CHAPTER: 1

“INTRODUCTION”

Section: A

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CHAPTER: 1

“INTRODUCTION”

SECTION: A

1.0) INTRODUCTION:

Taxation is an important source of Government Revenue. It is a crucial instrument of macroeconomic policy which contributes to ensure social justice and reducing the inequalities of income and wealth in the Economy. This source is also preferred to the reason that it involves no interest payment on the government. It rather helps to mobilize the maximum savings in the society through direct and indirect taxation.¹

VALUE ADDED TAX (VAT) is an indirect tax, which is imposed on goods and services at each stage of production, starting from raw material to final product. VAT is levied on the value addition at different stages of production. VAT is widely applied in the European countries across the globes, who have adopted this tax system.

VAT was first introduced in France. In 1954, the France economist, Maurice Laure, the joint director of the French tax authority, the Direction general des impost, initiated the concept of VAT, which came into effect on April 10, 1954. Initially introduced for large business of France, with the passage of time, VAT was employed for all business sectors of the

¹ ‘Economics of Value Added Tax’ Dr. S. P. Singh, Mohan Prasad Shrivastav and Satyendra Kumar Gupta, APH Publishing Corporation. (2008)
country. In France, Value added Tax is considered to be one of the major source state finance.

VAT was introduced to arrest the increasing smuggling and cheating, which were resultants of high sales tax and tariffs. Initiated in France, VAT is used as an instrument of taxation in all the member states of the European Union. Different VAT rates are employed in different member states of EU. The minimum VAT rate for the EU members is 15%. However, the reduced rate of VAT can be as low as 0%. The rate is determined by the VAT authorities of different countries.

There are also some countries, where VAT has been introduced to replace sales tax. India is one such country, were the system of VAT has been adopted for replacing the sales taxation system.²

At this moment VAT is the key source of government’s revenue in more than 150 countries. Nearly 70% of the world is now under the VAT.

The Value Added Tax system is designed to address various problems associated with the conventional sales tax system. In sales tax, there is no provision for input tax credit, which means that the end consumer may pay on an input that has already been taxed previously. This is known as cascading and leads to increases consumer tax and price level, which increases the rate of evasion and can be detrimental to economic growth.

The Value Added Tax system deals with these problems quite efficiently. As VAT is imposed on value addition-at every single stage—there is no incidence of cascading. In this way, the final consumer bears the burden

²[www.wikipeidia.com](http://www.wikipeidia.com)
of paying Value Added Tax. This system involves absolute transparency at every stage of taxation, thereby making the tax system quite comprehensible and simple.

In some countries like India, the system of VAT has been designed to change the existing system of sales taxation. Value Added Tax is different from the conventional system of sales tax, because VAT is charged at every stage of value addition—whereas sales tax is imposed on final value of transaction only.

The Value Added Tax system allows for Input Tax Credit or ITC, on the amount of tax levied at preceding stage of the value addition chain. The allowance for ITC is normally appropriated from the Value Added Tax liability imposed on the following stage of the sale of the product.³

1.1) REASON FOR SELECTING THE TOPIC OF RESEARCH:

VAT is state source of revenue in India. VAT in its comprehensive form is a tax on all goods and service (except export and government service) it special characteristics, being that it falls on the value added at each stage from the stage of production to retail stage.

Maharashtra is one of the 21 states which have introduced the VAT system of taxation from 1st April 2005. The design of Maharashtra state VAT is generally guided by the best legal framework as well as operating procedures. Another key factor in preparation of the design of state level VAT is national consensus on certain issues. The consensus has been arrived

³Economic & Political Weekly, Volume 20, No.3 June, 1995
at through the discussion in the Empowered Committee of State Finance Minister on implementation of state level VAT.

VAT was introduced in the place of Sales Tax because VAT is to avoid cascading effect of taxes. VAT is found to be very good and transparent tax collection system, which reduces tax evasion, ensures better tax compliance and increases tax revenue.

The researcher chooses the topic of research to find out whether this purpose is being satisfied by the implementation of VAT. The researcher wanted to study pros and cons of the actual effects of VAT and to come out with findings which would help in eliminating any short comings or deficiencies prevailing in the existing VAT system.

1.2) OBJECTIVES OF STUDY:

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 of

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.

1.3) HYPOTHESIS:

A) Sales Tax system has become more efficient due to VAT.

B) Revenue collection is increased after introducing VAT.

1.4) RESEARCH METHODOLOGY:

The study is based on the secondary data collected from the state budget of Maharashtra, the Reserve Bank of India bulletins and the Statistical Abstracts of Maharashtra. Simple statistical tools viz. averages, frequencies, percentage etc. are used for analysis and comparison of data. Data is also presented in the form of tables, graphs, for analyzing and interpretation of the data.
Some advance statistical techniques viz. co-relation, regression analysis etc. are also used for assessing association between different variables under study.

1.5) TOOLS OF ANALYSIS:

Statistical Techniques such as Buoyancy, Compound Growth Rate, Correlation Coefficient and Regression Line are used for the scientific classification and analysis of Secondary Data. Then, inferential interpretation is done after the analysis of comprehension revealed by the statistical techniques.

1.6) DURATION AND SCOPE OF THE STUDY:

VAT is introduced in India as well as in Maharashtra on 1st April 2005. Therefore, duration of the study is from April 2005 till today.

To study the structure of VAT in Maharashtra, it is compared with 9 countries in the world and 6 states in India. VAT structure in Maharashtra is studied thoroughly.

1.7) CHAPTER SCHEME:

CHAPTER 1: INTRODUCTION

Section: A

First chapter is a brief introduction of the growing importance of VAT in the general tax structure of the economy. It includes a statement of the objective and techniques of analysis used.
Section: B

The review of literature or work done in this field has also been discussed in this chapter.

CHAPTER 2: VAT: A THEORETICAL APPROACH

Second chapter discusses the concept of VAT with various forms particularly from the point of view of their practical usefulness in developing countries. An economic effect of VAT has also been examined in the chapter.

CHAPTER 3: VAT IN SELECTED COUNTRIES IN THE WORLD AND SELECTED STATES IN INDIA

Third chapter deals with VAT in some selected countries in the world and in some selected states in India.

CHAPTER 4: VAT IN MAHARASHTRA

Fourth chapter outlines the VAT system and recent amendments of MVAT 2002 in Maharashtra.

CHAPTER 5: VAT: ADMINISTRATION AND OPERATIONS.

Fifth chapter discusses administrative set up and operations of VAT system in Maharashtra.

