VAT Divergence In India : An Analytical Study Of Its Impact In Punjab

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INTRODUCTION

VAT is essentially a form of **indirect tax**. **In ordinary parlance ,VAT is a tax levied on sales which enhances the cost of a product and paid by the ultimate consumer. Technically, VAT is a multi-point Sales Tax running through different stages of production and trade but levied in such a manner that the value added of each stage is taxed once and only once, in order that there is no 'cascading' or 'tax on tax' effect and the burden to the final consumer is no more than what is intended by the prescribed rate of tax** [(Chanchawat L.K., 2004), (SahaShankar Siddhartha, 2005) and (Pillai K.G., 2005)]. Thus, it is a tax on the value addition at different stages of manufacturing and distribution of goods with the provision of granting credit (set-off) available for tax paid on corresponding purchases and the tax is collected on each transaction but paid on the value added stage only and ,therefore, is regarded as VAT [(Singhvi *et al.* , 2005) and (Datey S. V., 2007)]. After a number of budgetary announcements and postponements, finally, VAT substituted the earlier sale tax system in India in 22 states as of April 1, 2005 (Bhushan Kul, 2006). Till 2007, VAT had been introduced by more than 30 States/UTs, including Tamil Nadu (Implemented VAT from January 1, 2007) and the UT of Puducherry (Implemented VAT from April 1, 2007). From January 01, 2008, the Government made VAT effective in almost all States in India (Business Knowledge Resource, 2009).

RATIONALE BEHIND THE REPLACEMENT OF SALES TAX SYSTEM WITH VALUE ADDED TAX(VAT)

The **Core Difference Between Vat And Sales Tax** is that Sales Tax is a single-point tax, while VAT is a multi-point tax. In VAT system, the tax paid on purchases can either be adjusted against the output tax collected on sales or otherwise can be claimed as refund from the Government. For the whole process, the dealer has to provide the bill/invoice for each transaction. Hence, **invoicing is compulsory under VAT system**, that is why it is a more transparent system than earlier sales tax system as under the *Sales Tax Act,* no provisions for input tax credit (Purchase tax) was available. Since invoicing under VAT system is compulsory to avail set-off/VAT refund, it ensures more transparency.

Sales Tax was quite an ambiguous system, but VAT is more simplified, provides self-assessment of taxes paid and collection. The registered dealer can adjust the input tax against the output tax and is required to deposit the surplus. In this way, the dealer can himself assess his tax liability and can file returns on a self-assessment basis. There are no mandatory assessments. It certainly reduced the dealer- department interface.

The Sales Tax system did not allow input tax credit paid on purchases by the dealer. VAT has the provision to provide immediate Credit for input tax, which can be immediately utilized for payment of output tax. This in turn reduces the need of more working capital requirement.

VAT removes all tax costs from export goods as exports are zero rated. The Sales Tax system earlier prevalent in India did not remove all sales related tax costs from the cost of goods. Such costs got added to the cost, resulting in higher prices in international trade, which made Indian exports less competitive. The VAT system ideally leads to removal of such tax costs from prices and makes goods more competitive in international markets.

POST VAT REVENUE COLLECTION

The Indirect taxes (PHD Chamber of Commerce and Industry, 2009) contribute around 62 per cent of the total revenue of India and play vital role in nation building.

During 2005-2006, the tax revenue of the 25 VAT implementing States/UTs had registered an increase of around 13.8

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per cent over the tax revenue of 2004-2005, which is higher than compound annual growth rate of Sales Tax revenues of these states for the last five years up to 2004-2005. During 2006-2007, the tax revenue of the 31 VAT States/UTs had collectively registered a growth of about 21 per cent over the tax revenue of 2005-2006. During 2007-08, the tax revenue of 32 VAT States/UTs showed a further growth of 14.6 per cent during the first six month of 2007-2008 (April-Sept) as compared to the corresponding period of last year(Economic Survey 2007-2008).

VAT collection in almost all states and UTs showed tremendous progress during 2005-2009 under VAT regime. In the south side, Maharashtra state topped in VAT collection, Andhra Pradesh stood second during 2007-2008 with ₹ 30,945 crore as against ₹ 27,118 crore ,showing growth of 14.11 per cent while Andhra Pradesh with 20,106 crore as against 16,199 crore stood second with a growth rate of 12 per cent (Kumanath V. K., 2008).

Likewise in the North side, Punjab state projected to be the front runner in VAT collection with 43 per cent growth for the year 2008-2009 as against 20 per cent during the year 2007-2008 (Ahuja Charanjit, 2008). Haryana became the second runner up and projected a growth of 21 per cent for 2008-2009 (Ahuja Charanjit, 2008).

