CHAPTER IV

SERVICE TAX! CENTRAL VAT, STATE VAT OR DUAL VAT: LESSONS FOR INDIA
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SERVICE TAX; CENTRAL VAT, STATE VAT OR DUAL VAT - LESSONS FOR INDIA

Federal finance is an important branch of public finance, which deals with the fiscal systems prevailing at different layers of government. Issues relating to distribution of responsibilities and resources between the federal, states and local governments and issues relating to federal fiscal transfers to states and local bodies and sum transfers from states to local bodies assume lot of importance in a federal system. This is the subject matter of fiscal federation.

In this chapter we are going to study theoretical background, benefits of fiscal federation, tax and expenditure assignments between the centre and states, fiscal imbalances, an overview of harmonization of goods and service tax in Canada and Brazil, the possible harmonization of goods and service tax in India with various options of evolving central, state or dual VAT (service tax).

4.1 Theoretical Background (Allocation of Resources/ Functions)

India is a typical example of ‘federal state’. India is a union of several states with a strong union government at the centre. In a federation there is one federal government which forms the upper
layer of government and there are states or provinces, which form the lower layer of government. However, it is difficult to draw a line between the 'unitary' or 'federal' system of government. According to R.M. Bird (1979), "where a federation is an outcome of the 'devolution model' the centre happens to be more dominating than when a federation emerges out of 'aggregation'. This implies that 'aggregation' model makes the federating units stronger, while, 'devolution' model makes central government weaker". In this sense in India, the centre is neither too strong, nor too weak. Similarly, state units are neither sovereign nor dependants. Thus federation in India falls in between 'aggregation' and 'devolution' model.

According to Hemlata Rao (2006), 'there are basically three problems which are commonly confronted by all the federations. The first relates to 'vertical fiscal imbalances (VFI)', the second relates to 'horizontal fiscal imbalances (HFI)' and the third to 'fiscal adjustment (FA)'.

As a matter of fact, it is the central government which is endowed with the 'expanding' resources and the centre enjoys surplus, while the federating units have to perform 'expanding' functions (expensive) and have less resources, which do not match with their expenditure requirements. The states inevitably experience huge revenue gap. "The very fact that the federal government commands resources, while states have to look for federal fiscal
transfers, which gives rise to the problem of VFI. These imbalances are built in".3

The second problem, "the 'horizontal fiscal imbalances' (HFI) arise due to the differences in the resource raising capacity and fiscal of various similarly situated states. HFI is also due to the diversity in natural resources endowment and disparities in economic structure and socio-economic levels of development of federating units. This determines, on the one hand, the varying degree of fiscal capacity and on the other hand, the fiscal needs of the states. 'HFI coupled with VFI increases the need for fiscal transfers to the states in any federation".4

In order to correct the vertical fiscal imbalances federal fiscal transfers in the form of shared taxes, duties grants etc. are effected. While transferring resources to the federating units, care is taken to bring down the problem of HFI.

Like the division of functions, even the tax and non-tax resources are divided between the two layers of government. The resources which have an inter-state base are usually assigned to the federal government. Even resources generated from foreign trade and foreign exchange also are with the centre. Resources which have local base are assigned to the states. Some resources or revenue and a few functions also fall within the purview of both the layers of government and they are included under the concurrent list.
Besides, these demarcated powers and functions, there exists interdependency between different federating units and the federal government.

4.2 Tax and expenditure assignment in India

The tax and expenditure powers of the central and state governments are specified in the seventh schedule of the Constitution. The functions required to maintain macro economic stability, international relations and activities liable to significant economies of scale are either assigned exclusively to the centre or are to be performed concurrently with the states. The functions which have a state wide jurisdiction are assigned to the states.

The assignment of tax power is however, based on the principle of separation. The tax bases are assigned exclusively either to the centre or to the states. Important broad based and progressive tax powers have been assigned to the centre, which is also vested with residual power. A number of tax powers have also been assigned to the states, but from the point of view of revenue productivity, only the sales tax and purchase duties are important.

The Constitution recognizes that tax power assigned to the states are inadequate to meet their expenditure needs and therefore provided for a sharing of revenues from Personal Income Tax (Article 270) and Excise Duty (Article 272). The states in need of additional assistance can be given grant-in-aid (Article 275) and the tax
devolution and grants will be determined by the Finance Commission (FC), an independent quasi-judicial body appointed by the President every five years (Article 28).

4.3 Fiscal imbalances

Various studies in India have indicated the growing fiscal imbalances between the centre and states. M. Govinda Rao (1997) in his study argues that “the states on an average rose about 38 percent of current revenues and incurred 54 percent of expenditure. The revenue derived from exclusive state taxes 35%, those from central taxes is about 32% and the remaining 33 percent from sharable taxes or sources. The major taxes levied exclusively by the centre consists of customs duties (22%), excise duties (30%) and corporation tax (8%). Among the state taxes, sales tax contributes 20% of total tax revenue. Other state taxes individually contribute less than 6 percent of total tax revenue. Although on an average, the states incur 54 percent of total expenditure, their control over spending authority is much lower, as a significant proportion of this is incurred on the central sector and centrally sponsored schemes, which are essentially in the nature of shared cost programmes”.

4.4 Trends in states tax fiscal imbalances

The finances of state governments traditionally follow a pattern similar to that of the centre, albeit with a lag. State finances at the aggregate level have always been in revenue deficit. “The magnitude
of the deficit relative to GDP has also increased over the years. Almost all states, rich and poor, small and large, special category, general category, increasingly slid into revenue deficit. Only few special category states showed surplus on revenue account, but this is mainly due to the plan assistance of 90 percent in the form of grants adding to revenue receipts.

The year from 1997-98 to 2002-03 have been the worst in the state finances (Table 4.1). “The first half of this period saw one of the sharpest increases in salary bill of state government employees. The average salary per employee increased by close to 60 percent in a span of 3 years. This was also the period when central transfers relative to GDP fell and states were engaged in exemption. Proliferating tax competition leads to a fall in the level of own tax revenue relative to GDP.”

