CHAPTER I

INTRODUCTION AND DESIGN OF THE STUDY
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INTRODUCTION

An economy comprising certain geographical territory and inhabited by people is characterised by limited resources having rival uses in relation to unlimited human wants necessitating optimum utilisation of these limited resources. Numerous activities are undertaken by people in the economy to increase the supply of resources, to utilise the existing resources more effectively, to promote economic growth and to enforce justice in the economy.

But man is selfish and acquisitive. Left to themselves, individuals would seldom live in social harmony with perfect distributive justice. Man realised that some order was necessary to coexist in a social group, and to ensure this, some authority was required. Consequently, State was born. According to Plato,¹ a State is born out of the needs of mankind as no one was self sufficient but all had many wants. This was possible only by people living together and exchanging goods among themselves. This body of people was a State. Thus, Plato offered the economic reasoning for the origin of State. According to Aristotle² State was a natural political institution, since man by nature was a political

² Ibid.
animal. The institution of State was born to facilitate exchange of goods, protect life and to ensure good life for its subjects.

In order to ensure good life, goods are to be produced, distributed and consumed. These basic activities form basic aspects of life. A State is required to distribute goods in conformity with natural justice. The public and private sectors in the economy have different but complementary roles to play.

The important decision regarding what, how and for whom to produce is not guided by profit motive but by needs of the community as decided by the State. In a mixed economy, both private sector and public sector are recognised in the sphere of economic activities.

The State has to participate in the economic activities of the public. In order to provide employment and to meet the needs of the poor, public sector investment has to be taken in large amount. The presence of State in the economy has also been favoured for accelerating the rate of economic growth and to bring about more equitable distribution of income and wealth in the economy.

The State or Government in the context of modern Welfare State has to occupy a pivotal role in the production and distribution of goods, so that goods are available at cheap price to the weaker sections of the society. In the absence of production by public sector, these goods will be available to people only through marketing/pricing mechanism. In such a situation, a large section of society comprising the poor would go without consuming essential health and educational services because such goods are costly. So, a State cannot ignore the society. Consequently, the
State should directly undertake the responsibility of supplying these merit goods. Merit goods are those goods whose consumption is considered meritorious or desirable by the government. The goods whose consumption is considered harmful or undesirable are called non-merit goods. The consumption of merit goods is encouraged through subsides while non-merit goods may be discouraged through the levy of penalties and fines.

A modern welfare State can not remain content restricting its activities to merely satisfying the merit needs of society by producing only merit goods. Private and Public sectors are not mutually exclusive. They are interdependent on each other. Thus, the State is charged with duty of not only prescribing activities of these sectors but also determining the scope of the activities of the private sector to serve the society. Thus, in modern times, the scope of public finance is not only confined to financing of State activities, it is also concerned with other relevant issues such as stabilisation of income and employment in the economy, ensuring justice and optimum allocation of resources.

Mixed economy is the outcome of the acceptance of compromise formula between the two different schools of economic thought one, state ownership and control of means of production and the other, supporting the cause of free market system. In the mixed economy, both the public sector and private sector carry on productive activities in their respective spheres. However, private sector is guided by the State, so that their activities are in tune with the large interest of the society. In a mixed economy, the economic system is divided into following three parts or sectors:
1) Sector in which production and distribution is entirely managed and controlled by the State. It is the exclusive public sector.

2) Sector in which the State participates with the private enterprise in respect of production and distribution with State holding the majority share of activities.

3) Sector in which private enterprises, individuals or cooperatives have free access to function.

The origin of public finance is traceable in the origin of the modern State. It is one of these subjects or disciplines which lies on the border line between economic and politics. It is concerned with the income or revenue raising and expenditure incurring or spending activities of public authorities. The definition of state includes all kind of territorial government ranging from local bodies like Municipal Board, District Board, Gram Panchayat, Port trust to Governments (State and Centre). The vast array of problems centering around the revenue raising and expenditure incurring process of government is referred to as "public finance". According to Taylor, it deals with finance of the government. The finances of the government include the raising and disbursement of government funds. It is concerned with the operation of public treasury. To that extent, it is a science, a fiscal science, its policies are fiscal policies, its problems are fiscal problems.

According to Adam Smith,⁴ "the foremost duty of the State is that of defending the society against external violence or aggression and injustice. It calls for government administration and maintenance of law and order in the country to protect life, property, dignity of law-abiding citizens". The third duty is incurring expenditure on economic and social ends.


Public Expenditure

It is the end aim of collection of State Revenue. It deals with the principles and problems relating to the expenditure of public funds. This aspect studies the phenomena responsible for trends, pattern of public expenditure, evaluation of performance of public expenditure and studying about the ways of improving the spending policies of the government.

Public Revenue

It includes all incomes irrespective of their sources. It encompasses revenue from taxes, fees or receipts from borrowing. Taxation

is the main body of public finance. This includes study of problems of incidence and impact of taxation, whom the government wants to tax and who are taxed. It also studies the problems of tax evasion and tax avoidance and examination of causes and suggests remedial measures.

Public Debt

A government or public authority can also obtain income through raising loan in order to finance the short fall. Governments in developing countries rely on borrowings. The loans raised in a particular year constitute the receipts of the public authority for that year. It is an income of capital nature, while the provisions of repayment of the capital sum is the capital expenditure. The problems relating to the raising and repayment of loans are studied - the purpose of loan, sources, methods of raising it and payment of interest and principal amount. This part is known as Borrowing Policy.

Financial Administration

The study of Public Finance extends to the mechanism of financial organisation and administration under fiscal administrations, the study is concerned with the government machinery that is responsible for performing the various financial functions of the State like Budget.

Public Revenue occupies an important place in the study of public finance, which production occupies in the study of economics. The necessity of raising the public revenue follows from the necessity of incurring public expenditure. As the modern government has to perform several functions for the welfare of public and these functions cannot be
performed free of cost they involve substantial amount of public expenditure which can be financed only through public revenue.

Taxes

Taxes are the most common method of financing the government. In every country, public revenue is raised through taxes. They may be imposed on a person's income, wealth. They are direct or indirect. They are at different rates and nature.

Tax is a compulsory charge imposed by government on an individual or corporation. Irrespective of the benefits the public receive, they have to pay tax. There is no "quid pro quo" for the taxes paid to the government. There is no give and take relationship between a tax payer and an imposer.

Fees

Fee is charged by government for rendering certain services. The government guarantees the services to the person who pays fees. If any one wants to enjoy certain service or benefit he may have to pay a fee for it like licence fee.

\[5 \text{ Dr.B.P.Tyagi, Public Finance, Jai Prakash Nath Publications, Meerut, p.143.}\]
Price

The government sells goods and services and receives price. The government is a seller and the public are buyers for example providing Water Supply, Post and Telegraph Service, Transport Service etc.

Special Assessment

The government performs certain services as a result of which the property or wealth of a group of persons is increased. A levy in proportion to the increase in the value of wealth is known as special assessment.

Fines and Penalties

They are made for contravention of law. The government levies tax to obtain revenue. It imposes fines and penalties to deter people from doing certain acts contrary to law.

Gifts

A small portion of revenue of the government is derived from gifts of individuals, private organisations and foreign governments. But they are not regular and dependable source of revenue.

Borrowings

It is a temporary source. The money borrowed will be repaid from funds raised through other sources of revenue.
Printing of Paper Money

Finally, government may resort to printing of paper money as a means of paying their bills. The government has powers to create money and assign legal tender qualities. But this leads to inflation which ultimately ends in collapse of government. Printing of more paper money lead to economic problems like inflation, uncontrollable crisis and social problems like people losing confidence in the government.

The most common method is taking recourse to taxation. They are the largest part of public revenue. Tax is a compulsory payment which can not be refused without attracting punishment by the government. But no tax can be imposed beyond the tax paying capacity of individuals. Tax should affect all the people without making any distinction among citizens, ensuring the principle of equality before law. The tax policy of government must be optimum production oriented, clear-cut and less attentive to subsidiary objects.

Taxes are generally classified as a) Direct Taxes b) Indirect Taxes.

Direct Tax is that tax whose burden is borne by the person on whom it is levied. He can not transfer or shift the burden of tax to some other person. According to John Stuart Mill "a direct tax is demanded from the very person on whom it is levied. Indirect tax is one levied on a person in the expectation and intention that he shall indemnify at the expense of another.

As per this definition, a direct tax is really paid by the person on whom it is legally imposed, while indirect tax is imposed on one
person but is paid either partly or wholly by another person due to a consequential change in terms of contract or bargain between them.

According to E.Taylor "The terms direct or indirect tax are finally distinguishable in meaning only in terms of shiftability."  

