CHAPTER- 2
SALES TAX REFORMS IN INDIA

2.1 INTRODUCTION

Because of economic, cultural and historical factors, patterns of taxation differ from country to country. Ratios of tax revenue to Gross Domestic Product (GDP) in developing countries are very less compared to that of industrial nations. A number of developing countries have successfully undertaken major tax reforms. In the light of their experience, some lessons can be drawn for other developing countries that are contemplating or are in the process of making significant changes in the structure of their tax system. Strategic issues that apply to the tax reform of most tax instruments include how to broaden the tax base, how to rationalize sales tax rates, how to coordinate reform across different taxes, and how to improve the administration of sales taxes. Many tax reforms in developing countries in the 1980s attempted to address these issues.

Reforming the tax system is necessary to achieve fiscal consolidation, minimize distortions in the economy. The way of tax reforms across the world began in the mid 1980s. Many developing countries used tax policy as the principal instrument to correct fiscal imbalances. The Indian tax system reforms are unique in some respects. Unlike most developing countries Indian reforms have borne the domestic brand largely in response to changes in the development strategy over time while keeping in the tune with institutional arrangements in the country (Rao M G, 2005). The Indian tax reform experience can provide useful lessons for many countries due to the largeness of the country with multi level fiscal framework, uniqueness of the reform experience and difficulties in calibrating reforms due to institutional constraints.

There have been a number of attempts at improving the tax system since independence. The main objective of these attempts has been to enhance revenue productivity to finance large development plans. The various tax reform committees considered economic efficiency as one of the objectives. The first comprehensive attempt at reforming the tax system was by the Mathai Commission (1953-1954). It examined the workings of the tax system as a whole and sought a progressive tax
structure. Since then, there have been a number of attempts, most of them partial, to remedy various aspects of the tax system. On the Indirect taxes side, an attempt was made by the Indirect Taxes Enquiry Committee in 1972 under the Chairmanship of L.K.Jha. It presented the first part of its report in October 1977.

It desired to "pave the way for an integrated indirect tax system in the country which is more efficient, more equitable and better-oriented to further the objectives of planned development" (Burgess and Stern, 1992). To deal with the problem of cascading in excise duties the committee recommended an extension of the existing procedures for relief of input taxation, moving eventually to a VAT at the manufacturing stage (MANVAT). Further MODVAT was introduced in 1986.

Systematic and comprehensive attempts to reform the tax system at the central level started only after market based economic reforms were initiated in 1991. The Tax Reform Committee under the Chairmanship of Chelliah laid out a framework for reform of direct and indirect taxes as a part of the structural reform process, following the unprecedented economic crisis. The Committee focused its attention on central taxes and made some suggestions for state taxes particularly in the final report.

On Indirect taxes the Chelliah interim report recommended a move towards a VAT on a broad base to eventually replace central excise. It suggested reduction in the general level of import tariffs, reduced spread of rates. In Budget, presented in February 1992, the government started to move in the direction of the report’s recommendations. Taken together the Chelliah Committee Report constitutes the finest treatment of tax policy and reform issues in India in the past 30 years. The report provided an excellent combination lucid, theoretical analysis, empirical supporting evidence and practical policy recommendations.

In this chapter we have examined the discussions and recommendations of various committees, identifying those themes which have been ever present and those that have risen in importance. Section 2.2 analyses the Indirect Taxation Committee of 1976 and section 2.3 analyses Tax Reform Committee (TRC) which was appointed in 1991. Section 2.4 and 2.5 discusses about MODVAT and CENVAT respectively. Section 2.6 includes discussion on Kelkar Committee and last section draws conclusion.
2.2 INDIRECT TAXATION ENQUIRY COMMITTEE - 1976

An expression of increasing dissatisfaction with our indirect tax system led the government, in July 1976, to appoint the Indirect Taxation Enquiry Committee under the Chairmanship of Shri.L.K.Jha. The task before the Committee is to suggest measures which would build a more enduring system in the field of indirect taxation. This committee had very wide terms of reference which included the following:

