CHAPTER-1

INTRODUCTION

1.1 INTRODUCTION AND MOTIVATION OF THE STUDY

A tax is a compulsory levy payable by an economic unit to the government without any corresponding entitlement to receive a definite and direct quid pro quo from the government (Bhatia, 2003). A good tax system for achieving certain objectives chooses certain principles mainly benefit approach and ability to pay approach. According to benefit approach, the equitable tax system will differ on the expenditure structure where as according to the ability to pay approach, the tax problem is viewed by itself, independent of expenditure determination. A given total revenue is needed and each tax payer is asked to contribute in line with their ability to pay. Neither approach is easy to implement. If the benefit principle to be operational, expenditure benefits for particular tax payers must be known. For the ability to pay approach we must know just how this ability is to be measured. Therefore, both the principles have important in designing an equitable tax structure which is acceptable to most people and preferable to alternative arrangements.

The basic tenet of the ability to pay is equity. Equity is a basic criterion for tax structure design. Every one agrees that the tax system should be equitable. There are mainly two equity rules i.e. horizontal equity rule and vertical equity rule. Implementation of either rule requires a quantitative measure of ability to pay. This measure would reflect the entire welfare which a person can derive from all the options available to him including consumption and income. Income has been the most widely accepted measure of ability to pay, but more recently there has been growing support for consumption as the superior choice. Income has seemed as the base for personal taxation under income tax where as the consumption has been used in the sale and excise taxes.

Consumption base is difficult to construct and also difficult to administer because of problems in estimating consumption expenditure during a given period. Therefore, tax on consumption may be a part of the over all tax system, but not as its sole component. However, income base also suffers from certain limitations such as the ability to pay of a tax payer is as much dependent upon his needs as his income
and ability to pay depends upon marginal utility of money which is a complicated measure.

In spite of all the limitations, income as the index of ability is more appealing than other indices. In practice, it is helpful if we determine tax liability at multiple levies based upon income, consumption, and wealth etc.

World over, tax systems have undergone significant changes during the last twenty years. The wave of tax reforms across the world that began in the mid 1980s and it was actually accelerated in the 1990s. In many developing countries pressing fiscal imbalance was the driving force. Tax policy was employed as a principal instrument to severe budgetary pressures (Ahmad and Stern, 1991). As Bird (1993) states, ".........fiscal crisis has been proven to be the mother of tax reform" (Rao MG, 2005). Another motivation for tax reform was provided by the internationalization of economic activities arising from increasing globalization. Globalization emphasized the need to minimize efficiency and compliance of the tax system.

One of the most important reasons for recent tax reforms in many developing economies has been to evolve a tax system to meet the requirements of international competition (Rao, 1992). Developing countries face formidable challenges when they attempt to establish efficient tax systems. Because of the informal structure of the economy in many developing countries and because of financial limitations, statistical and tax offices have difficulty in generating reliable statistics, which prevents policy makers from assessing the potential impact of major changes to the tax system.

The evaluation of Indian tax system was motivated by similar concerns. Unlike most developing countries, Indian tax reform attempts have largely borne a domestic brand. Tax policy has evolved in the country in response to changing development strategy over the years. The introduction of VAT is an important component of recent tax reform packages in most of the countries. In many countries, reason for levying the VAT is to replace the cascading type sales taxes.

**Existing System of Indian Taxes**

Indian taxes are broadly of two types. i.e. Direct and Indirect taxes. Direct taxes are those that are levied directly on the income of a person whereas indirect taxes are those whose incidence is borne by individuals on purchase of goods and services for consumption.
Taxation is one of the principal sources of finance. Indirect tax dominates tax revenue and the proportion is extremely large in the case of state taxes. Like most of the developing countries, India relies heavily on indirect taxes for its revenue requirements. This is because the general income level of the population is low, and consequently, the base for direct taxation, particularly personal taxes, is small. Indirect taxes are major revenue yielder for the centre and state governments as also local bodies. Over the last four decades, since planning began, the pattern of taxation has continued to shift more and more towards indirect taxes.