CHAPTER 6: PATTERN AND GROWTH OF VAT REVENUE IN MAHARASHTRA

Sixth chapter works out buoyancy of VAT revenue in Maharashtra and deals with the problem of evasion of VAT revenue.
CHAPTER 7: ECONOMIC RATIONALE FOR VAT IN MAHARASHTRA.

Seventh chapter is devoted to explain the statutory provisions regarding the VAT in Maharashtra in the light of economic considerations namely Equity, Allocation, Stabilization and Administration.

CHAPTER 8: GOODS AND SERVICES TAX (GST)

Eighth chapter discusses the newest member of Value Added Tax (VAT) family i.e. Goods and Services Tax (GST) in detail. It also deals with the issue that how GST will work in Maharashtra.

CHAPTER 9: CONCLUSION AND RECOMMENDATIONS.

Ninth chapter summarizes conclusions and puts forth the recommendations of the study.

SECTION: B

1.8) ECONOMIC HISTORY OF VAT

1.8.1) HISTORICAL BACKGROUND OF VAT:

Going into the historical background of VAT, it can be stated that the concept of VAT, which was the brainchild of F Vans Siemens who first originated it in 1918 as an alternative to turnover tax in Germany. France was the first country to adopt it in 1954 and this largely paved the way for it being accepted as instrument for harmonization of tax. Subsequently, about 13 countries including Pakistan in 1990, Bangladesh in 1991, Sri Lanka in 1995, China in 1994, India in 2005 and Nepal in 2000 have adopted VAT.
The developed countries like Australia, Canada, the European Union, Spain, Japan, United Kingdom etc. have also adopted this system. Alongside, the US has not implemented VAT.

1.8.2) VAT IN INDIA:

The concept of VAT is not totally new to India as the central had introduced VAT system for about last ten years in respect of Central Excise Duties. The first preliminary discussion on state level VAT was held in a meeting of Chief Ministers convened by Dr. Man Mohan Singh, the then Union Finance Minister in 1995. The main theme of this meeting was discussing the basic issues on VAT and this was followed up by periodic interactions of State Finance Ministers. Subsequently, the important decisions were taken in a meeting of Chief Ministers of India convened by Shri. Yashwant Sinha, the Union Finance Minister in 1999.

The Empowered Committee of State finance Ministers headed by West Bengal Finance Minister, Dr. Asim Kumar Dasgupta and comprising of the Finance Ministers of Assam, Delhi, Gujarat, Jammu & Kashmir, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, Meghalaya, Punjab, Tamil Nadu and Uttar Pradesh endorsed the suggestion that every state law on VAT should have a minimum set of common features. At the conference of the State Finance Ministers held on January 23, 2002, it was agreed that all the 28 states as well as the Union Territories would introduce VAT with effect from April 1, 2003. This position was reiterated during the conference of state Chief Ministers held on October 18, 2002 that was Prime Minister. The Kelkar committee on tax reform has also recommended introduction of VAT in this report.
The Union Ministry of Finance considered these bills of state and union territories in line with the decision of the Empowered Committee of State Finance Ministers for incorporating the same in VAT bills to be placed in the state legislatures and subsequent transmission to the Government of India for presidential assent. At this stage, there were certain developments that delayed the introduction of VAT. Despite these developments, most of the states remained positively interested in implementation of VAT. Madhya Pradesh VAT bill had already been accorded presidential assent in November 2002. One state, namely Haryana, had already introduced VAT on its own with good results on revenue growth. It is important to note that in the meeting of the Empowered Committee on June 18, 2004, when Mr. P Chidambaram, the Union Finance Minister of India was invited and was kindly present, all the states, excepting one, once again categorically renewed their commitment to the introduction of VAT from April 2005. Ultimately, Union Finance Minister, Mr. P. Chidambaram unveiled in January, 2005 a White Paper on VAT, documenting a roadmap to levy uniform state-level tax on over 550 items and exempt 46 local items.4

1.8.3) WHITE PAPER ON VAT

- By GOVERNMENT OF INDIA

The White Paper on VAT formally released by the Union Finance Minister, Mr. P. Chidambaram, under the convenership of Empowered Committee of State Finance Minister Dr. Asim Kumar Dasgupta on January 17, 2005. The White paper on state-level VAT is presented in three parts. The first part starts with the justification of VAT and its

4www.yahoo.com (Siddhartha Sankar Saha)
background. These second part is the main design of VAT, as evolved on the basis of a consensus among the states through repeated discussions in the Empowered Committee, it has been elaborated. Finally an attempt has been made to discuss the other related issues for effective implantation of VAT in third part.

The main issues on White Paper on VAT are summed up as follows:

1) RATE STRUCTURE AND CLASSIFICATION OF COMMODITIES UNDER VAT:

The White Paper on VAT has made a roadmap for levy of a uniform state level tax on over 550 items. Petrol, diesel, liquor, lottery has been kept out of the VAT regime. Some states like Delhi have imposed VAT on diesel at 20%, which is higher than the 12% sales tax charged earlier. VAT can be classified into four categories, under each of which a different is prescribed.

- **Category I:**

  As many as 58 items, which are exempted from VAT, are covered under this category. These are natural and unprocessed products in the unorganized sector, the items that are legally barred from taxation and the ones that have social implication.

- **Category II:**

  Special rate of 1% VAT is applicable to gold and silver ornaments etc.
• **Category III:**

A rate of 5% VAT is applicable. This category covers the largest number of goods about 270. They are items of basic necessities such as medicines and drugs, all agricultural and industrial inputs, capital goods and declared goods.

• **Category IV:**

The general rate of VAT 12.5% is applicable to all the remaining commodities.

2) **RELATED ISSUES:**

While the VAT panel has relaxed the upper limit for traders coming under VAT regime from Rs. 40 lakhs to Rs. 50 lakhs turnover, traders in this category would have to make a choice of paying a composite VAT rate or forego input tax credit. Mr. P. Chidambaram sought to encourage all states to implement the new tax regime. Under the formula commended by the panel, states would get 100% compensation for revenue loss, if any, in the first year, while 75% of the loss would be compensated in the second year and 50% in third year. The Central Sales Tax of 4%, which yields Rs. 15,000 crore to States, would be phased out after April 2006. The White Paper also emphasized the potentiality of crosschecks with computerized information system. Doubts are, however, being raised as to whether the proposed computerization involving intense interaction with computers for every trader is feasible. The White Paper has not addressed frontally the issue propounded by the Kelkar Task Force in regard to the states right to tax services. VAT by definition has to cover both services and goods. It does not come out clearly in favour of including service under the VAT net. This is, of course, is a
matter that the Finance Minister will have to address by empowering the States to level service tax. It is logical that States should be so empowered.

