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VALUE ADDED TAX AND ITS IMPACT ON REVENUE GENERATION IN INDIA

Dr. RAJESHWARI U R
Assistant Professor
Christ University, Bangalore, India

ABSTRACT

The paper examined the impact of value added tax on revenue generation in India. The Secondary Source of data has been used. Data analysis was performed with the use of stepwise regression analysis. Findings showed that Value Added Tax has statistically significant effect on revenue generation in India. The study recommends that if GST is introduced, the revenue base of the country will definitely increase.

KEYWORDS: Taxation, Value Added Tax, Tax Revenue, State Taxes, India

INTRODUCTION

The reform of the tax system was an important component of structural adjustment initiated in 1991. The emphasis had been to simplify the central taxes within the frame work provided by the Tax Reform Committee. The attempts have been to broaden the base, lower the rate structure and simplify the administration. The attempt was made to rationalize customs duty in terms of lowering the peak and average tariff rates, and reduction in their dispersion, and of excise duties in terms of the coverage of MODVAT facilities to larger number of commodities and capital goods. These reforms surely led to improvement in the structure of central taxes.

With the reforms of central taxes, the focus was shifted to the reform of state taxes, particularly the sales tax. This was because, the sales tax contributes nearly 60% of the State's Own Revenues and almost one third of the domestic trade taxes in the country. The past discussions pointed towards the need to transform the prevailing sales tax system into a consumption type Value Added Tax.

The relevance of VAT has been under discussion ever since it was proposed by Jha Committee in 1977. In 1986, this idea was put into practice through the introduction of MODVAT as a partial replacement to excise duties. By 1994, the scope of the tax was expanded.

At the state level, efforts were made to bring the states together to agree for transforming their existing sales tax system to VAT system. This issue attracted considerable attention. Towards forgoing a consensus, the Union Finance Ministry appointed a Committee of State Finance Ministers from 10 different state governments to work out the rationalization measures and to achieve a co-coordinated structure of sales taxation in the states.

The Committees of States' Finance Ministers in 1995 and 1998 respectively and of the Chief Ministers in 1999 have put forth recommendations to replace sales tax by VAT.

The first major break through in the direction of tax reform came in the form of an agreement between Union Finance Ministers and the State Chief Ministers on November 16, 1999. The main objectives are:

1. Implementation of floor rates within the existing sales tax regimes.
2. Elimination of the tax based industrial incentives for new and expanding industries.
3. Replacing the existing system of sales tax with a VAT at the state level VAT.

On the basis of the above objectives, Empowered Committee comprising of nine State Finance Ministers was constituted on 17^{th} July 2000 to monitor the decisions taken in Chief Ministers Conference. Empowered Committee decided to rationalize the further rate structure under VAT to 5 rates:

1. Nil for certain goods.
2. 1% for gold, silver and precious stones.
3. 4% for certain essential goods and industrial inputs.
4. 20% for liquor and some petroleum products.
5. A Revenue Neutral Rates (RNR) of 10 to 12.5% for other goods.

In the budget 2002, the CST Act was amended and some of these amendments would help in implementation of VAT. Central government has agreed to compensate the states for loss due to implementation of VAT. The compensation package is 100% in the first year, 75% in second year and 50% in third year. The Committee recommended adoption of VAT from 1^{st} April 2003. But, Haryana is the only state to introduce VAT from 1^{st} April 2003. The target date for introduction of VAT was rescheduled in the meeting of Empowered Committee on June 18, 2004 with the new target set for April 1, 2005.

During this period, the Empowered Committee constituted to monitor the transition to the new tax regime through sustained deliberations, and at last 16 states have agreed to introduce VAT from 1^{st} April 2005.

It may be noted that the postponement of introduction of VAT from 1^{st} April, 2002 to 1^{st} April 2005 was due to various reasons such as divergent views on treatment of existing sales tax incentives already granted by states, treatment of Central Sales Tax under VAT, lack of commitment by central government at that time on compensating the states for loss in revenue etc. The important reason for postponement was lack of preparedness by the states. After a lot of persuasion by central government, VAT was introduced from 1^{st} April 2005.

REVIEW OF LITERATURE

Scientific analysis begins with the process of pursuing and critically analyzing the works earlier made on the related research problems. In this part brief review of past studies relating to various aspects of sales tax reforms in India, concepts of value added tax, VAT in some other countries are presented.

Purohit M C (1982) evaluates the sales tax system in India. The study presents the development of sales taxes and their various forms that exists in the country. It also discussed the objective criteria for the analysis like growth objective, equity consideration, administrative expediency and co-ordination.