According to A.R. Prest, "those taxes which are based on receipt of income are termed as direct, whereas those levied on expenditure are termed indirect. Income Tax, Profit Tax, Capital Gain Tax are direct; Customs, Duties, Excise Duties and Stamp Duties are indirect.

Antonio De Viti De Marco defines "direct taxes are the taxes on income from land and buildings, the tax on intangible or movable property, income from investments, income from business and professional activity, and tax on total income. Indirect taxes are those which strike the private consumption. They strike the income at the moment when the citizen spends it to acquire other goods".

It is not easy to differentiate the direct taxes from indirect taxes. A tax at one time is direct while at some other time it gets the characteristics of an indirect tax and vice versa. Finally, direct tax is that tax whose impact (burden) and the incidence fall on the same

6 Philip E. Taylor, op.cit., p. 307

person. Indirect tax is that tax whose impact and incidence fall on different persons. The impact of tax falls on the person who pays it to the government in the first instance. The incidence of tax falls on the person who finally bears the tax burden.

**Direct Taxes**

Direct Taxes are levied on income of individuals, income of companies and corporate entities, on the wealth of a person and on gifts.

On the basis, direct taxes are classified into:

**INCOME TAX:** On the income of individual.

**CORPORATION TAX:** On the profits of business organisation.

**WEALTH TAX:** On the wealth of person.

**GIFT TAX:** On the gifts received from donors.

Direct Taxes can be calculated by the individual who is paying and it is a straight payment. These taxes are paid in one instalment like Income Tax. The individuals have to fill complicated forms. In case of direct taxes, there is a possibility of tax evasion by not showing correct income.

Direct Taxes are levied on persons with high income and wealth. It goes well with the principle of "charging from the rich and spending for the poor".
Indirect Taxes

Indirect Taxes are those which are paid by one person at the first instance and collected from the public, by the tax payer, later, in the form of selling price. Thus, the burden is at the end shifted to the ultimate consumer.

Features

Indirect taxes are less inconvenient and less burdensome. The tax payers generally pay them while they buy goods and services in the market. The amount of tax is included in the price of commodities. The consumers pay without experiencing the pinch of paying tax. They are not even aware of the fact that they are paying tax.

Indirect Taxes are collected in the form of increased prices. Hence, no individual can evade the payment of indirect taxes. Indirect taxes are productive and elastic. When indirect taxes are imposed on essential commodities like sugar, edible oil, etc. their rates can be increased or decreased depending on the supply, economic conditions and the needs of Government.

Indirect Taxes contribute to promotion of social welfare. Taxes imposed on intoxicants like wine, opium, cigarette serve a great social purpose by curtailing and limiting consumption of such harmful commodities. Thus, they contribute to the welfare of the society.

Indirect Taxes are just and equitable. These are paid by all individuals when they purchase goods and services. When a rich person
buys more commodities and services he pays more to the government. A poor person who cannot afford everything pays less.

Indirect taxes serve as a powerful tool in moulding the production and investment activities of the economy. A proper structuring of indirect taxes can enable the authorities to twist the demand and supply forces in such a way as to yield desirable results by encouraging the development of priority industries.

Indirect taxes are of three types. They are Excise Duty (a tax on commodity) levied on goods produced or manufactured in India. Excise duties are normally levied by the Union Government except on commodities such as alcohol. Sales Tax is levied by State Governments on sale of goods. Customs duty is levied by the Union Government on value of goods imported into India and exported outside India.

Excise duty and customs duty form a sizeable portion of revenue to the Central Government and as such they are indispensable. The following table shows the importance of indirect tax revenue in the total revenue to the Government of India.
### TABLE I

**ROLE OF INDIRECT TAX IN REVENUE RECEIPTS**

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Receipts (Rs.in crores)</th>
<th>Indirect Tax Revenue (Rs. in crores)</th>
<th>Percentage of Indirect Tax to Revenue Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-1993</td>
<td>74128</td>
<td>54607</td>
<td>73.66</td>
</tr>
<tr>
<td>1993-1994</td>
<td>75453</td>
<td>53890</td>
<td>71.42</td>
</tr>
<tr>
<td>1994-1995</td>
<td>91083</td>
<td>64136</td>
<td>70.41</td>
</tr>
<tr>
<td>1995-1996</td>
<td>101131</td>
<td>75944</td>
<td>75.09</td>
</tr>
<tr>
<td>1996-1997</td>
<td>126279</td>
<td>90135</td>
<td>71.37</td>
</tr>
<tr>
<td>1997-1998</td>
<td>138514</td>
<td>104750</td>
<td>75.62</td>
</tr>
</tbody>
</table>

Source: India, 1999, Finance, p. 254

It is evident from the above table, that indirect taxes account for more than 70 per cent of revenue receipts. Moreover, the revenue from the indirect taxes is growing.

The following table projects the importance of direct taxes and indirect taxes, which highlight the indispensable role played by indirect taxes.

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TABLE II

TAX REVENUE AS A PERCENTAGE OF GROSS TAX REVENUE

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct Tax</th>
<th>Indirect Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994-1995</td>
<td>29.2</td>
<td>70.8</td>
</tr>
<tr>
<td>1995-1996</td>
<td>30.2</td>
<td>69.8</td>
</tr>
<tr>
<td>1996-1997</td>
<td>30.2</td>
<td>69.8</td>
</tr>
<tr>
<td>1997-1998</td>
<td>36.0</td>
<td>64.0</td>
</tr>
<tr>
<td>1998-1999</td>
<td>31.2</td>
<td>68.8</td>
</tr>
</tbody>
</table>


Analysis of the above table shows that direct tax and indirect tax revenue are increasing. Indirect taxes are twice larger than direct taxes which reflect the inherent flexibility in collecting the indirect tax revenue.

Due to the various advantages of indirect taxes, the collection is showing buoyancy over these years. The indirect tax collection is more than 2/3 of the total gross tax revenue of the country.

Among indirect taxes, the excise duty is important. Excise duty is levied on products and commodities manufactured in India. As excise duty is commodity tax, it is used to nurture an industry, to boost the development of certain industries by giving concessions, exemption and to desist the manufacture and consumption of certain undesirable
products by increasing the duty rates and not allowing concessions. Examples include Alcohol Products, Biris, Cigarettes.

**Definition of Excise Duty**

Excise Duties are levied and collected by the Central Government on all products, tobacco and all other goods manufactured in India except on alcohol liquor for human consumption, opium, hemp and other narcotic drugs. They are subject to excise levy by State Government. But when these opium, hemp or drugs are used in medical or toilet preparation, they can be levied with excise duty by Union Government.

Since time immemorial excise duties have been collected in the form of tax or toll. Even in the Mauryan period (4th century B.C), there is proof available for the levy of tax on manufactured goods. Later in the 19th century, excise duties were levied in 1894 on cotton yarn of finer counts which was later extended to fine cloths.

In Twentieth Century, the British imposed excise duty on salt. In 1917, excise duty on motor spirit was levied. In 1922, it was levied on kerosene. In 1930, the levy was made on silver articles and in 1934 on sugar and matches.

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9 Shiv Kumar Singh, Central Excise Duties and Economic Development in India, S.Chand & Co., New Delhi, p.44.
In the early stages of evolution, Indian Excise System had a basic purpose and philosophy behind its development. The main objective was either to restrict the internal consumption of scarce commodities or to make good the loss of revenue resulting from the shrinkage of revenue from protective customs duties on import of commodities. The imposition of duty on motor spirit and kerosene belonged to the first category. While subsequent levies such as duty on tyre, textiles, cigarettes belonged to the second category.

With the declaration of the Second World War, the Government felt the need to mobilise more revenue through excise duties and this led to the extension of duties to tobacco, coffee and tea. By 1948-1949, there were 15 items on the excise tariff schedule and the number remained the same level up to 1953-1954. Meanwhile, the revenue from these 15 commodities has increased from Rs.50 crores to Rs.94 crores.\(^{10}\)

Prior to the Central Excise and Salt Act 1944, there were separate 'Excise Acts' numbering 16.\(^ {11}\) All these were consolidated and a consolidating Act was passed in 1944.

The Central Excise and Salt Act was amended several times to remove pitfalls. During the year 1953-1954, a Taxation Enquiry Committee was appointed to review the tax structure of Indirect Taxes.

\(^{10}\) D.T.Lakdawala, K.V.Nambiar, Commodity Taxation in India, Sardar Patel Institute, Ahmedabad, p.41.

\(^{11}\) Ibid., p. 42.
The Committee recommended wide ranging suggestions including broadening the excise duty base in India. The Committee suggested additional taxation on luxury and semi-luxury goods at substantial rate.

