Unlike the erstwhile single point or cascade type of sales tax system, Value Added Tax (VAT) is a multi-point sales tax levied on the value added to goods with set-off for tax paid on purchases (inputs) and capital goods. What this means is that the amount of tax paid by the dealers for purchase can be deducted from the tax collected by him on sales, thereby paying just the balance amount to the government. Besides, the present VAT system can prevent the scope for evasion of sales tax. In this perspective, this article presents an overview of various key issues involved in VAT in India, including the traders' opposition to it.

Implementation of VAT in India

Siddhartha Sankar Saha

In the economic reforms of India, indirect tax reforms have become an integral part of the liberalization process since 1991. In the first phase of reforms, government of India has been steadily concentrating upon a tax structure that leads to a simple, moderate, rational and easy system. At the central level, an initiative has been taken to bring down both the excise and customs tariffs, reduce the number of rates, correct anomalies and get rid of the complexities in the system. In addition to indirect taxes levied by the centre, states are empowered to levy certain indirect taxes and sales tax, in fact forms major part of revenue for almost all states. There was wide variation in erstwhile sales tax rates of the same commodity in different states. In many states both inputs as well as outputs were taxed creating cascading effect. With a view to removing this shortcoming of erstwhile sales tax system, perhaps the viable solution found was to shift to destination based Value Added Tax (VAT).

There is no denying the fact that the introduction of VAT is a major tax reform as it eliminates the cascading effect associated with the existing sales tax regime. Erstwhile sales tax was levied on the *gross value* without allowing any set-off for taxes paid on inputs. VAT is levied only on the *value added* after setting off the tax already paid on the inputs. Since VAT requires computerized records it provides for greater transparency and authenticity. Thereby tax evasion can be reduced and compliance procedure can be improved by VAT mechanism. In a federal set-up like India, uniform VAT rates eliminate unhealthy competition among states to offer tax reduction concessions to attract investment and thereby it prevents reduction of revenues. In USA, another federal country, VAT has not yet been introduced. However, fed-

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eral states like Brazil and Canada have adopted VAT with varying degrees of success. The move to implement VAT in India has been postponed five times in the past as several state governments had expressed concerns about losing revenue. Initial hesitations about the VAT regime have been finally resolved with the announcement by the Union Finance Minister, Mr P. Chidambaram for implementation of VAT with effect from 1st April 2005.

Historical Background

Going into the historical background of VAT, it can be stated that the concept of VAT, which was the brainchild of F Vans Siemens first originated in 1918 as an alternative to turnover tax in Germany. France was the first country to adopt it in 1954 and this largely paved the way for it being accepted as instrument for harmonization of tax. Subsequently, about 130 countries including Pakistan in 1990, Bangladesh in 1991, Sri Lanka in 1995, China in 1994 and Nepal in 2000 have adopted VAT. The developed countries like Australia, Canada, the European Union, Spain, Japan, United Kingdom etc. have also adopted this system. Alongside, the US has not implemented VAT.

Let us look at some countries throughout the world that have adopted VAT system in *Table-1*.

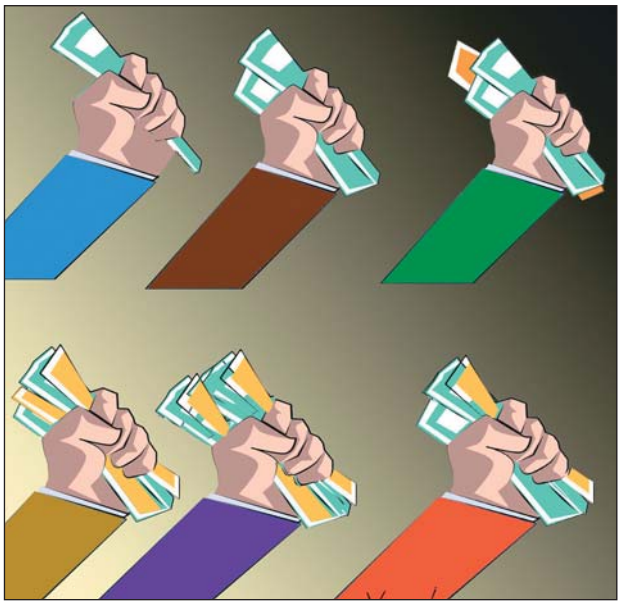
The concept of VAT is not totally new to India as the Centre had introduced a VAT system for about last ten years in respect of Central excise duties. The first preliminary discussion on State-level VAT was held in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister in 1995. The main theme of this meeting was to discuss the basic issues on VAT and this was followed up by periodic interactions of State Finance Ministers. Subsequently, three important decisions were

