Economic development has been one of the most popular slogans in almost all the developing countries all over the world. Similarly, achievement of high rate of economic growth, reduction of income disparities and poverty, and improvement of living standard of people are some development strategies towards which most of the government efforts have been directed in developing countries. It is known that government needs more revenue mobilization for overall economic development and state welfare. Besides this, for meeting day-to-day expenditure, the government has to continuously argument revenue through various fiscal measures.

The role of revenue in the development of a country is not less important than the role of oxygen for the existence of human body. In this context, a government needs to mobilize a lot of internal resources to fulfil its responsibility towards its nation and people\(^1\). In a developing country like India, there is a necessity for raising a larger volume of funds for the development and administration expenses.

The revenue collection is a challenging task in itself which demands increasing necessity of regulating expenditure in general and development expenditure in particular. However, resource mobilization is very low which compels the government to rely on foreign assistance. External assistance is uncertain, precarious, inconvenient and not conducive to the healthy and overall development. The foreign aids are not bad for economic development of the nation per se. But the experience of the most of the developing countries shows that there are negative effects of increasing international grants and loans to finance the public development activities. Thus, the government should depend on its own resources for generating revenue in order to finance these regular and development activities.

The government can collect revenue from taxable and non-taxable sources. Tax is a key source for revenue generation and mobilization.

According to Prof. Seligman Tax is defined as “Tax is the compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred.”

A tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the government. The taxpayer does not have any right to receive the direct benefit from the tax paid. The tax is paid to the government for spending towards common interest of the people. The tax is collected from have and basically, spent for the interest of have-nots in the society.

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3 Essays in Taxation, p. 432.
Taxes are major fiscal policy instruments and important government policy tools have an important role in increasing the rate of capital formation and thereby a high rate of economic growth can be achieved. Increase in taxes may be directed to increase in saving through the postponement of consumption. The increase in saving means a higher volume of resource is available for making useful and productive investments. Taxation may be used to promote useful investment in the private sector and to prevent the resource from immoral over speculative and unproductive investment as well as over lavish and luxurious consumption. Thus, taxes in developing countries serve as the severe means of raising revenue. Therefore, taxation may be utilized by the government as an effective tool for giving incentive to the proper growth of saving, investment and gross domestic product.

Consequently, there must be a structure of taxation, combining a number of taxes, which the government can vary from time to time according to changes in emphasis on different objectives.

In modern days, the objective of tax is shifted from the security perspective to the economic development. The modern objective of taxation is not only to maintain peace and security, but also to conduct development activities.

From the above facts, one can enumerate the objectives of tax as given below:

- To raise revenue for ensuring resource mobilization
- To distribute equally wealth and income in the society
- To encourage the production of certain products
- To encourage employment
- To ensure saving and investment
To contribute to the enforcement of government policy

To remove regional disparities and imbalances.

1.1 Introduction to Value Added Tax (VAT)

Value Added Tax is the most recent innovation in the field of taxation. Actually, VAT is considered one of the most important tax reforms of the second-half of the twentieth century. It is a scientific tax system, which was first introduced in 1954 in France\(^4\). VAT is a family member of indirect tax. The value added tax system is designed to address various problems associated with the conventional sales tax system. It is a tax that has developed as an alternative for the traditional sales tax. That’s why it is also called improvised version of sales tax. In sales tax, there is no provision for input tax credit, which means that the end consumer may pay tax on an input that has already been taxed previously. This is known as cascading and leads to increase consumer tax and price levels, which increases the rate of evasion and can be detrimental to economic growth. In contrast, the VAT that has been levied in the previous level can be deducted while paying taxes on the later levels. It has a special system where a person trying to deceive tax will be caught on either one of the subsequent levels. Therefore, the trend of tax evasion is highly discouraged.