During 1955-1960, more items were brought into excise net. In 1960s, metals, dyes, chemicals, plastics and various inputs were brought within the scope of excise duty. Already, in 1954, cement, rayon, foot wear, were covered.\textsuperscript{12}

In 1965, the Government appointed a one man Committee under the chairmanship of Boothalingam to examine and report on the rationalisation and simplification of direct and indirect taxes in India. The Committee recommended uniform ad valorem duty on all goods manufactured.

The Central Re-organisation Committee was appointed by the Government to make law comprehensive and to widen the tax base.

Duties of excise on all goods specified in the Central Excise Tariff are levied and collected in a manner as presented under Central Excise and Salt Act, 1944. Within the Ceiling Rate (Tariff Rate) approved by Parliament the Central Government has the power to reduce the rate or exempt any industry by notification in the Official Gazette.

When the first schedule to the Central Excise and Salt Act, 1944 was introduced, it comprised nearly 11 tariff items arranged in

\textsuperscript{12} Ibid.
alphabetical order. Over these years, the number increased. In March, 1960, the number had increased to thirty items which were rearranged in accordance with the Standard International Trade Classification (SITC).

By 1970, almost all important raw materials and manufactured inputs had been brought within excise arena. Till 1975, finished consumer goods were being added to the tariff list.

The Indirect Taxation Enquiry Committee appointed by the Government in 1976, made many recommendations on the role of indirect taxation for the promotion of economic uses of scarce resources.

A technical study group was appointed to review and revise the Central Excise Tariff for simplification and rationalisation of tariff. This was intended to reduce conflict as to assessment of duty between tax payers and tax collectors, to facilitate collection of data for policy formulation.

The technical study group decided to adopt the Harmonised System of Nomenclature (HSN) formulated by the Customs Cooperation Council (CCC) with necessary modification. Based on the recommendations, a new Central Excise Tariff Act was passed in 1985. It was brought into force on February 28, 1986 by replacing the then First Schedule to Central Excise and Salt Act, 1944.

For the levy and collection of excise duties, there are number of laws passed by Parliament and State legislatures depending on
whether the levy is by the Centre or State. The important laws dealing with Central Excise are:

a. The Central Excise Act, 1944.
b. The Central Excise Rules 1944
e. The Additional Duties of Excise (Goods of special Importance) Act. 1957.
g. The Medicinal and Toilet Preparations (Excise Duties) Act, 1955.
h. Customs and Central Excise Duty Drawback Rules, 1971
i. Customs, Excise, Gold (Control) appellate Tribunal (Procedure) Rules 1982.

Excise Duties help the Government to raise revenue from those sources which are inaccessible by direct taxation.

Since, the inception in 1948-1949, the contribution of excise revenue to government, is considerable. From a humble beginning of just
Rs. 51.66 crores, the revenue has grown up into a handsome amount of Rs. 53,200 crores.

The following table shows clearly the contribution of Excise Revenue to the Central Exchequer.

**TABLE III**

**GROWTH OF EXCISE REVENUE SINCE 1948-1949**

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue (Rs. in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948-1949</td>
<td>51.66</td>
</tr>
<tr>
<td>1950-1951</td>
<td>67.54</td>
</tr>
<tr>
<td>1951-1952</td>
<td>85.73</td>
</tr>
<tr>
<td>1953-1954</td>
<td>94.98</td>
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<tr>
<td>1954-1955</td>
<td>108.22</td>
</tr>
<tr>
<td>1955-1956</td>
<td>145.25</td>
</tr>
<tr>
<td>1956-1957</td>
<td>190.43</td>
</tr>
<tr>
<td>1957-1958</td>
<td>273.62</td>
</tr>
<tr>
<td>1958-1959</td>
<td>312.94</td>
</tr>
<tr>
<td>1959-1960</td>
<td>360.65</td>
</tr>
<tr>
<td>1960-1961</td>
<td>416.35</td>
</tr>
<tr>
<td>1961-1962</td>
<td>489.31</td>
</tr>
<tr>
<td>1962-1963</td>
<td>598.83</td>
</tr>
<tr>
<td>1963-1964</td>
<td>729.58</td>
</tr>
</tbody>
</table>

continued
<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue (Rs. in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1964-1965</td>
<td>801.51</td>
</tr>
<tr>
<td>1965-1966</td>
<td>897.92</td>
</tr>
<tr>
<td>1966-1967</td>
<td>1033.77</td>
</tr>
<tr>
<td>1967-1968</td>
<td>1148.25</td>
</tr>
<tr>
<td>1968-1969</td>
<td>1320.67</td>
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<tr>
<td>1969-1970</td>
<td>1524.31</td>
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<tr>
<td>1970-1971</td>
<td>1758.55</td>
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<td>1971-1972</td>
<td>2061.10</td>
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<tr>
<td>1972-1973</td>
<td>2324.25</td>
</tr>
<tr>
<td>1973-1974</td>
<td>2602.13</td>
</tr>
<tr>
<td>1974-1975</td>
<td>3230.52</td>
</tr>
<tr>
<td>1975-1976</td>
<td>3844.79</td>
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<tr>
<td>1976-1977</td>
<td>4221.45</td>
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<tr>
<td>1977-1978</td>
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<td>1979-1980</td>
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<td>1980-1981</td>
<td>6500.02</td>
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<td>1981-1982</td>
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<td>1982-1983</td>
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</tr>
<tr>
<td>1983-1984</td>
<td>10222.00</td>
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<tr>
<td>1984-1985</td>
<td>11151.00</td>
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continued
<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue (Rs. in crores)</th>
</tr>
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<tbody>
<tr>
<td>1985-1986</td>
<td>12956.00</td>
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<td>14470.00</td>
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<tr>
<td>1987-1988</td>
<td>16426.00</td>
</tr>
<tr>
<td>1988-1989</td>
<td>18738.81</td>
</tr>
<tr>
<td>1989-1990</td>
<td>22196.00</td>
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<tr>
<td>1990-1991</td>
<td>24335.00</td>
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<td>1991-1992</td>
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<td>1992-1993</td>
<td>30651.22</td>
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<td>1993-1994</td>
<td>31711.14</td>
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<td>1994-1995</td>
<td>37415.95</td>
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<td>1995-1996</td>
<td>41659.00</td>
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<tr>
<td>1996-1997</td>
<td>46916.00</td>
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<td>1997-1998</td>
<td>48137.00</td>
</tr>
<tr>
<td>1998-1999</td>
<td>53200.95</td>
</tr>
</tbody>
</table>

Source:


Union Excise Duties constitute most important source of income of the Central Government. The excise revenue has increased partly due to increase in industrial production and partly due to higher rate of duty. Receipts from Union Excise Duties are shared between the Centre
and States in accordance with the formula laid down by Finance Commission.

The structure of excise duty includes

a) Basic Excise Duty
b) Additional Excise Duty in lieu of Sales Tax
c) Cesses on specified commodities.

d) Additional Duties of Excise on Textiles.

With the growing needs of development, the excise system expanded both in range and depth. Now almost all goods are subject to excise duties.

ADMINISTRATIVE SET-UP FOR LEVY AND COLLECTION OF EXCISE DUTY

The executive powers of the Union formally vest in the President of India. Such powers are exercised by the President of India either directly or indirectly through officers subordinate to him in accordance with the Constitution. In exercise of his functions, the President is aided and advised by the Prime Minister, with the guidance of the Finance Ministry concerning central excise and customs matters.

In actual practice, the exclusive power of the Union concerning central excise and customs resides in the Finance Ministry. The Finance Minister is responsible for shaping the over all policies of the Government relating to central excise and customs.
The Finance Ministry has a department under it namely Central Board of Excise and Customs (CBEC) headed by a Chairman and consisting of members of the board, secretaries, commissioners. The CBEC is divided into wings, divisions, branches and sections. The CBEC is the principal adviser to the Finance Minister on matters of central excise, customs and their administration. The CBEC deals with the task of policy formulation concerning levy and collection of customs and central excise duties.

There are sixty three central excise commissionerates in the Union of India. Each Commissionerate is headed by a Commissioner. These Commissionerates are further divided into divisions under the charge of Assistant Commissioners.

The divisions are further divided into Ranges headed by Superintendent of Central Excise. The Range Office is the lowest organisational rung of Central Excise Department, with a well-defined area of work.

Each Commissionerate has about 5 divisions, and each such divisions had about seven ranges. Thus there are about 2100 excise ranges in the country. The following chart explains the hierarchy of Central Excise is shown below in Figure 1 of the research report.

