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ORIGINAL ARTICLE

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VAT – Sea-saw Change In Revenue Collection – A Bird View

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Abstract:

As a matter of drastic change in economic paradigm in India, the process of liberalization has been introduced in the year 1990-1991. This step is being treated as gateway to export led growth for the 21st century. The policies aimed at this reform, however by chance factor has with stood the political obstacles.

The need for the revamping country's tax system was felt since long due to its complexity in structure and unfairness in actual incidence. The premise holds that relatively lower tax rate would accelerate the pace of tax collection for the Government exchequer and deter the tax evasion. In 1991, the Government of India as a result, constituted a high level committee under the chairmanship of Raja Chelliah (Chelliah Committee) to rationalize indirect taxes and to introduce a modern tax system in the country.

KEYWORDS:,

VAT, Liberalization, Rationalize,Sales, Tax.

INTRODUCTION:

Therefore it is noticed un-integrated jungle of taxes related to the commodities include; custom duties and union excise duty. Sales tax, octroi have brought cascading of prices and lack of transparency in the collection process. Under the existing structure commodity is produced with input loaded with tax and output is then further taxed.

The output looses its cost competitiveness in the present barrier free market. * Multiplicity of levies of taxes leads of inflation and penalize the customer.* inspector raj is palpably punitive distortion the flow of the taxes to the state and national exchequer.*

Sales tax is single point levy imposed on the full value of goods at the every stage of the manufacturing chain. Every incidence of sales tax becomes a part of the cost product leading to multipoint taxation, cascading of prices and discouraging savings propensity.

Thus revamping country's tax system is needed to deliver buoyancy in revenue. India's current aggregate Tax / GDP ratio is around 14 pc. Value Added Tax (VAT, here in after) is promising one in this respect. The Empower committee of State Finance Ministers constituted by the Government of India, after prolonged discussion, recommended VAT to be introduced across the country. As a result, 21 out of 28 states finally implemented VAT as on April 1, 2005. it is worth mentioning in this context that the superiority of the system has long been recognized across the world. VAT was first initiated in Brazil in mid 1960's. The European countries adopted VAT in 1970's and 130 countries including federal states introduced VAT. Asia in this respect is not lagging behind. Large number of countries from Chaina to Srilanka introduced VAT. India has its VAT in different variant both at the centre (excise duties) and state level (sales tax).

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PART I: THE ROLE OF VAT

VAT is rationalized tax structure practiced and proved in many leading countries. Under this system the tax is levied only on the value addition and as a result would check cascading of prices of commodity. It replaces plethora of taxes at the state level include: sales tax, purchase tax, entry tax, turn over tax and so on. The central sales tax (CST), in rationalization process, is to be phased out which has already been halved (2pc) during this fiscal year. The VAT regime introduces in-built self-assessment and auditing by the dealers instead of inspection system under the sales tax.

VAT brings following benefits in the economy and creates enabling ambience for growth of the corporate sector in particular:

Elimination of cascading of taxes. Introduction of uniform and simple tax law. Transparent system: improved Tax Compliance. Input tax paid on previous purchases to be set off. Increase in revenue collection. Tax on value addition only fosters the Indian Common Market and encourages savings. Gaining competitive edge by the firm in exports and Benefit to the stakeholders ranging from common people to traders, industrialists and the government.