Punjab Deputy Chief Minister Sukhbir Singh Badal said that Punjab had recorded the highest ever VAT collection growth in the country. Speaking to the media persons , Badal said the progressive policies of state government has maintained the tempo of economic growth of the state despite the global recession. He further added the VAT collection that could hardly reach the magical figure of ₹ 5,000 crore in last 60 years of Independence, jumped to ₹ 8,150 crore, registering an average ₹ 1,000 increase every year, during the last three years (Business Standard,2010).

Table 1: VAT Collection in Punjab

Year	Tax Collection (₹ In Crore)
1970-71	37.28
1980-81	155.93
1990-91	570.16
2000-01	2637.9
2001-02	2684.33
2002-03	3072.44
2003-04	3307.94
2004-05	3816.38
2005-06	4626.87
2006-07	4829.02
2007-08	5871.29
2008-09	6290
2009-10	8150
2010-11	11000(Projected)

RESEARCH PROBLEM

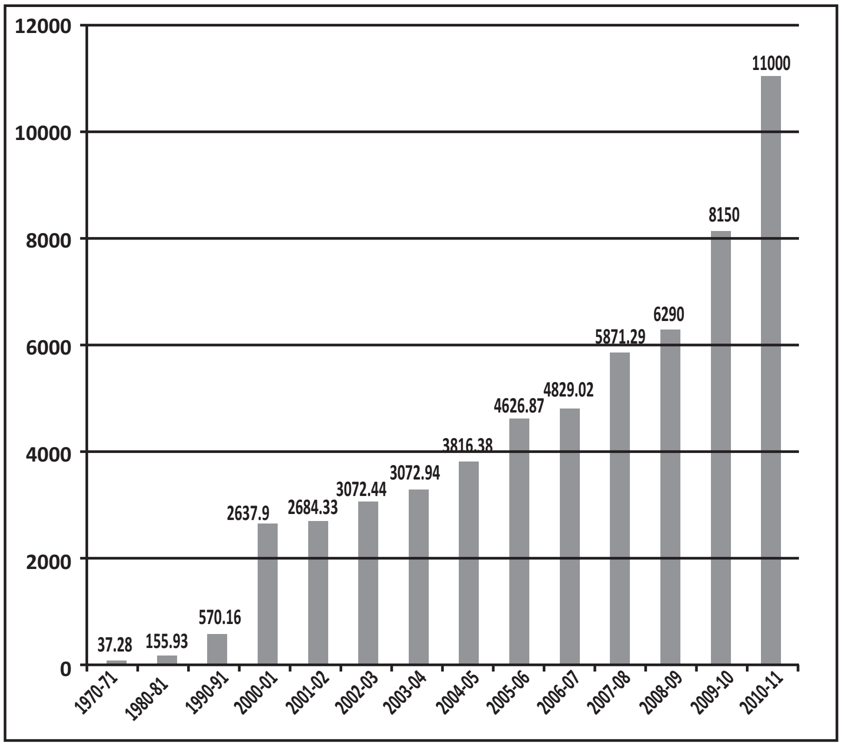
VAT was implemented in India with a view to bring uniformity and balanced economic development as suggested by Kelkar Task Force Committee organized under the chairmanship of Dr. Vijay Kelkar . However, this study revealed that tax analomies -Inter-state and Intra-state are still prevailing in India, which in turn results in diverse product rates and industrial migration from High VAT states to Low VAT states. This also causes different product rates- not even in different states, but also within the same state.

OBJECTIVES OF THE STUDY

The present study focuses on the various aspects of VAT and the impact on Industry in Punjab, and the core objectives of the research are :

- To identify as to whether Value Added Tax is causing divergence in the present taxing system among the states and thereby resulting in different rates for the same product intra-state and inter-state.

Figure 1: VAT Collection In Punjab



Source Of Data: Punjab Government Budget Excise And Taxation Department 2009-2010 And Actual Figures Includes Cst Revenues

- To study whether VAT results in Industrial Migration.
- To elaborate potential solutions of the identified problems .

