

JUSTIFICATION OF VAT IMPLEMENTATION VIS–A–VIS THE QUALIFYING PARAMETERS OF A SOUND TAX SYSTEM – AN ANALYTICAL STUDY IN THE INDIAN CONTEXT

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Abstract– Every good tax system is designed with an eye on the basic fundamentals of taxation which are popularly known as “Canons/ Principles of Taxation”. These principles indicate the soundness of a particular system of tax. VAT is a new entrant in the family of commodity/ indirect tax system. Does it justify its imposition in the light of the basic fundamentals required of a good tax system? The present paper is an attempt to analyse as to how far and to what extent introduction of VAT in India justifies the testing parameters of a good tax system.

Key Words–components; Good Tax System, Qualifying Parameters, Value Added Tax, Justification, Implementation, Commodity Tax, Cascading effect, Self-Assessment, Self-policing, Input –tax- Credit, Revenue.

INTRODUCTION

Tax plays an important role in the development of an economy. Its design and structure affects the overall structure of an economy. It is a driving force for an economy which accelerators the pace of its growth. Generally one section of community or the other always opposes a kind of taxation. A tax which favours the money lenders certainly harms the consumers and vice versa. So no tax system is complete and perfect. A good tax system is one which has the least shortcomings (Prof. Dalton).

Value added tax is a new entrant in the family of commodity taxation. It is believed to be a wonderful innovation of 21st century. It is of very recent origin in India. It is a big reform in the Indian commodity tax system and has replaced the erstwhile suffocated sales tax system. In India, it is a State level tax which was launched in the year, 2005. More than 145 countries across world have so far switched over to VAT. France is the 1st European country to adopt it in 1954. VAT offers a greater degree of flexibility in revenue and plays a significant role in economic stabilization (Malla, 2013). It is a tax levied on the value added to a product by a firm or a trader at each stage of its production and distribution. It is a multipoint tax levied on the value added to a product every time it changes hands. Carrying a provision of credit for the taxes paid at earliest stages which in common parlance is known as “Input-tax credit”, it has a low rate structure and is based on self – assessment, self policing and Self-regulation.

However, the secret of its success lies in proper invoicing (Purohit, 2006) and (Lakhi, 2005).

Taxation does not have only economic but also social and political implications. For every new tax like VAT, it has some definite motive. However, the motive behind a particular tax cannot be achieved unless a clear-cut policy regarding its imposition is followed. From time to time, economists have suggested various principles regarding taxation. Adam Smith – a classical a political economist, for example has stressed on the ways in which an economy could increase its productive capacity and ultimately achieve a higher rate of growth. One fundamental tool to increase the productive capacity is the adoption of a sound taxation policy. The modern economists like *Bostable* have also given some concrete taxation principals to accelerate the pace of economic growth. The question is whether Value Added Tax is a sound tax system in the light of taxation principles enumerated by the economists? The present paper is an attempt to examine and analyse the justification of its implementation in India in the light of these qualifying parameters.

Review of related Literature

A good tax system has been the quest of societies since centuries. As such the attributes of a good tax system viz, equity, economic efficiency and simplicity have been the subject of great interest among the experts and laymen alike (Chelliah, 1994). Cnossen (1997) is of the view that VAT raises more revenue with less administrative and economic costs. Singhvi (2004) opines that VAT improves compliance levels and reduces evasion / avoidance of tax by virtue of its self – policing effect. According to Parohit (1993), VAT is a simple, efficient and transparent system of commodity taxation. It is a less expensive system of taxation both for the traders as well as the consumers as it eliminates the cascading effect of taxes, Sundaram (2002), Muneer (2005), Chand (2006) and Dutta (2006). In the words of Archana (2005), VAT is a win-win system as it is characterized by a wider tax base, better compliance, simplicity, economy, transparency and increased revenue realization benefit. Under VAT, tax collection is easy, tax evasion is least and tax revenue is high, Raheel (2005). Gupta (2006) is of the opinion that VAT is a burden reducing and price and economy enhancing system of tax. VAT is an excellent tax instrument as it is revenue neutral and cascading free tax system (Yeole, 2006).

The present study attempts to examine and analyse whether VAT implementation in India is confirmed (as per the

literature reviewed above) by the basic attributes of a sound tax system.

Objectives of the Study

The study has been under taken to achieve the following objectives: -

- To examine the characteristics of a good tax system.
- To examine the general features of value added tax system.
- To analyse how far and to what extent the introduction of VAT system in India is justified under the qualifying parameters of a sound tax system, and
- To suggest the ways and means for the removal of bottlenecks in the successful operation of VAT in India.

Research Methodology

Since the study is conceptual in nature, hence the secondary source of data mostly comprising books, journals and various research publications, has been used to achieve the stated objectives. Besides this, personal interviews of and discussions held with the experts and the stakeholders of the subject, served as the primary source of data for the completion of the study.

Analysis and discussion

Qualifying parameters of sound tax system and justification of VAT implementation there under;

Equality

Equality implies that every liable person ought to contribute in proportion to the revenue which he generates under the protection of the State. In other words, the burden of tax must be fair and just. VAT justifies this principle because only those traders need to pay the tax whose annual turnover exceeds the prescribed limit (the limit varies from state to state). Farmers and small dealers with low annual turnover are outside the ambit of VAT in almost all the States in India.

