CHAPTER: 9

“FINDINGS AND RECOMMENDATIONS”

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“FINDINGS AND RECOMMENDATIONS”

9.0) INTRODUCTION:

Since ancient age, the objective of taxation has been to raise the revenue for Government. It still continues to be the most important source of revenue both in developed and developing countries. VAT alone occupies an important place in revenue structure of any state. In Maharashtra state too, VAT is major source of revenue. Study of the topic has been undertaken with the objectives stated below.

9.1) OBJECTIVES:

Following are the main objectives of the study:

1) To discuss various forms of VAT particularly from the point of view of practical usefulness in the state of Maharashtra.

2) To examine economic effects of the VAT from the point of view.

   A) Price Effects.
   B) Distribution Effects.
   C) Neutrality and Efficiency.
   D) Effects on Growth.
   E) Allocation of Resources.
   F) Equity.
   G) Stabilization.
   H) Tax Administration
3) To make an interstate comparison of VAT in the selected states in India and selected countries in the world.

4) To study the structure of VAT in Maharashtra.

5) To workout buoyancy of VAT revenue in Maharashtra.

To achieve these objectives, the study of VAT has been based on the material and data contained in the state budget of Government of Maharashtra, Reserve Bank of India Bulletins, Selective Statistics published by Department of Sales Tax, Statistical Abstracts of Maharashtra and so on... Similarly, the books on VAT by eminent scholars and authors were also referred for the study.

9.2) SUMMARY AND FINDINGS:

To attain the objectives mentioned above, each chapter in the study has been devoted for specific objective.

It can be summarized in nutshell that sales tax system has become more efficient due to VAT. It is seen that revenue collection has been increased after introduction of VAT.

Chapter 1 deals with the importance of VAT, traces economic history of VAT, reason for selecting the topic for research, the research methodology used and the available literature review for the purpose of this study.

Chapter 2 deals with the theoretical approach to the VAT. It covers meaning, definition, type, merits, demerits and optimal structure of VAT. There are four type of VAT viz.

1. Goss Product Variant
2. Income Variant
3. Consumption Variant
4. Wage Type of VAT

The study of all these four types in detail has revealed that the consumption Variant is divided to three sub points. The consumption type of VAT is very popularly used in developed and underdeveloped countries. The reason for preference of this variant is that it does not affect decision regarding investment because the tax on capital goods is also given set-off against VAT liability. The tax is neutral in respect of techniques of production. The consumption variant is more in harmony with the destination principle. We have studied this in third chapter.

This chapter is also devoted to the theoretical aspects of economic effect of VAT. Such economic effects are discussed with specific reference to price effect, distribution effects, neutrality and efficiency, effect on growth, allocation of resources, equity, consideration, stabilization and tax administration.

1) **Price Effect:**

The effect of VAT on prices is significant and direct. In general VAT causes increase in price of commodities depending upon the elasticity of demand and supply of the commodity concerned. Normally it is fully shifted forward because traders will have to maintain their level of profit by shifting VAT ahead.

The shifting would, however, depend upon the supply and demand conditions of the commodity in question. The degree of shifting would cause increase in price.

VAT would be inflationary if it is shifted forward as the consumer maintains its real consumption and accommodative credit policy follows. In fact, it would be necessary to have sufficient increase in wages (to offset increase in price due to VAT) to help the consumption level. Such
an increase in wages will cause inflationary spiral, for the business cost will trigger the price increase. More importantly, the price impact was negligible even for consumer goods. Hence, it would be correct to state that VAT is generally not inflationary.

2) Distribution Effect:

Distribution effect refers to incidence and equity aspects of the tax. That is, the issue of distribution effect who really bears the burden of tax? In the case of VAT this depends upon various possibilities of shifting, avoidance and evasion of tax, as well as on the composition of the users of commodity. The aspects of avoidance and evasion are related both to the structure as well as to the administration of the tax. VAT in comparison to other forms of sales tax stands the test of proper administration because it involves a self-policing mechanism. The buyer of commodity would take care to obtain an invoice so that he could claim credit for the tax due to the seller. Hence, the equity aspects related to avoidance and evasions are better taken care of by VAT.

