

A Theoretical Study on Value Added Tax in India

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INTRODUCTION

System of sales tax got first implemented by the government of Tamil Nadu way back in 1939 and then was later accepted for adoption by rest of the other states. The whole procedure of sales tax that existed had its own inherent issues like multiple levy, escaping of tax, hiding of actual sales by the businessmen and the like VAT worked out to be a problem solver for all of the above. France Government introduced VAT in the year 1954 for the first time. An authorized commission that consisted of the chief representatives representing the states mentioned about the VAT. It was in the year 2003, that maiden implementation of VAT following a thorough scrutiny of the problems persisted with CST and the factors that led to delay in the implementation.

January 2005, the Finance minister P. Chidambaram introduced white paper concerning VAT, where the way forward so that single rate of tax in all the states was stated in 1.4.2005. The country has structure of tax where the Centre and state alongside local bodies had a clear division of duties to be received. Taxes on the incomes, customs, central eliminate and tax on services were with the Centre. States retained VAT, stamp duty, revenue from lands and professional tax.

Local authorities collected the tax on the properties, public utility services like supply of water, underground drainage and the like. In the last decade and a half, the system of taxation has seen paradigm shift. The rationalizing of tax rates and the simplification was thought of. This led to wider acceptance, easier payments and efficiency in the tax administration. Tax laws have always been revisited so that amendment are implemented from time-to-time.

Tax revenues form a major source of revenue to any state. The tax system in India is consisting of Direct Taxes. The former is paid by that of individuals to the state

exchequer directly. Income tax forms a major direct tax contributor. Indirect tax have an intermediary in the process of tax collection from the person who bears with the ultimate burden of the levy.

Table 1. Overview of Indirect Tax in India

Kinds of taxes	Indirect tax and duties
Government	State and Centre
Categories	Customs and excise duties
Role of Central Government	Collection of Custom Duties and Retention
Sharing between central and state government	Excise duties

(Source: Compilation from the Author)

Table 2. Treatment of sales tax

State sales tax	<ul style="list-style-type: none"> • Collection from the state government on intra state sales tax act provisions are applicable
Central sales tax	<ul style="list-style-type: none"> • Levy by the government in the Centre • Collection by the state government • Restriction to interstate sale transactions which originate in the respective state Central sales tax act, 1956 provisions applicable

(Source: Compilation from the Author)

The system of Indirect tax has a very vital role to play in the overall economic development of the nation. This directly influences the production of goods and services along with the consumption. One-fourth of the revenues generated in the Indian economy is from the taxes levied on the physical commodities and the intangible services. The past experiences make it imperative that commercial tax form a very significant tax collected from both central and the state government.

The Indian government follows the regime of World Trade Organization and the system of Indirect taxes has been revamped following the footsteps of the member countries. It was in the 2003 National budget, the central Finance minister after the consultations with all states in India, at national level VAT was introduced. This has replaced the taxes that existed in the states.

The reason why the government introduced VAT was to bring in the transparent system and the efficient system of collection. The taxation model that existed in the country for half century, after the independence, had cascading and distortion in tax levied on production. Cascading effect means that levy of taxes at every stage of the chain of supply while no deduction in respect of tax paid earlier.

The taxes form a distortion effect by creating incentive artificially for the integration vertically. The result finally is that resources getting misallocated and affecting inversely country's economic growth. Finally there is negative imperative on tax base, this dampens the income to the government.

SHORTCOMINGS OF THE EARLIER SYSTEM

The earlier taxation system on sale of merchandises has numerous inadequacies which are as follows.

1. The structure is extremely complex. The final customer is unaware of the sum of duty he would contribute to the Regime exchequer. Clarity is missing in the whole process.
2. With label of STP chattels many problems are experienced. In animosity of their getting a bar against collection of tax when not payable, some arrant dealers aggregate taxes, which accomplish their abridged heavy. Customers are befooled and Government remains devoid of this tax collected in a crooked manner.
3. The earlier system has evolved arrangement of modes of artifice of taxes. Big fishes are seldom found in the net and these after-effects in low ability of sales tax revenue. Consequently this as well abnormally affects the assets tax acquirement and bearing of unaccounted money goes on.

VAT

Value added tax which has appear into force in about all Indian states and Union territories, is an assorted arrangement of tax on auction of goods. In this arrangement tax shall be levied at assorted points. An apparatus has been provided to admission acclaim for tax paid on acquirement of appurtenances and this mechanisms the above adorableness of the VAT system. Along acquainted call to cope with all-around markets has accountable India to accept this assured system. VAT is artlessly an anatomy of sales tax.

The system of taxation VAT was to address the problems found in the existing tax system. The VAT system replaced the sales tax prevalent locally from April 2005.

VAT was a simpler and transparent form of tax collected on the goods sold. Consumption was taken to be the base and followed destination principle. VAT is a levy done at multiple points leading to tax credit to be claimed on purchases done at each stage where set-off can be claimed against the tax that is to be paid. On sales at 0%, 1%, 4%, 5% and 20% except in a few states”.

