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Dr. Emil Sunley has written a well researched article comparing the tax burden on Bidis with that on Cigarettes in India. The paper makes a case not only for enhancing the tax burden on bidis but also for rationalisation of the tax on health grounds. It is argued that in spite of the fact that health risks involved in the consumption of bidis is at least as high as it is on cigarettes, the tax burden on the former is substantially lower. There is certainly a case for increasing the tax burden on bidis on health grounds and the argument that bidi is consumed by poor people and therefore, should be taxed at lower rates on equity grounds does not hold water for, health is as important if not more for the poor as it is for the rich.

The paper, thus, makes out a clear case for enhancing the excise rates on bidis. While the unorganised nature of the industry makes administering the tax on bidis difficult, the tax exemption granted for bidi manufacturers producing less than 2 million bidis a year enables significant avoidance of the tax. There is also no case for making the distinction between man made and machine made bidis.

Indeed, administering the tax on a dispersed industry is a challenge and given that improving the health status of the poor is extremely important in empowering them to acquire capabilities and gain freedoms, the policy makers should take note of the very important recommendations made in the study and implement them without delay.

MGRao

(M. Govinda Rao)

Dear Colleague:

Tobacco is the world's leading single agent of death, and India is the world's second-largest consumer of tobacco. In India, bidis account for the great majority of smoked tobacco, and they are no less harmful than cigarettes. Having worked at intervals in India and with many Indian colleagues for more than 50 years, I remain deeply concerned about the current and growing epidemic of illness and death from tobacco, including from bidis.

The attached report from Emil Sunley, one of the world's leading experts on tobacco taxation, shows not only *that* taxes on bidis should increase, but also lays out a rational, detailed plan for *how* to do so. Sunley's conclusions are clear:

- On a per-stick basis, bidis are at least as harmful as cigarettes, but the excise on bidis is only 8% that of the most similar type of cigarettes, and less than 1% that of standard cigarettes.
- Excise duty accounts for only 9% of the retail price of bidis; the recommended international benchmark for taxation from a health point of view is 70% or higher.
- Between half and three quarters of all bidis are completely untaxed, either because of exemptions or tax evasion.

Sunley's recommendations are equally clear. To rationalize taxation and protect health, policymakers should:

- In the immediate term, increase the excise rate on bidis from Rs 14 to at least Rs 168 per 1,000 sticks – resulting in a tax rate identical to that of the most similar type of cigarette.
- Improve tax collection by abolishing the distinction between handmade and machine-made bidis, limiting tax exemptions to only truly small producers or eliminating these exemptions entirely, requiring bidi tobacco sellers to report sales to manufacturers or their representatives, and requiring bidi manufacturers to report all tobacco purchases.

Another important opportunity described in the report is the planned introduction of a national goods and services tax (GST) in 2010 in India. This provides a unique opportunity to rationalize and simplify the tax treatment of tobacco products. Under the national GST, a single excise tax rate for all cigarettes (initially set higher than the current rate for regular filter cigarettes) can be implemented, and over several years, the excise rate on bidis per 1,000 sticks should be increased to the rate for all cigarettes.

The consumption and participation elasticities for tobacco are well understood. Not only could implementation of the recommendations in this report increase government revenues for important projects, but, even more importantly, could reduce the number of smokers in India by 18 million and deaths from smoking by at least 6 million. The high quality of the analysis and the potential enormous gains outlined here strongly suggest that the report should be considered in the strongest light during all subsequent considerations of tobacco taxation in India.

Sincerely,

John Crofton

Professor Sir John Crofton
Edinburgh, Scotland
January 2008

India

The Tax Treatment of Bidis

Emil M. Sunley

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1992–2006.

Executive Summary

Bidis are under-taxed compared to cigarettes, taking into account the health risks of each, and therefore, on health grounds, a strong case can be made for increasing the excise burden on bidis.

Under current law, handmade bidis are taxed at a lower rate than machine-made bidis. Also, bidis produced by manufacturers producing less than 2 million bidis a year are exempt from excise duty. As the manufacturing of bidis is highly fragmented, excise officers cannot maintain physical control over each bidi facility, as they do in the case of facilities for cigarette manufacturing.

The paper recommends the following priority reforms regarding the taxation of bidis: (i) the distinction between handmade and machine-made bidis should be eliminated; (ii) the excise rate on bidis should be increased from Rs 14 per 1,000 sticks to at least Rs 168 per 1,000 sticks, which would tax bidis per stick the same as micro non-filter cigarettes; (iii) the small producer exemption should be either eliminated or limited to truly small companies by requiring that all related companies would be considered a single company for purposes of this exemption; (iv) the sale of unbranded bidis should be prohibited and the name of the manufacturer should be required to be printed on the wrapper of each bidi packet; and (v) each person selling processed bidi tobacco to a bidi manufacturer or a bidi manufacturer's representative should be required to report all sales to the Excise Department and each bidi manufacturer should be required to report all purchases of tobacco.

The union Government is committed to introducing a national goods and services tax (GST) in 2010. This will provide an opportunity to rationalize and simplify the tax treatment of tobacco products. To this end, the paper makes the following recommendations: (i) under the national GST, excisable goods should be treated the same as other goods and therefore the April 2007 exemption of bidis from the state value-added taxes would not be taken as a precedent; (ii) there should be a single specific excise rate for all cigarettes, which initially should be set higher than the excise rate for regular filter cigarettes (adjusted for the general consumption tax component of the current excise duty); and (iii) over several years the excise rate on bidis per 1,000 sticks — handmade or machine-made — should be increased to the single rate for all cigarettes.

One of a series of reports on tobacco taxation funded by the Bloomberg Philanthropies as part of the Bloomberg Initiative to Reduce Tobacco Use

I. Introduction

The Indian market for smoking tobacco is dominated by bidis (also known as beedis and biris). A bidi consists of shredded tobacco which is hand rolled in a tendu leaf secured with a colorful string at one end. They are smoked primarily by men, especially in rural areas, and are rolled primarily by women, often in their homes. Bidis are under-taxed compared to cigarettes taking into account the health risks of each, and therefore, on health grounds, a strong case can be made for increasing the excise burden on bidis. However, the tax rate on bidis has been kept low to "protect the poor."

This paper primarily addresses the tax treatment of bidis. However, as cheap non-filter cigarettes are a substitute for bidis, the paper also addresses the tax treatment of cigarettes.

India's central government is committed to introducing a national goods and services tax (GST) in April 2010. This will provide an opportunity for India to follow best international practice and to separate its excise taxation on a few products from its general consumption tax. At that time, India should simplify and rationalize its excise treatment of bidis and cigarettes. Annual increases in excises on bidis do not need to wait until 2010. The goal should be to narrow the differential in the excise burden on bidis and cigarettes.

Bidis are under-taxed compared to cigarettes … a strong case can be made for increasing the excise burden on bidis.

The organization of the paper is as follows: Section II provides an overview of the bidi industry. Section III reviews evidence that bidis are at least as harmful as cigarettes. Section IV surveys the excise rates on bidis and cigarettes, revenue raised through excise taxation, the burden of excise taxation, and the consumption of bidis and cigarettes. Section V outlines the fundamentals of excise tax administration. Section VI turns to the policy issues: the distinction between handmade and machine-made bidis, the tax rate on bidis, the small producer exemption, and measures to reduce tax evasion. Section VII discusses the opportunity to rationalize and simplify excise taxation in the context of India adopting a national GST. Section VIII concludes.

II. Overview of the Bidi Industry

The production of bidis is highly labor intensive involving three constituencies: (i) the tendu leaf plucker,* (ii) the bidi tobacco farmer,† and

* The tendu leaf is a non-timber forest product that is found mainly in Madhya Pradesh and Chattisgarth (Central India). Leaf collection, mostly by tribal people, occurs from mid April until the first week in June; i.e., it provides employment for less than 8 weeks of the year.

† Bidi tobacco is a sun/air cured variety of tobacco that is grown mainly in Gujarat, Maharashtra, and Karnataka.