The distribution effect however depends upon the possibility of shifting of VAT. The extent to which shifting would take place would depend upon the elasticity’s of supply and demand. The greater the elasticity of demand, the less the firm would be able to shift. Since the demand for a commodity is a function of both its price and availability of its substitute, a broad-based VAT would have less chances of substituting one commodity for another and hence, shifting is more likely to take place.

The progressivity or regressivity of VAT depends upon various factors such as the number of exemptions and zero ratings, and on other compensatory features. VAT would be a proportionate tax if related to consumption and somewhat regressive when related to income the result of
distributional effects indicates that VAT is not a useful instrument infinite regressivity.

3) Neutrality:

The concept of neutrality is concerned with the extent to which to avoid distorting the working of market mechanism. It is important that VAT should not affect those decisions if it is to be neutral. The one way of the important objectives of tax policy is to attempt neutrality with respect to the economic behavior of producer as well consumers.

This is achieved through production when VAT does not induce firms to change their forms and methods of carrying on business. It is obtained in consumption when VAT does not induce consumers to change their pre-tax choices between taxed and untaxed commodities or between those taxed at different rates. This is distorted, if the tax rate differs from one category of goods to another.

VAT is designed to be neutral between capital and labour or investment and consumption. Even in respect of foreign trade, the zero rating keeps VAT neutrals.

4) Effect on Growth:

One of the important objectives of tax policy in developing economy is to increase the rate of saving and investment to achieve a higher rate of growth. A rational tax structure should prove helpful increasing the rate of saving in the economy. VAT can be viewed as a tax on articles of mass consumption to meet the costs of common benefits. VAT does not have any adverse effect on investment as capital goods and depreciation on capital are exempt under VAT. Thus, VAT is an ideal tax to help and achieve higher additional resources, increment saving ratio and thereby attain higher rate of growth in the economy.
5) **Allocation of Resources:**

The tax system in general and every tax in particular should avoid interference with the attainment of the optimum allocation and use of resources.

In the developing economy like India, the resources required for production are limited and scarce too. Hence, in a planned developmental process the government has to utilize such limited resources to maximum benefit limited resources to the maximum benefit to the people. It requires diverting the limited resources from undesired limited resources from undesired channels to the most desired channels.

This requires discriminatory VAT which should fall heavily on luxuries and exempt the basic necessaries of life.

6) **Equity:**

The distribution of the burden of taxation should be based according to the economic welfare of the taxpayers.

The basic and most widely used argument against VAT is that it is highly regressive-it collects more tax from people with small income, than from the rich.

Progressive taxation became an effective fiscal policy tool for achieving both stabilization and redistribution objectives without involving any conflict between these two objectives.

For making VAT progressive it has been argued that commodities can be classified into necessaries such as food items and non-necessaries, and if certain basic necessaries like food items are exempted from taxation. The remaining commodities can be taxed at different rates depending upon their relative importance in the generality of consumers’ household budgets. This would make the VAT relatively progressive. The
differential rates may be determined on the basis of the income elasticity of different commodities, relating the rate of tax to the degree of income elasticity.

7) Stabilization:

VAT has been advocated as a means of controlling inflation. It is said to be anti-inflationary because it reduces the purchasing power of the consumers.

The VAT is inflationary because it causes rise in prices. But it is less inflationary in comparison to borrowing or deficit financing which has to be used in developing countries to raise resources to finance development plans. However, the character of tax induced inflation is also to be taken not of as it is purposive and curtails the consumption of the taxed commodities. Thus, it causes rise in prices but does bring the effects of price rise as anticipated by the government.

According to the post Keynesian functional approach the stabilization objective can be realized by a combination of taxation. Other things remaining constant, in a deflationary situation taxation will be reduced and in an inflationary situation, taxation will be increased or alternatively the composition of taxation so organized as to respond automatically in the required direction.

8) Tax Administration:

Tax administration deals with the administrative cost and efficiency involved in the collection of taxes. A tax should be such which does not involve a complex and large machinery for its collection. In a tax like VAT where the incidence in most cases is on the buyer and not on the seller, the animus of dealer against tax payment arises largely because of complicated procedures of registration, filing returns and assessment.
Therefore, there is need to facilitate tax compliance by simplifying procedures.

