Chapter 6

SUMMARY OF FINDINGS AND RECOMMENDATIONS

The Raja Chelliah Committee constituted in the year 1991 recommended the introduction of VAT in India. Thereafter, the Empowered Committee of the State Finance Ministers was formed in the year 1999 and was entrusted the task of implementing VAT across all the States in India. The implementation of VAT was postponed thrice in 2000, in 2002 and in 2003. Finally, it was announced that all States have agreed to introduce VAT from 1st April 2005. A White Paper was released by Asim Das Gupta, Chairman of Empowered Committee, on 17th January 2005. The White Paper is a policy document indicating the basic policies to be adopted by the States in formulating VAT Act and Rules.

The present system of sales taxation is highly saturated, addressing only limited resource mobilization capabilities, and does not lead to tax buoyancy. Except when tax rates are enhanced, the industry is adversely affected leading to flight of trade, evasion, suppression and unhealthy competition among States. Various States have studied the impact of present taxation system and have felt the need for a major reform to the existing system of taxation. The States now propose to shed the complexities of the existing tax structure and are on the
threshold of the VAT era. Introduction of VAT, indeed, is a move towards more efficiency, equal competition and fairness in the taxation system. Since the VAT system was introduced in Kerala recently (i.e. 2005), no methodological studies to the best of the knowledge of the researcher have been conducted to examine the effect of VAT on the manufacturers/traders, consumers, VAT officials and also the government. Also, no attempt has been made to assess the working of VAT machinery in Kerala. It is in this backdrop that the present study titled “Reforms in Sales Tax Structure – A Study with Special Reference to VAT in Kerala” has been attempted.

The study was carried out with the following objectives in view:

1. To enquire into the reforms in sales tax structure.
2. To assess the perception of manufacturers/traders, consumers and government officials on Value Added Tax in Kerala.
3. To study the working of Value Added Tax Machinery in Kerala.
4. To assess the impact of Value Added Tax in Kerala.

In line with the objectives, the following hypotheses were set.

H01. Value Added Tax system is not simple, compared to the earlier levy under KGST and hence it is not easy for manufacturers/traders and officials to have a good understanding.
H02. The existing machinery under Value Added Tax is not sound enough for its successful administration as well as curbing tax evasion.

H03. The introduction of Value Added Tax has not led to a decrease in the prices of goods.

The study was descriptive and analytical in nature. Both the primary and secondary data were used for the study. The primary data were collected from the sample manufacturers/traders, consumers and VAT officials in Kerala with the help of scientifically pre-tested structured interview schedules.

For collecting the primary data, the State of Kerala was first divided into three zones - south, central and north. From these zones, one district each representing south, central and north has been selected, based on the larger number of VAT registered manufacturers/traders in the district. Accordingly, Thiruvananthapuram, Ernakulam and Kozhikode were selected. Of the three sample category-manufacturers/traders, consumers and VAT officials-manufacturers/traders were first selected from the list of registered manufacturers/traders maintained by the Department of Commercial Tax, government of Kerala.

There were in all 29729 registered manufacturers/traders in the selected districts of Kerala (8377 in Thiruvananthapuram, 10502 in Ernakulam and 10850
in Kozhikode) as on 31st March 2008. From these, a total of 150 manufacturers/traders, 50 each from the three districts were chosen by the method of Systematic Random Sampling. The manufacturers/traders category consists of the manufacturers/traders of consumer and industrial goods located in urban, semi-urban and rural areas.

A total of 450 consumers, comprising 150 each from the three districts (three consumers from the each selected manufacturers/traders) were selected systematically. The consumers consist of males and females. A total of 30 VAT officials, 10 each from the three districts were selected systematically. The officials consist of Commissioners, Assistant Commissioners and Assessing Officers.

The secondary data were collected from books, periodicals, Committee reports, official records, government publications and the Internet.

The data collected were classified and analysed with the help of a computer keeping in view the objectives of the study. For the purpose of analysis, statistical tools, viz. average, percentages, weighted mean and chi-square test were applied. The weighted mean was applied to determine the relative order of preference of the respondents. The chi-square test was applied to examine the significant variation in the opinion among respondents in the three zones of Kerala.
Major Findings of the Study

The major findings of the study on the basis of the analysis of the data are summarized below.