We look at 3 indicators of fiscal imbalances, revenue deficit, fiscal deficit and primary deficit. Table 4.1 shows that for the states considered together the revenue deficit as percentage of GDP comparing the average over 2000-2003 and 1993-1996 was higher by a margin of 1.9 percentage points. Even though the revenue deficit, fiscal deficit and primary deficits have decreased substantially in the year 2005-06 (BE) (Table 4.1, Graph 4.1), the overall debt/GDP ratio has not declined. In fact the outstanding liabilities of the states have increased from 22% in 1993-94 to 32.7 percent in 2005-06.
Table 4.1: Trends in states fiscal imbalances

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Deficit</th>
<th>Fiscal Deficit</th>
<th>Primary Deficit</th>
<th>Debt / GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-94</td>
<td>0.45</td>
<td>2.35</td>
<td>0.52</td>
<td>21.79</td>
</tr>
<tr>
<td>1994-95</td>
<td>0.69</td>
<td>2.72</td>
<td>0.79</td>
<td>21.40</td>
</tr>
<tr>
<td>1995-96</td>
<td>0.73</td>
<td>2.59</td>
<td>0.76</td>
<td>21.00</td>
</tr>
<tr>
<td>1996-97</td>
<td>1.31</td>
<td>2.27</td>
<td>0.90</td>
<td>21.00</td>
</tr>
<tr>
<td>1997-98</td>
<td>1.23</td>
<td>2.94</td>
<td>0.93</td>
<td>21.73</td>
</tr>
<tr>
<td>1998-99</td>
<td>2.61</td>
<td>4.31</td>
<td>2.24</td>
<td>23.02</td>
</tr>
<tr>
<td>1999-00</td>
<td>2.82</td>
<td>4.64</td>
<td>2.34</td>
<td>25.20</td>
</tr>
<tr>
<td>2000-01</td>
<td>2.61</td>
<td>4.16</td>
<td>1.69</td>
<td>27.42</td>
</tr>
<tr>
<td>2001-02</td>
<td>2.68</td>
<td>4.09</td>
<td>1.41</td>
<td>29.37</td>
</tr>
<tr>
<td>2002-03</td>
<td>2.29</td>
<td>3.94</td>
<td>1.14</td>
<td>31.15</td>
</tr>
<tr>
<td>2003-04</td>
<td>2.20</td>
<td>4.40</td>
<td>1.50</td>
<td>33.40</td>
</tr>
<tr>
<td>2004-05 RE)</td>
<td>1.40</td>
<td>3.80</td>
<td>1.00</td>
<td>33.30</td>
</tr>
<tr>
<td>2005-06 BE)</td>
<td>0.70</td>
<td>3.10</td>
<td>0.40</td>
<td>32.70</td>
</tr>
</tbody>
</table>

Averages:

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Deficit</th>
<th>Fiscal Deficit</th>
<th>Primary Deficit</th>
<th>Debt / GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-96 (A)</td>
<td>0.62</td>
<td>2.55</td>
<td>0.69</td>
<td>21.79</td>
</tr>
<tr>
<td>2000-03 (B)</td>
<td>2.53</td>
<td>4.07</td>
<td>1.41</td>
<td>31.15</td>
</tr>
<tr>
<td>(B) : (A)</td>
<td>1.90</td>
<td>1.51</td>
<td>0.72</td>
<td>9.36</td>
</tr>
</tbody>
</table>

Source: 1. (Basic Data) State Finance Accounts.
Note: RE: Revised Estimate; BE: Budget Estimate.

Graph 4.1: Trends in Major Deficit Indicators of State Governments

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Montek Singh Ahluwalia (2000), in his study highlights the problems in state finances. "He argues that financial position of the most states is actually facing a continuing squeeze on plan investment. He further says that after 1990-91 several states had a negative balance from current revenue (BCR) which contributed something to finance the plan. The negative balance of almost all states have tended the state governments to borrow to finance the negative BCR and then borrow even more to finance plan".8

4.5 Trends in revenues and expenditures of states

Fiscal imbalances in the states are structural. Expenditures have grown faster than revenues in the last 5-6 years by more than five percentage points (Table 4.2). Given the difference between levels of expenditures and revenues growth rate differences translate into substantiated revenue deficit.

Table 4.2 : Percent of States’ Revenue and Expenditure to GDP

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. States’ Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Own Tax Revenue</td>
<td>5.09</td>
<td>5.70</td>
<td>5.70</td>
<td>6.00</td>
<td>6.10</td>
</tr>
<tr>
<td>Own Non-Tax Revenue</td>
<td>1.38</td>
<td>1.50</td>
<td>1.30</td>
<td>1.50</td>
<td>1.30</td>
</tr>
<tr>
<td>Own Revenues</td>
<td>6.47</td>
<td>7.20</td>
<td>7.00</td>
<td>7.50</td>
<td>7.40</td>
</tr>
<tr>
<td>Total Transfers</td>
<td>4.46</td>
<td>4.10</td>
<td>4.10</td>
<td>4.60</td>
<td>4.70</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>10.93</td>
<td>11.30</td>
<td>11.10</td>
<td>12.10</td>
<td>12.10</td>
</tr>
<tr>
<td><strong>B. States’ Expenditures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Expenditures</td>
<td>13.68</td>
<td>13.80</td>
<td>13.40</td>
<td>13.50</td>
<td>12.80</td>
</tr>
<tr>
<td>Interest Payment</td>
<td>2.20</td>
<td>2.70</td>
<td>2.90</td>
<td>2.80</td>
<td>2.70</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>1.81</td>
<td>2.90</td>
<td>5.30</td>
<td>5.30</td>
<td>3.50</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>14.50</td>
<td>16.70</td>
<td>18.70</td>
<td>18.80</td>
<td>16.30</td>
</tr>
</tbody>
</table>

Source: Public Finance Statistics (relevant years), Ministry of Finance, Govt. of India.
The slowest growing item was the transfers from the centre, and given the difficulties of central finances, it is unlikely that central transfers will register a much faster growth.

However, it is the responsibility of states to restore the fiscal balance, by their own effort. Therefore, slower growth of different items is a matter of concern. Own tax revenues have not improved much over the years from 1999-00 to 2005-06, states own tax revenues lagged behind the revenue expenditure by about 5 percentage point in the same year. Interestingly in 2000s, efforts to contain the expenditures by the states reduced the total expenditure from 18.80 in 2004-05 to 16.30 point in 2005-06.

Hardening resources and increasing pressure on revenue expenditures have crowded out capital expenditure. The latter declined from 5.30 percent in 2003-04 to 3.50 percent in 2005-06. The burden of interest payments has not been reduced. Infact it has increased marginally from 2.30 percent in 1999-00 to 2.70 percent in 2005-06.