Goods other than those notified to be covered under the above rates are charged at a general rate ranging from 12.5% to 15% except in a few states. However, liquor, petrol or diesel are taxable at the minimum rate of 20% and may vary from state to state while, gold and bullion are taxable at the rate of 1%.

The CST as reduced to 2% giving effect from June 2008, has been planned to phase out so that there is free movement in respect of commodities from one state to that of another state. In Vat, the amount of tax which is paid on the purchased commodities from within respective state stands the eligibility for the tax credit. Tax on Input would be used as against the tax payment towards the sale; this would avoid the cascading impact and the value that got added is taxed.

The very essential ingredient of tax reforms implemented since liberating economy is that of introducing Value Added Tax (VAT). VAT is based on multiple destination based tax system, where levy of tax is on the value added at each transaction stage in the manufacturing distribution channel. Value addition denotes the rise in that of price of physical commodities and services at every level of manufacturing or transfer of physical commodities and services. VAT taxes final consumption of physical products and services. It is the consumer who bears it.

In most of the states such as Andhra Pradesh, Bihar, Karnataka, Kerala, Maharashtra, Orissa, Punjab and West Bengal the annual average growth rate is higher in VAT system. The average annual rate of growth of sales tax in these states was only 10.94%, which increased to 18.68% after five years of the introduction of VAT. It clearly shows that VAT has been a revenue raiser for the states.

VAT REFORMS IN INDIA

Indian Economy which is on the development mode, the economic reforms have been introduced over a period of time. In the middle of the 1980s, the Chelliah Committee proposed levy reform through introduce of Value Added Tax in the country. It is forms a latest and progressive system of tax having been adopted in more than 130 economies in the world. In India, initially the Central Excise was implemented and later the success led to the levy of service tax.

Meanwhile at equally stages value added tax (VAT) has been positively combined as of tax scheme, the similar is being protracted to state-owned sales tax charges. VAT was led in 22 states in India w.e.f. 1-April-2005 by substituting the distinct point trades tax structure.

Since the information that VAT has been effective in most of the states which has applied the VAT, “the states like Gujarat , Chhattisgarh , Jharkhand, Madhya Pradesh and Rajasthan with a view to integrate with the rest of country implement VAT in their respective states w.e.f. 1-April 2006. Punjab is one of the states which have introduced the value added tax system since April 2005”.

STATE SALES TAX VS VALUE ADDED TAX

Adopting of VAT in India brought about considerable change in respect of the indirect taxes. The introducing of VAT has been remarkable modification in the levy procedure and taxes collected on the sales made purchase done". In case of previous sales tax in the states, inputs have been taxed first before goods are manufactured and then tax is imposed with tax on inputs load after the goods get produced leading to unfair dual taxing with cascading taxes.

Earlier State Sales Tax system	State Value Added Tax system
Single Point taxation system under which goods were taxed only once i.e. at the time of sale	Multipoint taxation system under which tax is levied at each stage of sale in the supply chain and simultaneously, tax paid at earlier stage is set off against the output tax
There is array of taxes like surcharge, resale tax, lease tax; works contract tax etc.	There are only single tax levy and other taxes have been abolished".
There was no input tax credit mechanism that means input were initial taxed before making as also these were taxed again after production with input tax load which resulted in double taxation	Input tax paid or payable by a taxable person is allowed to be credited against the output tax liability which helps in removing the cascading effect
Assessments were mandatory and there was no provision for self-assessment	Based on mutual trust, assessment is made by tax payer itself".
There were mild penal provisions	There are rigid punitive requirements as the plan is based on mutual trust".
Various discretionary powers were delegated to the excise and taxation officers	Lesser discretionary powers are given to the excise and taxation officers as compared to earlier State Sale Tax system
There were various exemption schemes which are still to be continued	No new incentive schemes will be available

CHARACTERISTICS OF VALUE ADDED TAX (VAT)

1. VAT is not a direct Tax levied on goods.
2. It is extensive –base in nature. It involves the value addition to each commodity in various processes in the production and distribution.

3. It relies on the tenet of value addition. This is worked out summing up the payments of factors in the process of production or lessening the input costs from sales price.
4. VAT is credit of tax and refund of tax.
5. VAT eliminates effect with tax on sales and consists catch-up effect”.

MAIN BENEFITS OF APPLICATION OF VAT

- + Reduces tax fudging as VAT is forced on the base of demand/ bill at for each phase, so that tariff escaped at initial phase becomes fixed at the following stage;
- + A setting-off shall be certain aimed at input tax and also tax waged on prior purchases”;
- + Eliminates array of dues, namely, taxes such as tax on turnover, sur charge levied on the sales tax, supplementary surcharge, and the like get obliterated”;
- + Substitutes the current method of review by an arrangement of in built self-assessment of VAT obligation by the sellers and makers (in relations of proposal of earnings upon set-off of tax credit);
- + Progresses tax compliance;
- + Produces higher income progression;
- + Encourages attractiveness of ships; etc.