1. Review of the soundness of existing structure of Indirect taxes of center, state and local bodies.
2. Examining the role of indirect taxation in promoting economic use of scarce resources.
3. To view the structure and level of excise duties, their impact on prices, their incidence on various expenditure groups and their cumulative effects.
4. Examining the question of assisting particular industries or sectors by granting tax concessions, keeping in view the administrative and revenue aspects.
5. To study the problems due to lack of uniformity in sales tax laws.
6. The committee was also asked to study the issue of a proper balance between indirect taxes themselves.

The committee submitted its First Report in October 1977. It noted that there had been a steady increase in the share of indirect taxes in India. The share of indirect taxes in the total tax revenue is not only much higher than that of industrial countries—about 45% on the average share for most developing countries. It was not possible for the committee to express any views on a prior ground regarding the level of indirect taxation as a whole.

CRITERIA FOR A SOUND SYSTEM OF INDIRECT TAXATION

The committee pointed out some criteria which should determine the soundness of an indirect tax system:

1. It should have an adequate measure of built-in elasticity with reference to national income, so that as the national income rises, the revenue also go up at least proportionately, if not, at a higher rate.
2. Incidence of taxes should be progressive, so that it impinges more heavily on those who are better off than on those who are poor.
3. Since indirect taxation greatly influences the working of the economy they should satisfy the canons of taxation.
EVALUATION OF THE EXISTING SYSTEM

There had been some studies earlier on the incidence of indirect taxation. In order to get a more up-to-date picture of the distribution of the burden of indirect taxation among households, the committee commissioned the National Institute of Public Finance and Policy (NIPFP) to undertake a fresh study of incidence on the basis of comprehensive consumer expenditure data collected by NSS for the year 1973-74. The study showed that:

1. The most important feature of the estimate presented that they indicate a progressive distribution of the tax burden in terms of percent of expenditure.
2. The incidence was more on expenditure groups in urban areas than on those in the rural areas. The committee also found that, this difference is partly due to the higher proportion of non-cash expenditure for rural households and partly due to differences in the pattern of consumption between rural and urban households.

The committee found some of the weakness of the excise tax structure and there was no clear shift in the policy regarding the pattern of the taxation from one phase to another. The committee also set out the pros and cons of excise and advalorem duties and reasons why they preferred the extension of the advalorem system. The study of the committee showed that the indirect tax system as a whole is progressive with respect to consumer expenditure.

The committee also found that the existing system of indirect taxes had developed on a haphazard basis without any policy guidelines. There was a lack of uniformity and an abundance of avoidable diversity in rates, coverage and procedures etc, in indirect taxation. It is found that the existing indirect taxation did not have an adequate built-in-buoyancy because each year the tax rate had to be revised upwards and coverage increased to meet revenue requirements. The committee also noted the drawbacks of indirect taxation originating from multiplicity of rates, specifications and procedures etc.
The committee suggested some measures towards removing the major weakness of the sales tax system:

1. To accept a more rational and simplified system of sales taxation. One of the recommendations made by the expert group which have studied the sales tax systems of individual states has been that the sales tax should be a single point tax. It may be either at the first stage or last stage.

2. The second important step to be taken towards rationalization of the sales tax system is to bring about a reduction in the rates of central sales tax from the existing 4% to the level of 1% by stages if necessary.

**LONG-TERM REFORM OF THE INDIRECT TAX STRUCTURE**

In this context the committee put forth very strong theoretical and other reasons for the adoption of Value Added Tax (VAT). It recommended a VAT system at the manufacturing level- the so called MANVAT. According to the committee the main advantage of MANVAT would be that it would altogether eliminate cascading on account of taxation of raw materials and other inputs. The committee recommended a long term switch towards VAT system at both the central and state level together with abolition of Octroi at the local level. The government introduced MANVAT under the name Modified Value Added Tax (MODVAT).