Table-1

Country	Year in which VAT Introduced	Country	Year in which VAT Introduced	Country	Year in which VAT Introduced
Austria	January, 1973	Hungary	January, 1988	Morocco	April, 1986
Australia	July, 2000	Ireland	November, 1972	Mozambique	April, 1999
Argentina	January, 1975	Italy	January, 1973	Netherlands	January, 1969
Armenia	January, 1992	Iceland	January, 1990	Nepal	May, 2000
Algeria	April, 1992	Indonesia	April, 1985	Nicaragua	January, 1975
Bulgaria	April, 1994	Israel	July, 1976	Namibia	October, 1999
Bangladesh	July, 1991	India	April, 2005	New Zealand	May, 1986
Cyprus	July, 1992	Japan	April, 1989	Niger	January, 1986
Canada	January, 1991	Jamaica	October, 1991	Portugal	January, 1986
Chile	March. 1975	Korea	July, 1977	Poland	July, 1993
China	January, 1994	Kenya	January, 1981	Pakistan	November, 1990
Estonia	January, 1992	Luxembourg	January, 1970	Philippines	January, 1988
Fiji	July, 1992	Mongolia	May, 1993	Panama	March, 1977
Greece	January, 1987	Mexico	January, 1980	Paraguay	July, 1993
Georgia	March, 1993	Moldova	January, 1992	Peru	July, 1976
Ghana	June, 1998	Malta	January, 1996	Romania	July, 1993
Sweden	January, 1969	Thailand	January, 1992	Spain	January, 1986
Switzerland	January, 1995	Turkey	January, 1985	Uruguay	January, 1968
singapore	April, 1994	Tajikistan	January, 1992	Ukraine	January, 1992
Sri Lanka	April, 1995	Togo	March, 1995	Uzbekistan	January, 1992
South Africa	September,1991	Tunisia	July, 1988	Vietnam	January, 1999
Taiwan	April, 1986	United Kingdom	April, 1973	Venezuela	October, 1993
Yugoslavia	January, 2001	Zambia	July, 1995.	W. Samoa	January, 1994

(Source: Chanchawat, 2004, Pp.63-66)

taken in a meeting of all Chief Ministers of India convened by Shri Yashwant Sinha, the then Union Finance Minister in 1999. The important decisions were: (a) there will not be any sales tax rate war among the states and uniformity of sales tax rates should be made for different categories of commodities with effect from January 1, 2000, (b) in the interest again of harmonization of incidence of sales tax, the sales-tax-related industrial incentive schemes would also have to be discontinued with effect from January 1, 2000, (c) on the basis of achievement of the first two objectives, steps would be taken by the States for introduction of State-level VAT after adequate preparation. However, an Empowered Committee of State Finance Ministers was set-up in implementing these decisions and for the purpose of arriving at a consensus and implementing a nationwide state-level VAT. Fortunately, the Empowered Committee was able to achieve nearly 98% success in the first two objectives mentioned above in (a) and (b) within a period of about a year and a half through repeated discussions and collective efforts of Empowered Committee among State Finance Ministers, Finance Secretaries, The Commissioners of Commercial Taxes of The State Governments and Officials of Revenue Department, Ministry of Finance. Thereafter, systematic steps were initiated for the introduction of State-level VAT.