1.1.a Meaning of VAT

In the words of Ishwar Bhattarai & Girija Koirala, “VAT is a general consumption tax assessed on the value added to goods and services. It is a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the

\(^4\) India’s economic reforms and development: Essays for Manmohan Singh. New Delhi: Oxford University Press
final consumer. It is not a charge on companies. It is charged as a percentage of price, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is an indirect tax, in that the tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer). As VAT is intended as a tax on consumption, exports (which are, by definition, consumed abroad) are usually not subject to VAT or VAT is refunded.\(^5\)

The Economy Watch defines Value Added Tax (VAT) as a special type of indirect tax in which a sum of money is levied at a particular stage in the sale of a product or service (www.economywatch.com/business-and-economy/vat.html). Value Added Tax (VAT), or goods and services tax (GST), as defined by Wikipedia, is tax on exchanges. It is levied on the added value that results from each exchange. It differs from a sales tax because a sales tax is levied on the total value of the exchange. For this reason, a VAT is neutral with respect to the number of passages that exist between the producer and the final consumer. A VAT is an indirect tax, in that the tax is collected from someone who does not bear the entire cost of the tax.\(^6\)

VAT is a modern and scientific tax system. It is not similar to customs, excise duty or sales tax that has borne the traditions or historical heritage. It is not a tax that has been improved and amended, and accordingly inserted and deleted. It is a tax of the 21st century since it is highly developed and refined. It is a tax that suits the present speed of knowledge, development and skill.

\(^5\) Bhattacharai, Ishwor & Koirala Girija Prasad (2007), Taxation in Nepal with Tax Planning and VAT, Asmita Prakashan, Kathmandu.
\(^6\) en.wikipedia.org/wiki/value added tax.
1.1.b Value Added Tax in India

In developing countries like India, the role of indirect tax is seen to be more important. Of the indirect taxes, VAT is probably the best tax system and the most important innovation of the second-half of the twentieth century, which is considered as an effective means to collect revenue as a reformed sales tax of indirect tax system. VAT was introduced in 2005 in India.

The lesson learnt from tax reforms in developing countries proves that VAT is the most important choice and ingredient of tax reform. It may be adopted by a developing country with no difficulty and is an important instrument for the mobilization of internal resources and the pressure of VAT on economic activities is minimal or not at all. The tax reform and adoption of VAT is, therefore, essentially connected with the efforts of many underdeveloped countries to achieve the goal of economic development. Sales tax system in India has always been very dynamic and undergoing changes from time to time and quite often too frequently.

The system that was operating in Indian states was archaic, irrational and the most complex in the world. It interferes with the free play of market forces and competition, causes economic distortions and entails high cost of compliance and administration.

After independence of India in 1947, no serious efforts were made to reform the sales tax structure in India. But during the period un-coordinated and independent efforts were made by a few states, but these led to more complexity, rate and procedural difference and unhealthy tax competition. In the beginning of the 1990s, a few efforts have been made to streamline the tax structure. Originally, Sales tax was in two forms, the Madras System
(Multi-point) and the Bengal System (Retail Sales Tax), i.e., single point\(^7\). In both these systems, the defects are common with a slight variation here and there. Main defects in the sales tax system were:

- From the multi-point tax system a few states shifted to the first-point sales tax, but viewing the economic condition of the State additional sales tax or surcharge were added to the tax rates.

- The rate structure in various States was ranging from 0% to 20% and the special rates like 2%, 3%, 3.5%, 4%, 8% 10%, 12% and so on were existing.

- There were large number of tax exemptions of the commodities (tax free) in the States, e.g., in the State of Tamilnadu the Schedule ‘B’ represented such rebates although these sales were subject to certain conditions.

- Lack of compliance of the system. Apart from these general exemptions from the payment of sales tax, the incentives in the form of tax deferment, concessional rate of tax, purchase tax exemption, etc. were in vogue which led to eating away the major chunk of the State revenue besides creating an unhealthy competition amongst the existing non-exempted units and the new exempted units.