(iii) the bidi manufacturer. Manufacturing bidis involves four steps: (i) procurement of raw material, (ii) bidi rolling, (iii) sorting and roasting, and (iv) packing (Figure).

The Ministry of Statistics and Programme Implementation estimated that there were 6,693 bidi manufacturers in 1995 — the last year for which data are available. In contrast, there were only 40 cigarette factories and 55 chewing tobacco factories (Table 1). Many bidi factories probably were not included in the survey because they were below the threshold for the annual survey.* By 2004, the number of factories manufacturing all tobacco products had decreased to about 3,000.

A bidi roller can make about 1,000 bidis a day and is paid Rs 40 to Rs 80 (US$1 to US$2) for the day's work.

The bidi manufacturer procures the raw materials (leaves, tobacco, and thread) for making bidis. The tobacco used in bidis may be mixed with flavors such as chocolate, vanilla, clove or pineapple to make them attractive to youth. The actual bidi rolling is done mostly by female home-based workers who work under a contractor; the contractor collects the raw material from the manufacturer, drops off the materials to the rollers, and collects the previous day's output. Each roller is equipped with a leaf cutting die — a rectangular piece of aluminum about 2-1/2 by 1 inch dimensions used to cut the leaf for rolling it into a bidi. A roller can make about 1,000 bidis a day and is paid Rs 40 to Rs 80 (US$1 to US$2) for the day's work.

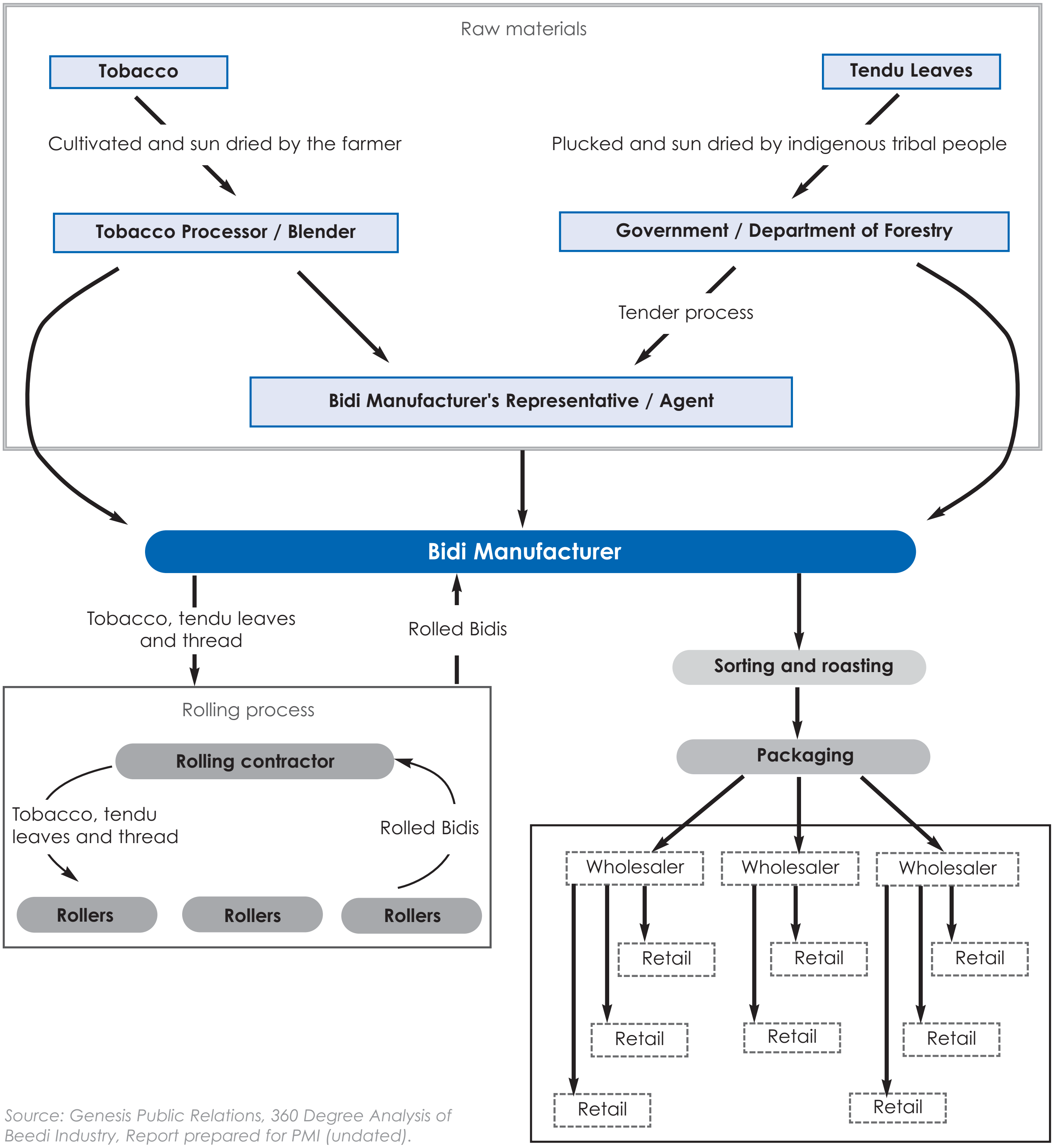
Generally, neither the contractor nor the roller owns the raw materials or the rolled bidis. They are contract workers for the manufacturer. Once the bidis are supplied back to the manufacturer, they are sorted and placed on trays for roasting. The roasting is carried out in a simple oven for a period of about 12 hours to get rid of any moisture. The roasting is complete when the coal is burned out. Bidis are sold in both branded and unbranded packs.

Bidi manufacturing is labor intensive. India's Ministry of Labor estimated that there were 4.2 million bidi workers in 2002.[1] If workers in related activities — tendu leaf collectors, cultivators, wholesalers and retailers — are taken into account, there could be nearly 8 million workers who obtain some part of their income from bidis. For many of these workers, such as leaf collectors, bidi work provides only a minority of their yearly employment.[2]

There are over 300 brands of bidis and no brand has a market share of more than 5 percent. Bidis are usually sold in packs of 25; there are also packs of 20. Branded bidis are priced at Rs 2.5 to Rs 5 per pack of 25, with the most common price being Rs 4 per pack (US$0.10).[3]

* For a factory to be included in the Annual Survey of Industries there must be 10 or more workers if the manufacturing is carried on with the aid of power, or 20 or more workers if manufacturing is carried on without aid of power. Home-based job workers are not counted as factory workers.

Figure: The Bidi Manufacturing Process



Source: Genesis Public Relations, 360 Degree Analysis of Beedi Industry, Report prepared for PMI (undated).

In terms of tobacco consumed, bidis command 48 percent of the market while chewing tobacco commands 38 percent and cigarettes 14 percent.[4] Thus, by weight, bidis account for 77 percent of the market for bidis and cigarettes (i.e., the market for smoking tobacco).

Although there are no specific figures of how many bidis are produced or consumed annually due to the fragmentation of bidi manufacturing and distribution, estimates range from 750 billion to 1.2 trillion. In fiscal year 2005/06, 106 billion cigarettes were consumed in India.[5] Thus roughly 10 bidis are consumed in India for each cigarette.*

By weight, bidis account for 77% of the market for smoking tobacco.

Table 1: Manufacturing of Tobacco Products

	Number of Factories	Total Output (Value) Rs million
Bidis		
1991	6,983	15,933
1992	7,472	16,422
1993	6,847	18,529
1994	4,235	21,115
1995	6,693	21,281
Cigarettes		
1991	39	8,574
1992	35	9,850
1993	36	12,724
1994	35	13,135
1995	40	15,244
Chewing Tobacco		
1991	64	1,228
1992	47	1,046
1993	56	1,348
1994	48	1,488
1995	55	1,730
Manufacturing of Tobacco Products[a]		
2000	2,643	106,473
2001	2,697	119,127
2002	2,477	98,507
2003	2,562	122,282
2004	3,078	120,752

[a] *Manufacturing of tobacco products includes bidis, cigarettes, and chewing tobacco. Data for the period 2000–04 are available only at the 4-digit level (e.g., manufacturing of tobacco products) and not at the 5-digit level (e.g., bidis). Source: Annual Survey of Industries.*

* If it is assumed that a bidi consists of 0.2 grams of tobacco and a cigarette 0.75 grams of tobacco and that 1 trillion bidis and 106 billion cigarettes were consumed in 2005/06, then by weight bidis accounted for 72 percent of the market for smoking tobacco, which is close to the 77 percent estimate based on tobacco consumed.