**SUGGESTIONS AND RECOMMENDATIONS OF THE COMMITTEE**

The Jha Committee dealt with the task of reforming the existing indirect taxes. It proceeded on the assumption that “the proposed changes should ensure an adequate and rising flow of resources to the Government and pave the way for an integrated indirect tax system in the country which should be more efficient, more equitable and better oriented to further the objective of planned development” (Bhatia, 2002). The committee tried to work out a system which can avoid the main weakness of the existing sales system and also the committee aimed at eliminating the snow-balling effect of indirect taxes.

1. One of the most important recommendations was that of adoption of Value Added Tax.

2. VAT in its comprehensive form extends from the mining and manufacturing stages to the retail stage. It can replace all other forms of internal indirect taxes.

3. If the excise tax system only were to be put on a value added basis, relief would be given only for excise tax paid on inputs. Such a relief cannot be given either in respect of sales tax or custom duties.

4. As regards import duties they cannot immediately be brought within the ambit of MANVAT. One of the main reasons for this is that at present fairly stiff rates on imported raw materials and intermediaries are levied to bring in sizeable amount of revenue.

The committee concluded their discussion of long term reform of the indirect taxation structure by summarizing very briefly how they envisaged the process of change.

EXCISE DUTIES

The committee recommended the reduction in the number of excise duty rates applicable to different products along with a similar change in the rates applicable to inputs. The committee pointed out that specific duty tends to be regressive. Advalorem duties have income elasticity and their rates need not be revised too frequently. So the committee recommended that the like items should be taxed at same rates and there should be different slabs of excise duties with a general average of 20% while a range of items should be kept exempt for economic and social reasons. Some of the recommendations were accepted by the Government and put in the budget for 1978-79.

CUSTOM DUTIES

The committee recommended lowering import duties on both raw materials and capital goods. The very high level of import duties on some product generates a vicious circle which leads other industries to seek higher protection in order to survive. So the custom duties should be so adjusted that in addition to the element needed to provide protection to domestic industries.
2.3 **Chelliah Committee Report: (Interim report of the Tax Reform Committee, December 1991).**

In pursuance of its commitment to reform the tax system, the Government of India constituted the "Tax Reforms Committee" on 29th August, 1991 under the Chairmanship of Prof. Raja J. Chelliah. It submitted its interim report on 23rd December 1991.

The committee was asked to examine the following aspects:
1. To improve the elasticity of both direct and indirect taxes.
2. Increasing the proportion of direct taxes in total tax revenue.
3. Making Indian tax system reasonable and broader.
4. Identifying new areas of taxation.
5. To improve compliance of direct taxes.
6. To simplify and rationalize of customs tariff with a view to reducing multiplicity and elimination of unnecessary exemptions.
7. To extend the MODVAT scheme.

The committee discussed the feasible contours of an ideal tax system with special reference to India. It also noted the deficiencies of the existing tax system and the need to reform it. The existing deficiencies included high tax rates, highly complex provisions, ineffective tax compliance, and instability of tax rates. The committee noted that each tax measure was adopted without reference to remaining tax structure.

The committee believed that the traditional concept of Additional Resource Mobilization (ARM) should be given up. It should no longer remain a regular component of fiscal planning. The ratio of tax revenue to GDP had recorded a continuous increasing over the years, but this had failed to generate corresponding growth. In this context, the entire approach of the authorities had been defective. This approach failed because of two reasons:

1. The economy did not respond quickly enough to ever changing tax measures.
2. The government used most of the additional revenue for meeting its own expenditure.

The committee ignored the burden which a tax payer has to bear, particularly on account of inflationary increase in taxable income and wealth. The committee intended that net tax liability of a tax payer should increase even with the suggested
rates. The committee forgot the fact that a current tax liability ought to be met out of
current income and should leave enough for tax payer to meet his consumption needs.
By adopting this approach the committee was making tax compliance more difficult
even for honest tax payers.