The Empowered Committee of State Finance Ministers - headed by West Bengal Finance Minister, Dr. Asim Kumar Dasgupta and comprising the finance ministers of Assam, Delhi, Gujarat, Jammu & Kashmir, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, Meghalaya, Punjab, Tamil Nadu and Uttar Pradesh - endorsed the suggestion that every State law on VAT should have a minimum set of common features. At the conference of State Finance Ministers held on January 23, 2002, it was agreed that all the 28 States as well as the Union Territories would introduce VAT with effect from April 1, 2003. This position was reiterated during the conference of State chief ministers held on October 18, 2002 that was presided over by the Prime Minister. The Kelkar Committee on tax reforms has also recommended introduction of VAT in its report. About 29 States and Union Territories had expeditiously sent their Bills to the Ministry of Finance, Government of India for prior vetting. The Union Ministry of Finance had considered these Bills of States and Union Territories, and sent their comments and suggestions to the States and Union Territories in line with the decisions of the Empowered Committee of the State Finance Ministers for incorporating the same in VAT Bills to be placed in the State legislatures and subsequent transmission to the Government of India for Presidential assent. At this stage, there were certain developments that delayed the introduction of VAT. Despite these developments, most of the States remained positively interested in implementation of VAT. Madhya Pradesh VAT Bill had already been accorded Presidential Assent in November 2002. One State, namely, Haryana, has already introduced VAT on its own with good results on revenue growth. It is important to note that in the meeting of the Empowered Committee on June 18, 2004 when Mr. P. Chidambaram, the Union Finance Minister, was invited and was kindly present, all the states, expecting one, once again categorically renewed their commitment to the introduction of VAT from April 2005. Ultimately, Union finance minister, Mr. P Chidambaram unveiled in January, 2005 a White Paper on VAT, documenting a roadmap to levy uniform state-level tax on over 550 items and exempt 46 local items.

VAT: What is it?

Value Added Tax is a general indirect tax assessed and collected on the *value added* to goods in each business transaction. It is levied on all commercial activities involving manufacture and trading of goods and services. It is significant to note that the value added at each entity in the business transaction is determined by the difference in the sale prices of that entity and purchase values of bought out items of that

entity. *For example, a manufacturer buys raw materials for Rs. 50,000/- and produces finished product and sales all these products to a trader for Rs. 75,000/- in one tax period. The value addition to the manufacturer is Rs. 25,000/-.*

VAT is charged at a uniform rate as a percentage of prices at which the goods are transacted and it is imposed at each stage of transaction in the production and distribution chain. It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is a general consumption tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services. VAT is a consumption tax because it is borne ultimately by the final consumer. It is not a charge on companies. It is collected fractionally through a system of deductions whereby taxable persons can deduct from their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business activities. VAT, therefore, is levied at every point in the series of sales by the registered dealers with the provision of *credit of input tax* paid at the previous point of purchase thereof. This mechanism ensures that the tax is neutral regardless of how many transactions are involved. It is assumed that due to crosschecking in a multi-staged tax, tax evasion will be checked, resulting in higher revenues to the government. The basic calculation procedure of VAT is the difference between tax liability and input tax credit at each stage of transaction. It is significant to note that though globally VAT also includes taxation of services, present system of VAT in India covers only tax on sale of goods within the state and services are not included in India.

VAT has been introduced to replace state sales taxes throughout the country and as a result, all these other taxes like turnover tax, surcharge on sales tax etc. have been abolished. In addition, under VAT regime, central sales tax (CST) is proposed to be phased out over the next few years. The Central Government had agreed to reduce CST over a period of three years (from April 2004) from 4% to 2%, 1% then 0% in the third year. The phase-out would reduce the burden on Indian industry. The Centre has already given an assurance to States that it would provide a safety net in the form of a compensation mechanism to offset any revenue losses on account of switchover to VAT. The domestic industry has been opposing the continuation of central sales tax (CST) once VAT is implemented, as it reckons that CST without a set-off in the VAT system could create distortions, given that several industrial units source their inputs from outside their State. However, a month back, the Finance Minister, Mr P. Chidambaram has announced a blueprint for removal of CST.

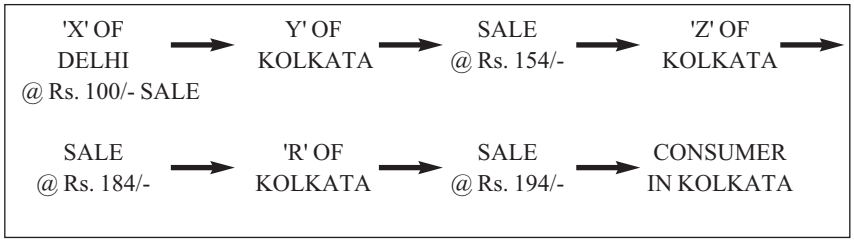
Computation Procedure of VAT

VAT is most certainly a more transparent and accurate system of taxation. The existing sales tax structure allowed for double taxation thereby cascading the tax burden. For example, before producing a commodity, inputs were first taxed, the produced commodity was then taxed and finally at the time of sale, the entire commodity was taxed once again. By taxing the commodity multiple times, it had in effect increased the cost of the goods and therefore the price the end consumer had to pay for it. Value added taxation creates an incentive for each participant in the chain from production to sale. A trader at the end of a month or quarter needs to produce all his purchase invoices and all the sale invoices. Trader gets a tax credit for all his purchases (since those are goods and services for which their producers have already been taxed), and is liable for taxation only on the difference between his purchase and sales invoices.

