CHAPTER 11

Review Of Literature
Taxes have a profound impact on the economy and the perception of the people on the fairness of the entire fiscal system. As such the attributes of a good tax system viz. equity, economic efficiency and administrative ease have been the subject of great interest among the experts and the laymen alike (Chelliah, 1994). So in order to make the Indirect Tax system more effective and more efficient what is needed, is the rationalization of the Commodity Tax structure (a dire need felt by the producers, consumers & the administrators). Rationalization becomes imperative if these taxes besides raising revenue are to be employed to achieve the objectives of equity and allocation on desired lines. Theoretical advancements and contributions of fiscal economists have greatly enriched our understanding about the various aspects of Commodity Taxation. From time to time, a lot of research work has been undertaken to study and analyze the various aspects of Commodity Taxation. These studies include those of Musgrave 1959, Alagh 1961, Zedi 1965, Peter 1971, Goshal 1972, Suman 1974, Chelliah and Lal 1974, Gulati 1974 and 1978, Tewari 1978, Subarmanium 1979, Alibi 1982, Agarwal 1984, David 1986, John 1986, Hatta 1986, Reddy 1989, Panday 1991, Ehtisham 1991, Mehta and Maway 1991, conducted at the All India level and across the States. A review of these studies would serve as an ideal backdrop for reformulating the entire domain of Commodity Taxation. In the present chapter, an attempt has been made to summarize some important studies on major Central and State Taxes so as to provide the basis for the present study.
The chapter has been divided into 2 sections. In section 1, some studies relating to Taxation in general have been presented. This section is further divided into 3 parts. Part I gives a bird’s eye view of some prominent studies on taxation conducted abroad. Part II concentrates on some major studies on various dimensions of taxation conducted both on official as well as at individual levels in India. Part III deals with studies on some important state taxes vis-a-vis, their incidence, elasticity and buoyancy, magnitude of evasion, structure, trends in growth, administration and major issues of concern in the pre-VAT launch era.

Section 2 is exclusively devoted to some major studies on Value Added Tax system (covering its concept, structure, social and economic effects, administration, implementation and other important dimensions) undertaken in and outside India.

Selection of the studies in each section has mostly been guided by:

i. conceptual and methodological strength of the study;
ii. empirical content in the study; and
iii. innovative reform proposals.

The review of the studies has been presented in a chronological order as under:

SECTION - I

STUDIES CONDUCTED ABROAD

Bird (1970) while commenting on tax administration, opines that an effective and efficient tax administration is a key to successful implementation of tax policies. According to him the tax policy appropriate for a given country at a given time is determined by the economic, political and social circumstances of the country. When the circumstances change, the appropriate tax policy also changes. Tax reforms are therefore, a never-ending process.
Newlyn (1977) examined the role of taxation in capital formation of a developing country and concluded that taxation constitutes a major source for capital formation in developing countries. In most of developing countries, the ratio of tax receipts to national income is typically low, ranging from 5% to 20% compared with 25% or more in the developed countries. It indicates that there is plenty of scope for increasing taxation to raise the level of savings, but it largely depends upon the type of taxation and on whom it is imposed.

Commenting on the short-comings of tax structure of developing countries, Radian (1980) believes that in developing countries, “the poor are asked to pay little, the rich are required to pay high rates but allowed to slip out of the tax net through the back door”. Every one is happy except the national treasury which stays empty.

Musgrave (1987) in one of the studies on taxation, concludes that tax structure in most of the developing countries is complex, inelastic, inefficient, inequitable and unfair and tax administration is selective and skewed.

Realizing the need for tax reforms, Stiglitz (1987) is of the view that in order to eliminate the draw-backs of tax policies, tax reforms constitute an integral part of economic reforms and the countries throughout the world have reformed or are attempting to reform their tax systems.

Khan (1988) made a case study of fiscal dependence on commodity taxes in Pakistan. The purpose of the study was to test empirically the relationship between fiscal dependence on commodity taxes and economic development by covering a time period from 1959 to 1984. The results showed that there was a direct relationship between fiscal dependence on commodity taxes & economic development. The results further revealed that the share of the manufacturing in gross domestic product was not a good proxy for economic development in Pakistan.
Khadka (1989) in his study "Sales Taxation in Nepal" discussed various forms of sales taxation particularly from the point of view of their practical usefulness in developing countries. The study traced out the historical developments of sales tax, examined its relative importance and incidence and found that the share of sales tax revenue & the commodity tax revenue in total tax receipts was showing an upward trend.

Rajeev (1991) examined the resource mobilization in India and Pakistan because domestic resource mobilization was considered to have become very important in both the countries in view of the serious financial constraints. After examining the economic profile and terms in taxation in both the countries, the author attempted to examine the direct taxes for resource mobilization. It was found that exemption limit for Income Tax was higher in Pakistan both in case of salaried and non-salaried persons. The rate of Income tax was observed to be higher in India than in Pakistan. In both countries, agricultural sector remained lightly taxed. In both the countries, Corporation Income Tax was found to be a buoyant source as compared to Personal Income Tax. The author suggested that better tax administration was a good alternative to higher tax rates as it reduced tax evasion.

World Bank (1991) while examining the tax structure of developing countries, concludes that the structure of taxation, its level, composition, design and implementation need a closer look so that disincentive effects are minimized while raising tax revenues. Tax reforms should, therefore, be designed to reduce distortions and disincentives, inefficiencies and inequalities in allocation of resources and to stabilize the economy.

Thirsk (1997) in his study on desirable tax reforms, suggests as under:

a) reducing the rates on both personal and corporate incomes;

b) eschewing selective tax incentives;

c) avoiding imposition of direct taxes on inter-industry transactions;
d) enlarging personal and corporate tax bases; and
e) improving administrative capacity through effective audit
techniques, stiffer penalties for non-compliance, computerizing
the tax records etc.

Hassan (1998) while examining evidences from Bulgaria regarding
tax reforms, opined that due to political factors while tax reform might start
with good intentions and well-defined objectives, the out-come might be
different from what was envisaged at the outset.

Gauthier and Reinikha (2001) examined the tax system in Uganda.
He examined the level of tax evasion and relationship between tax burden,
tax exemptions and tax evasion among various categories of firms in
Uganda. When tax revenues in Uganda fell to 5% of GDP in mid-eighties,
Uganda Revenue Authority was set-up in 1991 which undertook certain tax
reform measures. The sales tax which varied from 12-30% was replaced by
single rate VAT of 17%. A minimum tax based on turn-over was introduced
for small firms. Large firms continued paying Corporation Income Tax at
30%. A study of 243 firms for detailed information on taxes was conducted.
It was found that many firms evaded tax. Tax exemptions were more
common among large firms and medium firms shouldered disproportionate
share of total tax burden.

Mitra and Stern (2003) while attempting to explore the characteristics
of tax system which can raise resources, attempted to find out the links
between the tax policy, tax administration and investment climate by
studying, analyzing and comparing the evolution and reforms of tax system
of Central and South Eastern Europe and the Baltic, and Common Wealth of
Independent States. The study found that the ratio of tax revenue to GDP
decreased largely due to fall in the revenue from the Corporate Income Tax
and the decline in the importance of Individual Income Tax. The domestic
indirect taxes gained importance in overall tax revenues. The authors
suggested that the transition countries depending on their age of development should aim for a tax revenue-to-GDP ratio in the range of 22 to 31%. Regarding tax administration, the authors were of the opinion that to improve it, the tax payer should be made aware of general concept of taxation. Assistance should be made available to those tax payers who wish to comply voluntarily and the compliance cost should be reduced.

STUDIES CONDUCTED IN INDIA

Taxation Enquiry Commission (1953-54) observed that in order to make the taxation system of India more efficient and effective, there is a need to strike a balance between the objectives of achieving economic equality through tax mechanism and of maintaining unimpaired flow of investments and savings which make for the continued progress of productive enterprises. It further noticed that there is a sufficient scope for additional taxable capacity in the country and accordingly identified some areas like increase in Income Tax with additional reliefs for savings and investments, increase in Excise Tax, introduction of Agricultural Income Tax, adoption of extension in the scope of Property Tax, Sales Tax, increase in Commodity Taxation etc., as some of the most potential areas for generating additional resources. The study recommended some sweeping measures like effective enforcement of tax laws, imposition of additional taxes on luxury consumption, widening the base and the rates of indirect taxation etc., for overhauling the taxation system in the country.

Kaldor (1956) while reviewing the tax system of India, made an observation that the existing direct taxation in India was inefficient and inequitable because of its measurement on wrong base of income which paved the way for tax avoidance and evasion. The study also observed that poor tax collection due to inefficient administration, absence of detailed statistics regarding wealth and transfer of property, insignificant relationship between rise in GNP and tax receipts, have made the taxation system
ineffective. With a view to reshape the taxation system, the study suggested a number of measures ranging from addition of some new direct taxes in the prevailing system for extending its base to the replacement of income tax by expenditure tax and compulsory enquiry of accounts of traders to curb the problem of tax evasion.

Lakadwala and Khambadkone (1959) who are considered as pioneers in the field of taxation in India, while measuring the sensitivity of Union Taxes, opined that the more income elastic the tax structure, the more it confirms to the objectives of revenue productivity, equitable distribution of income and economic stability. The study concluded that on the whole, the Central Taxes were income elastic.

Sahota (1961) in one of his studies, calculated the elasticity of Indian tax structure in relation to national income, national expenditure and price level. He estimated the income elasticity of Indian tax system as a whole and also of individual taxes like Income Tax, Corporation Tax, Central Excise Duties, Motor Vehicles Tax etc. He reported that Motor Vehicle Tax, Central Excise Duties and Indirect Taxes in Urban sectors showed elasticity greater than unity while all other taxes of Central and State Governments showed elasticity less than unity. The major finding of the study was that Indian tax structure had low degree of elasticity (0.83) in relation to national income and also indirect taxes have been more elastic than direct taxes.

Boothalingam Committee (1968) conducted a study to investigate the direct tax laws with a view to suggest the means for their rationalization and simplification. The study concluded that the prevailing tax structure in the country was so ill-designed that instead of increasing economic efficiency, it has paralyzed the economy. The observations made by the study are similar to that of Kaldor's study conducted earlier. In order to put taxation system on the right track and to make it economy friendly, the study suggested various measures like abolition of annuity deposit scheme, raising of
exemption limit of Income Tax, replacement of Estate Duty by Inheritance Tax, rationalization of Custom Duty rate structure, etc.

Direct Taxes Enquiry Committee (1971) while examining the causes and extent of black money, tax evasion, avoidance, arrears, exemptions and the administrative aspects of direct taxes, reported that the deterioration in moral standard, improper application of tax laws, interference of political parties, corrupt business practices etc., were some of the factors responsible for the problem as per the findings of the Committee. Inefficient enforcement of tax laws corroborated the observation of Taxation Enquiry Commission Report (1953-54). The Committee gave a number of suggestions regarding the rate structure, deductions, exemptions, minimization of administrative delays, allotment of Permanent Account Numbers (PAN), establishment of National Development Fund, setting up of a Reconstruction and Stabilization Reserve Fund to encourage corporate savings, declaration of Central Board of Direct Taxes as an independent body with a provision of more facilities to Income Tax Staff to promote research and inspection. These recommendations proved to be instrumental in unearthing black money and checking tax evasion.

Suman (1974) observed that direct taxes as the percentage of total tax revenue, occupied relatively greater importance in the tax structure of developed countries as compared to under developed countries like India. He pointed out that inadequate taxation of agricultural sector, political considerations, gradual raising of exemption limits, inefficiency of tax administration, a high degree of tax evasion and avoidance, were the important factors which had come in the way of effective use of direct taxation in India. It had been noticed by the study that the tax evasion was mainly concentrated in upper income brackets. The study suggested that efforts should be made to make the tax laws simpler.
Choksi Committee (1977) examined the possibility of consolidating four direct taxes, viz. Income Tax, Surtax, Wealth Tax, Gift Tax and the rationalization and simplification of tax structure of India. The study while making an attempt to make the tax structure more realistic, simple and rational, felt the need for lowering the rate of income tax with a view to generate more revenue and the integration of agricultural income with the non-agricultural income. Similar observations were made by Taxation Enquiry Committee (1953-54) and Raj Committee on agricultural wealth and income.

