ABSTRACT

A STUDY OF VAT IN INDIAN TAX SYSTEM- AN EVALUATION

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

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

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

The various kinds of Indirect taxes and duties levied in India, at the state and Central level are illustrated hereunder: Both the Customs and Excise duties are levied and collected by the Central Government. While the Customs duties are levied, collected and retained by the Central Government, the Excise duties are shared by the

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

VAT proposed to be introduced in India is a simple and a transparent tax collected on the sale of goods. VAT is to be consumption based and applied on destination principle[5]. Under the consumption type VAT, the base excludes the value of both intermediate inputs and investment items from the gross value of goods and services. The base—as defined—is close to the one in retail sales taxation. VAT computation is to be based on the invoice-based credit method. Under this method, a firm at any stage of the production-distribution chain charges its customers the VAT on its output, submits the tax to the treasury, and then claims for the VAT already paid on its input purchase. The emphasis placed on each transaction means that the evidence for each sale or purchase, the invoice, becomes a crucial document to monitor and administer the VAT.[6] Thus, the burden of VAT is not borne by producers or suppliers of taxable goods or services, but rather by the ultimate consumers thereof. Who is covered by VAT? All business transactions carried on with a state by individuals, partnerships, companies etc. will be covered by VAT. VAT will not cover small businesses with a turnover below a certain limit which will be decided by each state. The turnover limit for eligibility of retailers to opt for payment of tax at compounded rate of tax may be Rs 20-50 lakh (USD 40,000 to 80,000) as may be specified by the respective states.[5] All retail dealers9 with annual turnover above the limit specified will have to pay VAT even if their entire business is in retail. Retail dealers below a threshold limit of annual turnover, as may be specified in the respective State VAT legislation, may opt for payment of tax at a flat rate of 1-2 per cent. The terminology is not uniform in all the States. Presumptive tax, turnover tax or composition of tax has been used to describe the levy of tax on retailers. The `sales' not liable to tax under the VAT Act: Since the VAT Act applies only to sales within a State, the following sales shall not be governed by the VAT Act: a) sale in the course of inter-state trade or commerce which shall continue to be liable to tax under the Central Sales Tax Act, 1956; b)[7] sale which takes place outside the state; and c) sales in the course of export or import.

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

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

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

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

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

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

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

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