It is significant to note that though globally VAT also includes taxation of services, present system of VAT in India covers only tax on sale of goods within the state and services are not included in India.

Let us consider a hypothetical case (*Table-2*) to clarify the computation procedure of VAT. The following transaction chain under VAT regime assumes CST rate is 4% and VAT rate is 12.5%.

Table-2



(i) Raw material producer ➪ X (ii) Manufacturer ➪ Y
(iii) Whole seller ➪ Z (iv) Retailer ➪ R

The above hypothetical case is elaborately presented at a glance in computing VAT in *Table-3*.

Table-3

Computation Procedure Of Sales Tax Under VAT regime

Seller to Buyer	Cost price	Value addition (VA) (Including profit) (Rs.)	Selling Price (Rs.)(Excluding Tax)	Tax Rate	Invoice value (Rs.) (Including Tax)	Tax Payable (Rs.)	Tax Credit (Rs.)	Net CST Outflow [i.e. seller will deposit in Government treasury] (Rs.)	Net VAT Outflow [i.e. seller will deposit in Government treasury] (Rs.)	Total net tax outflow [i.e. seller will deposit in Government treasury] (Rs.)
1	2	3	4	5	6 == (4 + 7)	7 == (4×5)	8	9	10 == (7 -8)	11 == (9 + 10)
X to Y	0	100(VA) + 4(CST)	100	4% CST	104	4	0	4.00	0	4.00
Y to Z	104	50	154	12.5% VAT	173.25	19.25	0	0	19.25	19.25
Z to R	154	30	184	12.5% VAT	207.00	23.00	19.25	0	3.75	3.75
R to consumer	184	10	194	12.5% VAT	218.25	24.25	23.00	0	1.25	1.25
Total								4.00	24.25	28.25
Total tax to the Government (CST + VAT)										28.25

From the above table it is found that though real value addition should be Rs.190 [i.e. (Rs.100 + Rs.50 + Rs.30 + Rs.10], total value addition (including CST) in all stages calculated is Rs. 194 [i.e. (Rs.100 + Rs.4) + Rs.50 + Rs.30 + Rs.10] as CST paid cannot be claimed for credit under present VAT system. Therefore, total VAT collected at different stages is Rs.24.25 (i.e. 12.5% of Rs. 194). Here it is important to note that until CST is totally phased out, the main objective of VAT will be lost. Because amount of VAT calculated is Rs.24.25 (i.e. 12.5% of Rs. 194) in lieu of actual amount of VAT is Rs. 23.75 (i.e. 12.5% of Rs. 190) in the sense that manufacturer will have to bear an additional tax burden Rs 0.05 (i.e. 12.5% of Rs. 4, which is CST) under present VAT system. Truly speaking, VAT rate should not be charged on Rs. 4 (i.e. 4% of Rs. 100 as inter- state trade). However, the final price, which the consumer has to pay under present VAT regime, is Rs. 218.25 (i.e. Rs. 194 +. Rs. 24.25), thereby ultimately consumer will have to pay additional tax burden until CST system is entirely abolished.

Why VAT in India?

The trading community in India had exploited the erstwhile sales tax system in adopting loopholes in the system administered by the state or the centre. If a well-administered system comes in, it will close avenues for traders and businessmen to evade paying taxes. They will also be compelled to keep proper records of their sales and purchases. Many sections argue that the trading community has been amongst the biggest offenders when it comes to evading taxes. Under the VAT system, no exemptions will be given and a tax will be levied at each stage of transaction of a product. At each stage of value-addition, the tax levied on the inputs can be claimed back from the tax authorities. Industry experts argue that the VAT system, if enforced properly, forms part of the fiscal consolidation strategy in India. It could, in fact, help address the fiscal deficit problem and the revenues estimated to be collected could actually mean lowering of the fiscal deficit burden for the government. Further any globally accepted tax administrative system, will only help India integrate better in the World Trade Organization regime.