III. How Harmful Are Bidis?

Health experts agree that all tobacco products cause disease. As a cigarette consists of about 0.75 to 0.85 grams of tobacco and a bidi consists of about 0.15 to 0.25 grams of tobacco, one might assume based on the amount of tobacco in each cigarette or bidi that one cigarette is as harmful as 4 or 5 bidis and that the tax burden, per stick, on bidis should be one-quarter or one fifth that on cigarettes.

Epidemiologic studies suggest that the all-cause mortality among bidi smokers is at least as high as that among cigarette smokers. Using Mumbai's voters' list, a recent prospective cohort study — the gold standard of epidemiology — followed 99,750 individuals aged 35 or older.[6] The study found that the adjusted relative risk was 1.64 for men who smoked bidis and 1.37 for men who smoked cigarettes, compared to 1.00 for men who never smoked.* As the number of bidis or cigarettes smoked per day in this study was quite low (median 5 cigarettes or 12 bidis), the higher relative risk for bidi smokers could reflect that the median bidi smoker consumed more sticks (although less tobacco) than the median cigarette smoker.

All-cause mortality among bidi smokers is at least as high as that among cigarette smokers….bidis are at least as dangerous as cigarettes per stick, if not more so.

To address this concern, the study compares bidi and cigarette smokers who smoke 1–5 sticks a day and who smoke more than 5 sticks. The study concludes that the risk of death per stick was higher for bidis than for cigarettes. For men who smoked 1–5 bidis a day the relative risk was 1.42; for men who smoked 1–5 cigarettes, the relative risk was 1.20.† If we focus on smokers of greater than 5 sticks a day (bidis or cigarettes), the findings are quite robust. For men who smoked 6–10 bidis the relative risk was 1.56, while for men who smoked 6 or more cigarettes (including those with a pack a day plus habits) the relative risk was 1.50. This supports the conclusion that bidis are at least as dangerous as cigarettes per stick, if not more so.

Why might bidis be more harmful if they contain less tobacco per stick? One possibility is that bidis are self-extinguishing, and thus the bidi smoker must suck harder to keep the bidi lit, bringing more smoke deeper into the lungs. One health study found that bidis contain two to three times the tar and nicotine as regular cigarettes. In this study, smoke from regular cigarettes and bidis was given to Swiss albino mice. Bidi smoke reliably caused cancer in doses small enough that regular cigarette smoke in the same doses left the mice apparently healthy.[7] That bidis contain higher levels of nicotine and tar is indirectly admitted in the advertising of a major bidi manufacturer who proclaims that a bidi lasts about 8–10 puffs and

* The 95% confidence interval was 1.47–1.81 for bidi smokers and 1.23–1.53 for cigarette smokers. The confidence intervals obviously overlap.

† The 95% confidence interval was 1.20–1.68 for bidi smokers who smoked 1–5 sticks and 1.02–1.42 for cigarette smokers who smoked 1–5 sticks.

gives a complete smoking satisfaction while a cigarette lasts 15–20 puffs before giving the same level of satisfaction.[8]

One health study found that bidis contain 2 to 3 times the tar and nicotine as regular cigarettes.

IV. Overview of Rates, Revenue, Tax Burden and Consumption

This section outlines some basic facts regarding the taxation and consumption of bidis and cigarettes. Section VI takes up various policy issues raised by these facts.

Excise rates on bidis and cigarettes

India imposes specific excises (per 1,000 sticks) on both bidis and cigarettes. For bidis, the rates depend on whether the bidis are handmade* or machine-made (Table 2). The excise rates on bidis were not increased for

Table 2: Excise Duty Rates on Bidis, 1993/94–2007/08 (Rs per 1,000 bidis)

Year	Handmade	Machine-made	Handmade	Machine-made
	Current Rupees		2007/08 Rupees[a]	
1996/97	5.5	11.6	10.1	21.2
1997/98	6.5	15.5	10.9	25.9
1998/99	6.5	15.5	10.2	24.3
1999/00	6.5	15.5	9.0	21.5
2000/01	8.0	17.0	10.7	22.8
2001/02	9.0	19.0	11.6	24.5
2002/03	9.0	19.0	11.1	23.5
2003/04	9.0	19.0	10.7	22.6
2004/05	9.0	19.0	10.3	21.7
2005/06	9.0	19.0	9.9	20.9
2006/07	12.0	22.0	12.7	23.3
2007/08	14.0	26.0	14.0	26.0

[a] *Calculated based on CPI year-over-year percent change for industrial workers (2001 weights)*

Source: Department of Revenue, Ministry of Finance, International Monetary Fund

* To be more specific, the lower rate is for bidis, other than paper rolled bidis, manufactured without the aid of machines.

four years between 2002/03 and 2005/06. The rates for handmade bidis were then increased 33 percent in 2006/07 and an additional 16 percent in 2007/08.* Bidis produced by manufacturers producing less than 2 million sticks a year without machines are exempt from the excise.

Until the two recent increases in excise rates on bidis, the rates had barely kept pace with inflation. In terms of 2007/08 rupees, the excise rate for handmade bidis in 2005/06 (Rs 9.9 per 1,000 sticks) was lower than the rate in 1996/97 (Rs 10.1 per 1,000 sticks).

The excise rate for handmade bidis in 2005/06 was lower than the rate in 1996/97 (in terms of 2007/08 rupees).

For cigarettes, the excise rates vary by the length of the cigarette and are higher for filter than for non-filter cigarettes (Table 3 for rates in

Table 3: Excise Duty Rates on Cigarettes, 1993/94–2007/08 (Rs per 1,000 cigarettes — current rupees)

Year	Non-filter ≤60 mm	Non-filter >60–70 mm	Filter ≤70 mm	Filter >70–75 mm	Filter >75–85 mm	Filter >85 mm
1993/94	120	250	330	630	850	[a]
1994/95	60	280	370	710	950	1,350
1995/96	60	300	400	750	1,000	1,350
1996/97	75	315	430	800	1,070	1,350
1997/98	90	350	500	820	1,100	1,350
1998/99	100	370	550	900	1,200	1,470
1999/00	110	370	550	900	1,200	1,470
2000/01	115	390	580	945	1,260	1,545
2001/02	135	450	670	1,090	1,450	1,780
2002/03	135	450	670	1,090	1,450	1,780
2003/04	135	450	670	1,090	1,450	1,780
2004/05	135	450	670	1,090	1,450	1,780
2005/06	150	495	740	1,200	1,595	1,960
2006/07	160	520	780	1,260	1,675	2,060
2007/08	168	546	819	1,323	1,759	2,163

[a] *Rs 600 or 300 percent + Rs 20, whichever is higher*

Source: Department of Revenue, Ministry of Finance.

* The percentage increases for machine-made bidis were 16 percent in 2006/07 and 18 percent in 2007/08.

Handmade bidis account for over 98 percent of the market for bidis.

nominal terms and Table 4 for rates in 2007/08 rupees). For purposes of excise taxation, the length of a filter cigarette includes the filter, which is normally 10 mm. Thus a 70 mm filter cigarette has about the same amount of tobacco as a 60 mm non-filter cigarette.

Manufacturers of bidis and cigarettes also pay an education cess* of 2 percent of the excise duty and a secondary and higher education cess of 1 percent of the excise duty.† These levies, which raise the effective excise burden by 3 percent, are not discussed further.

