CHAPTER I

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Tax is a fee charged by a Government on a product, income or activity. If tax is levied directly on personal or corporate income, then it is a direct tax. If tax is levied on the price of a good or service, then it is called an indirect tax. The purpose of taxation is to finance public goods and services, such as street lighting, street cleaning, road, dams, utility services etc. Since public goods and services do not allow a non-payer to be excluded, or allow exclusion by a consumer, there cannot be a market in the goods or services, and so they need to be provided by the Government or a quasi-Government agency, which tend to finance themselves largely through taxes. The word tax is derived from the Latin word ‘taxare’ which means ‘to estimate’.

“A tax is not a voluntary payment or donation, but an enforced contribution, exactly pursuant to legislative authority" and is any contribution imposed by Government whether under the name of toll, tribute, impost, duty, custom, Excise, subsidy, aid, supply, or other name.” (Black’s Law Dictionary)

In India, the tradition of taxation has been in force from ancient times. It finds its references in many ancient books like 'Manu Smriti' and 'Arthasastra'

"A comprehensive VAT widens tax net, as it makes tax evasion difficult. Going by the experience of other countries, VAT has proved beneficial and leads to revenue buoyancy." ¹

"India can be globally competitive as a fully integrated market in the Value Added Tax regime."

- Raja Chelliah, the architect of the VAT system in India.

Introduction of VAT by Indian States has been hailed as one of the biggest tax-reforms in several decades. The Empowered Committee (EC) of State Finance Ministers was the Central body which coordinated the design and implementation of VAT. Currently, all Indian States have implemented VAT and the transition to VAT has been fairly smooth.

¹ World Bank country Director Michael Carter
The main motive of VAT has been the rationalization of overall tax burden and reduction in general price level. Thus, it seeks to help common people, traders, industrialists as well as the Government. It is indeed a move towards more efficiency, equal competition and fairness in the taxation system. The main benefits of implementation of VAT are:-

- Minimizes tax evasion as VAT is imposed on the basis of invoice/bill at each stage, so tax evaded at first stage gets caught at the next stage;
- A set-off is given for input tax as well as tax paid on previous purchases;
- Abolishes multiplicity of taxes, that is, taxes such as turnover tax, surcharge on Sales tax, additional surcharge, etc. are being abolished;
- Replaces the existing system of inspection by a system of built-in self-assessment of VAT liability by the dealers and manufacturers (in terms of submission of returns upon setting off the tax credit);
- Tax structure becomes simpler and more transparent;
- Improves tax compliance;
- Generates higher revenue growth;
- Promotes competitiveness of exports; etc.

1.1 **THE INDIAN CONTEXT**

The White Paper\(^2\) on VAT mentions that ‘VAT is a state subject derived from Entry 54 of the State List, for which States are sovereign in taking decisions’. The Empowered Committee (EC) of State Finance Ministers (created by the Ministry of Finance, Government of India) is the body which drafted the details of VAT through several rounds of consultations and also tried to get the assent of all States for implementation. After missing two\(^3\) previous deadlines of April 1, 2002 and April 1, 2003 (Haryana implemented VAT from April 1, 2003), VAT was finally implemented with effect from April 1, 2005 by all States apart from the five\(^4\) Bharatiya Janata Party (BJP – opposition party at the centre) ruled States of Gujarat, Rajasthan, Madhya Pradesh, Chhattisgarh and Jharkhand and three other States – Uttar Pradesh (UP), Uttarakhand and Tamil Nadu. The decision of the BJP ruled States was political while

\(^2\) A White Paper on State-Level VAT, by The Empowered Committee of State Finance Ministers, January 2005, pp 1
\(^3\) Progress on Issues on VAT implementation, CII, July 2005, pp 1
\(^4\) Ibid
severe resistance by traders was cited as the reason for non-implementation by UP. Uttarakhal’s decision was dictated by that of UP as the former has recently been carved out of the latter. In the case of Tamil Nadu, the reasons included opposition by traders and issues on VAT compensation though the real reason seemed to be the impending state elections in 2006. As of January 1, 2008, VAT has been implemented by all States and Union Territories.

The primary justification for this reform was based on the inherent advantages of VAT over the existing Sales tax regime. This included rationalization of tax burden, reduction in prices, simplification of tax structure, greater transparency, improvement in tax compliance, reduction in inter-state ‘tax-war’ and increase in state Government revenues. Hence, the beneficiaries would include consumers, the business community as well as the Government. The main disadvantages of the existing Sales tax regime are the multiplicity of taxes and the double taxation of commodities resulting into a cascading effect on prices.

One of the important components of tax reforms initiated since liberalization is the introduction of VAT. VAT is a multi-point destination based system of taxation, with tax being levied on value addition at each stage of transaction in the production/distribution chain. The term 'value addition' implies the increase in value of goods and services at each stage of production or transfer of goods and services. VAT is a tax on the final consumption of goods or services and is ultimately borne by the consumer. It is a multi-stage tax with the provision to allow 'Input tax credit (ITC)' on tax at an earlier stage, which can be appropriated against the VAT liability on subsequent sale. This input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax. It is given for all manufacturers and traders for purchase of inputs/supplies meant for sale, irrespective of when these will be utilized or sold. The VAT liability of the dealer/manufacturer is calculated by deducting input tax credit from tax collected on sales during the payment period. If the tax credit exceeds the tax payable on sales in a month, the excess credit will be carried over to the end of next financial year. If there is any excess unadjusted input tax credit at the end of second year, then the same will be eligible for refund. Taxation Departments are carrying out the responsibility of

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5 A White Paper on State-Level VAT, by The Empowered Committee of State Finance Ministers, January 2005 pp 1-5

6 Ibid
levying and collecting VAT in the respective States. While the Central Government is playing the role of a facilitator for the successful implementation of VAT, the Ministry of Finance is the main agency for levying and implementing VAT, both at the Centre and the State level.

The Department of Revenue, under the Ministry of Finance, exercises control in respect of matters relating to all the direct and indirect taxes, through two statutory boards, namely, the Central Board of Direct Taxes (CBDT) and the Central Board of Customs and Central Excise (CBEC). The Sales tax Division, of the Department of Revenue, deals with enactment and amendment of the Sales tax Act; levy of tax on sales in the course of inter-State trade or commerce; levy of VAT; etc. The Central Board of Excise and Customs (CBEC) deals with the tasks of formulation of policy concerning levy and collection of Customs and Central Excise duties, allowing of Central Value added Tax (CENVAT) credit, etc. The decision to implement State level VAT was taken in the meeting of the Empowered Committee (EC) of State Finance Ministers, held on June 18, 2004, where a broad consensus was arrived at to introduce VAT in all States/Union Territories (UTs). The power to levy taxes and duties is distributed among the three tiers of Government, in accordance with the provisions of the Indian Constitution. The main taxes/duties that the Union Government is empowered to levy are: - Income Tax (except tax on agricultural income, which the State Governments can levy), Customs duties, Central Excise and Sales tax and Service Tax. The principal taxes levied by the State Governments are: - Sales tax (tax on intra-State sale of goods), Stamp Duty (duty on transfer of property), State Excise (duty on manufacture of alcohol), Land Revenue (levy on land used for agricultural/non-agricultural purposes), Duty on Entertainment and Tax on Professions and Callings. The Local Bodies are empowered to levy tax on properties (buildings, etc.), Octroi (tax on entry of goods for use/consumption within areas of the Local Bodies), Tax on Markets and Tax/User Charges for utilities like water supply, drainage, etc.

In the wake of economic reforms, the tax system in India has undergone a radical change, in line with the liberal policy. Some of the changes include:- rationalization of tax structure; progressive reduction in peak rates of Customs duty; reduction in corporate tax rate; Customs duties to be aligned with ASEAN levels; introduction of value added tax; widening of the tax base; tax laws have been
simplified to ensure better compliance. Tax policy in India provides tax holidays in the form of concessions for various types of investments. These include incentives to priority sectors and to industries located in special area/regions. Tax incentives are available also for those engaged in development of infrastructure.

The authority to levy a tax is derived from the Constitution of India which allocates the power to levy various taxes between the Centre and the State. An important restriction on this power is Article 265 of the Constitution which States that "No tax shall be levied or collected except by the authority of law". Therefore each tax levied or collected has to be backed by an accompanying law, passed either by the Parliament or the State Legislature.

1.2 CONSTITUTIONAL PROVISION

- Union list (only Central Government has power of legislation).
- State list (only State Government has power of legislation).
- Concurrent list (both Central and state Government can pass legislation).

Article 265-Constitution stresses that no service tax in India shall be charged or collected other than by the concerned authority.

Article 268–Duties levied by the Union but collected and appropriated by the States:

- Stamp duties and such other duties of Excise on medicinal and toilet preparations as are mentioned in the Union List shall be levied by the Government of India but shall be collected
  - in the case where such duties are leviable within any Union territory, by the Government of India, and
  - in other cases, by the States within which such duties are respectively leviable.
- The proceeds in any financial year of any such duty leviable within any State shall not form part of the Consolidated Fund of India, but shall be assigned to that State.

Article 269 Taxes levied and collected by the Union but assigned to the States

- Taxes on the sale or purchase of goods and taxes on the consignment of goods shall be levied and collected by the Government of India but shall be assigned
and deemed to have been assigned to the States on or after the 1st day of April, 1996 in the manner provided in clause (2) by law.

**Article 270** Taxes levied and collected by the Union and distributed between the Union and the States:

- Taxes on income other than agricultural income shall be levied and collected by the Government of India and distributed between the Union and the States in the manner provided in clause (2).

**Article 271** Surcharge on certain duties and taxes for purposes of the Union

- Notwithstanding anything in articles 269 and 270, Parliament may at any time increase any of the duties or taxes referred to in those articles by a surcharge for purposes of the Union and the whole proceeds of any such surcharge shall form part of the Consolidated Fund of India.

**Article 272** Taxes which are levied and collected by the Union and may be distributed between the Union and the States- Repealed by the eightieth Constitution amendment Act

- Union duties of Excise other than such duties of Excise on medicinal and toilet preparations as are mentioned in the Union List shall be levied and collected by the Government of India, but, if Parliament by law so provides, there shall be paid out of the Consolidated Fund of India to the States to which the law imposing the duty extends sums equivalent to the whole or any part of the net proceeds of that duty, and those sums shall be distributed among those States in accordance with such principles of distribution as may be formulated by such law.

In India's prevalent Sales tax structure, there has been a problem of double taxation of commodities and multiplicity of taxes, resulting in a cascading tax burden. For instance, in this structure, before a commodity is produced, inputs are first taxed, and then after the commodity is produced with input tax load, output is taxed again. This causes an unfair double taxation with cascading effects. Hence, the VAT has been introduced to replace such Sales tax structure. Moreover, it seeks to phase out the Central Sales tax (CST) and several efforts are being made in this regard.
At the Central level, there is Central Value Added Tax (CENVAT) which pertains to the rationalization of Central Excise duty structure in India. At present, there is a uniform rate of CENVAT of 16 per cent on most of the inputs and final products. The CENVAT has been introduced to end all the disputes that were taking place due to classification of various types of inputs as rates were different on different varieties. Accordingly, the CENVAT Credit Rules have been notified and amended, from time to time, which are as follows:-

- The CENVAT Credit Rules, 2001
- The CENVAT Credit Rules, 2002
- The CENVAT Credit Rules, 2004

Under these, a manufacturer or producer of final products and a provider of output service is allowed to take credit (known as CENVAT credit) of the duty of Excise, as mentioned in the Rules, paid on specified inputs and capital goods used in or in relation to the manufacture of specified final products. The CENVAT credit so allowed can be utilized for payment of: - (i) any duty of Excise on any final product; or (ii) an amount equal to CENVAT credit taken on inputs, if such inputs are removed as such or after being partially processed; or (iii) an amount equal to the CENVAT credit taken on capital goods, if such capital goods are removed as such; or (iv) service tax on any output service, as per the conditions laid down in the rules. It was proposed to reduce the general CENVAT rate on all goods from 16 per cent to 14 per cent in order to give a stimulus to the manufacturing sector.