3) PROCEDURE OF SELF-ASSESSMENT OF VAT LIABILITY AND AUDIT DEALER:

One major simplification proposed under VAT regime is that unlike the existing sales tax system there will be no compulsory scrutiny of returns. If no specific notice is issued by the VAT department proposing departmental audit of the book of accounts of the dealer within the time limit specified in the Act, the dealer will be deemed to have been self-assessed on the basis of returns submitted by him.

Correctness of self-assessment should be checked through a system of departmental audit. A certain percentage of the dealers will be taken up for audit every year on a scientific basis. If however, evasion is detected on audit, then the audit for previous periods would be taken up. The audit team will conduct its work in a time-bound manner and audit must be completed within six months. The audit report will be transparently sent to the dealer also.  

1.8.4) RAJA J. CHALLIAH COMMITTEE:

The Tax Reform Committee, 1992 headed by Raja J. Challiah, appointed for rationalization of the structure of excise duties for better tax compliance and administration and scope of extending the MODVAT scheme, felt the restructuring of excise duties is must. Major rationalization measures followed in 1992 and 1993-94 budgets was the merger of special

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excise duty with the basic excise duty and reduction of excise duty on capital goods and instruments of 10% and to an even lower rate of 5% for power sector.

For modernization and necessary reform in central excise duties following measures were initiated 1994-95 budgets.

1) The MODVAT has greatly helped to reduce the cascading effects of inputs taxes.

2) MODVAT scheme extended to capital goods and petroleum products.

3) Exemption will be virtually eliminated.

4) MODVAT now covers all yarn.

These changes are largely as simplification and rationalization of the structure.

a) Combined with the reduction in custom and excise duties, they should help to moderate prices in the sector.

b) Shift in the bulk of excise duty from specific to ad valorem rate which will assure much greater built in buoyancy of revenues.

c) Reduction in the total number of ad valorem tax rates to about half the existing number, which will be major step towards simplicity and transparency.

d) Continuing the process of lowering rate when they are unduly high.

e) Application of uniform rates for similar commodities to the extent possible.
f) Removal of complication price list procedures.

g) Reduction of number of special exemption notifications by about half. MODVAT rules were relaxed and many important changes incorporated in MODVAT scheme in 1995-96 and 1998-99 budgets:

i) Allowing MODVAT credit for specified quality control and R and D (Research and Development) equipments.

ii) Utilization of MODVAT credit for furnace oil and low surplus heavy stock used for generation of power in factory manufacturing excisable goods.

Thus, MODVAT had been restructured in the union budgets from 1991-92 to 1996-97.

- SALIENT PROPERTIES OF CHELLIAH COMMITTEE REPORT:

1) With a view to increasing revenue TRC (Tax Reform Committee) recommended broadening the tax base for both direct and indirect taxes. For example, for the first time committee recommended inclusion of certain ‘services’ within the ambit of indirect tax. It also recommended inclusion of agricultural income in certain cases within the purview of income tax and enlarging the scope of TDS+ (plus) withholding tax.

2) The committee simultaneously recommended simplification and fairness of taxation system as a whole for better acceptability by the people in general.
3) It also recommended abolition of interest tax to encourage more domestic savings.

4) Lowering of rate of tax both for individual and corporate assesses was also recommended by the committee.

5) It also recommended the withdrawal of certain exemption as per provision of direct taxation to avoid misuse by unscrupulous assesses.

6) Certain favorable change in the pattern of tax in case of foreign experts staffed in India was recommended to attract more foreign investment and foreign technical know-how.

7) It recommended Value Added Tax (VAT) for Excise Tax System.

8) It also dealt with the tax administration system thereby giving focus on early settlement of disputes, computerization for further effectiveness of settlement commission, Tax-payer Information System and even personnel policies recruitment, promotion and evaluation of performance.

9) The committee also recommended a three tier approach to tackle corruption in the tax administration by:

a) using vigilance machinery more purposely

b) getting rid of really corrupt officers; and

c) Rationalization of appointment and transfer to sensitive and so called “lucrative” posts.
10) The committee recommended continuing the existing scheme of summary assessment after correcting certain anomalies of the existing schemes.

1.8.5) KELKAR RECOMMENDATIONS ON VAT:

The Task Force on Indirect Taxes with Vijay Kelkar as chairman has submitted the consultation paper on 25th October 2002. The Task Force has been recommended along with the rationale in all important areas of Customs and Central Excise Tax administration.

VAT is unanimously acknowledged to be a major reform in the indirect tax system for the following reasons.

I) It eliminates the cascading effect of taxes,

II) It promotes competitiveness of export,

III) It simple and transparent structure and

IV) It improves compliance.6

- Recommendations

A. As regards preparing for State VAT, the report recommends that publicity awareness programs should be started jointly by the Central Government and State Government and the former should extend financial support for this, if required. Since the State VAT is accepted to be implemented from April 1, 2003, it is also necessary that the publicity awareness program should be implemented at the earliest.

B. Regarding uniformity of definitions, it recommends that an attempt should be made towards uniformity of all state legislations, procedures and documentation relating to VAT.

C. With reference to compensation to States it recommends that issue of compensation, if it arises, must be primarily tackled through mutually acceptable mechanism of additional resource mobilization through Service Tax and not through budgetary support.

D. The report also recommends that with the introduction of VAT, all other local taxes be discontinued, and the same should be taken into account in determining the RNR.

E. Regarding the Additional Duties of Excise (ADE), it recommends that whereas AED may continue for textiles up to 2005, it may continue ever there- after for cigarettes, which should not be subjected to VAT.

F. On the subject of credit on inter-state transactions, it recommended that the VAT scheme should provide for grant of credit of duty by the importing State for the duty paid in exporting State, in the course of inter-state movement of goods.

G. Regarding stability and continuity of the VAT regime, it recommended that for the stability and continuity of VAT, a VAT council or a permanent suitable alternative vested with adequate powers to take steps against discriminatory taxes and practices and eliminate barriers to free flow of trade and commerce across the country should be explored.7

7www.google.com
1.8.6) MANUFACTURES VALUE ADDED TAX (MANVAT):

One of the important recommendations from the Indirect Taxation Enquiry Committee (1978), popularly known as L.K. Jha committee, was that of adoption of VAT as back as 1978-79. The committee opted on Manufacturer’s Value Added Tax (MANVAT). It observed that in order to eliminate or reduce to negligible proportion cascading and distortions in relative factor prices caused by import, excise and sales taxation certain long term changes in the direction of generalized set off for taxation of input were not only required but has become a dire necessity for the country’s economy.