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\(^{13}\) Records maintained by Statistics Department, Madurai Commissionerate.
FIGURE I
ORGANISATIONAL STRUCTURE OF CENTRAL EXCISE DEPARTMENT

Central Board of Excise and Customs

Chief Commissioner of Central Excise

Commissioner of Central Excise

Joint Commissioner of Central Excise

Deputy Commissioner of Central Excise

Assistant Commissioner

Superintendent

Inspector

---

The Central Board of Excise and Customs is a statutory body, established under Central Board of Revenue Act, 1963. The Board consists of five or six members. The duties and responsibilities are equally divided between the members and Chairman. The Chairman and the members are currently of the rank of Additional Secretaries to the Government of India.

For the purpose of easy administration, each State is divided into Districts. The Commissioner is the Chief Officer of the (Revenue) District. Tamil Nadu has four Commissionerates with headquarters in Chennai, Trichy, Coimbatore and Madurai. Chennai is divided into 3 Commissionerates I, II and III. The composite Madurai District is also known as Madurai Commissionerate. The Central Excise Commissionerate of Madurai consists of the territorial limits of Madurai City, Virudhunagar, Sivakasi, Manamadurai, Palani, Dindigul, Theni, Karaikudi, Rajapalayam, Kovilpatty, Tirunelveli and Tuticorin. The geographical coverage of sample units is exhibited in Figure 2 of this research report.

The contributions of these Commissionerates to the total revenue of the country are given in Table IV.
TABLE IV

EXCISE REVENUE OF COMMISSIONERATES OF TAMIL NADU

(Based on the Year 1997-1998)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Excise Revenue (Rs. in crores)</th>
<th>Percentage to All India Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chennai</td>
<td>2016.07</td>
<td>4.188</td>
</tr>
<tr>
<td>Coimbatore</td>
<td>603.82</td>
<td>1.254</td>
</tr>
<tr>
<td>Trichy</td>
<td>585.78</td>
<td>1.217</td>
</tr>
<tr>
<td>Madurai</td>
<td>492.33</td>
<td>1.022</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3698.00</strong></td>
<td><strong>7.681</strong></td>
</tr>
</tbody>
</table>

Source: Records of Statistics Department, Head Quarters, Madurai Excise Department.

It is evident from the above table that the Tamil Nadu Commissionerate has contributed about 7.7% revenue, in the previous year. The collection of excise revenue has been increasing over the years. The Table V depicted below is a pointer to these facts.
TABLE V

EXCISE REVENUE OF TAMIL NADU

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Excise Revenue (Rs.in Crores)</th>
<th>Percentage to All India Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-1991</td>
<td>1798.26</td>
<td>7.38</td>
</tr>
<tr>
<td>1991-1992</td>
<td>2130.82</td>
<td>7.60</td>
</tr>
<tr>
<td>1992-1993</td>
<td>2278.53</td>
<td>7.43</td>
</tr>
<tr>
<td>1993-1994</td>
<td>2352.13</td>
<td>7.41</td>
</tr>
<tr>
<td>1994-1995</td>
<td>2791.04</td>
<td>7.46</td>
</tr>
<tr>
<td>1995-1996</td>
<td>2992.54</td>
<td>7.18</td>
</tr>
<tr>
<td>1996-1997</td>
<td>3514.34</td>
<td>7.49</td>
</tr>
<tr>
<td>1997-1998</td>
<td>3698.00</td>
<td>7.68</td>
</tr>
</tbody>
</table>

Source: Records of Statistics Department, Head Quarters, Madurai.

Thus, the various commissionerates in Tamil Nadu are trying to collect more revenue to the government, making excise revenue a major source of income to the government. Tamil Nadu Commissionerate has been identified as a centre yielding more than two thousand crores.

The excise duty being levied on homogeneously produced commodities, plays an important role in shaping the industrial economy.

The excise duty being a commodity taxation gives rise to certain problems.
a) The tax structure is characterised by multiplicity of levies on the same base.

b) The tax rate categories on different commodities are numerous, which distorts tax incentives.

c) The tax structure suffers from cascading effect which rises consumer price more than what accrues to the exchequer by way of additional revenue.

d) The cascading effect (i.e) taxing the input, then taxing the final products comprising the taxed inputs leads to double tax that is tax on tax, which leads to higher cost causing constraint on ultimate growth.

e) There is lack of transparency in the tax structure that hinders exact calculation of tax incidence for an economic analysis.

f) A number of appendages have been added to the basic structure which have led to the erosion of efficiency of tax system.

g) The monitoring system has become weaker- ‘Excise’ has been made complicated with the code of rules and procedures in Central Excise Act and Central Excise Rules.  

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The Final Report of the Tax Reforms Committee also has located many pitfalls in the excise administration.

The cascading effect of excise duties has been the subject matter of debate since a long time. Excise duty may adversely affect resource allocation and dislocate production. When the government imposes tax on particular goods, some persons may stop buying as they fail to obtain optimum satisfaction. The production of other goods will increase while that of taxed goods will decrease. Thus there will be poorer allocation of resources. When central excise duty is levied, at all stage, selling prices are marked-up and consumers suffer. Prices are increased more than the tax amount. It is called "pyramiding" effect. Excise duties are inflationary. The Modified value added tax scheme was introduced to eliminate the pyramiding effect.

The Modified Value Added Tax was introduced with effect from 01-04-1986 by the then Finance Minister of India, Mr.Vishwanath Pratap Singh, in line with Value Added Tax system prevailing in foreign countries.

The origin of value added tax can be traced back to workings of FVON Siemen who proposed it in 1918 as a substitute for the then established German Turnover Tax. A value added tax is a tax levied on the value that is added to goods and services by entrepreneurs at


18 Mahesh C. Purohit, Principles and Practice of Value Added Tax, Gayathri Publications, New Delhi, p.71.
each stage of production and distribution. This is considered a superior way of indirect taxation. It is much better than indirect taxes such as excise duties, sales tax, customs duties etc. The tax on value added prevents the cascading effect of an indirect tax. VAT replaces other multiple taxes. In case of exports with input taxes removed, the export promotion gets a boost.

For the purpose of imposition of the tax, it is essential to measure the value added and the tax on which the tax is to be levied. In a unit engaged in productive operation, the value added is the difference between the gross value of output and that of the intermediate goods purchased for the purpose of production.

In India VAT in its original form could not be adopted due to the large number of small and medium industries. The manufacturers have to know the cost details of his predecessors. The data are inaccessible due to maintenance of business secrecy. In a single VAT, the State Government lose their power to levy tax under Article 246 of the constitution. So it was intended to introduce VAT principles in the existing excise duty structure which took the form of modified value Added Tax.

MODVAT is a procedure-oriented scheme. It is aimed at allowing relief to the manufacturer from the cascading effect. It is an improvement over the proforma credit. The proforma credit was limited in scope. In order to extend the benefits of proforma credit scheme, MODVAT was introduced.
In developed countries, the concept of Value Added Tax has been followed for a long period.

The study is a maiden attempt since there is no published source available. All the data have been compiled for conducting 'selective audit' or for appeal purposes. These data in a booklet form are circulated to all divisions and ranges for department use only. The Government through various committees, tried to study the effect of MODVAT scheme. The Government, based on its observations, representations from trade and reports of various committees, have made many changes in the scheme. Such changes some times, led to further complications like concession for small scale unit with and without MODVAT facility, extension of MODVAT credit to nut, bolt, spares, components made in 1994-1995 Union Budget. This makes the scheme more tough.

Hence, it is necessary to study the scheme in the light of amendments made from time to time. This study evaluates the scheme by bringing out the benefits and drawbacks of the scheme, the views of assessees regarding the scheme and how the authorities feel about the scheme. The study also evaluates the effect of extension of MODVAT credit to capital goods, the need for MODVAT in the direction of VAT.

STATEMENT OF THE PROBLEM

Union excise duty is the major source of revenue to the Union Government. It is an indirect tax. From the day of inception, the contribution of union excise duty has been increasing. Almost all the commodities have been brought under excise net. The revenue of 51.66 crores in 1948-1949 has grown in to Rs.53,200 crores. This growth is
attributed to various reforms in production, Five year plans, liberalisation policy, Industrial Policy Resolution and the like. In 1990 the industrial gates of India were opened to multinational. This decade is characterised by privatisation. All these have led to growth in production, distribution and income. The excise realisation also has grown. In the year 1986, as a stop-gap arrangement for introduction of VAT, Modified Value Added Tax was introduced with the purpose of elimination of cascading effect and stimulating industrial growth. The Modified Value Added Tax, enables the manufacturers to take instant credit of duty paid on inputs. This scheme helps them to clear the goods easily by adjusting their duty liability either in MODVAT credit account or by paying cash. So, a substantial portion of duty liability on final products, is discharged by utilising MODVAT credit account. In order to take this credit, lengthy procedures are to be followed. MODVAT Rules contained in section 57A to 57U are very complicated and subject to lot of interpretations.

