Vol 6 Issue 2 March 2016

ISSN No : 2230-7850

International Multidisciplinary Research Journal

Indian Streams Research Journal

Welcome to ISRJ

RNI MAHMUL/2011/38595 **ISSN No.2230-7850**

Indian Streams Research Journal is a multidisciplinary research journal, published monthly in English, Hindi & Marathi Language. All research papers submitted to the journal will be double - blind peer reviewed referred by members of the editorial board.Readers will include investigator in universities, research institutes government and industry with research interest in the general subjects.

Address:-Ashok Yakkaldevi 258/34, Raviwar Peth, Solapur - 413 005 Maharashtra, India
Cell : 9595 359 435, Ph No: 02172372010 Email: ayisrj@yahoo.in Website: www.isrj.org

Indian Streams Research Journal

International Recognized Multidisciplinary Research Journal

ISSN: 2230-7850 Impact Factor : 4.1625(UIF) Volume - 6 | Issue - 2 | March - 2016

CHALLENGES OF K-VAT IN SYSTEM OF TAX

Ashok Omkar

Assi.prof and Commerce Virashiva College Bellary.

ABSTRACT :

The requirement for composed improvement of local exchange charges in Indian government nation has moved the center to changes in the States' business charge frameworks. The nitty gritty investigation has prompted a concensus on the need to change the common deals charges into a destination based utilization sort esteem included duty. The endeavors to change the business charges, be that as it may, have not been dependably in the right heading and, moreover, have met with resistance from dealers. Taking into account the experience picked up in this way, the paper endeavors to set out the technique and phases of change towards developing the worth included expense which is not so much distortionary but rather more worthy to the brokers.

KEYWORD: challenges of k-vat , Tax Reform Committee , organization.

INTRODUCTION:

An essential part of basic modification started in 1991 has been the change of the duty framework. In the primary period of changes, the accentuation has been to streamline and justify Central charges inside of the structure gave by the Tax Reform Committee. The endeavors have been to widen the base, lower and disentangle the rate structure, and streamline the organization and requirement. There has additionally been an endeavor to legitimize traditions obligation as far as bringing down the top and normal levy rates, and decrease in their scattering, and of extract obligations as far as the scope of MOD VAT offices to bigger number of items and capital merchandise. Despite the fact that it is too soon to pass a judgment, these changes most likely have prompted change in the structure of Central duties as the offer of direct assessments in the aggregate expanded forcefully from 19 for every penny in 1990-91 to 29 for each penny in 1995-96.

With the changes under path at the Central level, the center has now moved to the change of State expenses, especially the business charges. This is on account of, the business charge contributes near 60 for every penny of the States' own particular assessment incomes and very nearly 33% of the local exchange charges in the nation. In this way, it is vital to legitimize the business charge frameworks winning in various States to minimize the relative value contortions and prepare for facilitated and fit advancement of the local exchange charges.

The recent discussions on the desirable direction of reforms in sales taxes have pointed towards the need to transform the prevailing sales tax systems into a consumption type value added tax (VAT) to be levied by the States concurrently with the VAT at the manufacturing stage leviable by the Centre.1 A number of States have already taken steps to rationalise their sales tax systems with a view to ultimately achieve the desired reforms. However, there are considerable variations across the States both in the direction, content and sequencing of reforms and the time is now ripe to understand and analyse the measures taken hitherto. At the same time, many of the States have been facing resistance from the traders, and in order to make the VAT acceptable to the tax payers, it is necessary to go into the reasons for their apprehensions.

The objective of this paper is review and analyse the progress of sales tax reforms in the States, and indicate the sequencing of the measures needed to rationalise the sales tax systems based on the experience of other countries. Section II discusses the desirable form of domestic consumption taxes in India. In section III, we discuss, review and analyse the progress in rationalising the sales tax systems in different States. Some lessons of experience of introducing VAT in Thailand, another developing country, with a large number of small dealers and a complicated sales tax system with 21 rate categories before it was replaced by a single rated VAT is discussed in Section IV. In the light of the experience gained so far and the sequencing of reforms in Thailand, the transitional steps towards achieving the VAT at the State level in India are suggested in Section V.