Reforms in Sales Tax Structure

1. In India majority of the population has fairly low incomes and consumption and hence we can rely only on indirect taxes for taxing that section of the population.

2. Realizing that a reform of indirect tax system has become necessary, the Central government appointed an Indirect Taxation Enquiry Committee in 1976 under the Chairmanship of L.K.Jha to make recommendations on a thorough overhaul of the system of indirect taxes.

3. The Committee which submitted its Final Report in 1977 recommended that the Central Excise be gradually transformed into a Value Added Tax at the manufacturer’s level.

4. The first major act of reform at the Central level was undertaken in 1986 through the introduction of Modified Value Added Tax in Central Excise under which the manufacturers could get credit for taxes paid on input against the tax payable on output.
5. There has not been much progress in the reform of the structure of sales tax. The State sales taxes, being levied on gross value at successive stages of production, leads to considerable cascading which results in higher levels of cost of production in the economy.

6. In addition to the problems resulting from cascading, both the first point and multipoint tax induce vertical integration. Since the tax applies to sales, the firm has an incentive to vertically integrate its activities to reduce the number of sales transactions and to minimize the payment of tax.

7. Another feature of the sales tax system has been the presence of a large number of rates. This widens the area for disputes and makes compliance very expensive and administration difficult.

8. The Empowered Committee of the State Finance Ministers constituted by the Ministry of Finance, Government of India, on the basis of resolution adopted at the Conference of Chief Ministers on 16\textsuperscript{th} November 1999 under the Chairmanship of Asim Das Gupta came out with a White Paper on State Level VAT, which was released on 17\textsuperscript{th} January 2005 by P. Chidambaram, the Finance Minister, Government of India and decided to implement VAT in all States w.e.f.1\textsuperscript{st} April 2005.
9. The Finance Minister P. Chidambaram in his budget speech made on 28th February 2005 stated that VAT is a modern, simple and transparent tax system that will replace the existing sales tax and eliminate the cascading effect of sales tax. He also stated that in the medium to long term, it is his goal that the entire production, distribution chain should be covered by a national VAT, or even better, a Goods and Services Tax.

10. VAT has emerged as one of the most important fiscal innovations of the century as is evident from the fact that more than 130 countries have already adopted this tax and many more countries are going to switch over to it in the years to come.

Perception of Manufacturers/Traders, Consumers and Government Officials on VAT in Kerala

1. The majority of manufacturers/traders (62%) and VAT officials (86.7%) find no difficulty in understanding the VAT system.

2. The majority of the manufacturers/traders in the south and north zones say that the VAT system favours the Government. Whereas a majority in the central zone says that the VAT system favours dealers. But, contrary to what manufacturers/traders say, most of the VAT officials say that the VAT system
favours dealers. However, most of the VAT officials in the central zone say that the system favours customers.

3. Regarding the source of awareness to understand and learn about VAT system, most of the manufacturers/traders depend on tax consultants, whereas most of the consumers rely on the media or newspapers.

4. Almost all of the manufacturers/traders (96%) are making e-filing of returns.

5. Most of the VAT officials say that the dealers are benefited by VAT system on account of availing of input tax credit. Low tax burden and simplified procedure are the other benefits.

6. Most of the VAT officials say that the customers are benefited by VAT system by way of avoiding a cascading effect of tax. Prompt billing and more transparency are the other benefits.

7. The majority of VAT officials say that the Government is benefited by VAT system on account of high tax revenue. Wide coverage of tax and simple tax administration are the other benefits.
8. 86.7 per cent of the VAT officials find no shortcomings in the present VAT system. Again, 65.3 per cent of the manufacturers/traders are of the view that VAT is more beneficial than the earlier sales-tax.

9. 50 per cent of the VAT officials say that the rate of dealers’ compliance with the VAT system is moderate.

10. 40 per cent of the VAT Officials rate VAT system as good and 36.7 per cent rate it as effective. In the meantime, 24 per cent of the manufacturers/traders rate VAT system as good and 33.6 per cent rate it as effective.

11. A large majority of the manufacturers/traders (76%), consumers (74.22%) and VAT officials (93.3%) are of the firm opinion that the government should not go back to KGST.

12. The study reveals that 44 per cent of the manufacturers/traders file the return on the due date and 45.4 per cent file returns within a period of 1 to 6 days of the due date. But 10.6 per cent file returns after the due date.