In any economy, the income from domestic production must be more than the income from customs duty on imported items. Of late, the customs revenue is increasing compared to excise revenue. This is a matter of serious concern. The problem is not only concerned with loss of revenue but also of employment, standard of living etc. The Government in 1986, while introducing MODVAT on inputs and in 1994 extending it to capital goods, believed that these concessions would accelerate the industrial growth, leading to increase in excise revenue. The MODVAT credit utilisation has been growing substantially. This necessitates an evaluation of the scheme. It is right time to find out the reasons for the slow growth in revenue from domestic production. The MODVAT scheme as a boost for industrial growth needs to be analysed.
Moreover in order to enjoy the concession, laborious procedures must be followed, which many times lead to litigations.

Modified Value Added Tax, is a unique scheme under central excise which enables a manufacturer to avail credit of duty paid on inputs (notified inputs-known as specified inputs) used in or in relation to the manufacture of dutiable final products, directly or indirectly and whether such inputs are contained or not in the final products and utilise such credit of duty on input towards payment of duty on excisable final products.

Modified Value Added Tax is not a new concept but was existing under different schemes such as Proforma Credit under Rule 56A and Chapter X Procedures.

MODVAT came into existence as a result of report submitted by the Technical Study Group appointed by Government to study Value Added Tax prevailing in European countries and to suggest adopting VAT in India and to mitigate cascading effect of excise duty.\(^\text{19}\)

The main objective of introducing MODVAT Credit Scheme is to eliminate cascading effect on cost of production and thus passing on the reduction in cost to the consumers in the form of reduced selling price.

\(^{19}\) Ishwar C. Dhingra, op.cit., pp.675-676.
The following table shows the MODVAT credit utilisation since its inception i.e 1986-'87.

**TABLE VI**

**MODVAT CREDIT TO EXCISE DUTY**

<table>
<thead>
<tr>
<th>Year</th>
<th>Excise Revenue (Rs. in Crores)</th>
<th>MODVAT Credit (Rs.in Crores)</th>
<th>Percentage of MODVAT to Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986-1987</td>
<td>14407.29</td>
<td>1913.59</td>
<td>13.28</td>
</tr>
<tr>
<td>1987-1988</td>
<td>16426.00</td>
<td>2819.91</td>
<td>17.16</td>
</tr>
<tr>
<td>1988-1989</td>
<td>18738.81</td>
<td>3809.01</td>
<td>20.33</td>
</tr>
<tr>
<td>1989-1990</td>
<td>22196.95</td>
<td>5278.93</td>
<td>23.78</td>
</tr>
<tr>
<td>1990-1991</td>
<td>24335.65</td>
<td>6495.56</td>
<td>26.69</td>
</tr>
<tr>
<td>1991-1992</td>
<td>28020.08</td>
<td>7965.35</td>
<td>28.43</td>
</tr>
<tr>
<td>1992-1993</td>
<td>30651.22</td>
<td>10840.23</td>
<td>35.36</td>
</tr>
<tr>
<td>1993-1994</td>
<td>31711.14</td>
<td>11896.40</td>
<td>37.51</td>
</tr>
<tr>
<td>1994-1995</td>
<td>37415.95</td>
<td>21686.74</td>
<td>57.96</td>
</tr>
<tr>
<td>1995-1996</td>
<td>41658.77</td>
<td>29951.20</td>
<td>71.89</td>
</tr>
<tr>
<td>1996-1997</td>
<td>46916.04</td>
<td>34221.88</td>
<td>72.94</td>
</tr>
<tr>
<td>1997-1998</td>
<td>48137.19</td>
<td>35164.52</td>
<td>73.05</td>
</tr>
</tbody>
</table>

Sources: Statistical Year Books, circulated by Central Excise Department
It is clear from the above table that manufacturing industries have been really benefited. They have obtained a benefit of about 73% reduction in duty liability in 1997-1998 thus, relieving them from cash crisis, on the other hand the Government has lost a substantial revenue. It was expected that due to this concession scheme, many manufacturers would register with the excise department and pay duty. To some extent, the Government has succeeded in its mission. While analysing the Table II, one can find out the revenue is also increasing. But the increase in revenue does not commensurate with the increase in MODVAT credit. More MODVAT credit utilisation indicates more goods are produced. So a study of excise revenue as a percentage of gross domestic product was made.
TABLE VII
EXCISE REVENUE, MODVAT CREDIT AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Domestic Product at current prices (Rs.in crores)</th>
<th>Excise Revenue (Rs.in crores)</th>
<th>Percentage of Excise Revenue to GDP</th>
<th>MODVAT credit as Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980-81</td>
<td>122472</td>
<td>6500.02</td>
<td>5.30</td>
<td>-</td>
</tr>
<tr>
<td>1981-82</td>
<td>143216</td>
<td>7420.74</td>
<td>5.18</td>
<td>-</td>
</tr>
<tr>
<td>1982-83</td>
<td>159395</td>
<td>8058.50</td>
<td>5.05</td>
<td>-</td>
</tr>
<tr>
<td>1983-84</td>
<td>186723</td>
<td>10222.00</td>
<td>5.47</td>
<td>-</td>
</tr>
<tr>
<td>1984-85</td>
<td>208533</td>
<td>11151.00</td>
<td>5.34</td>
<td>-</td>
</tr>
<tr>
<td>1985-86</td>
<td>233799</td>
<td>12956.00</td>
<td>5.54</td>
<td>-</td>
</tr>
<tr>
<td>1986-87</td>
<td>260030</td>
<td>14470.00</td>
<td>5.56</td>
<td>0.730</td>
</tr>
<tr>
<td>1987-88</td>
<td>294851</td>
<td>16426.00</td>
<td>5.57</td>
<td>0.956</td>
</tr>
<tr>
<td>1988-89</td>
<td>352706</td>
<td>18738.00</td>
<td>5.31</td>
<td>1.079</td>
</tr>
<tr>
<td>1989-90</td>
<td>408662</td>
<td>22196.00</td>
<td>5.43</td>
<td>1.291</td>
</tr>
<tr>
<td>1990-91</td>
<td>477814</td>
<td>24335.00</td>
<td>5.09</td>
<td>1.359</td>
</tr>
<tr>
<td>1991-92</td>
<td>552768</td>
<td>28020.00</td>
<td>5.07</td>
<td>1.440</td>
</tr>
<tr>
<td>1992-93</td>
<td>630772</td>
<td>30651.22</td>
<td>4.86</td>
<td>1.718</td>
</tr>
<tr>
<td>1993-94</td>
<td>732874</td>
<td>31711.00</td>
<td>4.33</td>
<td>1.623</td>
</tr>
<tr>
<td>1994-95</td>
<td>868019</td>
<td>37415.95</td>
<td>4.31</td>
<td>2.498</td>
</tr>
<tr>
<td>1995-96</td>
<td>1006286</td>
<td>41658.77</td>
<td>4.14</td>
<td>2.976</td>
</tr>
<tr>
<td>1996-97</td>
<td>1149215</td>
<td>46916.04</td>
<td>4.08</td>
<td>2.978</td>
</tr>
</tbody>
</table>

Source: India, '99, p.244
Analysis of the above table brings out that the revenue to Gross Domestic Product reduces, whereas MODVAT credit to Gross Domestic Product, increases. The revenue to gross domestic product was about 5% in the Eighties, has come down to 4% in the Nineties. The comparison of gross domestic product and revenue gives an impression that due to MODVAT credit, the revenue suffers.

This is again reenforced the necessity of analysing 'Net Value Added' (Excess of Value of Output over Value of Input and depreciation) to excise revenue.

The table given below is a pointer to these facts.