Government revenue

In fiscal year 2006/07, the excises on bidis and cigarettes raised 16 percent of total tax revenue and 64 percent of excise revenue. Data are not available on the excise revenue from handmade vs. machine-made bidis,

Table 4: Excise Duty Rates on Cigarettes, 1996/97–2007/08 (Rs per 1,000 cigarettes — 2007/08 rupees[a])

Year	Non-filter ≤60 mm	Non-filter >60–70 mm	Filter ≤70 mm	Filter >70–75 mm	Filter >75–85 mm	Filter >85 mm
1996/97	137	576	786	1,463	1,957	2,469
1997/98	150	585	836	1,371	1,839	2,199
1998/99	156	579	861	1,409	1,878	2,301
1999/00	152	512	761	1,246	1,661	2,034
2000/01	154	522	777	1,265	1,687	2,069
2001/02	174	580	864	1,406	1,871	2,296
2002/03	167	556	828	1,347	1,792	2,200
2003/04	161	535	797	1,296	1,724	2,116
2004/05	154	515	766	1,247	1,659	2,036
2005/06	165	545	815	1,322	1,758	2,160
2006/07	170	551	827	1,336	1,776	2,184
2007/08	168	546	819	1,323	1,759	2,163

[a] *Calculated based on CPI year-over-year percent change for industrial workers (2001 weights)*

* A cess is an earmarked tax.

† The education cess (introduced in 2004) and the secondary and higher education cess (introduced in 2007) apply to income tax, corporation tax, customs duties, and service tax in addition to excise tax.

but the Department of Revenue believes that handmade bidis count for over 98 percent of the market for bidis. Although 10 bidis are smoked for every cigarette, in 2006/07 bidis accounted for only 5.7 percent of the excise revenue from bidis and cigarettes, down from 7.4 percent in 1993/94 (Table 5).

Although 10 bidis are smoked for every cigarette, in 2006/07 bidis accounted for only 5.7% of the excise revenue from bidis and cigarettes, down from 7.4% in 1993/94.

When excise rate on handmade bidis was increased 33 percent at the beginning of 2006/07, excise revenue from bidis increased only 16 percent. Why was the increase so low? Part of the explanation is that there is a payment lag between when the excise liability accrues and when payments are received by the government. As bidi manufacturers are required to make excise payments only every three months,[9] the expected increase in revenue in the first financial year from a 33 percent increase in the rate would be 24.75 percent — payments in the first quarter would reflect production during the previous financial year. That revenue increased only 16 percent would also be due to some bidi smokers reducing consumption, switching

Table 5: Excise Revenue from Bidis and Cigarettes, 1993/94–2006/07 (Rs millions)

Fiscal Year	Total	Bidis	Cigarettes	Bidis as a Percent of Total
1993/94	29,591	2,195	27,396	7.4
1994/95	29,629	2,200	27,429	7.4
1995/96	36,502	2,233	34,269	6.1
1996/97	42,242	2,415	39,827	5.7
1997/98	48,162	3,238	44,924	6.7
1998/99	49,153	3,233	45,920	6.6
1999/00	51,843	3,217	48,626	6.2
2000/01	55,343	3,538	51,805	6.4
2001/02	54,167	3,572	50,595	6.6
2002/03	55,004	3,604	51,400	6.6
2003/04	58,317	3,364	54,953	5.8
2004/05	63,431	3,482	59,949	5.5
2005/06	74,785	3,680	71,105	4.9
2006/07	75,119	4,262	70,857	5.7

Source: Department of Revenue, Ministry of Finance.

Establishing the same per-stick tax for bidis as for cigarettes would require the rate for bidis to increase from Rs 14 per 1,000 to at least Rs 168 per 1,000, which is the current rate for micro non-filter cigarettes.

from taxed to untaxed bidis, or switching to the lower-priced cigarettes. There also would be some increase in tax evasion; that is, bidi manufacturers underreporting production. Steps to improve compliance are discussed in Section VI.

Excise burden — bidis vs. cigarettes

By any measure, per gram of tobacco per stick, or relative to the retail price, bidis are under-taxed relative to cigarettes. The excise burden on bidis is Rs 0.07 per gram compared to Rs 0.22 per gram for micro non-filter cigarettes, which are low-priced cigarettes aimed at the low-income segment of the market, and Rs 1.092 for regular filter cigarettes, which are the most popular category of cigarettes (Table 6). Thus, per gram of tobacco, handmade bidis have only one-third the excise burden of micro non-filter cigarettes, which in turn have only one fifth of the burden of regular filter cigarettes.

Given that the epidemiologic studies indicate that bidis are at least as harmful as cigarettes per stick, the under-taxation of bidis is even greater. Establishing the same per-stick tax for bidis as for cigarettes would require the rate for bidis to increase from Rs 14 per 1,000 to at least Rs 168 per 1,000, which is the current rate for micro non-filter cigarettes (Table 7).*

Table 6: Excise Burden per Unit of Tobacco, 2007/08

Category	Grams of Tobacco (per 1,000 sticks)	Excise Duty (Rs per 1,000 sticks)	Excise Duty Per Gram of Tobacco (Rs per gram)
Handmade bidis	200	14	0.07
Micro non-filter cigarettes (≤60 mm)	750	168	0.22
Regular filter cigarettes (≤70 mm)	750	819	1.092

* If the lowest taxed regular filter cigarettes were used as the new bidi benchmark (as opposed to micro non-filters cigarettes), the tax rate for bidis would increase from Rs 14 per 1,000 to Rs 819 per 1,000.

When the excise burden is measured as a percentage of the retail price, the burden is 33 percent or higher for cigarettes but only 9 percent for bidis (Table 8).* This again suggests that bidis are under-taxed relative to cigarettes.

As a percentage of retail price, the excise burden is 33 percent or higher for cigarettes but only 9 percent for bidis.

Tables 6 and 7 overstate the true excise burden on both bidis and cigarettes because part of the excise duty is in the nature of a general consumption tax, as explained below. The excise duty on bidis comprises three elements: (i) the Central Value Added Tax (CENVAT), (ii) the National Calamity Contingent Duty (NCCD), and (iii) Beedi Workers' Welfare Cess (BWWC) (Table 8). For cigarettes, the excise duty also comprises three parts: (i) CENVAT, (ii) NCCD, and (iii) the Health Cess (HC) (Table 9).

As NCCD applies to bidis, cigarettes and other goods that are often subject to excise duties, it is an excise-type levy.† BWWC applies only to

Table 7: Excise Burden on Cigarettes and Bidis, 2007

Category	Most Popular Brand	Retail Price Per Stick (Rs)	Excise Duty Per Stick (Rs)	Excise Duty as a Percent of Retail Price
Cigarette filter:[a]				
>75–85 mm	Four Square	3.0	1.759	58.6
>70–75 mm	Wills Navy Cut	3.4	1.323	37.8
≤70 mm	Gold Flake	2.4	0.819	34.1
Cigarette non-filter:				
>60–70 mm	Cavanders Gold Leaf	1.25	0.546	43.7
≤60 mm	Charminar	0.50	0.168	33.6
Bidis:				
Handmade	-	0.16	0.014	8.8

[a] Filter cigarettes >85 mm are omitted as they constitute only a negligible share of the market.

Source: Philip Morris International and author's estimates

* Within each category of cigarettes there is considerable variation in prices. Among premium brands (filter >70–75 mm), the price per pack of 20 is Rs 100 for India Kings, Rs 90 for Marlboro, Rs 76 Gold Flake, and Rs 60 for Four Square. The most popular brand in the filter >75–85 mm category (Four Square) is cheaper than the most popular brand in the filter >70–75 mm category (Wills Navy Cut). According to Philip Morris International, before March 2007, the price of Four Square was Rs 58 per pack and Wills Navy Cut was Rs 54 per pack, but after the 5 percent excise increase in the 2007/08 budget, the price of Four Square was increased to Rs 60 per pack while the price of Wills Navy Cut was increased sharply to Rs 68 per pack.