2.3.1 TAX REFORM COMMITTEE – FINAL REPORT (FIRST PART)

The first part of the final report of the Tax Reforms Committee was submitted
on 29 August 1992. In this report, the committee has dealt with and made
recommendations on the issues in the following broad areas:

1. Corporate profit tax, problems relating to business taxation.
2. Further reform of the domestic indirect taxes.
3. Improvements in tax administration, procedures, removal of complicated
   provisions.
4. Major problems relating to tax administration.
5. Revenue audit.

The committee has also identified some problem areas like:

1. Complicated code of rules and procedures in the Central Excise Act and
   Rules.
2. No updated procedure with the changes in administrative structure.
3. Lack of training of officers and improper placement of officers.
4. Changes in the tax rates and procedures without preparation at the field level.
5. Classification of goods for assessment of duty.
6. Lack of customs expertise in central excise collectorates.

The committee emphasized the need for a simple, broad based domestic
indirect tax system with a few rates of duties and covering most services. Multiplicity
of excise duties should be reduced to only two or three rates. The committee viewed
that, if exports are to be completely freed of excises, then the tax burden on the final
export product arising from the taxation of all inputs and from that of machinery must
be removed through set-off.

The committee recommended following steps to reform indirect taxes:

1. Extension of excises to cover most manufactured goods at present exempt and
   some selected services which mentioned in the Interim Report.
2. Reduction in the level of rates on some commodities which are unduly high.
3. Gradual reduction in the number of rates moving them towards three rates between 10 and 20 percent, for all goods that would be covered by the VAT system.

4. Extension of MODVAT credit to all inputs that are used in the production.

5. Extension of MODVAT credit to machinery not fully at the time of purchase but in installments during a subsequent period of years which could be laid down in the law.

6. Extension of VAT to the more important services used by productive enterprises.

7. As regard to the sales tax, the committee viewed that this tax could be converted into a form of state VAT within the manufacturing sector.

2.3.2 Tax Reform Committee Final Report – (Second Part)

The final report- part 2\textsuperscript{nd} of the committee was submitted in January 1993 and this report mainly dealt with restructuring and rationalization of import duties. The final report covered,

1. Specific group of industries
2. Removal of major anomalies in the import tariff structure
3. Restructuring of excise duties and
4. Review of exemption notification in the import tariff.

The committee raised some fundamental questions with regard to the import duties, such as,

1. The guiding principles for their restructuring
2. The final structure at the end of the reform period
3. The time period for completing the reforms

The committee had recommended a programme for reduction in the range and kinds of reduction in import duties in the Budget for 1992-93. In the final report, the committee recommended that auxiliary duties should be merged with basic duties. The committee also noted that the suggestion of a single rate was not practicable in view of existence of infant industries and a diversified industrial pattern. Further, the committee recommended a four-tier duty structure of 5%, 10%-15%, 15% and 30%.

In the field of excise duties, the committee recommended that at manufacturing level, VAT should be at only three rates of 10%, 15% and 20%. How
ever, for non essential commodities the rate may be selective rates of 30%, 40%, or 50%. But in any case, the highest rate of VAT should not exceed 50% except in items like cigarettes.

Thus recommendations of the committee were of far-reaching significance and the adoption could totally transform our tax structure.

2.4 MODIFIED VALUE ADDED TAX – (MODVAT)

The union budget for 1986-87 initiated a major reform in the indirect tax system of the Indian economy by introducing Modified Value Added Tax (MODVAT). The main objectives were (Narayana, Bagchi, Gupta, 1991):

1. “To progressively relieve inputs from excise and countervailing duties” and
2. To provide “a transparency which disclose full taxation of the product”.

It is termed as “modified” as it is restricted only up to manufacturing stage. The operation of MODVAT could be said to have had the following effects (NIPFP, 1996):

1. An increase in transparency of the tax burden under the UEDs (Union Excise Duties).
2. A reduction in the cascading effect of input taxation; and
3. The generation of a mechanism to check tax evasion through self-policing.