In indirect taxes, commodity taxes have an important place in the Indian fiscal structure. Commodity taxes mainly constitute Custom duties, Union Excise Duties, Sales taxes, State Excise Duty, motor vehicle and passenger and goods tax. All the tiers of Government levy these taxes. The central government levies custom duties and union excise duties and the state government levy sales taxes, state excise duty, motor vehicle and passenger and goods tax. Local self-government imposes Octroi.

**CUSTOM DUTIES**

Import and export duties constitute Custom Duties. Export depends upon terms of international trade and hence it alone constitutes a major source of revenue. The main objective of levying import duty is to provide effective protection to the domestic industry. The basic Custom Duty is of two types: (1) standard rate applicable to all commodities and (2) rate applicable to preferential areas. The basic Custom Duty is levied under Customs Act 1962 and the additional duty of customs is levied under the Customs Tariff Act, 1975.

**UNION EXCISE DUTIES**

Union Excise Duty under Article 272 of the Constitution is levied on all the goods manufactured in the country. This is levied by center but it is shared with the states. Modified Value Added tax (MODVAT) had been introduced under the basic Excise Duty with effect from March 1, 1986. It was introduced to select number of commodities but the coverage was limited to 37 Chapters out of a total of 91.

However, the coverage was extended with effect from March 1, 1987 to all the commodities except Petroleum products, textile products, tobacco, cinematography and matches. MODVAT was extended overtime to cover almost all goods and finally
it was replaced by the Central Value Added Tax (CENVAT) in the budget 2000-01. The coverage has been extended to all the commodities except high-speed diesel (HSD), motor spirit and matches.

**SALES TAX**

Structure of sales tax in India consists of states’ sales tax and Central Sales Tax (CST). The former is levied on intra-state transactions and the latter on inter-state transactions. In India, sales tax is the major source of revenue for the states. Article 246 of the constitution of India empowers the states to make tax laws for items enumerated in the State List. The states can also levy tax on the entry of goods into the local area, taxes on consumption and sale of electricity and the taxes on sale or purchase of goods other than newspapers. The Central Sales Tax, which is known as CST is Origin-based. The main drawback of CST is that the industrially advanced states producing taxable goods collect bulk of revenue levying the consuming states with little income. The consignment tax system created additional problems for the industrially backward states as they got much lesser share of the CST. CST has been considered a clear aberration as the tax collection was based on Origin principle. It was introduced for ensuring uniformity of tax rate all over the country.

But, over a period of time the states found it difficult to accept the CST procedures and rates. The 46th Constitutional Amendment envisages the levy of tax on consignment transfers. This would aggravate the inequality of tax burden among the different states. The richer states would get larger resources from CST causing further inequality amongst the states.

As the economy grew freer, business complexities led the taxation structure towards its own peril. This warranted a revision of the existing taxation system to broaden the base for taxation. For achieving this, the government introduced a single rate of excise as a major step. State governments have attempted to follow this principle by way of adoption of uniform floor rates of tax. Through VAT the states now propose to discard the complexities of the existing sales tax structure.

**NEED FOR REFORMS IN SALES TAX**

It has been debated upon for a fairly long time about the need for a major reform by the state to garner revenues. The government emphasized the need for
buoyant revenues to satisfy the state’s requirements of funds for its developmental activities. It has been felt that the present system of taxation is highly saturated, addresses only limited resource mobilization capabilities and does not lead to tax buoyancy except when tax rates are enhanced.

The inherent economic and administrative problems which may be summarized as follows:

1. Sales tax is a levy on commodities which, in most cases are also subject to excise duties. As excise duty and sales tax are levied by different layers of government, it becomes difficult to determine judiciously the impact of their levies.

2. Another problem relates to the taxation of inputs and capital goods, by the central and state governments, through excise duties and sales tax respectively. Apart from generating cascading effect, sales taxation of inputs benefits the comparatively richer states at the cost of poorer states.

3. In order to attract trade, some states have been indulging in a kind of ‘rate war’. Differential rates of sales tax on the same set of commodities in different states often lead to uneconomic diversion of trade.

4. Sales tax discourages horizontal integration and on the contrary encourages vertical integration in industries. The wide spread taxation of inputs at very point of sale encourages the industries to go in for in-house production of their requirements rather than sourcing.