In the light of cost of collection and efficiency, tax administrative has been discussed superiority of indirect taxes to direct taxes on the grounds of administrative cost and efficiency has been established. VAT are easier to administer if the rates are specific than ad valorem.

Optimal structure of VAT has studied with reference to -
1. Progressive v/s Regressive Nature
2. Ad Valorem v/s specific Taxes
3. Income Elasticity in the Tax System
4. Gross Product v/s Income v/s Consumption v/s wage Type of VAT

Tax equity, the general practice is to adopt income as the index of ability to pay and to favour a progressive tax system. VAT is a tax on the sale commodities and whosoever purchases the commodity, has to pay the tax at the same rate irrespective of his income or ability to pay. Therefore, the tax is not progressive. Therefore, though VAT is regressive in nature and against the equity principle on attempt can be made to attain the principle of equity by exempting necessities from the purview of the tax.

The VAT which are levied upon the prices of the commodities are known as Ad Valorem taxes and the VAT which are related with the physical measures such as weight, length etc. of the commodities are known as specific taxes.

VAT show a higher degree of income elasticity if they are ad valorem by nature. The improvement in tax administration may increase the income elasticity of the tax system by reducing evasion, extension of
Consumption variant is neutral between different methods of production; there would be no effect on tax liability due to the method of production. This method is widely used. The reason for preference of this variant is that it does not affect decision regarding investment because the tax on capital goods is also set-off against VAT liability. The consumption variant is more in harmony with the destination principle.

**Chapter 3** discusses VAT in selected Countries in the World and selected States in India has been studied. A comparative view of the structure of VAT in France, Italy, Germany, Canada, Mexico, Brazil, Bangladesh, China and United Kingdom has been presented in tabular form in section A, studying coverage, rate structure, exemption and revenue collection.

It is observed that, consumption type of VAT is used in all the countries. Every country has two rates simultaneously in operation, i.e. standard rate and reduced rate. Standard rate is varying from 5% to 20%, reduced rate is varying from 0% to 10%.

The comparative study of VAT in Delhi, Jammu and Kashmir, Gujarat, Kerala, Assam and Bihar has been analyzed in section B (Chapter 3). All the aspects viz., rate of tax and point of levy, exemption, registration, and so on… are covered in this study.

It is observed that, necessities are totally exempted from VAT in all the states. The VAT rate schedule is near about same in these states except in Gujarat which has higher rate i.e., 60%.

**Chapter 4** is dividing into section A and section B. section A studies in detail the position and provision of VAT in Maharashtra as below:
1) Historical Background
2) Difference between MVAT and BST
3) Pre-VAT and Post-VAT Period’s Revenue Collection
4) Planning for implementation of VAT in the State
5) Analysis of Staff Requirement and Re-Organization of Sales Tax Department
6) Computerization of the Taxation Department and Check Gates

By abolishing Sales Tax, VAT is introduced which made many changes in sales tax department. Revenue collection of Government of Maharashtra has been increased after the introduction of VAT. There was an increase in the growth of net revenue collection by 42.10% after introduction of VAT during the year 2005-06.

Section B describes the main and important amendments of the present MVAT ACT 2002 as amended up to 21st April 2011. The description relates to the act, rate schedule of VAT, exemptions and tax structure.

Chapter 5 has been devoted to the study, in detail of tax administration and tax operation. Tax administration covers the administrative personnel along with their duties and powers. Tax operation describes the rules and procedures regarding registration, online process of VAT registration, voluntary registration, returns, e-returns, set-off and refunds, assessment, payment of tax, e-payment, appeals, offence and penalties and penalty and interest.

It is observed that, the Maharashtra State is the first state which has implemented or used e-registration, e-return and e-payment process. Use of e-registration, e-return and e-payment process solves a lot of difficulties in the operation. The process of e-registration is user friendly.
Maharashtra Government made compulsory the e-registration and e-return system from 2005-2006 and e-payment system from 2009-2010. Due to this system the number of registered dealers has increased and thereby the revenue collection. This system is convenient and time saving for the dealer for payment of tax.

**Chapter 6** deals with buoyancy of VAT revenue in Maharashtra. Firstly the concept is defined and explained, and then buoyancy of VAT revenue has been calculated. Lastly, methodology and sources are explained.