- Non-interaction between the Central agencies and the Sales tax administrative agencies.

- Narrow tax base, i.e., number of identified dealer is lesser.

- No tax on value addition after first-point of sale.

\(^7\) Empowered Committee (2005), *A White Paper on State-Level Value Added Tax*, Committee Constituted by the Ministry of Finance
Avoidance at first-point on some portion of price.

Evasions at first-point by bill trading, i.e., bills are returned or destroyed at destination.

1.1.c Types of VAT
The essential distinction between these three variants is their treatment of capital goods, that is, items such as machinery, buildings, equipment, furniture and vehicles or any asset that will not be used up entirely within the tax year of purchase.

1. Gross Product Variant: Under this variant, deductions are allowed for raw material and components purchase, however, no deduction/set off is allowed for purchase of Capital goods. Tax paid on Capital Input such as purchase of Plant, Machinery and equipments, etc. are not eligible for set off, and hence, not deductible from the tax collected on sales.

2. Income Type Variant: Under this type of variant, the cost of a capital asset again is not deducted when it is purchased. However, the firm is permitted to deduct the amount of depreciation that occurs in a given year on its capital assets. Under the
usual definition of income type value added tax base, depreciation is allowed on all capital assets, whether old or new. Depreciation could, however, be limited only to capital assets purchased after the adoption of the tax.

3. **Consumption Type Variant:** This type of tax corresponds closely to the personal consumption account in national income statistics. It provides closely the neutral treatment of capital assets. Under this tax base, a firm that purchases a capital asset may deduct, in the year of purchase, the full value of this purchase. In contrast to the income-type value added tax base, where depreciation is deducted year by year, the consumption value- added approach permits no adjustment for depreciation since to do so—after allowing deduction of full value in the year of purchase—would amount to deducting the price of the capital goods twice.

In this way, the variants of VAT differ in their treatment of capital goods. Among these three types of VAT, the consumption variant is the most superior form of VAT and is universally practiced.

**1.1.d Principles of VAT**

VAT can be implemented either under the origin principle or the destination principle.

**(A) Origin Principle**

Under this method, the tax base is obtained by adding the incomes produced by the firm. This implies that all exports are taxable and all imports are non-taxable. Where there is a border and cross-country trade, this principle gets important to imported goods or services over domestic production. Countries with international boundaries do not prefer to have this principle. But in European community (EC) where there is a common border this principle of taxation is essential. The main reason behind not following this principle is of
revenue loss. It also discourages exports, either directly or indirectly.

**B) Destination Principle**

This principle is quite popular and followed by a large number of countries. Under this principle, goods or services are taxed on at the place where they are produced and not at the place where they are consumed. This means all imports are taxed, while all kinds of goods and services are free to taxation. The main advantage of this principle is non-discrimination between import and internal production. This principle is favourable for promoting export. Many countries follow this principle because they are eager to boost their exports.

1.2 Need of the Study

VAT has become important source of revenue to the States in India. The Government of India is intending to increase percentage of VAT imposed on goods and services because of its relevance to income base of the states but citizenries’ perception is different towards different tax systems. It is therefore appropriate to carry out a research to determine the impact of VAT on the state’s economic development with other Tax system under commercial tax. Thus there is the need to understand with empirical facts of the impact of VAT on the economic development of the Tamilnadu (Pre & Post VAT Period).

1.3 Statement of the Problem

In a country like India with a federal Constitution, the constituent States have to adopt a consumption (or destination) type of indirect tax. This taxation can ensure a common market in the country, avoid cost escalation and also minimize inter-State tax exportation. It is these objectives with which Value Added Tax system was introduced.
Since the VAT system was introduced in Tamilnadu recently (i.e.2007) no methodological studies to the best of the knowledge of the researcher have been conducted to examine the effect of VAT on the traders, consumers, VAT officials and also the government. Besides, no attempt was made to assess the VAT administration mechanism in Tamilnadu. It is therefore, appropriate to carry out a research to determine the impact of VAT on the state’s economic development with other Tax system under commercial tax. A part from this, the Government of India has also contemplated to bring drastic reforms in indirect taxation viz, Introduction of GST. Thus, there is the need to understand with empirical facts of the impact of VAT on the economic development of the Tamilnadu (Pre & Post VAT Period).