4.6 Reasons for slow growth of tax revenues

An important reason for the deceleration in the growth rate of sales taxes has to be found in the inability to extend the base to the services sector. Sales taxes has been the main source of revenue to the states in India. “During the last decade, the services sector has grown at 8 percent per year, much higher than both the primary (2.8
percent) and secondary (5.7 percent) sectors, and since the mid 1990s, over 70 percent of the growth of the economy was attributed to this sector.9 As the states have power only to levy taxes on goods, the production and consumption of services remains outside the tax net. “In the medium term buoyancy in states taxes can be improved only when the states are empowered to extend sales taxes to services”.10 This would also help to evolve a comprehensive destination based value added tax at the state level. This however requires amendment to the Constitution to put consumption of services in the concurrent list.

The bases of state taxes are rendered narrow also because of large scale exemptions, evasion and avoidance of taxes. In the case of sales tax for example, besides wide ranging exemptions, there are generous schemes of incentives in terms of tax exemption and deferment. While the efficacy of such fiscal incentives in promoting industrialisation is limited.

Finally, lack of proper information system and administrative machinery to implement taxes is a general shortcoming in all the states. “Much remains to be done to simplify the tax system and strengthen administration and enforcement of the tax”.11 There is hardly any co-operation between the states tax departments and the central tax authorities. Complicating in the tax system add to complexity in administrative thus adding compliance cost and reducing revenue productivity.
4.7 Introduction of goods and service tax (GST)

Following June 18, 2004, decision of the Empowered Committee (EC) of State Finance Ministers to implement state level VAT from April 1, 2005, 25 states/UTs had introduced VAT to replace the sales tax by December 31, 2005. The eight states/UTs are yet to introduce the VAT. Despite the initial transitional problems and lack of clarity, the implementation of VAT has been smooth and the results encouraging.

“The initial trend in revenue collection in the VAT implementing states is quite encouraging. During the first 7 months of VAT implementation (April – October 2005) the total revenue (provisional) for VAT implementing states showed an increase of around 14.4 percent, which is higher than the compound annual growth rate of these states taxes for the last 5 years”. Enthused by the successful implementation of state level VAT, the honourable Union Finance Minister Sri Chidambaram in his budget speech (2006-07) has given a time frame for introduction of GST (Goods and Service Tax) by 2010. When the GST is introduced it enables the country to have a common market throughout the country.

4.8 Meaning of GST

GST generally refers to an integrated taxes on final goods and services consumed at the different levels of production and consumption with setoff for purchases of inputs used in the course of business activity.
There is a controversy among the economists as to who should levy and collect service tax in India? Whether it should be exclusive domain of central government (as the present practice in India) or the state government or dual VAT, empowering both the centre and state governments. As of now, the central government in India levies and collects service taxes under its residuary power. State governments have no Constitutional power to levy on service taxes (except electricity, entertainment, amusing and gambling). Before going to make a case for state VAT (service tax), it is prudent to look at the international experience in federal finance, so that we can draw several lessons from those countries.

4.9 VAT in federal countries

While VAT has been introduced in more than 135 countries, it is probably not an accident that a comprehensive VAT has not been adopted in any of the federations. There are 5 important federations in the world, viz., Australia, Brazil, Canada, U.S.A. and India. None of these federations has adopted a comprehensive VAT. Each of them has a different form of sales tax or a twisted form of VAT.

With a view to analyse the problems in introducing a comprehensive VAT or GST in a federation, in this chapter we present some case studies of VAT in two important federations. It includes, Brazil a developing country, where there is central and state VAT and Canada a developed country, which has central VAT.
and provincial sales tax. The study illustrates the structure adopted by both the national and sub-national govt. and hopefully provide some insight into the problems of VAT in federal countries.

4.10 VAT in Brazil

The system of taxes on goods and services in Brazil is characterised by the variety of taxes, which are levied by all the 3 tires of Govt., viz., federal, state and municipal govts. “The prevailing indirect taxes could be grouped into 3 categories. The first group comprises VAT-IPI (Imposto Sobre Products Industrializados), a federal VAT on manufacturing sector and ICMS (Imposto Sobre Operacoes Relatives A Circulacao De Mercadorias E Servicos), a State-VAT on consumption covering agriculture, industry and a number of services. The second group consists of taxes which are mostly sector specific. One of the important taxes in this group is ISS (Imposto Sobre Services) a tax on services which is not included in the ICMS. It is a cascading type tax levied by municipalities and covers services under industrial, commercial and professional sectors, with the rates varying from 0.5 to 10% in different municipalities. The other indirect taxes under the second group consist mainly of (i) tax on financial transactions (IOP), (ii) tax on retail sale of fuels (IVVC) and (iii) tax on transmission of financial amount and rights (IPMF). The third category comprises contributions to social integration programme (PIS), the public
employees financial reserve fund (PASEP) and various other social contributions."\textsuperscript{13}

Trends in revenue from all the commodity taxes in general and from VAT in particular indicate that the proportion of domestic taxes on goods and services has declined from 27\% of the total tax revenue in 1968 to 25\% in 1992. However, the share of VAT in total domestic taxes on goods and services has increased from 67\% in 1968 to 79\% in 1992. Also the trend in tax revenue as percent to GDP indicates that whereas these taxes contributed 16.7\% of GDP in 1970, the ratio declined to 10.5\% in 1988, but increased to 12.9\% in 1991. Although the ratio went up in 1991, it was below the 1970 mark in the later year. The proportion of IPI in GDP has declined from 4.4\% in 1970 to 20\% in 1988 and that of ICMS from 6.9\% to \% during the same period. In 1991 there was a small increase in the share of both these taxes bringing the total to 9\%. The other major indirect taxes also recorded a change in their proportion to GDP. Whereas their proportion was 5.4\% of the total in 1970, it went upto 6.2\% to 5\% in 1980. However, in 1988 it declined to 3.5\%. The trends in the proportion of different taxes indicate that the fiscal role of VAT has again been on an increase, although the same is not yet very significant in the overall fiscal structure of Brazil.

4.11 Federal VAT

The Federal VAT levied in Brazil is known as IPI (Imposto Sobre Products Industrializados). It is a selective tax restricted to the
manufacturing sector and is levied on all transactions of taxable industrial products on the principle of value added. The tax base consists of industrial value added defined as sales minus purchases of inputs, keeping capital goods outside the creditable base. The scope of IPI is however, restricted to (i) importers of foreign goods who subsequently sell them; (ii) industrial establishments performing any industrial process from which a chargeable product results even if it is actually exempt or subject to zero rate and as (iii) establishments assimilated by the law to industrial establishments.

