L.N.Mithila University Kameswarnagar, Darbhanga

A STUDY OF VAT IN INDIAN TAX SYSTEM- AN EVALUATION

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Present thesis is a record of work done by the candidate Mr. Jagnnath Chaudhary himself. To the best of my Knowledge no part of this thesis form the basis for award any previous degree to the candidate or anybody else.

Mr. Jagnnnath Chaudhary is also a fit and proper candidate by his nature and conduct to award Ph.D. Degree in the faculty of Commerce from L.N. Mithila University, Kameshwar Nagar, Darbhanga.

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ABSTRACT

A STUDY OF VAT IN INDIAN TAX SYSTEM- AN EVALUATION

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The present study describes the various aspects of VAT in Indian Tax system. The main purpose of the research is to examine the implications of VAT on streamlining Tax System in India with special reference to commercial taxes in Bihar. The theme will mainly cover the implications of VAT on streamlining Tax System in India in the light of the changing global scenerio and further it will discuss its impact on the changing age of commercial Taxes in Bihar.

The objective of research is to evaluate the implications of VAT on streamlining and restructuring of the Tax System in India and specially in Bihar in the broader light of the role of commercial taxes in Bihar since tis emergence to the age of VAT. It will also discuss the suggestions to combact the drawbacks and to stabilize the Value Added Tax System and will further explore the pavement for its smooth functioning.

This reserch was secondary sources data. The basic reserch design used the data gathered form official report books related with value added Tax, research journals and surveys undertaken by different authorities. Lastes data and the analysis there of along with statiscial tables, charts and fiugre had been used for drawring conclusion and making recommendation.

The various kinds of Indirect taxes and duties levied in India, at the state and Central level are illustrated hereunder: Both the Customs and Excise duties are levied and collected by the Central Government. While the Customs duties are levied, collected and retained by the Central Government, the Excise duties are shared by the Central Government with the State Governments. The State sales tax is levied and collected by the states on all intra state transactions. Central Sales Tax is levied by the Central Government and collected by the states and such levy is restricted to interstate sales originating in the concerned state. The former is regulated by the concerned State Sales Tax Act, while the Central Sales Tax is regulated by the Central Sales Tax Act, 1956.[4] In the budget for 2003, the Finance Minister of India, after various rounds of consultation with the states of India, proposed the introduction of VAT in India on a nationwide basis, replacing the State Sales Tax Act (India has 28 states and each state has enacted on sales tax). Broadly stated are the key features of VAT to be introduced in India:

VAT proposed to be introduced in India is a simple and a transparent tax collected on the sale of goods. VAT is to be consumption based and applied on destination principle[5]. Under the consumption type VAT, the base excludes the value of both intermediate inputs and investment items from the gross value of goods and services. The base—as defined—is close to the one in retail sales taxation. VAT computation is to be based on the invoice-based credit method. Under this method, a firm at any stage of the production-distribution chain charges its customers the VAT on its output, submits the tax to the treasury, and then claims for the VAT already paid on its input purchase. The emphasis placed on each transaction means that the evidence for each sale or purchase, the invoice, becomes a crucial document to monitor and administer the VAT.[6] Thus, the burden of VAT is not borne by producers or suppliers of taxable goods or services, but rather by the ultimate consumers thereof. Who is covered by VAT? All business transactions carried on with a state by individuals, partnerships, companies etc. will be covered by VAT. VAT will not cover small businesses with a turnover below a certain limit which will be decided by each state. The turnover limit for eligibility of retailers to opt for payment of tax at compounded rate of tax may be Rs 20-50 lakh (USD 40,000 to 80,000) as may be specified by the respective states.[5] All retail dealers9 with annual turnover above the limit specified will have to pay VAT even if their entire business is in retail. Retail dealers below a threshold limit of annual turnover, as may be specified in the respective State VAT legislation, may opt for payment of tax at a flat rate of 1-2 per cent. The terminology is not uniform in all the States. Presumptive tax, turnover tax or composition of tax has been used to describe the levy of tax on retailers. The `sales' not liable to tax under the VAT Act: Since the VAT Act applies only to sales within a State, the following sales shall not be governed by the VAT Act: a) sale in the course of inter-state trade or commerce which shall continue to be liable to tax under the Central

Sales Tax Act, 1956; b)[7] sale which takes place outside the state; and c) sales in the course of export or import.