† Specifically, the NCCD is a surcharge by way of duty or excise levied on goods specified in the Seventh Schedule of the Finance Act of 2001. The goods subject to NCCD include tobacco products, petroleum products, high tenacity yarn of polyesters, and motor vehicles.

An estimated 52–70 percent of all bidis do not get taxed because of non-compliance or small producer exemption.

bidis and HC applies only to cigarettes and therefore these also are excise type levies. CENVAT, in contrast, applies to most manufactured goods at a 16 percent rate and is similar to a value-added tax that applies only through the manufacturing stage. However, in the case of bidis (and cigarettes) the CENVAT is a specific levy and if translated into ad valorem rate, it would be much higher than 16 percent. Thus part of the CENVAT levy on bidis and cigarettes is in the nature of a general consumption tax (the amount equal to 16 percent of the manufacturer's price) and part is in the nature of an excise (the amount in excess of 16 percent). Given the markup between manufacturing and retail, a 16 percent CENVAT is roughly equivalent to a 10 percent tax on retail.

Table 8: Excise Duty on Bidis, 2007/08 (Rs per 1,000 sticks)

Type of Bidi	Total	CENVAT	NCCD	BWWC
Machine-made	26	20	2	4
Handmade	14	9	1	4

Source: Department of Revenue, Ministry of Finance.

Table 9: Excise Duty on Cigarettes, 2007/08 (Rs per 1,000 sticks)

Type of Cigarette	Total	CENVAT	NCCD	HC
Filter:				
>85 mm	2,163	1,748	235	180
>75–85 mm	1,759	1,424	190	145
>70–75 mm	1,323	1,068	145	110
≤70 mm	819	659	90	70
Non-filter:				
>60 mm	546	441	60	45
≤60 mm	168	133	20	15

Source: Department of Revenue, Ministry of Finance.

If CENVAT up to 10 percent of the retail price is considered the general consumption tax that applies to all manufactured goods, and only the amount of CENVAT in excess of 10 percent of retail price is considered a "true" excise levy, the excise burden when measured as a percentage of the retail price would be reduced by 10 percentage points. Thus the excise burden on bidis would be zero, and the excise on cigarettes would be 23 percent of the retail price or higher.

The excise rate on bidis cannot be considered in isolation from the excise rate on cigarettes, particularly micro non-filter cigarettes.

Tax-paid bidis

As indicated above, there are no specific figures on how many bidis are produced or consumed annually — 750 billion to 1.2 trillion sticks can be taken as a rough estimate. However, given that almost all bidis are handmade, it is possible to estimate the number of bidis that are tax-paid (Table 10). In the most recent year, it is estimated that only 360 billion bidi sticks were tax-paid in 2006/07, suggesting that 52 to 70 percent of all bidis are not taxed due either to non-compliance or the small producer exemption. The number of bidis that are tax-paid has been on a downward trend. This may reflect a combination of deterioration in tax enforcement

Table 10: Tax-Paid Bidis, 1996/97 to 2006/07

Year	Duty for Handmade Bidis (Rs per 1,000)	Revenue (Rs millions)	Tax-Paid Bidis[a] (billions of sticks)
1996/97	5.5	2,415	440
1997/98	6.5	3,238	500
1998/99	6.5	3,233	500
1999/00	6.5	3,217	490
2000/01	8.0	3,538	440
2001/02	9.0	3,572	400
2002/03	9.0	3,604	400
2003/04	9.0	3,364	370
2004/05	9.0	3,482	390
2005/06	9.0	3,680	410
2006/07	12.0	4,262	360

[a] *Revenue divided by excise duty per stick.*

Source: Department of Revenue and author's estimates and/or bidi smokers upgrading to cigarettes. It could also reflect a switch from taxed to untaxed bidis.

The major policy issues are: (i) the distinction between homemade and machine-made bidis, (ii) the excise rate on bidis, (iii) the small producer exemption, and (iv) steps to improve compliance.

Cigarette consumption

There are estimates of Indian cigarette consumption based on manufacturer inquiries, the Tobacco Board of India, and production and trade data (Table 11). Total cigarette consumption declined from a high of 104 billion sticks in 1997/98 to a low of 85 billion sticks in 2001/02, but then rose steadily to 107 billion sticks in 2006/07. The increase in cigarette consumption is probably largely explained by the increase in India's real growth rate — growth in real per capita income accelerated beginning in 2003. With rising income per capita, some bidi smokers will switch to cigarettes.*

Table 11: Cigarette Consumption and Market Share, 1993/94 to 2006/07

Year	Cigarette Consumption (Million sticks)	Market Share (in percent)				
		Non-filter ≤60 mm	Non-filter >60–70 mm	Filter ≤70 mm	Filter >70–75 mm	Filter >75–85 mm
1993/94	85,623	1.0	36.0	46.0	12.0	5.0
1994/95	93,673	7.0	36.0	43.0	9.0	5.0
1995/96	100,950	18.0	28.0	41.0	8.0	5.0
1996/97	102,806	19.0	23.0	44.5	8.5	5.0
1997/98	104,142	19.4	23.0	44.0	8.2	5.4
1998/99	102,200	NA	NA	NA	NA	NA
1999/00	98,433	11.8	22.4	49.4	10.6	5.8
2000/01	97,800	9.6	21.1	52.0	11.3	6.0
2001/02	84,580	8.5	22.6	52.0	10.7	6.2
2002/03	89,550	8.0	23.0	52.5	10.0	6.5
2003/04	93,040	7.5	23.5	53.0	9.5	6.5
2004/05	98,860	7.3	23.7	53.3	9.2	6.5
2005/06	105,530	7.0	24.0	53.5	9.0	6.5
2006/07	107,500	NA	NA	NA	NA	NA

Note: Market share not given for filter cigarettes >85 mm, as the share is de minimis. NA = Not available.

Source: ERC, World Cigarettes, 2001, 2005, and 2006.

* As cigarettes are often sold by the stick, some bidi smokers also smoke an occasional cigarette.

Although the excise schedule distinguishes six categories of cigarettes — two non-filter and four filter — most cigarettes that are sold are regular filters (<70 mm) and regular non-filters (>60–70 mm). This suggests that the schedule of excise rates could be simplified and this is discussed further in Section VII.

Prior to 1994/95, the micro non-filter cigarette (≤60 mm) commanded only a 1 percent share of the cigarette market (Table 11). Following the 50 percent reduction of the excise rate on these cigarettes in 1994/95 from Rs 120 to Rs 60 per 1,000 (Table 3), market volumes for cigarettes increased as bidi smokers were won over to the cigarette market. The market share for micros rose to 19 percent by 1997/98. In recent years the market share of micro non-filter cigarettes has slipped back to 7 percent, as the excise rate on these cigarettes has risen more rapidly than the excise rate on handmade bidis. All this suggests that the excise rates on bidis cannot be set independently of the excise rates on cigarettes, particularly the rate on micro non-filters. Substitution between bidis and cigarettes must be taken into account.

The introduction of a national GST in 2010 would provide an opportunity to simplify and rationalize the excise taxes on tobacco products.

V. Administration of Excises on Bidis and Cigarettes: An Introduction

Excises are levied on the importation of excisable goods (if the goods are imported) or on the manufacturing of excisable goods (if the goods are produced domestically). The taxable event is importation or manufacturing and not the sale of these goods.

Excises are generally administered similarly to customs duties. If collected at the border, the customs procedures apply directly. If collected on domestic production, the procedures followed are usually analogous to customs procedures, with the producer's facilities being analogous to a customs warehouse.

In the case of goods that are manufactured domestically, excise duty is usually chargeable only on finished goods ready for sale to consumers. Although rolling of bidis is a manufacturing process, excise duty would not be charged on bidi rollers, as the bidis still need to be roasted before they are ready for sale to consumers. Roasting, as explained earlier, is done by the manufacturer who also packages the bidis.

One could argue that un-roasted bidis are a saleable product; they could be dried in the sun and therefore should be subject to excise duty.

As a practical matter, it would not be possible to collect excise duty from bidi rollers.