1.4 Scope of the Study

This study intends to analysis the growth and Contributions of tax in Tamil Nadu in general and Value Added Tax in particular. Since, sales taxes are the significant sources of revenue to the state exchequer, contributing nearly 60 per cent of the state’s own tax revenue; sales tax has come to occupy the Centre stage of the fiscal in Tamil Nadu. VAT is the most diversified and simple as well as transparent indirect tax system with in-built capacity to raise more tax revenues without distorting the existing tax structure and is yet able to widen the tax base. Though this study, the researcher analysed the impact of VAT towards state economy by taking secondary data for period 12 years from 2001-12 (Pre & Post VAT period). The scope of the study is limited to Tamilnadu. Further study aimed to quantify the effectiveness of VAT by measuring the perceptions of VAT payers under various divisions in Tamilnadu.
1.5 Objectives of the Study

1. To study the nature and growth of tax revenue in Commercial Tax Department of Tamilnadu.

2. To describe the VAT procedure, Practices and collections policy and trend in Tamilnadu.

3. To discuss the contributions of VAT for the growth of Tamilnadu economy.

4. To identify the Trader’s Perception about the Awareness, Administration mechanism and Service Quality of VAT.

1.6 Hypotheses of the study

\( H_1: \) There is no impact on different tax systems under Commercial tax in Tamilnadu both pre & post VAT period.

\( H_2: \) There is no impact of VAT in Revenue growth of Commercial Tax in Tamilnadu

\( H_3: \) There is no significant difference between different categories of trader’s perceptions about VAT

1.7 Methodology

It is an empirical research relates with VAT in Tamilnadu under Commercial Tax Department (VAT, TNGST, Central Sales Tax, Entertainment Tax, Betting tax, Luxuries Tax, Entry Tax on Motor Vehicles). In a way, it is a policy research because it aims to evaluate the effect of new tax policy VAT introduced by the Government of India in the year 2005. This study has been based on both Primary data and Secondary data. Secondary data has been collected through Dept of Commercial Tax in Tamilnadu. Further the study
has identified the perception of VAT payers with the help of Primary data. Primary data has been collected through Interview Schedule Samples of 260 Traders has identified from Tamilnadu (tax payers in Commercial tax Department) and time series Secondary data for a period of 12 years 2001-13 has been collected.

1.8 Sampling

The primary data were collected by conducting a survey among 260 Traders in Tamilnadu for this study. The survey has been conducted for a period of 6 months from July 2013 to December 2013. After stratifying geographical area of survey, convenience sampling technique has been used for selecting the respondents from 7 divisions headquarters of Commercial tax department namely, Chennai East(45), Chennai North(32), Chennai south(40), Chennai central(30), Trichy(25), Vellore(70), Triunelveli(18). Respondents were contacted at the Commercial tax office, Auditors office, & Common service Centre. The data were measured on a 5-point Likert-type scale from 1 (Strongly Disagree) to 5 (Strongly agree). The sampling frame is given below Table 1.1.