**TABLE VIII**

NET VALUE ADDED OF MANUFACTURING SECTOR AND EXCISE REVENUE

<table>
<thead>
<tr>
<th>Year</th>
<th>Total of Input (Rs. in crores)</th>
<th>Value of Output (Rs. in crores)</th>
<th>Net Value Added (Rs. in crores)</th>
<th>Excise Revenue (Rs. in crores)</th>
<th>Percentage of Increase of Net value added over the previous year</th>
<th>Percentage of Increase in Excise Revenue over the Previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>233029</td>
<td>299196</td>
<td>54827</td>
<td>28020</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1992-93</td>
<td>282943</td>
<td>368614</td>
<td>71248</td>
<td>30651</td>
<td>29.95</td>
<td>9.38</td>
</tr>
<tr>
<td>1993-94</td>
<td>320855</td>
<td>425744</td>
<td>88434</td>
<td>31711</td>
<td>24.12</td>
<td>3.45</td>
</tr>
<tr>
<td>1994-95</td>
<td>390796</td>
<td>517987</td>
<td>108517</td>
<td>37415</td>
<td>22.70</td>
<td>17.98</td>
</tr>
<tr>
<td>1995-96</td>
<td>507491</td>
<td>670514</td>
<td>139397</td>
<td>41659</td>
<td>28.45</td>
<td>11.34</td>
</tr>
</tbody>
</table>

Net Value Added : Value of output - (Value of Input+Depreciation)

The table furnished above clearly indicates that the increase in revenue does not commensurate with the increase in "Net Value Addition". The reasons are utilisation of MODVAT credit, SSI concessions and rationalisation of duty.

It is necessary for the government to evaluate any scheme that affects its revenue. Hence, the study of MODVAT scheme is essential for the government. Moreover, the scheme contains complicated provisions and procedures to be followed to reap its benefits. So MODVAT credit scheme is interesting to study from the point of view of the initiator of the scheme and users of the scheme.

Hence, the study of MODVAT scheme is necessitated to review and evaluate the scheme so as to make the scheme more flexible and beneficial to manufacturers assessees, government and consumers.

The following objectives have been formulated to study the scheme wide and deep.

**OBJECTIVES OF THE STUDY**

The study has been undertaken with the following objectives.

1. To examine the MODVAT scheme, its benefits and drawbacks to find out the dominant factor that influence the scheme.

2. To study the performance of divisions.

3. To know the extent of utility of MODVAT credit in different divisions of the commissionerate to detect revenue leakage.
4. To study the reasons as to why no public interest litigation has been filed for not passing the benefit of the scheme to consumers.

5. To analyse the impact of MODVAT scheme on different industries.

6. To find out the real beneficiaries of the scheme.

7. To identify the various difficulties faced by industries in taking MODVAT credit as well as difficulties faced by authorities in implementing the scheme and to offer concrete suggestions for the betterment of the scheme.

HYPOTHESES

Based on the foregoing research objectives, the following statistical null hypotheses have been formulated to facilitate findings of the present study.

1. The linear regression coefficient is zero with regard to

   (i) Excise revenue of India
   (ii) Excise revenue of Madurai Commissionerate
   (iii) Utilisation of MODVAT credit in India
   (iv) Utilisation of MODVAT credit in Madurai Commissionerate

2. The divisions do not differ significantly with respect to the average liabilities of duty to Assessable value.

3. The average ratios of Excise revenue (PLA) to Duty Liability of nine divisions are equal.
4. The average ratios of Input credit to Duty Liability of all nine divisions are same.

5. The average ratios of Capital Goods credit to Duty Liability of the nine divisions are equal.

6. The average ratios of PLA to Duty Liability for the six industries are same.

7. The average ratios of Input credit to Duty Liability for the six industries are same.

8. The average ratios of Capital Goods credit to Duty Liability of all industries are equal.

9. The scheme is not dominated by more procedural drawbacks (flaws).

10. The coefficient of correlation between two dimensions is zero.

11. All the four dimensions have equal mean score.

**SCOPE OF THE STUDY**

1. The study is confined to manufacturer assessees registered with Central Excise Department, Madurai, who pay excise duty and avail themselves of both MODVAT credit (input and capital goods) continuously for a period of five years (i.e) 1994-1995 to 1998-1999.

2. The study covers division-wise analysis of all nine division of Madurai Commissionerate, which is the study of the universe.
3. The study analyses the interview schedules administered to fifty Central Excise officials, to find out their attitude towards the scheme.


REVIEW OF RELATED LITERATURE

There are not many published sources exclusively on Modified Value Added Tax. A doctoral dissertation had been done on Planning, Resource Mobilisation in Developing economy, by D.K. Radha submitted to the Indian Statistical Institute, New Delhi, 1987. The purpose of the study was to build a model to measure monetary and financial market, mobilisation of money, subsidies, and to examine the deficit. The dissertation did not speak anything about Central Excise Duty as form of commodity tax.

The Interim and Final Report of the Tax Reforms Committee 1991, chaired by Professor. Raja J. Chellaiah, brought out the pitfalls of MODVAT scheme such as irregular utilisation of credit, misuse of scheme, intricacies of deemed credit, etc. This report throws a flash light on the scheme.

The report of the Technical Study Group on Central Excise Tariff, 1985, chaired by R.C. Mishra evaluated the schemes of set-off, Proforma Credit and Chapter X procedures. The report recommended to adopt (a) one enactment for levy of duties, (b) consolidated Tariff Act (c) rationalisation of duty structure (d) tariff nomenclature (e) extension
of duty credit to all products (f) unified Value Added Tax (g) Manufacture VAT (MANVAT).

A research study on the "Incidence of Indirect Taxation in India-Who Pays the Tax" by Pawan K. Agarwal under the sponsorship of Ministry of Finance, Government of India, is worth mentioning. The study estimates the incidence of major indirect taxes in India namely union excise duties customs duty, countervailing duties and sales tax. The research was made to study the incidence of taxation for the year 1989-1990. The scope includes not only excise duties but also sales tax and customs duty.

The National Institute of Public Finance and Policy, has made a research on "MODVAT Misuse". It was submitted to the Ministry of Finance; This research was done under the chairmanship of Shome Parthasarathy. The research findings were published in Economic Times, March 29, 1996. The study brought out pitfalls such as

a. checking invoices should be more meaningful than a mere arithmetical check.

b. accountability seems to be low with scant emphasis on checking even when it is feasible.

c. there is unauthorised availment of MODVAT credit leading to increase in the quantum of input credit.

d. the majority frauds are due to procedural flaws.
e. cases of MODVAT misuse are found where goods are sold to exempted sector and their invoices are sold off separately to manufacturers.


The study undertaken by Parameswaran titled "The Power of Taxation under Indian Constitution" explained the taxation systems in India. The study considered various methods of resource mobilisation, contribution of taxes, the role of direct and indirect taxes and their relative merits and demerits.

The study undertaken by M.M. Ismail titled "Working of Modified Value Added Tax scheme in Kaleeswar Mills, Kalayarkoil" has brought to light the working of MODVAT scheme and the problems faced by the particular unit.

Several articles have been written on MODVAT by various professionals and legal experts. These articles are regularly published in Excise Law Times, a special bi-monthly magazine on excise and customs.

The article titled "Modified MODVAT" by BH. Shiramaurthy published in Excise Law Times, July 15, 1998 (p.103), differentiates MODVAT scheme from VAT by explaining that the present MODVAT
scheme is nowhere near the concept of VAT, where in, the manufacturer collects the gross tax on the article from the buyer, retains with him the duty already suffered by way of input duty and pays to the government the residual tax, with the result that at any given stage, the commodity pays the duty liability there on. The above factor of VAT scheme are not made inbuilt in the MODVAT scheme.

Article captioned, "MODVAT and Assessable Value for Captive Consumption" by K.M.Gopalakrishnan (Excise Law Times, May 15, 1998, p.A19) brings out the technical flaw contained in Rule 57 for calculating the value of goods captively consumed. He also brings to sharp focus that the reversal of MODVAT credit shall be made at the original amount and not at the current prevailing rate of duty on such material.

"Tax Administration by A.K. Bandyopadyay (Excise Law Times, January 1, 1997, p.A14) criticised the MODVAT scheme as inadequate in the era of liberalisation. He pointed out that MODVAT system is abused by manipulation of document and slackness of control over dealers who are also in the chain of movement of goods and documents in the system and further observed that tax reforms induce tax payers to bribe rather than pay taxes.

The article titled "Indirect Taxes: An Inflationary Budget" by Aravind P.Datar, published in Charatered Secretary, July, 1998, critically evaluated the budget for the year 1998-'99. The author welcomes the SSI concession extended to manufacturers of computers.

The article titled "Policy on Modern Small Scale Industries- A case of Government failure" by Suresh D.Tendulkar and T.A.Bhavain
published in the Indian Economic Review (pp.38-39) critically analysed operational efficiency of small scale industry in the context of reservation of items for the exclusive manufacture by SSI. The author is of the view that the fiscal concession and reservation did not induce small units to improve efficiency and to attain optimum size but these measures provide strong incentive to remain small in atomistic fashion.

The Indian Economic Diary dated February 5-11, 1998 (p.647) has expressed worries about small scale units. The article further observed that the SSI sector in the country perceive that entry of multinational corporations and de-reservation of items will erode their market share.