The Reform Of Domestic Trade Taxes in India : important Issues

The complexities of and relative price distortions arising from the prevailing excise and sales tax systems have been very well documented by several studies and reports of the committees and study groups. (Burgess, Howes and Stern, 1993, government of India, 1992, NIPFP, 1994, NIPFP, 1995). Briefly, the levy of manufacturing excises by the Centre and the predominantly first point sales tax by the States has created parallel systems of taxation with narrow base. The multiplicity of rates and exemptions in both the systems has contributed to enormous complexities. In some States there are as many as 20 tax rates and when the rate differentiation in turnover taxes and surcharges are taken account of, the number of rates would work out to be more (NDPFP, 1994). Although in the case of excise duties the tax credit facility on inputs and capital goods has been extended to a large extent, in most States sales taxes continue to be levied on inputs, capital goods and final consumer goods alike. Given the oligopolistic market structure, this has contributed to the levying of tax on tax, and mark up on tax at successive stages of production and distribution chain. In addition, the levy of inter-State sales tax, which is in the nature of a tax on inter-State trade has nullified the advantages of a large common market by impeding the free flow of inter-State trade. Besides causing unintended relative price changes, this has contributed to significant inter-regional inequity. It is for these reasons, the National Institute of Public Finance and Policy (NIPFP, 1994) study team appointed by the Ministry of Finance opined, "Domestic trade taxes in India are in urgent need of reform The system that is operating at present is antiquated, complex - according knowledgeable experts, the most complex in the world - and injurious to the economy in many ways." (P. 1).

At the Central level, the recent initiatives have considerably simplified and rationalised the excise duties. The replacement of the system of gate passes with the invoice based assessment system, conversion of specific levies with ad valorem tax and reduction in the number of tax rates, and extension of MODVAT credit to most commodities and more importantly, to capital goods have brought about significant degree of simplification and rationalisation of the tax. Nevertheless, much more remains to be done in terms of the rationalising the structure of the tax, extending the tax credit, improving the infonnation system, and administration of the tax, before converting into a full fledged manufacturing level VAT.

Reform of Sales Taxes by the States.

At the State level, efforts are under way to bring the States together to agree for transforming their existing sales tax systems to VAT systems. The issues of feasible type of VAT to be levied and the stages by which this has to be reached have attracted considerable attention by both academicians and policy makers in the last few years. Towards forging a consensus, the Union Finance Ministry appointed a Committee of States' Finance Ministers from 10 different State governments to work out the rationalisation measures and their sequencing to achieve a rational and a coordinated structure of sales taxation in the States.

The Experience of Thailand in Introducing the VAT:

Second, policy environment was created to switch over from the cascading type tax with the 21 tax rates to a single rate consumption type VAT. Of course, in India interstate tax competition makes it more difficult to make such a radical change in one stroke, but significant rate reduction and rationalisation is within the realms of feasibility as some of the States like Karnataka have found when they reduced the number of tax rates drastically last year.

Some important lessons from the experience of Thailand in introducing the VAT are notable. First, the tax was introduced after a thorough preparation for almost five years. The government appointed as many as eleven working groups to work out the details, evolve necessary legal framework, build the information system and computerisation, cater to the educational and training needs of the tax payers and tax officials and to coordinate the work of the various working groups to ensure a smooth transition. In this task international advisers and consultants also played a very important role.4 The preparation also created the confidence to the policy makers and showed that even with a low tax rate, the targeted revenues could be realised. The reforms resulted in the simplicity, lower tax rate, a properly worked out scheme of tax relief on inputs and capital goods and the most important, the provisions to refund the tax to the exporters within a month.