<table>
<thead>
<tr>
<th>Sl.no</th>
<th>divisions</th>
<th>Type of business</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Trader</td>
<td>Manufacturer</td>
</tr>
<tr>
<td>1</td>
<td>Chennai E</td>
<td>31</td>
<td>6</td>
</tr>
<tr>
<td>2</td>
<td>Chennai S</td>
<td>13</td>
<td>9</td>
</tr>
<tr>
<td>3</td>
<td>Chennai N</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td>4</td>
<td>Chennai C</td>
<td>19</td>
<td>3</td>
</tr>
<tr>
<td>5</td>
<td>Vellore</td>
<td>30</td>
<td>14</td>
</tr>
<tr>
<td>6</td>
<td>Trichy</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>7</td>
<td>Triunelveli</td>
<td>13</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>124</td>
<td>55</td>
</tr>
</tbody>
</table>

*Source: Primary Data*
1.9 Reliability Analysis

To analyze the reliability of interview schedule items used in this study, Cronbach’s alpha test has been used and drew the following results: the questionnaire consists of five variables namely, Knowledge & Information about tax system, VAT administration, Service Quality of VAT, and Satisfactory level of VAT system. Thus, alpha ranged from 0.7 to 0.94, as per the table 1.2, which is a satisfactory level. According to Nunnally (1994) a scale of alpha > 0.7 is considered reliable.

<table>
<thead>
<tr>
<th>Constructs</th>
<th>No. of questions</th>
<th>Alpha</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knowledge &amp; Information about tax system</td>
<td>5</td>
<td>0.76</td>
</tr>
<tr>
<td>VAT administration mechanism</td>
<td>8</td>
<td>0.86</td>
</tr>
<tr>
<td>Service Quality of VAT</td>
<td>12</td>
<td>0.83</td>
</tr>
<tr>
<td>Satisfactory level of VAT system</td>
<td>5</td>
<td>0.94</td>
</tr>
</tbody>
</table>

Table 1.2 Reliability Analyses

1.10 Statistical Tools used

The collected data were analyzed by applying tools such as Factor Analysis, Chi-Square Test and ANOVA Test with the help of Statistical Package for Social Science (SPSS). The researcher has applied various statistical tools for specific purpose like,

- Multiple correlation has been applied in order to evaluate relationship among various tax collections under commercial tax revenue.

- In order to identify the impact of VAT on other Tax systems, the estimated Revenue of Commercial tax for the upcoming 10yrs were analyzed by using the Trend analysis.

- Two way ANOVA is used to identify the difference among the different rate of tax with different divisions.
✓ Paired T test has been carried out to identify the impact of VAT on CST, GST in Tamilnadu

✓ A test of association has also been done between the demographic variables viz. Age, Income level of business, ownership of business to the Familiarity in submitting tax return.

✓ Further, ANOVA Test has been carried out by considering scores of VAT administration mechanism w.r.t. ownership, nature, and income level of the business in order to observe the significant age group, income level of a respondent.

✓ SERVQUAL Model has also been developed by using Factor Analysis is also presented in this study.

1.11 Limitations of the Study

- Only taxpayers in the urban areas were interviewed. Although overwhelming majority of taxpayers lives in urban areas, there are taxpayer in small towns and rural areas as well. This group of taxpayers could have responded differently particularly in regard to the accessibility to the tax offices.

- The co-operation of respondents is very much required for a survey based research. The co-operation of a few respondents did not come up to the expectations.

- The time span of the present study ranges from 2001-02 to 2012-13 (pre-VAT 2001-06 & Post VAT 2007-12) has been collected. Secondary data on a particular aspect supplied by the various machineries under VAT are found to be different.
1.12 Chapter Scheme

The chapterisation of this thesis has been done in the following manner

* In the first chapter the origin and growth of VAT at the global level and at the national level along with the specific objectives as well as limitations of the study were highlighted.

* Chapter II deals with the review of the relevant research studies connected with the study.

* Chapter III provides the conceptual and Administration mechanism of VAT.

* Chapter IV deals with the nature & growth of commercial tax revenue in Tamilnadu

* Chapter V is devoted to analysis the VAT revenue and its impact on GST, CST, and few macroeconomic variables of Tamilnadu economy.

* Chapter VI narrates the Perception of traders about the three aspects of VAT viz, Awareness, Administrative mechanism and Service Quality.

* Chapter VII briefs the Summary of the major findings along with suggestions and conclusion.