Jha Committee (1978) reviewed the indirect tax system and its working in India. The Committee upheld the observations of Boothalingam Study (1968) that indirect taxes were irrational, regressive and complicated and hence required a lot of improvement to make them rational, uniform and elastic and in this direction made some concrete suggestions like bringing about a Central legislation to make the sales tax structure uniform throughout the country, adoption of Value Added Tax as a substitute of either Excise Duty or Sales Tax, replacement of Octroi by turnover tax and handing over the revenue so collected to local bodies, withdrawal of differential rate of Excise Duty on industrial raw-materials and adoption of a uniform rate, reduction in imports with a view to promote exports and improve upon the balance of payments.

Jha (1978) while conducting a study on the taxation and economic development in India, attempts to anatomize the contribution of taxation to the economic-transmission and socio-economic cohesion. For gauging the contribution of taxation to the economy, the study used different parameters including the reports of policy panels. The observations of study coinciding with the findings of Kaldor (1956) and Direct Taxation Enquiry Committee (1971) are devoted to the rationalization of tax structure with an eye at eradicating the growing magnitude of tax evasion and contradicting proportion of direct taxes in the total tax revenue. The study emphasizes the rationalization of tax structure to mobilize additional resources.
In his study Rao (1979) attempted to examine whether the Indian tax system was automatically responsive and which individual taxes were responsible for observed anomaly. He distinguished between the elasticity and tax buoyancy measures and related these to static and dynamic characteristics of a system. While reporting that India relied more on indirect taxes, the study observed that this was not the peculiar characteristic of Indian economy alone. The estimation of overall elasticity of tax system revealed that it was not adequately responsive. Further, it was revealed that direct taxes were responsible for sluggishness of aggregated tax elasticity.

The Long Term Fiscal Policy (1985) reveals that in the prevailing tax structure in India, there was preponderance of indirect taxes. A need was felt for striking a balance between the direct and indirect taxes. It was also observed that lack of buoyancy in Income Tax was attributed to narrow coverage of working population, numerous exemptions, deductions and widespread evasion. It was observed that personal income tax and corporate taxes ought to yield more revenue by widening the tax base, plugging the loopholes in tax laws, fostering the climate conducive to better tax compliance and bringing about sustained improvements in tax administration.

Corroborating with the findings of Ministry of Finance in its long-term Fiscal Policy of 1985, Prakash (1989) while attempting to examine the percentage of Gross Domestic Product claimed by taxation in India, concluded that in view of the predominance of indirect taxes, the taxation failed to become an effective means of bringing about redistribution of economic resources and to achieve the objective of social justice. The study concluded that a balance be maintained between the direct and indirect taxes though indirect taxes are unavoidable in view of low level of development.

Chelliah Committee (1991) conducted a detailed examination of taxation system to make it simple, credible, yet progressive and transparent.
The study while corroborating with the arguments of Taxation Enquiry Commission (1953), made a chain of recommendations such as:

a) extension in tax base with inclusion of certain services and agricultural income within the ambit of indirect taxes;

b) lowering of individual and corporate tax rates;

c) adoption of VAT as a substitute for excise tax system;

d) overhauling of tax administration to make it more effective, efficient, transparent and assessee friendly;

e) taxing "Hard to Tax", i.e. imposing tax on self-employed persons in a variety of professions;

f) withdrawal of certain exemptions to avoid misuse by unscrupulous assesses.

The study observed that the indirect taxes are mostly cascading type.

Burgess and Stern (1993) traced the development and structure of tax revenues in India since independence. The study revealed that structure of taxation in India appeared to be influenced by Centre - State allocations and development policy.

While commenting on the tax reforms in India, Bird (1993) analysed the report of Tax Reforms Committee headed by Raja J. Chelliah and concluded that the essence of the proposed changes was to lower nominal rates and to broaden the base with respect to both direct and indirect taxes.

Rekhi Committee (1993) made an extensive study of indirect tax system with the objective of evolving a common code. The Committee observed that there is a dire need to constitute some legal institutions and committees to increase the economic efficiency and effectiveness of indirect tax system of the country. It also observed that because of a large number of exemption notifications, disputes over classification of commodities arise and hence there is a need to reduce the number of notifications especially after the annual budgets.
Chelliah (1994) was of the view that 1980’s could be called as the decade of tax reforms as these reforms were undertaken by many developing countries. According to him, equity, economic efficiency and the administrative ease were the criteria for sound tax system. He maintained that in India where only a small proportion of earners were subjected to direct taxes, the progress of the tax system depended on total tax revenue collected from small percentage of well to do population. So the reforms should aim at broadening the base, inducing better compliance and curbing inflation. For this, the author suggests that the Central Government be given the power to levy a unified tax on non-agricultural and agricultural incomes.

Dwivedi (1994) estimated the commodity-wise rates, base and price elasticity (for advalorem rates) and buoyancy of excise duties. The commodities which were found to have rate elasticity greater than one include sugar, refined diesel oil, motor spirit and caustic soda. Commodities having rate elasticity almost equal to 1 (one) include tea, coffee, rayon and art, silk fabrics, wireless receiving sets, air condition machinery, refrigerators, motor vehicles, tyres and tubes, woolen yarn, jute products, pig iron, plastic materials, electric wires and cables, electric batteries and electric motors. Other commodities had rate elasticity less than 1 or 0.

Sinha (1994) opined that the prevailing tax structure in India was outdated, irrational, inefficient and was unable to cope up with the changing realities. He reported that under the Constitution, thirteen sources of tax revenue belonged to the Centre, and the Centre collected about 97% of tax revenue from only four taxes i.e. Corporation Tax, Income Tax, Custom Duties and Union Excise Duties. The states have the power to levy taxes on agricultural income but this source has never contributed more than 0.58% to state’s total revenue. The study confirms the complicated structure of Indian tax system in different states and union territories with different rates. The study suggested the rationalization of tax structure and reduction in tax rates.
Aggarwal (1995) estimated tax incidence of major indirect taxes, e.g. Union Excise duties, Custom Duties and State Sales Tax. The study found sizable variations in the contribution of individual taxes to combined effective tax rates. The distribution of the burden of indirect taxes was found to be progressive both in rural as well as urban areas. The effective rates of all taxes combined as well as individual taxes for consumption basket of food items were to be lower than those for non-food items both in urban and rural areas. The study indicates the need for reducing input taxation with a view to mitigating its ill effects.

Sury (1997) in his study of Indian tax system, examined the constitutional provisions regarding tax system and the relative role of direct and indirect taxes in India. He attributed the declining share of direct taxes to small scale industrial activities, lack of monetization and accounting practices, low level of income, scaling down of direct tax rates, plethora of exemptions, concessions, abolition of estate duty and large scale tax evasion. At the state level also, the share of direct taxes decreased mainly due to decrease in share of land revenue and agricultural income tax. The author opined that relatively high buoyancy of tax system revealed the success of a tax system as a tool of resource mobilization.

Das Gupta and Mukerjee (1998) analysed the role of incentives and institutional reforms in tax enforcement. Emphasizing that tax administration is fundamental for enforcement and compliance, they argued that institutional reforms could succeed in improving standards of compliance. The existing machinery is ineffective and incapable of catalyzing administrative reforms. While examining the functioning of Indian Income Tax Administration, the study emphasized the need for sweeping reforms in organization and utilization of information and positive incentive mechanism to increase tax compliance and reduce tax evasion. The study further brought out the need for computerization of information
system, greater autonomy in tax administration, improvement in standard auditing, introduction of presumptive taxation and monitoring of compliance costs for adequate tax enforcement.

Jha (1999) examined the reasons for tax evasion and implications of offering incentives to evaders in India. The study outlined the various tax measures and amenities especially the Voluntary Disclosure of Income Scheme (VDIS) of 1997 undertaken by the Government of India. Citing the various ways and means of black income besides tax evasion, the study also discussed the methods adopted for making the black income white. The study concluded that sensible tax policies should include reduction in tax rates which could widen the tax base and the elimination of amnesty schemes would make the tax administration more creditable.

While examining the structure and reforms of taxation in India especially post-1999 tax reforms, Sree Kantaradhya (2000) opined that economic reforms like marketisation and globalization etc., require the support of appropriate tax system. The study revealed that the share of direct taxes in the gross revenue of the Centre increased and that of indirect taxes decreased. However, it was observed that the direct taxes in the combined revenue of the Centre and states were still very low. Reduction in tax rates was attributed to increase in buoyancy and broadening the tax base. To augment the resource mobilization in the rural areas, the study suggested to reform land revenue and agricultural income tax. Further in the realm of indirect taxes, a need for developing an integrated system of commodity taxation was felt to avoid the cascading effect. For this purpose, the Centre must pressurize the states for introduction of Value Added Tax (VAT).

Kelkar Committee (2002) made an extensive study on direct and indirect tax systems and observed that there was a great scope for improvement in the taxation system of the country to make it in tune with the global economic scenario. The Committee made swooping recommendations for the
simplification and rationalization of direct and indirect taxes ranging from overhauling the tax administration to the extension of base of various direct and indirect taxes, increase and decrease of rate in respect of different taxes, withdrawal of some exemptions and concession to boost tax revenue, introduction of Value Added Tax with uniformity in procedures and rates, etc.

Bhalla and Rajni (2004) in their analysis of performance of the Indian taxation system in terms of buoyancy and Tax-GDP ratio of different Central taxes for the decade of 1993-94 to 2002-03, concluded that indirect taxes continue to occupy a dominant position although there is a trend towards an increase in the share of direct taxes and decrease in the share of indirect taxes. The study further reveals that the direct taxes are more buoyant than that of indirect taxes and suggests that more emphasis should be laid on improving the performance of direct taxes as the increase in the share of direct taxes also results in the development of economy.

Dhingra (2005) while attempting to examine the tax reforms and administration in India, held that in view of the new economic policy emphasizing more on encouraging competitiveness and rapid shift towards free trade, indirect tax revenue is likely to increase at a slower rate in future. Under this scenario, efforts have to be made to increase direct tax revenue by expanding the tax base, bringing all professionals, small traders and retailers and companies under the tax net and effectively dealing with huge black money in the country. To achieve these broader objectives, the study suggests various measures. One of the suggestions is that state VAT be introduced in all the states simultaneously.

STUDIES ON STATE TAXES

(A) Structure, Trends in Growth and the Issues Involved

Sharda (1986) examined the growth of and changes in the revenue structure of Himachal Pradesh against the backdrop of requirements of
development. The study focused on analysis of aggregate revenue, its tax component as well as the cross-section study of public revenues of neighboring states with a view to examining the comparative tax performance of Himachal Pradesh. The study finds that Himachal Pradesh didn't raise sufficient revenue through its own tax measures due to low rate structure of the individual taxes and obligation of Central Government to make up the deficit. The study finds that the state's taxation has registered perceptible structural shifts with the declining importance of direct taxes and increasing reliance on indirect taxes. In Himachal Pradesh Sales tax, Excise duties and taxes on transport are the major components of indirect taxation. Among these, the Sales tax has acquired key position due to its high responsiveness to change in income, coverage of more items and upward revision in its rates.

Guhan (1991) while reviewing the state finances in Tamil Nadu revealed that the state has had an outstanding record in mobilizing tax revenues and concluded that Additional Sales Tax in the state had reached a plateau.

Another study on similar lines and with the same issues and objectives for Utter Pradesh was conducted by Bajaj and Aggarwal (1991) for the period 1965 - 90. The study reviewed the structure and growth of receipts of the State Government with special reference to tax revenue, non-tax revenue, central assistance for plan expenditure and the level and pattern of government expenditure. The study found that the overall resources in the State had risen commendably. The growth was mostly attributable to increase in tax revenues. The tax structure was dominated by indirect taxes. Sales Tax and Excise revenues from liquor contributed about 73 % of total revenues.

Bagchi, Bajaj and Byral (1992) reviewed the growth of revenue and its components in their study on budgetary trends and plan financing in the
states. The study revealed that baring Bihar and U.P. the growth rates were found almost similar in all states. The study also revealed that the growth rates in major taxes levied by states, however, show some variations. Two taxes, agricultural tax and entertainment tax are losing their significance because of their slow growth due to fall in the tax base. The only state tax which shows reasonably high rate of growth and constitutes the major source of state finances, is the Sales Tax. The study reveals that there is a great scope for exploiting some taxes. What is needed, is to pay more attention to rationalization of tax structure, extension of tax base to cover services etc., and harmonization of state taxes in order to improve the revenue productivity of the tax system and equity in the distribution of its burden.