Discusses the rationale for the opposition of VAT as is introduced in India. Reviews the experiences of the developed and developing countries with VAT which may provide lessons for effective implementation of VAT in India---Case in point for developed countries is France; United States; which represents a federal structure like India is also briefly considered as an illustration for federal structure not adopting

VAT; Case in point for transitional countries is the Russian Federation; Section IV reviews the rationales for the VAT in comparison with other types of indirect taxes. Also considered is the proper system of administration of VAT for India: should VAT be implemented at the state level or at the federal level; Also stated are the authors view on the proper implementation and administration of VAT in India. Section V analyzes critical issues in the VAT design, implementation, and policy implications and provides concluding remarks.

Value-Added Tax, one of the most radical reforms to be proposed for the Indian economy, could finally become a reality after four years of political and economic debate. Yet, the biggest hurdle before the government is not making India 'a common market' through a uniform sales tax structure, but removing a complicated tax structure that also allowed for fraudulent practices. The decision to introduce VAT was publicly discussed first at a conference of state chief ministers and finance ministers in November 1999. At that time, the deadline of April 2002 was agreed upon to bring in VAT. However political instability and a lack of initiative pushed this reform to the backburner. Now a year later, despite a backlash from the trading community and some political circles, there appears to be a realistic scope for VAT to be introduced. Twelve states have so far passed legislation to implement the VAT regime and of these five have sent their Bills for Presidential assent. Let us explore VAT and what it means.

VAT is a sales tax collected by the government (of the state in which the final consumer is located) – which is the government of destination state on consumer expenditure. Over 120 countries worldwide have introduced VAT over the past three decades and India is amongst the last few to introduce it. India already has a system of sales tax collection wherein the tax is collected at one point (first/last) from the transactions involving the sale of goods. VAT would, however, be collected in stages (instalments) from one stage to another. The mechanism of VAT is such that, for goods that are imported and consumed in a particular state, the first seller pays the first point tax, and the next seller pays tax only on the value-addition done – leading to a total tax burden exactly equal to the last point tax.

India, particularly the trading community, has believed in accepting and adopting loopholes in any system administered by the state or the Centre. If a well-administered system comes in, it will close avenues for traders and businessmen to evade paying taxes. They will also be compelled to keep proper records of their sales and purchases. Many sections hold the view that the trading community has been amongst the biggest offenders when it comes to evading taxes. Under the VAT system, no exemptions will be given and a tax will be levied at each stage of manufacture of a product. At each stage of value-addition, the tax levied on the inputs can be claimed back from the tax authorities. At a macro level, there are two issues, which make the introduction of VAT critical for India. Industry watchers say that the VAT system, if enforced properly, forms part of the fiscal consolidation strategy for the country. It could, in fact, help address the fiscal deficit problem and the revenues estimated to be collected could actually mean lowering of the fiscal deficit burden for the government. The International Monetary Fund, in its semi-annual World Economic Outlook released on April 9, expressed its concern over India's large fiscal deficit – at 10 per cent of the GDP. Further any globally accepted tax administrative system, will only help India integrate better in the World Trade Organisation regime.