Initially, only selected items in 37 Chapter were covered under the scheme. Subsequently, the list of the items covered was slowly expanded and by 1994, products in 77 chapters out of 91 chapters in Central Excise Tariff Act- 1985(CETA) were covered under MODVAT scheme. Textile sector was also brought under MODVAT during 1996 and tobacco sector was covered in 2000. Thus, MODVAT almost all manufacturing sectors except,

1. Matches not eligible as final product, and
2. High speed diesel (HSD) and motor spirit (petrol) are not eligible as inputs.

Focusing on MODVAT rates, the rate categories have been reduced, specific rates converted into advalorem rates and, exemption notifications curtailed significantly. MODVAT had nine categories of rates (viz. 5, 10, 15, 20, 25, 30, 35, 40, and 50) contrasted with a very large number of rates a few years back. There are exceptions of higher or lower rates. The higher rate of 225 percent is levied on certain specified luxury goods and the lower rates in the range of 1 to 8 percent are levied on a few specified necessities.
The MODVAT is restricted in scope. A manufacturer can avail of MODVAT credit provided:

1. The inputs and the final products are both covered within the chapter of the Central Excise Tariff to which the MODVAT scheme has been extended.
2. The final products are not exempted from excise duty.

2.4.1 A COMPARISON OF MODVAT SCHEME WITH VAT SCHEME

The limitation of the MODVAT scheme is that it cannot be extended beyond the manufacturing stage unlike a VAT which can reach up to the retail stage. Under MODVAT credit chain ends with the manufacturer as a duty collection point. Wholesale and retail trade being outside the control of the Center and MODVAT has a limited role in reducing cascading effect.

We have noted that the potential of a VAT scheme to generate expected levels of revenue can be realized only if the VAT credit method functions efficiently. The experiences of VAT countries suggested that while a multi rate VAT is desirable for an equitable distribution of tax burden, most of the developed and developing countries adopted only three or four differential advalorem VAT rates, mainly to minimize the costs of administration, if there are multiple rates and too many laws governing their application. This limitation applies to the MODVAT scheme.

Thus, the MODVAT which was prevailing until recently was only a step towards adopting a full fledged VAT. MODVAT was renamed as CENVAT on 1.04.2000.

2.5 CENTRAL VALUE ADDED TAX (CENVAT)

MODVAT was extended and replaced by the Central Value Added Tax known as CENVAT in the Budget 2000-01. CENVAT has in general, a single rate of 16 percent with some variations for selected commodities. The coverage of CENVAT has been extended to all the commodities except high speed diesel (HSD), motor spirit (petrol) and matches. In addition to general rate, there are three different rates of Special Excise Duty (SED) of 8%, 16% and 24% on specified products. Most of the items and SED are final products but some of the items also fall in the category of intermediate goods. The main features of CENVAT can be summarized as follows:
1. **Universal Incidence and Set-off**

To be called a CENVAT, the excise tax must be universal so that the producer pays excise duty on his total output of goods. Excise paid on all the excised inputs used in the production or marketing of the good must be deductible from excise paid on the final output. The central service tax must also be integrated into the proposed CENVAT. Then all services under the tax authority of the center would also be subject to the same tax.

2. **Single Basic Rate**

The key to a comprehensive VAT type system is a single general rate which is eligible for VAT deduction. A switch over from the deduction to a credit system can be considered once the computerized cross-checking system is fully operational.

3. **Equity**

An equitable indirect tax system requires lower effective indirect tax rates for basic human necessities. Food products, basic medicine and medical equipments should be fully exempt. For life saving drugs, life saving equipment and special gadgets and equipment for the handicapped an alternative would be to maintain the current exemptions.

4. **Positive Externalities**

Lower tax rates can also be justified on selected goods on environmental grounds. The natural and biological fertilizer and pest-retarding agents may be exempted from CENVAT.