The Correlation of Coefficient between Net State Domestic Product and VAT Revenue for the period 2005-2010 is calculated. The value 0.987 indicates that both variables are highly correlated to each other.

Buoyancy of VAT revenue for the period 2005-2010 is worked out as 1.69%. It implies that 1% change in state income leads to 1.69% additional revenue from VAT.

Division wise VAT revenue collection from the period 2005-2006 to 2009-2010 has been studied in details. It is found that VAT revenue from Mumbai division is the highest. It comes to more than 60% of the total revenue collection from all the division.

It is concluded that, the VAT revenue has been responding to increase in SDP relatively at lower degree.

Compound Growth Rate of VAT revenue has also been worked out for the period 2005-2010 it is 10.81%.

Chapter 6 also deals with the tax structure of Maharashtra. Details of states tax revenue from different sources of taxes have been shown year wise in tabular form. Such sources are stamps and registration fees, state excise duties, electricity duties and so on … VAT also contribute
nearly about 60% to the total states tax revenue. Thus, the VAT contribution is 31,688 crores (56.87%) in 2009-2010 and 35,986 crores (56.37%) in 2010-2011.

VAT revenue as a percentage of State Domestic Products varies between short ranges of 3% to 4% over the last 5 years. Thus, the proportion of VAT revenue has remained constant even with the increase in SDP.

Furthermore, chapter-6 studies in detail the problem and estimation of evasion in VAT revenue of Maharashtra.

A methodology has been evolved to estimate the evasion. The main features of the methodology are -

i) Weighted average has been calculated by assigning different weights to necessities, comforts and luxuries.

ii) Evasion has been ascertained as a difference between the expected collection and actual collection of VAT.

It is observed that, the tendency to evade the tax has been on an increase during last four years, it is 11.42% in 2007-2008, 17.64% in 2008-2009 and increased to 28.58% in 2009-2010.

The main reason of evasion of VAT is that purchasing the goods without the invoice. If the bill or invoice of the purchased goods will not be taken by the consumer, tax will completely avoided.

One of the biggest sources of evasion known to anyone familiar with tax enforcement is the practice of suppression of sales and purchase. Duplicate manufacturing and assembling activity, almost all such production is neither registered nor recorded from places well known to the retailers and consumers who get a bargain on these products with the price reduced to the extent of the tax amount and perhaps sometimes even more. All such manufacturers are neither registered with the Small Scale Industries
Departments nor with the Sales Tax Department there by safely avoiding the tax net.

Evasion of tax takes place when the people report dishonest tax that includes declaring less gains, profits, or income than what has been actually earned and they even go for overstating deductions. The Evasion of Tax level depends on certain factors such as fiscal equation which means that people's tendency to pay less tax declines when the payment due from taxes becomes obvious. The level of Tax Evasion is also dependent on the efficiency of tax administration and corruption levels.

The level of Evasion Tax also depends on the chartered accountants and tax lawyers who help companies, firms, and individuals evade paying taxes. Thus, tax evasion has become a common phenomenon either in case of direct taxes or indirect taxes. But, there is a one point of difference between direct and indirect taxes. When income tax is evaded by an assessed, he enriches himself by defrauding the government and impoverishing the treasury. But in the case of evasion of indirect taxes, like VAT by the traders it becomes altogether different.

The probable reasons for such heavy evasion have been discussed in detail in this chapter.

**Chapter 7** studies the economic rationale for VAT in Maharashtra in the light of economic considerations namely equity, resource allocation, administration and stabilization.

Government of Maharashtra attained equity consideration by according exemptions to the basic necessities of life and agriculture or by taxing at very low rates of VAT. Luxuries have on the other hand, been taxed at a comparatively higher rate of VAT.
Exemption for equity purpose have also been judged from the point of view of

1) Wide Spread Exemption and
2) Revenue Collection

Out of 550 entries of goods of different descriptions as enlisted in schedule A, B, C, D and E barely 58 entries approximately are totally exempted. It means the exemptions are not wide spread but limited. It further means that majority of goods have been brought within the purview of VAT thereby increasing the total collection of VAT revenue.

