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Lecture on : Need for having a  
Value Added Tax system by Dr.  
Parthasarathi Sfaome, Adviser to  
the Finance Minister,  
Government of India.

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1<sup>st</sup> Floor, Parliament Library Building  
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(a/0910/rc)

DR. PARTHASARATHI SHOME: Thank you Mrs. Margaret Alva and the hon. Members of Parliament. I am really very appreciative of the fact that so many Members have come to apprise themselves of the Value Added Tax. There is a need for understanding the Value Added Tax system. There is a lingering doubt as some States have not yet introduced VAT. I would hope to convince that we do need a Value Added Tax system in India.

I will try to structure my presentation. I will start with a little bit of introduction as to why we need to have a Value Added Tax. Then I will spend a little time on the concept of the VAT. Then I will point out why Value Added Tax is better than Sales Tax. Finally, I will conclude with some of the remaining concerns regarding VAT and the direction in which we have to move further.

First, I am trying to explain the constitutional provision regarding the tax assignment and how our tax system is structure between the Centre and the States in the Indirect Tax area only. If I look at the constitutional provision, as per the Constitution, the manufacturing is assigned to the Centre but when you finish the manufacturing, you come to distribution and trust becomes sales. It rests with the States. As regards manufacturing, the Centre has been imposing excise duties and sales tax on its distribution stage. Finally, the sales tax is paid by the consumer which belongs to the States. Now up to here, the taxes are collected by the Centre and the States as per the Constitution.

If we look at the services, which is a major sector today comprising more than 50 per cent of our GDP. Our Constitution do not assign services for taxation specifically because probably our forefathers did not imagine this as a potential taxable base. The residual things were assigned to the Centre. As a result, the Centre is taxing the services under the residual category. The 88<sup>th</sup> Amendment to our Constitution has amended the residual category. Following which the Centre can legislate, collect and appropriate service tax. So, the legislation belongs to the Centre whereas the States may collect and appropriate as per the guidance and

rules set by Parliament. However, all the service taxes are legislated, collected and appropriated by the Centre and that is shared as per the Finance Commission's rules with the States. With 88<sup>1</sup> Amendment the States have come responsibility to collect and appropriate but once Parliament determines how that should be done. Before these issues are finally determines the Centre and the States are conversing if not negotiating as to how the distribution of the services should be collected by the Centre and the States. But there is no clear view at the moment as to how it should be divided. One thing is clear that the power to legislate has been given to the Centre alone. So, if we look at our goods and services both, namely, what we manufacture and then it reaches to the consumer finally, a part of it is with the Centre and a part is with the States. As far as the services are concerned, the total taxation today is with the Centre and what is being discussed is that how to divide it between the Centre and States, though not legislate but to collect and to appropriate. So prior to VAT and given this constitutional framework in Sales Tax, VAT-able input credit was not given. Now all production and consumption taxes whether they are indirect taxes at the Centre or at the States both have become VAT-able, namely, input credit tax is given. There is no distortion of resources and allocation. Hence the VAT was necessary to be introduced.

Now when we think of manufacturer, the manufacturer buys inputs. There is a tax on the input. Suppose a manufacturer has bought something at Rs.100 worth of inputs. On the input there is a sales tax or excise duty of 10 per cent. So, it becomes Rs.110. Now he uses that input and manufactures a toy car and sells it at Rs.150 to the retailer. The retailer adds another 10 per cent and he sells it at Rs.165 to the consumer. So, he has paid Rs.10 as tax. He pays tax on the inputs like steel and other raw material and pays tax on that. This is called the input tax. Now unless he is allowed to take out Rs.10 in some form the other, he will bring it into price at which he sells it to the consumer to whom he sells it at Rs.165. When he pays Rs.10 as tax, he has to take out from the system because

otherwise at every stage, the tax on the input; would be added to the price. So, the Government allows him to take out Rs.10 that he pays for his inputs.

(b/snb)

So, the Government collects from this person a sum of Rs. 15 - Rs. 10, that is, Rs. 5A. If the Government did not allow *this*, then what he would have done is that he would have added Rs. 50 to Rs. 110/- and the price of the product would have been Rs. 160/-. That is called the Input Tax Credit. I have a technical table here. I will try and explain this table to you.