At the State level, the Empowered Committee of State Finance Ministers have finalized a design of VAT to be adopted by all the States/UTs. This basic design of VAT remained as the essential features of VAT and kept common for all the States/UTs, like, the rates of VAT on various commodities are kept uniform for all. At the same time, it provides a measure of flexibility to the States/UTs so as to enable them to meet their local requirements.

At present, there are two basic rates of VAT, namely, 4 per cent and 12.5 per cent, besides an exempt category and a special rate of 1 per cent and zero rates for a few selected items. The items of basic necessities and goods of local importance (up to 10 items) have been put in the zero rate brackets. Gold, silver and precious stones have been put in the 1 per cent schedule. There is also a category with 20 per cent
floor rate of tax, but the commodities listed in this schedule are not eligible for input tax rebate/set off. This category covers items like motor spirit (petrol, diesel and aviation turbine fuel), liquor, etc.

Haryana became the first State in the country to introduce Value Added Tax in 2003. Till 2007, VAT has been introduced by all States/UTs, including Tamil Nadu (implemented VAT from January 1, 2007) and the UT of Puducherry (implemented VAT from April 1, 2007).

Over the years, the experience of implementing VAT in India has been very encouraging, with the Empowered Committee constantly reviewing the progress of implementation. The revenue performance of VAT-implementing States/UTs has also been very significant. During 2006-07, the tax revenue of the 31 VAT States/UTs had collectively registered a growth rate of about 21 per cent over the tax revenue of 2005-06. During 2007-08, the tax revenue of 32 VAT States/UTs showed a further growth of 14.6 per cent during the first six months of 2007-08 (April-September) as compared to the corresponding period of previous years.

1.2.1 Revenue Receipts of the State Governments

The adoption of State-level VAT has been one of the major tax reforms undertaken by State Governments. VAT is the most important tax revenue for States, contributing more than one-half of their own tax receipts. Not withstanding the slowdown, VAT Receipts as a per cent of OTR (own tax revenue) increased in the case of 9 non-special category States in 2009-10 (Revised Estimate). Andhra Pradesh registered the highest VAT receipts-GSDP (VAT-OTR) ratio of 6.2 per cent, followed by Kerala (5.8 per cent) and Tamil Nadu (5.4 per cent). In 2010-11 (Budgeted Estimates), ten non-special category States are expected to record higher VAT-OTR ratios, reflecting better growth prospects. The proposal to implement GST to replace VAT, along with some other indirect taxes, is still under discussion, but when implemented it would simplify the system of taxation, improve efficiency and increase tax buoyancy and compliance. Among special category States, six States recorded lower VAT-OTR ratios in 2008-09. In 2009-10 (Revised Estimates), five special category States, viz, Arunachal Pradesh, Jammu and Kashmir, Manipur, Tripura and Uttarakhand, recorded lower VAT-Own Tax Revenue ratios. In 2009-10 (RE), Manipur recorded the highest VAT-OTR ratios at 82.7 per cent, followed by Arunachal Pradesh and
Nagaland. In terms of GSDP, VAT collections were highest in Jammu and Kashmir and lowest in Nagaland in 2009-10 (RE) among the special category States. While Jammu and Kashmir continues to be at the top in terms of VAT-GSDP ratio in 2010-11 (BE), Mizoram was at the bottom.

Finance in most States remained under stress during 2008-09 and 2009-10. In 2008-09, revenue account was impacted across 19 States largely due to the upward revision of salaries in a few States and the impact of a slowdown on own tax and non-tax collections. Poor Central tax collections also let to lower tax devolutions as a ratio of GSDP across 26 States, albeit partly compensated through higher grants from the centre. Deterioration in revenue account was evident in higher GFD-GSDP ratios across the majority of States in 2008-09. None the less with the fiscal headroom generated in previous years, 21 States could continue to achieve revenue surplus in 2008-09. The re-emergence of a revenue deficit after three years and higher capital outlay led to a higher GFD-GSDP ratio across States in 2009-10. A noticeable point is that two States with chronic revenue deficits, viz., Kerala and Punjab, recorded marginal improvements in revenue account in 2008-09 and 2009-10 is shown in Table 1.1.
### Table: 1.1

Revenue Receipts of the State Governments

<table>
<thead>
<tr>
<th>State</th>
<th>2005-08 (Avg.) <em>(Budgeted Estimates)</em></th>
<th>2008-09 (Revised Estimates)</th>
</tr>
</thead>
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<tr>
<td></td>
<td>RR/ GSDP</td>
<td>OTR/ GSDP</td>
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<tr>
<td><strong>I. Non-Special Category</strong></td>
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<tr>
<td>1. Andhra Pradesh</td>
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<td>8.5</td>
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<td>2. Bihar</td>
<td>23.4</td>
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<td>3. Chhattisgarh</td>
<td>17.5</td>
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</tr>
<tr>
<td>4. Goa</td>
<td>16.9</td>
<td>8.2</td>
</tr>
<tr>
<td>5. Gujarat</td>
<td>11.5</td>
<td>7.1</td>
</tr>
<tr>
<td>6. Haryana</td>
<td>13.2</td>
<td>8.2</td>
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<td>7. Jharkhand</td>
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<td>5.1</td>
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<td>8. Karnataka</td>
<td>17.3</td>
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<td>9. Kerala</td>
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<td>10. Madhya Pradesh</td>
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<td>12. Orissa</td>
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<td>13. Punjab</td>
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<td>3. Himachal Pradesh</td>
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<td>4. Jammu and Kashmir</td>
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</table>

**Memo Item:**

1. NCT Delhi            | 10.1     | 8.2      | 1.2       | 0.6     | 9.9      | 7.3      | 1.4       | 1.1     |
2. Puducherry           | 24.0     | 6.9      | 6.9       | 10.1    | 20.9     | 6.2      | 5.3       | 9.4     |

**Source:** Based on Budget Documents of Various States, Commercial Tax Department.
### Table: 1.1

**Revenue Receipts of the State Governments (Continued)**

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<th>State</th>
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<th>2010-11 (BE)</th>
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<td>OTR/ GSDP</td>
<td>ONTR/ GSDP</td>
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<td>6.8</td>
<td>1.8</td>
</tr>
<tr>
<td>2. Puducherry</td>
<td>22.0</td>
<td>6.9</td>
<td>5.1</td>
</tr>
</tbody>
</table>

RR: Revenue Receipts  OTR: Own Tax Revenue  #: Data for All States are as per cent to GDP
ONTR: Own Non-Tax Revenue.  CT: Current Transfers.

Source: Based on Budget Documents of the State Governments, Commercial Tax Department.
### Table: 1.2

**Tax Revenue**

<table>
<thead>
<tr>
<th>State</th>
<th>2008-09 (Accounts)</th>
<th>2009-10 (Revised Estimates)</th>
<th>2010-11 (Budget Estimates)</th>
<th>Tax Revenue/All States' Tax Revenue (Per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td><strong>I. Non-Special Category</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Andhra Pradesh</td>
<td>45,160</td>
<td>52,773</td>
<td>61,504</td>
<td>9.4</td>
</tr>
<tr>
<td>2. Bihar</td>
<td>23,865</td>
<td>26,295</td>
<td>34,244</td>
<td>4.9</td>
</tr>
<tr>
<td>3. Chhattisgarh</td>
<td>10,852</td>
<td>11,061</td>
<td>12,311</td>
<td>2.2</td>
</tr>
<tr>
<td>4. Goa</td>
<td>2,109</td>
<td>2,333</td>
<td>2,775</td>
<td>0.4</td>
</tr>
<tr>
<td>5. Gujarat</td>
<td>29,283</td>
<td>32,529</td>
<td>36,861</td>
<td>6.1</td>
</tr>
<tr>
<td>6. Haryana</td>
<td>13,380</td>
<td>15,967</td>
<td>18,663</td>
<td>2.8</td>
</tr>
<tr>
<td>7. Jharkhand</td>
<td>11,108</td>
<td>11,324</td>
<td>12,307</td>
<td>2.3</td>
</tr>
<tr>
<td>8. Karnataka</td>
<td>34,799</td>
<td>36,339</td>
<td>45,288</td>
<td>7.2</td>
</tr>
<tr>
<td>9. Kerala</td>
<td>20,266</td>
<td>21,791</td>
<td>25,710</td>
<td>4.2</td>
</tr>
<tr>
<td>10. Madhya Pradesh</td>
<td>24,381</td>
<td>28,489</td>
<td>29,718</td>
<td>5.0</td>
</tr>
<tr>
<td>11. Maharashtra</td>
<td>60,048</td>
<td>63,959</td>
<td>74,722</td>
<td>12.4</td>
</tr>
<tr>
<td>12. Orissa</td>
<td>16,275</td>
<td>17,416</td>
<td>20,364</td>
<td>3.4</td>
</tr>
<tr>
<td>13. Punjab</td>
<td>13,234</td>
<td>16,384</td>
<td>19,216</td>
<td>2.7</td>
</tr>
<tr>
<td>14. Rajasthan</td>
<td>23,942</td>
<td>25,921</td>
<td>31,273</td>
<td>5.0</td>
</tr>
<tr>
<td>15. Tamil Nadu</td>
<td>42,195</td>
<td>44,154</td>
<td>51,840</td>
<td>8.7</td>
</tr>
<tr>
<td>16. Uttar Pradesh</td>
<td>59,565</td>
<td>66,967</td>
<td>77,823</td>
<td>12.3</td>
</tr>
<tr>
<td>17. West Bengal</td>
<td>25,741</td>
<td>28,567</td>
<td>35,214</td>
<td>5.3</td>
</tr>
<tr>
<td><strong>II. Special Category</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Arunachal Pradesh</td>
<td>598</td>
<td>601</td>
<td>830</td>
<td>0.1</td>
</tr>
<tr>
<td>2. Assam</td>
<td>9,340</td>
<td>9,880</td>
<td>12,570</td>
<td>1.9</td>
</tr>
<tr>
<td>3. Himachal Pradesh</td>
<td>3,080</td>
<td>3,463</td>
<td>4,590</td>
<td>0.1</td>
</tr>
<tr>
<td>4. Jammu and Kashmir</td>
<td>4,746</td>
<td>4,955</td>
<td>6,416</td>
<td>1.0</td>
</tr>
<tr>
<td>5. Manipur</td>
<td>751</td>
<td>801</td>
<td>1,233</td>
<td>0.2</td>
</tr>
<tr>
<td>6. Meghalaya</td>
<td>965</td>
<td>1,040</td>
<td>1,316</td>
<td>0.2</td>
</tr>
<tr>
<td>7. Mizoram</td>
<td>478</td>
<td>510</td>
<td>681</td>
<td>0.1</td>
</tr>
<tr>
<td>8. Nagaland</td>
<td>578</td>
<td>589</td>
<td>860</td>
<td>0.1</td>
</tr>
<tr>
<td>9. Sikkim</td>
<td>563</td>
<td>558</td>
<td>712</td>
<td>0.1</td>
</tr>
<tr>
<td>10. Tripura</td>
<td>1,129</td>
<td>1,264</td>
<td>1,736</td>
<td>0.2</td>
</tr>
<tr>
<td>11. Uttarakhand</td>
<td>4,552</td>
<td>5,075</td>
<td>6,369</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>All States</strong></td>
<td>4,82,983</td>
<td>5,31,004</td>
<td>6,27,147</td>
<td>100.0</td>
</tr>
<tr>
<td><strong>Memo Item:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. NCT Delhi</td>
<td>12,181</td>
<td>13,174</td>
<td>15,583</td>
<td>-</td>
</tr>
</tbody>
</table>

*Source: RBI Bulletin 2010-11. State Finances: A study of Budget 2010-11 Pg: 46*

From the above Table 1.2 the percentage revenue to tax revenue to the total state revenue is highest in Maharashtra and Uttar Pradesh and lowest in Goa among the Non-special category. It is highest in Assam and lowest in Arunachal Pradesh in special category states.
1.2.2 Major Milestones in Indirect Tax Reforms

1974 - Report of LK Jha Committee suggested VAT
1986 - Introduction of a restricted VAT called MODVAT
1991 - Report of the Chelliah Committee

1.2.3 VAT/Goods & Services tax (GST) and recommendations accepted by government

1994 - Introduction of Service Tax
1999 - Formation of Empowered Committee on State VAT
2000 - Implementation of uniform floor Sales tax rates (1%, 4%, 8% & 12%) Abolition of tax related incentives granted by the States
2003 - VAT implemented in Haryana in April, 2003
2004 - Significant progress towards a Central VAT
2005-06 - VAT implemented in 26 more States
2007 - First GST Study Released By Mr.P.Shome in Jan
2007 - FM announces for GST in Budget Speech
2007 - CST Phase out Starts in April 2007
2007 - Joint Working group formed by EC in May 2007
2007 - WG Submits its report in November 2007
2008 - EC finalizes its view on GST structure in April 2008
2009 - GST proposed to be implemented from 1.4.2012

1.3 TRANSITION FROM VAT TO GST

The existing VAT is a major improvement over the Sales tax regime that existed at the state level before VAT was introduced. Similarly, the existing CENVAT (Central VAT) regime at the national level was also an improvement over the Central Excise duty.