5. The exact incidence of tax is not easily visible in the present system.

6. On account of cascading and hidden effects of single point tax, the final product becomes expensive making the same uncompetitive in inter-state and international markets.

7. The existing tax base is confined to commodities only. Services are exempt from taxation due to the constitutional limitations. Both the Union List and the State List do not cover taxation of services. A few selected services are separately taxed under specific provisions of the constitution.

To tackle with the foregoing weakness of the sales tax system, experts have suggested introduction of VAT. Various states have studied the impact of present taxation system and have felt the need for a major reform to the existing system. It has been felt that introduction of VAT creates a level playing field to industries and a
VAT scenario addresses the challenges of globalization for replacing the archaic system of sales tax in revenue generation. Countries which have introduced VAT have felt that the economic efficiency concern can be better addressed in a VAT regime. It has also been experienced by governments, the world over, that VAT improves compliance levels and reduces evasion of tax by virtue of its self-policing effect.

1.2 REVIEW OF LITERATURE

Scientific analysis begins with the process of pursuing and critically analyzing the works earlier made on the related research problems. In this part brief review of past studies relating to various aspects of sales tax reforms in India, concepts of value added tax, VAT in some other countries are presented.

Gurumurthi S (1997) examined the sales tax reforms. In his view, any model proposed for a value added tax system in the Indian fiscal federation should be formulated in a manner, which is politically acceptable to the center and state. The study made an attempt to present a model, which, while preserving the economic objective of a VAT is also feasible from the point of implementation in the Indian political economy. The study also pointed out that with some structural changes in tax reforms it should be possible to introduce a VAT successfully in India on the line of EC models.

Acharya Shankar (2005) analyzed the contour of India’s tax reform story from mid 1970s to at present and finds that enormous progress has been made in the last 30 years. The study presented the consensus regarding the desirable elements of a modern national tax system and compares this ‘model’ with Indian reality of the mid 1970s. The study summarizes the tax reforms in the field of both direct and indirect tax structure. Key issue for further reform include the plethora of complex exemptions plaguing customs tariff, low buoyancy of excise, integration of CENVAT with state VAT and broad basing of direct taxes.

Purohit M C (1982) evaluates the sales tax system in India. The study presents the development of sales taxes and their various forms that exists in the country. It also discussed the objective criteria for the analysis like growth objective, equity consideration, administrative expediency and co-ordination. The major recommendations of the study are:
1. There should be uniformity of rates.
2. Raw materials should be exempted to avoid cascading.
3. Tax on services should be introduced to make the tax progressive in Indian context.
4. The incidence of the tax should be calculated by taking account of the effective rates of tax.

Dr. Raja J Chelliah, et al, in their Primer of VAT (2003) have described at length the major defects of state sales taxes as cascading type which leads to escalation of costs, distortion in resource allocation and also as creator of barriers to free trade within the Indian Union. The authors have also opined that the sales tax system that operated is neither in the interest of individual states nor in the national economy as a whole. Apart from explaining the meaning and characteristics of VAT, the study has also argued for a case as why VAT is to be preferred to the state sales tax system.

Sury M M (1997) has held the view that sales tax is the most intricate and controversial aspects of India tax system. The study has described and analyzed different dimensions of sales tax in India such as historical evolution, nature, problems and alternative remedies for its simplification and rationalization.

Dr. Astha Ahuja (2004) has examined various theoretical issues related to the operation of VAT. It provides an overview of the present tax system of India. This study also traces the efforts made by the central and state governments in India to rationalize indirect tax system of the country in the direction of VAT. The study has also drawn on the experience of other countries and evaluates various options available for a smooth switchover to VAT in India.

Govinda Rao M (2003) discussed the treatment of inter-state transactions in the levy of state VAT. It addressed conceptual issue of Central Sales Tax (CST) and the need to phase out the tax to ensure a common market, advances interim measure to reduce the CST to operational level and the final reform to zero-rate. The study examines the revenue implications of CST reduction in the short term and zero rating in the long term. It also examined the issue of compensating the states for the loss of revenue and finally deals briefly with the management information system needed to monitor inter-state transactions in the absence of CST.
Aggarwal P K and Narayana A V L (1995) examined the revenue implications of options proposed in the NIPFP (1994) study for reforming the present system of domestic trade taxes in India towards a system of Value Added Tax. The focus of the study was mainly to identify the revenue neutral VAT rate or rates for the center and the states within the broad frame of the recommended rate structure. An attempt was also made to estimate the yield of selected VAT rate scenarios.