First, let us say, VAT is 10 per cent. Now, there are several stages of production of anything. But first is the supplier of raw materials. The next is the manufacturer who uses those inputs and he manufactures the product. Then the manufacturer sells his produce to the wholesaler; then the wholesaler sells it to the retailer and finally the retailer sells it to the consumer. This is the chain of production and distribution. Let us now say that the raw material was purchased at , Rs. 50. There is a ten per cent tax. But when this supplier of inputs sells it to the manufacturer, he sells it at Rs. 50/- + 10 per cent tax. So, this manufacturer buys from the supplier at Rs. 50/- + Rs. 5/-, that is, at Rs. 55/-. He pays Rs. 50 as the price and Rs. 5/- for the tax. Then, as far as this supplier is concerned, he has taken Rs. 5/- from the manufacturer and he simply pays on that Rs, 5/- to the Government here. There is no credit in this case because here we are not sure as to how he bought his input. The manufacturer has paid Rs. 50/- worth of raw materials and has paid Rs. 5/- as the tax. He transforms this Rs. 50/- input with labour and other kinds of things and he puts the price of his product at Rs. 100 when he sells it to the wholesaler. He will collect a ten per cent tax on that Rs. 100. The wholesaler buys this product from the manufacturer and he pays Rs. 110. Now, let us go back to the manufacturer. He had collected Rs. 10A as tax but he paid Rs. 5/- as tax. So, the input tax that the manufacturer paid was Rs. 5/-. The output tax that he collected was Rs. 10/-. What he pays to the Government is Rs. < 10/- minus his input tax credit. So, he pays Rs 5/- to the Government. Then, the

wholesaler has paid Rs. 110/-. He adds a wholesale margin and that margin is Rs. 20/-. He sells that product at Rs. 120 to the retailer. He collects from the retailer Rs. 12/-, but the retailer has paid Rs. 120. But coming to the wholesaler, he has paid Rs. 10/- as input tax and he has collected Rs. 12 from the retailer. As far as he is concerned, he will give to the Government: Rs. 12/- minus his input credit tax, that is Rs. 10/-. So, he will pay to the Government a sum of Rs. 2/-. Now, the retailer will add a margin of 30 per cent to Rs 120 and put the price of the product at Rs. 150/-. He will collect from the consumer a sum of Rs. 150/- for his product. It is so very important here that the consumer asked for a bill so that it will show that the product has cost the consumer a sum of Rs. 150/-. Again, the retailer has paid Rs. 12/- as tax to wholesaler and he has collected 15 per cent from the consumer. So, the net amount that the retailer will pay to the Government is Rs. 15 minus Rs. 12, that is Rs. 3/-. So, the Government, in the entire chain, has collected Rs. 5/- + Rs. 5/- + 2/- + Rs. 3/-, that is Rs. 15A.

The next thing is that if we have had sales tax alone, then all these would not have been covered. If the Sales Tax was at the level of the retailer, then the Government would have collected only Rs. 15/-. As far as Government is concerned, in both the cases, the actual amount of tax is the same.

What is the main difference between VAT and Sales Tax? Now, under VAT even if the Government is collecting Rs. 15/- at the retailer level and in both cases of VAT and Sales Tax it is the same amount that is being collected, even at this stage it was not administrable. VAT is basically an administrative mechanism for collecting retailers' sales tax. In retail sales tax if you miss that final retailer, in developing countries where you have the final retailer, then administratively we can collect part of the total tax of Rs. 15/-. But VAT is also necessary in terms of economic difficulties.