In the Sales tax regime, there was the burden of tax cascading or tax-on-tax. For e.g., producers have to pay tax on their inputs for which tax had already been

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7 Progress on issues on VAT implementation, CII, 2005 and State VAT Laws
paid. Also there was a problem of multi-point Sales tax in several States. When the producer sold goods to a wholesaler tax was levied. When the wholesaler sold such goods, on which he had already paid tax to a retailer, tax was again levied and so on, a sequence of tax-on-tax or a cascade. After the implementation of VAT, set-off was allowed for the tax paid on inputs and for the distribution channel. Set off was allowed for any tax paid by the previous seller.

In VAT system, set-off was allowed for CENVAT, which was levied when goods move from the Central tax to State tax. Secondly, there were several other indirect taxes such as luxury tax, entertainment tax, which were not subsumed in VAT. Thirdly, services were taxed separately, where it needs a separate Act for its implementation. There is no set off allowed for the tax paid on services. Numerous other Central taxes such as Central Excise duty, Customs duty were not subsumed in VAT, and finally CST was phased out.

1.4 NEED FOR THE STUDY

VAT has been implemented in good spirit. The Centre has started to compensate the States for their revenue losses. It was really tough for the Centre to implement VAT in different States as most of the States were purely dependent on the grants from the Centre. Though, there were opposition from many State Governments, it was possible for the Centre to implement VAT. VAT is a step towards the implementation of GST. GST is a comprehensive structure of both goods and services. It is perceived by the general public that VAT is necessary to curb tax evasion and to contribute to the National exchequer sizeable revenue. This study analyzes the main reason for tax-evasion by the traders, and the general public on VAT system. VAT compels the traders to maintain books of accounts and regular filing of returns. In this scenario, it is necessary to know the extent of difficulties undergone due to the implementation of VAT. Puducherry being a small State depends on the Centre for its main source of revenue. It has to generate more revenue out of its own resources. So, it necessary to know how the revenue of this State has increased or decreased due to the implementation of VAT. This study reviews the administrative difficulties of the tax department undergoes in administering VAT and its preparedness and expectations under the proposed GST. Also, study attempts to know the expectations of the traders in the forthcoming GST scenario. More than 150 countries in the world have been
experiencing the VAT/GST regime. India is now moving towards GST to be rolled out in April/Oct 2012. Hence, this study is very relevant in India in the especially Puducherry context of transition from erstwhile tax regime to VAT and further GST.

1.5 SCOPE OF THE STUDY

The study was conducted to analyze the effectiveness of implementing VAT. It covered the opinions of the professionals, traders, manufacturers and the general public, consumers. It brought to light the beneficial impacts of VAT. This study emphasizes the reason for transition from VAT to GST. This study was conducted with regard to the State of Puducherry which includes Karaikal, Mahe and Yanam regions.

1.6 SIGNIFICANCE OF THE STUDY

VAT is the most important tax revenue for States, contributing more than one-half of their own tax receipts. It is expected to bring down the incidence of harassment and corruption that trade and industry encounter. The introduction of VAT has brought great apprehensions in the minds of many and the same will be passed on to the consumers. There was fear among the contributors of tax that the cost of goods might go up, harassment would be more and so on. VAT was introduced in Puducherry in the year 2007. The VAT will not provide full set off for input tax but also abolish the burden of several existing taxes viz, turnover tax, surcharge on Sales tax, additional surcharge, special additional tax etc. The State level VAT will be self-policing, improving tax compliance and reducing prices and all these will increase tax buoyancy This study is an attempt to examine the pre and post VAT regime and, the pros and cons of old as well as the new system. It is very important in this context to find out the possibility, practicability and prospects and constraints of the transition from VAT to GST (Goods and Service tax). This study is very relevant in the context of the administration of VAT in India with special reference to Puducherry State. Puducherry is being a Union Territory with little scene for increasing tax revenues which hitherto setting more of Central funds. Now, the State is forced to raise more funds (OTRs) to get an equated Central fund. Hence this study assumes greater significance.
1.7 STATEMENT OF THE PROBLEM

MODVAT was implemented in India with effect from 01-03-1986 on selective goods and gradually, it had been extended to all commodities in the name of CENVAT from April 2002. Services were also included with CENVAT from 2004-05. By replacing Sales tax, VAT was introduced in the States from 01-04-2003 (Haryana 01-04-2003). Almost all the States in India have implemented VAT and encountered with administrative difficulties in implementing VAT. The implementation of any levy in any country for that matter requires careful study of the existing financial system. Likewise, at the time of introducing VAT in India faced lot of hurdles, implementation bottlenecks, pitfalls in collection and so forth. The generation of VAT revenue signifies sizeable portion to the nation exchequer. This augmentation is from the sectors of services, goods, consumables, components and raw materials.

Amidst this background the present research work is carried out to have an inquisitive look into the following matters namely, implementation hurdles as faced by traders regarding the VAT, system and implementation and elicitation of opinion from the general public regarding the system of VAT and administration of Puducherry. Puducherry constitutes four divisions namely Puducherry, Karaikal, Mahe and Yanam. The population of the State is more than 12 lakhs.

1.8 OBJECTIVES OF THE STUDY

The present study is carried out with the following objectives:

- To study various aspects of VAT system in India and to analyze the aspects of VAT system in developed countries.
- To examine responses from the experts regarding implementation and administration of VAT in Puducherry State.
- To elicit the opinion of traders (business men) relating to their perception about VAT in Puducherry State.
- To evaluate the opinion of General Public regarding the VAT in Puducherry State.
- To analyze the current Sales tax form and its impact in the administration of VAT.
• To study the problems and prospects of administration of the proposed Goods and Services Tax in the years to come.
• To suggest suitable measures for better administration and recovery of service tax in India and in particular the State of Puducherry.

1.9 HYPOTHESES

• There is no significant difference between trade registration and trader characteristics (H01).
• There is no significant difference between regular filing of tax returns and trader characteristics (H02).
• There is no significant difference in the problem faced in the present VAT system between regulated and unregulated traders (H03).
• There is no significant difference in the problem faced in the present VAT system between proprietorship and partnership trading concerns (H04).
• There is no significant difference between problem faced in the present VAT system and experience of the trader (H05).
• There is no significant difference between problem faced in the present VAT system and business turnover (H06).
• There is no significant difference between problem faced in the present VAT system among wholesaler, retailers and manufacturers (H07).
• There is no significant difference between problem faced in the present VAT system and method of taxing (H08).

1.10 PERIOD OF THE STUDY

The various factors involved in the implementation and administration of VAT is analyzed and compared during the period 2002-2010.

1.11 RESEARCH METHODOLOGY

This study is intended to identify the present status of VAT, and the main reasons for switching over to GST. The study is descriptive in nature, based on simple random method. The primary data was collected from the respondents (Traders, General public and Experts) about the perception of the present VAT system and their expectations in the forth coming GST. The Interview Schedule has been formulated
and administered accordingly. The Secondary data was collected through reputed Journals, Newspapers, Books, Websites, published and unpublished records of the Commercial Taxes Department of Puducherry. This study brings out suggestions and inferences drawn from the analysis of both primary and secondary data.

1.1.1 Pilot study and pre-testing

A preliminary investigation was undertaken by contacting 30 respondents to identify the important variables regarding the implementation and administration of VAT. The purpose of the pilot study was to test the quality of the items in the interview schedule and to confirm the feasibility of the study. This investigation was conducted in different parts of Puducherry. The test was used to determine the reliability of the data collected. The test called Cronbach’s Alpha coefficient, which is generally used in the research circle for ascertain the reliability and validity of the scale items, which is obtained from the analysis. The value for this coefficient ranges between 0 and 1. It is found from the study that the Cronbach alpha value is 0.902 and is statistically significant at 5 per cent level.

1.1.2 Main Study

Primary Data Collection

The necessary primary data having dealt under various chapters of data analysis which have been collected through interview schedule administered to Experts, Business men and General public.

Experts: The term ‘experts’ here include professional and administrators who are dealing with VAT operations, compliance, procedures and formalities etc. Out of the 55 experts contacted, 36 were practicing Chartered Accountants and the remaining were administrators.

Businessmen: Here refers to ‘Traders’. It includes wholesalers, retailers and manufacturers. In Puducherry State, 195 traders have been contacted by the researcher through the interview schedule. These traders deal in industrial goods, consumer goods, essential goods and other goods.

General Public: This includes public both from urban and rural areas. Sample size is 107.
1.12 STATISTICAL TOOLS

Various tools were used to test the fairness of the present study. The following are:

- Kruskal Wallis ANOVA
- Mann Whitney U test
- Canonical correlation
- Factor Analysis
- One way ANOVA (F-test)
- t-test
- Friedman ANOVA and Kendall’s Coefficient of Concordance

1.12.1 Statistical technique

The primary data collected from respondents comprising administrators of tax system, professionals (tax consultants), traders and general public are subjected to various statistical analysis from Descriptive, Non-parametric Kruskal Wallis ANOVA and Mann Whitney U test along with cross tabulation analysis to Multivariate technique like Canonical correlation, Factor analysis and Multiple regression analysis. Apart from the above two tests, parametric tests such as One-Way ANOVA for comparing mean perception scores of more than two groups and t-test for comparing the mean perception scores between private and public sector employees are also used in the present study. Also, another non-parametric test called Friedman ANOVA and Kendall’s Coefficient of Concordance is adopted to analyze the data in the rank form. The details of the statistical tools are mentioned hereunder.

**Mean (\( \bar{X} \)):** \( \bar{X} = \frac{\sum X_i}{n} \) Where, \( X_i \) is opinion score of respondent ‘i’ and ‘n’ is number of observations (respondents)

**Standard Deviation (\( \sigma \)):** \( \sigma = \sqrt{\frac{\sum X_i^2}{n} - (\bar{X})^2} \) Where, \( X_i \) is opinion score of respondent ‘i’, ‘n’ is number of observations (respondents) and \( \bar{X} \) is mean score.

**Cross Tabulation and Percentage Distribution:** The cross tabulation or contingency Table analysis is used to determine if there is a pattern or relationship between the respondents’ socio-personal characteristics and various aspects associated
with the implementation of VAT system. The percentages are calculated to compare the relative frequency of each level of opinion across the categorical variables.

**Mann-Whitney Test:** The Mann-Whitney test is used when there are two groups (say, an experimental group and a control group) on which a measurement has been made that results in scores which can, at least, be ranked, or ordered. The Mann-Whitney procedure calculates a value of a statistic called ‘U’. The Mann-Whitney U ranks all the cases from the lowest to the highest score. The "Mean Rank" is the mean of those ranks for each group and the Sum of Ranks is the sum of those ranks for each group. U1 is defined as the number of times that a score from group 1 is lower in rank than a score from group 2. U2 is defined as the number of times that a score from group 2 is lower in rank that a score from group 1. U is defined as the smaller of U1 or U2. The computational formulas for U1 and U2 are as follows:

\[
U1 = n1n2 + (n1 (n1 + 1))/2 - R1
\]
\[
U2 = n1n2 + (n2 (n2 + 1))/2 - R2
\]

Where, 
- \(n1\) = number of observations in group 1
- \(n2\) = number of observations in group 2
- \(R1\) = sum of ranks assigned to group 1
- \(R2\) = sum of ranks assigned to group 2

In this example U1 is the smaller and hence, it is U, Mann Whitney test statistic.