Regarding resource allocation Government of Maharashtra has given an encouragement to the dispersal of industries through VAT Incentive Package Scheme of 2007; by extending the deferred payment of VAT by new industries set up in underdeveloped areas.

Similarly certain exemptions and relief have been according to exportable commodities, producer’s goods and certain charitable institutions, thereby giving impetus to their production.

Tax administration has been dealt from both the angles viz. the dealers and the department. Maharashtra Sales Tax Department is going the information technology way with the help of MASTEK Ltd. A global IT company is helping the Sales Tax Department to implement MAHAVIKAS, an automation program to make the department user-friendly. The Maharashtra Sales Tax Department is a major revenue earning department and contributes over 60% of the total revenue of the state.

The study of stabilization aspect leads to the conclusion that the VAT acts both ways. It has inflationary effects in so far as it raises the prices by the amount of tax. On the other hand, it is anti-inflationary. VAT having a high degree of elasticity built in flexibility withdraws from circulation into
the Government treasury an amount of revenue, which is more than proportionate to the rising state income, leaving correspondingly less money in the hand of the public. This has depressing effect on aggregate demand for goods and services resulting in an anti-inflationary effect.

**Chapter 8** is devoted to the study of “Goods and Service Tax” (GST). The study of how will GST work in Maharashtra has also been study in depth here. The study reveals that GST is superior to the existing forms, which are prevailing in Maharashtra. Central taxes such as Central Excise Duty, Additional Excise Duty, Service Tax and so on… should be subsumed under the GST. And State Taxes and Levies such as VAT, Entertainment tax, Luxury Tax and so on… would be subsumed under GST.

If the tax bases are successfully harmonized, it is possible to pool the resources of the tax administration so as to improve tax administration.

More than 150 countries have introduced GST in same form. It has been a part of the tax landscape in Europe for the past 50 years and is quickly becoming the preferred from of indirect tax in Asian-Pacific region.

**9.3) SUGGESTIONS AND RECOMMENDATIONS:**

1) VAT is an indirect type of tax. And indirect tax is regressive by nature. To decrease the regressivity in VAT, basic necessities should be exempted. In VAT rate schedule, 58 commodities are exempted out of 550 commodities. It means total 10.54% commodities are exempted. At least 15% commodities should be exempted in VAT rate schedule.

2) The VAT rate on Luxurious goods such as diamond, gold and silver is only 1%. To increase the revenue collection and to make tax structure
more progressive. It is suggested that VAT rate on such goods should be increased up to 5% by the government.

3) Assessment was done by the sales tax officers when Bombay Sales Tax Act 1959 was in force. After introducing VAT, assessment is done by the chartered accountants.

   It can be said that the out-sourcing of departmental work has been indirectly done. It may cause disadvantage like chartered accountant may give mock information for the profit of the company. Hence, it is suggested that, assessment work should be done by the sales tax officers.

4) Ward System was implemented before the VAT was put into action. Under this system, wards were given Sales Tax Officer wise pin code. So, every Officer had the information about each company belonging to his ward. He had to keep the record of companies whether the company has paid the tax or not. Due to this system, tax was paid regularly in time. Therefore, the rate of tax evasion was also less.

   But after introducing the VAT, ward system was rejected in the Maharashtra State. That’s why Sales Tax Officers do not have complete information regarding the company. He is supposed to work for the company only for a quarter. Therefore he cannot assess properly the performance of the company. The states like Rajasthan, Gujarat have still this Ward system, which is helpful for controlling the evasion. It will be better if it is implemented in Maharashtra once again.

5) Total number of Registered Dealers under MVAT Act is 7, 08,167(on 21/12/2010). But audit of all the dealers is not completed yet. Because in comparison with the number of registered dealers, the force of
administrative staff is only 9,285. The ratio of dealer to administrative staff is found to be 1:0.13 which is much lesser.

Therefore, it is very essential to increase the number of Administrative Staff.

6) VAT is introduced in 2005. The figure showing revenue collection includes the revenue from VAT as well as from Sales Tax. The researcher thinks that Revenue collection of VAT and Sales Tax must be stated separately. Similarly, while showing the figure of total revenue collection, the amount of refund payment should be stated separately, by which the net revenue collection from VAT can be found easily.