What is VAT? VAT is a multi-stage tax on value added at each stage. From each stage of supplying raw materials to manufacturers, to wholesale, to retailer, you are collecting some part. Some of the tax collected at each stage is

called the value added. On the price of the product, it is the same. Input Credit Tax at each stage of transaction on tax is paid on input. You are giving Credit Input Tax. This is also called Input Tax Credit, or ITC. There is no cascading effect. As I showed, in every stage you are allowing Input Tax to be taken out. The net value is the net value. Since we do not allow Input Tax Credit, there is a tax on tax. In as much as we are taking out this Rs. 10/- minus Rs. 5/-, this -5 is the Input Tax Credit. (cl/0930/rbn)

In the next stage you are taxing only the net value added. Therefore, you are taking out the tax on tax which the sales tax suffers from. This is a very very important point because this is the main difference between the VAT and the sales tax. But the sum of the tax collected at different stages of value addition is equivalent to the tax on aggregate value added or the price of the product at the final or retail point of sale. VAT is a destination-based tax on consumption. In the international context it is considered to be the most important event in the evaluation of tax system in the previous century because it has been introduced in 130 countries. France introduced it in 1950 on selected commodities. France introduced it on selected commodities. But Brazil was the first country in the sixties to introduce it on all commodities and at the level of the States. So, Brazil was the first country to introduce VAT at the State level. In European Union, it is so important that you cannot become part of it unless you introduce the VAT. VAT has been introduced in a number of countries from China to Sri Lanka.

QUESTION: What about the United States of America? DR.

PARTHASARATHI SHOME: The United States of America has not introduced VAT. There is a reason for that. It has a long history of sales tax at the retail level. They have a good control of sales tax system. As I said, VAT is an administrative mechanism. If you are able to collect retail level sales tax at the final retail level without any problem, then there is no reason to have VAT. In America, they have the culture of going and buying things from huge mega stor

But in many countries, including France, there is no culture of going to mega stores to buy things. They do not go to large shops, whereas in America people go to huge and big shops. There the tax system is very stringently administered and the cost of not meeting the Revenue Department's tax requirements is so stringent that there may not be actually any need for having an administrative mechanism of this sort. They have very strict measures. They are overwhelmingly retail sector. Their retail sector is overwhelmingly large whereas in Europe the retail sector is overwhelmingly small.

QUESTION: If VAT is so much advantageous, then why did America not introduce VAT?

DR. PARTHASARATHI SHOME: It is advantageous if your retail sales tax is not working.

QUESTION: Has Russia introduced VAT?

DR. PARTHASARATHI SHOME: Russia has introduced VAT. China has introduced VAT. Emerging European countries and East European countries have all introduced it.

QUESTION: In the list of countries that you have provided, Russia is missing.

DR. PARTHASARATHI SHOME: That is a good point. I will include that also.

QUESTION: It is because that would create a misconception.

DR. PARTHASARATHI SHOME: For European countries, adoption of VAT is compulsory. You have to introduce it.

QUESTION: So, it means that people are paying the same level of tax, whether it is in the sales tax regime or in the VAT regime.

DR. PARTHASARATHI SHOME: VAT has only replaced the sales tax. It does not go parallel. In fact, I will deal with that when I come to the Indian context. In both the regime, consumers are paying the same tax. Please see the table. The consumer is paying the same tax. It is only Rs. 15. The price is Rs. 115. That is the point. That is the most important point. Sales tax is tax on tax, whereas VAT

is not tax on tax. In fact, during the sales tax regime, the consumers have to pay on some commodities.

QUESTION: How is it ensured that benefits are passed on to the consumers? DR.

PARTHASARATHI SHOME: That is very difficult. They should have proper monitoring. They are penetrating the market to check the prices that are being charged. They have asked the manufacturers, including some of the multinationals, as to what they are doing with regard to this. In some States the prices of products have gone down. Every State must have a monitoring cell for Jow, it is not cascading, there is no tax on tax. So, the consumers should get benefit. That is the major challenge to see whether that is being passed on to consumers or not. (40/mks)

DR. MARGARET ALVA: Mr. Shome, do you think that the Government is ensuring that it get its tax? ARTHASARATHI SHOME: Yes.

DR. MARGARET ALVA: Is the benefit not necessarily going to the consumers?

ARTHASARATHI SHOME: This is very difficult. I admit that as one of the challenges. We tried to solve in the Empowered Committee. QUESTION : If the consumer is going to be benefited, then who will lose - the manufacturer or the Government?