Table I – Differences between VAT and sales tax

Basis	Sales Tax	VAT
1.Origin of tax	Sellers pay tax	Consumers pay tax
2.Assessment	Book based and checked by the tax officials	Sell assessment, dealers assessment would be audited
3.Accounting	No input tax credit is allowed	Input tax paid earlier by the registered dealer is allowed to set off against output tax and carry forward is also allowed.
4.Collection point	Single point i.e. at the selling point.	Multi-system of taxation. Tax is passed from the manufacture to whole sellers who then transfer to the retailers and then finally to the customers.
5.Books of accounts	Sales registers and sales invoice are to be maintained	Registered dealers to claim input tax credit both **sales registers** as well as **purchase registers** compulsorily to be maintained.
6.Closing Stock valuation	The cascading of taxes affects closing stock and not reflects true value as the tax component has already been added to it.	Closing stock valuation is based on true value i.e., actual and without tax components.
7.Chain of collection tax	Single point collection.	Multi-chain processes of collection comprising manufacturer, interstate dealers, local dealers, and customers
8.Nature of tax	Sales tax is considered as hidden cost the customer does not know how much of tax is paid the dealers/suppliers.	Entire tax burden is reflected and tax paid by the consumer is considered as transparent cost.
9.Compliance	Traders, dealers are compelled to comply with sales Tax act officials are involved in verification of every account.	VAT encourages self-assessment and voluntary compliance and thus administrative overhead cost of the government is supposed to be less.
10.Transparency	Entire system is opaque.	Revenue collection process is transparent. No input tax credit (ITC) in case of suppression of fact
11.Infrastructure Support	Physical verification of all documents under the inspector raj regime the cost.	Networking of entire system through increases initial cost but effective in the future.
Taxation	Double or more taxation to increase in prices.	Multi-chain taxation brings benefit to the ultimate consumers.
Basis of taxation	Sales value resulting in higher prices for consumer.	Value addition resulting in reduction of prices.
Cash out flow	Higher tax liability discourages savings and investment growth.	Low tax liability accelerating the pace of growth of savings as well as investment.

Table – II Effects of VAT on industries

Types of goods	Features	Tax credit	Impact on Prices
Consumer Durables (Automobile, TV, White Goods, etc.)	Large back end supply chain. Value added over multiple stages	Scope for input tax credit high Costs reduce.	Price reduction
FMCG (Personal Care, Tea, Detergents, etc.)	Large front-end distrib-. ution. Maximum value addition on manufacture	Scope for input tax credit low. Costs increases.	Price Increases
Software	Maximum value addition at the incubation period.	Tax Holiday/concession is allowed. Export profit is exempted from tax.	No impact on prices
Pharma	Long downstream distribution chain, involving transportation cost.	No uniformity in the policy across the states. No ITC, Supplies from local warehouses cost more	Price differential across States due to different Tax Schedules
Textile	Maximum value addition on manufacture and wide front-end distribution.	Fabrics are outside VAT. Various taxes exist in the states not implemented VAT.	Price fluctuation due to CST along with other taxes. In the ex- port fronts no change.
Service (Health care, Insurance, entertainment etc.)	Delivery of personalized services as per requirement of the customers.	Service tax imposed, no ITC.	No change in prices.

PART II VAT VIS-A VIS CORPORATE TAX

Higher corporate tax generally deters the savings and investment propensity. The tax reform measures suggests its reduction under the plea that low corporate would facilitate corporate investment and establish both forward and backward linkages in the entire economy. The assumption has been proved true across the world. Ireland, since long, followed policy of low corporate tax coupled with high VAT and has emerged as fastest growing economy in the European Union. Russia, during post disintegration period witnessed rampant corruption and tax evasion all around. It consequently, moved to income tax at the rate of 13pc. This has resulted in shooting up of income tax collection up to 50pc. Estonia, fastest growing Baltic state has abolished corporate tax on the profits if invested domestically. This strategy attracted export oriented investment that enables the corporate sector to attain competitiveness in the global market. India in this context has followed similar strategy particularly in its IT sector. IT Act 1961 promulgated tax holidays in the respective section of 10(A), 10 (B) and 10 (C).

Tax Holidays: The ITES are allowed tax exemption U/S 10 (A) and 10 (B) of the Act in respect of profits derived from the export of computer software/ hardware.

Section 10 (A) of the Act states that, any undertaking of manufacturing software either in the (Free Trade Zone) FTZ (established after 1-4-1980) or in the hardware and software park (established after 1-4-1993) or in the special economic zones (SEZs) is eligible for 100pc exemption of profits derived from export of computer software for a period of 10 years up to 2009-10.

On the other hand, Sec10 (B) states that, any computer software manufacturing firm located in the SEZs and commences production or after 1-4-2004 will enjoy 100pc tax exemption on the profit for first 5 years and 50pc for the next 2 years and further of 50 pc provided it has transferred to specific reserve account named “Special Economic Zone Re-investment Reserve account” by debiting the Profit and Loss account. The amount of the reserve account should be utilized for acquiring plant and machinery.