Iyer and Karup (1992) in their study on Kerala State Finances, observed that in Kerala with a narrow base of tax, the sales tax was the major source of state’s revenue. According to the study, the main reason for slow growth in tax base of Kerala was the dominance of export-oriented cash crops over the agriculture in Kerala. Through an amendment of CST in 1976, agricultural commodities meant for export, are exempted from tax. This resulted in tax loss to Kerala. Kerala’s share in total collections forms 2% of total collections from CST.

Godbole Committee (1998) in its study on economic reforms in Jammu & Kashmir observed that the tax ratio to State Domestic Product (SDP) is just 4.5% – the lowest in the country due to low tax effort, complicated rate structure, poor tax compliance, large scale exemptions, archaic tax administration leading to leakages and facilitating tax evasion, mounting pressure of tax arrears etc. To augment the tax revenue, the Committee suggested a numbers of measures which include:

a) necessary amendments in the relevant tax laws;

b) setting up of a tribunal to decide the pending cases on major taxes to avoid revenue loss;
c) creation of Specialized cadres of officers for dealing with sales tax and excise duties;

d) switching over to Value Added Tax System;

e) introduction of entry tax on motor vehicles to deal with the evasion of sales tax;

f) levy of passenger tax at 20% of the fare and withdrawal of lump sum payment facility;

g) levy of tax on professions, trades, callings and employment; and

h) introduction of service tax and tourist tax.

To increase the buoyancy of tax revenues, the Committee suggested increase in the tax effort by widening the tax base, rationalizing the rate structure and ensuring better tax compliance.

Institute of Social Sciences (2002) in its report on Jammu and Kashmir State Development, finds tax revenue as a key player in the budgeting exercise of the state. The components of tax revenue in order of higher revenue collections are Sales Tax, Excise tax on goods, tax on vehicles, stamp duty, electricity duty, tax on passengers and entertainment duty. The study reveals that during the period 1996-97 to 2000-01, the increase in the tax revenue has been to the tune of 153%. The study further reveals that the share of tax revenue in total receipts of the state in 1996-97 was 9.1 % which steadily increased to 13.2% in 2000-01 suggesting that there is enough scope for tax revenue being the major contributor in future as well. The study has also identified some avenues of mobilization of additional resources through taxes like tax on service sector industries, enhancement of toll tax, stamp duty, passenger tax, introduction of professional tax & complete shifting over to VAT.

(B) Buoyancy and Elasticity of State Taxes

The growing reliance on taxation for financing public sector programmes raises the question as to how buoyant and elastic is the Indian tax structure. This question gains importance for two reasons:
I. Additional taxation is desirable when tax yield has a fairly high degree of responsiveness to the changes in tax base and tax rates.

II. Enhancement of tax rates yields revenue at a rate lower than expected and more importantly encourages tax evasion on one hand and distorts price structure on the other (Dwivedi, 1994).

Quite a few studies are available on this issue. For example:

Purohit (1978) in his study of elasticity and buoyancy of state taxes for the decade of 1960-61 to 1970-71, has shown that tax yield of states having per capita income ± 10% of national average, have income elasticity higher than 1. Agricultural income tax and land revenue lack built in flexibility and commodity taxes are highly elastic.

In his study Rao (1979) while attempting to measure the elasticity of indirect taxes at the state level, opined that these taxes are much more elastic than direct taxes. The low elasticity of direct taxes was attributed to tax administration as there was ample scope for simplification and rationalization of the tax structure. The wide difference between elasticity and buoyancy estimates indicated that the increased revenue productivity came through new tax measures.

Due (1986) in his study on excise and sales taxation in India, concluded that sales taxes have demonstrated a high degree of both elasticity and buoyancy. The buoyancy in the period 1970-71 to 1981-82 was 1.55. Twelve large states in India showed buoyancy in excess of 1.5 and Karnataka showed 1.82. Most of the buoyancy was a product of high elasticity which according to the study averaged 1.31 for 16 larger states with highest of 1.6 in Andhra Pradesh and Tamil Nadu. Only Assam showed elasticity and buoyancy of less than 1.

Sharda (1986) on measuring the buoyancy and elasticity of excise revenue of Himachal Pradesh during the period 1967 - 68 and 1982 - 83, finds the coefficient of buoyancy and elasticity more responsive to changes.
in the SDP than to income from the registered manufacturing sector. His estimates show that the values of coefficient of buoyancy and elasticity of excise revenue with respect to SDP are 1.295 and 1.095 respectively. The study further shows that the values of coefficient of buoyancy and elasticity with respect to income from registered manufacturing are 0.903 and 0.764 respectively at 1% level of significance.

In their review on budgetary trends and plan financing at the state level during sixth and seventh plans, Bagchi and Sen (1991) on measuring the buoyancy estimates of revenue receipts and major taxes of selected states with respect to SDP during 1980’s arrived at the conclusion that the buoyancy of total revenue receipts and tax revenues of the states is more than 1 or nearly 1 in all the states.

While attempting to measure the changes in the tax structure in a survey conducted on state finances in Tamil Nadu during the period 1960-90, Guhan (1991) finds that the individual taxes in this period have been buoyant as the result of the factors such as additional taxation, inflation, elasticity of SDP growth and variations in efficiency of tax collection.

With an attempt to measure the buoyancy of total revenue in general and the sales taxation in particular during 1981-82 to 1989-90 in his analytical study on the sales tax system of Jammu and Kashmir, Dar (1996) estimates the buoyancy of total revenue at 1.06 which is more than unity, but the buoyancy of state’s own tax revenue is only 0.88 (Significant at 1% level with 8 degrees of freedom) showing a coefficient of determination of 0.67. The buoyancy of sales tax is 0.97 (Significant at 1% level) with the coefficient of determination of 0.73. This shows that as far as the productivity and the income responsiveness of the state’s sales tax is concerned, the performance of the tax is unsatisfactory to a significant level.
Godbole Committee (1998) in its report on economic reforms in the state of Jammu and Kashmir, quotes the study of buoyancy of sales tax for each Indian state by Prof. M. C. Purohit of NIPFP for the period 1970-71 to 1990-91 where it was found that as compared to other Indian states, the state of Jammu & Kashmir has failed to exploit its capacity to make efforts to raise the buoyancy coefficient despite the fact that the state enjoys residuary powers under its Constitution and could tax the services and invisible contract unlike the other states in the country.

Yasmeen (2004) while measuring the buoyancy and elasticity of sales tax in Jammu & Kashmir, finds that sales tax is highly elastic and buoyant in the state because of a lot of discretionary changes. The study holds increase in tax rates, number of imported goods and volume of imports responsible for widening the sales tax base which in turn contributes to its buoyancy and elasticity.

(C) Incidence of State Taxes

Estimation of incidence of taxation is an uphill task. A number of attempts have been made in India to estimate the incidence of taxation. The first systematic and comprehensive study of incidence of indirect taxation was made by Taxation Enquiry Commission (1953-54). The study was based on the fourth round of National Sample Survey (NSS), data collected for the period April - September, 1952 and assumed to hold good for 1953-54. The study was based on the assumption that indirect taxes are passed on entirely to the consumer.

Two similar types of studies (1958-59 and 1963-64) were carried out by the Ministry of Finance, Government of India by applying similar sources of data and methodology.

Some Studies have also been conducted for the individual states e.g. National Council for Applied Economic Research (1970) attempted to
analyse the incidence of taxation in Gujarat and Karnataka. Both the studies were based on sample surveys which incase of Gujarat were confined to urban sector only and incase of Karnataka extended to rural areas also. The main findings of Gujarat study revealed that in Gujarat the tax system as a whole is progressive as the locals in some households paid 8% taxes and the higher income households paid 22% of their income as taxes. On the other hand, the Karnataka study also showed inter-sectoral disparity of tax incidence at all levels of income with the incidence of all taxes on households in the urban sector at 11.4% as against 6.7% in the rural sector. In Gujarat, the tax system as a whole turned out to be progressive in urban sector but regressive in rural sector.

Jha Committee (1973-74) attempted to measure the incidence of indirect taxation for the year 1973-74. The study attempted to measure the incidence of tax on some major commodity groups separately such as consumption goods, intermediate goods and capital goods. The study found that the indirect tax burden as a proportion of expenditure has kept on increasing with higher per capita expenditure groups which stood 7 times more as against lower per capita expenditure groups because of differences in their consumption pattern.

Another most comprehensive and methodologically sound study on incidence of indirect taxes is the one conducted by Chelliah and Lal for the year 1973-74 covering all Central and State indirect taxes except import duty. The study assumed that the entire burden of commodity taxes is shifted to consumers in proposition to their consumption. It was based on the 28th round of NSS of household expenditure carried out during the period October 1973 to June 1974. The study also concluded that the Central indirect taxes are more progressive than State indirect taxes.

Sinha (1981) in his study on property taxation in India, makes a scientific analysis of incidence of property taxes. The study discusses the
valuation of property and determination of the base of property tax and also examines the question of re-organizing the rate structure of tax on progressive lines. The study also examines the revaluation and the collection of property tax and suggests some guidelines for the reconstruction of urban property tax.

Purohit (1982) showed that the sales taxes in India are progressive. The index rises from 100 in lowest group to 522 in the highest expenditure group. His results discard the notion that sales taxes are always regressive.

U.P. State Taxation Review Committee (1984 - 85) attempted to measure incidence of sales tax on the basis of household consumption expenditure survey conducted both in rural and urban areas. The survey revealed that the incidence of indirect taxes on household consumption expenditure was 2.58%. The data also indicated that the indirect taxes have been less progressive in rural areas than in the urban areas.

(D) Evasion of State Taxes

The most serious drawback of Indian Tax System coupled with administrative inefficiency is the large scale tax evasion and accumulation of black money (Dwivedi 1986). Therefore, some concrete measures are needed to be taken to fight the tax evasion. A developing country like India has no choice but to fight tax evasion for increasing revenue because due to political pressures, it is very difficult to raise the tax rates.

Very few attempts have been made to measure the tax revenue losses on account of evasion. Most of the studies are in the shape of Government Reports. Moreover, most of the studies on tax evasion specifically deal with the sales tax evasion.

Lokhnathan (1963) attempted to measure the magnitude of sales tax evasion in Andhra Pradesh. The results of this study indicated that sales tax losses occurred on a large scale in Andhra Pradesh. Of the ten commodities,
the loss varied from a minimum of 20% of ideal yield (expected sales tax revenue) on pulses to a maximum of 97% on chilies. For all the commodities combined, there was a 68% difference between the collected sales tax and the ‘ideal yield’ of sales tax in the year 1959-60.

Mysore Taxation Enquiry Committee (1969) made an attempt to estimate the magnitude of sales tax evasion in Karnataka State. The findings of the Committee reveal that the sales tax revenue of the state in 1968-69, which was around Rs. 360 million, constituted just 6% of the total household expenditure on the items subjected to sales tax.

Direct Taxation Enquiry Committee (1971) opines that the problem of tax evasion and black money are closely inter-related and both affect the national income. It is estimated that Rs. 1000 crore was evaded in 1965 and Rs 1400 crores in 1968. The Committee held the following factors responsible for tax evasion:

a) deterioration in moral standard;
b) improper enforcement of tax laws;
c) interference of political parties;
d) higher rates of taxation;
e) corrupt business practices; and
f) donations by trade and industry to political parties.

Jha (1978) in his study on taxation and the Indian economy, attributed tax evasion to:

a) complexity in tax administration; and
b) lack of co-operation between the tax administration and civil administration.

Chelliah and Purohit (1985) measured the evasion of sales tax in Tamil Nadu during the period 1974-75 to 1979-80. Their study approximates the sales tax evasion on an average between 10 and 20%.
However, according to the study, the evasion of tax was to the extent of 25% of potential tax in the state during the year 1977-78.