Keen Michael (2000) described and compared two recent proposals for forms of VAT intended to alleviate these difficulties: the VIVAT (Viable Integrated VAT) and CVAT (Compensating VAT). Both enable the VAT chain to be preserved on inter-provincial trade without compromising the destination principle. The key difference between them is that the CVAT requires sellers to discriminate between buyers located in different provinces of the federation, whereas VIVAT requires them to discriminate between registered and non-registered buyers. According to the study, the ideas of VIVAT and CVAT both provide ways of implementing the destination principle without breaking the VAT chain on inter-state exports or inducing game playing.

Purohit M C (1997) presented the salient features of the structure of the VAT in Brazil and discussed issues related to the management of the state VATs in that country. The existing system of taxation in Brazil is based on tax reforms enacted as part of the 1988 constitutional reforms which aimed at strengthening the structure of Value Added Tax at the state level. The study also discussed the fiscal importance of the federal and the state VAT in Brazil. The federal VAT levied in Brazil is known as ‘Imposto Sobre Produtos Industrializados’ (IPI) and the state VAT is known as ‘Imposto Sobre Operacoes Relatives a Circulacao de Mercadorias e Servicos’ (ICMS), replaced the then sales taxes in 1960s. As regards the structural strength of the ICMS, the mechanism of inter-state adjustments based on the principle of ‘Origin’ creates inter-state inequity.

Gurumurthi S (1999) analyzed the current division of responsibility between the center and the states with regard to the commodity taxation in its historical perspective and the efforts initiated during the last 15 years to introduce the VAT in place of Union Excise Duties at the central and the sales taxes at the state level. This study offers an alternative VAT model for India based on certain principles applicable also to other federal economies planning to introduce the VAT. The study also
discussed the recent developments in the European Union and Canada, which represents a major departure from the traditional approach to the federal VAT.

Renuka Vishwanathan (2002) considered whether what is planned for implementation by April 2002 in the core concepts of Value Added Taxation and assesses the extent to which presents initiatives will lay a sound foundation for eventual modernization of the indirect tax structure at the state level. The study has been made from the perspective of the existing commodity tax structure of Karnataka state. It suggested certain basic improvements in the existing system of state level commodity taxation to transform it into a destination based VAT:

1. The present structure of multiple commodity taxes should be replaced by a single, multipoint value added tax.
2. The existing tax coverage of most commodities should be replaced by across the board coverage of all commodities.
3. The existing tax coverage of a few specified services should be extended to coverage of most services.
4. The current list of multiple rates should be rationalized into single common rate.
5. Large tax exemption lists should be drastically pruned.

Gurumurthi S (1993) discussed the introduction of VAT in a country with a federal structure with a view to suggesting a possible approach to moving towards VAT in a large federal economy such as India. The study also presented the various approaches to VAT in relation to other forms of direct and indirect taxes and described how certain other federal economies have grappled with VAT. The issues associated with the switch-over to VAT in the Indian situation are then analyzed and a possible model for VAT in India is proposed.

Rao Govinda and Sarma J V M (1997) presented the need for coordinated development of domestic trade taxes in Indian federal polity has shifted the focus to reforms in the states’ sales tax system. This paper attempted to set out the strategy and stages of reform towards evolving the value added tax which is less distortionary and more acceptable to traders. The objective of this paper is to review and analyze the progress of sales tax reforms in the states and indicates the sequencing of the measure needed to rationalize the sales tax system based on the experience of other countries. This paper also discussed some lessons of experience of introducing VAT in Thailand
another developing country, with a large number of small dealers and a complicated sales tax system with 21 rate categories before it was replaced by a single rated VAT. In the light of the experience gained from Thailand, the transitional steps towards achieving the VAT at the state level in India are suggested. They are:

1. The first step in the introduction of the VAT is to rationalize the existing tax rates on the lines suggested by the state finance ministers committee and extend the tax beyond the first point by setting off the tax paid at the previous stage.
2. It is too important to work out the revenue neutral rates as the tax base is expanded in order to demonstrate the advantages of the VAT to the tax payers.
3. It is important to have the tax payers on the side of reforms.