The committee advocated a serious consideration for moving over a VAT system at the manufacturing level termed as MANVAT. Under this scheme, popularly referred to as the ‘tax credit ‘ or invoicing the producer will be allowed to deduct from the tax payable on output the tax they would have paid on inputs. According to the Jha committee, “from the administrative angle MANVAT should not present in surmountable difficulties”. From the point of view of accounting, the large manufacturers would not find it difficult to cope with the requirements of the VAT. The smaller manufacturers in certain industries would pose some administrative problems. In fact, the major part of excise revenue is collected from relatively smaller number of large products. Special scheme for the growth of smaller producers, may thus, be devised.

If an excise tax system is to be put on a value added basis, relief would be given only for excise tax paid on inputs. Such a relief cannot be given either in respect of sales tax or custom duties.
Moreover, if a sales tax continues in the present form, they would impinge on input and much of the advantage of MANVAT would be lost. Therefore, simultaneous with the MANVAT, the existing system of sales taxation would have to be reformed.

If the system of MANVAT was to be adopted and sales taxation on inputs was also to be eliminated, substantial benefits would accrue to the economy.

The main difference between extended system enshrined under rule 56-A and MANVAT is that the former is based on procedures involving physical checks, whereas the latter is mainly based on the invoiced method.\(^8\)

- **RULE 56-A:**

The rule 56-A provides for in effect, an adjustment of tax paid on inputs against the tax payable on the output under certain conditions. The extension of the scope for relief under rule 56-A, which we have earlier recommended would in fact be one of the preparatory steps for the introduction of MANVAT. In fact, if the application of rule 56-A is generalized, it would amount to adoption of MANVAT would have many advantages over full extension of the scope of the rule 56-A. Under the procedure laid down by rule 56-A, there are various requirements of maintenance of records and documentary evidence, as well as physical verification by excise authorities. In term of records, commodity wise accounts in form RG-23 have to be maintained. For a multiple product firm with a wide range of ancillary spares, the efforts and costs involved in the upkeep of such records could be prohibitive. Besides, as at present, we are

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informed that any cancellation/erasure (even though genuine) in documentation disqualifies the tax credit claim.

As for physical verification, the rules specify that the manufacturer has to inform the proper officer within 24 hours of the receipt of duty paid inputs. The officer can then come and verify the quantity thereof. As the scope of application of the rule 56-A gets extended, this process would entail considerable harassment to a manufacturer who receives this materials and components though various consignments every day. At present the departmental officers are required to verify the receipts, where the duty involved exceeds a certain limit. The enforcement of this check under an extended operation of rule 56-A is bound to impose a severe burden on the tax administration and in a way it would be tantamount to re-imposition of physical control on all factories.

To sum up, if the existing restriction and checks are retained, a general application of rule 56-A to all or most of the inputs would involve several problems of administration and compliance. The system would become too cumbersome. If the restrictions are removed and more reliance is laid on accounts, we would, in fact, be moving toward the system of MANVAT. Therefore, while we have recommended a wider application of rule 56-A, in the interim, we feel that in the long term solution lies in switching over to a system of MANVAT.  

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1.8.7) MODIFIED VALUE ADDED TAX:

The Tax Reform Committee, 1992 headed by Raja J. Challiah, appointed for rationalization of the structure of excise duties for better tax compliance and administration and scope of extending the MODVAT scheme, felt that restructuring of excise duties is must. Major rationalization measures followed in 1992 and 1993-94 budgets was the merger of special excise duty with the basic excise duty and reduction of excise duty on capital goods and instruments of 10% and to an even lower rate 5% for power sector.

For modernization and necessary reforms in central excise duties following measures were initiated in 1994-95 budgets.

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2) MODVAT scheme extended to capital goods and petroleum products.

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These changes are largely as simplification and rationalization of the structure.

1) Combined with the reduction in custom and excise duties, they should help to moderate prices in the sector.

2) Shift in the bulk of excise duty from specific to ad valorem rate, which will assure much greater built in buoyancy of revenues.
3) Reduction in the total number of ad valorem tax rates to about half the existing number, which will be major step towards simplicity and transparency.

4) Continuing the process of lower rates, when they are unduly high.

5) Application of uniform rates for similar commodities to the extent possible.

6) Removal of complicated price list procedure.

7) Reduction of number of special exemption notification by about half. MODVAT rules were relaxed and many important changes incorporated in MODVAT scheme in 1995-96 and 1998-99 budgets:

   a) Allowing MODVAT credit for specified quality control and R and D (research and development) equipment.

   b) Utilization of MODVAT credit for furnace oil and low surplus heavy stock used for generation of power in factory manufacturing excisable goods.

Thus, MODVAT had been restructured in the union budgets from 1991-92 to 1996-97.

**OBJECTIVES OF MODVAT:**

Introduction of MODVAT scheme in the Indian tax structure has under noted objectives:

1) The MODVAT system has the objective to save payment of interest at different stages of excise duties.
2) MODVAT would normally help to simplify the export procedure followed in the country. The manufacturer’s exporters would be considerably on input and will use the same on any excisable product produced by them.

3) The MODVAT scheme is designed to avoid repeated payment of duties from raw-materials stage to that of final product and thereby reduced total burden of duties on final product.

- **MERITS OF MODVAT:**

  The MODVAT scheme introduced in India has its following uses:

  1) The MODVAT scheme was expected to encourage exports in the long run through its refund of final duty paid on input required for the production of exporter manufacturers.

  2) MODVAT scheme has greatly helped to reduce the cascading effects on input taxes.

  3) MODVAT can help in attaining self-reliance and indigenization. Under this scheme, manufactures using imported raw-material or duty free goods cannot gain. Whereas duty paid inputs can claim credit under this scheme.

  4) MODVAT scheme is expected to reduce the cost of final goods through the system of instant credit to the duties paid on the inputs them, also its subsequent reduction of interest cost.
5) MODVAT scheme with its simplified procedure can help the manufacturers to seek concessions in an earlier fashion.

6) MODVAT in the long run is expected to curb tax evasion, as under this scheme no tax can be avoided and it will thus resort a check to black money generation.\(^{10}\)

1.8.8) CENTRAL VALUE ADDED TAX:

The Finance Act, 2000, introduced the new Central Value Added Tax (CENVAT) scheme replacing the MODVAT from April 1, 2000.

