introduced in Karnataka for levying taxes on sales.

Central State Tax is an origin based tax i.e. the tax levied belongs to the state which produces those goods and which is the state of origin.

CST brought in the concept of Forms wherein inter-state sales were allowed to be taxed at lower rates through the production of Form C and for branch transfers of goods made from one state to another through the production of Form F and such other forms to facilitate interstate trade. These forms became the subject of numerous litigations and increasing tax compliances as the taxpayers were dependent on the receipt of such forms to claim exemptions.

CST was finally subsumed by the introduction of GST in 2017.

Many states followed the multi-point tax system wherein the sales tax was levied at each point of sale and thus, adding to the cascading effect. However, gradually states adopted the single-point system where the sales tax was levied only at the first or earliest points of sale.

State specific sales tax was replaced with the Value Added Tax (VAT) system eventually.

Value Added Tax - The Tax That First Allowed Input Tax Credit

Value added tax is simply the tax payable on the value addition made on a product. The earlier systems of transactional tax did not allow claim of input tax credit to manufacturers and sellers and this contributed to the system of cascading taxes. Hence, the Union government introduced the Manufacture VAT (MANVAT) and later the Modified VAT (MODVAT) in 1986 to allow manufacturers of certain types of goods to claim excise duty paid on their raw materials and capital goods.

This was replaced by the Central VAT (CENVAT) in 2002 which allowed the manufacturers & service providers to claim input tax credit on their supplies thus reducing the cascading effect to a large extent. The input tax credit was allowed for excise duty paid, service tax on input services and also additional customs duty on imports and notified cess.

Along with Central VAT by the union government the various state governments also started to introduce VAT in place of sales tax which allowed for input tax claim of VAT paid on purchases. Each state passed their own laws for VAT with Karnataka passing the Karnataka Value Added Tax Act, 2003 effective from 1st April 2005 and Maharashtra passing the Maharashtra Value Added Tax Act, 2002 effective from 1st April 2005.

Service Tax - The First Tax On Services

The service sector constituted up to 40% of the Gross Domestic Product (GDP) of the country in 1994 but had not been subject to tax till then. After the liberalisation of the Indian economy in 1991, the government decided to impose Service Tax. Hence, the Finance Act, 1994 introduced Service Tax at the rate of 5% on only 3 services i.e. telephone bills, insurance company premium and stock broker commissions.

First it was a positive list wherein services that were subjected to service tax was specified, but in 2012 it was changed to a negative list wherein all services except those that were notified under the negative list was subject to service tax.

As India started becoming a service-oriented economy from a manufacturing economy, service tax started to become an important source of revenue for the government where it grew from Rs. 407 Crore in 1994 to Rs. 2,10,000 Crore in 2015 and after multiple revisions in the service tax rates, cess and surcharge.

With the introduction of service tax, construction companies and hotel businesses faced a unique situation wherein their supplies was taxed under both service tax and sales tax laws.

To avoid double taxation and unnecessary litigation, the concept of abatement was brought in wherein sales tax / VAT was levied on the goods component and service tax on the services component.

Goods & Services Tax - the tax that brought the Centre and the States together

Till GST was introduced, the Centre and States could levy taxes as permitted by the constitution. The GST act subsumed all the Indirect Taxes existing at the time except for Basic Customs Duty and Excise & Sales Tax on certain goods.

GST changed the earlier origin-based taxation wherein the states from which the supplies originated from were benefitted to the current destination-based taxation where the states in which the goods are consumed.

The GST Bill was originally proposed by then Prime Minister Atal Bihari Vajpayee in 2002 and it was finally approved on 29th March 2017 and was made effective from 1st July, 2017. GST was introduced through The Constitution (One Hundred and First Amendment) Act, 2016 which introduced Article 246A which gives powers to both the Parliament and the State legislators to make laws in GST.

The GST laws and amendments are not governed by the Finance Ministry but by the GST Council, which is composed of the Union Finance Minister and the State Finance Ministers or representatives and the Minister of State for Finance.

Under GST laws, input tax credit is freely available subject to certain conditions and certain ineligible activities. The GST rates are also rationalised based on their importance in society with necessities being charged at 5% or 12% rates.

Today, revenue generated from GST has reached record-breaking levels with the highest tax collection under GST being made for the month of March 2021 with a record-high of Rs. 1.41 Lac Crores despite the COVID pandemic affecting businesses in India.

Other taxes

Along with the above types of taxes, various stated also used to levy other indirect taxes such luxury tax on certain luxury goods, entertainment tax on cinemas and theatres, professional tax on practising professionals and entry tax for goods brought into the state for sale or consumption. All of the indirect taxes levied have been subsumed under GST after its implementation except for Professional Tax.

Following are the chronology of events leading to indirect tax reform in India:

 # 1935 - Tax on sales of goods a provincial subject
 # 1939 - Sales Tax launched in India in the State of Madras
 # 1956 - Central Sales Tax brought in to govern inter-state sale of goods
 # 1962 - Customs Act introduced by subsuming earlier customs related laws
 # 1985 - Central Excise Tariff Act introduced to specify rates for excise duty
 # 1986 - MODVAT or modified VAT, introduced on select commodities
 # 1994 - Service tax introduced in India
 # 1999 - Centre announced decision to introduce VAT in India
 # 2002 - CENVAT introduced on commodities at central level
 # 2003 - VAT introduced in first Indian State of Haryana
 # 2005 - VAT in 24 States/UTs
 # 2006 - VAT implemented fully in entire India
 # 2017 - GST implemented in entire India by subsuming most of the other indirect taxes in India

NOTIFICATIONS AND CIRCULARS FOR THE MONTH OF JULY 2021

- **Three Central Tax Notification. -** *Click here*
- **One Central Tax Circular. -** *Click here*

Sr. No	Subject	Notifications/Circulars No. Date of Issue
1	Seeks to exempt taxpayers having AATO upto Rs. 2 crores from the requirement of furnishing annual return for FY 2020-21.	31/2021-Central Tax dated 30.07.2021
2	Seeks to amend Rule 80 of the CGST Rules, 2017and notify Form GSTR 9 and 9C for FY 2020-21. Rule 80 provides for exemption from GSTR-9C to taxpayers having AATO upto Rs. 5 crores.	30/2021-Central Tax dated 30.07.2021
3	Seeks to notify section 110 and 111 of the Finance Act, 202 w.e.f. 01.08.2021.	29/2021-Central Tax dated 30.07.2021
4	Clarification regarding extension of limitation under GST Law in terms of Hon'ble Supreme Court's Order dated 27.04.2021.	157/13/2021-GST Circularno dt. 20-07-2021

GST DUE DATES FOR THIS MONTH

AUGUST

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
1	2	3	4	5	6	7
8	9	*GSTR-7 & GSTR-8 10	*GSTR-1 11	12	*GSTR-1 13	14
15	16	17	18	19	*GSTR-3B/5/5A 20	21
22	23	24	25	26	27	28
29	30	31				

2021

* *Monthly return for taxpayers with Annual Turnover more than Rs.1.50 Crores or Taxpayer who has opted Monthly return option.*

* *For taxpayers with Annual Turnover less than Rs.1.50 Crores or Taxpayer who has opted quarterly return option (QRMP).*

CONTACT US

Mumbai Address

2nd Floor, Gita Building,
Sion Circle, Sion (East),
Mumbai – 400022

Bangalore Address

No.8, 3rd Floor,
VK COMMERCE, 3rd Main
Rajajinagar 6th Block, Opp.
IT Park, Bangalore - 560010

+91 7738066622
info@incorpadvisory.in
www.incorpadvisory.in

Disclaimer