"The coverage for the taxable transaction under the IPI includes those industrial products that have been the objects of an industrial process, viz., changing the nature, performance, completion, display or purpose of a product or improving its readiness for consumption. However, agricultural and mineral products are excluded from the purview of IPI. Also retail and wholesale trade as well as services are excluded from its scope, making it restricted to a few select industrial activities only".14

4.12 Rate structure

The IPI has a multiplicity of rates with considerable varieties across commodities. This is mainly attributable to 3 factors: first, an equity consideration, necessities are either taxed at low rates or exempted. Secondly, the tax rates are based on the degree of processing of commodities. That is the rates vary according to the
content of processing. Finally, luxuries and sumptuary goods are taxed at high rates. The rates are specified in a lengthy tariff list and are subject to frequent changes. “In general IPI rates are: 330% on cigarettes, 200% on beer, 77% on perfumes 40-50 percent on automobiles, 20 percent on wine, 8-10 percent on chemical inputs, 4-15 percent on paper, 4-10 percent on electrical machinery and equipment as well as non-metal minerals, and 4-6 percent on metals”. Although, the intention of rate differentiation is to differentiate tax burdens according to the nature of the products. It is generally felt that it is not easily manageable at the level of manufacturing, it could be better managed at the consumption level.

IPI levied on raw materials, intermediary products and packaging materials into industrial establishments gets credit against the tax liabilities of the final goods, provided the final goods are not exempt from tax. However, the credit is available with respect to exports and production of certain articles, specified by law.

Imported goods are subject to IPI but the products exempt from import duties are automatically exempt from IPI applicable on imports. The import of various equipments, tools and machinery is exempt.

4.13 Exemption under IPI

The major exemptions or exclusions are for (i) some specific inputs. (ii) the outputs of firms installed in Momans Free Zone – the
ZFM (Zona Franca de Mamaus) and approved by proper authority and (iii) a large number of specific products or exempted from the IPI. These include food items, pharmaceuticals, fertilizers, skins and leathers and shoes. Exports are zero rated.

**Table 4.3 : Revenue from the IPI by Commodities 1991**

<table>
<thead>
<tr>
<th>Items</th>
<th>Commodities with break of the IPI Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cars and other vehicles</td>
<td>16.2</td>
</tr>
<tr>
<td>2. Tobacco</td>
<td>13.2</td>
</tr>
<tr>
<td>3. Drinks</td>
<td>10.1</td>
</tr>
<tr>
<td>4. Wholesales</td>
<td>10.0</td>
</tr>
<tr>
<td>5. Chemical products</td>
<td>8.1</td>
</tr>
<tr>
<td>6. Metal products</td>
<td>7.0</td>
</tr>
<tr>
<td>7. Paper and paper products</td>
<td>3.5</td>
</tr>
<tr>
<td>8. All other industries</td>
<td>27.2</td>
</tr>
</tbody>
</table>

Source : Mahesh C. Purohit in VAT structure in Brazil.

Most of the revenue of the IPI is generated from a few select commodities (Table 4.3). These include cars and other vehicles (16.2), tobacco products (13.2) etc. The collection of revenue from different states is uneven; 3 states namely, Minas, Gerais, Rio de Janeiro and Sao paulo account for 75% of the total collection. In all about, one half of the revenue is collected from 3 categories i.e., vehicles, tobacco and beverages.

**4.14 State VAT**

VAT levied by the states known as ICMS (Imposto Sobre Operacoes Relativas Circulacao be Merca dorias E-services) which replaced the sales turnover taxes in sixties. However, the coverage of
ICMS is not all inclusive. First, the base of the specific taxes is explicitly excluded. Secondly, a large number of capital goods produced in Brazil are exempt. For example, agricultural machineries and equipments were exempted in 1969 followed by exemption in 1971, for a wide range of equipment and machinery for the industrial sector intended for the northern and north-eastern regions. Exemptions also include intermediate imports, imports exempted from import tax, fertilizer and pesticides, many inputs for agricultural production, vegetables, eggs and sale of agricultural equipment in the north-eastern states, except for these exemptions “the base of the ICMS includes the sale of goods at all stages of production – distribution process, including retail trade as well as agriculture and cattle rearing sectors. However, it excluded tax on services which is levied separately under ISS”.  

In general there are five rate categories in the ICMS. Sumptuary consumption items such as liquor, cigarettes, tobacco, electronic goods, video games, sports communications, gas and alcohol are taxed at 25%, most other items are taxed at 18% standard rate; and electrical consumption between 50-200 KW is taxed at 12%. The tax rate is 8.8% on capital goods, and 7% for rice, beans, bread, salt, meat and food items. Industrial exports are zero rated.

The tax base of ICMS is inclusive of tax. This implies that the effective rate of tax on the basic price is in fact higher than indicated
in the tax low. To illustrate the standard rate for consumer goods being 18% the tax liability would be calculated as follows:

\[0.18 \times \{\text{retail price (including tax)}\}\]

i.e., for a price of $100 the tax is 18, the retail price excluding tax is $82. If the tax rate is related to the base price i.e., $82, the rate works out as:

\[(18/82) \times 100 = 21.95\%\]

The effective tax rate could still be higher in such cases where the base of ICMS is inflated by inclusion of the estimated value added at later stages of processing (such as retailers). This system of inflating the base is referred to as ‘Substituição Tributaria’.

4.15 International and interregional transaction

ICMS being a state VAT, the tax is levied on all ‘intra state sales, that is the sales made within the state’. However, in a federal country, any sale with a state which occasions the movement of goods from one state to another does not remain a purely interstate transactions. “Therefore in treating interregional transactions, Brazil follows the origin principle”.17 Where the tax is levied by the exporting state. The importing state allows credit for the tax paid in the state of origin.

However, to neutralise the impact of varying levels of development in different states, the tax rate on interregional transactions varies according to destination, while the general rate
on inter state transactions is 12%, the differential interstate rate is 7%, for goods sent from south-east to north-east or to the central west. Though the levy of a higher rate of tax (17%) on sales and reimbursement at a lower rate (7%), these states raise 10% on imports. “This adjustment operates as equilibrium mechanism even when less developed states exports to rich states, yielding a correspondingly revenue lost to the rich states. For eg., when the transaction takes place between a poor (exporting) state and rich (importing) state, the poor state collects 12% which is reimbursed by the rich state. Thus, the rich state raises 5% (17-12%) on imports consumed in the state”.