The reason for advocating for VAT is that it has replaced a complicated tax structure that will also do away with the fraudulent practices. Under a VAT regime, the point of levy will be shifted to consuming state. The producing states would still earn higher revenue, as higher production in the state of origin would also lead to higher employment, overall development and ultimately higher consumption levels in that state. In such scenario, all investment decisions to a great extent would depend upon the qual-

There is no denying the fact that the introduction of VAT is a major tax reform as it eliminates the cascading effect associated with the existing sales tax regime. Erstwhile sales tax was levied on the *gross value* without allowing any set-off for taxes paid on inputs.

ity of infrastructure, skilled and cheap labour and other non-tax incentives provided by the states. This would be an ideal scenario for overall growth and investment in the country and eventually it will improve the competitive advantage of Indian industry to face the global competition. Taxation experts, however, say VAT is good for the consumer as household expenses will come down by 4 to 8 % in the long run. This is based on the hypothesis that most people in the tax chain will bargain with each other for maximum benefits. The experts say consumers will start getting the full benefit of VAT a year after its implementation. Recently the World Bank has also urged India to expedite the introduction of VAT as this is the best way to tax services, which now form more than half of the GDP. The following are the main objectives in diverting from the erstwhile sale tax system to VAT:

- To increase the competitiveness of Indian industry by removing the cascading effect of the erstwhile sale tax system;
- To remove the multiple taxes which were prevalent in the Indian tax system;
- To ensure that all barriers to inter-state trade and commerce should be removed and a unified national market is created;
- To also ensure that there is simplicity and transparency in the system;
- To bring revenue neutrality in the long run under VAT regime;
- To promote the self-regulated mechanism;
- To encourage and result in a better-administered system that deters tax evasion;
- To keep proper records of sales and purchases made by taxpayers;
- To avoid the problem of under valuing, as all stages of production and distribution are subject to a tax.
- To prevent exemption and impose tax at each stage of value-addition to products under the VAT system;
- To encourage the taxpayers by the input tax credit method ensuring better tax compliance;
- To generate a trail of invoices that supports effective audit and enforcement strategies.
- To help in fiscal consolidation for the country in bringing a steady source of revenue reducing the debt burden.

White Paper on VAT

The White Paper on VAT formally released by the Union Finance Minister, Mr. P. Chidambaram, under the convenership of Empowered Committee of State Finance Ministers, Dr. Asim Kumar Dasgupta on 17th January 2005. The White Paper on state-level VAT is presented in three parts. The first part starts with the justification of VAT and its background. In the second part, the main design of VAT, as evolved on the basis of a consensus among the states through repeated discussions in the Empowered Committee has been elaborated. Finally an attempt has been made to discuss the other related issues for effective implementation of VAT in the third part. The main issues of White Paper on VAT are summed up as below.

(1) Rate structure and classification of commodities under VAT

The White Paper on VAT has made a roadmap for levy of a uniform state-level tax on over 550 items. Petrol, diesel, liquor, lottery have been kept out of the VAT regime. Some states like Delhi have imposed VAT on diesel at 20%, which is higher than the 12% sales tax charged earlier. VAT can be classified into four categories, under each of which a different rate is prescribed.

☞ **Category I:** As many as 46 items, which are exempt from VAT, are covered under this category. These are natural and unprocessed products in the unorganized sector, the items that are legally barred from taxation and the ones that have social implications.

☞ **Category II:** Special Rate of 1% VAT is applicable to gold and silver ornaments, etc.

☞ **Category III:** A rate of 4% VAT is applicable. This category covers the largest number of goods - about 270. They are items of basic necessities such as medicines and drugs, all agricultural and industrial inputs, capital goods and declared goods.

☞ **Category IV:** The general rate of

12.50% VAT is applicable to all the remaining commodities.

(2) Related Issues

While the VAT panel has relaxed the upper limit for traders coming under the VAT regime from Rs. 40 lakhs to Rs. 50 lakhs turnover, traders in this category would have to make a choice of paying a composite VAT rate or forego input tax credit. Mr. Chidambaram sought to encourage all States to implement the new tax regime. Under the formula commended by the panel, States would get 100% compensation for revenue loss, if any, in the first year, while 75 % of the loss would be compensated in the second year and 50 % in third year. The Central Sales Tax of 4%, which yields Rs. 15,000 crore to States, would be phased out after April 2006. The White Paper also emphasizes the potentiality of crosschecks with computerized information systems. Doubts are, however, being raised as to whether the proposed computerization involving intense interaction with computers for every trader is feasible. The White Paper has not addressed frontally the issues propounded by the Kelkar Task Force in regard to the States' rights to tax services. VAT by definition has to cover both services and goods. It does not come out clearly in favour of including services under the VAT net. This is, of course, a matter that the Finance Minister will have to address by empowering the States to levy service tax. It is logical that States should be so empowered.