Sharda (1986) while attempting to find out the causes of the evasion of excise duty in the states of Himachal Pradesh, reached to the conclusion that it was mainly the Prohibition policy adopted by the State which lead to evasion by encouraging illicit manufacturing and consumption of harmful and socially undesirable commodities.

Purohit (1987) in his study on structure and administration of sales taxation in India, remarks that the tax evasion in India is of 2 types viz. tax evasion on unrecorded transactions (by concealment of particular transactions of purchase or sale) and tax evasion on recorded transactions (recorded by the dealer in the books but either shown as belonging to exempted category or taxable at a lower rate). In addition to these major types of evasion, the study cites certain other methods such as recording the first sale which is taxable as the second one which is exempt, undervaluation of sales turnover or by under-invoicing, stock transfer and works contract.

Sinha (1988) while attempting to ascertain the reasons responsible for the wide spread sales tax evasion in the state of Bihar, attributed it to the maintenance of fake accounts by shopkeepers, transactions under fake names and complicity of sales tax officials with traders in evading taxes especially during inter-state movement of goods.

In the state of Tamil Nadu, tax evasion is rampant in case of stamp duty and registration fees, mainly because of considerable under-reporting of sales value of properties (Guhan 1991).

Dar (1996) while making an analysis into the poor performance of sales taxation in the state of Jammu and Kashmir, attributed the sales tax evasion to:

a) inefficiency in the tax assessment;
b) import of goods by the unregistered dealer on the name of registered dealer through the illicit use of Form “C”;

c) wrong declarations made by the dealers; and

d) inadequate information system.

Godbole Committee (1998) on economic reforms in Jammu and Kashmir, attributes sales tax evasion in the state to ‘bill trading’, i.e. issue of bogus bills by a registered dealer as if a sale has been made when there is no sale. This is so because in Jammu and Kashmir, the scheme of first point tax is in practice. This results in great loss to state exchequer. This observation corroborates with the finding of Purohit (1987).

Institute of Social Sciences (2002) in its report on state development of Jammu and Kashmir, identifies two state taxes which are more prone to evasion, namely stamps and registration fees (due to mal-practices of the parties concerned by showing less price for their properties) and sales tax (due to lack of vigil on the goods entering the state and other kinds of illegal and unethical activities).

Yasmeen (2004) on measuring the fiscal significance of sales tax in Jammu and Kashmir, holds under-invoicing and importing goods into the State without any documents, responsible for sales tax evasion in the state.

SECTION - 2

REVIEW OF STUDIES ON VAT

This section of review is exclusively devoted to Value Added Tax System and delves deep into some major studies on its various dimensions like origin and development, conceptual frame-work and structure, social and economic effects, administration, implementation and other important issues of this tax system, conducted at international and national levels.
(A) Studies Conducted Abroad

VAT has become a favourite feature of economists and the governments all over the world. It is presently in operation in around 140 countries and covers almost 75% of the world's population. Different countries have adopted it in varying degrees. A brief review of some international studies is presented in chronological order as under:

Winsfey (1973) while evaluating the various methods of computation of VAT liability observed that the complexities involved in the procedure of computing VAT show that the consumption type has the advantage of simplicity. Under this method, the firm can deduct the entire tax paid on durable goods when purchased while all producer goods are exempted. It is thus essentially a tax on all retail sales and must cope with the problem of defining when a good is sold for use in production or consumption.

The Accounting Standards Committee, London, in its Corporate Report (1975), recommended the preparation of Value Added Statement (VAS) as a component of Value Added Accounting.

In its Survey Report on the practice of value added tax in Korea, its performance appraisal process, the Ministry of Finance (1980), suggests that the introduction of VAT did not have any marked unstable impact on prices. The study shows that the whole-sale prices in Korea increased by 9% and the consumer price by 10.7% in 1977 when VAT was introduced in the country. This increase was led by food and beverages caused by agricultural failure due to weather conditions. The result of the price changes shows that in Korea the introduction of VAT did not have any marked influence on price changes.

Smiddy (1980) in his study, "Let Us Standardize Value Added Statement" observed that the preparation of VAS being a tool of VAT income measurement, widens the scope of VAT and that is why many
progressive companies of both developed and developing countries are preparing VAS in the disclosure and presentation of their accounts.

Brookings Institute (1981) in its study on impact of value added tax on prices suggests that a reduction in VAT by 1% would reduce prices by 0.7%.

Cnossen (1981) in a study on Dutch experiences with the value added tax, examined the distributional effects of VAT and came to the conclusion that in Dutch Countries, VAT was designed in such a way that it could be distributionally neutral.

Sandford (1981) in his study on Costs and Benefits of VAT, recognizes value added tax as an offshoot of economic union which has emerged as an instrument of tax harmonization in the European Economic Community Countries. The study concludes that adoption of VAT was a necessity in the absence of which the success of common market experiment would have been seriously hampered. In certain cases, its adoption was almost a pre-condition for entry in the common market.

Mikesell (1982) on analyzing fiscal administration and its application for the public sector concludes that in fact VAT is an alternative way of collecting a tax on consumption expenditure. It can be looked upon as multi-stage tax which produced a yield equivalent to that of a single-stage sales tax. In other words, VAT is a substitute for cascade type sales tax.

Sinclair (1983) in his review of “Value Added Tax: Lessons From Europe”, commented that if VAT is replacing other less efficient indirect taxes with an unchanged total yield, the reduction in the discretionary waste generated by the tax system behaves like a rise in aggregate output. The demand for money, therefore, should rise. So long as this is the only effect upon the demand for money and the supply of money is unchanged, the overall price level should fall.
Commenting on the effects of VAT on prices, Tanji (1983) in his study on Taxation and Price stabilization, opines that the fact that VAT would be inflationary, depends not only on the possible off-setting changes in other taxes and on accommodating money supply but also on the reaction of wages, transfer payments, liquidity and psychological effects.

The Tax Council (1983) in its sixth Report on value added tax presented to the President of Republic of Paris while analyzing the impact of VAT on prices confirms that the extra effect would depend on whether it is a new tax or a substitute for another. The overall experience suggests that the tax is not inflationary. The study suggests that rate changes do not have automatic impact on prices but the degree of impact depends upon the general economic condition and on the other measures taken by the government.

Commission on Taxation (1984) in its third Report on Indirect Taxation of Dublin examined the distributional effects of VAT and the study indicated that VAT is not a useful instrument to mitigate regressivity. In Ireland, for example, it is found that although the poor spend relatively more of their income on groceries than the rich, in absolute amounts the rich spend twice as much as the poor. Similar results were found for Canada in an official study relating to Family Expenditure Survey.

Tait (1985) examined the changes in the consumer price indices, credit and wages in 35 countries for 2 years on each side of the date VAT was introduced and also investigated the another 6 examples of rate changes in the existing VAT systems and concluded that in 63% of the countries there was little or no effect of the introduction of VAT on consumer price index.

Hamonangan and Malcolm (1986) in their study on computerization of VAT in Indonesia, discuss an approach to the computerization of tax administration on the introduction of value added tax in Indonesia. The
study concludes that an effective use of computers in support of tax administration can contribute to the success of the system especially in the areas like planning, revenue projection and audit selection. Computers can provide important and timely information for tax administrators.

The World Tax Report, Portugal (1986) on effects of VAT reveals that sometimes traders will take advantage of the confusion to raise the prices exorbitantly and even to levy VAT when they are not liable, naturally differential rates will cause changes in relative prices.

Dengel (1987) opines that more recently it has been held that the price level has risen by more than the tax increased in the wake of increase of the VAT rate which suggests that enterprises use value added tax increase as an opportunity to raise their own prices.

Gil Diaz (1987) in his study on introduction of VAT in Mexico, informs that in order to provide some incentive to the states in the wake of introduction of VAT, the share of federal revenues going to the states was calculated for 3 years proceeding VAT introduction. The share was approximately 12% and this was increased to 13% to make the system more attractive to the states.

Han (1987) worked on the value added tax in Korea and concluded that this tax system unlike other countries has rationalized its tax structure where it has replaced 11 different kinds of indirect taxes. Eight taxes which were replaced by VAT had 53 rates. To make the people fully aware about the new system, the Korean Government campaigned with the help of the chamber of commerce and industry, daily newspapers, television, radio and other mass media at least for 2 years.

In an empirical study on comparative tax systems of Europe, Canada and Japan, Lienard Messese and Owens (1987) concluded that in France,
VAT was found to be proportional or mildly regressive when measured in relation to consumption and regressive in relation to income.

Milka (1987) in his overview of problems in administering a value added tax in Developing countries, opines that although it is generally suggested that VAT administration has an advantage of built-in-policing, yet it may not be effective unless selection of cases for auditing is made in accordance with the criteria of the size of dealers.

In his study on "Valued Added Tax: Revenue Inflation and Foreign Trade Balance", Tait (1987) while trying to remove the fear that this tax is inflationary in nature, narrates that Governments in different countries have adopted extra-ordinary interventionist policies to cope with the sensitive problem of price change at the time of introduction of VAT. A price freeze for instance was adopted by Belgium, Korea and Netherlands while the U.K, adopted price and wage control policies and Ireland adopted the policy of control of profit margin.

It is true that the emergence of VAT as a highly buoyant and elastic source of revenue in a period of just 30 years is something unprecedented in the history of taxation. The History of taxation reveals that no other tax than VAT has swept world in some 30 years from theory to practice and has carried along with it academicians who were once dismissive and countries that rejected it, comments Tait (1988) in his study on "Value Added Tax: International Practice and Problems".

Tait (1988) in a study on evasion, enforcement and penalties, cites the following forms of VAT evasion:

a) avoiding registration by the traders who are liable to VAT;

b) purchasing goods from unregistered suppliers and their sale without charging VAT;

c) inflating the claims to deduct VAT paid at earlier stages;
creating an imaginary VAT number on invoices taken for purchases from unregistered suppliers;

claiming credit for purchases meant for non-business purposes;

Selling the illegally imported goods with full VAT added;

under report or understating goods;

non remittance of collected VAT;

using own production for household consumption;

false export claims;

bogus traders/companies fabricating fake export invoices for claiming VAT rebates on goods never handled;

existences of Barter arrangements; and

commission of accounting errors that may delay the receipt of VAT revenue due.

The study also prescribes some preventive measures as a part of enforcement. These measures are:

power of assessment to tax authorities on suspecting misreports and incase of absence of returns;

record requirements and provisions of information to be fulfilled by the traders;

power of entry and inspection of business premises; and

imposing heavy financial and non-financial penalties.

Yet in another study, Tait (1988) comments that the simplest practical way to run a federal-state sales tax system including VAT is to adopt a form of revenue sharing similar to that of Federal Republic of Germany.

While examining VAT rates, Tait (1988) concludes that it is better to have the fewer rates than the single rate.

In a study on VAT experiences in the Republic of China (Taiwan), Yen et al. (1988) concluded that the Republic of China (Taiwan) replaced 3 important commodity taxes in a bid to simplify tax system and launched a
massive awareness campaign for about 3 years before its formal launch in the country.

Hassington (1989) while examining the compliance and administration costs of VAT in U.K., and the extent of tax evasion thereof, remarks that the change in U.K., from a final point sales tax to a VAT, raised the number of tax payers from 74000 to 1.2 million and the number of collectors from 2000 to 13000.

Atkinson and Stiglitz (1990) in their joint attempt on lectures on public finance, are of the view that VAT fulfills the criteria that there is no loss of technical production efficiency when the rates are optimally determined and there should be no taxation of inputs into the production process.

Carl (1990) in his study "Choosing Among Types of VAT", views that the countries that have introduced the comprehensive VAT, have shown a remarkable degree of unity in selecting among the possible combinations. Virtually, all have opted for the consumption type, destination based implementing tax credit method with multiple structures.

Milka and Carlos (1990) in an attempt to provide some guidelines for the better administration of VAT, suggest that all aspects of VAT administration should be designed with the aim of increasing voluntary compliance. Some of the basic requirements for the successful administration of VAT as underlined by the authors are:-

a) an appropriate Tax payer Identification Number (TIN);
b) a simple VAT return form;
c) an effective tax payer assisting programme;
d) a reliable electronic data processing system;
e) system for cross-checking information in VAT returns;
f) an enforcement system that applies different strategies to different kinds of non-compliance; and
g) a sound and effectively applied penalty system.
Militzer and Ontscherenki, I. (1990) in a study entitled, “The Value Added Tax: Its Impact on Savings”, examined the case of 230 ECD countries which indicated that there is no statistically significant relationship between saving rates and VAT. According to them, some of the disadvantages of VAT include inflation and regressivity. VAT would lead to inflation in the economy which would have an adverse effect on real savings. This as per the study was true in the case of Japan and Denmark.