Excises on the domestic manufacturing of tobacco products normally are comparatively easy to administer, as there are only a small number of manufacturers of tobacco products. In India, for example, there are only a few facilities for manufacturing cigarettes — 40 factories in 1995 (Table 1), which is the last year for which data are available — making the administration of the excises on cigarettes manufactured locally relatively easy. Physical controls are maintained at each manufacturing facility, which allows monitoring of what goes into the factory and what goes out. Each consignment of cigarettes is certified by the excise officer.

In contrast to cigarettes, the manufacturing of bidis is highly fragmented — there are thousands of bidi factories. It would not be practical to maintain physical controls at each bidi manufacturing facility (or on sellers of tobacco used to produce bidis). (In Section VI other measures to reduce non-compliance are outlined.)

As 98 percent of bidis are handmade, eliminating the distinction between handmade and machine-made bidis and taxing all bidis at a rate of Rs 14 per 1,000 would have negligible revenue effect in the short-term. Over time, it should lead to greater use of machines to produce bidis.

Under the Indian Excise Law, any person engaged in the production or manufacturing or any process in production or manufacture of goods subject to excise is required to register with the proper excise officer.[10] However, if a person produces less than 2 million bidis annually, he is not required to register but is required to file an annual declaration.

VI. Policy Issues

The major policy issues relating to the tax treatment of bidis are: (i) the distinction between homemade and machine-made bidis, (ii) the excise rate on bidis, (iii) the small producer exemption, and (iv) steps to improve compliance. The introduction of a national GST in 2010 would provide an opportunity to simplify and rationalize the excise taxes on tobacco products, and this is discussed in Section VII.

Handmade vs. machine-made

India traditionally has favored small-scale manufacturing by providing lower excise duties if the goods are made without the use of a machine or power. This has led to considerable litigation and probably has slowed innovation.[11] These distinctions are being abolished, but some still continue, including the lower rate for handmade bidis.

The excise rate on bidis depends on whether they are handmade (Rs 14 per 1,000) or machine-made (Rs 26 per 1,000). The use of a cutting dye by the rollers and the use of a simple oven during the roasting process are not considered to be the use of a machine, which would disqualify the bidis for the lower handmade rate. However, use of a stapler for closing the packing could lead to the excise officer asking for a higher rate of duty. There has been litigation as to whether handmade bidis packed with wrappers/labels which are manufactured with the aid of machines by job workers would result in the bids being classified as machine-made bidis subject to the higher excise rate.[12] The government lost this case, but it has now agreed to follow the court decision.[13]

As 98 percent of bidis are handmade, eliminating the distinction between handmade and machine-made bidis and taxing all bidis at a rate of Rs 14 per 1,000 would have negligible revenue effect in the short-term. Over time, it should lead to greater use of machines to produce bidis. This would have two effects. First, although there would be fewer people employed in bidi manufacturing, they should be higher paid, reflecting their improved labor productivity. Second, bidi manufacturing would be less fragmented, making it easier to collect excise duties on manufactured bidis.

Excise rate on bidis

As epidemiologic studies indicate that bidis are as or more harmful than cigarettes per stick, the excise rate on bidis — handmade or machine-made — should be increased to at least the rate on non-filter micro cigarettes — the low-priced cigarettes most likely to be purchased by the poor. (The final section of the paper considers a rationalization of cigarette and bidi excises when a national GST is introduced.) Thus the rate on bidis would be increased Rs 14 to at least Rs 168 per 1,000 sticks. If the rate on bidis were set at Rs 168 per 1,000 sticks, the average retail price of bidis would double from about Rs 4 to Rs 8 per pack of 25 bidis.

Some will argue that increases in the excise on bidis would hurt the poor. However, if the poor bidi smoker reduces his consumption of tobacco, wouldn't he and his family be better off? Moreover, governments surely have better ways of helping the poor than providing cheap tobacco products.*

If the rate on bidis were set at Rs 168 per 1,000 sticks, the average retail price of bidis would double from about Rs 4 to Rs 8 per pack of 25 bidis….Some will argue that increases in the excise on bidis would hurt the poor. However, if the poor bidi smoker reduces his consumption of tobacco, wouldn't he and his family be better off? Moreover, governments surely have better ways of helping the poor than providing cheap tobacco products.

* Introduction of a national GST, discussed in the next section, will require careful consideration of the distributional aspects of indirect taxes, including excises on tobacco products. Exempting basic (unprocessed) foods would provide better protection for the poor than would under-taxing bidis.

Small producer exemption

Excise duty is not charged if the manufacturer produces less than 2 million bidis in a financial year.* To produce more than 2 million bidis in a year requires only 6 rollers making 1,000 bidis a day. For a manufacturer this would hardly permit economies of scale in buying tobacco and tendu leaves or in sorting, roasting and packing the bidis. Of course, some bidi manufacturers may claim they produce less than 2 million bidis a year when they produce much higher volumes. There are no data available on the number of manufacturers who either claim or qualify for the small producer exemption.

Excise duty is not charged if the manufacturer produces less than 2 million bidis in a financial year. To produce more than 2 million bidis in a year requires only 6 rollers making 1,000 bidis a day.

Beginning with financial year 2006/07, bidi manufacturers who want to benefit from the small producer exemption must file an annual declaration giving required particulars including the quantity of bidis manufactured in the previous financial year, the details of the manufacturing processes undertaken by the manufacturer, and the details of any process of manufacture of bidis undertaken by job workers (such as rolling bidis).[14] The first declarations (for financial year 2006/07) were to be filed on or before March 31, 2007. It is too early to know just how many declarations were filed. However, if bidi manufacturers who otherwise qualify for the small producer exemption fail to file the required declaration, they cannot avail themselves of the exemption. This should give the small producers a strong incentive to file the declaration.

A high proportion of bidis that are untaxed probably escape taxation through tax evasion.

To avoid harassment of small producers, excise officers are neither permitted to visit any manufacturer who has filed a declaration for purposes of conducting verification nor to summon him. There is one exception to this rule: If intelligence inputs are received that a manufacturer has filed a false declaration, or has violated any other provision of law, the jurisdictional Commissioner of Central Excise may authorize a survey or other such action in order to detect any irregularity.[15] This rule seems to tie the hands of the excise officer, but it may be needed if there is a long history of excise officers harassing small bidi producers.

The small producer exemption is available on a per manufacturer basis; a manufacturer may have one or more factories. The test for qualifying as a small producer, however, does not require aggregating manufacturers that are under common control. By setting up additional companies under common control, the 2 million ceiling can be easily

* Specifically the small producer exemption is for bidis, other than paper rolled bidis, manufactured without the aid of machines, by a manufacturer by whom or on whose behalf no bidis are sold under a brand name, in respect of first clearances of such bidis for home consumption by or on behalf of such manufacturer from one or more factories up to a quantity not exceeding 20 lakhs (2 million) cleared on or after the 1st day of April in any financial year (Item 2403 10 31 of the First Schedule to the Central Excise Tariff Act of 1985).

circumvented. For example, it would be possible for two or more manufacturers under common control to share facilities.

To close this loophole, a "manufacturer" for purposes of the small producer exemption should include all companies that are owned or controlled directly or indirectly by the same interests. In determining whether a manufacturer is a small producer, all "associated enterprises," as defined in the Income Tax Act, could be aggregated.* An approach that would be simpler than the Indian definition of associated enterprises would be to provide a general rule as follows: "For purposes of the small producer exemption, all entities or businesses (whether or not incorporated and whether or not organized in India), under common ownership, would be considered a single manufacturer." Common ownership would then be defined as follows: "Two or more entities or businesses are under common ownership if the same persons own (directly or indirectly) 50 percent or more in value of the equity interests in each such entity or business."[16] Another potential simplification would be to eliminate the small producer exemption entirely.

Another potential simplification would be to eliminate the small producer exemption entirely.

Tax compliance

A high proportion of bidis that are untaxed probably escape taxation through tax evasion. Bidi manufacturers simply underreport their sales. As most bidi manufacturers are closely held private companies that do not need to report to public shareholders or to banks, it is quite easy to keep two sets of books or possibly no books at all.