4.16 Tax harmonisation

National Public Finance Council (Conselhode Politica Fazendaria-Confaz) plays an important role in harmonizing the interstate tax under ICMS. CONFAZ determines the exemptions or reductions in the rates of ICMS through meetings at regular intervals. However, the interstate rates are fixed by the enactment of the senate. CONFAZ consists of all states representatives with 27 councils. The CONFAZ can change the rates but the need to have unanimous approval of such a proposal, the changes are not regular. Under the agreements of the CONFAZ, some specific products such as vegetables, eggs and domestic fish are exempt. Also it has granted exemptions to sale of agricultural equipment to the north-east and to Para, Anopa and Rondonia. Similarly, agricultural
exports including specific vegetables and fruits are exempt. Small businesses are also exempted on administrative considerations. It is important to note that although CONFAZ harmonizing inter state trade, some of the states try to grant concessions (such as grant of payment deferrals to attract industries that are not permissible). However, the credits earned by the exporters are rarely reimbursed in cash by the govt. Exports are thus non-refundable leading to an additional burden on the exporters.

4.18 Proposed reforms

The existing structure of VAT in Brazil is characterised by a variety of taxes, IPI is levied at the federal level and ICMS at the state level. Both the IPI and ICMS have multiplicity of rates. Also owing to differences in the stage of development of states, it has given rise to malpractice by the rich states (such as offering of special tax deferrals) such practices have increased enormously in recent years.

With a view to avoiding the problem of multiplicity of taxes at different levels of govt., Brazil was contemplating another major Constitutional reform to have a new VAT called IVA (Imposto Sobre Valer Adicionado), replacing the existing IPI, ICMS and the cascading type ISS. The IVA would be an extension of the existing ICMS of the state level. However, unlike the existing origin base taxation, the IVA would be collected at the destination point. It is proposed that the tax invoices for interstate transfers would be issued inclusive of tax,
but the state would be compensated for the interstate transactions through clearing house mechanism. It is proposed that the new VAT would be levied only by the States. The Federal Govt. would withdraw from the field of internal commodity taxes. It is also proposed that interstate transactions would be settled through a clearing mechanism and the tax would be levied on destination principle. “The entire structure of federal financial relations were currently under review in that country”.19

To have equity and administrative expediency the number of rates and exemptions would be drastically reduced, although a zero tax rate would prevail for items primarily used by the low income groups. Also, capital goods and exports would be zero rated.

4.19 Lessons to be drawn

A regime of exclusive state VATs on the pattern of Brazil or the EU, to replace both central taxes and sales taxes, however commendable in principle, does not seem to be warranted for Indian federal system. It is because if the centre withdraws from the commodity taxation, it weakens the central Govts financial position. The weak central Govt. at the centre is politically disastrous, as it encourages the divisive sources to raise its ugly head at the regional level.

However, despite the various limitations with the federal VAT in Brazil, it is useful to learn that, as the case with the European
Union where VAT is levied by each member state with its own levies, with a floor level of tax rate, the state VAT of Brazil could also be a model for other federations like India.

4.20 Harmonisation of provincial sales taxes in Canada – an overview

Canada like India is one of the largest federation in the world, that has implemented a comprehensive value added tax (VAT) at the central level (federal), known as goods and service tax (GST). The GST replaced the prevailing manufacturers sales tax (MST) on January 1, 1991.

"However, at the level of provinces, there are different forms of sales taxes in Canada. At the sub-national level, sales tax is levied by all provinces except Alberta". "There are three different models: Quebec levies O-VAT (known as Quebec sales tax – QST); three of the provinces (viz., Newfound land, Nova Scotia and New Burnswick) levy a harmonised sales tax (HST) – a combination of GST and state VAT! and rest of the provinces levy a retail sales tax (Purohit 2000).

In India too, attempts have been made for more than a decade ago to introduce the principles of VAT at the federal level in its Union Excise Duties (UEDs). Beginning with 1986, it has gradually introduced the principles of VAT and expanded the coverage of UEDs. Overtime, it has brought most of the commodities under VAT. By now, almost all commodities fetching 90 percent of the revenue
covered through a system of VAT, know as Central VAT (CENVAT). “At the state level, India had a system of first point sales tax. Attempts are, however, made by the ‘Ministerial Empower Committee under the chairmanship of Asim Das Gupta to Pursuade’. State Governments through consistent negotiations and dialogue to introduce state level VAT. As a result, in India state governments (about 25 states) have introduced state level VAT from 1st April 2005”.23

In view of the similarities of the federal structure and the efforts of harmonising of commodity tax systems in Canada and India, we need to draw the experience of Canada in achieving harmonisation of goods and service tax with provincial sales tax in that country.

4.21 Federal efforts at harmonisation

The GST which replaced the MST in Canada in 1991 is a multi-stage sales tax operated on the invoice-credit method and collected at each stage of business. It is a destination based tax levied at the rate of 7 percent, on the consumption of domestically produced goods and services. “The GST had a mass hostile reception among the people in Canada and the resentment persisted well after the tax came into operation, so much so that the liberal party which came to power in 1993 made an electoral pledge to abolish or replace it. However, the tax had started yielding substantial revenue over
Yet the continued resentment against it and the election pledges – led the new Government to ask the Standing Finance Committee of Canada's House of Commons to suggest alternatives. The committee submitted its report in 1994.

"However, after a long negotiation with the provinces, the federal government, has entered into an agreement with 3 provinces (viz., Newfoundland, Nova Scotia and New Brunswick) to introduce a harmonised sales tax (HST) which is a combination of GST and provincial sales tax being levied in each of the provinces. Effective on April 1, 1997 HST has been levied at the rate of 15 percent (GST at 7 percent and state VAT at 8 percent) in these provinces (Purohit, 2000)."

HST is legislated and administered by the federal government. The provinces receive their share (8%) from the Federal Government. The share is calculated on the basis of a formula, which is based mainly on consumption although some other variables are also taken into consideration. In addition, the provinces receive some grant as adjustment assistance to compensate the provinces for the loss of revenue due to reduction in tax rate and its effect on revenue.