Podder (1990) in his study on options for a VAT at the state level, provides the following 3 options for the introduction of VAT in a federal country:

- a) a national VAT with inter-government revenue sharing arrangements;
- b) origin based VAT; and
- c) destination based VAT.

Smith (1990) observes that the consumption type method of computing VAT liability seems preferable in theory at least because by resting on consumption, it minimizes any influence taxation might exert on decisions regarding the productive process in industry.

Commenting on the revenue raising potential of VAT, Cnossen (1991) is of the view that a properly designed VAT raises more revenue with less administrative and economic costs than other broadly based taxes. A VAT with few exemptions can generate revenue of about 0.4% of GDP for every percentage point of the rate. Furthermore, VAT does not influence the method of doing the business.

Graham (1991) in his study “Planning for VAT” discusses from the perspective of management, the process by which an organization actually implements a VAT. The study also identifies and discusses the issues that the administrators would need to address on VAT implementation. For the successful administration of VAT, the author suggests the use of existing
structure of an organization or establishment of a separate unit or outsourcing the task or adoption of a mixture of these options.

In his study, "Is the Timing Right for VAT in Bangladesh", Jamal-u-Din (1991) observed that when VAT was introduced in Bangladesh, there was a confusion as to whether it was right time for Bangladesh to adopt VAT, but now there is an observation that VAT did fairly well as far as revenue collection is concerned. The earnings from VAT show that it is one of the most important sources of government revenue and the increasing net of VAT proves that it is going to be in the same position or even in better position in future also if the tax administration can introduce a proper system of accounting for VAT for the tax payers registered under VAT. This will have a positive impact on the collection of revenue through VAT.

In their study Milka et al. (1991), in order to remove the chances of frauds, under reporting, avoidance and evasion of tax, advocate for the conduct of audit for VAT which according to the authors may be of 3 types, viz.:

The Advisory Visit

This visit would take place soon after a new tax payer has commenced business. This visit serves two purposes:

a) to educate the tax payer about his obligations and to ensure that his records etc. are adequate; and

b) to gather some basic information that may help the administration in its future dealings with the tax payer.

Desk Audit

It is the checking of the return for arithmetic accuracy, calculating ratios from the return data and checking for completeness etc. It is conducted in the tax office without any discussion with the tax payer.

Verification Audit

Also known as control audit or routine control audit, is generally a check of selected aspects of the tax payer's record. Its goal is to minimize
evasion through frequent control checks so that evasion can be quickly checked and penalized.

Sol (1991) suggests the use of computers for VAT requirements and accordingly suggests the computer systems design and structure and the processes appropriate for VAT requirements. The study also suggests the preparation of a comprehensive cost/benefit analysis by a team of experts while deciding on the extent of computerization most suitable for the organization.

In two other studies on value added tax-administration and policy issues, Tait (1991) remarks that International Monetary Fund (IMF) has been prominent in urging developing countries to adopt the VAT to reap its fruits.

Value Added Tax Act of Bangladesh (1991) requires that in order to facilitate the checking of returns, the tax payers maintain some statements regarding the purchase and sale of goods.

In his study, “A Growing Presence: Value Added Tax in Asia-Pacific”, McKenzie (1992), examined the growth of VAT in the Asia-Pacific region and concluded that a significant feature in the development of VAT is the emergence of regional trends alongside global growth. Although Europe has been at the forefront of the expansion of tax, the Asia-pacific too has played a significant role during the last 25 years in the growth of the tax.

Emphasizing the need for adoption of VAT, Bosch (1993) in his study entitled, “Value Added Tax: The European Experiences”, unfolds that VAT had its origin in France in 1950’s and is the requisite form of indirect taxation for several countries.

Burgess et al. (1993) while commenting on the Canadian experiences with VAT, are of the view that taxation of commodities at two levels cannot be carried on independently, but ultimately there has to be an integration in some form and suggest a scheme for the manufacturers’ VAT and Central
and State sales taxes converted into a destination based VAT, can at best be regarded as a possible and workable solution. The relatively slow progress in introducing VAT at state level and the resistance to the idea of abolishing inter-state tax corroborate this prognostication.

Commenting on the rate structure of VAT in different countries, Kwong (1993) in his study, “GST in Singapore: Some Aspects of Administration and Compliance”, has observed that different countries have different rate structure. However, in the Western Europe, Denmark is the only country with a uniform rate, i.e. 25%. Similarly in the Asia-Pacific region, Singapore had introduced a uniform rate of 3% which has latter been increased to 5%.

Reviewing the administrative aspect of VAT, Mintz et al. (1994) oppose the decentralized administration of VAT for the reason that businessmen would be faced with a nightmare of increased tax complexity as was witnessed in Quebec federation. The authors suggest that only one agency either the federal government or a Joint Federal Provincial Agency should administer the tax.

As regards the burden of VAT and its effect on GDP and prices, The Department of Finance, Government of Canada (1994) in the Federal White Paper, anticipated that the integrated VAT would make no difference to the average tax burden for the Canadian families, but would have a wholesome effect on GDP growth and will lower the prices.

Howell (1995) in his study on “Selected Issues in Designing a VAT” discusses the alternative variants of a VAT which he asserts are three viz, the Product type, the Income type and the Consumption type and concludes that from amongst the three variants the Consumption type variant is the most appropriate if implemented on the original principle as it is economically most neutral and as such widely adopted in the countries that
have VAT. However, this variant requires a highest tax rate to achieve a given revenue yield. For this, some countries have attempted to expand the base of Consumption VAT by taxing capital goods partially.

Elaborating extensively on the two methods of VAT computation and their economic implications viz., the credit method and the subtraction method, Howell (1995) in the same study concludes that in a VAT system with a single rate, no exemptions and zero-rating, both the methods will produce identical results and hence choice between the two must be made on the grounds other than the tax policy. On the other hand, in a VAT system with multiple rates and extensive exemptions, neither of the two is completely capable of overcoming the undesirable effects and hence the choice between the two comes down to a comparative trade-off between costs and benefits in each.

In an attempt to determine the base of a VAT and its estimation, Howell (1995) is of the view that the applicable base of a VAT depends on a number of aspects related to its design i.e., whether it is origin or destination based, income or consumption type, implemented with a credit invoice or subtraction method and contains many or few exemptions. The study has developed a general framework for estimating the base of the most widely adopted form of VAT — a destination based, consumption type system, implemented with credit invoice method which suggests gross domestic product (GDP) of an economy as the starting point and from this various adjustments in the shape of final private consumption expenditure, investment expenditure, final government expenditure on goods and services and government expenditure on wages and salaries can be made.

Commenting on the basis of VAT, Keen and Smith (1996) opine that the destination base is both more compatible with independent taxation of consumption and in practice less likely to result in important economic distortions.
While identifying the important issues in the value added tax in China, Chui and Liang (1997) view that the Asian giants too have not been lagging behind in the introduction and adoption of VAT. China for instance has introduced VAT w.e.f. January 1, 1994. It is now the principle indirect tax that replaced the Industrial and Commercial Consolidated Tax. China has become a largest country to adopt a VAT system to the full retail stage and the system has similar features as in most European Countries.

Cnossen (1997) has reviewed the existing VATs against the requirements of a good VAT. The review has shown that not all VATs extend through the retail stage or adequately cover the public sector bodies. The study suggests that services should also be taxed comprehensively.

Cnossen (1997) in his review of global trends and issues in value added taxation, has suggested that in high income countries a single uniform rate of VAT is the best while as in low-income countries which face major constraints on administrative capacity, lower than standard rates or exemptions for selected unprocessed foodstuff make sense in alleviating the regressivity of VAT.

In his study on “Dual VAT and Cross Border Trade-Two Problems, One Solution”, Bird (1998) states that the State VAT being based on destination principle, requires restructuring of Central Sales Tax. This would result in considerable decline in state’s own tax revenue in many states in a federal setup.

Bird and Gendron (1998) offer a useful overview and analysis of two similar problems to which they assert, is a common solution. The problems are:

a) The imposition of VAT by both national and sub-national governments in a single country; and

b) implementing VAT on cross-boarder trade e.g. between nations where only one level of government imposes the tax.
The solution is a dual VAT levied either by two levels of government or by one level of government or an organization representing such governments as is in vogue in the federal government of Canada and the provincial government of Quebec.

Keen and Ligthart (2002) in their study on coordinating tariff reduction and domestic trade reform show that in small open economies any revenue neutral tariff cut accompanied by price neutral destination based VAT, will enhance both net revenue and welfare.

Throwing light on the advantages of VAT, Sanjive (2003) in his study entitled “The ABC of VAT”, views that VAT would enhance the competitive strength of domestic trade and industry, simplify and rationalize the sales tax system, push up the economic reform process further and achieve unification of state level sales tax. The author suggests that in order to achieve high compliance and proper implementation, a number of indirect taxes like Central Sales Tax, Entry Tax and other local taxes should be scrapped.

Some recent theoretical explorations have argued that VAT being a tax on the formal sector of the economy and combined with weak administration, helps the spread of informal economy which is not conducive for development, Emran and Stiglitz (2004a, 2004b), Hines (2004), Gordon and Wei (2005).

Bird (2005) in his study on “Value Added Taxes in Developing and Transitional Countries: Lessons and Questions” argues that although VAT is not necessarily a “money machine” but if the tax is administered properly, the conventional conclusion that this is the best way to make up for the revenue loss from trade liberalization holds.

Mustafa (2005) examined the issues related to VAT in Asia-Pacific Countries vis-a-vis its neutrality, regressivity, inflation, competitiveness and
need for professional advice and concluded that on the whole as per the experiences of many European and Asia-pacific countries, the benefits of VAT outweigh its disadvantages and observes that the lessons learnt by the European countries from the implementation of VAT, can be a valuable guide for the Asia-Pacific Countries.

Salahudin (2005) evaluated the accounting for value Added tax in Bangladesh and concluded the tax payers in manufacturing and service sectors in order to substantiate their returns be asked to prepare Value Added Statement (VAS) to facilitate the verification of their returns by the tax authority and suggested that there should be a proper guideline for the preparation of VAS. For this purpose, the tax administration should take the help of professional accountants and academicians. This will make the checking of returns easier for large tax payers in manufacturing and service sector.

(B) Studies Conducted in India

In India it was debated for fairly a long-time about the need for a major reform by the Government to garner revenues. It was felt that the introduction of Value Added Tax creates a level playing field to industries and a VAT scenario addresses the challenges of globalization for replacing the archaic system of sales tax in revenue generation. Countries which have introduced VAT have felt that the economic efficiency concern can better be addressed in a VAT regime. It has also been experienced by the governments the world over that VAT improves compliance levels and reduces evasion/avoidance of tax by virtue of its self-policing effect, Singhvi (2004).

The Government has time and again emphasized the need for buoyant revenues to satisfy the state’s requirements of funds for its development activities. The erstwhile system of sales tax was highly saturated, addressed only limited resource mobilization capabilities and did not lead to tax buoyancy except when tax rates were enhanced. In the event when the tax
rates are enhanced the industry is adversely affected leading to diversion of trade, evasion, suppression and unhealthy competition among states. Various states studied the impact of erstwhile sales tax system and felt the need for a major reform. It, therefore, seemed that VAT was the answer.

Apart from some official committees and commissions, at the individual level also many researchers have supported the view of adoption of VAT system during the last two decades as a means to achieve harmonization in commodity taxation. In the present liberalized economic scenario, optimal commodity taxation has assumed greater significance and is now sine-quo-non for achieving target based foreign direct investment. This is believed to give impetus to investment in various sectors of economy which ultimately will lead to improvement in tax revenue generation. For this purpose, researchers both at official and unofficial levels have recommended that commodity tax harmonization and rationalization should be attempted through introduction of comprehensive VAT.