CENVAT is basically an input duty relief scheme under Central Excise designed to reimburse the user manufacturer with the duty paid on the input, which we had absorbed as part of purchase price, when buying the same for producing finished products. The new CENVAT scheme has been simplified with all cumbersome procedures being dispensed with. The rules have been further amended vide 37 / 2000 (CENT) dt.3/5/2000].\(^{11}\)

- FEATURES OF CENVAT:

1. New rules comprising CENVAT scheme have simplified procedural aspects.

2. CENVAT provides relief to manufacturer on the duty element borne by him in respect of new material (input) used by him. Under this scheme, a manufacturer can take credit of the duty paid on the input materials purchased by him in the manufacture of final product.

\(^{10}\) Value Added Tax*, B. K. Chittora, Shudhada Saraswat Prakashan, Pune (2005)

3. The distinctions between capital goods and inputs for duty credit have been abolished. In other words, there is single scheme for availing CENVAT credit in respect of input as well as capital goods.

4. Procedure submitting MODVAT declaration has been abolished. No statutory records have been prescribed under CENVAT.

5. CENVAT does not stipulate for registration of dealers as existed earlier.

6. Special excise duty paid on input can be available as CENVAT credit. However, this can be utilized for payment of basic duty only. It cannot be utilized for payment of Special Excise Duty (SED).

7. The coverage of input has been widened to cover all the items listed in the tariff schedule except High Speed Diesel (HSD), Oil and Motor Spirit (Petrol).

- **ADVANTAGES OF CENVET**

  1] **Simplified Rules:**

      The Finance Act, 2000 has introduced a new set of simplified rules for manufacturers to avail and utilizes CENVAT credit, in respect of both inputs and capital.

  2] **Wider Coverage of Inputs:**

      The coverage of input has been widened with the result that excepting High Speed Diesel Oil and Petrol all other inputs as per Tariff Schedule are covered.
3] Absence of Statutory Records:

No declaration is necessary for availing of credit in respect of input immediately and in respect of capital goods in two installments.

4] Defacing Not Necessary:

Assesses are not required to submit duty paid documents to the depot for defacing.

5] No Reversal of Credit in Respect of Job Work:

Manufacturers can avail a CENVAT credit even in respect of input/capital goods sent to a job worker or further processing, testing repair or any other purpose, without reversing credit equivalent to 10% of the value of goods and also without giving any intimation.

- CENVAT Credit for Inputs:

As per Rule 57 AC (1), CENVAT credit for inputs may be taken immediately on receipt of the input in the factor of the manufacturer.

- RULE 57 AC (2) CENVAT Credit for Capital Goods

The CENVAT credit in respect of capital goods received in a factor at any point of time in a given financial year shall be taken only for an amount not exceeding 50% of the specified duty paid on such capital goods in the same financial year. The balance of CENVAT credit may be taken in any financial year subsequent to the financial year in which the capital goods were received in the factor of the manufacturer.
RULE 57 AC (3) Depreciation / Expenditure Not be Claimed

The CENVAT credit of specified duty paid on the capital goods shall not be allowed in respect of the part of the value of capital goods, which represents the amount of specified duty on such capital goods, which the manufacturer claim as depreciation u/s 32 of the Income Tax Act, 1961 or as revenue expenditure under any other provision of the said Income Tax Act.

RULE 57 AC (4) Removal of Inputs / Capital Goods for Job Work

The CENVAT credit shall be allowed even if any input or capital goods are sent to a job worker for further processing, testing, repair or any other purpose and it is established from the records, challans or any other documents produced by the assertion availing the CENVAT credit that the goods are received back in the factor.

Under the CENVAT scheme, manufacturers are simply required to ensure that the goods are received back and the same should be substantiated from the records, challans or memos / other documents.

Manufacturer Obligation in Respect of Dutiable and Exempted Goods (RULE 57 AD)

No CENVAT credit shall be allowed on such quantity of input, which is used in the manufacturer of exempted goods, except in the circumstances mentioned hereunder;

Where a manufacturer avails of CENVAT credit in respect of any inputs intended to be used as fuel, and manufacturers such final products which are chargeable to duty as well as exempted goods, then the
manufacturer shall take CENVAT credit only on that quantity of inputs which is intended for use in the manufacturer of dutiable goods.\textsuperscript{12}

1.9) ROLE OF VAT IN DEVELOPING COUNTRIES:

The general advice given by International Monetary Fund (IMF) and World Bank to developing countries over the past few decades has been to replace trade taxes with domestic consumption taxes, particularly value added taxes (VAT), and to maintain relatively high corporate income tax rates. This article review recent literature that supports and challenges this conventional view.

The seminal work on the subject of taxation and development was done by Burgess and Stern, who reviewed previous literature and presented what, is still, thirteen year later, regarded as one of the most important works in the field.

The role of direct taxation in developing countries is much more limited. In contrast to developed countries where taxation on personal income and social security contribution raises two-thirds of the total tax revenue, a narrow tax base and high enforcement costs in developing countries render direct taxation impractical. The income tax base in developing countries is mostly comprised of the wages of public sector employees because most other taxpayers are self-employed or small businesses who evade paying all, or most, of the income tax. In addition, taxation of personal capital income is easily evaded.

\textsuperscript{12} ‘Value Added Tax’, B. K. Chittora, Shudhada Saraswat Prakashan, Pune (2005)
Taxes are necessary to overcome the free riding inherent in the financing of public goods, to control market imperfections, and to achieve social justice through redistribution. Economic growth (efficiency) is promoted by the first set of goals, whereas social justice (equity) is promoted by redistribution and the provision of public and merit goods, mostly notably health and education.

Literature on the subject generally assumes that the goals of promoting economic growth and social justice are shared by developed and developing countries; however, a number of major differences between developed and developing countries may call for different taxes designs. These differences include variations in industry type (primarily the relatively high shares of agricultural and small businesses in developing countries), in the size of administrative and compliance costs, in the levels of corruption, in the level of monetization in economy, in political constraints, and in the relative size of the informal economy.

The structure of taxation in developing countries is radically different from the structure of taxation in developed countries. About two-thirds of the tax revenue in developed countries is obtained from direct taxes, mostly personal income tax and social security contributions. The remaining one-third comes primarily from the domestic sales tax. The situation is exactly reversed in developing countries, in which about two-third of the tax revenue comes from indirect taxes. These indirect taxes include the VAT, the sales tax, and excise and taxes on trade. The remaining one-third comes primarily from the corporate income tax.