**The Kruskal-Wallis test:** The Kruskal Wallis test, sometimes called an H test, is an alternative procedure to a one-way ANOVA. The Kruskal-Wallis test assumes that the population variances are equal. Unlike an ANOVA test, the Kruskal-Wallis nonparametric alternative can be used with ordinal or ranked data. The Kruskal Wallis test calculates ‘H’ value as test statistics. In order to calculate H value using Kruskal Wallis test, first to place the combined observations, \(y_{ij}\), into order of magnitude and replace with their ranks, \(R_{ij}\). Then calculate the sum of the ranks for the responses to each treatment, \(R_i\) and then calculate H using the following formula:

\[
H = \frac{1}{S^2} \left[ \sum_{i=1}^{a} \frac{R_{i i}^2}{n_i} - \frac{N(N + 1)^2}{4} \right]
\]
Where \( S_2 = \frac{1}{N-1} \left[ \sum_{i=1}^{n} \sum_{j=1}^{n} R_{ij}^2 - \frac{N(N+1)^2}{4} \right] \)

\( N = \) Number of total observations.

**‘t’ Test:** This test is used to determine the significant difference in mean perception scores between two respondent groups by socio-economic characteristics such as sex, marital status, etc. The formula for calculating the ‘t’ value is:

\[
t = \frac{\bar{X}_1 - \bar{X}_2}{\sqrt{\left( \frac{\sigma_1^2}{n_1} + \frac{\sigma_2^2}{n_2} \right)}}
\]

Where,

\( \bar{X}_1 = \) Mean of the group 1

\( \bar{X}_2 = \) Mean of the group 2

\( \sigma_1^2 = \) Variance of the group 1

\( \sigma_2^2 = \) Variance of the group 2

\( n_1 = \) Size of the Group 1

\( n_2 = \) Size of the Group 2

**F test:** The F test, i.e., One Way Analysis of Variance is used to ascertain statistical significance of the difference in mean perception among three groups or more based on socio-economic characteristics such as age, education, income level, etc. The formula for calculating ratio of variance or simply ‘F’ is

\[
F = \frac{S_B^2}{S_W^2}
\]

Where,

\( F = \) Ratio of variance (F Value)

\( S_B^2 = \) Between group variance

\( S_W^2 = \) Within group variance

**Friedman ANOVA and Kendall’s Coefficient of Concordance:** This test is for ranking data used to identify the similarities among the respondent groups in ranking
the items. Evaluating the extent of similarity in ranking the items is mandatory to arrive at irrefutable conclusion about the preferred item(s) among the group of items related to the aspect. The Kendall’s coefficient of concordance, also called Kendall’s W, ranges between 0.0 and 1.0 with 0.0 for perfect dissimilarity and 1.0 for perfect similarity. The statistical significance of the Kendall’s W is ascertained by using Friedman ANOVA chi-square value.

**Canonical Correlation:** The association between the perceived status of VAT’s role and importance as well as tax patterns and respondents’ socio-economic characteristics, the canonical correlation analysis is undertaken. The Canonical correlation is similar to multiple regression analysis, but the goal of the canonical correlation analysis is to quantify the strength of the relationship between the two sets of variables (criterion or dependent and predictor or independent). This statistical technique is used here for determining the magnitude of the relationships that may exist between the respondents’ perception about VAT’s role and importance and their socio-economic conditions. The canonical correlation analysis is very much useful in explaining the nature of whatever relationships exist between the set of criterion variables (VAT’s role and importance) and set of predictor variables (socio-economic status), generally by measuring the relative contribution of each variable to the canonical functions (correlation between two sets) that are extracted. The first step of canonical correlation analysis is to derive one or more canonical functions. Each function consists of a pair of variates, one representing the independent variables and the other representing the dependent variables. The maximum number of canonical variates (functions) that can be extracted from the sets of variables equals the number of variables in the smallest data set, independent or dependent. The strength of the relationship between the pairs of variates is reflected by the canonical correlation. When squared, the canonical correlation represents the amount of variance in one canonical variate accounted for by the other canonical variate. This is the amount of shared variance between the two canonical variates. Squared canonical correlations are also called canonical roots or eigenvalues. The most common practice is to analyze functions whose canonical correlation coefficients are statistically significant beyond some level, typically .05 or above. If other independent functions are deemed insignificant, these relationships among the variables are not interpreted. The significant canonical functions with very low canonical correlation (much less than 0.30) are also not considered for making inference.
**Factor Analysis:** Factor analysis is used to identify the dimensions underlying the nature of VAT. The method of factor analysis used here is the principal component method of factor analysis with Varimax rotation. The Varimax rotation is an orthogonal rotation of the factor axes to maximize the variance of the squared loadings of a factor (column) on all the variables (rows) in a factor matrix, which has the effect of differentiating the original variables by extracted factor. Each factor will tend to have either large or small loading of any particular variable. A varimax solution yields results which make it as easy as possible to identify each variable with a single factor. This is the most common rotation option. The Rotation actually helps to make the output more understandable and is usually necessary to facilitate the interpretation of factors. The underlying major dimensions of VAT extracted from Factor analysis are used in further analysis after christening a suitable name to them. The scores of the items with high loadings with each factor are averaged and average scores are used in subsequent analysis.

### 1.13 LIMITATIONS

- The inherent weakness of primary source of data applies to this research study only.
- The inadequate knowledge of the respondents about VAT policies, procedures and methods likely to affect the response of general public.
- The samples and the data collection are based on the willingness and reactions of the respondents.
- The process of administration of VAT is an ongoing process and the inference and conclusions based on collected information may not reflect the future course of action.
- As the reforms are continuous in nature, the findings of the study in the right of evaluation of data may change from time to time.

### 1.14 CHAPTERISATION

The objective of the study is to provide some of the findings and evidences for the implementation of VAT and a transition to GST. The chapters of the study are classified as follows:

CHAPTER 1 captioned “Introduction and design of the study”–presents the statement of the problem, scope of the study, significance of the study, objectives of the study, methodology, limitations of the study and classifications of Chapter. Review of
literature reviews the entire gathering and empirical research associated with the implementation and administration of VAT.

CHAPTER 2 entitled “VAT-A conceptual framework”, explains in brief the genesis of indirect taxes, their reforms and, A white paper on State level- VAT. It deals with the snapshot of the Puducherry State and the working of VAT in this State.

CHAPTER 3 titled “GST–An Global Experience” gives a brief idea about GST in India and other foreign countries. It discusses the features of different models of GST practiced in various countries and gives a suggestive model for India.

CHAPTER 4 captioned “Data Analysis I–Opinion of Experts” brings a view about the professionals and administrators who are directly connected to the implementation and administration of VAT. Both their views were compared to find out the significant difference in their perception about VAT.

CHAPTER 5 entitled “Data Analysis II–Opinion of Traders” narrates the perception about the VAT by traders. The traders were classified into regulated and unregulated for the study. Various statistical tools were applied to find out the significant difference between the traders and their trade characteristics.

CHAPTER 6 titled “Data Analysis III–Opinion of General Public” depicts a view of the general public about the reasons for its implementation and the significance it plays to the nation to increase its revenue. Their expectation for a better model of tax is studied under this chapter.

CHAPTER 7 entitled “Findings, Suggestions and Conclusions” presents the brief summary of Findings of the Study, suggestions for future research avenues and conclusion.
1.15 REVIEW OF LITERATURE

M. GOVINDA RAO\(^8\) (2000) in his article entitled “Tax reform in India: achievements and challenges” throws light on major changes in tax systems in several countries over the last two decades for a variety of reasons. The objective of this paper is to analyze the evolution of the tax system in India since the early 1990s. This paper describes and assesses the introduction of new forms of direct and indirect taxes, their revenue and equity implications and the successes achieved in their implementation. The paper concludes that after eight years of reform improving the tax system remains a major challenge in India.

OLAOYE CLEMENT OLATUNJI\(^9\) (2009) in his article entitled “A Review of Value Added Tax (VAT): Administration in Nigeria” discussed as a result of the uncommon nature of VAT system, majority of the populace in the country are unaware of its existence, consequently, the low credibility of government makes people scorn the payment and collection of VAT. The purpose of this study is to review the effectiveness of the administration of VAT as it relates to how it can improve government revenue and through more light on its contribution to the economic growth of Nigeria. In addition to the preliminary interviews was a review of study relating to the problems of administration and collection machinery of VAT. Simple percentages and chi-square (\(\chi^2\)) were used for data analysis. There is need to embark on business enumeration in each state with a view to having data base on business. Seminars and workshops so far organized on this issue are narrow its scope and design. There should be functional VAT offices in every council area to coordinate a vigorous campaign to educate people and seek their cooperation. This will no doubt erode the negative attitude that some of the consumers have developed towards VAT. The government should adequately make provision for retrieving the proceeds of VAT from companies and other agents of collection.

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C.A. SUDHIR HALAKHANDI\textsuperscript{10} (2009) in his article entitled “Goods and Service Tax - An Introductory Study”, this article focuses on how this tax system will work, and discusses the problems likely to be faced by the Central Government while introducing this tax. It also briefly touches upon the Present state level VAT and Central Service Tax. He highlights that there is no principle difference between present tax structure under VAT and GST as far as the tax on goods is concerned because GST is also a form of VAT on Goods and services. Here at present the sales tax, with an exception of CST, is a VAT system and in case of service tax the system also has the CENVAT credit system hence both sales tax and service tax are under VAT system in our country. At present the goods and services are taxed separately but in GST the difference will be vanished. The overall system of GST is very much similar to the VAT, which can be considered as first step towards GST.

JAIDEEP MISHRA\textsuperscript{11} (CBEC) 2011 in his concept paper titled prepared by Central Board of Excise and Customs stresses that keeping certain service providers outside the tax chain would increase the effective tax on total supply by precluding the benefit of tax credit in subsequent stages of output. An efficient system of tax setoff would encourage sourcing from the most efficient suppliers and discourage doing everything in house. By way of definition, a service is deemed as anything that does not constitute supply of goods, money or immovable property, save for three specific instances: in the context of an employee and employer, that provided by a constitutional authority, etc, or local government, and that labeled as manufacture as per the Central Excise Act.

THIRTEENTH FINANCE COMMISSION ON NATIONAL COUNCIL OF APPLIED ECONOMIC RESEARCH IN THEIR REPORT\textsuperscript{12} (2009) states that the broad objectives of this study refers to analyzing the impact of introducing comprehensive goods and services tax (GST) on economic growth and international trade; changes in rewards to the factors of production; and output, prices, capital, employment, efficiency and international trade at the sectoral level. Analysis in this study indicates that implementation of a comprehensive GST in India is expected to

\textsuperscript{10} C. A. Sudhir Halakhandi, Goods and Service Tax – An Introductory Study, The Chartered Accountant, 2007, pg. no. 5915

\textsuperscript{11} The Times of India, 27\textsuperscript{th} September 2011.

\textsuperscript{12} The Thirteenth Finance Commission, Government of India, NCAER, 2009. New Delhi
lead to efficient allocation of factors of production thus leading to gains in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, viz. land, labour and capital.

INE LEJEUNE\textsuperscript{13} (2010) in her article titled “Shifting from the balance” explains about the trend away from direct forms of taxation and towards indirect taxes Continues inexorably. China and India have both signaled their intention to move towards a uniform VAT system to replace current regimes. The countries of the Gulf Cooperation Council (GCC) are working towards a VAT system. As countries reform and implement their indirect tax Systems, they need to confront a number of challenges. And we see some significant programmes of reform arising in response to these. Notably, the European Union has embarked on a ‘once in a lifetime’ consultation on reform of the VAT system, in order to develop recommendations for a simpler and easier to administer value added tax system within what are now 27 Member States of the EU. The issues that this programme of consultation seeks to address are relevant to all countries that are looking to create efficient, balanced and effective indirect tax systems.