5. **Import and Export**

All imports would also be subject to an identical deductible VAT and non-deductible VAT. Exports must be zero rated and entitled to a refund on CENVAT paid. Highlights of the scheme as contained in CENVAT Credit Rules, 2002 are as follows:

- Under CENVAT, manufacturer has to pay duty as per normal procedure on the basis of “assessable value”. However, he gets credit of duty paid on inputs.

- Credit will be available of duty paid on (a) raw materials (b) material used in relation to manufacture like consumable etc (c) packaging materials (d) paints.
• The input may be used directly or indirectly in or in relation to manufacture. The input need not be present in the final product.
• Duty paid on high speed diesel and motor spirit is not available as CENVAT credit, even if these are used as raw materials.
• No credit is available if final product is exempt from duty – Rule 6(1) of CENVAT credit Rules.
• Credit is to be availed only on the basis of specified documents as proof of payment of duty on inputs.
• Credit of duty on inputs can be taken up instantly.
• In some cases, it may happen that duty paid on inputs may be more than duty payable on final products. In such cases, though the CENVAT credit will be available to the manufacturer, he cannot use the same and the same will lapse.
• CENVAT rules do not require input-output co-relation to be established.
• Credit of duty paid on machinery plant, spare parts of machinery, tools etc are available.
• CENVAT on inputs is available only if the process amounts to 'manufacture'. Otherwise CENVAT is not available.

2.5.1 SOME WEAKNESS OF CENVAT

The structure of CENVAT is characterized by some weakness:
1. The existing procedures for physical controls are outmoded.
2. The provision of registration of wholesalers has created loopholes in the system to avoid payment of tax.
3. The coverage of CENVAT has not been extended to all the commodities.
4. There is a special provision related to deemed credit. Deemed credit is available only in respect of commodities where chain of various processes is broken due to some exempted goods that are used.

2.6 KELKAR COMMITTEE

In July 2002, the finance minister had proposed setting up of two task forces to recommend measures for simplification and rationalization of Direct and Indirect taxes. Accordingly, two task forces set up in September 2002 under the Chairmanship of Vijay Kelkar, Adviser to Ministry of Finance and Company Affairs. The Task
Force on direct taxes presented its consultation paper to the Government on November 2, 2002. The discussion paper on indirect taxes was presented on November 25, 2002. The Task Force submitted their final reports to the Government in December 2002. These Task Forces have made important recommendations on toning up tax administration to put in place a system that is simple, effective and at par with international standards. The main recommendations on Indirect Taxes relates to widening of the tax base, removal of exemptions, expansion in the coverage of service tax etc.

2.6.1 RECOMMENDATIONS OF THE COMMITTEE

The Committee suggested some suggestions for reform of Indirect Tax structure:

1. As regards duty exemption for the small scale sector, The Task Force on Indirect Taxes recommended that duty exemption should be extended to only small units with a turnover of Rs.50 lakhs. Duty exemption limit for the larger SSI units should be gradually brought down to Rs.50 lakhs as per the following time frame: From Rs.100 lakhs to Rs.50 lakhs by the year 2004-05 and from Rs.75 lakhs to Rs.50 lakhs by the year 2005-06.

2. The Task Force on Indirect Taxes laid down a broad approach to customs tariff reforms in India. It envisages a zero duty for essential items, 10% duty for raw materials, input and intermediate goods and 20% for final goods by 2004-05.

3. Following introduction of State Value Added Tax, these duties are proposed to be further reduced to 5% for basic raw materials, 8% for intermediate goods, 10% for furnished goods and 20% for consumer durables.

4. It is recommended that there should be only three types of duties, viz. Basic Custom Duty, Additional Duty of Customs and Anti-Dumping duties. All other duties should be removed. It is also recommended that the grant of exemptions must be judged against the following criterion and if this done it would widen the tax base. As a policy, all exemptions must be removed except in case of:
   - Life-saving goods
   - Goods of security and strategic interest.
   - Goods for relief and charitable purposes
   - International obligations including contracts.
5. Since there is a strong interdependence of goods and services in the production and distribution activities, the report recommended that the tax on services should be fully integrated with the existing CENVAT on goods by a modern VAT type levy on all goods and services to be imposed by the central government hereafter called the central GST.