Bird Richard (2000) reviewed the Canadian experience and speculates on the likely future evolution of sub national consumption VAT in countries. The study also discussed about the recent development in thinking about sub national VAT- not as a way to implement a regional sales tax but rather as a substitute for local business taxes. The two distinct approaches to sub national VAT which have been discussed in this paper are:

1. More attention should be paid to matching expenditure and revenues of sub national governments.
2. Like all taxes, sub national taxes should not unduly distort the allocation of resources.

He concludes that VAT may also become an increasingly important focus for discussion at the sub national level as well in at least some countries. VAT is now the key to central government finance in most developing and transitional countries and of course it is also very important in many developed countries with the conspicuous exception of the United States.

Shome Parthasarathi (2001) analyzed the economic principles underlying the VAT and framework for correct revenue implications of introducing a VAT that would replace the sales tax. The place of a VAT in a particular state among other state VATs is of special concern. This aspect is analyzed in the context of further action needed to harmonize VAT across states. Possible alternative treatments to bring in inter state sales within the base of an eventual VAT covering all states is also addressed in some detail.
McLure E Charles (2000) describes an ingenious and elegant scheme for implementing a destination-based value added tax on cross-border trade within a nation or group of nations. Sales to local purchasers (registered traders, households and unregistered traders) would be subject to the local VAT, but sales to purchases in other states would be zero-rated for state VAT and subject instead to a "Compensating Value Added Tax" (CVAT). Credit would be allowed for tax on purchases by registered traders for the local VAT on interstate purchases and for the CVAT on interstate purchases.

Purohit M C (2002) presented case studies of the structure of VAT in a few selected federal countries, such as Brazil, Canada and India, to understand the problems of introducing a harmonized VAT in a federation. It illustrates the case of the European Union (EU), drawing upon the harmonized federal features of its member states. The paper also derives lessons from these case studies in order to recommend a suitable structure for a sub-national VAT in India. The examples of Canada and the EU suggest that there should be no tax on the basis of 'Origin'. The case study of Brazil suggests that if the tax is levied on the basis of 'Origin' the set off needs to be given in the importing state, which in addition to making the tax destination-based serves as an 'equalizing mechanism' in a federal structure. The other models available in the literature suggest that the central and state VATs could corroborate each other in carrying the tax of the origin state to the destination state.

Gurumurthi S (2002) analyzed the experiences of certain selected developed, developing, and transition economies which have either implemented or experimented with the VAT during the last four decades. The study gives an overview of different approaches to the VAT and describes the form and certain variants of the VAT. The study also focused attention on the problems associated with the introduction of a full-fledged VAT in India in the historical perspective of the division of responsibility between the center and the states in commodity taxation, recommends an alternative VAT model which could be considered not just for India alone but for federal economies in general in the light of fiscal federation issues.

Purohit M.C (2007) presents evaluation of VAT and analyses its rationale and brings out the reasons for its popularity as a fiscal measure. In the Indian context, it presents up to date development in introduction of VAT by the union and by all the
states. The study presents an extremely informative account of the management of VAT in France, GST in Canada and federal & state VAT in Brazil.

Zodrow R George (2001) examined the debate regarding the relative merits of the VAT and retail sales tax (RST) in the context of fundamental tax reform in the U.S. If first reviews the current status of debate, concluding that proponents of the credit method VAT are correct that it is superior to a standard RST, although some of their arguments are some what exaggerated. Passage of a VAT may, however, be politically infeasible in the U.S. The paper then examined two "VAT-type" modifications of the RST and compares the relative merits of the VAT and such a Modified RST. The focus of this paper is on alternative ways of enacting fundamental tax reform. A wide variety of consumption tax reform proposals have of course been offered. Most recently attention has been focused on two alternatives- the Flat tax and a National Retail Sales Tax (NRST). This paper reviews the VAT versus NRST debate in the current context, focusing on difference between the two taxes rather than the common problems.