Although VAT in India is yet in its infancy, the economists, fiscal experts, academicians and researchers have been working with extreme devotion and concentration on different dimensions of this new system of taxation right from its inception on the global scene. A brief sketch of studies conducted at the national level in India is presented as under:

Indirect Taxation Enquiry Committee (1978) made a pioneering attempt by studying in depth the cascading effect of input excise. The study recommended the adoption of Value Added Tax (VAT) at the manufacturing stage called MANVAT to tackle the problem of cascading effect of excise taxation. This report is considered to be one of the exhaustive studies of indirect taxation ever made in any country, Due (1986).

Explaining the concept of ‘VAT’, Khadka (1989) states that VAT is a levy imposed on the value added by each firm through its production and
distribution activity. Value added for a firm is nothing more than its gross receipts from sales minus all expenditure for all goods and services purchased from other firms. This very value added is the legal base of VAT.

In his study on tax system in transition, Mitra (1991) opined that tax system reforms may be directed towards integrated structure of taxes comprising of a basic Value Added Tax on consumption applying at a uniform rate depending on revenue requirements to domestic production of goods and services and zero rating of exports under Value Added Tax.

Tax Reforms Committee (1991) in its report observed that adoption of a full fledged VAT up to retail stage poses certain problems in a federal set-up where states may not agree to surrender their tax powers. In such cases the solution is either to have VAT at the Union level and share the proceeds of tax with states on the basis of some pre-determined agreed formula or to have two VATs, one at the National level up to the manufacturing stage and other State VAT from distributors to retailer’s level. Both the systems would be satisfactory from the point of view of efficiency and inter-state equity.

Tax Reforms Committee (1991) in the same report suggests that in order to make VAT system simple and administrable, it should be levied at 2 or 3 rates say at 15 or 20%. The selective excise duties on non-essential consumption goods could be levied at 30, 40 or 50%. It would be ideal if there were one comprehensive VAT replacing the present system of Central Excise, State Sales Tax and other indirect taxes except the state levy on alcoholic liquor and the states entertainment tax. The proceeds could be shared between the Centre and the states. With a comprehensive base, limited exemptions and fairly moderate rates, there will be less scope for evasion.

Again in the same report, Tax Reforms Committee (1991) recommends the broadening of the base of VAT with the inclusion of services such as
transport services, private nursing homes, computer maintenance and consultancy services, automobile repair and services to be called as a full-fledged value added tax under which a tax credit is available when it is paid as business expense. With the result, there is no cascading of the tax.

Chelliah Committee (1992) on examination of the indirect tax system of India, has clearly stated that the snow-balling effect commonly known as ‘cascading’ leading to escalation of production costs, distortion, loss of competitiveness, vertical integration and uncontrolled pattern of incidence, can be tackled through adoption of VAT. Further, in order to bring the indirect tax system of the country in tune with the international standards and competition, he recommended VAT as the best alternative to enable the products to compete in the international markets.

Purohit (1993) in his study “Adoption of Value Added Tax in India: Problems and Prospects” while identifying the problem areas in VAT administration at the state level which include the problems relating to staff requirement, training of personnel, suitable computational technology, allotment of TIN Numbers and auditing, is optimistic that VAT would be able to do away with all these problems in due course of time.

Holding an optimistic view about the convenience in the administration of State VAT, Purohit (1993) in the same study, opines that as per the prevailing standards of administration, the administration of VAT would not be so difficult for the following reasons: -

a) it has policing features;

b) it would be having an extensive base; and

c) it would also involve all the registered dealers.

Gurmurthi (1993) in his study “VAT and Fiscal Federalism” while commenting on the suggestions of Jha and Chelliah Committees regarding the complete change-over to the VAT system, opines that this would involve
redistribution of tax powers between the Centre and the states. The states would not be willing to part with their sovereign powers.

Favouring the adoption of VAT, Purohit (1993) in his study “Approach towards State-VAT”, opines that state VAT would be superior to sales tax system in terms of allocative efficiency, neutrality and other economic effects. It would also simplify the sales tax system. The number of rates would be reduced to minimum. The number of exemptions would be curtailed. It would reduce the amount of tax evasion and above all would be transparent.

In the same study, Purohit (1993) suggested to introduce the system of value added tax to a limited extent. To begin with, the States may like to introduce the tax for a few select commodities only. The selection could be made on the basis of the extent of evasion in a particular commodity in the state and on the basis of value added after the first point. Secondly, in the meantime, the state should prepare a blue-print for switching over to State VAT on all commodities after giving requisite information to tax payers and the consumers and providing proper lead time to the taxation department as well as tax payers for introducing the new tax.

Gurmurthi (1993) in another study, suggests that the choice to opt for a VAT in replacement of Sales Tax, should be left to the states and it is the states which should exercise full powers with regard to existing rates, exemptions, administration and collection in the case of VAT.

Purohit (1993) in one more study “VAT in Indian Federation” gives a brief sketch of experiments of some Indian States with VAT and narrates that the experiment of these states i.e., Andhra Pradesh, Kerala, Maharashtra and Madhya Pradesh in the past, is of paramount importance for the other states. These states have faced many problems of administrative or operational nature in their efforts to introduce VAT. The experience of the
states that experimented with some form of VAT, indicates that except Maharashtra, no state had attempted introduction of proper form of VAT. Levy of VAT on a few selected commodities (as in Kerala and Andhra Pradesh) was also not in its proper form. The first and the foremost prerequisite of VAT is to give input credit for all purchases for all commodities. Also there was no requisite preparedness on the part of tax departments in these states.

Commenting on the reforms in the governance of State-VAT, Purohit (1993) suggests as under:

a) operation of State-VAT through a single Master File, based on unique Tax Identification Number (TIN);
b) adoption of suitable computational technology;
c) prioritization of training of personnel;
d) adoption of selective assessment procedures; and
e) launch of a big awareness campaign to educate the tax payers.

Kiran and Usha (1993) opine that the introduction of a full-fledged VAT in India would seem to present numerous administrative and constitutional difficulties including the vexed question of union-state relations.

Once the Centre withdraws from the field of Commodity Taxation, the states would be able to levy a comprehensive VAT, comments Purohit (1993). As a next step, it should be useful to combine all the taxes on commodities and services levied by the states. Once the sales tax is converted into state-VAT, some of the taxes like excise duties, electricity duty, entertainment tax, and luxury tax on hotels, could be integrated with the state-VAT. Entry tax, Octroi, tax on animals and boats could be integrated with State-VAT. Finally when the state governments are authorized by the Centre to levy tax on some select services, these also could be integrated with the State-VAT.
It would be a best practice to adopt a VAT with a small and low rate structure coupled with exemptions confined to some basic and essential commodities. Purohit (1993), in this direction, examined the structure of VAT in his study, “Adoption of VAT in India: Problems and Prospects”. The study reveals that the structure of tax among all the VAT countries suggests that there is a trend to have a small number of rates in most of the countries. Some of these countries levy VAT with a single rate. Some countries have low rate of tax (between 2 and 5) on necessities and high rates on luxuries. The general trend is to have 2 or 3 categories only. Some countries exempt a few basic food items, medicines, clothes and footwear.

For India, a dual VAT seems to be suitable and conclusive. Towards this end, Burgess et al. (1993) in their joint attempt on the reforms of indirect taxes in India, opine that VAT in India might either be the responsibility of the Central Government or the State Governments or both. However, the authors are of the view that the State run VATs can only be considered as a long-term option. In the short-run, a dual VAT is almost certainly the only way forward in the development of value added taxation in India.

On the possible option for the adoption of VAT in India and commenting on the Jha Committee’s suggestions of imposing VAT at the Central level, Purohit (1993) believes that this would require a constitutional amendment which may be difficult under the present political situation of the country. The states would not agree to surrender their taxing powers because this could further create financial dependence of the states on the Centre.

In the same study, Purohit (1993) mentions that another option is to have 2 different VATs, one at the Central level called Central- VAT and another at State-level, called State-VAT, for former would substitute Union Excise Duties and the latter would replace Sales Tax. The State VAT could,
however, have varying rates across all states. The State VAT could also consider set-off for the Central Sales Tax (CST).

Yet another option as mentioned by Purohit (1993) is to have a complete State VAT wherein the total revenue from the Union Excise Duties is pooled reimbursing the states on the basis of collection.

Chelliah (1994) in his study on tax reforms, was of the view that MODVAT should be converted into full fledged VAT at the Central level covering the manufacturing and service sectors. The Central VAT should be converted into VAT on goods and extended to cover electricity and transport of goods and passengers.

Dwivedi (1994) made a critical review of the recommendations of Tax Reforms Committee (Chelliah Committee) on VAT and concluded that to expect that VAT will achieve all the professed goals of a good tax system, will prove misleading. The most significant achievement will be reduced cascading. The VAT will also be evaded as any other tax in India as long as the corruption remains a part of social life. So before any tax reform is undertaken, it is better to reform the administrative machinery.

NIPFP (1994) on examining the issues and options in the reform of trade taxes in India, held that Value Added Tax could provide better solution to most of the ills of the erstwhile system of trade taxes. The study emphasized a dual system of VAT at the level of Centre and states. It also brought out the legal, administrative and institutional requirements for VAT.

Sinha (1994) in his study on tax structure in India, strongly recognized the recommendations of Chelliah Committee on VAT and suggested that Central Excise Duties should be converted into VAT.

Aggarwal (1995) in his study on estimation of tax incidence of major indirect taxes, observed that the reported effective rates of sales tax seem to have implication for replacing sales tax by states’ Value Added Tax. It was
suggested that under the State VAT, a uniform rate of about 14% on average would leave the tax burden unchanged.

Bagchi (1995) in his study “VAT and States: Misconceived fears,” cautions that in order to reap the fruits of VAT, it should:

- **a)** apply to all goods and services with minimum exclusions; and
- **b)** adhere strictly to the principle of destination following preferably the tax credit method whereby exports are easily freed of tax and imports are taxed on the same footing as the domestic products.

Bagchi (1995) in another study, views that a national VAT as is in vogue in China in place of all major and minor taxes on goods and services, would no doubt solve most of our indirect tax problems and rid the system of incentives.

Purohit (1995) while advocating for the introduction of VAT in India as a major Indian commodity tax structure reform, suggests that the introduction of VAT be attempted in phases with the objective that the impediments to its adoption which are psychological, structural as well as administrative in nature, should be first removed. It is also essential that public opinion be moulded to have adequate appreciation of a full-fledged VAT.

Murty (1995) examined various types of VAT and their applications in a federal country. Recognizing the impact of tax reforms on Centre-State financial relations, the study opined that the ultimate aim of commodity tax reforms should be the adoption of comprehensive VAT covering value added by all business enterprises from manufacturing to retailing activities. The tax should have consumption base, follow the tax credit method, and use the destination principle to calculate the tax liability. The study suggested the approach of sharing the tax base by the Centre and the states and concluded that for India it might be ideal to have Central and State VATs with one or two rates.
Purohit (1995) opines that in the long run, State-VAT should prove to be the most suitable option to the Indian federation for a variety of reasons such as:

a) *this would not require any change in the existing constitutional provisions relating to tax powers between the Centre and the States;*

b) *it would strengthen the financial autonomy of the states and would not adversely affect the finances of the Central Government;*

c) *the existing deficiencies of the Central Sales Tax (CST) could be eradicated through the introduction of state- VAT on destination principle; and*

d) *it is feasible to be administered by the existing sales tax machinery of the states.*

While commenting on the revenue neutrality of State-VAT, Purohit (1995) views that in addition to achieving economic efficiency and to avoiding cascading of tax levied at earlier stages, the State-VAT would enable the states to raise larger revenues.

Bagchi (1997) in his report on VAT in Maharashtra which according to him happens to be the 1st Indian state to take some bold steps to usher in a regime of VAT covering in principle the entire spectrum of manufacturing and trading in the State. The report briefly discusses the salient features of changes that have been made in the sales tax system of the state to invest it with the character of VAT, the difficulties and to draw lessons for other states and also for the future. The report concludes that Maharashtra with its strong industrial base could afford to take the rise and hope to absorb the revenue loss through an expansion of its trade and industry. If VAT is to gain a wider acceptance among the states, there has to be a commitment on the part of the Centre to relax the constraints on the State's power to tax consumption within their territories.
In his study on evolution and reforms in sales tax system in Tamil Nadu, Gurmurti (1997), points out that there are some structural problems in introducing Value Added Tax in its true spirit in the context of fiscal federation operating in India. While Value added and fiscal federalism are strong bed-fellows in general, the problem of introducing a full-fledged VAT in India is far more difficult since sales tax happens to be the only elastic source of revenue available to states. In more than one sense VAT which has been introduced in Tamil Nadu and Maharashtra, only touches the tip of ice-berg.