Dr.A.K. Bandyopadhyia’s "MODVAT and Central Excise Revenue" in Excise Law Times, January 01,1998, (pp. A14-16) reviewed the share of revenue from excise and customs. The article has brought to light that the central excise revenue realisation since 1986, has been increasing not withstanding the introduction of MODVAT. Article pointed out MODVAT scam which is nothing but irregular availment of MODVAT credit. The author stressed the need for VAT to eliminate flaws like lengthy procedure, imperfect control over dealers, ambiguity in MODVAT Rules, lack of clear guidance to MODVAT assessees and lack of common sense in implementing the various rules.

Rajesh Rekhani in his article titled "New Scheme for SSI units if Beneficial" (Excise Law Times, June 01, 1997, p.189) evaluated the SSI exemption notification announced for the year 1997-1998. The article warned the SSI to think over the proposal of switching over to SSI exemption scheme, so as to avoid lapsing of accumulated credit.
V. G. Ranganathan in his article titled "Valuation under Section 3A" (Excise Law Times, May 15, 1997, p.A3) expressed his anguish that valuation of duty on the basis of annual capacity is against the principle of commodity tax. Unless a commodity comes into existence the tax cannot be levied. The author observed that installed capacity is one thing and actual manufacturing is another thing. He pointed out further that lack of raw material, operational problems, etc., affect the quantity of manufacture of goods and depending upon the production capacity alone would be illogical besides being arbitrary.

M.M. Paul in his article titled, "Second Stage Dealer" (Excise Law Times, June 01, 1997, p.A87) expressed his wrath about the restriction on second stage dealer with regard to authentication of invoices issued by them. He observed that such restriction is more severe than physical control and approaching the Inspector may lead to corruption and misuse of MODVAT benefit.

G.K.Loyalka in his article titled, "New SSI Scheme", (Excise Law Times, June 15, 1997, pp. 20-22) has criticised the SSI scheme contained in Budget 1997-1998, that if a small scale industry wants to take MODVAT credit, it has to compete with large scale units, by paying duty at full rate.

D.V.Sidhaye in his article titled, "Pre-Deposit; Some Thoughts" (Excise Law Times, July 01, 1999, pp.A10-12) made an observation regarding the pre-deposit of amount equivalent to duty and penalty by the assessee in case of appeal. The author observed this rule that is very harsh for a sick SSI unit with acute shortage of funds.
Ashok Dhingra, in his article titled, "MODVAT-Ownership of Capital Goods Whether Necessary," (Excise Law Times, July 01, 1999, p.A19) criticised the attitude of excise authorities for refusing the MODVAT credit on capital goods not owned by the assessee. He was of opinion that what is not expressly provided in the law cannot be supplemented by executive instructions.

One more article titled, 'Service Tax And Excise Phobia' by T.A. Rustagi (Excise Law Times, January 01, 1998, pp.8-10) appreciated the role of indirect taxes and service tax as a supplementary to excise, though, service tax is levied on service and there is no distinction in the consumption of goods or services.

D.Xavier in his article titled, "MODVAT facility and its Implementation ' (Excise Law Times, January 01, 1998, p.A34) observed that the MODVAT scheme has become cumbersome, source of harassment and litigation. There are frequent changes of MODVAT Rules, thereby denying the benefit even for minor technical mistake. Under Rule 57CC, the matter of reversal of credit for exempted item is fixed at 8% of price. It is also suggested in this article that much paperwork could have been avoided if an outright average credit was allowed on dutiable goods.

An article titled, 'VAT on the Reforms Agenda', published in the Economic Times, November 01, 1999 by M.Govinda Rao, analysed the reasons for failure of VAT in Sales tax, Maharashtra. The article also prescribes the various steps to be undertaken by the government in introducing VAT in India.
An article titled, ‘Fiscal Federalism-Towards An Appropriate VAT system for Federal Economy’ by S.Gurumoorthy (Economic and Political weekly, October 2-8, 1999, pp. 2875-2887) compared VAT in India with VAT in other countries. The article examined commodity taxation in India, namely excise duty and sales tax, by highlighting the drawbacks of MODVAT.

A.B.Rao in his article titled, "Unjust Enrichment" (Excise Law Times, September 15, 1999, p.A127) discussed Section 11B of Central Excise Act which provided for unjust enrichment. There is a statutory presumption that the duty of excise has been invariably passed on to consumers unless otherwise proved.

S.C. Trivedi, in his article titled "Need to make Rules and Regulations practicable" (Excise Law Times, September 15, 1999, A.129) examined that central excise law is deficient towards the needs or requirements of the industry; with too many amendments how the law has been made impracticable.

D.V. Sidhye in his article entitled "Trading of MODVAT Availed Inputs" (Excise Law Times, February 15, 1999, pp. A36-37) pointed out the reason for inflation in prices due to capital blockage in inputs, cost of manpower, higher inventory cost, extra insurance expenses where the MODVAT availed inputs are lying unutilised for a long period.

A.K. Varma in his article titled "MODVAT - Accounting treatment in Central Excise and Income Tax" (Excise Law Times, December 01, 1999, pp. A65-67) discussed the controversies leading to dispute between department and assessees. One such area of dispute
relates to the determination of assessable value of final products availing of the MODVAT credit on inputs. The author raised the question of valuing the inventory and made an appeal of repealing Section 145A of Income Tax Act.

S. Mukhopadyay in his article titled "VAT in India-Backward HO" (Excise Law Times, November 15, 1999 pp. A24-26) enumerated the various cases of failure of VAT in India. The reasons for withdrawal of VAT in Maharashtra were (a) extra burden on tax-payers in term of account keeping which small dealers find difficult to comply with (b) multiplicity of rates making the working of VAT more complicated (c) harassment of tax payers having increased after the introduction of VAT. The article, explained in length the VAT stories of Maharashtra, Kerala, Gujarat, Tamil Nadu, Uttar Pradesh and West Bengal. A lot of fraud in the form of fake invoices was discovered and the State found itself bogged down in litigation. The author also stressed that in a federal state where the centre has not much control over the States it is very difficult to impose one VAT. For unitary countries, VAT may be of use. Countries such USA and Australia did not opt for VAT. The level of the economic standard and the tax compliance by the payers in India is far below the standards of other countries. He concluded that VAT is not suitable for India, as sales tax is already prone to evasion and allowing credit is to make it doubly evasion prone.

The Institute of Chartered Accountants conducted a research study and evolved an accounting treatment and method of valuing inventory for companies operating under MODVAT scheme. The accounting treatment of MODVAT is included in the present study.
The above survey of literature, though it is brief, attempts to bring out useful work on Central excise. Innumerable journals in India have devoted themselves to this subject area of MODVAT. However, the present study "Modified Value Added Tax Practices" by industries in the composite Madurai District (also known as Madurai Commissionerate, for Excise purposes only) is a humble beginning in this direction. The study tries to uncover various issues such as benefits and drawbacks of the scheme, beneficiaries of the scheme, difficulties faced by department and assessees, impact of MODVAT credit on revenue. The study also includes the suggestions offered by manufacturers and department for making the scheme flexible and useful. It is hoped that the present study will go some way towards bridging this gap.

RESEARCH DESIGN AND METHODOLOGY

In view of the nature of data from universe, sample survey and secondary sources collected and presented in this research report, "descriptive research" is considered to be the most appropriate for the present study. Hence, the study has been found to be descriptive and analytical. The research problem and interview schedules have been formulated and framed accordingly. The suggestions of the study emerge from the inference drawn from the study of universe (Madurai Commissionerate) and sample survey of manufacturer assessees registered with Central Excise Department, Madurai and excise authorities employed in different range offices of Madurai Commissionerate.
PRIMARY DATA

The present study is an empirical one based on census survey and sample survey. First-hand data were collected from the field through separate interview schedules. One interview schedule was administered to the manufacture assessees to collect information regarding payment of duty, duty liability, MODVAT credit, their observations about the various provisions of the scheme, problems they face in following the procedures etc. The other interview schedule was administered to excise authorities to gather data regarding the provisions of the scheme, the beneficiaries of the scheme, their level of understanding the subject MODVAT, non-transparency of the Act and the like. Discussions were held with knowledgeable persons such as experts in excise, lawyers, excise consultants and manufacturers for designing the questionnaire.

SECONDARY DATA

The study also depended on the secondary data available in the department of Central Excise. The data relating to central excise are not normally published in any magazine or journal. Hence, necessary particulars were collected from the computerised records of central excise department. The secondary data collected from Central Excise Department were used for the study of the universe (Madurai Commissionerate). The other secondary data were collected from standard text books of related topic, excise law times (a special magazine on excise and customs) journals of repute, reports of various committees, Issues of Economic Survey, The Hindu Industrial Survey, Budget Papers, etc.
PILOT STUDY

The interview schedules meant for manufacturer-assesseees were prepared with the consultation of excise consultants and lawyers who are Central Excise practitioners. In order to revamp the interview schedules, in the light of comments, the interview schedules were pre-tested with 30 manufacturer-assesseees. After pre-testing, necessary modifications have been effected.