PARTHASARATHI SHOME \textsuperscript{14} In this report presented to the tenth plan entitled as “Tax Policy and Tax Administration for the Tenth Plan (2001)” focuses on the necessary stance of the authorities in the area of tax policy and tax administration for the Tenth Plan comprises many facets. For central taxes, the potential of corporation and personal income taxes—that have demonstrated the highest revenue buoyancy—has to be tapped further. Measures include improvements in the tax structure as well as in tax administration. The former issue has to focus on minimizing exemptions and incentives and improving the base of the minimum alternate tax (MAT). The latter issue should include increasing the number of assesses while reducing taxpayer burden to improve compliance, and introducing Comprehensive and meaningful computerization for major functional areas of administration. Indirect taxes have demonstrated low buoyancy which is likely to continue given anticipated structural changes in indirect tax structure. A composite reduction in customs tariffs to

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\footnotesize{\textsuperscript{13} Ine Lejeune, Indirect taxes Price, water coopers house, Belgium}\textsuperscript{14} Dr. Parthasarathi Shome Report submitted for the Tenth Plan under the Chairmanship of Reserve Bank of India Chair Professor Indian Council for Research on International Economic Relations (ICRIER Planning Commission Govt. of India. New Delhi May 2001}
\end{flushleft}
internationally comparable levels for increased competition and global integration should be kept apace. This is reflected in the projected customs revenue being allowed to decline marginally in terms of GDP during the Tenth Plan period even in light of exemptions under the customs being streamlined. A comprehensive central value added tax (CENVAT) that allows full credit for all inputs including capital goods and minimizes the number of rates could also have a short term negative revenue impact. But this has to be accepted to eliminate distortions affecting industry adversely. If multiple and complex exemptions are removed, robust revenue improvement could nevertheless be realized from both Union excises and a state level VAT. Base expansion to include the consumption of services comprehensively should be carried out forthwith at the level of both the Centre and states. It would also support the objective of improved revenue productivity. States should rationalize their sales taxes first and then introduce a broad based VAT by April 2002 as has been agreed. Equally importantly, they have to address the issue of taxation of interstate trade under a state level VAT. Without that, the VAT—currently focused only on intra-state trade—would remain distortion. States should be allowed to tax the consumption of those services that are of an intrastate nature. This would help compensate loss of revenue in some states as they move to a VAT. The ultimate goal should be to have a harmonized VAT comprising both the Centre and states. State excises as well as smaller taxes have to be rationalized further and their revenue potential fully realized. A goal of 4 percent of GDP in additional resource mobilization, that would be required for a 15 percent nominal growth rate during the Tenth Plan, would be difficult to achieve from taxes alone. The Group did not find convincing evidence from the Centre or the states of adequate preparedness for it. Their objective seems to be one of maintenance of tax to GDP levels. Though the Group has indicated several measures for additional resource mobilization to meet the revenue goal, the requirement for additional resources for the Tenth Plan has to be couched also in the correction of public utility charges for which there exist many possibilities. This aspect was, however, outside the scope of analysis of the Advisory Group.
AB LORWERTH, ALED AND OTHERS,\textsuperscript{15} in their study entitled “Efficiency considerations and the exemption of food from sales and value added taxes” states that the efficiency considerations underlying the widespread exemption of food from sales and value added taxes and the implication for tax policy. Household and restaurant meals and both constant and increasing returns cases are examined. Higher taxes on food offset the non-taxation of time inputs into household production, even under constant returns to scale. With increasing returns, gains from taxing food are higher and amplified by subsidizing restaurant food and all marginal cost components of restaurant meals. On efficiency grounds, exemption of food from sales and value added taxes emerges as socially costly policy, especially under increasing returns.

ALM, JAMES A. AND OTHERS \textsuperscript{16} in his research paper entitled “Audit Selection and firm compliance with a broad - based sales tax”. It is examined that the process by which firms are selected for a tax audit and the determinants of subsequent firm compliance behavior, focusing upon the Gross Receipts Tax in New Mexico. A two-stage selection model is used to estimate the State’s audit selection rule and, condition upon audit selection, the firm’s compliance choice. The first stage estimation results indicate that auditors select returns based upon a systematic, even if informal, audit rule. The second-stage results show that firms that exhibit greater variation in deductions, provide services, miss filing deadlines, and have an out- of-stage mailing address have a lower.

ANDERSON, JOHN E. AND OTHERS, \textsuperscript{17} in their study entitled “Tax Evasion on Gratuities” throws light on Tax evasion on tips earned by servers is a pervasive problem, one that has received almost no attention in the tax evasion literature. The authors develop a model of joint server and employer tax compliance to derive predictions for how the customer tipping rate, the server’s sales and tax rate, and the expected IRS penalty on employers influence compliance by both parties. They test the model by examining interstate differences in reported hourly pay (wages plus

\textsuperscript{15} Ab Lorweth, Aled and others, Canadian Journal of Economics, Feb 2002 35 (1) pp.166-82.
\textsuperscript{16} Alm James A. and others, Audit Selection and firm compliance with a broad - based sales tax, National Tax 57 (2), June 2004, pp.209-27
\textsuperscript{17} Anderson, John E. and others, Tax Evasion on Gratuities, Public Finance reviews 33(4) July 2005 pp.466-87.
reported tips) during 2001. They use the Occupational Employment Statistics surveys, data on IRS regional audit rates, data from each state’s food and beverage service industry, and information on each state’s minimum wage and tax laws to perform ordinary least squares and two-stage least squares estimation. Empirical results generally provide strong support for a number of the theory’s predictions.

**OECD TAXATION.**\(^{18}\) entitled “Application of Value added Taxes in Three Non-OECD Economies: Chine, Russia and India” states about the expansion of value added taxes to more than 140 countries is one of the major developments in the consumption taxes area over the last twenty years. Whilst the statistical part of this publication is limited to OECD member countries it is useful to provide an overview of the VAT systems being developed in three major non-OECD economies i.e. China, Russia, and India.

**AZARIA, N.T AND OTHERS**\(^{19}\), in their study entitled “The revenue raising capabilities of a VAT system in developing countries”, This paper attempts to elaborate on the revenue-raising capabilities (economics efficiency and viability) of a value-added tax (VAT) system, particularly in developing countries. The analysis concentrates on the effect of a VAT on tax revenues raised, and the main objective is to determine whether a VAT system generates greater benefits than previously utilized sales taxes, i.e. pre-existing sales taxes (PEST). Using a panel data regression analysis, our results indicate that while all countries gain revenue from the presence of VAT, it is significantly more in developed countries, although the dummy VAT variable interacted with trade openness enters positively for the lower- and upper middle-income groups. This proves the importance of trade for VAT revenues, but also that VAT combined with interaction variables is conducive to higher tax revenues.

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\(^{19}\) Azaria, N.T and others, The revenue raising capabilities of a VAT system in developing countries, South African Journal of Economic and Management Sciences, N.S, March 2005 8 (1) pp.63-76.
GARNER, C. ALAN\textsuperscript{20} in his book entitled “Consumption Taxes: Macroeconomic Effects and Policy Issues” throws light on proposals for fundamental reform of the federal tax code are receiving increased attention in the business press and among economic analysts and policymakers. President Bush has identified tax reform as a top priority, calling for a tax system that is “pro growth, easy to understand, and fair to all.” Moreover, the President has appointed a commission to consider different approaches to tax reform. One approach might be to improve the current income-based federal tax code, perhaps by broadening the tax base and lowering income-tax rates. However, another approach might be to replace current income taxes altogether with a consumption tax. Switching the federal tax system from an income tax to consumption tax could have important macroeconomic effects. Most economists believe that switching to a consumption tax could increase saving and real output per person over the long run, although studies differ on the size of these effects. However, switching to a consumption tax might also require sizable short-run economic adjustments and create challenges for monetary policymakers. Garner analyzes the macroeconomic effects of replacing the current federal tax system with a consumption tax. First, he provides some background on the goals of tax reform and the basic difference between an income tax and a consumption tax. Next, he describes three widely discussed versions of a consumption tax: a national retail sales tax, a value added tax, and a consumption-type flat tax. Finally, he examines the macroeconomic effects of adopting a consumption tax. All three proposals could raise U.S. output over the long run, but adopting a consumption tax could have sizable transition effects as well. These transition effects could vary depending on which consumption tax was adopted and how monetary policy responded to the reforms.

CHOUINARD, HAYLEY\textsuperscript{21}, in their study titled “Incidence of federal and state gasoline taxes” focuses on the federal specific gasoline tax falls equally on consumers and wholesalers whereas state specific taxes fall almost entirely on consumers. The consumer incidence of state taxes is greater in states that use relatively little gasoline.

\textsuperscript{20} Garner, C. Alan, Consumption Taxes: Macroeconomics effects and policy issues, Federal Reserve Bank of Kansas city economic review, 2\textsuperscript{nd} quarter 2005, 90(2), pp.5-29.

DAMANIA, R.\textsuperscript{22} in his study entitled “The Impact of Goods and services Tax on product market competition” explores the effects of a goods and services tax on the degree of competition in an oligopolistic industry and identifies a new mechanism through which the tax influences product market competition. This analysis focuses upon the effects of the tax in a concentrated industry and it is demonstrated that there exist circumstances under which the tax may promote competition by rendering tacit collusion more difficult.

FEHR, HANS AND OTHERS\textsuperscript{23} in their book “Value added taxation in the EC after 1992: Some applied general equilibrium calculations”, examine the quantitative effects of the transitional system of value added taxation for intra-EC trade between 1993-97 as recently adopted by the ECOFIN-Council. First, the administration of the current destination principle and the interim solution are described. A short representation of the empirical general equilibrium model featuring seven EC regions and fourteen production sectors follows. Finally, the effects of a switch to the transitional system are evaluated by using numerical simulations. The adopted provisions with regard to cross-frontier sales to final consumers open tax arbitrage possibilities, which favor low tax countries at the cost of their EC partners. When decomposing welfare effects international tax revenue shifts prove to dominate, while substitution effects have relatively little influence on economic welfare.

GALE, WILLIAM G.\textsuperscript{24} in his research paper entitled “The required tax rate in a national retail sales tax” focuses on the required tax rate in a national retail sales tax (NRST). It show the proposals, such as one to replace virtually all federal revenues with a 23 percent tax-inclusive NRST, are based on assumptions that real government spending would decline by $480 billion per year and that there would be no tax avoidance, evasion, or political erosion of the tax base in an NRST. Correcting for these assumptions indicates that the required tax-inclusive rate would be over 50 percent and the required tax –exclusive rate would be over 100%.

\textsuperscript{23} Fehr, Hans and others, Value added taxation in the EC after 1992: Some applied general equilibrium calculations, European Economic Review, Dec 1993 37 (8), pp.1483-1506.
MONA PRASAD has presented his views on his doctoral thesis titled “Introduction of Value Added Tax in Indian States: How has the revenue performance been?”, states that a majority of Indian states replaced the existing sales tax system with Value Added Taxes (VAT) with effect from April 2005. This policy paper analyzes the revenue performance of states which implemented VAT from April 2005 in comparison with those which implemented it later. It considers all the major general category states with the exception of Delhi and Goa. The study uses a first differenced regression analysis to analyze the differences between the VAT and non-VAT states. Against the express objective of increasing state government revenues, the study shows that there was actually a reduction in the rate of growth of revenues of VAT states compared with the non-VAT states. There were also several variations among states which implemented VAT. This paper then explains possible reasons for variations which include factors like number of prevailing VAT rates, exemptions, inclusion of inputs in the concessional rate category, and differences in definitions of commodities and state tax legislations.

In order to improve VAT revenues of states and better achieve the objectives of VAT introduction, this paper recommends a freeze on the list of VAT exempted commodities, precise and uniform definition, across states, for key items like ‘capital goods’ and ‘industrial inputs’, removal of inputs from the concessional rate of 4%, and careful monitoring of refunds as well as the impact of the low threshold limit for VAT registration.

RENDAHL, PERNILLA in his thesis titled “Cross-Border Consumption Taxation of Digital Supplies: A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce” highlights that the Consumption taxes such as a value added tax (VAT) or a goods and services tax (GST) is an important revenue source for several countries, not least within the European Union (EU) which has had a harmonized VAT since the end of the 1960s. The intention of consumption taxation is to tax expenditures made by persons for their private purposes, i.e. the tax burden is carried by the final consumer.