Transition Towards the VAT : Suggested Measures

In the interest of minimising cascading effects and relative price distortions, and improving revenue productivity of the tax system, there is a general agreement that the prevailing sales tax system should be transformed into a consumption type VAT. It is therefor, important that the reforms in the sales tax systems undertaken by the States should facilitate a smooth switch over to VAT. It is also important to create a vested interest for such a reform. Given the complexity of the prevailing system and the large number of players involved in the game, this can only be reached in stages with well backed up research and preparation. However, it is necessary to lay down the various stages and evolve a definite time table to be followed by all the States and Union Territories to ensure that the reforms are in the indicated direction and progress in achieving the goal is broadly uniform.

The first step in the introduction of the VAT is to rationalise the existing tax rates on the lines suggested by the State Finance Ministers' Committee, and extend the tax beyond the first point by setting off the tax paid at the previous stage. Some of the States have already taken steps and many are contemplating action in this direction. However, it is important to ensure that the reform does not fail even before it begins, and the success of rationalisation and expansion of the tax base, as mentioned earlier, depends on three important factors.

First, the rate rationalisation into four floor rates should be done taking account of all supplementary levies like surcharge on sales tax and turnover tax. If these supplementary levies are continued and if their rates too are differentiated depending on the turnover range of the dealers, there will be much more rate differentiation than what is intended and the purpose of minimising rate differentiation will be defeated. Once removed the policy makers should desist the temptation to introduce such levies from time to time to meet the exigencies of revenue. More importantly, it must be noted that the rationalisation exercise can not succeed unless the Union Territories are actively involved in it.

Second, it is important work out the revenue neutral rates as the tax base is expanded in order to demonstrate the advantages of the VAT to the tax payers. The emphasis should be on long term revenue productivity coming from the better tax compliance. It must be noted that Thailand levied the tax at 7 per cent even when the revenue neutral tax rate was 10 per cent, and this went a long way in the acceptability of the tax. Interestingly, this ensured a high overall revenue productivity as the revenues increased at the average rate of about 30 per cent after the adoption of VAT. Interestingly, the reform led to significant improvements in the buoyancy of income and corporation taxes besides the VAT. With improved buoyancy, the task of fiscal adjustment was rendered easy, and the Government could in fact, reduce the marginal rate of income tax from 50 to 37 per cent, and of corporation tax by 5 points to 30 per cent. In contrast to this, much of the resentment in Canada against the levy of the goods and services tax was due to the perception that the rate of tax levied was not really revenue neutral and the new tax rate did not take into account the expansion of the tax base which included services

In the third stage, it is important to eliminate all forms of tax reliefs and incentives for industrialisation. Simultaneously, the States can introduce the system of providing tax credit on the purchases of inputs and capital goods to the manufacturers. This is a more neutral and better form of incentive than the various types of incentives provided by the States. However, as the central sales tax will still be in vogue, the principle can be extended to purchases within the state, which, from the national viewpoint is not entirely desirable as it can result in inter-state tax spillovers. However, as a transitional step, this may be the next best solution

The fourth stage of reform involves further rate rationalisation into one or at the most two rates estimated to ensure revenue neutrality by taking into account the expanded tax base. Simultaneously, the Central sales tax should be abolished, the input relief extended to all inputs and capital goods, whether bought from within or outside the State. This would also require the creation of a clearing house mechanism to relieve the tax on inter-State sales to ensure that the tax collected by the exporting State is returned to the State where the final sale tax place. It is necessary to recognise that a full-fledged VAT can not be achieved unless inter-State sales tax is significantly brought down and eventually, all such sales are either zero rated or set off.

Abolition of inter-State sales tax will be the most contentious issue in the introduction of VAT. Due to the fear of losing revenues, the States have not been able to come to the agreement on the issue of abolishing or even reducing the inter-State sales tax. Of course, political leadership in a number of States did not hesitate loose large amount of revenues for populist reasons like introducing prohibition or to initiating a number of subsidies and transfers. But, it is unlikely that they will be easily persuaded by the need to reform the tax system by abolishing the central sales tax unless a compensatory mechanism is introduced though, the revenue from the tax constitutes just about 17 per cent of the sales tax revenue. The Centre could work out a scheme to pursued the States to give up the inter-State sales tax in return for giving them the power to tax services. After all, if the economy is fully liberalised and import of consumer goods allowed at low rates of tariffs, the States would lose a lot of business if they persist with the inter-State sales tax. (Import may become cheaper than purchasing from other States. If necessary, the Centre may also provide a compensation to cover a certain percentage (say 50 per cent) of the revenue from CST in each State for a specified period (say, three years) until the reforms are firmly in place and revenue productivity of the tax system shows significant improvement. The compensation may be based on the latest years' revenue from the CST or the average of the last two/ three years. As it is, the introduction of the VAT, backed by a proper information system is likely to enhance the revenue productivity of personal income and corporate taxes significantly and as the amount of compensation involved is within the realm of feasibility, the Centre can certainly do so in the interest of efficiency.