Although very little comparative data on tax non-compliance are available, 52 to 70 percent non-compliance probably is not out of line with international experience. The US Internal Revenue Service, which probably does the best job in developing reliable estimates of non-compliance, estimates that non-compliance is 1 percent for wages (subject to withholding) and 4 percent for interest and dividend income (subject to information reporting), but 57 percent for non-farm proprietor income, 72 percent for farm income, and 51 percent for rents and royalties (all of which are not subject to withholding or information reporting).[17]

There is no magic fix to tax evasion by bidi manufacturers, but there are two proposals that should be considered: (i) prohibit the sale of unbranded bidis to consumers, and (ii) require information reporting on the sale of processed bidi tobacco. The Revenue Department may want to devote more resources to tax compliance in this area.

There is no magic fix to tax evasion by bidi manufacturers, but there are two proposals that should be considered: (i) prohibit the sale of unbranded bidis to consumers, and (ii) require information reporting on the sale of processed bidi tobacco.

* Most income tax laws require that transactions between related parties (or associated enterprises) be at arm's length. India's Income Tax Act of 1961, for example, has a definition of associated enterprise (Section 92A), which could be adapted to define "manufacturer" for purposes of the small producer exemption.

Unbranded bidis

The government should ban unbranded bidis — each packet of bidis would be required to be branded with the manufacturer's name printed on the wrapper, as is customary in urban areas.

In rural areas unbranded bidis are commonly sold in the market, making it almost impossible to determine who manufactured these bidis. The government should ban unbranded bidis — each packet of bidis would be required to be branded with the manufacturer's name printed on the wrapper, as is customary in urban areas.

The Cigarettes and Other Tobacco Products Act of 2003 (COTPA) authorizes the Indian government to issue rules requiring warning labels on all tobacco products. The government has made proposals for warning labels, but the required labeling has not as yet been implemented in large part due to opposition from bidi manufacturers. The matter is under consideration by a cabinet committee. When warning labels are implemented for tobacco products, the identity of the manufacturer could be required to be printed on the label as well. However, if moving forward on warning labels is not going to happen in the near term, the government, on a separate track, should require that bidis be sold only in branded packets with the manufacturer's name printed on the wrapper.

Information reporting

It would be reasonable to require any person selling processed bidi tobacco to a bidi manufacturer or a bidi manufacturer's representative to register with the Commissioner of Excise and to make annual declarations of any sales of processed tobacco, including the name of the purchaser.

Bidi tobacco is a sun/air cured variety of tobacco, which is processed into flakes and aged for 6 to 12 months. The processor may blend tobacco flakes from different cultivars. As bidi tobacco is used to manufacture an excisable good, it would be reasonable to require any person selling processed bidi tobacco to a bidi manufacturer or a bidi manufacturer's representative to register with the Commissioner of Excise and to make annual declarations of any sales of processed tobacco, including the name of the purchaser. This reporting requirement would be much less onerous than the regulation of the purchase and sale of tobacco that existed prior to 1978. Bidi manufacturers would be required to report all purchases of bidi tobacco.[18] With information reporting on tobacco inputs, the excise officer would be able to estimate the production of the bidi manufacturer.

VII. GST Reform

During the annual budget speech for 2007/08, the Union Finance Minister announced the intention to introduce a national GST effective from the beginning of April 2010. This tax will replace CENVAT and the services tax at the central level and replace the state value-added taxes.

A GST joint working group has been set up to prepare a road map for the introduction of the GST with members from both the central government and state governments.[19] It is to make recommendations regarding the structure of the GST and finalize its report in October 2007. Critical questions include whether the tax will be levied only at the national level with revenue shared with the states or whether the national government and the states will each levy a GST on a common tax base, giving each state the right to set its own tax rate or rates.

The introduction of a national GST presents the best opportunity to rationalize and simplify excises on tobacco products.

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Background

India's Constitution distributes fiscal legislative powers between the central governments and the state governments.

The central government can levy excise duties on goods other than alcoholic beverages (and narcotics). In 2000, the central government adopted CENVAT, which transformed India's excise duties to something closer to a value-added tax (VAT)* at the manufacturer's level. CENVAT is generally a 16 percent excise duty on manufactured goods with an input tax credit allowed for tax paid at an earlier stage. As indicated earlier, bidis and cigarettes pay a specific CENVAT that is higher than 16 percent of the value of the manufactured product. As value added beyond the manufacturing stage is not subject to CENVAT, the 16 percent rate through the manufacturing stage is on average equivalent to a 10 percent tax through the retail level. It is higher or lower than 10 percent depending on the markup for wholesale and retail distribution.

If a primary purpose of the excise — in addition to raising revenue — is to discourage consumption of tobacco products, a strong case can be made for specific excises, as the tax is levied on the "thing" to be discouraged (e.g., the number of cigarettes or bidis consumed).

The central government can also tax inter-state sales of goods (the central sales tax), but not sales of goods within a state. As there is no Constitutional provision regarding the taxation of services, the central government is taxing certain services.

States can tax sales within a state, and a uniform state-level VAT was introduced in April 2005 at a rate of 12.5 percent.[20] This tax, which has been adopted by all states except one, applies to the production and distribution stages beginning at the manufacturing stage. An input credit is allowed for VAT paid at an earlier stage. In April 2007, the Empowered Committee of State Finance Ministers on VAT decided to exempt bidis, raw tobacco leaves and tobacco leaves used for making bidis from the state-level VAT.[21] This

* A value-added tax, properly designed, is a broad-based consumption tax collected at each level of production and distribution. To avoid tax cascading, an input credit is allowed for VAT paid on purchased goods and services.

Specific taxation is highly predictable because the amount of tax owed does not fluctuate with the exchange rate or pricing variables. It facilitates business planning and is easier to administer because it is only necessary to determine the physical quantity of the product taxes, and it is not necessary to determine its value.

may have been a state response to the increases in the excise duty on bidis in 2006/07 (33 percent) and 2007/08 (16 percent). In designing a national GST, the bidi exemption from the state-level VAT should not be taken as precedent. All excisable goods should be subject to the national GST.

A national GST likely will require an amendment to the Constitution or possibly the states will need to delegate their fiscal powers regarding the sales of goods within a state.

Rationalization of indirect taxes

It is important to distinguish the roles of import duties, a broad-based consumption tax, and excises. *Import duties* may be used as a convenient way of raising revenue, but their main economic function is the protection of domestic production. The purpose of a *broad-based consumption tax* is to raise revenue from domestic consumption. This tax should therefore treat imports and domestic products alike, or otherwise it also exercises a protective (or even anti-protective) function. Ideally, the broad-based consumption tax should treat all goods and services the same and not favor or penalize one type of consumption or production over another. *Excises* similarly should treat imports and domestic production alike.* Excises also should not be seen as a substitute for or an alternative to the broad-based consumption tax. Excises should be confined to a narrow range of goods, such as tobacco products, the consumption of which the authorities wish to discourage, for example, for health and environmental reasons. Excises are the normal way of applying supplementary taxes to such goods. Excises should not be used to promote employment or local manufacturing.

Specific excises need to be adjusted to keep pace with inflation and the growth of real incomes. Specific taxes can be automatically adjusted for changes in the consumer price index (CPI). It is critical that the adjustment be automatic. Australia and New Zealand have automatic inflation adjustments for their cigarette excises.

Rationalization and simplification of excises on smoking tobacco

Excises can be either specific taxes (e.g., based on the number of cigarettes or bidis) or ad valorem (based on value). If a primary purpose of the excise — in addition to raising revenue — is to discourage consumption of tobacco products, a strong case can be made for specific excises, as the tax is levied on the "thing" to be discouraged (e.g., the number of cigarettes or bidis consumed).†

* Under WTO rules, taxes on domestic consumption (including excises) cannot be used to provide domestic protection.