(3) Procedure of self -assessment of VAT liability and Audit of Dealer

One major simplification proposed under VAT regime is that unlike the existing sales tax system there will be no compulsory scrutiny of returns. If no specific notice is issued by the VAT department proposing departmental audit of the books of accounts of the dealer within the time limit specified in the Act, the dealer will be deemed to have been self-assessed on the basis of returns submitted by him.

Correctness of self-assessment should be checked through a system of departmental audit. A certain percentage of the dealers will be taken up for audit every year on a scientific basis. If, however, evasion is detected on audit, the concerned dealer may be taken up for audit for previous periods. The audit team will conduct its work in a time-bound manner and audit must be completed within six months. The audit report will be transparently sent to the dealer also.

Why opposition to VAT?

There are several grounds for which the trading community has been opposing the introduction of VAT and has observed several strikes opposing its introduction. They expect the possibility of harassment by the tax inspectors as the outward reason for their opposition. They argue that since under VAT system, proper records need to be maintained which is very cumbersome and would lead to harassment. Some have expressed apprehensions that introduction of VAT would lead to price rise. If we go by the experience of other countries only in Uruguay and Chile there have been high inflation following the introduction of VAT and in other countries the price rise has been marginal.

The real reason behind the traders opposing VAT is apparently different. There is less scope for tax evasion under VAT and there will be stricter compliance. Perhaps the trading community wants to retain the scope for tax evasion as it existed under the erstwhile sales tax structure.

Dr. Ashok Mitra, noted Marxist economist and former Finance Minister of West Bengal, has also opposed VAT because it would be a negation of the federal principle as it would concentrate more powers at the Centre and also because it is being introduced at the behest of the WTO. The introduction of VAT in place of the existing sales tax will be 'unconstitutional,' according to Dr. Ashok Mitra. Some also argued that VAT places a heavy direct impact of tax on the labour-intensive firm compared to the capital- intensive competitor, since the ratio of value added to selling price is greater for the former. This is a real problem for labour-intensive economies and industries. To exempt small traders from VAT the minimum turnover for VAT has been made Rs.5,00,000. But the trading community argues that this limit is too low. The Empowered Committee of State Finance Ministers on VAT had foreseen a problem specific to India, which is 94 % of the traders in rural India have a turnover of Rs. 50 lakh

or less. There is a compensation scheme for them as they are required to pay only 1 % composition tax and need not pay VAT or file returns. However, they cannot claim setoffs on the previous sale. So, why are the traders upset?

However, the real reason is different. There is less scope for tax evasion under VAT and there will be stricter compliance. The trading community wants to retain the scope for tax evasion as it existed under the erstwhile sales tax structure. Perhaps, this being the real underlying reason for their protest there can be no sympathy for their opposition. India has a very large informal economy. A very large number of transactions are not invoiced. Under a VAT, if a trader is unable to produce the invoices for his purchases, he becomes liable for tax on all of his sales invoices, without any credits for prior processes. The taxes for all the previous stages will be incurred at the first point of invoiced sale. Thus, there is a real fear that the organized traders who invoice their sales might end up bearing the entire tax burden. The regime envisages documentation to plug tax evasion. That is what seems to be worrying the traders, who will have to keep tax invoices, cash memos or bills. Every registered dealer should issue to the purchaser serially numbered tax invoices and keep a counterfoil or duplicate of it duly signed and dated. Quantity and description of goods and unit price are mandatory in the invoice. Returns furnished by the dealer would be scrutinized and he would be made to pay the deficit in case of a mistake.

Service Tax & VAT

Over a period of time, the definition of 'service' has undergone change. Of late, services cover wide range of activities such as management, banking, insurance, hospitality, administration, communication, entertainment, wholesale distribution and retailing including research & development activities, etc. The share of services sector in the real GDP in India has surpassed that of agriculture and industry at a relatively faster pace as compared to other industrialized nations. Service sector has become the main contributor to the GDP not merely in developed economies like US, Japan & UK but also in developing economies like China, Indonesia, Pakistan & Brazil.