ARTHASARATHI SHOME: What is happening is that we are putting the cart before the horse. The manufacturer is also being benefited. Before, he was not getting the input tax credit. Now, he will be taking out. He is getting some benefit because he is not bearing the input tax as he was before. For the first time, we are beginning further stages of distribution in a direct context. We are moving on to wholesalers and retailers. The Sales Tax is supposed to be up the tax up to the final stage because of the constitutional provisions. As it was difficult to collect, most of the States were collecting the

Sales Tax at the manufacturing level, with a margin. So, in reality, the further stages were not covered. They were being presumed that this would be the margin. In this VAT, those States are being covered. So, the challenge is that the benefit that the manufacturers are getting will have to be passed on to the wholesaler at the retail stage so that the consumers get the same price as before, if not less.

QUESTION : Is it not the normal practice that without cash memos, the consumers are getting benefit of the sales tax evasion?

DR. PARTHASARATHI SHOME: Now, -the normal practice will change as we expect. When you will go to the retailer, he would like to issue a cash memo because if the Government is run under VAT, collecting VAT directly from the retailer, he will collect the whole amount. The Government will not give the retailer any input tax credit unless he has demanded his own cash memos from wherever he bought from the wholesaler because only then he can take credit.

QUESTION : Do you not think that Indians have got super brain? DR.

PARTHASARATHI SHOME: Those things we have to contain. We have to move on.

One very important point is that we say that we have introduced the VAT now in April 2005. But at the Central level, we actually introduced the concept of the VAT, like in France, in particular commodities through this Fiscal Strategy Paper. This was a White Paper which was presented to Parliament. In the Excise Duty at the Central level, certain commodities were being VATed, which could be called MODVATed. The scope expanded over the years and MODVAT changed to CENVAT. Then, even the Service Tax was introduced and it was also allowed input tax credit. Recently, for the last two years, we are also allowing input tax credit between the Excise Duty and the Service Tax. So, at the Centre we had already a VAT for the last 2-3 years, a full-fledged VAT. Now, what we have done is that we have introduced much more demanding matter which is VAT at the State level because all the States had to come to a common denominator like a

common tax structure or a common base or the method of taxing. That also was a major improvement over the Sales Tax because in the Sales Tax there was a lot of competition. So, VAT is replacing the State Sales Tax. The Centre had already the VAT. But now, we have a VAT at the State level. This is the history.

It started actually in 1994. In 1995, Dr. Singh then invited the Chief Ministers and said, "Let us see how we can improve our State-level tax systems." In November 1999, the Chief Ministers of States decided to introduce a State-level VAT. Actually, in 2000, the Empowered Committee was constituted. So, after the decision was taken, the Empowered Committee of State Finance Ministers was formulated and from there, as you know, in April 2003, it was planned to be introduced but it could not be done. Now, in 2005, we have finally introduced it. So, from December 1994, we have come to this point. It was introduced by 23 States. Some States are still out. What is very challenging and what we have achieved, that is, the major achievement in the Indian fiscal federal policy is that VAT at the State level is very, very difficult to combine. Structurally, I think, two other countries, namely, Brazil and Canada, have done it. Our structure is simpler than that of either of the two countries. This is what the Centre has done for the VAT at the State level. It has shared some cost - the cost of computerization - and given technical assistance to the States. We have taken turn-key for the North Eastern States - computerization of VAT. We have special computerization grants for special category States. So, the Centre is very much involved with this, but as a catalyst. It is standing apart and helping wherever it is necessary.

For inter-State trade, an information system is being developed. For example, under the Sales Tax, there was very little information among the States as to which dealer or trader is selling and buying from one State to the other. When anyone was buying, say, from Maharashtra and it was going to Madhya Pradesh, the tax was collected at Maharashtra and kept there. In Madhya Pradesh, no one had any information. Maharashtra's Finance Minister and the Tax Administration Department did not have any information whether the person has

paid any tax or how much it brought into Madhya Pradesh. It was very, very difficult to control that. Here, we are developing what is called 'Tax Information Exchange System (TINXSYS)', which will develop a complete roster or tax roll of trade and tax paid among States. So, it will be instantaneous information. The Centre and the States are sharing equally the cost of development of this project. We are also going to link this with the Ministry of Information Technology, who will also take it on their umbrella project and link it with the Central Tax Information System (TIN). This is all being developed under VAT.