Poddar Satya and Morley English (1994) described the use of cash-flow VAT for a banking deposit/loan operation and indicate the practical difficulties blocking use of the full cash-flow method. This paper presented an approach to applying a VAT to financial services that is designed to operationalise the cash-flow method. The cash-flow method has been considered a conceptually sound method of applying a VAT to financial services with some attractive attributes in the context of credit-invoice VAT system. The paper concentrates on the key conceptual issues involved in the design of the cash-flow approach being developed. It does not attempt to assess the administration or compliance costs that the system would impose, nor does it cover all of the critical design issues that would arise.

Casperson Erik and Gilbert Metcalf (1994) have shown that when viewed from a lifetime perspective, a VAT in the United States would be substantially less regressive than when viewed in a traditional, annual income based framework. These incidence results were generated through a two stage process. The first stage was the estimation of the relationship between annual income and age using longitudinal PSID (Panel Study of Income Dynamics) data to construct a measure of lifetime income, and the second involved using this information to analyze consumption patterns with the CEX (Consumer Expenditure Survey) cross sectional data set. As a
result of annual income based tax incidence analyses, expenditure based taxes such as a VAT is generally viewed as being fairly regressive. The analysis shows, however that a VAT would be only moderately regressive over the life cycle. Moreover adjustments such as zero rating would be effective at further reducing VAT regressivity. With regressivity less of a legitimate concern, the political feasibility of a VAT might be enhanced.

Rao Kavita (2004) made an attempt to provide some dimensions to the extent of gain/lose to states from the introduction of VAT. The estimates indicates that the impact varies considerably across states, while some states seem to gain consistently from such a transition, in some states the gains could convert to losses depending on the assumptions on increments to value added. The estimates are based on the assumption of all states are adopting uniform VAT design. One way for the states to avoid incurring losses with introduction of VAT would be through variations in the rates and structure of VAT.

Purohit M.C (1991) gives a complete picture of the sales tax system that existed in India, prior to introduction of VAT. He has also emphasized the need for reforming the sales tax system and explained at length the options available in designing VAT.

Sukumar Mukhopadhyay (2005) provides a comprehensive coverage of the economic ramifications of VAT. The author has also analyzed the VAT design in India, which is based on 'White Paper' on State Level Value Added Tax released by Empowered Committee of State finance ministers on January 17, 2005. In addition, the author has provided an analysis of the VAT design in selected states like Karnataka, Delhi, Haryana, Maharashtra and West Bengal.

Pillai G.K (2005) presented the prominent features of VAT on a comprehensive canvas. He explained the positive impact of VAT on the national economies of several countries. The Indian experience of the adoption of VAT at the central level is examined in detail for the benefit of the states contemplating its implementation by April 2005. Some timely suggestions are also given to remove the apprehensions of the trade, industry and the tax administration.

Rao Hemalata (2002) discussed the need for commodity tax reforms in India. The study also analyses the concept and design of VAT, the issue relating VAT bases,
Exemptions, Rates, Computation methods and the principles of VAT. This study also discusses in detail options of VAT in India, treatment of interstate sales, the CST, options of state level VAT and other relevant issues like the VAT administration, Audit, Planning and preparations.

Charles McLure, Jr. (2005) discussed opportunities, risks and challenges on the assumption that a transaction based credit invoice method VAT would be enacted as an additional source of federal revenue. This study analyses that the federal adoption of a VAT would create opportunities for the states to improve their tax systems substantially by replacing their existing retail sales taxes. But the study does not discuss other aspects of the desirability of the federal governments entering what has long been considered the fiscal preserve of state and local governments.

Robin Burgess, Stephen Hower and Nicholas Stern (2004) argue that India would benefit from moving towards VAT system. The study focuses on the way in which a VAT can be best introduced into India given the countries federal structure. Special attention is given to the problems that would arise under either a states’ or a dual VAT with regard to taxing interstate trade.