7) Every company must be audited at least once in five years. The return submitted by the company, whether it is correct or not, can be found out through the audit. Because, Audit officer requires the dealer ---
   I. To accord him the necessary facility to check or verify the cash or stock which may be found there in, and
   II. To accord him the necessary facility to inspect such books of accounts or other documents as he may require and which may be available at such place,
   III. To furnish such information as he may require as to any matter. This may be useful for or relevant to any proceeding under this Act.

   After this, the audit officer obtained the detail information about the company. Therefore, the sales tax officer / audit officer knows whether the dealer is lying to the officer or giving correct information.
8) If the income of a particular company is above 60 lacks, then the company has to submit the Form No. E-704. As per mandatory requirement of the form no. E-704, such companies must undergo audit. In the audit every transaction of the company is cross checked with the other company transaction with it. This process takes quite a lot of time, because if the company is geographically away or separated then it takes time to manually call for the record of transaction.

Therefore, it is suggest that transaction details of every registered dealer should be invited. Submission of such details electronically (on computers or E-returns) will require less time.

9) New Amendment is usually introduced in any month rather than beginning of the financial year. For instance, under the MVAT (Amendment) Rules 2010, (dated 5th February 2010), amendment of Electronic payment and Refund was implemented in Feb. 2010.

This type of amendment must be started from the beginning of the financial year, so that it is acknowledged by the Sales Tax Officers and dealers also. And they can work smoothly according to the Amendment. They get confused due to the introduction of continuous new amendments.

10) To fill the Form No. E-704, time period of ten months is granted.

(Because, any person or dealer who is having a furnished return under Sub-Section (1), (2) or (3) discovers any omission or incorrect statement there in, may furnish a revised return in respect of the period covered by the return at any time before the notice for assessment is served on him, in respect of the period covered by the
return or before the expiry of a period of eight months from the end of
the year containing the period to which the return relates, whichever is
earlier.)

But, some dealers do not fill the form within the period of ten
months.

Fine should be charged on the dealers who did not fill the form
no.704 within ten months.

11) It is observed that expenditure of the investigation branch of Sales
Tax Office is more. To find out the amount of tax avoidance is a
rigorous task for them.

If all these transactions would be done through the bank, then
the details of expenditure could be getting easily.

Therefore, it is suggested that, all the transactions should be done
through the bank.

12) The staff working with the Sales Tax Officers must be trained with
the knowledge of computer, e.g.: TALLY, SAP

To create computer proficiency among the staff, motivational
programs must be arranged.

13) When Sales Tax was under operation, the details about
manufacturing and trading practices of the dealer, number of partners
e tc. was available to the Sales Tax Officers while auditing, because the
registered record of the details was available to the sales tax officers.
But after introducing VAT, the details of dealers are not available to
the Sales Tax officers while auditing, because the record of registered
dealers was put to an end after introducing VAT.
But as opinion of the researcher, registered record of dealers must be kept for acknowledgement of their complete information.

14) E-Registration, E-Return, E-Payment and all the forms are connected through the internet in Maharashtra but due to this, while claiming for returns, paying the payment or filling the form at a time, so many dealers are available on the website. Therefore, sometimes website hangs and it creates problem. It is suggested that, website should be developed more.

15) E-payment has been made compulsory under which e-payment is done through the net-banking. 19 Banks signed the contract for the e-payment. Similarly e-payment is possible on the website of sales tax office also.

  Suppose a dealer has no account in these banks or if he is living in the small town or village where net-banking facility is not available. Then, he has to face so many problems and spend lot of time to open his account in this bank.

  Therefore, researcher think that, contract must be made with other banks also for e-payment as well as to save the time of the dealer and help him on the website of sales tax office.

16) Evasion of VAT is increased in large scale in year 2009 – 2010. It rose from 17.64% (2008 – 2009) to 28.58%. Revenue collection from VAT of Maharashtra Government is decreased due to the high rate of evasion.

  It must be made compulsory for all the dealers to issue the bills to the consumers at the time of sale. To ensure whether the dealer is
issuing the bill or not, the record of his purchases and sales can be checked. It will be helpful to minimize the rate of VAT evasion.