Now, we come to the VAT structure in India. There are basically two rates, namely, 4 per cent and 12-1/2 per cent. As you know, in the Sales Tax regime, the rates were 4 per cent, 8 per cent, 12 per cent and 16 per cent. So, many of the rates have now come down, to an extent, from 16 per cent to 12-1/2 per cent. Many of the States will now gain. Similarly, many of the 8 per cent rates of the Sales Tax regime has now come down to 4 per cent. So, while we are giving taxpayers the benefit of lower rates, the Administration mechanism under VAT has to take care of this cross-checking of invoices that should make up for any loss in revenue because of the tax rate reduction. We are giving tax rate reduction but telling the taxpayers that it would be better to show and keep their invoices and only then, they can take input tax credit. Then, we will follow it up.

But we are giving a lot of leeway in that sense. Some goods are exempted such as natural and unprocessed products. As these are of social significance, these have been exempted. Similarly, each State has been given a list of 15 items. They can pick up 10 items, on their own, of local importance out of that list. However, these items may differ from State to State because we are heterogeneous group of people at some level. Somewhere pulses may be important or somewhere rice may be important. Even, let us say, *bindi* may be important in one State. So, the States are allowed to pick up their own 10 items of local importance which can also be exempted.

(e/0950/rc)

Then there is one per cent tax on gold, silver and precious stones. For basic necessities like medicines, agricultural and industrial inputs, these are at four per cent.

QUESTION: What about tools in different categories?

DR. PARTHASARATHI SHOME: If they are agricultural inputs, then it will be exempt and if they are industrial inputs, they will be at four per cent. QUESTION:

But agricultural inputs were at four per cent DR. PARTHASARATHI SHOME: But after the introduction of the VAT, the Empowered Committee decided to exempt it.

QUESTION: Lakhs of workers use mechanical tools and other things. DR.

PARTHASARATHI SHOME: Sir, I will find out the correct position. After it was introduced, it has been decided to expand the list. It might have gone into the locally important items. If it is not, then all inputs are at four per cent. So, it will be probably at four per cent.

QUESTION: Can we define it as 'hand tool'? What about service sector? DR.

PARTHASARATHI SHOME: The service sector is in the hands of the Central Government. Suppose there is a restaurant which is buying all those items, then it will have to pay.

QUESTION: In the case of health, if I go for an x-ray, will the VAT be applicable?

DR. PARTHASARATHI SHOME: It comes under personal service category and that is not under VAT at all at the moment. As I indicated, taxes on all services are currently being collected and appropriated by the Centre only. But that is going to come up this if there is any particular item under services that will be given to the States for collection and appropriation. QUESTION: What about big nursing homes?

DR. PARTHASARATHI SHOME: The States are not collecting VAT because the Constitution does not allow. I would like to tell you whether it is State or Centre, several services are under service tax and they are under the Centre. The Centre is collecting tax. But the Centre is not collecting tax on personal services which are medicines and professions like legal, accountants, CAs and so on and so forth. So, in the case of health, neither State nor Centre is collecting tax.

QUESTION: What about timber which is imported? It is our observation that some of the States are charging four per cent and some are charging 12.5 per cent tax on timber.

QUESTION: Out of 23 States, only Andhra Pradesh is charging VAT at the rate of 12.5 per cent on tea.

(f/snb)

In 22 States, only four per cent is being charged. How are you going to balance all these things.

DR. PARTHASARATHI SHOME: For example, if you look at Brazil you would find much more wider variations in the rate. Each State is a federal State. In fact, there is an academic view within India that VAT has modernised the rates too much. We have to come to a very closely uniform rate structure for a federal State.

QUESTION: Four per cent is being collected from all the other States, like in Maharashtra it is four per cent, in Orissa it is four per cent, but only in the State of Andhra Pradesh is 4.5 per cent. The entire tea trade is affected. Andhra Pradesh was a big trading centre for tea. Now it has gone to other States. Fake trade is taking place and the end result is that the cost of tea in the State of Andhra Pradesh has gone up, whereas in the neighbouring States the cost of tea has gone down. It is the case not only with tea, but also with other commodities like coffee, *chappals* etc. Eighty per cent of coffee is purchased from Karnataka by the multi-national companies. They are purchasing at four per cent tax and they can sell to the State of Andhra Pradesh at four per cent only. Whereas when small traders from Andhra Pradesh go to Karnataka, he pays four per cent, but when they come back to

Andhra Pradesh, they are required to pay 12.5 per cent tax. The net result of all these things is that with the introduction of VAT, the cost of consumer goods in the States have gone up.