Indian Tax Institute (1997) after examining the theoretical aspects of value added tax and studying the implementation of MODVAT in India, reported that excise taxation in India contained complicated network of exemptions and preferences and if all these features of excise taxation were retained in a comprehensive VAT, it would be the negation of the essential character of VAT.

In his study on “An Experimental VAT in the State of Andhra Pradesh”, Mukhopadhyay (1997) finds that the idea of VAT in Andhra Pradesh met with some resistance in the beginning but has been gradually accepted. The tax collection was low because of the adjustment of the opening balance in 1995-96. The study suggests that the coverage of VAT should be extended gradually following the selected commodity approach already in vogue in the state. The study further suggests that the number of rates should be reduced from the current 6 to 2. The study also sets out a formula for the calculation of VAT payable as under:

\[ \text{VAT} = (\text{Sales} - \text{Purchases}) \times \text{VAT Rate} \]

Thrisk (1997) in his study on Tax reforms in developing countries, viewed that often VAT is termed as a panacea for a wide variety of fiscal ills including need for higher revenues. This unqualified enthusiasm for VAT is
misplaced if preparations for VAT are inadequate, enforcement is weak, if it has numerous rates, is interlaced with numerous exemptions. Then it may even be worse than the indirect taxes it replaces.

Godbole Committee (1998) in an attempt to suggest reforms in Jammu and Kashmir economy, recommended the introduction of VAT as a substitute for sales tax in order to garner more revenues for the budgetary support of the State.

Godbole (2000) in his commentary on Maharashtra budget was disappointed to know about the State Government's proposal to abolish the value added tax (VAT) system on the recommendations of Narayan Valluri Committee earlier appointed by the State Government. Godbole views that VAT was considered as a feather in the cap of Maharashtra sales tax administration by the knowledgeable observers and institutions both in the country and abroad. Any new taxation system is bound to face teething trouble. Some decline in the rate of growth of revenue in short run also cannot be ruled out but the Maharashtra administration has the requisite innovativeness to deal with these issues in a constructive manner. Instead, the State Government has for inexplicable reasons taken a hasty decision of abolishing the VAT system.

Sree Kantaradhya (2000) examined the structure and reforms of taxation in India especially the post-1991 tax reforms and suggested that Centre must renew its pressure on states to convert the Sales Tax into State VAT as a big tax reform measure.

Shome (2000) opined that unfinished task of tax reforms besides other things, included neutralizing the effect of reduction in tax base as a result of introduction of VAT. The study among other measures of long-term nature, suggested the designing of full-fledged VAT as an important measure of tax reforms.
Analyzing the price effects of VAT, Purohit (2001) opines that in general VAT causes increase in prices of commodities depending upon the elasticity of demand and supply of the commodity concerned. Normally it is fully shifted forward because traders would wish to maintain their level of profit by shifting VAT ahead. All traders will initially bear tax and compliance costs but would like to recoup in due course. The degree of shifting would cause increase in prices.

Purohit (2001) on analyzing the effects of VAT on growth i.e., on savings and investments, holds that VAT does not have any adverse effects on savings as it can be efficiently used to curb the consumption of luxuries as well as socially undesirable goods. Also it does not effect the investments as the capital goods and depreciation on goods are exempt under VAT. If it would increase revenues because of its buoyancy, then it would mobilize additional resources for growth.

Analyzing the possibilities of successful administration of VAT in India, Purohit (2001) stresses on the use of computerization of tax procedures.

Purohit (2001) examined the problems and prospects of introducing VAT at Central and State levels. In view of the weaknesses in Union Excise Structure, the study suggested the withdrawal of CENVAT and its replacement by full State VAT. The study recommended the introduction of State VAT with four rate structure, abolition of Sales tax related incentives and effective and efficient governance of State VAT.

Kelkar Committee (2002) acknowledged that VAT is a major reform in the indirect tax system of India. For a smooth and speedy implementation of VAT at the level of Centre and states, the Committee made the following recommendations:

a) starting of a publicity awareness programme jointly by the Central and State Governments;
b) ensuring uniformity in state legislations, procedures and documentation relating to VAT;

c) discontinuing all local taxes with the introduction of VAT; and

d) exploring the possibility of a VAT Council for the stability and continuity of VAT.

Institute of Social Sciences (2002) in its report on Jammu and Kashmir State Development, strongly advocated for the complete shift over to VAT system in the state. In this connection, the report suggested that the tax administration should be computerized and the Government should arrange training programmes for its officers/staff for implementing this new tax mechanism more effectively. Trade bodies, chamber of commerce and industry, universities and the experts in the field of economics and fiscal management should be involved in creating mass awareness and training of the officers/staff.

In his study, “A VAT of Worries,” Sundaram (2002) opines that the present tax base for mobilization of revenue is quite narrow and the tax structure is complex with multiplicity of rates which leads to prolonged litigation, wastage of time and resources of the country. He views VAT as a win-win situation for both industry and the Government because it is a system that has a combination of reasonable rates on goods and services and can be set-off to eliminate the cascading effect of taxes.

Yasmeen (2003) in her attempt to suggest the reforms in Sales Tax Structure in Jammu and Kashmir, opines that introduction of VAT in Jammu and Kashmir is cumbersome as it requires more extensive records which is not possible in a state having large number of small unorganized and uneducated vendors. Since a large number of tax payers are brought under the purview of the tax, it increases administrative complexity. Moreover, switch over to VAT immediately does not seem feasible. Further, VAT has a cross audit feature. It is not an automatic one. It requires a proper record system and frequent checks; otherwise there is a possibility of great tax
evasion. However, the study concludes that introduction of VAT in Jammu and Kashmir on experimental basis should be tried.

Ahuja (2004) made a comprehensive study of VAT in India and some selected countries of the world. The study presents an integrated view of various dimensions of VAT in theory and Practice. VAT has claimed world-wide attention as more and more countries are adopting it in varying degrees to reform their system of commodity taxation. Drawing on the experiences of other countries, the study evaluates various options available for a smooth switch over to VAT in India. The countries considered for the purpose were, Brazil, Argentina, Mexico, Germany and Canada.

In an attempt to throw light on the concept and methodology of collection of tax under VAT regime, Kumar et al. (2004) discussed the historical background and the terminology used for VAT in different countries. According to the study treatment of capital expenses while calculating VAT demarcates the variants of VAT which can be divided into 4 categories viz.:

\[ a) \text{ Gross Product Type} \quad (Sales - Purchases = \text{Amount on which VAT is applicable}); \]

\[ b) \text{ Income Type} \quad (Sales-Purchases-depreciation = \text{Amount on which VAT is applicable}); \]

\[ c) \text{ Consumption Type} \quad (Sales - purchases - Capital Expenses = \text{Amount on which VAT is applicable}); \]

\[ d) \text{ Wage Type} \quad (Sales-purchases-Profit-Capital Expenses = \text{Amount on which VAT is applicable}). \]

Apprehending that VAT may initially lead to decline in revenue generation particularly in consumer states, Joo (2004) analyses the probable impact of VAT on revenue generation in the State of Jammu and Kashmir. The study analyses the impact of revenue loss in Jammu and Kashmir after VAT adoption on the basis of consolidated form, on division wise basis i.e., separately in Kashmir and Jammu divisions and on the basis of selected but
main revenue contributing commodities such as electronics, electric goods and cement which are commonly used in Jammu and Kashmir State. The data used for the analysis shows that slippage of tax revenue due to VAT adoption is only in respect of the above three commodities and in case of the remaining commodities taken for the purpose of study, revenue shows a moderate or marginal rise. The study concludes that revenue slippage is a temporary phenomenon and in the long run, revenue may show marginal decline because income generation on these products shows more elasticity.

Naruka and Gupta (2004) in their study on Value Added tax, attempt to give a brief account of historical background, features and illustrations regarding the computation of VAT liability. The study also discusses tax collection authorities’ and Governments’ views about VAT besides some major concerns of businessmen about VAT. The study concludes that VAT is better as compared to erstwhile system of commodity taxation and suggests the involvement of all political parties because without political willingness, the successful implementation of this new tax regime in India is very difficult.

The study further classifies ways of calculation of VAT liability into three methods such as:

a) **Addition Method** \((Addition \ of \ all \ the \ value \ adding \ items \ like \ wages, \ rent, \ interest \ and \ profit);\)

b) **Subtraction Method** \((Sales - Purchases); \ and\)

c) **Tax Credit Method** \((Sales+VAT-VAT \ paid \ to \ the \ preceding \ firms).\)

VAT requires more preparation than any other form of commodity tax, (Ahuja, 2004). This tax was not introduced over night in any country. Taiwan for example took 17 years to prepare for this tax. The corresponding period for Korea was 6 years. The question of introducing VAT was considered several times in the United Kingdom before its introduction in 1973. A very simple, clear and adequate VAT law should be formulated so
that there will not be any difficulty in understanding the VAT system for the common people. Besides, an extensive general information campaign to educate the public should be launched. An adequate information system for the successful operation of VAT should be developed.

Considering VAT as a step to unite economic India, Archana (2005) opines that with the introduction of VAT, the overall tax burden will be rationalized and prices in general will fall, tax base will widen, compliance will be better and the revenues will increase. VAT will make the tax structure simpler and more transparent. In short, it is a win-win system. Further, with VAT's uniform structure, it would be possible to cut cumbersome paper work by computerizing records — a step that would usher in transparency in tax accounting.

In his study “VAT implementation and its consequences” Bansal (2005) provides an insight into the transition into the VAT regime from the sales tax regime. The study examines how the implementation of VAT changes the rules of the game for business in India. It attempts to bring forth the key strengths and the fallacies of the new system. The author highlights that there are many discrepancies in the VAT Bills of different states. The Central Government must actively seek to harmonize these in the interest of the business. The author also suggests that all states must go for VAT simultaneously with full clarity as to the future road map. Further, Central Sales Tax (CST) should be abolished to make India one whole market and encourage inter-state trade and commerce.

Bashir, et al. (2005) in their study “VAT compliance in Jammu and Kashmir: an empirical analysis” opine that in the state of Jammu and Kashmir, Government implemented VAT in a hurry with out making any ground exercise before its formal launch. The study reveals that neither the traders nor the tax officials have a complete knowledge about this newly introduced commodity tax system. The study further reveals that besides the
continued existence of CST, the proper maintenance of accounting under VAT is the main concern pinching the trading community. The study also suggests that besides educating the traders through an effective awareness campaign, VAT requires the establishment of proper Management Information System (MIS) which is so far lacking in the Department of Commercial Taxes in the state.

Bhat (2005) opines that in view of the ignorance of People particularly the traders, the time for the introduction of VAT in Jammu & Kashmir was not appropriate. A large number of traders don’t oppose the introduction of VAT per se rather it is just the ignorance of law that makes them jittery. The Government should gear up its machinery to launch a massive awareness programme across the state.

Bezborah and Singh (2005) while examining the problems and prospects of Value Added Tax in India, declare VAT as a rational alternative tool to sales tax structure to be introduced at the state level i.e., sales tax be converted in to a state VAT.

Under VAT, there would be no regular trips to tax department, no standing in long ques for forms, no hesitating tax inspections and no assessments by officers. Instead, a businessman will himself calculate his tax liability. This will make the purchases and sales documents as valuable as the currency notes. But VAT demands a great deal of paper work and accurate accounting (Bushan, 2005).

To have an effective and efficient governance of state VAT, a prerequisite is to adopt a suitable computational technology. It is necessary to have a requisite system suitable to the structure and administrative needs. The training of personnel needs prioritization. The training is all the more crucial when it comes to administering VAT (Chittora, 2005).
In her study of tax reforms and administration, Dhingra (2005) advocates for introduction of VAT at the state level in all the states simultaneously as a major reform of taxation. For this purpose, she suggests that an adequate and time bound programme be delineated. Further, all apprehensions of state governments and traders be removed. Tax reforms at the state level must draw more attention to reap better results from the reform process.