Certainty

This Principle suggests that there should be no confusion about the payment of a tax. Every tax payer must know the time, manner and the mode of tax payment. Value added tax is clear on all these counts, as a consumer has to pay the tax at the time of purchase and a dealer at the end of tax period (In some States after one month and in some at the end of a quarter). The consumer knows how much he has to pay as the amount of tax is shown separately in the invoice. The seller also knows how much is due from him after adjusting the input-tax credit. He has to deposit the amount due as tax after the tax period with the bank against a proper receipt which he needs to submit to the Tax Department. So there is nothing uncertain as regards the rates, time, amount, mode and place of payment of under VAT.

Convenience

Tax payers should suffer the least inconvenience in the payment of Tax. VAT is also less inconvenient for the tax

payer. This is evident from the fact that a trader has to pay only for the period he makes the sales. He is not charged for the period during which he does not make any sales. Further, he needs to pay the tax within the prescribed time slot after the expiry of the tax period. The place of payment and the authority to which the tax is to be paid is clear. VAT in India is so designed that it avoids the wastage of time and resources in the collection and payment of tax.

Economy

The compliance cost incurred by the tax payer and the collection cost incurred by the collection authority should be the least. For tax payers (traders and consumers), VAT is an economical tax because there is no cascading effect and also there is a provision of credit for input taxes. Also for the government, the tax is economical because it is based on self-assessment and self-policing and self-regulation. Hence, it is less time and less labour consuming tax. It is pertinent to mention here that the maximum portion of collected amount, goes to the public treasury.

Productivity

Taxation must accumulate enough money for the government to run the administration efficiently. This principle also connotes that it is better to impose a few productive taxes rather than to go for a large number of unproductive taxes. VAT in India is so designed that it brings more revenue to the government. There are least chances of tax evasion. It has an unbroken chain. It has the capacity to bring more and more tax payers under its ambit by virtue of its strict laws and stringent clauses. Further, it has replaced all other less productive and unnecessary taxes like turnover-tax, surcharge etc. This has made the tax system more purposeful and more productive.

Elasticity

Elasticity in taxation helps the government to increase the revenue without any addition to the cost of collection. There is a greater scope for the extension in tax base under VAT because of the provision of the thresh-hold limits. In case of emergencies and adverse circumstances in the country, thresh-hold limits for registration of dealers can be lowered to enable the authorities to garner more revenue. Further, by bringing services under the ambit of VAT (proposed by the Union Government), the tax will become more elastic.

Diversity

The burden of tax should not centralize on one group. Every tax payer must be made to contribute to the state exchequer. Since different sections of the society have been brought under the preview of VAT, hence it has made the indirect tax system more diversified in contrast to the erstwhile sales tax system.

Simplicity

Every tax should be simple and easily understandable to a common man. VAT when compared with the erstwhile sales

tax system (which was complicated owing to the multiplicity of rates and plethora of exemptions and concessions) is simple to understand and easy to calculate. Simply a tax payer must have the knowledge of applicable rates and the methods of the computation of tax liability. Since VAT is based on self assessment, hence a tax payer is familiar with the mechanism of tax calculation which signifies its simplicity.

Expediency

A tax should not become a subject of criticism by the stakeholders. There should be no doubt about its desirability under a particular economic set up. Introduction of VAT as a substitute for the erstwhile sales tax system was highly desirable because sales tax had completely suffocated the indirect tax structure of the country because of its short comings.

Co-ordination

There must be a co-ordination between different taxes that are imposed by various taxation authorities such as Central, State and Local Bodies. Since VAT has subsumed a number of other taxes, hence it has paved the way for the complete co-ordination of tax management in the country (Sangmi and Malla, 2006).

Neutrality

A tax should avoid interference with the attainment of optimum allocation and getting of maximum satisfaction i.e., it should neither be inflationary nor deflationary. There should be no negative impact on the relations between the stakeholders of a tax system. Elimination of cascading effect of taxes under VAT has made it non-inflationary to a reasonable extent. Besides, empowering the trader with self-assessment and self-policing coupled with an end to erstwhile Inspector Raj in the country in the field of commodity taxation, there is no scope for any conflict in the relations between the tax payers and the tax collectors.

From the analysis made above, it emerges that India has done well to implement the VAT at the State Level as its implementation is reasonably justified vis-a-vis the qualifying parameters of a sound tax system.

CONCLUSION AND SUGGESTIONS

The aforesaid principles are considered to be the essential requirements of a good tax system. Practically, there are difficulties in the administration of the tax under a particular economic, social and political set up. According to Prof. Dalton, the best system of taxation from the economic point of view is one which has the least bad economic effects. The analysis made above shows that introduction of VAT in India justifies all these principles and is currently doing well on all fronts in almost all the States. Adoption of VAT in developing countries especially in India is really an achievement. However, the real achievement for the new dispensation will be noticed when:

- The tax rates are rationalized, across the States.

- The Competing tax incentives and concessions are removed, to avoid discrimination.
- Uniformity in rate structure across the country is fully ensured.
- Phasing out of Central Sales Tax (CST) is successfully provided for, and
- An integrated Value Added Tax structure for all goods and services combining Central Value Tax (CENVAT), State VAT and all other state level taxes and duties is adopted.

Further, in order to enlighten and educate the stakeholders, rigorous awareness campaigns through advertising designed to create a trust amongst the tax payers should be undertaken. Such campaigns will remove the doubts and apprehensions from the minds of tax payers.

The tax payers need to behave as responsible citizens. They should leave no ground for tax evasion/ tax avoidance. They should follow the maxim, “The more the revenue to the Government, the more the facilities to the people”. The Government should take all possible measures to make the tax friendly to the tax payer by simplifying the mechanism/ machinery of tax administration.

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