Further Sec. 10 (C) adds that, export oriented software manufacturing undertaking will enjoy a 100pc deduction of profits derived from the export for a period of 10 years up to 2009-10. Thus, the ITES undertaking are enjoying tax holidays up to 2009-10.

During 2001-02 to 2003-04, the BPO-ITes grew at mind-boggling rate reflected in the following econometric analysis (Raul, 2005).

Correlation Coefficient (r) (Employment & Revenue):0.80473

Compound Growth Rate (cgr) of employment: 44.733pc

Compound Growth Rate (cgr), of Revenue: 48.522 pc

The aforesaid econometric analysis has aptly demonstrated that relatively lower corporate tax (tax concession/holidays) inter alia acts as growth driver of the BPO-ITes sector. At present, BPO industry has 50000 employees on rolls and values of work out sourced by the domestic clients increased from $200 million in 2002-103 to $600 million by March 2005. The call center and BPO market growing excess of 60pc. This trend is exempted to sustain in future years.

Besides, the Government of India allowed tax holidays for the industries established in the notified area for boosting the pace the industrial culture and mitigating regional imbalances. The manufacturer with a view to avail of these opportunities may establish subsidiary units in these area and transfer almost finished product to the subsidiary unit and with very little value addition (mostly transport cost and very little labour cost) claim refund of ITC. Appropriate tax administration to check the attitude of tax evasion is imperative for real growth on industries.

CENTRAL SALES TAX VIS-À-VIS VAT

It has been argued that though there will be revenue loss during initial years of implementation of VAT, however, it would lead to revenue growth. Many states opposed the move of phasing out of CST since they are at present earning about Rs 18000 crore annually. The slashing down of CST rate from 4 pc under section 8 of the CST Act 1956, by half to 2 pc would mean a 50 pc drop in the revenue earning.

The Government of India as result has agreed to compensate for 100 pc of loss in the first year 75 pc and 50 pc respectively during 2nd and 3rd year of introduction of VAT. Such compensation would be based on as agreed formula for compensation of revenue loss they would suffer. However, there is lack of unanimity among the states regarding a definite roadmap for phases out of CST and appropriate compensation for revenue losses which have resulted in delay in their plan for switch over to VAT. Gujarat, Chattisgarh, Madya Pradesh, Rajasthan would switch over to the VAT regime by April 2006. Jharkhand has committed to switch on January 1, 2006 while Uttar Pradesh is yet to commit a date for such switch over.

PART III SUPPLY CHAIN MANAGEMENT UNDER VAT

Supply chain management (SCM) is directly linked with VAT. Strengthening SCM ensures firms competitiveness in borderless global market. In the process attaining firms cost effectiveness the role of government regulations cannot be ignored, as the service provides have no control over it. The arrays of tax laws and varying tax levies dictate how the SCM of the firm is configured. The multiplicity of taxes adds to costs to goods that ultimately loose its competitiveness especially in the free trade area (FTA) in which India is a signatory.

SCM is a process of planning, organizing and controlling the flow of materials and services from suppliers to the end users. This integrated approach incorporates wide ranges of suppliers, supply management, integrated logistics and various operations, Morey (1997).SCM gained wide acceptability due to its multidimensional coverings; cost effectiveness, maintaining upstream and downstream linkages to ensures smooth supply of raw materials, finished goods, increased flexibility in terms of delivery and response time. Starting from the transportation of components, SCM moves on to warehousing, finished goods inventory, materials handling, packaging, customer services, purchasing and finally raw material inventory.

It is expected that post VAT regime would deliver stream of benefits in purchasing, distribution, marketing and other functional areas of the firm. Rationalization of taxes, encompassing levying taxes on consumption, allowing input tax credit, phasing out central taxes, abolishing entry tax, turn over tax, etc. would facilitate the firm to achieve cost efficiency and operational effectiveness in the context of globalization of business. The firms as a result can take appropriate decisions in respect of: Sourcing decisions i.e. whether the raw materials to be procured within or outside the state, Make or buy, Distribution decision, Number of stock points, and Liking depots to the markets.