Since during 1980s, developing countries have undergone frequent tax reforms, gradually replacing trade taxes with domestic
consumption taxes, particularly the VAT. These reforms were part of two world-wide trends that affected developed countries as well. The first trend was economic liberalization and adherence to the World Trade Organization (WTO) requirements, which called for the elimination of all barriers to free trade. The second trend was the rapidly increasing popularity of the VAT all over the world.

The purpose of replacing trade taxes with domestic consumption taxes was principally to improve macro-economic stability and to introduce the benefits of free trade to developing economies. Export taxes are seen as inefficient because they put the local producers, who export their goods at a disadvantage compared to foreign producers. The VAT was viewed as more efficient than import taxes because it does not discriminate between domestic and imported goods. By eliminating import taxes, local consumer benefit from the lower prices created by the competition between domestic and foreign producers. Additionally, eliminating import taxes forces local producers to become more efficient and concentrate their efforts on their comparative advantage.

Equity considerations, namely reducing poverty and inequality, have been of secondary importance, when considered in the tax reforms of the developing countries. Focusing only on efficiency can result in the adoption of regressive tax policies. For example, taxes on goods with low price elastic ties of demand, such as some cereals and domestic fuel, are efficient as they do not distort behavior. However, since the poor consumes these goods disproportionately, equity considerations will weigh against the adoption of such regressive tax policies.
The current consensus that favors a reduction and eventual elimination of trade, taxes, and almost exclusively relies on VAT as the instrument of indirect taxation in developing countries. They argue that the consensus is built on fragile result derived from a partial model that ignores the existence of an informal sector. The result from a more complete model demonstrates (that replacing trade taxes with VAT) can reduce welfare under plausible assumption, and conclude that the result raising serious doubts about the wisdom of the indirect tax reform policies pursued by a large number of developing countries.

In an earlier version of the article, Emran and Stiglitz asserted “that while a radial (across the board) uniform reduction in trade taxes reduces the production distortions between tradable and no tradable sectors; a revenue-neutral radial increase in VAT increases the inter-sectorial distortions between formal and informal sectors. It extends their analysis to the case of a selective reform of trade tax and VAT in an economy with an informal sector.\textsuperscript{13}

1.9.1) ECONOMIC ASPECTS OF VAT

A) Positive Aspect:

As a substitute of turnover or sales tax, VAT helps to reduce the tax evasion and also helps to avoid the cascading effect of existing system of taxation. VAT enhances the revenue of government and also reduces the tax burden of consumers and manufacturers. By introducing VAT there is a possibility of collection of tax efficiently. It facilitates domestic trade because

\textsuperscript{13} \url{www.google.com} By Avi-Yonah, 2007
export is totally exempted from VAT. It provides concessions to manufacturers in an easier manner. VAT facilitates tax invoices which are maintained by each dealer to get the tax credit. Uniform tax base throughout the country can be achieved by implementing VAT.

B) **Negative Aspect:**

It is not acceptable for an individual to keep salaries within the firms for using the firms for personal purposes, though this incentive is provided by the VAT. In order to maintain tax invoices for VAT, dealers should require larger administrative staff. It will increase the cost of human resources. Cost of human resources will increase the price of the goods. The benefit of merger with the firms will be restricted by this system of taxation. There is no provision of cross verification of documents and complication may arise due to multiplicity of tax rates. VAT goes against the principle of equity in taxation.

C) **Procedural Aspect of VAT:**

Various techniques are available to compute VAT. Procedure to be adopted depends to a great extent on the model to be followed and the law and regulations to be enacted by the Union and State Government and the rules to be framed for this purpose.

Out of various techniques available for this purpose the most popular one is tax credit method. Union Government has already adopted the system for central excise as CENVAT. Therefore, this may be assumed that our State Government basically will also follow the same VAT.\(^\text{14}\)

\(^{14}\)[www.wikipedia](http://www.wikipedia)
1.10) REVIEW OF LITERATURE

1.10.1) VALUE ADDED TAX:

Mr. B. K. Chittora from university of Rajasthan has done in depth the study in the field of taxation and in his renowned book “Value Added Tax”, he discussed how VAT system is more advantages than the sales tax system.

In his opinion due to the following reasons VAT is better than sales tax.

1) VAT has best international practice, characterized by trust, transparency, stability, simplicity, efficiency and a dealer-friendly tax administration.

2) VAT is the only solution to remove cascading and pyramiding effect to achieve economic efficiency. Thus, in this system there is no tax on inputs.

3) There is less scope for under valuation and tax evasion proposed VAT.

4) In this system of tax, invoice is must for claiming set off; this enables the tax authority to cross check declared transaction between tax payers.

5) VAT with its audit trail improves compliance.

6) VAT encourages self-policing mechanisms.

7) VAT would give the big-push for macro jump in the economy of a country.

8) VAT remove multiple taxes like surcharge, turnover tax etc. on goods.
9) VAT gives better resources allocation in our economy. It ensures removal of various taxes and levies.

10) VAT increases tax neutrality in the international trade.

11) There is minimal litigation, if VAT is adopted because of less rate slabs.

12) VAT ensures no war due to different tax rates between the states.

13) VAT promotes development of ancillary industries in the state.

14) VAT removes every type of barriers to interstate trade and commerce and export of goods from India.

15) VAT gives broad tax base.

16) VAT ensures only few tax exemptions.

17) VAT makes the law sensible to demand and price of goods.

18) VAT develops self-regulated mechanism; similarly it gives effective enforceable penalty system.

19) VAT assures a reliable information technology support system to achieve automation e-filing of returns etc.

20) VAT develops mechanism to promptly solve taxpayer’s queries in order to firmly establish that taxman is a facilitator.15

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1.10.2) VAT: A VARIANT OF SALES TAX

As the title suggests VAT is different from sales tax in its implementation. The article “Indian Economic Journal” has thrown some light on “VAT: A Variant of Sales Tax”.

The following is the extract from the article “VAT: A Variant of Sales Tax”.

Unlike a multi-stage turnover tax, which is applied to the full value of product every time it changes hands in the process of production and distribution, VAT is assessed at every stage on the increments of value acquired by the product since the last taxable transaction. Like any other form of sales tax this tax also falls on consumers spending, but it is collected in installments in the course of production and distribution in proportion to earlier stage. Thus, the government gets revenue in installments as the goods pass through production and distribution process.

VAT is simply a fractional way of gathering the same yield as the purchase or sales tax. The only different is the larger number of taxpayers, the inclusion of retail stage and the higher administrative expenses.