In any case, the fear of losing revenue is likely to weigh heavily in any rationalisation measure leading to the introduction of the VAT. Unless the bureaucrats are assured that they will not be penalised in the case of short term revenue loss, they are likely to develop a cold feet. It is therefore, important for the Centre to create a fund to compensate the States in the event of a significant shortfall in revenue. The detailed modalities of compensation can be worked out and the multilateral institutions can also be asked to assist the fund as they have shown a keen interest in the sales tax reform in recent years.

It is important that the detailed steps involved are discussed threadbare by the Centre and the States and a detailed time table drawn up by which time all the parties concerned will undertake the reform measures needed. Once broad measures are agreed upon and the time table drawn, it is necessary to appoint a number of working groups by the States to work out the structural, legal, operational, and transitional details, the development of the required information system, computerisation of the returns and the creation of the clearing house mechanism. This will ensure a certain measure of uniformity and harmony in the evolution of the VAT and also adherence to a time bound plan of removing the inefficiencies and distortions that bedevil the sales tax systems at present.

CONCLUSION:

The recent discussions on the desirable direction of reforms in sales taxes have pointed towards the need to transform the prevailing sales tax systems into a consumption type value added tax to be levied by the States concurrently with the VAT at the manufacturing stage leviable by the Centre.1 A number of States have already taken steps to rationalise their sales tax systems with a view to ultimately achieve the desired reforms.

However, there are considerable variations across the States both in the direction, content and sequencing of reforms and the time is now ripe to understand and analyse the measures taken hitherto.

The replacement of the system of gate passes with the invoice based assessment system, conversion of specific levies with ad valorem tax and reduction in the number of tax rates, and extension of MODVAT credit to most commodities and more importantly, to capital goods have brought about significant degree of simplification and rationalisation of the tax.

In contrast to this, much of the resentment in Canada against the levy of the goods and services tax was due to the perception that the rate of tax levied was not really revenue neutral and the new tax rate did not take into account the expansion of the tax base which included services This would also require the creation of a clearing house mechanism to relieve the tax on inter-State sales to ensure that the tax collected by the exporting State is returned to the State where the final sale tax place.

But, it is unlikely that they will be easily persuaded by the need to reform the tax system by abolishing the central sales tax unless a compensatory mechanism is introduced though, the revenue from the tax constitutes just about 17 per cent of the sales tax revenue.

REFERENCES:

1.Burgess, R, S Howes, and N. Stern (1993), "The Reform of Indirect Taxes in India", Suntory-Toyota International Centre for Economics and Related Disciplines, Ef. No.7.

2.Government of India (1992), Final Report of the Tax Reforms Committee, (New Delhi: Ministry of Finance).

3.Joshi, Vijay, and I. M. D. Little, (1996), India *s Economic Reforms 1991-2001, (New Delhi: Oxford University Press).

4.NBPFP (1994), "Reform of Domestic Trade Taxes in India - Issues and Options", (New Delhi: Nationl Institute of Public Finance and Policy).

5.NIPFP (1995), "Report of the States' Finance Ministers' Committee on Sales Tax Reform" (New Delhi: National Institute of Public Finance and Policy).

6.Tulasidhar, V. B., and M. Govinda Rao (1986), "Cost and Efficacy of Fiscal Incentives-The Case of Sales Tax Subsidy", Economic and Political Weekly, Vol. XXI, No.41, October 11, pp. 1799-1806.