REVIEW OF LITERATURE

The fundamental objectives of VAT harmonization in different states could not be attained and still discrepancies existed in various states (Price Water House Cooper,2006) on account of threshold limits, composition scheme, input tax credit, return, bad debts etc.**(Bansal Sumit,2005)** e.g. Threshold Limit varied in different states ranging from ₹ 2,00,000 to 5,00,000; Composition Scheme ranges from ₹ 25 lakh to 50 lakhs. Kerala did not have any provision stock older than one year like Punjab and Delhi provided credit time of only three months. Some states like Punjab provided monthly sales return if the sales reached ₹ One crore while in Delhi, this amounted to ₹ 5 crore. Some states like Delhi, allow credit for genuine businesses- bad debts were written off in the books of accounts. Others like Haryana did not allow any such Bad debts. VAT did not bring uniformity among different states of India due to federal system of Indian economy and the objective of balanced economic development could not be attained during VAT regime **(Padmavathi C ,2006).**

Due to the lack of uniformity in VAT rates, different prices are prevailing for the same product in the same state which hamper the fundamental principle of VAT uniformity and cause industrial migration - from high VAT states to Low VAT states. As the traders below ₹ 5 Lakh turnover did not require to charge any VAT, Traders earning ₹ 5 -50 Lakh would pay 1 per cent VAT and Above ₹ 50 Lakh, the VAT rate would be applicable @ 4 per cent **(Cygnus Research Team ,2006 and Sthanumoorthy R. (2006).**

Over 100 bus body builders **(Roy C Vijay ,2008)** in Punjab and Haryana in Small and Medium enterprise sector, were losing business to neighboring state Rajashthan due to tax anomalies as Punjab and Haryana charged 12.5 per cent VAT from bus body builders, while Rajasthan charged only 4 per cent. The study indicated that on an average, 10 to 15 percent of the Punjab and Haryana businesses had been lost to Rajasthan annually because of lack of uniformity in tax pattern in the states.

DATA BASE AND RESEARCH METHODOLOGY

The present research work involves both theoretical analysis as well as empirical study. To elicit theoretical conclusion ,the researcher examined the available literature in the form of books, research works, research articles, reports of various committees/commissions and also the reported decisions of Supreme Court of India and the various High Courts of the India.

To access the VAT inconsistency with regard to VAT rate inter-state, the data from the various official websites of the Excise and Taxation Department of concerned state had been retrieved. To evaluate the impact of VAT Divergence on the industrial migration and prices of the various products ,the primary data was collected by the researcher through the field study.

DIVERGENCE UNDER THE VAT REGIME IN INDIA

One of the important objectives of VAT implementation in India was to bring harmony among states with respect to VAT rates Intra-states and inter-states. However, this objective could not be achieved as different VAT rates have been imposed in different states for the same goods.

The white paper issued by the empowered committee on VAT intended to bring uniformity in all states. Since tax on local sales is a state matter in a Federal economy like India and hence, each state has enacted different VAT laws suitable for their states.

Table 2 shows the varied VAT rates prevailing in the different states of the India. Petrol is one of the most consumable product. However, VAT levied in Punjab is 27.5 percent, where as, the rate for the same in the neighboring states like Haryana is 20 per cent and in Chandigarh, it is 22 per cent and likewise in case of other products, inconsistency persists . It shows that uniformity of VAT rates could not be attained.

Table 2 : Tax Rates Applicable In Various States As On 31st January , 2010

ITEM NAME	Delhi	West Bengal	Himachal	Haryana	Punjab	Chandigarh	M.P.	A.P.	Bihar
Petrol	20	20	25	20	27.5	22	28.75	32.55	27
Lottery Ticket	20	12.5	20	20	0	30	0	12.5	12.5
Tea excluding Green Tea	5	4	4	12.5	5	4	4	12.5	12.5
Student Use Stationery	12.5	12.5	4	12.5	12.5	4	12.5	12.5	12.5
Atta/Maida	0	0	4	12.5	5	4	0	4	4
Cereals/Pulses	0	0	4	4	5	4	0	0	4
Capital Goods	12.5	4	4	4	5	4	12.5	12.5	12.5
Waste Paper	12.5	4	4	4	5	4	4	4	4
Computer Consumable	5	12.5	4	4	5	4	4	12.5	4
Computer Stationary	12.5	4	4	4	5	4	4	12.5	4
Tools	12.5	4	4	0	5	4	4	4	4
Car	12.5	4	4	12.5	12.5	12.5	12.5	12.5	12.5

Source: -Data compiled and organized by the researcher from the Various Official Websites of Sales Tax Department of states, various books on the VAT Act of the respective State.