SAMPLING DESIGN

To obtain primary data, two surveys were undertaken in the study area. First, 220 interview schedules were distributed to all manufacturer-assesseees who use MODVAT credit scheme. Yet another sample survey of 50 excise authorities, was conducted. Both the surveys were conducted during the period March 1999 - September 1999.

As per records of Computer Section, Central Excise Department, Madurai, there were 338 industrial units paying duty and using MODVAT credit as on 1-4-99. Of them many had 4 years record or 3 years records, or just started taking credit. Hence they have not been considered for the study. As the period of the study covers 5 years, the assesseees with five year continuous records were chosen for the study. The number of such industries were found to be 220.

A list of their addresses was obtained from the Excise Department. The interview schedules were administered personally by the researcher. The respondents were approached from many angles (i.e), through their cost auditor, excise consultant, range inspectors and friends.
to convince them about the genuineness of the study and to persuade them to supply necessary data.

Table IX furnished below, shows the number of manufacturer-assessees selected for the study.

**TABLE IX**
**NUMBER OF INDUSTRIAL UNITS CHOOSEN IN EACH CATEGORY OF PRODUCT**

<table>
<thead>
<tr>
<th>Industry</th>
<th>No. of units</th>
<th>Total Number of units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chemicals</td>
<td>38</td>
<td>44</td>
</tr>
<tr>
<td>Rubber</td>
<td>30</td>
<td>38</td>
</tr>
<tr>
<td>Textile</td>
<td>70</td>
<td>105</td>
</tr>
<tr>
<td>Engineering goods</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Machinery, Electricals and Electronics)</td>
<td>18</td>
<td>24</td>
</tr>
<tr>
<td>Plastic</td>
<td>60</td>
<td>71</td>
</tr>
<tr>
<td>Cement</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Others (Paper, Sugar and others)</td>
<td>0</td>
<td>51</td>
</tr>
<tr>
<td>Total</td>
<td>220</td>
<td>338</td>
</tr>
</tbody>
</table>

Source: Records of Computer Section, Madurai Commissionerate as on 1.4.1999.

There are many small scale units in all these industries who operate within clearance limit of Rs.100 lakhs and do not avail
themselves of MODVAT credit scheme. Hence, they were not considered for the study.

Out of 338 units many units with four years record, units declared sick, units went out of the scheme, industries contributing meagre revenue had to be excluded. Thus industries with five years record and major revenue generators were chosen. The number of such units was found to be 220.

The above table did not include fireworks and matchworks. The fireworks being a labour intensive industry do not use MODVAT credit on capital goods. Matchwork units do not have the facility of MODVAT. Hence, they have not been considered for the study.

There are Nine divisions in Madurai Commissionerate, with about 9 range offices each, scattered all over the southern districts of Tamil Nadu. As a detailed study covering all officials of the 81 ranges is not possible, 50 range offices were selected by using random sampling technique. The range offices included were Tirunelveli, Rajapalayam, Virudhunagar, Tuticorin, Madurai Division I, Madurai Division II, Karaikudi, Sivakasi. From each range one excise official was chosen and administered with interview schedule.

**SELECTION OF SAMPLE MANUFACTURER - ASSESSEES**

The total number of excise licencees are innumerable. Under central excise each factory of the same corporate entity is given separate licence. Hence, a company/industrial unit may have 5 or 6 licences. Hence, the number of licence holders are numerous. Only industrial units
(i.e) corporate entities are considered for this study. Moreover, all the industrial units are not subject to levy of excise duty. Many units are small scale operating within the exemption limit of Rs.50 lakhs or within the clearance limit of Rs.100 lakhs without MODVAT facility. Many units are exempted from the application of MODVAT Credit Scheme (like) match industries. The study has excluded fire works units as they are clustered around only in 3 divisions-Sivakasi, Kovilpatty, Virudhunagar. Many of them are operating on small scale basis, they are labour oriented industries and do not make use of MODVAT credit on capital goods. The study did not consider industries such as sugar, paper and others contributing meagre revenue to the treasury.

To study the impact of scheme, it is necessary that the assessees should have utilised both input credit and capital goods credit for a period of 5 years. Hence those assessees with 5 years records were chosen. These were done with the permission duly obtained from the Commissioner of Central Excise, Madurai. The addresses of the 220 units were obtained from the computer section of Excise Department and interview schedules were administered.

For a meaningful analysis, the interview schedules were grouped into six categories - on the basis of nature of industry like Cement Industry, Chemical Industry, Textile Industry, Engineering Goods (Machinery Electricals and Electronics) Plastic industry and Rubber industry. These industries are located in large numbers and they are major revenue generators to the Excise Treasury.
COVERAGE OF PERIOD

The primary data through interview schedules were obtained from assesses for a time period of five years from 1994-1995 to 1998-1999. The study of universe (divisionwise analysis) also covers five years from 1994-1995 to 1998-1999.

FRAME WORK OF ANALYSIS AND STATISTICAL TOOLS EMPLOYED

The survey considered the nine divisions of Madurai commissioneerate and sample survey of 50 excise authorities and 220 industrial units scattered over the territories under the jurisdiction of Madurai Commissionerate.

Most of the analysis is based on the responses of assesseses in the form of frequency tables. Statistical tools such as percentage, mean, weighted average mean, inter-correlation coefficient, t-test, F-test, Model fitting, Factor analysis test have been used for analysing the data. All these tests etc. have been made by using SPSS Package of version 6.0. The data collected have been tabulated, analysed, interpreted and presented in this research report.

PROBLEMS AND LIMITATIONS OF THE STUDY

Every research study suffers from limitation. Some of these are inherent in the research design while some others become part of the study during various stages of operation. The present study is subject to the following constraints and limitations.
1. The industries have to be convinced about the study. The industries are reluctant to give information as failure to pay duty or duty evasion attract criminal punishment. The researcher had to approach them from various angles like cost auditor, consultants, personal visits and continuous letter correspondence.

2. The study covers only those industrial units with five years record as to payment of duty, utilisation of both credit on inputs and capital goods. Units without five years record, units opted for MODVAT scheme (SSI) recently, units opted out of MODVAT scheme and sick units have been excluded.

3. Any research into financial aspect of industry is very difficult. Study of MODVAT, a very delicate and technical subject with penalties and punishments under Central Excise Act, Civil Procedure Code, Criminal Procedure Code is very difficult. In order to get the statistical data relevant for the study, the researcher knocked the doors of Excise Department and manufacturers continuously.

4. In order to make the study more comprehensive and complete, the universe (all 9 divisions of Madurai Commissionerate) was also analysed under the heading "Divisional Analysis". The results of this analysis help one to understand the trend in collection of duty, MODVAT credit of all assesses registered with excise department.
SCHEME OF RESEARCH REPORT

The present study of MODVAT practices in selected Industries in Composite Madurai District (also known as Madurai Commissionerate) has been divided into 7 chapters. The first chapter titled "Introduction and Design of the study" gives a general view of Central Excise Duty, MODVAT scheme, objectives of the study, hypotheses, scope of the study, review of related literature, methodology, sampling design, limitations of the study and organisation of the research report.

Chapter II entitled "Central Excise Duty - An overview" presents a clear account of union excise duty, its importance in government revenue, the various enactments pertaining to central excise duty.

Chapter III titled "Modified Value Added Tax" discusses the scheme, the various rules contained in the scheme, procedures to be followed in order to reap the benefits of the scheme.

Chapter IV captioned "Small Scale units and MODVAT" is designed to study the status of Small Scale industries, their importance, their contribution to excise revenue, the MODVAT rules applicable to small scale industries.

Chapter V christened "MODVAT in Selected Industries" presents a general picture of industries, their importance and role in the economy of India. This chapter covers excise revenue contribution and MODVAT credit utilisation of the industries chosen for the study. This helps to study the backdrop of economy in which they operate.
Chapter VI presents the Analysis of Survey Data. The analysis is made from two angles - from the point of view of the Excise Department for which studies of all divisions are made and from the point of view of assessees (i.e) industries - for which the interview schedules have been administered. This chapter also presents the analysis of data collected from Central Excise Authorities.

Chapter VII brings the research report to a logical conclusion by highlighting the summary of the survey findings and the suggestions put forth by the respondents in making the MODVAT scheme more flexible and beneficial.