"Quebec levies a VAT known as Quebec Sales Tax (QST). Unlike HST where the federal government collects HST comprising both the taxes (GST + state VAT), Quebec collects GST as well as the
QST (which has been converted into a value added tax at the state level). Quebec collects GST along with QST and remits the yield of GST to the federal government after deducting the charges for collection”.26

"The model of dual taxation i.e., GST (the federal VAT) levied by the federal government and the provincial sales tax (PST) levied by the provinces is followed in Ontario, Manitoba, British Columbia and Prince Edward Island. Quebec and Prince Edward Island levy PST on the GST inclusive while Ontario, Monitoba, Saskatchewan and British Columbia impose PST on the price exclusive of GST”.27 None of the provinces levies tax on inter-state sales. Their retail sales tax (VAT) jurisdictions are confined to sales within their own boundaries.

4.22 Lessons to be drawn

After having analysed the structure of GST in Canada, we have drawn an important lesson for India, even though the Standing Finance Committee of the House of Commons have reservations about the structure of the GST, the committee has identified three important weaknesses of the system ! The GST has a narrow base, the tax is extremely complex and there is no harmony between federal and provincial tax systems. Despite these weaknesses, the sub-national governments in Canada have considerable fiscal autonomy. Eventhough in 3 provinces (viz., Newfoundland, Nova Scotia and New Brunswick), HST is being administered by the federal
government, Quebec, Ontario, Monitoba, British Columbia, Prince Edward Island and Saskatchewan administer GST along with PST. These provinces are not prepared to part with their fiscal autonomy to the federal government (an important fact to be noted).

Whether the Canadian experience is of much relevance for India in the present state of centre state relation. In Canada the Constitutional delineations of power between the centre and the provinces are so firmly established the provincial government can perhaps agree more readily on the joint imposition of VAT. In India, the power position of the states and the centre is yet to settle down. In this context the increased involvement of the centre in the tax domain of the states will be treated a shift in the balance of power in favour of the centre.

In the light of these facts in Indian federal set up also, state governments who have already introduced state level VAT are not willing to sacrifice their fiscal autonomy. They are demanding to be empowered to levy and collect service taxes. For this a suitable Constitutional amendment should be effected. This measure can also be used as an incentive to lure other non-VAT states to adopt state level VAT as soon as possible. If all the states and union territories in India adopted state level VAT, it would facilitate the introduction of GST throughout the country by 2010, as envisaged by the Union Finance Minister in his union budget speech of 2006-07. Inclusion of
service tax in increment list, enables the state Govts. to retain their fiscal autonomy, on the one hand, and increases the tax revenue on the other.

4.23 The model of dual VAT

Keeping in view the federal considerations and to have a harmonised system of VAT at the state level, it has been advocated to have a dual VAT system in the country. Manufacturing stage CENVAT at the centre and consumption type state VAT at the state level. This would enable the govt. to achieve reforms in the field of taxation. In this connection Purohit (2001) cites the example of European Union which has successfully introduced and practiced state VAT with flow rates imposed by the European commission. The experience therefore, suggests that state VAT is not only desirable but also the only long-run reform feasible under the Indian Constitution.28

Under the proposed system of dual VAT of assigning tax powers, the centre would divide the existing system of UEDS (Union Excise Duties) into two!

First, Sumptuary Excises (SES) would be levied by the Central Govt. on a few select commodities only. These would at the most be a dozen in number. “The centre would retain the revenue generated from the SES. The SES would yield the centre approximately the same revenue from the UEDS”29 which would be retained for its own
use on the basis of the recommendations of the Tenth Finance Commission.

The second component of UEDS (i.e., excluding those brought under SES), called CENVAT would continue to be collected as is being done today. However, it would not be treated as central revenue for the purpose of Finance Commission devolution. “It is in fact to be treated as a state tax being collected by the centre. Accordingly, its yield would be distributed among the states on the basis of collection”.$^{30}$ This would help the state to provide set-off for the tax paid to the centre at the manufacturing level. The manufacturer under the proposed system would be taxed twice, once by the centre under the CENVAT and the second time by the states under the state VAT. However, the states would provide set-off if the tax payer has already paid CENVAT.

As far as revenue generation is concerned the empirical study is conducted by Purohit (2001) indicates that “the states own tax revenue (SOTR) increases because of the inclusion of the yield of the CENVAT (which is now given to the states on the basis of collection) which yields larger resources to providing states”.$^{31}$ But economist like Bird (1998) disagrees in this regard. He argued that “the state VAT being based on destination principle requires restructuring or gradual phasing out of CST, which results in considerable decline in the SOTR in many states”.$^{32}$
However, Purohit's (2001) empirical estimates suggest that the "state VAT would not only give more revenues to the developed states but also benefit others. Precisely because of this reason, experiences of many VAT states have induced other states (non VAT states like Tamil Nadu, Madhya Pradesh etc.) to introduce state VAT by abolishing sales tax in their respective jurisdiction".33

4.24 Harmonisation of state VAT (comprehensive state VAT)

After having a look at the overview of tax – harmonisation of provincial sales tax as in Brazil and Canada. We can build up a case for state VAT with service tax. Several arguments can be put forth for service tax to be assigned to state governments to have a broader state level VAT.

➢ The Constitution of India has assigned customs, excises in general and income taxes to the Union Government, about two thirds of the revenue raised by the government at all levels happened to be collected notionally, although around 55 percent of the expenditures are incurred at the sub-notional, that is state level. "The Indian Constitution made arrangements for the devolution of funds from the centre to the states to be adjudicated by a statutory commission".34 However, the states generally feel constrained by lack of tax powers and zealously guard against any encroachment on the tax powers restored in them by the Constitution, especially the power to levy sales tax which
constitute the most important of the main source of revenue to the state governments. Therefore state governments should be empowered to levy taxes on services to offset the excessive burden on public expenditure.

- For revenue reasons, in India sales taxes are levied on all commodities including, inputs and capital goods while because of Constitutional limitations, services are excluded from the purview of state governments, discriminating against goods and in favour of services. “These arrangements of commodity tax system in India have given rise to many problems, complexity, lack of transparency, distortions in economic decisions and inequities in inter jurisdictional division of tax bases. It is increasingly felt that tax harmonisation is not possible without assigning tax power to state governments to levy taxes on services”.