In the middle of the 20th century the Internet opened up the possibility for electronic commerce. Many problems arise when the rapid evolution of techniques related to e-commerce is mixed with the objective of consumption taxation, particularly in cross-border supplies to consumers. This study focuses on the cross-border consumption taxation on digital supplies in business to consumer e-commerce from an international coordination perspective

**MONICA PINHANEZ** 27 in her thesis titled “Reinventing VAT collection: industry vertical assessment, revenue increase, and public sector reliability”. This dissertation shows how administrative reforms of the State Tax Administration Bureaus (STABs) in Brazil between 1997 and 2005 contributed to strengthening public sector bureaucracies and institutions at the sub-national level, while increasing tax revenues and compliance. STABs’ administrative reform comprised changes in organizational structure, technological processes, and institutional arrangements. Beyond the market-oriented reforms, these joint changes made possible to taxpayers and tax collectors to visualize the connections and functioning of the tax administration and collection process that they were not able to think about before, i.e., there is evidence for how the administrative reform facilitated the understanding of the links among the several processes in the tax collection, particularly the backward and forward linkages in each industry

**LIAM EBRILL, MICHAEL KEEN, JEAN-PAUL BODIN** 28 in their book titled “The Modern VAT” discusses the genesis of Value-added tax, or VAT, first introduced less than 50 years ago, and how it is now a pivotal component of tax systems around the world. The rapid and seemingly irresistible rise of the VAT is probably the most important tax development of the latter twentieth century, and certainly the most breathtaking. Written by a team of experts from the International Monetary Fund, this book examines the remarkable spread and current reach of the innovative tax, and draws lessons about the design and implementation of the VAT, as experienced by different countries around the world. How efficient is it as a tax, is

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it fair, and is it suitable for all countries are among the questions raised in this highly informative and well-researched book that also looks at the likely future of the tax

SOK BOM, J. S. D.\textsuperscript{29} in his research paper entitled “Value-Added Tax (VAT) and the federal income tax reform” throws light on whether or not a value-added tax (VAT) can work to positively reform the current federal income tax for individuals. Seeking a way to reform the current federal tax system, plagued by complexity, inefficiency, and unfairness, should begin with an observation of the fundamental ideas of income tax and consumption tax. A good reform idea must have strengths from each. A federal VAT, as a reform plan for the current federal tax structure, may work well to simplify the tax code and help reduce tax evasion, provided that the VAT is properly drafted. Furthermore, concerns about a federal VAT's propensity to collect more revenue and its regressive nature are often overstated. However, the major obstacle to the adoption of a federal VAT may be state and local tax structures that would offset most profits arising from such a VAT. Thus, a coordination of the federal and state tax systems would be an essential prerequisite to any federal tax reform plan that includes a VAT.

LUIGI ALBERTO FRANZONI\textsuperscript{30} in his research paper entitled “Tax Evasion and Tax compliance” offers an overview of the theoretical and empirical research on tax evasion, delineating the variety of factors affecting noncompliance and examining possible remedies. Particular emphasis is placed on the institutional and procedural rules governing the tax enforcement policy. The foregoing offers an analytical framework for treating some salient aspects of tax noncompliance, suggesting causes and possible remedies. As must be clear by now, tax evasion is a complex phenomenon that cannot be eradicated by marginal changes in enforcement practice. Social and moral attitudes, which play a very important role, are very slow to change and are often beyond the reach of public policy. Standard enforcement therefore remains crucial. The empirical evidence suggests that a stricter enforcement regime is likely to induce greater compliance; the key variable here is the probability of detection. Research into the impact that these procedural aspects have on taxpayer

\textsuperscript{29} Sok Bom, J.S.D., Value-Added Tax (VAT) and the federal income tax reform, University of Illinois, urbana-champaign, 2008, 138 pages; 3314820

\textsuperscript{30} Luigi Alberto Franzoni, Tax Evasion and Tax Compliance, University of Bologna, Italy, 1999.
compliance is still in its infancy. Better integration of the research on tax evasion with the ‘law and economics’ analysis of legal rules is definitely desirable. As theoretical analysis proceeds, additional empirical work will be needed together with more extensive study of comparative tax enforcement law and procedure.

**PRAMOD KUMAR RAI** 31 In his thesis “The challenges of tax collection in developing economies (with special reference to India)” gives an overview of the Indian tax system and discusses the challenges in tax collection faced by developing economies using India as a model. The paper discusses the ways and means to reduce the black economy and to improve tax compliance for better collection of revenue. The paper further proposes the establishment of a dispute resolution system in developing economies similar to that of the United States for speedy and fair settlement of taxation disputes.

**HARI SHARAN** 32 in his thesis entitled “Essays on Value Added Tax Evasion and Tax amnesty programs” focuses on panel data from 1972 to 1999; the first essay of this dissertation analyzes how VAT evasion has changed as reliance on VAT in the sample of 25 OECD countries increased. The VAT ratio and VAT share are used as alternative measures of VAT reliance as independent variables. The results show that an increase in the VAT ratio and VAT share decreases VAT evasion. Overall, the results are quite robust to the various regression specifications. Proponents argue that tax amnesties raise revenues both in the short run and the long run, by bringing former non-filers back into the tax system. Opponents contend that amnesties produce little short-run revenue and weaken incentives for long-run tax compliance. Over the last 23 years, 27 states offered tax amnesties for a second or third time. While previous research has estimated the impact of specific tax amnesties, none have estimated how the impact changes when they are offered repeatedly. The results from the second essay of this dissertation show that these additional tax amnesties generate less short-run revenue than predecessors and tend to magnify revenue losses associated with disincentives for long-run tax compliance. The third and the last essay utilizes time series methods to analyze the Colorado, Maine and West Virginia tax amnesties, using quarterly total tax revenue data for the period from 1980 to 2002. The results

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31 Pramod Kumar Rai, The challenges of tax collection in developing economies (with special reference to India), University of Georgia, Lawathens, Georgia 2004.
32 Hari Shara, Essays on Value Added Tax Evasion and Tax amnesty programs, West Virginia University, 2005, 171 pages; 3191237
show that the Colorado amnesty had no short run or long run impact on tax collections. At the same time, the results also show that the Maine and West Virginia tax amnesties raised revenues in the short run but that revenue collections actually fell in these states in the long run.
Conference Papers

RITA DE LA FERIA & MICHAEL WALPOLE 33 in their conference paper entitled “EU VAT and Australian GST Models Compared” they highlight that the taxation of financial supplies is one of the most vexing aspects of a Value Added Tax (VAT). Conceptually, VAT should apply to any fee for service but where financial services are concerned there is a difficulty in “identifying that charge separately from the other elements that are included when determining levels of payments of interest or fees.” As a result, most jurisdictions simply exempt financial supplies for VAT. Exempting financial supplies, however, gives rise to significant difficulties. In particular, the supplier of financial services will have to bear input tax on acquired supplies, thus increasing the costs borne by those suppliers; where those costs are passed on in the supply chain. Exempting financial services will ultimately cause a cascade of tax. This is anomalous in a tax intended to be borne only by final consumers, rather than by suppliers in the chain of VAT transactions. Very few states have attempted to modify the conventional approach of exempting financial services from VAT. A notable recent exception is Australia which introduced a type of VAT (the GST) in 2000 which provided for a “reduced input tax credit” system for certain financial supply providers. Within the EU, as in most countries, financial services are exempt from VAT. However, the issue of how to treat financial supplies under VAT has remained important, and in 2006, the European Commission put forward a consultation paper where it set out, for discussion, potential alternative treatments. Amongst these, was the possibility of introducing a GST type system in Europe? After consultation it has determined that a redefinition of financial services, compiled with the introduction of a cost sharing system, and the introduction of an “option to tax”, may be the best solution. It has, therefore, recently put forward a legislative proposal along those lines. This paper compares the current treatment of financial supplies in the UK/EU and in Australia. It will use these comparisons to inform consideration of the possible introduction of an option to tax model in the EU, and consider the possibility of such a system in Australia.

GOVT. OF EUTHOPIA\textsuperscript{34} conducted a study on “VAT Implementation Process in Ethiopia” This paper provides an assessment of the economic impact found when replacing Ethiopia's sales tax with a value-added tax (VAT). The paper assesses the effectiveness of VAT's in terms of its ability to achieve several objectives. These objectives include: Generation of more government revenue and encouragement of investment and trade by modernizing the tax administration. Moreover, the study identifies the problems encountered during the implementation of VAT and recommends possible solutions.

LUIGI ALBERTO FRANZONI\textsuperscript{35} on his research on “Tax Evasion and Tax compliance” offers an overview of the theoretical and empirical research on tax evasion, delineating the variety of factors affecting noncompliance and examining possible remedies. Particular emphasis is placed on the institutional and procedural rules governing the tax enforcement policy. The foregoing offers an analytical framework for treating some salient aspects of tax noncompliance, suggesting causes and possible remedies. As must be clear by now, tax evasion is a complex phenomenon that cannot be eradicated by marginal changes in enforcement practice. Social and moral attitudes, which play a very important role, are very slow to change and are often beyond the reach of public policy. Standard enforcement therefore remains crucial. The empirical evidence suggests that a stricter enforcement regime is likely to induce greater compliance; the key variable here is the probability of detection. Research into the impact that these procedural aspects have on taxpayer compliance is still in its infancy. Better integration of the research on tax evasion with the ‘law and economics’ analysis of legal rules is definitely desirable. As theoretical analysis proceeds, additional empirical work will be needed together with more extensive study of comparative tax enforcement law and procedure.

DELFIN S. Go\textsuperscript{36} in his research paper entitled “An analysis of Value Added Tax in South Africa” a report conducted by World Bank. In this paper, we describe South

\textsuperscript{34} Report of Govt. of Ethiopia on the study investigating and analyzing value added tax (VAT) implementation in Ethiopia in 2006.

\textsuperscript{35} Luigi Alberto Franzoni, “Tax Evasion and Tax Compliance”, University of Bologna, Italy 1999.

Africa's value added tax (VAT), showing that (1) the VAT is mildly regressive and (2) it is an effective source of government revenue, compared to other tax instruments in South Africa. We evaluate the VAT in the context of other distortions in the economy by computing the marginal cost of funds - the effect of raising government revenue by increasing the VAT rates on household welfare. Then we evaluate alternative, revenue-neutral tax systems in which we reduce the VAT and raise income taxes. For the analysis, we use a computable general equilibrium (CGE) model with detailed specification of South Africa's tax system. Households are disaggregated into income deciles. We demonstrate that alternative tax structures can benefit low-income households without placing excess burdens on high-income households.

MICHEAL KEEN and BENOCKWOOD .L 37 in their research paper titled “The Value –Added Tax: Its Causes and Consequences to IMF” have analyzed whether, the VAT proved, as its proponents claim, an especially effective form of taxation? To address this paper first shows that a tax innovation-such as the introduction of a VAT-reduces the marginal cost of public funds if and only if it also leads an optimizing government to increase the tax ratio. This leads to the estimation, on a large panel, of a system of equations describing the probability of VAT adoption and the revenue impact of the VAT. The sign of the revenue impact is generally ambiguous, but most countries that have adopted a VAT seem to have gained a more effective tax instrument in doing so.

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37 Micheal Keen and BenLockwood, The Value-Added Tax: Its Causes and Consequences, Center for Economic Studies and Institute for Economic Research, Institute for Fiscal Studies (IFS), University of Warwick, July 2007 Paper No. 07/183
Articles

N. JANARDHAN RAO & FEROZ ZAHEERA\(^{38}\) gives an idea about the genesis of VAT by putting an end to the 55 year old sales tax regime in India. VAT- adding value at each stage of production. The implications of taxation with regard to set-off of input-tax credit. In this article highlight how this system works and various outcomes in removal of hindrances in the movement of goods across the Country. The major obstacle in implementation is the rule by different parties at different state levels. As the author opines, Inter-state trade, if it involves competitive taxation it might as well be easier and heaper imports for State.