Aggarwal P K and Narayana A V L (1995) examined the revenue implications of options proposed in the NIPFP (1994) study for reforming the present system of domestic trade taxes in India towards a system of Value Added Tax. The focus of the study was mainly to identify the revenue neutral VAT rate or rates for the center and the states within the broad frame of the recommended rate structure. An attempt was also made to estimate the yield of selected VAT rate scenarios.

Gurumurthi S (1997) examined the sales tax reforms. In his view, any model proposed for a value added tax system in the Indian fiscal federation should be formulated in a manner, which is politically acceptable to the center and state. The study made an attempt to present a model, which, while preserving the economic objective of a VAT is also feasible from the point of implementation in the Indian political economy. The study also pointed out that with some structural changes in tax reforms it should be possible to introduce a VAT successfully in India on the line of EC models.

Sury M M (1997) has held the view that sales tax is the most intricate and controversial aspects of India tax system. The study has described and analyzed different dimensions of sales tax in India such as historical evolution, nature, problems and alternative remedies for its simplification and rationalization.

Shome Parthasarathi (2001) analyzed the economic principles underlying the VAT and framework for correct revenue implications of introducing a VAT that would replace the sales tax. The place of a VAT in a particular state among other state VATs is of special concern. This aspect is analyzed in the context of further action needed to harmonize VAT across states. Possible alternative treatments to bring in inter state sales within the base of an eventual VAT covering all states is also addressed in some detail.

Rao Hemalata (2002) discussed the need for commodity tax reforms in India. The study also analyses the concept and design of VAT, the issue relating VAT bases, Exemptions, Rates, Computation methods and the principles of VAT. This study also discusses in detail options of VAT in India, treatment of interstate sales, the CST, options of state level VAT and other relevant issues like the VAT administration, Audit, Planning and preparations.

Dr.Raja J Chelliah, et all, in their Primer of VAT (2003) have described at length the major defects of state sales taxes as cascading type which leads to escalation of costs, distortion in resource allocation and also as creator of barriers to free trade within the Indian Union. The authors have also opined that the sales tax system that operated is neither in the interest of individual states nor in the national economy as a whole. Apart from explaining the meaning and characteristics of VAT, the study has also argued for a case as why VAT is to be preferred to the state sales tax system.

Rao Kavita (2004) made an attempt to provide some dimensions to the extent of gain/lose to states from the introduction of VAT. The estimates indicates that the impact varies considerably across states, while some states seem to gain consistently from such a transition, in some states the gains could convert to losses depending on the assumptions on increments to value added. The estimates are based on the assumption of all states are adopting uniform VAT design. One way for the states to avoid incurring losses with introduction of VAT would be through variations in the rates and structure of VAT.

Robin Burgess, Stephen Hower and Nicholas Stern (2004) argue that India would benefit from moving towards VAT system. The study focuses on the way in which a VAT can be best introduced into India given the countries federal structure. Special attention is given to the problems that would arise under either a states' or a dual VAT with regard to taxing interstate trade.

Dr.Astha Ahuja (2004) has examined various theoretical issues related to the operation of VAT. It provides an overview of the present tax system of India. This study also traces the efforts made by the central and state governments in India to rationalize indirect tax system of the country in the direction of VAT. The study has also drawn on the experience of other countries and evaluates various options available for a smooth switchover to VAT in India.

Sukumar Mukhopadhyay (2005) provides a comprehensive coverage of the economic ramifications of VAT. The author has also analyzed the VAT design in India, which is based on 'White Paper' on State Level Value Added Tax released by Empowered Committee of State finance ministers on January 17, 2005. In addition, the author has provided an analysis of the VAT design in selected states like Karnataka, Delhi, Haryana, Maharastra and West Bengal.

Acharya Shankar (2005) analyzed the contour of India's tax reform story from mid 1970s to at present and finds that enormous progress has been made in the last 30 years. The study presented the consensus regarding the desirable elements of a modern national tax system and compares this 'model' with Indian reality of the mid 1970s. The study summarizes the tax reforms in the field of both direct and indirect tax structure. Key issue for further reform include the plethora of complex exemptions plaguing customs tariff, low buoyancy of excise, integration of CENVAT with state VAT and broad basing of direct taxes.

Charles McLure, Jr. (2005) discussed opportunities, risks and challenges on the assumption that a transaction based credit invoice method VAT would be enacted as an additional source of federal revenue. This study analyses that the federal adoption of a VAT would create opportunities for the states to improve their tax systems substantially by replacing their existing retail sales taxes. But the study does not discuss other aspects of the desirability of the federal governments entering what has long been considered the fiscal preserve of state and local governments.