- The most important consideration empowering the states to levy service tax is the evolution of a destination based, retail stage consumption type value added tax (VAT) at the state level. There is consensus to transform the prevailing cascading type, partly origin based pre-retail sales tax systems into a destination based consumption type value added tax at retail stage. For this, “it is important to provide tax relief on all taxes on inputs and capital goods. In an interdependent system where goods enter into the provision of services and also may be used as input in the
manufacture and trading of goods, complete crediting of input taxes is possible only when all goods and services are taxed (Rao M. Govinda, 2001). This calls for empowering of states to levy taxes on services. In the absence of such empowerment of states the state VAT will only be partial of it would not be possible to extend credit to input tax on services. The input tax included in the services cannot be relieved, if services are not taxed, nor is it possible to relieve the tax on export completely. The present system of taxing services separately from goods not only leads to evasion and avoidance, but also can be a source of distortion.

Two alternative models are suggested for sharing of tax powers with the states. In fact, the predominant view as also endorsed by the study group on reform of domestic trade taxes in India is to “distinguish between services having national ramifications and those with regional ramifications and assign the latter to the states (NIPFP 1994).” One of the approaches to sharing tax powers with the states is to give concurrent power to levy tax on all services to the centre as well as states, subject to the standard negative and exemption list. This will enable the states as well as the centre to include all tradable services in the tax base and provide credit on all inputs as well as output taxes paid on services forming inputs in the production/trading of goods and services. This would require the amendment of the Constitution to place taxation of services in the concurrent list. This could be
done by inserting an additional item in the central list and also amending entry 54 in the state list (the present entry 54 excludes sale of newspapers from sales taxation. There is no need for providing this in the constituent entry), to read, "Taxes on the sale and the purchase of goods and services" subject to the provision of entry 92-A list 1”.

- The alternative approach as suggested by the expert group on domestic trade taxes, is to separate the list of services to be taxed by the centre and states is in keeping with the principle of separation in the tax assignment. However, the system of having separate lists of services for the centre and states would create complication and distortions in the tax system. Moreover, selective sharing of tax powers would not enable the states to provide input credits in respect of tax paid as such services, which are not within their purview. For example, if railway freight or air freight is not included in the state list, sales tax on diesel or aviation fuel by the railways and aviation department cannot be set-off or credited nor this can be zero rated if the ultimate commodity is exported.

- Giving concurrent powers to levy taxation of services to the state could raise genuine fear among the business community. The fear is mainly due to the fact that the power to levy sales taxation on goods to the states has resulted in considerable degree of
complications in the tax system and fiscal disharmony within the country. The levy of taxes at multiple rates and taxation of inputs, outputs and capital goods have resulted in tax on tax, with additional graded turnover taxes, surcharges on sales tax and entry taxes, it is often impossible to determine the tax liability with any degree of accuracy. Therefore, often tax payment has to be negotiated. “Considering this, the business community would be naturally against assigning power to levy taxes on services to the states (respondents are sharply divided over this issue) (see Chapter VI)”.38

It is therefore, important that the states should start simplifying and rationalising their sales tax systems with a view to evolving a state VAT. In fact it is stated that the first step to introduce state VAT is to simplify the prevailing sales tax system by merging the turnover taxes and surcharges with the main levy and reduce the number of tax rates. Quite a few states continue with these additional levies. It is therefore important to ensure that assignment of the power to levy taxes on services should be a part of package of reforms to evolve a destination based retail state VAT.

4.25 Integrating other state taxes under state VAT

With the withdrawal of the centre from the field of commodity taxes, states would be able to levy a comprehensive state VAT. As a corollary, it should be useful to combine all the taxes on commodity
and services levied by the states. In addition to sales tax, state govt.
are levying other taxes like state excise duty on the consumption of
alcohol, opium, narcotic drugs, entry tax, tax on electricity, tax on
goods and passengers carried by road or inland waterways, motor
vehicle tax, tax on luxuries like entertainment, amusements, betting
and gambling etc. When sales tax is converted into a state VAT, some
of the taxes mentioned above could be integrated in the state VAT.

Further, the empowered committee of State Finance Ministers
has recommended the central govt. to authorise state govt.s. to levy
tax on some of the localised services, including sales tax related
services (such as service component of works contracts), these also
could be integrated into the state VAT.

4.26 Service tax road ahead

Govt. of India has set up several ‘expert group committees’ and
‘task forces’ on the recommendations of Raja Chellaiah to look into
various aspects of service tax. It includes services to be covered,
basic changes in the structure of service tax and review of the
experience of levy of service tax in India since 1994. The various
committees constituted by the govt. are as follows:

1) Expert group on taxation of services (2000), Chairman Govinda
Rao M.

2) Advisory group on tax policy and tax administration for 10th Plan
(Planning Commission 2000).
3) Task Force on indirect taxes (Kelkar Committee), 2002.

4) Task Force on implementation of FRBM (Fiscal Reforms and Budget Management Act) 2003.

Govt. of India had set up an expert group in 2000 to go into all aspects of service tax including “services to be covered, basic changes in the structure of service tax and review of experience of levy of service tax in India since 1994". The expert group was constituted under the Chairmanship of M. Govinda Rao. The terms of references included:

a) To examine the existing structure of service tax and to make recommendations on extending the tax base in the area of services, and the timing thereof.

b) To examine the existing procedure for collection of service tax, and to make recommendations as may be considered necessary for making it more effective, to augment voluntary compliance, and to reduce compliance cost.

c) To make recommendations, on any other matter related to or incidental to above points.

The report had suggested to have a separate legislation for service tax.

“Advisory Group of Planning Commission recommended to make Constitutional amendment to allow states to tax services,
whereby centre may levy tax and authorise the states to administer and collect them and authorise states to levy service tax and integration of services tax with VAT on goods with appropriate mechanism to set-off taxes on input services, against goods and vice versa".  

Vijay Kelkar’s Task Force recommendation (2003) on service tax stated that “the implementation of service tax should be facilitated by having a comprehensive tax base. The govt. should identify certain minimum number of services which are not subject to service tax like public utilities, social services (health, education etc.) and sovereign services rendered by the State".

4.27 Tax reforms and GST

Vijay Kelkar’s Task Force on implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, recently submitted its report in July 2004 to the Govt. The report outlines the fiscal strategy to be adopted to meet the objectives of FRBM Act. Thus the task force has recommended the following strategies for tax reforms:

- widening the tax base
- few rates, lower rates
- enhancing equity of the tax system – vertical as well as horizontal equity
- Shift to non-distortionary consumption taxes to increase efficiency in production and enhance internal competitiveness of Indian goods and services. The destination based VAT on all goods and services is the best method of eliminating distortionary and taxing consumption.