SANJAY KUMAR, A L NAGAR, SAYAN SAMANTA \(^{39}\) in their article titled “Indexing the Effectiveness of Tax Administration” highlights the capacity of the tax administration needs to be continuously augmented to keep pace with the changing requirements of tax policy. One of the key challenges in this respect is to measure the effectiveness of the tax administration. This article develops an econometric model for indexing the effectiveness of tax administration by using the principal component method to remove the feedback effect between voluntary and enforced compliance. This model shows that there has not been a large change in the effectiveness of the direct tax administration in the country over a period of time, despite the fact that there has been a substantial increase in the quantum of direct tax revenue, particularly over the last few years. This calls for attention to strengthen the tax administration.

ASHOK CHANDAK\(^{40}\) in his article “Sales Tax and Incentives and VAT” analyses the white paper on ‘State level Value Added Tax’ related on 17.01.2005. He gives an illustration of exemption of VAT its chain and the various methods for its calculations and its difference. He has described the Haryana model, Punjab model and Maharashtra model of VAT as an example. At last to conclude he has made his remark on the remissions model which is an alternative mechanism to replace the exemption and bring all transaction in the VAT chain. Basic philosophy of VAT states that there cannot be only incentives under fiscal laws. There are certain


\(^{39}\) Sanjay Kumar A. L Nagar, Sayan samanta, Indexing the Effectiveness of Tax Administration, Economic & Political Weekly, December 15 2007 pg.014.

practical difficulties in implementation both to the Government and to industrial units/dealers, which may be solved only in time to come.

**R KAVITA RAO** \(^{41}\) in her article entitled “Goods and Services Tax: The 13th Finance Commission and the Way Forward” analyses the significance of this commission as required to look into the revenue impact of the introduction of the goods and services tax. Its report, based on the recommendations of a task force constituted to study the issue, recommends a highly uniform and centralized format that does not adequately recognize a tax reform exercise in a multi-level fiscal system that involves compromises and trade-offs. While several flaws can be pointed out in its design, developments that have taken place before and since the report was submitted have to a large extent rendered the commission’s recommendations irrelevant. All this underlines the need for a model that goes beyond uniform rates of tax and allows states to vary beyond a floor, with a fixed classification of commodities and services, so that they can choose an appropriate rate to ensure that their revenue requirements are met. In her Concluding Remarks Given the approach adopted by the THFC and the developments that have taken place before and since its Report was submitted, its interventions in the GST arena have been rendered irrelevant. While the union government did initiate discussions on the lines suggested by the THFC, the discomfort voiced by states has changed the trajectory of the talks. In the dialogue until the second draft of the constitutional amendment bill, the centre has given up the veto power proposed for the union finance minister and also agreed to dilute the demand for uniformity. While what exactly this entails will be revealed in the days to come, what is apparent is that the highly centralized model of the THFC is not in play anymore. While there is some open-endedness on what the GST regime will mandate as essential for all states, it is desirable to retain some commitment or conformity on the following issues. Classification of goods and services: While the states may be allowed to choose the rates associated with different categories of goods or services, the classification of goods and services into different categories should remain the same across all states and the Central government.

ARINDAM DAS-GUPTA, in his article entitled “The VAT Versus The Turnover Tax With Non-Competitive Firms” focuses the VAT is compared to a turnover tax (TT) given monopoly final goods and intermediate goods firms interacting strategically. Linear demands and constant costs are assumed. Via examples it is shown that for both "Cournot" and "Stackelberg" games, a revenue neutral VAT may not exist to a given turnover tax; and the TT can dominate the VAT simultaneously in welfare, revenue and output terms. In other examples it is shown that the VAT dominating the TT by all three indicators is also possible. It is also shown that outcomes are identical to the "Cournot" game when the consumer goods firm is the strategic leader. When the intermediate goods firm is the leader, intermediate price distortion is lower and welfare higher than in the "Cournot" game under both taxes; and the output neutral VAT rate to any feasible TT rate is higher than in the "Cournot" game.

Dr. K. REVATHI in her article “Value –Added Tax and its importance” highlights the main objective of VAT and discusses the origin of VAT and gives its meaning and elaborated the principles behind the effective VAT structure how computerization helps in VAT administration. Under Vat, the burden will be reduced. She gives an idea that the States should be ready to adopt and meet the international challenge to compete in the global market. She concludes that the basic tax reform is related to global standard. The main reason for implementation is to make our products more competitive globally.

KUMAR SATYAKAM In his paper “Goods and Services Tax: future of India” he has given the meaning of GST, its advantages, various problems to be faced while implementing GST and emphasized on the recommendations of Joint working Group of Empowered Committees guidelines for better administration and the suggestions for the state and central government for its preparedness. To conclude, it may boost our economy and enable us to compete at the global front. As a result, even our system may match the international phenomenon. This is the biggest advantage of GST. Every system has its own intricacies embedded at the initial stages. Lower


incidence of tax, reduced prices, a move towards the global concept, reducing cost of tax compliance, better revenue collection, an efficient and harmonized consumption tax system in the country all this looks good on the card, but is it really so easy to implement? Keeping the various constitutional, technological, procedural and political barriers, the job seems easier said than done. The author has brought out the strength, weakness, opportunities and threats of the present VAT system.

V. RAVI KUMAR in his article “VAT in India- Issues and Concerns” discusses that India has switched over from its sales tax system that had existed for more than 50 years. While this change has been welcomed most of the trading community at large, the changeover would be a success only when the same is implemented across the country. This article analyses some of the major issues and concerns arising out of this so called fractures implementation of VAT. Here he discusses that when the goods move from a VAT state to a non-VAT state, the credit of locally procured materials would be available against the central sales tax that is required to be paid. On the contrary, movement of goods from a non-VAT state to VAT state would not be able to set-off its tax paid on the purchases, which would obviously result in position that the customer would be required to bear an additional brunt of tax in that case. The author concludes that the movement towards the VAT regime is a welcome step for the Indian economy, but to get the complete benefits of this VAT, it is necessary that the whole nation should understand the issues and concerns of the trade and the industry at a large in evolving a common system of taxation across the country.

**Working Papers**

A study was conducted to analyze whether the adoption of the value-added tax (VAT) in developing countries was an effective way of stabilizing tax revenues. Using a large panel of 103 developing countries observed over 1980-2008 and several alternative estimation methods in order to deal with the self-selection bias and the endogeneity issue of VAT adoption, They found robust evidence that the presence of VAT lead to significantly lower tax revenue instability. On average, countries with a value added tax experience tax revenue instability forty to fifty percent lower than the

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countries which do not have a VAT system. Those effects decrease with the levels of economic development and trade openness.46

This paper does emphasize on the views expressed regarding the tax design proffered 'do not reflect the position of the government'. And that the idea is to invite feedback and debate, and to do so well before the system and legislation for a comprehensive goods and services tax is in place. A well-thought-out and implemented goods and services tax (GST) would further modernize the indirect tax regime; provide setoffs for tax credit right along the value chain, across both goods and services, and both for central and state levies. However, the proposed negative list for service tax does appear to have a fair share of anomalies, and across sectors and industries. The point is that the negative drawbacks of a tax system on welfare and economic efficiency do need to be drastically curtailed. The mavens insist that a 'simple, neutral and stable' tax system is the most effective policy instrument in the contemporary practice of public finance

This concept paper stresses that keeping certain service providers outside the tax chain would increase the effective tax on total supply by precluding the benefit of tax credit in subsequent stages of output. An efficient system of tax setoff would encourage sourcing from the most efficient suppliers and discourage doing everything in house. By way of definition, a service is deemed as anything that does not constitute supply of goods, money or immovable property, save for three specific instances: in the context of an employee and employer, that provided by a constitutional authority, etc, or local government, and that labeled as manufacture as per the Central Excise Act.47

LORDS CHARALAMBOUS48 in his research paper entitled “India Ready for Single Goods and Services Tax” throws light on over the past four decades; VAT has been an important instrument of indirect taxation with 130 Countries having adopted this, resulting in one-fifth of the world’s tax revenue. Tax reform in many of the developing countries has focused on moving to VAT. Most of these countries have gained from it, and hence the suggestions that others stand to gain from its adoption.

46 http://poliecon.com/2011/09/24/is-vat-stabilizing
47 The Times of India, 27th September 2011, pg.6.
For a developing economy like India it is desirable to become more competitive and efficient in its resource usage. Apart from various other policy instruments, India should pursue taxation policies that would maximize its economic efficiency and minimize distortions and impediments to efficient allocation of resources, specialization, capital formation and international trade. With regard to the issue of equity it is desirable to rely on horizontal equity rather than vertical equity. While vertical equity is based on high marginal rates of taxation, both in direct and indirect taxes, horizontal equity relies on simple and transparent broad-based taxes with low variance across the tax rates. Traditionally India’s tax regime relied heavily on indirect taxes including customs and excise. Revenue from indirect taxes was the major source of tax revenue till tax reforms were undertaken during nineties. The major argument put forth for heavy reliance on indirect taxes was that the India’s majority of population was poor and thus widening base of direct taxes.

The broad objectives of this study is conducted to analyze the impact of introducing comprehensive goods and services tax (GST) on economic growth and international trade changes in rewards to the factors of production; and output, prices, capital, employment, efficiency and international trade at the sectoral level. Analysis in this study indicates that implementation of a comprehensive GST in India is expected to lead to efficient allocation of factors of production thus leading to its in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, viz. land, labour and capital. 49

This paper is the first working paper for 2009 and the third since the initiation of Goods and Service Tax. It discusses the contractual issue of carrying forwards the Sub-national tax reform agenda and thus lights on the principles, issues and procedures related to the objective of achieving a common Goods and Services market. The Introduction of the state level VAT in 2005 was the first sub-national tax reform that provided for greater competitiveness of Indian Industry and trade. The GST first proposed in the budget speech of 2006-07 and now under active discussions of the Empowered Committee of State Finance ministers is the next logical step in the quest for a common market. In this paper, the authors raises certain key issues in the

objective of the tax, its design with tradeoffs in the available choices, administrative infrastructure and the tax base and rates.\textsuperscript{50}

\textbf{MANASAN, ROSARIO G.}\textsuperscript{51} in his article titled “Estimating Industry Benchmarks for the Value Added Tax” has analyzed Various indicators (e.g., VAT-to-GNP ratio, VAT evasion rate) and suggest that problems in VAT administration have not only persisted during the 1990s but also appear to have worsened. This study makes use of the 1994 Input Output Table to estimate industry benchmarks for the ratio of VAT-able inputs to total output as well as the effective VAT rate. In so doing, it also attempted to decompose the sources of the leakage in VAT collections in 1999-2001. While in the aggregate the VAT-able purchases of the firms under the Large Taxpayer Unit of the BIR are less than their total output in the current year, it appears that many of these firms do claim excessive input VAT credits. The ratio of the value of total purchases to total sales is higher the corresponding I-O based benchmark in some 68\% of large VAT-payers. In this regard, the use of industry benchmarking to automatically trigger audit would help reduce the leakage in VAT collection. To start with, audit should focus on industries/sectors whose ratio of VAT-able purchases to taxable sales exhibit the greatest variance relative the I-O benchmark. But what is more worrisome is the lack of correspondence between the total negative VAT due in the previous year and the excess input tax carried over from the previous year in 1999-2001. This development suggests the absence of a good monitoring system for the excess input tax carried over from one period to the next and is clearly indicative of lapses in VAT administration. Finally, it should be stressed that, to be credible, industry benchmarking requires that each grouping represent a fairly homogeneous set of firms/ taxpayers in terms of key characteristics. Since VAT liability is largely dependent on the input-output structure of firms. In this regard, the 38 major sectors currently being used by the BIR in classifying firms appears to be inadequate. Prospectively, BIR should move towards a finer level of classification approaching at the minimum the I-O level of disaggregation.