However, warehousing a key aspect of inventory management is affected due to existence of CST. The companies need new warehouses to meet the increasing demand of the market. In this respect stock transfer would get 4 pc more expensive which would defeat very purpose of doing interstate branch transfer to warehouses.

COST EFFECTIVENESS OF INDUSTRIES

The IMF research findings indicate that, VAT tends to increase prices of the commodities significantly. To neutralize such impending effects, Belgium, Korea, and Netherlands adopted strategy of price freezing, UK adopted price control mechanism while Ireland adopted the policy of control on profit margins. India in the same measure classified entire ranges of commodities into different strata (0 pc, 1 pc, 4 pc, and 12.5 pc) for levying taxes.

The price fluctuation, however, will depend upon the length of the chain where in value addition is made. Table 2 summarizes effects of the VAT on industries. Table discerns that VAT itself has inherent deficiencies to deliver promised buoyancy in revenue. The anomalies are:

* Inter state stock transfer is costlier as it will get 4 pc more expensive. * Suppliers from the local warehouses will cost more to the suppliers, as they have to pay 4 pc more on stock transfer for which no ITC is available. * The registered dealers would get refund the VAT already paid on earlier purchases. It however, will take at least 3-9 months, which would affect the working capital planning of the companies and increasing in financial cost. * Dealers need to maintain separate accounts for inter state and intra state sales for availing of ITC.

* The retailers have to pay input tax and sell the product at MRP. As their margin is vatable therefore profit volume would definitely go down. As a result the manufacturer will only fix the MRP considering VAT liability and margin of suppliers in the entire chain. This will ultimately result in common malpractices like, suppression/under valuation of output, showing input credit at inflated rate, misleading declaration of qualities, cloning, export fraud and false invoices.

* The government has to monitor inter state sales transaction without earning revenue involving more expenditure.*Higher compliance costs and threat of fraud related costs.*Intrastate players are in better-off position under VAT in comparison to Inter-State players. *Warehousing scenario has not been changed under the present hybrid tax system as inter state transfer to the state warehouses is no longer viable. *Disruption is caused in the value chain with the failure of VAT chain. It causes not only loss to the real value in terms of VAT credit but also brought stress in the long-standing buyer relationship.* Coexistence of VAT and CST distorts the supply chains and financial transaction. * Small retailers are facing difficulties in the context of maintaining VAT track records due to low levels of computerization, key requirements for successful VAT.

PART IV EVALUATION

Globalization of business and creation of world trade blocks fuelled the development of SCM. A domestically and globally competitive distribution channel requires all parties to move goods and services in accordance with customers' requirements. It is designed for the firms to totally control and coordinate goods and services through out the channel of distribution. Moreover, the WTO ministerial conference at Hong Kong declared that duty free and quota free market access to be allowed to the LCDs. Revamping of tax structure in the country at this juncture would definitely boost up the competitiveness of domestic goods in the global market.

VAT promised buoyancy in revenue collection. Its success however, hinges on translating admittedly attracting feature in to concrete administrative arrangements. The manufacturing strategies under VAT regime are changing, economics, and efficiencies have emerged as basis of all such decisions. Thus, introduction of innovative measures such as tax information, and tax information network by the help of creative use of India's information technology expertise would enable to generate audit trials for most items of expenditure and incomes amenable to taxation.

CONCLUSION

Integration of state level VAT into country wide goods and service tax (GST) would greatly facilitate the process of bringing all economic activity within the reach of tax information network. This network would enable tax authorities to clamp down on evasion. Moreover, to avoid VAT anomalies in respect of inter state transfer; there should be one large mother warehouse that would supply 4-5 state with smaller warehouse working purely as strategic spaces to feed the market and goods to be supplied to it directly from the factory cutting across the state boundaries.

Lastly, automation and re-engineering of tax administration, computerization, electronic filing, addressing taxpayer queries, training of sales officials, and the like are some of the tasks to be immediately addressed to for expediting the pace of buoyancy in the revenue collection under the VAT regime. An overhaul of the sales-tax administration in the states is therefore an imperative.

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