DR. PARTHASARATHI SHOME; Now, I come to the point - why is VAT better than Sales Tax? In case of Sales Tax we were having a single point taxation system. We were losing a lot in this process. We were relegating to the manufacturers level with a little margin. But now you can divide your collection at different levels. There was a tendency to seek exemptions and concessions. VAT has certain variations but if you look at the tax structure, it is much more homogenous.

(gl/1000/rbn)

Secondly, there was a tendency to under value the goods at the first point to reduce the tax liability or consciously trying to shift value addition to subsequent stages. Now, because you are effecting it at different points, that tendency is not there. It was impossible to capture transactions in the future stages since there is no tax at subsequent stages. We can keep track of it up to the first dealer or second dealer. But after that it was impossible to find out how much value was being lost, etc. Now, VAT makes it possible to capture the entire value addition. There were many more tax rates and there were many more taxes. All these taxes have been subsumed under the VAT. All those taxes, like the turnover tax, have gone now. So, the tax payer has to pay less number of taxes. Then, many States, as you all know, had competition in tax rates and in tax exemptions. Now, that has gone because you cannot add any new taxes, exemptions and incentives. Now, it is much more uniform. Sales tax, as I explained, was a tax on tax. Generally, the sales tax is levied uniformly on sale or purchase of all commodities including raw materials. It became impossible to precisely ascertain the total tax incidence on the final product and that led to many complications. This led to tax pexortation, that is when the commodities were sold outside the State, to another State or another country, the input tax in the product price also got exported,

which not only acted as a barrier in the inter-State trade but also adversely affected the export competitiveness of Indian industry. Under VAT, full input tax credit is allowed in respect of all inputs. This ensures that the tax incidence falls only on the final product and remains completely transparent. There is also no exportation of input taxes to other States or countries. In fact, under VAT, no tax is charged on exports and at the same time credit is given for all taxes on inputs and purchases related to such exports. But all the States need to adopt VAT. Unless all the States come in, we are going to have a problem in terms of inter-State trade and giving credit. As far as the CST is concerned, these are the lacunae. If a trader or a manufacturer imports inputs from another State and pays CST in that State, he does not get the credit in his own State when he is using that to produce goods. So, there is a tendency to buy that input in his own State. We can do that when all the States have a similar system. What I am saying is that suppose a manufacturer in Madhya Pradesh is importing inputs from Maharashtra, he has paid 4 per cent CST in Maharashtra. When he is producing chappals in Madhya Pradesh what happens is that he will get the credit only when he buys the components from Madhya Pradesh. (hl/1005/mks)

But if he has bought from Maharashtra, he has paid the 4 per cent. But he cannot get that 4 per cent credit. So, there is a tendency of trade diversion, that is, what he could import before, and it was cost-effective to import from Maharashtra. He cannot import and do that now because it becomes cost-ineffective if he buys within Madhya Pradesh. Of course, if he cannot buy from Madhya Pradesh that is a different issue. However, he will still buy. Now we can remove that. As a result, the Central Sales Tax (CST) can be removed and it will be removed. That is why, we keep on hearing that CST should and will be removed. But that can only happen if two things happen. One is that if all the States come in, because, the CST removal will depend on whether some States, that have now agreed on the VAT, agree on CST removal. But those States that have not introduced VAT will

say that as they are getting some revenue from CST, why they should give it up. That is one problem

The second problem is that Tax Information Exchange System (TINXSYS), which I was mentioning, will have to be developed for the information exchange so that Madhya Pradesh tax administrator should know that as this trader in Madhya Pradesh has given 4 per cent in Maharashtra, he will give him credit. Unless he has that information, he cannot give the credit. That is the major lacuna in our system so far. So, the Central Sales Tax (CST) has to go. QUESTION : Can we say that if VAT is introduced in all the States, the entire CST will go and no discrepancy will be there?