13. The majority of manufacturers/traders (80%) in the central zone and 66 per cent of the manufacturers/traders in the north zone find it difficult to file return
and other forms by themselves. They depend on tax consultants for filing returns and other forms.

14. The majority of manufacturers/traders say that they are passing on the input tax credit to the consumers.

15. Most of the manufacturers/traders (63.3%) are of the view that there are positives in the present VAT system. They gave first preference to the point that tax evasion has come down and second preference to the point that present system of filing returns and self-assessment is easy.

16. The study reveals that most of the consumers (93.3%) are aware of VAT system in Kerala. Again, 88.7 per cent of the consumers are aware that all registered dealers under VAT have to issue bills in prescribed forms.

17. Most of the consumers (82.4%) are aware that they are inadvertently letting dealers evade tax legitimately due to government by not collecting bills. Again, 67.1 per cent of the consumers are aware that all registered dealers have to show the tax element in the bills.
18. A majority of the consumers (51.1%) are not aware that the dealers have to pass on the input tax credit to the consumers. However, 65.3 per cent of them are aware of different tax rates under VAT.

19. The study reveals that 52 per cent of the consumers are aware about VAT dealers and non-VAT dealers. But 61.6 per cent are not aware about the classification of goods under VAT based on HSN coding.

20. 61.6 cent of the consumers are not aware of the fact that goods under VAT are generally classified based on HSN coding.

21. 73. 8 per cent of the consumers say that they demand bills while buying goods.

22. Most of the consumers (72.9%) are aware that introduction of VAT has not resulted in any decrease in the price of goods.

**Working of VAT Machinery in Kerala**

1. Majority of the manufacturers/traders are aware of the Administrative Machinery under KGST and VAT Acts.

2. A large percentage of the manufacturers/traders and VAT officials are of the opinion that the existing tax machinery under VAT is sound enough for its successful administration and curbing tax evasion.
3. Most of the manufacturers/traders (58.7%) are of the view that the VAT officials are friendly with assessee.

4. A large percentage of the manufacturers/traders and VAT officials (48.7%) are of the view that officers find time to give assistance to the assessee whereas 27.3 per cent of the manufacturers/traders and 40 per cent of the VAT officials say that officers find no time to give assistance to assessee.

5. Majority of the manufacturers/traders and VAT officials say that officers are not colluding with tax evaders.

6. Most of the VAT officials (76.7%) say that they are giving certificates in time, but only 49.3 per cent of the manufacturers/traders agreed to their view.

7. Majority of the manufacturers/traders (57.3%) are of the view that they are not getting refunds in time, whereas 50 per cent of the VAT officials say that they are giving refunds in time and 16.7 per cent officials have no opinion about this view.

8. Majority of the manufacturers/traders (52.7%) say that there is delay in the assessment. Though 30 per cent of the VAT Officials agree with the view of the
manufacturers/traders, 43.3 per cent of the Officials say no delay and 26.7 per cent have no opinion.

9. Majority of the manufacturers/traders say that penalties provided under the VAT system is heavy, whereas most of the VAT officials have no such view.

10. 38 per cent of the manufacturers/traders say that officials deny input tax credit on minor grounds whereas 36.7 per cent have no such views and 25.3 per cent have no opinion. At the same time a large percentage of the VAT officials (70%) say that they do not deny input tax credit.

11. Most of the VAT officials (86.7%) say that they are not able to complete the verification of returns on the date of filing. Further, 83.3 per cent say that they are overburdened with works.

12. 50 per cent of the VAT officials say that VAT Administration Machinery has not been geared up for implementing VAT, whereas 33.3 per cent do not agree with the above view and 16.7 per cent have no opinion.

**Impact of VAT in Kerala**

1. Majority of the Manufacturers/traders are of the view that VAT law is more beneficial to them than the earlier KGST, since they get credits for the input tax
paid on their purchases which will reduce the cost of manufacture/trade. Hence most of them do not want the government to go back to KGST.

2. There is substantial delay in getting the refund order. As a result, manufacturers/traders will not be in a position to pass on the benefits of refunds to the consumers.