In one the most large scale reforms of the country's public finances in over past 50 years, India has finally agreed the launch of its much-delayed Value Added Tax (VAT) from 1st April 2005. At a rate of 12.5%, VAT will come in on April 1, 2005. The tax, agreed after state finance ministers met in New Delhi, is designed to make accounting more transparent, cut trade barriers and boost tax revenues. The system had been postponed many times, mainly because of opposition from the powerful trading lobby. Ashim Dasgupta, who heads a panel overseeing the implementation of VAT, said: "We are very happy to announce that a broad consensus among states was arrived at the meeting to introduce VAT on April 1, 2005." The Congress-led new left-leaning United Progressive Alliance (UPA) government has made implementing VAT one of its key priorities. According to analysts VAT is essential in tackling the problem of tax evasion. In India, all the state governments collect over Rs 85,000 crore (Rs 850 billion) by way of sales tax and further over 20,000 crore (Rs 200 billion) by way of Central Sales Tax. This is what officially comes mostly from petroleum, liquor, iron and steel and cement companies. Rough estimates suggest that these industries account for over 50 per cent sales tax for the states and the Centre. Majority of the officials in sales tax departments believe that what they actually collect is less than 50 per cent of the revenue that should otherwise accrue to them if all transactions are accounted for by the

businessmen. March 24, 2005: The state finance ministers in consultation with Finance minister P. Chidambaran decided to scale down the composite tax to 0.25 per cent from the earlier one percent over sales Turnover. This levy will be applicable to traders out of the VAT ambit and having a sales turnover between Rs. 5 lakh-Rs. 50 lakh per year. The Next major decision by the state finance ministers is to phase out central sales Tax (CST) during next three years. While the 4 percent CST stays during 2005-06, it will be slashed to 2 percent in 2006-07. CST will not be levied from April 1, 2007. India has a large un-organised market, especially agro-based industries and here a large number of transactions go unrecorded. The menace of stock transfers adds to the problem of tax evasion. In India, introduction of VAT will only change the collection methods for sales tax rather than reform the indirect tax system. In the initial phase of development, the economy is based on primary activities and industrial activities do not have a major role in the system. As a result, Gross Domestic Product (GDP) is not very high and the government has to depend upon taxes on commodities and services for mobilizing resources rather than on taxes on income and property. Such a situation prevails in almost all the primary economies. As the economy develops, the proportion of revenue generated from taxes on income and property rises. Tax-GDP ratio (tax revenue as percentage of GDP) of India is very low in comparison with not just the developed countries, but many developing countries as well. Whereas developed countries like Sweden, Greece, United Kingdom, and USA have tax-GDP ratio higher than 30 percent, many of the developing countries too have a higher ratio- Korea 26 percent, Brazil 21 percent, and Mexico 18.5 percent. In

comparison, the tax-GDP ratio of India is very low, just 14.4 percent in 2001-02. While the tax-GDP ratio in India (centre and states combined) was 13.8 percent in 1980-81, it increased to 15.8 in 1991-92. Owing to structural adjustments and rationalization of tax structure during the nineties, the ratio declined to 13.4 percent in 1998-99. Since then the ratio has shown mild improvement. It reached 14.4 percent in 2001-02.

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PREFACE

The essence of VALUE ADDED TAX (VAT) lies in the inherent qualities of transparency, productivity, equitability, non-cascading & non-interfering effect and above all in its simplicity. The concept of Value Added Tax is almost a century old. History of sales tax may be traced back to remote antiquity. France was the first country to introduce tax in 1914. Then after several European countries followed. In our country, it was firstly introduced through Government of India Act, 1935. VAT was first pioneered by France in 1954. But a full-fledged VAT was initiated first in Brazil in mid of 1960's and then it was adopted by European countries in 1970's. With the rapid global economic changes, VAT has acquired a high esteem and currently it is being levied in more than 150 countries including our close neighbours Nepal, China, Pakistan & Bangladesh. Value Added Tax is a tax which is levied on value addition effected throughout the production-distribution chain. It has qualities of a good tax system. VAT is revenue friendly because taxes are imposed on entire value additions allowing minimum exemptions. VAT is broad based and very simple in implementation and also in its incidence bearance. It is based on tax invoice method and it leaves audit trail. Its transparent, non-cascading, self-policing, non-interfering, increasing registrations, making exports more competitive nature further makes it a very scientific method of indirect taxation. Basically, VAT is a tax on consumption in which Commodity is the subject, the Consumer is the target and Transparency is the objective.