VAT DIVERGENCE -IMPACT ON PRICES

❁**Inter State Impact :** In a country like India, states are given autonomy to tune in VAT rates suitable to it which hampers the very purpose of VAT implementation i.e. varied rates for the same product in different states .In Punjab, student stationary is taxed @ 12.5 per cent, where as in Chandigarh, it is charged @ 5 per cent. Due to this very reason, stationary is sold in Punjab at a higher rate as compared to Chandigarh . Similar is the case of other products. The Table 3 shows VAT divergence and its impact on the price of Petrol. It can be stated that the customer needs to pay more for products in Punjab as VAT levied in Punjab is 27.50 per cent which is very much higher as compared to the neighboring states and UTs. Similarly, in Punjab and Haryana, VAT levied on Bus body industry is 12.5 per cent, while in the Rajsthan state, it is only 4 per cent which enhances the cost of bus body business in Punjab, forcing them either to close down or to migrate to Rajasthan state as they are losing customers to Rajasthan.

Table 3: Petrol Rates Persisting In Different States

Product Name	Punjab	Chandigarh	Haryana	Himachal	Delhi
Petrol Price	49.05	44.52	45	46.96	44.63
VAT % age	27.50	22	20	25	20

Source: - Data compiled and organized by the researcher through Field Study

☸**Intra State Impact:** According to the white paper issued on VAT presented by the empowered committee, the traders selling below ₹ 5 Lakh will not pay VAT. Those selling between ₹ 5-50 Lakh will pay 1 percent VAT, whereas those selling above ₹ 50 Lakh will have to pay 4 per cent VAT on medicine u/s 21(6) (Punjab Tax Payer Guide, 2007). This dichotomy leads to different prices of the same medicine in the same area and created unnecessary tax war among pharmaceutical traders in India. The field survey revealed that the same medicine is available at varied rates from different sellers as the small traders have the option for the invoicing. However , it is mandatory for the big shop keepers to levy VAT on all the transactions.

VAT DIVERGENCE AND INDUSTRIAL MIGRATION

These different VAT rates are hampering the smooth movement of goods across the states and destroying the very purpose of introducing VAT. Due to hike in VAT rate, some industrial units are shifting from Punjab state to other states such as Baddi (Himachal) and U.P. and Haryana and the same is the case in the rest of India.

☸ **Rubber Industry:** 30 per cent rubber industry has either migrated to Himachal Pradesh or has closed down its operations due to diverse VAT rates among two states.

☸ **Sports & Leather Goods Industry:** Jalandhar sports goods industry began its 5 days continued dharna demanding for complete abolition of VAT(5 per cent) on sports goods, on the pattern of UP, which declared its sports industry of Meerut as VAT-free and because of this reason, Punjab state is losing its business to Meerut. One of the major leather and sports goods industry -Bawa Skin Company in Jalandhar City shifted its production base to Baddi (Himachal Pradesh).

☸ **Bus Body Industry :**Punjab and Haryana are charging 12.5 per cent VAT from bus body builders, while Rajasthan charges only 4 per cent . More than 100 bus body builders in Punjab and Haryana in Small and Medium enterprise sector were losing business to neighboring state Rajasthan due to tax anomalies.

FINDINGS OF THE STUDY

☸ Table 2 highlights that divergence that exists intra-state and inter-states as some states levy VAT on some goods at the rate of 5% and while other states are either charging nothing and some also charging higher VAT rate i.e.12.5%.

☸ Due to the VAT inconsistency, different prices are prevailing in the different states as shown in the above Table 3 pertaining to the prices of petrol.

☸ Due to this divergence, many industrial units of Sports Goods , Leather Goods , Bus body Builders etc. are either migrating to other states or they are forced to close down their industry.

SUMMARY ,CONCLUSION AND RECOMMENDATIONS

More than 160 countries have gained the geniuses of VAT Implementation as it is considered as a weapon to accelerate the revenue of the govt. in the form of taxes. The present study however has revealed some defects of the VAT Act . The first foremost objective of the VAT was to bring about the uniformity in the tax rates in India with a view to bring the uniformity and to stop the unwanted tax rate war among the states. However, this objective of the committee could not be achieved as Divergency is still prevailing intra-state and inter-state . Consequentially, it resulted in different rates for the same product within the state and between states. Further, it also gives temptation to the industrial units to migrate to the non-VAT state or low-VAT state and hence, the objective of the balanced economic development could not be sustained . In brief, VAT could not be implemented in India as desired by the Kelkar Task Force. However , it has certainly proved to be a vehicle to generate more revenue for the state governments. It is recommended that the states should gain full advantage of VAT and instead of rushing towards GST Act, firstly, the VAT should be honestly and uniformly implemented as it has been quite successful in the European countries from where it has been borrowed .

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