2.6.2 RECOMMENDATIONS ON VALUE ADDED TAX

The Task Force on Indirect Taxes unanimously acknowledged that VAT is a major reform in the indirect tax system of India. By adopting VAT the country would join majority of the countries and to derive the advantage thereof in like measure. The Task Force has had the benefit of meeting with Empowered Committee of the Finance Ministers of the States, constituted for the purpose of implementing a nation-wide State-level VAT. Most of all vital areas have been covered by the Empowered Committee and it could not be appropriate, nor is it considered necessary for this Task Force to re-examine these issues. The Task Force would like only to highlight few issues to ensure successful implementation of VAT, and its continuity and stability in a dynamic sense.

PREPAREDNESS FOR STATE-VAT

The committee recommended that a publicity awareness programme should be started jointly by the central government and state government.

UNIFORMITY OF DEFINITIONS

It is recommended that an attempt should be made towards uniformity of all state legislations, procedures and documentation relating to VAT.

COMPENSATION TO STATES

It is recommended that issue of compensation must be tackled through mutually acceptable mechanism of additional resource mobilization through service tax and not through budgetary support.

CREDIT ON INTER-STATE TRANSACTIONS

It is recommended that the VAT scheme should provide for grant of credit of duty by the importing state for the duty paid in the exporting state, in the course of inter-state movement of goods.

STABILITY AND CONTINUITY OF THE VAT REGIME

It is recommended that for the stability and continuity of VAT, a VAT council or a permanent suitable alternative vested with adequate powers to take steps against
discriminatory taxes and practices and eliminate barriers to free flow of trade and commerce across the country should be explored.

Thus, the Kelkar Committee’s Final Report on Indirect Taxes shows impressive clarity in its tariff proposals and provides ample evidence of much thought having gone into the framing of the recommendations. The Task Force has been able to put together many good proposals on customs, excise, VAT and Service Tax.

2.7 CONCLUSION

We have examined the discussions and recommendations of various committees, identifying those themes which have been ever present and those that have raised importance. Both the central government and the state government on the other have embarked on a massive attempt to reform the commodity taxation regime in India. If reform is to be successful it is necessary to examine the particular problems which have arisen in the existing sales tax system which a reformed structure might encounter and which it might be designed to solve.

When Jha Committee (1977-78) began its examination of the commodity taxes in the country, the economy was still shackled by many problems. Viewed in that background, it was an important step for it to depart from the beaten track and suggest the levy of a VAT at the manufacturing stage which the Committee called MANVAT. The Tax Reform Committee (1992) carried forward the work of the Jha Committee by highlighting the deficiencies of the extended system of excise taxation. It was therefore convinced that the answer to the deficiencies and the problems encountered in the sphere of commodity taxes lay in a VAT. Therefore the Committee recommended a Central VAT to replace excise duties but on a much wider base, including levy on services, in addition to an expanded coverage of excise duties. The Kelkar Committee (2002) highlighted the VAT as a major reform in the indirect tax system of India.

In conclusion, Value Added Tax is the most desirable method to combat adverse effects of input taxation. In its ideal form, VAT is a multi-stage tax levied on all stages of production and distribution of a commodity. VAT avoids the cascading effect which is the chief demerit of a generalized system of excise or sales taxation. It also discourages vertical integration of industries to the advantage of small-scale sector. To tackle the problems of existing sales tax system the only rational alternative is a VAT. Introduction of VAT is typically accompanied by major simplification in terms of both bases and rate structure such as advocated for India.
REFERENCE


Tax Reforms Committee (Chairman: Raja J Chelliah), Interim Report (December 1991), and Final Report Part I (August 1992), Part II (January 1993), Ministry of Finance, Government of India.