Indian Union is a quasi federal State. Under the Indian constitution power to impose tax has been assigned both to the Union as well as the States. Certain categories of subjects for taxation have been assigned to Union and States in List I and List II of the Seventh Schedule to the Constitution of India. Residuary powers to tax vest with the Union. With the liberalization of the economy, India as a signatory to World Trade Organization Protocol has to reduce and rationalize customs duty and this will actually result in more pressure in indirect taxation. Indirect Taxation in the Indian context offers few opportunities. Commodity Taxes as of now comprise of Customs Duty, Union Excise Duty, State Excise Duty, Entry Tax, Luxury Tax and Sales Tax related other levies imposed by the States. Same commodities are taxed at different stages under different Acts in an un-integrated manner. This has resulted in cascading effect. Besides the value of the goods, tax on tax in a series of change of hands from manufacturer to consumer result in economic distortions. When the cosmetic goods are to compete with goods imported, the retail price to consumers have to be cost effective. In the manufacturing side if the inputs are taxed without discretion, manufacturing cost of a finished product increases. Raw materials for a particular manufacturer may be a finished product for another industry. This has effected the ancillary industries. Different Committees appointed by Government of India since 1970's have mainly concentrated on the levies made by the Centre. No comprehensive study of Sales Tax Administration in any of the States has been undertaken. In spite of the same, there is a feeling that the Sales Tax Administration in States has been commented upon. One of the draw backs of the levy of Indirect Taxes is that there is absolutely no exchange of information on the goods

produced or imported from outside the country by the Union Administrators of Excise Duties and Customs with Sales Tax Authorities of the goods slip through the Union Excise Duties or Customs and if the goods in case of goods levied to first-point tax in the State slips through a wholesaler or distributor, the evasion cannot be checked easily. Under the existing system maintenance of accounts as well as issue of authentic sale memos or vendor's receipt by the purchaser leaves much to be desired. Such inherent deficiencies can hopefully be rectified through VALUE ADDED TAX regime.

In pursuance to recommendations of the Indirect Taxation Enquiry Committee Government of India have adopted Mod VAT since 1986. Indirect Taxation Enquiry Committee of 1978 examined the following important questions to consider the necessity and desirability of switch over to Value Added Tax System in India:

(a) First, after the recommendations that we have made in regard to excises, and import duties have been implemented, what would be the further benefits to be derived by the introduction of VAT ?

(b) Second, should the long-term objective be the replacement of the existing systems of excises, sales taxation and certain other indirect taxes by the comprehensive VAT ?

(c) Third, if a comprehensive VAT system is ruled. out, to what stages should VAT be confined ?

(d) Fourth, would the advantage to be gained be significant in quantitative terms so that the attempted reform would be worth the cost and efforts involved ?

(e) And, finally, would the administration of VAT be feasible in India ?

The Committee recommended switch over to VAT. Tax Reforms Committee during the years 1991, 1992 and 1993 have recommended move towards Value Added Tax covering services and committees. To make the VAT system simple and easily administrable, it should be levied at two or three rates only. They have recommended broadening of tax based and simplified assessment procedures. It is of interest to see that the Committee disregarding the possible erosion of resources base of States favoured extending the collection of Mod VAT at wholesale stage. They have recommended taxation on the following services by the Union: Advertising Services; Services of stock brokers; Service of automobile insurance; Service of insurance of residential property, personal effects and Jewellery; and Residential telephone services. The Committee further advised the Centre to agree: to impose a consignment tax subject to certain conditions; to give back to the States the power of levy Sales Tax on sugar, textiles and tobacco; and to share a given percentage of its gross tax revenues with the States. This would mean that the States would automatically share in the expanding revenues from taxes on services.