- Enhancing the neutrality between present consumption and future consumption.

- Establishing an effective and efficient compliance system – establishing a programme for tax payer service and education to promote valuers compliance with tax obligations, making non-compliance risky for violators, simplifying compliance procedures to reduce transaction costs and using information technology.

"The Task Force has proposed to levy of goods and service tax (GST) as a common tax for goods and services and availability of CENVAT to all the assesses. GST is proposed at both central and state level and shall be accompanied by the simultaneous withdrawal of all the cascading taxes".42

According to the existing framework of taxation of goods and services, the central Govt. levies tax on goods at the manufacturing level, while the states levy tax on goods at the point of sale. Taxation of services on a limited scale began in 1994 only by central Govt. The tax on goods and services by the centre has gradually shifted towards a VAT type regime, while taxation of goods by states also came under state VAT regime.
The Constitutional difficulties associated with the taxation of services, have been addressed by the 88th amendment to the Constitution, which was passed in 2003. Traditionally, the centre had powers to tax the manufacturing of goods. The 88th amendment has carried these powers forward to extend all services, including the service of trading and retailing of goods. The amendment enables parliament to formulate, by law principles for (a) determining the modalities and levying the service tax by the central Govt. (b) collection of the proceeds by the centre and the states and (c) sharing of the proceeds between the centre and the states.

The Task Force has proposed three advalorem rates in addition to zero rate. The proposed rate structure under this purpose, the total tax burden on most goods by centre and states would work at 20 percent. This compares favourably with the standard VAT rates seen in OECD countries.

### Table 4.4 VAT rates (in percent)

<table>
<thead>
<tr>
<th>Rates</th>
<th>Centre</th>
<th>State</th>
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</thead>
<tbody>
<tr>
<td>Floor</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Standard</td>
<td>12</td>
<td>8</td>
</tr>
<tr>
<td>Higher</td>
<td>20</td>
<td>14</td>
</tr>
</tbody>
</table>


The Task Force proposes a 'grand bargain' whereby states will have the power to tax all services concurrently with the centre.
Therefore several economists have questioned the KTF proposals on the grounds that it would seriously undermine the states autonomy in fiscal matters. The proposed 'grand bargain' has serious implications for the states. Firstly, the possibility of convincing the states to give up five rate VAT model for a single rate VAT that too at 8% (down from the RNR 12.5%) seems to be an impossible task.

The second implication of KTF Report is that the recent Constitutional amendment (95th amendment) authorises the central govt. to levy tax on transactions beyond manufacturing has to be examined carefully and allow states to levy service tax and share the revenues. Accordingly, "there can be two methods of sharing the service tax powers", one is to give the states concurrent powers. This would create some problems in case of services of national level ramifications, such as railways, telecommunications, insurance etc.

"The sale of services to a registered dealer in another state will entail a treatment similar to that of goods and there appears no problems. However, when the interstate sale is to a final consumer, it is necessary to define the rules of apportioning revenues. Although this may not be entirely destination based, some operational rules will have to be evolved as in Canada".43

Third implication in the KTRF Report relating to taxes forming a part of the state list. These comprises, stamp duties, registration
fees and taxes on works contract. The KTF Report suggests that these taxes form a part of CENVAT. At present it is estimated that the centre collects more than 60% of the country’s tax revenue. Stamp duties and registration fees yield approximately 6% of states own tax revenue. Works contract also yield a substantial revenue in the states sales tax system. Sharing of these tax bases by the centre will only further worsen the vertical imbalance.

The proposed ‘grand bargain’ of KTF report, hence contains several ‘irritants’ which seriously affect the states financial autonomy. Therefore, Purohit (2004) opines that “the proposed GST as recommended by the KTF report would not only destroy the autonomy of the states by denying them the power of taxation and makes them mere administrative units. Further the proposed GST will provide an opportunity to the centre to make an inroads into the state list of taxes”.

Therefore, several issues need to be sorted out before the implementation of GST, as state govts. definitely will not agree to the KTF proposal to forego their fiscal autonomy. The Union Finance Minister in his budget speech of 2006-07 has proposed a road map for Goods and Service Tax (GST) introducing from April 1st 2010. Before that several issues of KTF have to be sorted out to have a consensus among all state govts. in the country.
4.26 Chapter Summary

In this chapter an attempt has been made to study theoretical background of allocation of resources, expenditure assignments between the centre and state and fiscal imbalances etc. To understand how the VAT system is working in other countries, a case study of Brazil and Canada has been considered, thereby lessons have been drawn for Indian Federation. In addition to this, whether India should have Central VAT, State VAT or Dual VAT? is also discussed.

Assigning concurrent powers to tax services to the states will help transform the prevailing distorting tax system into a destination based retail stage VAT. At the same time, it would also ensure and help orderly development of a rational and harmonised commodity tax system in the country. There is a consensus that in Indian federal polity, the most acceptable reform alternative is to have a dual VAT. The manufacturing VAT at the central level and destination based consumption type retail stage VAT at the state level.

The system of service taxes that should be developed in the context of state VAT is general rather than selective. The preference for general approach over selective approach is mainly to relieve all taxes on inputs and for administrative consideration.
Notes and References:


3. ibid., p. 4.


7. ibid., p. 37.


14. ibid., p. 103.

15. ibid., pp. 103-105.

16. ibid., p.105.


20. It has two levels of Govt. federal and provincial. There are ten autonomous provinces and three territories under the Federal Govt. The territories are: North West Territory.

21. Alberta has Petroleum Resources, it does not levy sales tax.

23. Except J & K and 5 BJP ruled states, Tamil Nadu and Uttar Pradesh Govts. have not agreed to introduce State VAT. But now Tamil Nadu Government has accepted to introduce VAT from April 2007.


27. Ibid., pp. 28-29.


29. By virtue of the residuary entry in the Union list in the Seven Schedule to the Constitution the Central Govt. not exclusive power to levy taxes on services. The State Govt. can levy taxes only on a few specific services, such as on luxuries, entertainment, bettings and governing stamp duties, taxes on goods and possession caused by road and inland water, wires and taxes on advertisement.


34. Every five years Govt. of India appoints a Statutory Finance Commission to recommend the devolution of tax and non-tax revenues between the Centre and States.


37. NIPFP (1994) op. cit., pp. 47-60.

38. See Chapter VI ‘Perspectives of Service Providers and Administrators’, for more detail.


44. ibid.,