DR. PARTHASARATHI SHOME : Yes. But then, TINXSYS will also have to be developed. Unless it is developed, the Madhya Pradesh administrator will not know. If he says, okay, this trader has imported from Maharashtra and so, he is claiming credit. But he will have to know whether he actually did buy and pay in Maharashtra. So that information and development has to be there.

One question was raised that in Andhra Pradesh all the prices are going up. We are trying to follow the Empowered Committee as to what the States are experiencing. Seven or eight States have reported under-price effect. Only one State in the North East has said that the manufacturers and traders are not passing on the price benefit and the prices are increasing. All other States have said that they are not observing price increase. At the same time, we follow inflation. The Wholesale Price Index and the Consumer Price Index, which we are following for the industrial workers, are not showing an inflationary trend. In fact, inflation is stabilized. It could be that in some particular commodities it has gone up from 4 per cent to 12-1/2 per cent, which is very unlikely, but other than a few commodities, we have not observed it. On the other hand, VAT Monitoring Cells are beginning to penetrate the markets and so on and so forth. So, that is the impact of the VAT Monitoring Cells which are monitoring the price movements. So far, no strong inflationary impact of VAT has been reported by the States.

QUESTION : Sir, here the history of tax collection mechanism is defective and corrupt in this country. In that case, even the educated consumers also are not demanding receipts. If the receipts are given, we do not know as a consumer whether it is true or fake? A lot of things are going on in' the collecting mechanism. In that case, I would like to know whether it is defective or not because the retailers are more in number. So, is it not a difficulty with the Administration dealing with more taxpayers now? Instead of all these defects in the system, how can the VAT be operated leaving all the manufacturers and input suppliers and wholesalers' market? They are leaving all those people and it is only tax at the retailer's end, who are in direct contact with the consumers. Is it not going to be more defective and complicated? (j/1010/rc)

QUESTION: VAT is high on quality and rather low on simplicity. Now if that is so, the countries like United States which have a good retail sector find that the disadvantages of VAT outweigh the advantages. Now that we are on the threshold of retail revolution, definitely we are going towards greater preparedness in organising retail selling. In view of the above, do you think that VAT will be a necessity?

I found in Canada that every retailer gives a receipt which contains two entries. The first entry indicates the federal sales tax and the other entry indicates sales tax. But in India we have still not come to that kind of retail sector. It is not that organised.

Thirdly, why is it that some people in some States are complaining that as a result of the introduction of VAT there has actually been an increase in the prices? From the explanation which you gave I found that there is no tax on agricultural inputs. But in most of the States I found that there is a complaint that seeds, fertilisers and other things are being taxed whereas there was no tax at all. The tax was not being collected earlier but they are charging tax on those items.

QUESTION; On some items the words 'maximum retail price' are printed. But when we purchase these items, we have to pay that amount. So, what is the significant of MRP? It is the retail price and on that amount, particularly on medicines, they charge tax. So, this ambiguity may be removed.

Secondly, on some items the prices are not printed in terms of rupees and paise. They simply put some bar-coding form. With the result, the consumers are at the mercy of retailers as they charge more. So, this should be rationalised and regularised.

QUESTION: The Government of India created a corpus of Rs.5000 crore to compensate any State which will be in a disadvantageous position. Do you feel that any State is going to lose due to the implementation of the VAT?

You have said two things. One is that there shall be a sober influence on the prices where as you have also said that the prices should not increase. I would like to know which one is correct.

QUESTION: In the Sales Tax regime, there was a single collection point and in the VAT, there is going to be multi-point tax collection. The Administration was not able to collect the Sales Tax in the single point system. Then how the Administration will be able to collect VAT in the multi-point system?

QUESTION: After the implementation of the VAT, a review had been made by the Government of India. It presented that report to Parliament. According to this review, last year when VAT was not implemented, the tax collection was to the tune of Rs.12180 crore. Now it went up to Rs.14650 crore. So, it means roughly about Rs.2000 crore enhancement in tax collection is there, (k/snb)

It seems that by implementing VAT the Government of India is trying to earn more money. That is the main purpose of introducing VAT. I am convinced about the fact that with introduction of VAT evasion of tax, to a great extent, could be arrested, but in practice, there a lot of anomalies in it. In my view, the Government of India and the State Governments have totally failed in this regard.

