Chapter 4

Taxes and Subsidies

October 2019

This chapter should be cited as
ERIA (2019), 'Taxes and Subsidies', in Phoumin, H., S. Kimura and R. G (eds.), *Energy Pricing in India: A Study on Taxes and Subsidies.* ERIA Research Project Report FY2018 no.15, Jakarta: ERIA, pp.33-34.

Chapter 4

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India has a federal system of taxation wherein the central and state governments/local authorities levy taxes on goods and services based on a taxable event. All taxes levied within India need to be backed by an accompanying law passed by the Parliament or the respective state legislature. India has two conventional types of taxes – direct taxes (income, corporate, capital gains, security transaction, etc.) and indirect taxes. Other taxes include cess – a tax whose revenues are earmarked for a specific purpose. The present study is confined to indirect taxes, which are further classified as producer and consumer taxes for ease of understanding. In India, there are several multi-tiered (central, state, and local levels) and multi-rate indirect taxes. The main indirect taxes are central excise, customs duty, service tax, central sales tax, and value added tax (VAT). Additionally, other indirect taxes, such as entry tax and octroi, are also levied by the state and local governments. The subsequent section explores the tax structure before the implementation of GST on 1 July 2017 in each segment considered for the study.

1. Methodology

The identification of subsidies presented herein is primarily based on a literature review of various government and public documents, and stakeholder consultations. The study also focuses on understanding the implicit and explicit subsidies existing in these product segments and the mechanism of subsidy transfer which in many cases is assessed based on existing data and certain assumptions. This study adopts the definition of subsidy of the International Energy Agency as follows:

'Any government action that lowers the cost of energy production raises the revenue of energy producers or lowers the price paid by energy consumers.'

This definition is designed to capture all the diverse and non-transparent types of energy subsidies that commonly exist. The energy subsidies have been differentiated according to whether they confer a benefit to producers or consumers. While consumer subsidies lower the price to end consumers, producer subsidies involve measures that seek to maintain or expand domestic supply. In certain developing economies such as India, consumer subsidies are more prevalent.

For taxation, the study team reviewed the literature to understand the tax structure associated with each product and aggregated the data available in the public domain. Whenever data availability in the public domain is limited, a bottom–up approach of the price build-up of respective products was carried out considering the consumption of products, final product prices, notified rate of sales tax/VAT in each state, notified distributor commission for each product, etc. to identify the total tax revenue that each product contributed to the state/central governments. For the purpose of understanding, taxation has been classified into producer taxes and consumer taxes.

In this context, producer taxes are levies on fossil fuel production and import and transport processes until the product reaches the end consumers. The taxation rates are determined by the central government through the MoPNG, Ministry of Coal, and Ministry of Finance. Consumer taxes are levies on the purchase or sale of products to end consumers; here, the taxation rates are determined mainly by the state government/local authorities but a certain tax on interstate purchase is determined by the central government.