In developing countries keeping the form of sales tax intact, the introduction of some of the essential features of VAT, the benefit of VAT can be drawn step by step transforming the present form into VAT. Recently in India on different levels the issue of VAT is replaced by Sales Tax.\(^\text{16}\)

\(^{16}\) The Indian Economic Journal, Vol. 26, July 2003
1.10.3) WHY VAT IN INDIA?

This is the article by Siddhartha Sankar Saha published in the “The Chartered Accountant”. He discussed the reason for advocating VAT in India, as VAT replaces a complicated tax structure. Under a VAT regime, the point of levy will be shifted to consuming state. The producing states would still earn higher revenue, as higher production state of origin would also lead to higher employment, overall development and ultimately higher consumption levels in the state. In such scenario, all investment decisions to a great extent would depend upon the quality of infrastructure, skilled and cheap labour and other non-tax incentives provided by the states.

Taxation experts, however, say VAT is good for the consumer as household expenses will come down by 4% to 8% in long run. This is based on the hypothesis that most people in the tax chain will bargain with each other for maximum benefits. The experts say consumers will start getting the full benefit of VAT a year after it implementation. Recently the World Bank has also urged India to expedite the introduction of VAT as this is the best way to tax services, which now from more than half of the GDP.

The sales tax system has number of short comings and the traders are able to take advantage of the same. If a well administered system like VAT is introduced, it will close avenues for traders and business-man to evade paying taxes. They will also be compelled to keep proper records of their sales and purchases. VAT makes tax system simpler and helps in doing away with the fraudulent practices. Implementing VAT in India will help to overcome the short coming in the sales tax system.17

17 The Chartered Accountant, June 2005.
1.10.4) TAX REFORM COMMITTEE ON VAT : A CRITICAL REVIEW\(^{18}\)

D.N. Dwivedi discussed in the article, titled as ‘Tax Reform Committee on VAT: A Critical Review’ published in the book ‘Commodity Tax in India’ the recommendations of Tax Reform Committee (TRC).

The TRC appears to have adopted two stage approaches in making its recommendations for moving towards a full-fledged VAT system-first, to cover the central excise tax into a ‘full-fledged VAT’. And second to extend the VAT to ‘Wholesale Stage’ though taxing goods at the stage falls in the tax jurisdiction to sales falls in the tax jurisdiction to state governments.

In making its recommendations, TRC appears to have been guided by three main considerations.

   i) Simplification of Excise Rate Structure.

   ii) Revenue Neutrality,

   iii) Broadening the Tax Base.

1) **Simplification of Excise Rate Structure:**

   In order to prepare the ground for introducing the genuine VAT system at the manufacturing level, the committee has suggested reducing in the multiplicity of rate of excise duties to 2 or 3 rates, say, 10%, 15% or 20%. A selective excise duty on non-essential commodities or commodities

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\(^{18}\)Commodity Taxes in India, Direction for Reforms, Edited by M.C. Purohit & Vishnu Kanta Purohit , Gayatri Publication, New Delhi (1995)
injurious to health could be levied at 30%, 40% or 50% with a few exceptions like cigarette.

2) **Revenue Neutrality:**

Given the revenue need of the country, any tax reform and change in tax policy must be revenue neutral. If it is not and if compensating revenue from alternative source is not forthcoming, then such a reform would prove catastrophic in India’s fiscal policy.

3) **Broadening the Tax Base:**

The TRC has contemplated two methods of broadening the tax base.

a) Expanding Excise Duty Base.

b) Extending the Tax Net to the Service Sector.

In the opinion of TRC (Tax Reform Committee) ‘Having regard to the revenue need of the Government, it is not possible to achieve an ideal VAT system in the near future without extending the tax net to many, if not most, services. The future growth of revenue in a direct tax regime that we want to achieve will depend significantly on our ability to tap the service sector which develops faster than the commodity sector as the economy grows’.

The measures suggested to broaden the tax base are intended to serve a dual purpose:

1) Recovering the revenue lost due to excise reform measures, and.

2) Preparing ground for a smooth transition to VAT system.
1.10.5) AN ASSESSMENT OF VAT IN COMPARISON WITH A CASCADING SALES TAX

An interesting study has been done by Mr. R. J. Challiah, P.K. Aggrawal, P.C. Purohit and R.K. Rao on the above topic. They have put forward the advantages of VAT by the ITC(Input Tax Credit) method, which are discussed below:

1. Deriving from the fact that VAT by the ITC method permits easy and effective targeting of tax rates, exports can be zero rated, i.e. goods being exported out of refund of taxes paid at the earlier stages. In the ITC method, this implies that only the tax paid at the penultimate stage needs to be refunded to the exporting dealer.

2. Since VAT does away with cascading, it avoids distorting business decision. The need for vertical integration is dictates only by the market forces or technical considerations and not by the tax structure.

3. Since all stages of production and distribution are subject to tax, this form of taxing avoids the problem of undervaluing, without introducing cascading.

4. Since the dealer gets a set-off for taxes paid at the earlier stages, these are not treated as part of costs and this is expected to reduce that component of cost as well as the associated financing requirements. Further, the problem of enhanced cascading via the mark-up rule, too, is curtailed.

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In addition, the input tax credit method, by generating a trail of invoices, is argued to be a system that encourages better compliance since the purchaser seeks an invoice to get input tax credit. Further, this trail of invoices supports effective audit and enforcement strategies.

From the point of view of the state, another interesting feature of VAT is its stability as a source of revenue. Owing to the fact that consumption is more stable than income, VAT provides a very stable source of revenue.

VAT permits effective targeting of tax rates. It does away with cascading and avoid the problem of undervaluing.

1.10.6) OPTIMAL TAX SYSTEM AND THE TECHNOLOGY OF TAX COLLECTION.\textsuperscript{20}

It is an Economic analysis of the structure and operations of tax collection. This study, ‘Optimal Taxation and Optimal Tax System’ by Joel Slemord, discusses the need for technology of tax collection.

In the United States, operating the tax system requires the participation of over 100 million taxpayers, hundreds of thousands of tax professionals, and a multi-billion dollar budget for the Internal Revenue Service and its state counterparts. The resources cost of operating the income tax system alone, including the administrative cost borne by government and the compliance cost borne by government and the compliance cost borne by

\textsuperscript{20} Optimal Taxation & Optimal Tax System, By Joel Slemord, Oxford University Press, New York (2006)
the taxpayers, has been estimated to be as high as $ 35 billion annually, or about 7% of revenue. This cost is large both in absolute terms and relative to the distortion cost of taxation. For example, it is more than twice as recent estimates of the efficiency of assets used within the corporate sector.