In this article, the author outlines the coverage and structure of the Philippines' value-added tax (VAT) on goods and services and discusses the problems in its

\textsuperscript{50} Government of India chairmanship under Satya Poddar Working Paper No.1/2009-DEA GST Reforms and Intergovernmental Considerations in India, March 2009 Department of Economic Affairs Ministry of Finance

administration as well as indicators of inefficiency, low effort and evasion that appear to be growing even worse. Making use of the national input-output tables, she constructs industry benchmarks for the VAT to aid the Bureau of Internal Revenue in its audit process—collections within an industry which fall notably short of the benchmark could act as a sort of automatic trigger for government investigation and in the process reduce leakages. Before this can happen, however, industries should be defined to a greater degree to ensure an appropriate level of homogeneity within a given industry category.

**Conference Paper**

**Comptroller & Auditor General of India (CAG)**[^52] conducted a study on “Implementation of Value Added Tax in India—Lessons for Transition to Goods and Services Tax.” Comptroller & Auditor General of India (CAG) to discuss the findings of the CAG on the preparedness for transition from sales tax to value added tax, the rationale for the tax reforms, IT related issues to GST as well as legal and operational issues relating to tax reforms.

The Union Government is now actively engaged with the Empowered Committee of State Finance Ministers to finalize the structure of the GST as well as of modalities of its expeditious modalities of its expeditious implementation.

This Report synthesized the findings of the performance audits conducted by 23 of field offices where they reviewed the transitional process from the sales tax regime to the VAT system by evaluating whether the States had planned well for the transition, the administrative machinery had been appropriately geared to suit the requirements of the new tax regime, the legislative provisions were adequate and properly enforced, adequate and effective internal controls were in place and the new systems had stabilized and were functioning effectively after four-five years of introduction of VAT. The Report underlined the fact that certain fundamental issues which were required to be tackled prior to implementation of VAT were not addressed and their consequent fallout in the post-VAT scenario.

The study presented in this book covers a comparative study of EC VAT, Australian GST and Canadian GST concerning how digital supplies are taxed in

[^52]: Comptroller & Auditor General of India (CAG), Implementation of Value Added Tax in India—Lessons for Transition to Goods and Service Tax, Govt. of India, 2010.
business to consumer cross-border supplies. It particularly focuses on if there are risks for double taxation and unintentional non-taxation and identifying the causes for such cases. In addition the possible remedies for double taxation and unintentional non-taxation are discussed. The findings in the study are evaluated based on rationality, which refers to if the consumption taxation upholds the principles that are part of the OECD, Ottawa Taxation Framework Conditions. The principles that are part of the Framework Conditions are; neutrality, efficiency, certainty and simplicity, effectiveness and fairness and flexibility.

**VITO TANZI, HOWELL ZEE** 53 in his research paper entitled “Tax Policy for Developing Countries” in this paper he focuses while VAT has been adopted in most developing countries, it frequently suffers from being incomplete in one aspect or another. Many important sectors, most notably services and the wholesale and retail sector, have been left out of the VAT net, or the credit mechanism is excessively restrictive (that is, there are denials or delays in providing proper credits for VAT on inputs), especially when it comes to capital goods. As these features allow a substantial degree of cascading (increasing the tax burden for the final user), they reduce the benefits from introducing the VAT in the first place. Rectifying such limitations in the VAT design and administration should be given priority in developing countries.

**PARTHASARATHI SHOME**54 under his chairmanship a study was conducted in the topic “Tax Policy tax administration for the tenth plan” by Indian Council for Research on International Economic Relations and the outcome of the study is that the necessary stance of the authorities in the area of tax policy and tax administration for the Tenth Plan comprises many facets. For central taxes, the potential of corporation and personal income taxes—that have demonstrated the highest revenue buoyancy—has to be tapped further. Measures include improvements in the tax structure as well as in tax administration. The former issue has to focus on minimizing exemptions and incentives and improving the base of the minimum alternate tax (MAT). The latter issue should include increasing the number of assesses while reducing taxpayer burden to improve compliance, and introducing comprehensive and meaningful


computerization for major functional areas of administration. Indirect taxes have demonstrated low buoyancy which is likely to continue given anticipated structural changes in indirect tax structure. A composite reduction in customs tariffs to internationally comparable levels for increased competition and global integration should be kept apace. This is reflected in the projected customs revenue being allowed to decline marginally in terms of GDP during the Tenth Plan period even in light of exemptions under the customs being streamlined. A comprehensive central value added tax (CENVAT) that allows full credit for all inputs including capital goods and minimizes the number of rates could also have a short term negative revenue impact. But this has to be accepted to eliminate distortions affecting industry adversely. If multiple and complex exemptions are removed, robust revenue improvement could nevertheless be realized from both Union excises and a state level VAT. Equally importantly, they have to address the issue of taxation of interstate trade under a state level VAT. Without that, the VAT—currently focused only on intra-state trade—would remain distortionary. States should be allowed to tax the consumption of those services that are of an intrastate nature. This would help compensate loss of revenue in some states as they move to a VAT. The ultimate goal should be to have a harmonized VAT comprising both the Centre and states. State excises as well as smaller taxes have to be rationalized further and their revenue potential fully realized

**Books**

ATUL M SETALVAD 55(2009) in his book entitled “Law of Sales and Principles of VAT” This is a book on the law of sales and on principles of the imposition of sales tax or VAT highlights the introduction of transaction related into transactions related to sale or purchase of goods every day—we purchase when we buy a newspaper, a carton of milk or a motor car. A newspaper vendor sells goods as does the shopkeeper. The book discusses the law on the subject: the right of the seller to receive payment and the right of the buyer to receive goods of the kind and quality he wants. Though the transaction is usually quite straightforward and simple, there are endless variations that arise when goods are to be delivered later, or when the sale is on credit, each of which can create legal problems

The various legal problems arising in such transactions are fully examined, including: the meaning of ‘goods’ and ‘documents of title’; the distinction between contracts of sale, sales proper, between sales and other relationships resembling sales such as agency and hire purchase; the obligations of the parties relating to the time of delivery and the quality and suitability of goods; the inter se rights of the sellers and the buyers as to when property in the goods and title to the goods passes; the rights and remedies of the unpaid seller and the buyer who has not received the goods in time, or at all, or who has received goods which are not of the kind or quality he had agreed to buy. Auction sales are a special kind of sale and the book discusses the rights of all the parties involved: the seller, the auctioneer, and the auction purchaser. Virtually, all sales attract sales tax, generally known as VAT, a tax generally imposed in India by the state legislatures. The Constitution regulates and restricts the power of states to levy sales tax. These topics are exhaustively considered in the work as also the concept of ‘deemed sales’, ie, transactions which, in law, are not sales but on which sales tax or VAT can be imposed. The book will be very useful to determine when sales tax or VAT can be levied, though it does not consider the formalities which the seller of goods is required to comply with under the VAT laws.

**DR. MAHESH C. PUROHIT** 56 (2001) in his book entitled “Value added Tax Experiences of India and other countries (third edition)” in this book the author has written this books when MODVAT was introduced in India. An in-depth study was conducted on the structure and operations of VAT. France being a pioneer in adopting this tax, is a prime subject in their attempt to present a comprehensive over view of the structure and administration of VAT. Other countries of Europe, Asia and the pacific, the African continent, Central America and the Caribbean are also discuses for comparative view. The study was organized under the Indo-French Exchange programme jointly organized by Government of France and India Council for Social Science Research New Delhi.

**PRAKASH SAHAY** 57 (2009) in his book entitled “Principles of VAT in India” (2 Vols.) The purpose of this book is to assist people and practitioners in understanding the fundamental principles of VAT. The Fiscal Policy and law are important for the

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development and growth of the society. Tax administration plays important role. This book focuses on the principles and basic concepts of VAT law. This book first examines the fundamental concepts, the federal and provincial powers to tax under constitutional doctrines. Key concepts of the tax systems and the basic principles of tax policy that influence the structure and politics of the law are explained. Tax law must make difficult compromises between competing social and economic values, revenue requirements, administrative efficiency, a sense of fair play and the costs of fiscal administration

**BALRAM SANGAL & JAGDISH RAI GOEL**\(^\text{58}\) in his book titled “All India VAT Tariff” covering States VAT rates. This book an volume on States VAT rates of commodities under difference Schedules is an encyclopaedia covering VAT rates in almost all states in India. Lot of amendments have related to VAT rates have also been annexed for easy and quicker reference. It gives a brief guidelines on rates in almost states in India.

**CHATURVEDI & ASOKAN**\(^\text{59}\) (2005) in his book entitled “Guide to Mastering VAT” This book focuses on the part of major indirect tax reforms in the country, sales tax structure prevalent at the State-level is being replaced by Value Added Tax (VAT) in many States w.e.f April 1, 2005. The essence of VAT is that it provides credit/set-off for tax paid on purchases against the tax payable on sales. The book contains various chapters on what is Value Addition. Methods used practice for VAT calculations. VAT Administration in India and relevance to Input Tax Credit available for Capital Goods. Input Tax Credit the reasons for refusals and Reversals, Assessment and its Computations, Maintenance of Accounts, Filing of Returns and Final Assessments. VAT And Small Dealers, Why VAT? Text of White Paper on State-Level Value Added Tax, Annexure containing First Hand Information on VAT , Self Assessment procedures Important Things to Know Before Transition to VAT. The book also contains Text of ICAI Guidance Note on State-Level Value Added Tax, issued in March 2005 : With a view to provide guidance on various accounting issues that are likely to arise on implementation of State-level VAT, the Institute of Chartered Accountants of India has issued ‘Guidance Note on Accounting for State-


level Value Added Tax'. The Guidance Note provides guidance in respect of accounting for various aspects of State-level VAT.

**ABHISHEK A RASTOGI & ADITYA KUMAR** 60 (2009) “Goods and Service Tax: New face of Indirect Taxes in India”. This book gives a elaborate discussion on the nature and elements in the GST. It covers the features of GST in Indian context. It analyses the GST and its impact on key sector of Industries. It gives an insight into the economics of indirect taxes and the current structure of Indian indirect taxes coupled with where the country is headed with the GST. The provisions applicable in the European Union, the UK and Canada which are most similar to the Indian political and social scenario have been deliberated upon. At last the book emphasis the Government and the law makers should adequately prepare in terms of important aspects such as infrastructure, resources and constitutional validity.

**V.S. DATEY** 61 (2009) on in his book “Service Tax & VAT” describes in details about the pros and cons of Indirect taxes and the role of Constitution of India, pertaining to taxation. He deals with the Inter-State and Intra-State sale of goods its meaning and the transaction which does not mean sale. Basics of VAT and the highlights of State VAT is given in detail. An overview of CENVAT system and the meaning and the glimpse of Service tax and its procedures is also explained.

**DR. AVADHESH OJHA, SATYADEV PUROHIT AND REENA GARG** 62 (2006) in their book titled “VAT in India” A Global View Law & Procedure is the first complete book of its kind dealing at length with totality of the legal and procedural requirements relating to VAT as applicable in different states. This book is unique in the sense that it incorporates the provisions of VAT laws of some of the States as illustrations so as to bring out the global concept of VAT to any discerning reader of any state for this book. This book discusses in briefly the VAT laws and procedures of many States.

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ABHISHEK A. RASTOGI in his book entitled “Guide to Goods and Services Tax” This book is mainly based on the report of the 13th Finance Commission report and the first discussion paper on GST. It gives the reasons for implementation of GST in India and how far the progress towards GST has been attained. It discusses the different models of GST. A recommendation of the Task force on Tax burden and Tax rates and the key principles and procedures for registration is dealt in. It gives a brief idea about the various taxes prevailing and the subsumed taxes under forthcoming GST. To conclude the author gives the various issues which needs attention.


This paper is intended to provide general background for the conference on the value added tax (VAT) organized by the International Tax Dialogue (ITD), and hosted by the government of Italy, in March 2005. This section describes the main features of the VAT, and its continuing spread. As in all areas of taxation, the distinction between policy and administration is not entirely clear-cut, but for convenience—and in the same spirit as the distinction between the two sets of parallel sessions at the conference—Section II focuses on issues that are primarily ones of policy, and Section III on issues of administration. Section IV summarizes the main conclusions, focusing on likely challenges for the VAT in the years ahead.


64 The Value Added Tax Experiences and Issues Background Paper Prepared for the International Tax Dialogue Conference on the VAT Rome, March 15–16, 2005