Doshi, et al. (2005) offer their views on the impact of VAT on various industries such as pharmaceutical, steel, automobile, cement, sugar, consumer electronics and appliances, tobacco and tea industry. The authors predict that the imposition of VAT on these industries will make the commodities costlier for the consumers.

Misra (2005) in his study on “problems and Prospects of VAT” examines the Indian experience with VAT and notices that Andhra Pradesh introduced VAT in April 1995 and 19 Commodities were chosen for VAT by adding a separate (sixth) schedule to Andra Pradesh Government Sales Tax Act prescribing a multipoint tax for these 19 commodities.

While appreciating its simple and transparent characteristics for which VAT is preferred everywhere, Muneer (2005) views that its inherent disadvantages include high cost of compliance for the small dealers at the retail stage and high cost of administration for the government. Also VAT could be inflationary in the short run. The author suggests that VAT should not intervene in the choices of economic agents and create distortions. Further, VAT should include services also as is the case in most of the countries that have introduced it.

Nour and Paramanik (2005) in their study “VAT: A Suggested Method,” classify the types (variants) of VAT under 4 heads:
a) Gross product type where \( \text{Gross VAT} = \text{Consumption} + \text{Investments} + \text{Wages} + \text{Profit} + \text{Depreciation} \);
b) Income type where \( \text{Income VAT} = \text{Consumption} + \text{Investments} - \text{Depreciation} = \text{Wages} + \text{Profit} \);
c) Consumption type where \( \text{Consumption VAT} = \text{Wages} + \text{Profit} + \text{Depreciation} + \text{Investments} \); and
d) Wage type where \( \text{Wage VAT} = \text{Consumption} + \text{Investments} - \text{Depreciation} - \text{Profit} = \text{Net National Income} - \text{Profit} \).

The new tax system benefits the customer in a big way i.e. he would get the product with proper receipt which ensures the quality of the product and that too without any price increase. The government is also benefited. Tax collection would be easy. The possibility of tax evasion would be least. The government would get the estimated tax amount. This will enable the government to carry on the works as per the plan, (Raheel, 2005).

Saha (2005) in his study, “Value Added Tax (VAT): Right Way to Tax Reforms,” concludes that introduction of VAT is a dynamic and right step taken by Government of India for reducing the regressive character of her indirect taxes. It is levied at each stage of production and yet maintains its efficiency properly because full credit is given for the VAT levied on all inputs in production. It has the advantage in counting plagued with tax evasion.

Sharma (2005) in his commentary on “VAT in Store” declares VAT as a long pending reform measure that should have been implemented couple of years ago. The correction of anomaly on the indirect tax front, has been long due as duality of taxation between centre and states has increased the incidence of taxation. Since excise is charged at the time of manufacturing, it is embedded in the sales tax also, as a result of which the same base is taxed twice. VAT will try to correct incongruity since inputs will not be taxed. Under VAT, paid invoices of manufacturers will enable
them to avail of VAT credit and, therefore, will discourage manufacturers and traders resorting to tax evasion at each stage.

Sinha (2005) while deliberating on value added tax accounting, opines that there are a number of methods of computation of value added. The most commonly used methods are additive method and subtractive method. Subtractive method is very popular where bought-in-materials and services are deducted from revenue i.e., sales value.

Bahir (2006) comments on both the positive and negative implications of VAT in India. According to him, the positive implications include reduction in general price level, stoppage of tax rate war, increase in revenue, decline in tax evasion, benefits of lower cost of production to consumers, attraction of foreign investment, increase in exports, etc. The negative implications are increase in the price of goods of basic necessities, variation in the State VAT structure hampering the common national market, increase in the scope of corruption, non-reduction in cascading effect, some provisions creating doubts and fears in the minds of businessmen, etc.

Chanda (2006) made a study on implementation of VAT in India in which he analyzed the benefits of VAT and also took a stock of concerns in relation to implementation of VAT and concluded that VAT removes evasion of tax and checks the cascading effect.

Dutta (2006) in his study “Value Added Tax: Issues and Concerns”, opines that adoption of VAT would not only help in avoiding cascading or pyramiding effect of indirect taxation, but would also help in reduction of tax evasion. It is obvious that VAT is an important step towards the re-structuring of indirect taxation of the country. The study makes an attempt to highlight the different fundamental aspects of VAT and concludes that VAT is a more disciplinary approach in the indirect tax regime.
Gupta (2006) in his study “VAT - Problems and Prosperity” opines that VAT is a burden reducing tax on consumers. It is not a price enhancing system but enhancing the economy. Prices will fall, demand will rise and production will increase. In the study, the author has made a review regarding conceptual analysis with recent developments, computation and the problems of VAT followed by necessary suggestions for its better and effective implementation.

With the introduction of State Level VAT, the challenge before the government is to integrate the Central VAT (CENVAT), Service Tax, General Sales Tax (GST) and other such taxes together (Inigo, 2006). VAT encourages voluntary compliance and thereby simplifies assessment procedures. It eliminates the disputes regarding the rates and reduces the cost of compliance and the cost of administration. It shuts the doors for traders to evade the taxes. The traders are also compelled to maintain proper accounts. The best form of adoption of VAT would be making it a central subject and administered by the Centre like that of income tax and distribution of revenue to the states be based on the percentage of contribution to the exchequer by each of the states or on the basis of each state’s contribution to GDP.

Explaining the concept, types, features and objectives of VAT, Jerinabi and Santhi (2006) in their joint study on traders’ views on VAT in Coimbatore city conclude that traders are not averse to VAT, but the unfamiliarity with the VAT seems to bother them. It would have been more prudent on the part of the government to have allowed a period of transit before the formal-launch of VAT. The study also suggests that VAT should be introduced in all the states compulsorily in order to have a common market in India. The authors opine that transmission of knowledge on VAT to traders will bring about ease in computing procedure, filing of returns and will also result in whole hearted acceptance from the dealers.
Mohanty (2006) believes that the basic objectives of VAT are to supply the commodities to the ultimate consumers at the cheaper prices. Most of the states have accepted VAT as a successful model for fiscal reform. VAT will also help the state governments to implement various development plans and programmes.

Introduction of VAT in India is rather late but a right and transparent step towards reform and rationalization of indirect taxation in the modern context of globalization (Nare - 2006).

In a study titled “VAT: Current Scenario in India”, Padmavathi (2006) highlighted the rationale behind the implementation of VAT, the salient features of the 1st phase of VAT and the present status and the future of VAT in India. While delving deep on the effects of VAT on consumers, companies and revenue of VAT states, the author concludes that implementation of VAT in India is surely an achievement. However, the real achievement for the new regime will be witnessed when rationalization of rates, procedural aspects of systematic provision of tax credit on inputs, removal of competing tax incentives and concessions and the phasing out of CST are successfully provided for in a phased manner. Adoption of VAT in the states so far has given no relief to the consumers and the companies because of spurt in inflation. However, the tax revenue in the VAT states has registered a reasonable growth. The author has also underscored a need for an integrated VAT structure for all goods and services combining the CENVAT, State VAT and all other state level duties.

VAT in India tries to cater to the economic exigencies. It is not a new tax in India. It has been there in the grab of MODVAT. However, with its conceptualization in India, VAT received both bouquets and brick bats (Prasad, 2006). VAT replaces sales tax with uniformity all over India and most importantly to check tax evasion and be consumer friendly. It is a
system in which the citizens will be free in the choice and the operation of their economic life i.e., it is a neutral tax.

The adoption of VAT was a long pending fiscal reform in the indirect system in India. This observation was made by Rodrigues, (2006) in his study entitled, “VAT and New Perspective in Tax Policy for Goa”. The author has made an attempt to study and present a detailed overview of VAT in Goa, compare VAT in Goa with the neighboring states, study and compare the impact of VAT on India and the rest of the world and provide guidance on various aspects of State Level VAT.

Sadar (2006) states that the efficiency of the implementation of VAT in different states in India will definitely depend on effective and sincere administration. There will be a need of co-ordination and co-operation between all the concerned agencies.

VAT is a rational system of tax which prevents the cascading effect of tax, checks tax evasion and augments revenue. VAT is presently in operation in 140 countries and covers almost 75% of world’s population (Sagar and Badade, 2006).

The countries which have switched over to VAT have raised more tax revenue. VAT is one of the most radical reforms that have been proposed for the Indian economy after years of political and economic debate. It is perceived to promote neutrality and uniformity of tax burden and to provide incentives for increased productivity and industrialization. These ideas were expressed by Shollapur and Sunagar (2006) in their study on ‘Managing Transition under VAT: Dealers’ Perspective. The study analyses the dealers’ contention of VAT in Karnataka and the ways and means adopted by them in making a smooth transition to VAT. The study reveals that for the smooth transition, the dealers have underscored the need for further information. Most of the dealers have made necessary preparations for VAT accounting.
Majority of them are filing their returns through professionals. Most of them feel that VAT was introduced at the right time and the rate structure under VAT is reasonable and normal. The study suggests that elaborate arrangements should be made to disseminate information on VAT and for this purpose VAT Information Centre should be opened at each headquarter at least during the transition period.

The success of VAT implementation depends on the stakeholders, viz. the Government, the Traders and the Consumers. In view of the problems faced by the business houses, the application of VAT in this era is really challenging not only for the businessman but also for the state government and the regulatory bodies, (Singh et al., 2006). For the successful implementation of VAT, computerization is very essential at all the levels and VAT compliant software is the need of the hour in order to secure and visualize the transparency among the stakeholders.

Singh (2006) in his attempt to study the rates of VAT and point of levy under the Bihar Value Added Tax Act, 2005 informs that in Bihar VAT is levied under 1% (3 items), 4% (266 items), (12.5% standard rate), 0% (38 items). Basically there are only two rates viz. the standard rate of 12.5% and the lower rate of 4% . VAT is levied on the sale of goods at each stage of sale and the dealer gets deduction of tax at each point of sale.

In their study on “An Evaluation of VAT in Jharkhand”, Sinha et al. (2006) opine that with the introduction of VAT, the multiplicity of taxes like turnover tax, surcharge on sales tax, additional surcharge etc, prevailing under sales tax in several states, will be abolished. In addition, the CST is also going to be abolished. As a result, overall tax burden will be rationalized and prices in general will also fall. The tax structure will become simple and more transparent.

In fact, VAT is the same sales tax in a new form. Both the local sales tax and the VAT aim to tax the event of sales of goods (Thakur et al., 2006).
Vajyalakashmi (2006) while explaining the difference in law on account of availability of value added tax credit and the appropriate accounting treatment for the same, concludes that since VAT on sales is collected on behalf of the authorities, it should not be included as sales but should be credited to a separate account (VAT Payable Account) and treated as Current Liability.

If VAT is properly designed and implemented, it would be an excellent tax instrument which goes a long way in evolving simple revenue neutral and cascading free tax system in the country (Yeole, 2006).

RESEARCH GAP

Successful tax reform efforts require the detailed knowledge of the defects of the current tax system and the possible effects of alternative/substitution tax measures (Thirsk, 1997). It is important to study the basic issues, the need for tax reforms in terms of revenue, economic efficiency and effectiveness in administration. Some of the important issues which need examination include consistency of tax structure with economic and social objectives, global economic requirements and national economic policy.

The preceding literature review reveals that no concrete attempt has been made to appraise the tax system in vogue in the State of Jammu and Kashmir in general and the Value Added Tax System in particular especially after its implementation. The present study is an attempt to fill up this gap. Through a comprehensive appraisal of various aspects of some fiscally significant taxes followed by the appraisal of the perception of stakeholders (Consumers, Dealers and Tax Administrators) in relation to Value Added Tax System regarding its various dimensions ranging from desirability to Structure, price stability and economic welfare, administration, implementation, compliance, neutrality and harmonization, the study is expected to act as a sound empirical base for bringing reforms in the state tax system so far as its design, social and economic effects, administration, implementation and other significant issues are concerned.
REFERENCES


76


Indian Tax Institute (1997): Value Added Tax (With Reference to India), Gujran Wala Town, New Delhi.


84


86