Purohit M.C (2006) analyzed the effort made by various tax reform committees. The study makes an attempt to empirically examine the effects of introduction state-VAT to replace the existing sales tax in the states. For an in-depth analysis it takes a case study of Rajasthan and recommended measure needed to improve governance from the point of tax department of all states.

RESEARCH GAPS

Many literatures which covers the common aspects like Indian tax system, sales tax reforms, Jha Committee of 1976 and the Tax Reform Committee which was appointed in 1991. There are few literatures which have covered all relevant issues relating to VAT. So, the purpose of this study is to consolidate the valuable studies on VAT and to present all important aspects of VAT in a systematic manner. There are very few studies exist on State level Value Added Tax and made an attempt to provide some dimensions to the extent of gain/loss to states from the introduction of VAT. Therefore, it now becomes important to study revenue impact of VAT because the impact varies considerably across states. Some states may gain consistently with the introduction of VAT and some states may lose revenue depending on the
assumptions on increments to value added. So, this study analyses the revenue impact of VAT which considers each states which have adopted VAT.

**THE PRESENT STUDY AND ITS IMPORTANCE**

VAT has gained popularity among different nations due to its non-distortionary impact on resource allocation and economic decisions of the producers, traders and consumers. The study examines the need for commodity tax reforms in India and discusses in detail the concept and design of VAT, the issues relating to VAT bases, Exemptions, Rates, Computation methods and Principles of VAT. The study also discusses the experience of selected federal economies with VAT introduction.

On the other hand, the present work mainly focuses on the State VAT. It analyses the progress in rationalizing VAT system in different states. It also interprets the data and provides empirical estimates of revenue gain/loss in the context of VAT. This work seeks to assess the change in tax revenue that is resulted from the introduction of VAT by all the states, following a uniform design. An attempt is made to identify the state wise revenue effects. It presents the results of the empirical analysis of the relative tax performances of the individual states as revealed by the annual data on state tax revenue for pre-VAT and post-VAT period.

**1.3 OBJECTIVES**

Objectives of our study are as follows:

1. To review the Sales Tax System existed in India, prior to the introduction of VAT (prior to 1.4.2005).
2. To ascertain the weakness and the need for reforms in the sales tax system.
3. To study Value Added Tax system.
4. To study VAT in some Federal countries.
5. To study the adoption of Value Added Tax in various states of India.
6. To study Haryana’s VAT experience.
7. To study whether the Value Added Tax increased the revenue of the government.

**1.4 HYPOTHESIS**

1. There is a positive relationship between the Value added tax and the revenue of the government.
1.5 **Research Methodology**

In order to study the recent trends in sales tax collections in all the states, data of sales tax for the period from 1990-91 to 2007-08 has been collected. All these data have been collected from secondary sources from Reserve Bank of India Publications, from the web site of Central statistical organization, Department of revenue, Ministry of Finance, Government of India.

In order to study the state Value Added Tax, all the states which adopted VAT from 1st April 2005 has been taken up and key features of their VAT Acts has been considered. Apart from this, the main features of the Value Added Tax as a whole, has been presented.

Since India is a large federal country, the study also taken up some of the large federal economies which have adopted VAT system earlier. Since Haryana is the first state to adopt VAT systematically, Haryana’s VAT experience, its relevance and possible lessons has also been traced in the study.

The study captures the developments that took place during the introduction of VAT in the financial year (2005-06). However, the system of sales tax that existed prior to 1.4.2005 has also been captured in the study. The study made use of simple statistical tools like Percentage, Compound growth rates and Graphs, etc.

1.6 **Scheme of Presentation**

For referential convenience the present study has been organized into Seven Chapters. Chapter II deals with the major sales tax reform committees in India and the recommendations of the committees. Theory of VAT and issues in designing VAT are discussed in chapter III. Chapter IV examines the experience of selected federal economies with VAT introduction. In chapter V, an attempt has been made to study the nature and forms of sales tax and the characteristic feature of the sales tax system. The weakness of the sales tax system, the need for reforms in the sales tax and also need for Value Added Tax has been discussed. Chapter VI deals with the State Value Added Tax. A snapshot of the key features of the VAT system of major states has been presented in this chapter. In chapter VII, summary of findings, conclusions and suggestions have been presented.
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