† Within the Asian region, 18 countries levy specific excises on cigarettes: Australia, Brunei, Hong Kong, India, Korea, Japan, Laos, Macau, Maldives, Mongolia, Nepal, New Zealand, Papua New Guinea, Philippines, Singapore, South Korea, Sri Lanka, and Taiwan. Four countries levy ad valorem excises on cigarettes : Bangladesh, Cambodia, Thailand, and Vietnam; and four countries use a mixed system of specific and ad valorem levies: China, Indonesia (from July 2007), Malaysia, and Pakistan. See, Emil M. Sunley, "Tobacco Excise Taxation in Asia: Recent Trends and Developments," a paper prepared for the Fourth Meeting of the Asia Tax Forum, April 18–20, 2007, Hanoi, Vietnam.

In addition, specific taxation is highly predictable because the amount of tax owed does not fluctuate with the exchange rate or pricing variables. It facilitates business planning.

On a per stick basis, the excise duty on handmade bidis (Rs 14 per 1,000) is only 8 percent of the excise duty on micro non-filter cigarettes (Rs 168 per 1,000).

Specific excises have another advantage. It is easier to administer because it is only necessary to determine the physical quantity of the product taxes, and it is not necessary to determine its value.

One drawback of specific excises is that they need to be adjusted from time to time to keep pace with inflation and the growth of real incomes. Specific taxes can keep pace with inflation if they are automatically adjusted for changes in the consumer price index (CPI). It is critical that the adjustment be automatic; i.e., by an administrative order and not require a decision by an executive agency or approval by a legislative body. Both Australia and New Zealand have automatic inflation adjustments for their cigarette excises.*

To align fiscal policies with public health objectives, the excises on bidis and cigarettes could be simplified and reformed along the following lines. First, there would be a single rate for bidis (per 1,000 sticks) — the distinction between handmade and machine-made bidis would be abolished, as proposed in Section VI. Second, there would also be a single rate for cigarettes (per 1,000 sticks), which would initially be set higher than the rate for regular filter cigarettes. If cigarettes and bidis are subject to the national GST, as is the normal international practice, the excise rates for bidis and cigarettes should be adjusted to reflect that the GST replaces CENVAT which currently applies to these products. The total tax burden on these products (GST + excise) could be increased. Collapsing the six current rates to a single rate may need to be phased in. Third, over several years, the rate of excise on bidis would be increased to the rate for cigarettes.

The distinction between handmade and machine-made bidis should be abolished.

* Australia adjusts its cigarette excises every February and August based on the six-month change in the CPI. New Zealand adjusts its cigarette excise annually on the first of December. In addition, in May 2000, New Zealand increased the indexed rate by 22.8 percent due to health concerns.

VIII. Summary and Recommendations

Before turning to the recommendations, we summarize the basic facts regarding the tax treatment of bidis and cigarettes.

- For bidis the excise rates (per 1,000 sticks) depend on whether they are handmade or machine-made. However, over 98 percent of all bidis are handmade.
- Bidis produced by manufacturers producing less than 2 million bidis a year without machines are exempt from the excise duty. To produce more than 2 million bidis in a year requires only 6 rollers making 1,000 bidis a day.
- The excise rate on handmade bidis was increased 33 percent in 2006/07 and an additional 16 percent in 2007/08.
- Over the period, 1993/94 to 2006/07, excise revenue from bidis fell relative to the revenue from cigarettes.
- On a per stick basis, the excise duty on handmade bidis (Rs 14 per 1,000) is only 8 percent of the excise duty on micro non-filter cigarettes (Rs 168 per 1,000).
- The excise duty on micro non-filter cigarettes is 21 percent of the duty on regular filters.
- If the excise burden is measured as a percentage of the retail price, the burden on handmade bidis is 8.8 percent while the burden on cigarettes is 33 percent or higher.
- The excise duty on both bidis and cigarettes, as a percent of retail price, is about 10 percentage points lower if the general consumption part of CENVAT is not considered a "true" excise duty.
- Although there are no specific figures on how many bidis are produced annually — estimates range from 750 billion to 1.2 trillion — only 360 billion bidis were tax paid in 2006/07, so 52 to 70 percent of bidis were untaxed.
- The excise rate on bidis cannot be considered in isolation from the excise rate on cigarettes, particularly micro non-filter cigarettes, which compete with bidis. When the excise rate on micro non-filter cigarettes was cut in half in 1994/95, excise revenue from bidis flattened and the micro non-filter share of the cigarette market increased to 19 percent. The market share of micro non-filters fell as the excise rate on these cigarettes increased more rapidly than the rate on handmade bidis.

Recommendations:

The priority reforms in the taxation of bidis would be as follows:

- The distinction between handmade and machine-made bidis should be abolished.
- Prior to simplification of cigarette excises, the excise rate on bidis should be increased from Rs 14 to at least Rs 168 per 1,000 sticks, which would tax bidis per stick the same as micro non-filter cigarettes. If adopted, this reform would increase the average retail price from about Rs 4 to Rs 8 per packet of 25 bidis.
- To ensure that the small producer exemption is limited to truly small manufacturers, the term "manufacturer" for purposes of this exemption should include all companies that are owned or controlled directly or indirectly by the same interests. Consideration should be given to eliminating the prohibition on excise taxation authorities conducting routine inspections of small bidi manufacturers, which could be accompanied by appropriate safeguards for the integrity of this process. Alternatively, the small producer exemption could be eliminated entirely.
- To improve compliance, there should be no unbranded bidis sold to consumers. The identity of the manufacturer should be required to be printed on the bidi wrapper.
- Also to improve compliance, each person selling processed bidi tobacco to a manufacturer or a manufacturer's representative should be required to report all sales and each bidi manufacturer should be required to report all purchases of tobacco.

Introduction of a national GST will provide an opportunity to rationalize and simplify the tax treatment of tobacco products, as follows:

- Under the national GST, excisable goods should be treated the same as other goods. In particular, the April 2007 exemption of bidis from the state VATs should not be taken as a precedent.
- There should also be a single rate for cigarettes (per 1,000 sticks), which would initially be set higher than the rate for regular filter cigarettes. Collapsing the six current rates into a single rate may need to be phased in.
- Over several years the excise rate on bidis per 1,000 sticks — handmade or machine-made — should be increased to the rate for all cigarettes.

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Endnotes

1 Press Information Bureau of the Government of India, "Government Restructuring Welfare Schemes for Beedi Workers to Make Them More Effective," January 15, 2002. As most bidi workers are in the unorganized sector, there is no estimate of full-time equivalent workers. However, it is assumed that most bidi rollers are in full-time employment. For further information on the bidi workforce, see, International Labor Organization, "Employment Trends in the Tobacco Sector: Challenges and Prospects," (2003), pp. 88–94).

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7 Journal of Cancer Research and Clinical Oncology, 1988; 114: 647–649.

8 http://www.indiamart.com/shaktibeedi

9 Section 11AA of the Excise Law

10 Section 6 of the Excise Law

11 Discussion with Sukumar Mukhopadhyay, former Member of the Central Board of Excise & Customs.

12 The case of M/s. Ajanta Sada Biri Co. [1997(95)ELT 513(T)]

13 Trade Notice No: 06/2007

14 Condition 2 to S. No. 36 of Notification No. 3/2006-Central Excise. This requirement was promulgated after an initial proposal requiring small producers to register was rejected.

15 F. No. 201/06/2006-CX-6

16 The general rule and definition of common ownership are drawn from, Ward M. Hussey and Donald C. Lubick, *A Basic World Tax Code and Commentary*, 1996 edition.

17 Eric Toder, "What is the Tax Gap?" Prepared for American Bar Association Conference on the Tax Gap, June 21, 2007; "IRS Updates Tax Gap Estimates, IR-2006-28, February 14, 2006 (www.irs.gov/newsroom/article/0,,id=154496,00.html).

18 India has a Tax Information Exchange System for the state VAT. See www.tinxsys.com.

19 For the terms of reference for the group, see www.tinxsys.com.

20 States can also impose excise duties on alcoholic beverages.

21 "Bidis, raw tobacco leaves out of VAT levy," Business Line, April 15, 2007.

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