Direct and indirect taxes are the primary sources of revenue of the Indian government, which are utilized to enhance the developmental needs of the country and its people by way of public expenditure. It is also well known that services constitute a larger proportion of the consumption of the rich rather than of the poor as the demand for services is income-elastic. Depending on the socio- economic compulsions, each country evolved a taxation system on services adopting either a comprehensive approach or a selective approach. While most of the developed countries tax all the services with very few and limited exemptions, some of the developing countries tax select services only. Hitherto, India has adopted a selective approach to taxation of services.

Dr. Manmohan Singh, the then Union Finance Minister, in his Budget speech for the year 1994-95 introduced the new concept of Service Tax on services of telephones, non-life insurance and stockbrokers. Service Tax had been levied on the recommendations made in early 1990's by the Tax Reforms Committee headed by Dr.Raja Chelliah. The Committee felt that government should move towards full-fledged VAT system covering services and commodities. Service tax must be a part of VAT at the central level. It was envisaged that as the central excise duties on

goods would get gradually transformed into a value added tax at the manufacturing level, service tax would get woven into that system. Therefore, a tax could be levied on services that enter into the productive process. It is felt that VAT mechanism would mitigate the burden of service tax and take care of the cascading effect on the ultimate customers. The basic objective of service tax is broadening the tax base, augmentation of revenue and larger participation of citizens in the economic development of the nation. "In a way it (VAT) is no different from excise duty. In course of time, it is our dream to move on to Goods & Services Tax (GST) in future," the Union Finance Minister, Mr. P. Chidambaram said at the time of releasing White Paper on VAT. Ultimately, GST would replace excise duties and service tax to emerge as a national VAT. As stated earlier, service tax was introduced in India for the first time in 1994. The Finance Acts of 1996, 1997, 1998, 2001, 2002 and 2003 and Finance Bill of 2005 added more services to tax net by way of amendments to Finance Act, 1994. At present, total number of services on which Service Tax is levied has been more than 59 despite withdrawal of certain services from the tax net or grant of exemptions (goods transport operators, outdoor caterers, pandal and shamiana contractors, and mechanized slaughter houses). Service tax is charged @10% on the gross value of services.

Conclusion

VAT is one of the most radical reforms that have been implemented for the Indian economy after years of political and economic debate. In implementing VAT, the biggest benefit perhaps is that it could unite India into a large common market. This will translate to better business policy as each producer will have a big common market before him. Besides, if the government makes a conflict with the trading community, the benefits of VAT may not be materialized effectively as a big part of the currently formal economy may turn informal in order to avoid paying any tax at all. Admittedly, VAT is more efficient tax mechanism in the sense that it avoids cascading of taxes and renders self-policing easy thereby problems of double taxation can be removed. At the same time, it can breed sophisticated attempts at evasion, since evidence of tax paid on inputs is virtually a gateway to VAT refunds. Persons who specialize in tax avoidance can manipulate such evidence. Experience in the UK and the EU with VAT has shown that large leakages are common in VAT, with false claims for refund. Experience in India with MODVAT [now known as Central Value Added Tax (CENVAT)] had highlighted this when a CAG's enquiry showed thousands of crore of MODVAT being evaded through false entries of inputs bearing excise duties. VAT may not impact consumers as much as traders. One hopes that VAT—2005 will usher in a new era of transparent and consumer-friendly tax system that adds value to economic reforms in India. The government perception is that VAT will help common people, traders, industrialists and also the government. According to it, VAT is indeed a move towards more efficiency, equal competition and fairness in the taxation system. The tax structure, in fact will become simple and more transparent and this will improve tax compliance and also augment revenue growth. The states are supposed to increase their level of preparedness substantially by implementing a clear plan of action with regard to computerization, training and orientation, designing of forms and documents as well as briefing of trade and industry. It is believed that a successful implementation of the long awaited VAT mechanism from 1st April, 2005 by all the States and UTs will enable both the industry as well as the economy in India to become more competitive. Finally it can be concluded that to cope with the changing scenario of indirect taxation, if practicing accountants refresh their knowledge, they can exploit new found opportunities made under VAT regime by providing advice to their clients. ■

VAT has been introduced to replace state sales taxes throughout the country and as a result, all these other taxes like turnover tax, surcharge on sales tax etc., have been abolished. In addition, under VAT regime, central sales tax will be phased out over the next few years. The Centre had agreed to reduce CST over a period of three years (from April 2004) from 4% to 2%, 1% then 0% in the third year. The phase-out would reduce the burden on Indian industry.