More important than the magnitude of the costs, though, the ease of administering various taxes has critical implications for the optimal structure of tax systems. Tax codes which are based on unobservable quantities often look desirable on paper. The choice among real tax system must confront the fact that some taxes can be administered more easily than others. If optimal tax theory is to be a reliable guide to action; it must consider the issue that arises in operating the tax system.

Integrating the issue of administrative case into optimal tax theory will require a shift of emphasis away from the structure of preferences, from the structure of preferences, which has been the principal focus of optimal tax theory, towards the technology of tax collection. In what follows, they shall use the term optimal tax system to refer to the normative theory of taxation that considers not only the structure of preferences the technology of collecting taxes.

1.10.7) STRUCTURAL CHANGES AND TAX REFORMS. 21

In his article by M. C. Purohit in the magazine ‘Economic & Political Weekly’ the author has taken into account the structural changes and tax reforms by various authors. The last two decades have witnessed restructuring to tax system in most developed and developing countries. The

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21 Economic & Political Weekly, June–July 1995

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revolutionary changes attempted include broadening of the tax base, reducing the number of rates, curtailing tax incentives, bringing down the important tariff and Value Added Tax to replace internal commodity taxes. More importantly, there has been a change in the traditional goals of tax policy.

India has followed the path of planned economic development. Its tax policy was assigned the goals of accelerating growth with social justice based on a socialist pattern of society.

Leading to changes in economic policy the existing goals relating to equity and social justice have been replaced by the objectives of neutrality and efficiency. Evasion and consequential parallel economy have been given increasing importance and redistribution aspects have been given a low profit. The latter aspect has been assigned primarily to expenditure policy.

One of the paper Tax Reform in India by Robin Burgess of the London School of Economics has come out with an important conclusion emerging from the comparative analysis is suggests that the tax GDP ratio for India is comparable to that of other developing countries. Initially, in 1950-51 the tax ratio in India was 6.7% of GDP. As compared to this, the average ratio for the developing countries at percent is 14% of GDP.

The paper by N. S. Bhat, ‘Development Expenditure and Public Debit tests the hypothesis that increase in public expenditure raises public debt in India. The study suggests ways and means to reduce public debt for the posterity. The author prescribes that the government should reduce its developmental role to give way to the private sector.
In regard to tax reform, it would have been useful to point out that in the context of the new economic policy some of the reform is not in the requisite direction and various other reforms are still needed. Some of the aspects have been touched upon by Brahmananda but there are various areas where a lot has to be done. There is a need to rationalize the capital gain tax and the corporate tax in the country. Presumptive taxation is required to be extended and strengthened. The taxes have to be geared to help us have environmental friendly production system through proper pricing of utilities or a tradable permit.

In the context of new economic policy some rethinking is definitely necessary in regard to custom duties. A rational tariff policy for India may be to reduce custom duties gradually. Also, it is essential to have adequate anti-dumping legislation such as those pursued in the US. It is also important to emphasis that the development strategy is based on the domestic saving to avoid the Mexican type crisis.

1.10.8) SALIENT FEATURES OF THE STATE-LEVEL VAT DESIGN.\textsuperscript{22}

Mr. M. M. Sury from the University of Delhi is president of Indian Tax Foundation (ITF), New Delhi. He has done in-depth study in the field of taxation and in his renowned book ‘Central-State Finance Relations in India 1870 to 2010’, he has described ‘Salient Features of the State-level Vat Design’.

VAT is essentially a federal or central tax, while in India it is aimed at replacing state as well as central sales taxes. Its effective implementation depends almost entirely on the co-operation of the state government.

A VAT regime is theoretically meant for a unified market in which the VAT levied can always be set-off against taxes already paid, irrespective of the state-wise location of the manufacturing or trading entities. In India, these interstate adjustments are proving to be difficult to implement in view of the existing constitutional provisions regarding distribution of taxation powers between central and states.

In view of the above constraints and also to provide some flexibility to the states, the Empowered Committee, through its deliberations over the years, finalized a design of VAT to be adopted by the states. The model design seeks to retain the essential features of VAT which are as follows:

1) Rate of VAT of various commodities shall be uniform for all States/UTs.

2) Model VAT design makes provision for eliminating the multiplicity of taxes. In fact, all state taxes on purchase or sale of goods are required to be subsumed in VAT.

3) Provision has been made for allowing input tax credit, which is the basic feature of VAT. However, since the VAT being implemented is inter-state VAT only and does not cover inter-state sales transactions, input tax credit will not be available on inter-state purchases.
4) There are provisions to make the system more business friendly. For instance, there is provision for self-assessment by the dealers. Similarly, there is provision of a threshold limit for registration of dealers in terms of annual turnover of Rs. 5 lack. Dealers with turnover lower than this threshold limit are not required to obtain registration under VAT and are exempt from payment of VAT. There is also provision for composition of tax liability up to annual turnover limit of Rs. 50 lack.

5) Regarding the industrial incentives, the states have been allowed to continue with the existing incentives, without breaking the VAT chain. However, no fresh sales tax/ VAT-based incentives are permitted.

6) Export will be zero-rated, with credit given for all taxes on inputs/purchases related to such exports.

VAT makes the tax system more business friendly by eliminating the multiplicity of taxes. It will create unified market in which the VAT levied can always be set-off against taxes already paid. Thus it makes the system simpler and more effective.

1.8.9) SET ANOMALIES RIGHT

- ECONOMIC TIMES

Small scale industrialists and traders have urged the union government to defer the introduction of the Value Added Tax (VAT) till corrections in the existing sales tax and entry tax system are made K. B.

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23 Economic Times (11/02/2003)
Aggarwal, the senior vice president of merchants chamber of commerce, made this suggestion.

He felt that the entry tax, which is currently being levied by Maharashtra, Kerala and Assam, was not ‘VAT-able’. Hence, there would be price – cascading effect. Moreover, under the VAT mechanism, Central Sales Tax would be continued at 2 % in 2003-2004 and was likely to be reduced to 0 % in 2005-2006. Hence, the consuming state would continue to suffer both in terms of trade diversion and higher cost.

Further, the union government’s decision to transfer certain services to the state for the purpose of levying service tax would create complications and additional tax burden unless state service tax was made ‘VAT-able’.

In this context, he felt corrections were necessary in the state VAT mechanism. The states have been told to get the laws enacted by the last week of March, so that they can switch to the new regime by April 1. Apprehensions of a delay in the implementation schedule stem from reports that most states are not geared to enact their VAT laws.
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