Purohit M.C (2007) presents evaluation of VAT and analyses its rationale and brings out the reasons for its popularity as a fiscal measure. In the Indian context, it presents up to date development in introduction of VAT by the union and by all the states. The study presents an extremely informative account of the management of VAT in France, GST in Canada and federal & state VAT in Brazil.

STATEMENT OF THE PROBLEM

In India, VAT is one of the important instruments introduced by the government to generate additional revenue. After its adoption into Indian tax system, always it generated debate among several people. In this context, this study tries to examine the implication of VAT on revenue generation in India.

OBJECTIVE

1. To examine the relationship between VAT and revenue generation in India.

HYPOTHESIS

H0: VAT has no significant relationship with revenue generation.

H1: VAT has significant relationship with revenue generation.

METHODOLOGY

The study has used secondary data. The required data has been collected from Reserve Bank of India Publications. In order to study the impact of Value Added Tax on revenue generation, data has been collected for post- VAT period (2005-2014). For the analysis of data, stepwise regression has been used. The regression equation used for the prediction can be expressed as,

$$Y = a + b_1X_1 \dots \dots .. \mu$$

Where,

Y=Total revenue collected

a=constant

b_1=Partial regression coefficient attached to variable X_1

X_1=VAT

X_2=State Excise

X_3= Taxes on Vehicles

X_4= Taxes on goods and passengers

X_5= Taxes on electricity

X_6= Taxes on Entertainment

X_7=Taxes on others

RESULTS AND DISCUSSIONS

In India, total revenue includes tax revenue and non-tax revenue. The share of tax revenue is 73% and non-tax revenue is 27% in 2013-14. The major contributor for tax revenue is State's own tax revenue which includes taxes on income, taxes on commodities and services and property taxes. Among these commodity and service tax contributes highest (86.2%) to the State's own tax revenue. Commodity and service tax includes Value Added Tax, State excise, Taxes on vehicles, Taxes on goods and passengers, Taxes on electricity, Taxes on entertainment and others. Value Added Tax is the one of the important contributor to commodity and service taxes. The share of VAT has increased from 70% to 73% from 2005 to 2013-14.

The result depicts the relationship between the dependent variable (total collected revenue) and independent variable (value added tax). The value added tax has a strong positive correlation of 0.996 with the dependent variable, total revenue. In order to test the significance of hypothesis, the results revealed that only the value added tax selected on the basis of highest partial correlation to meet the entry probability requirement of less or equal to 0.05 (≤ 0.05). The result further showed that the value added tax has a strong positive correlation of 0.996 with the dependent variable, total revenue.

Further, the result showed that value added tax had R^2 of 0.992 on the total revenue of India which implies that value added tax predicts 94.2% of the variation in total revenue. To further affirm the significance of this test, the result also showed that the regression sum of square is greater than the residual sum of square which means that the independent variable accounted for the better part of the variation in India's total revenue.

Again the significant of the R^2 was tested with the ANOVA where by F value which is statistically significant at 0.000 confirms the strength of the contributions of value added tax account for a high explanation of the India's total revenue, thus affirming the model as a viable tool for measuring the country's total revenue.

The implication of this result is that value added tax has contributed most to total revenue in India and thus justifying the fact that value added tax has a significant effect on total revenue in India and an improved strategy such as monitoring aimed at improving the value added tax which will boost the total revenue in the country.

CONCLUSION

The result of the study revealed that value added tax is beneficial to the Indian economy. This can be understood from the behaviour of the variable in this research, which shows that value added tax is statistically significant to revenue generation in India. The result of this study indicates that if GST is introduced, the revenue base of the country will increase.

RESULTS

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.996[a]	.992	.991	.01748

a. Predictors: (Constant), VAT

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.272	1	.272	888.710	.000[b]
	Residual	.002	7	.000		
	Total	.274	8			

a. Dependent Variable: total_revenue

b. Predictors: (Constant), VAT

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.870	.169		5.143	.001
	VAT	.936	.031	.996	29.811	.000

a. Dependent Variable: total_revenue

Excluded Variables[a]

Model		Beta In	t	Sig.	Partial Correlation	Collinearity Statistics
						Tolerance
1	state_excise	.371[b]	1.010	.351	.381	.008
	taxes_vehicle	-.336[b]	-.618	.559	-.245	.004
	goods_passengers	-.004[b]	-.022	.983	-.009	.045
	taxes_electricity	-.038[b]	-.221	.832	-.090	.044
	taxes_entertainment	.122[b]	1.023	.346	.385	.078
	taxes_others	.150[b]	.737	.489	.288	.029

a. Dependent Variable: total_revenue

b. Predictors in the Model: (Constant), VAT

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