In case of India, where the consumption variant operated through Credit Invoice Method VAT has been introduced, it is hopefully thought that on the whole, the positive growth in revenue, control of inflation will take place and trade and commerce will more competitive and also tax-leakages will be checked. Rate-path has been significantly simplified under VAT-zero rated, 1%, 4% and rest on 12.5% rated, while e xports are zero-rated and petroleum products have been kept initially out of the rate classification under VAT.

Commercial Taxes in Bihar are the most important constituents of the state's revenue. Sales tax has come to occupy the most important place among the state taxes in Bihar. Bihar introduced this tax in 1944 through Bihar sales Tax Act 1944. Before the introduction of VAT in Bihar, sales tax was regulated by the Bihar Finance Act 1981 along with some other commercial taxes through different acts like Entry Tax, E1rrtertainment Tax, Luxury Tax, Electricity Duty, Advertisement Tax. Since its inception, the sales tax in Bihar has registered increasing growth rate. In 1950-51 growth rate was around 11.1% while in 2004-05 it has reached the growth rate of about 20%. In pre VAT era, in Bihar sales tax, there were provisions of imposition of Additional Tax and Surcharge also. In old tax system goods were generally taxed on first point basis. But, with the advent of VAT in Bihar, scenario has changed totally as the tax administration and structure are concerned. The implication of VAT in Bihar is expected to be most significant. The huge number of dealers will be registered and grabbed in to tax net hitting even the last points of sales largely in production distribution chain. Four type of tax rates as per the national standards under VAT instead of 17 type of tax rates in old system, will further check the illegal trespassing and make the trade environment cordial and competitive. Simple procedure for registration, zero-rated export, input tax rebate, rebate on entry tax, freedom from regular traditional type assessments, easy forms procedures, compounding facilities etc in one under VAT will created a path of building confidence in traders and

that will open the numerous channels of revenue generations. On the other hand, new and useful
provisions of risk-analysis, cross verifications, auditing, tools of debt management & automation and harsh penal provisions will equip the tax administration to curb the tax evasion and tax avoidance.

A well drafted law which should be simple, transparent and unambiguous, attitudinal changes, publicity, education of tax payers, much facilitating environment and mechanism for the settlement of disputes, online answering of quarries system, a good advisory cell and overall a cordial linkage between tax payers and administration will check the obstructions in the way of success of VAT in future.

The main purpose of the research is to examine the implications of VAT on streamlining Tax System in India with special reference to commercial taxes in Bihar. The theme will mainly cover the implications of VAT on streamlining Tax System in India in the light of the changing global scenerio and further it will discuss its impact on the changing age of commercial Taxes in Bihar.

The objective of research is to evaluate the implications of VAT on streamlining and restructuring of the Tax System in India and specially in Bihar in the broader light of the role of commercial taxes in Bihar since tis emergence to the age of VAT. It will also discuss the suggestions to combact the drawbacks and to stabilize the Value Added Tax System and will further explore the pavement for its smooth functioning.

In the light of above description the present thesis have been completed under seven chapters including Introduction, Findings & Conclusion.

The first Chapter of the present thesis is Introduction in which introductory remarks of the present research work have been introduced.

The second chapter of the present thesis have been discussed the VAT System.

The third chapter of the present thesis have discussed about meaning, development and present position of VAT in Indian Tax System.

The fourth chapter of the present thesis has evaluated Commodity taxation under VAT in India with special reference to Bihar.

The fifth chapter of the present thesis have been discussed about the Commercial taxes in Bihar and its importance in tax system.

The sixth chapter of the present thesis has discussed about the impact of VAT on commercial taxes in Bihar.

The seventh first Chapter of the present thesis is Finding and Conclusion in which, concluding remarks and suggestions have been discussed.

In the last a vast Bibliography of Book, Journals, periodicals and government publication have been mentioned.

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20/06/12

Jagannath Chaudhary

Scholar