3. Most of the consumers say that introduction of VAT has not resulted in any decrease in the prices of goods.

4. Introduction of VAT has made significant improvement on the State sales tax revenue. The average increase in the sales tax under KGST during 2001-02 and 2004-05 was 13.29 per cent, whereas the average increase in the sales tax under VAT during 2005-06 and 2008-09 was 22.59 per cent.

5. The number of appeals filed under VAT before the Sales Tax Appellate Tribunal is much less, compared to the number of appeals filed under KGST. The number of appeals filed under KGST before the Sales Tax Appellate Tribunal during 2001-02 and 2004-05 was 14959, whereas the number of appeals filed under VAT during 2005-06 and 2008-09 was only 467.
Recommendations

Based on the findings of the study, the following recommendations are advanced to increase the perception of manufacturers/traders, consumers and VAT officials and also to improve the working of VAT Machinery in Kerala.

1. Conduct Tax Payer Education Programmes

The study reveals that a majority of manufacturers/traders find difficulty in filing return and other forms by themselves and they have to depend on tax consultants for filing returns and other forms. It is suggested that the government should conduct tax payer education programmes at major business centres to make manufacturers/traders aware as to how to file returns and other forms with the taxes department. Supply of pamphlets and booklets at very low price describing as to how to file returns and other forms and organizing workshops will also help the manufacturers/traders to file the returns and other forms by themselves.

2. Encourage Voluntary Compliance

It is observed by the VAT officials that the rate of dealers’ compliance with the VAT system is moderate. In order to encourage voluntary compliance, the tax structure and administrative procedure should be well designed by the government. It is suggested that the government should design a suitable tax structure compatible with voluntary tax compliance and a simple tax collection and verification mechanism as a means of promoting voluntary compliance.
3. Ensure Reduction in the Prices of Goods and Services

The study reveals that a majority of the manufacturers/traders are passing on the input tax credit to the consumers. At the same time a majority of the consumers say that introduction of VAT has not resulted in any decrease in the prices of goods and also that they are not aware of the dealers having to pass on the input tax credit to the consumers. VAT is tax levied on goods or service at each point of sale values and it removes the cascading effect through full rebate of tax on inputs. Hence there will be a reduction in the prices of goods or services on introduction of VAT. But the consumers say that there was no decrease in the prices of goods. It is suggested that the government should constitute a Committee consisting of Chartered Accountants/Cost Accountants and VAT officials to find out the reasons why there is no reduction in the prices of goods after the introduction of VAT and the government may take steps based on the reports given by the Committee.

4. Computerization of VAT Administration

The Study reveals that manufacturers/traders are not getting certificates in time and also there is delay in completing the assessment in time. Computerization of VAT offices, including check posts, imparts speed, efficiency and productivity of the operations of the taxes department. It is suggested that the government should take immediate steps to make available adequate number of computers in
all offices, including check posts, so that the officers can issue certificates and complete assessments in time. The government may also hold discussions with the VAT Officials to avoid the delay in completing the assessment in time.

5. Give Refunds in Time

From the study, it is observed that a majority of the manufacturers/traders are not getting refunds in time. A VAT refund normally poses problems because the legal and administrative framework is such that the tax officials are reluctant to give refunds. Manufacturers/traders have to comply with tortuous procedures to obtain the refund. Hence it is suggested that the government should direct the officials to give refunds due to the tax payers within three months from the end of every financial year as prescribed under VAT law.

6. Verification of Returns on the Date of Filing

From the study it is revealed that the VAT officials are not able to complete the verification of returns on the date of filing. The reasons may be due to the filing of larger number of returns on a specific date and the return contains too much information. It is suggested that the filing of returns should be monthly for large and medium tax payers and quarterly for small tax payers. The monthly or quarterly return should be simple and it should call for only limited information.
7. Take Measures to Increase the Revenue of the Government

The study reveals that the introduction of VAT has resulted in an increase in the revenue of the government, compared to the increase in revenue before the introduction of VAT. The increase in the revenue was 34.92 per cent during 2006-07, 14.5 per cent during 2007-08 and 18.35 per cent during 2008-09. This shows that there was not much progress in the revenue collection during 2007-08 and 2008-09. It is suggested that the taxes department should take the following steps to increase tax revenue:

a) Conduct periodic inspection to detect tax evasion, if any.

b) Introduce a scientific audit system.

c) Identify unregistered potential tax payers.

d) Prevent the misuse of input tax credit by the dealers.