I have already represented about it to the Empowered Committee, to the Government of India and also to the Government of Andhra Pradesh.

Our State is purchasing a lot of things from the State of Uttar Pradesh. Ours is not a producing State. Take for example the case of the *chappals*. The raw materials used for making *chappals* are being purchased from the State of Uttar Pradesh. Uttar Pradesh is not implementing VAT. Our traders are paying CST. Again, in our State itself, they are paying, when VAT was not implemented they were paying around eight per cent tax, around 4.5 per cent tax. In our State the tax rate has gone up. In the State of Andhra Pradesh they are paying CST. For Rs. 100 they are paying almost 20 to 25 per cent tax. On a number of items they are paying tax on tax.

Take for example tea. Tea is a poor man's commodity. Out of the 23 States that have implemented VAT so far, 22 States are charging 4 per cent VAT, but in our State they are charging 4.5 per cent. We represented to the Government about this. The argument of our Government is that the income of the State Government and tax collection rate has not gone up as compared to other States. QUESTION: It has been mentioned that VAT is a multi-point tax structure -manufacturer to the consumer. Now, if an ordinary man goes to a shop to buy a soap or a battery, instead of Rs. 10/- the shopkeepers are taking Rs. 12/- citing the reason of VAT. Now my point is that at every point, on every commodity the price that should be charged from a consumer should be written on that commodity. It should be clearly mentioned as to how much the retailer should charge and how much the consumer should pay. If it is not written clearly, then the consumer will be at a loss. (1/1020/rbn)

DR. PARTHASARATHI SHOME: The first question was regarding invoice. It is said that we are not ready for invoice and that invoice do not form part of our habits and so on and so forth. I have really seen and tried to introduce VAT in some countries. I have also improved the VAT in other countries. Countries

which are very similar to us, for example the emerging East European countries and countries like Thailand, do not have the culture of invoice. South Africa when it emerged from apartheid regime to modern regime, at that stage I was instrumental in introducing the VAT regime. You have seen that invoice culture comes into being. Of course, there are many challenges. The main point is that every participant in the manufacturing and distribution process will have to demand invoice. Otherwise, he is not going to get the credit. But with regard to consumers, we have to see that. A point was raised that when you go to market to buy something, shop keepers say that the price increase is because of the VAT, which may not be correct. Even in the case of fish, they say that it is due to the VAT, whereas there is no VAT for fish. We are in a transitory stage. But that does not mean that invoice mechanism will not work. That has to work. It is because there will be scrutiny by the administration of the manufacturer and the wholesalers. If they have taken so much credit and if there is no matching invoice, then they will be prosecuted or whatever is the penalty mechanism. That, of course, presumes that there will be proper scrutiny of the State going on. The ratio will be ten per cent. Ten per cent of the total tax payers, they have to carry it out. If they are not going to do it, they will suffer. Already we see that it is happening, particularly in the suburbs. If you go to Life Style, you will see how modern it is. (mI/1025/mks)

If you go to Chennai or if you go to the retail grocery shop, they will automatically give you. The culture is setting in. On the other hand, France, Germany and United Kingdom still have the VAT because they have a major small retail sector.

For example, in Singapore, leakage is zero and still they have introduced VAT. It depends on the objective also. In India, we do not have a tax up to the retail level of the Centre; we only have up to the manufacturing level. So, the invoice up to the manufacturing level could show both. But beyond that, there is no excise duty. It would never show as far as our constitutional provisions

continue. As regards agriculture and seeds, J will check up with the Empowered Committee. The issue of MRP is very interesting in the case of drugs and medicines. That was determined some time ago so that the producers and retailers cannot charge any amount that they like given the social importance of this particular commodity. Actually, VAT is a tax on the ultimate valued added. Under the Sales Tax system, you were taxing at the manufacturing level with a little margin. There are two views on this. One view is that administratively it is easy to collect on MRP. On the other hand, VAT is a habit formation. It means, you do collect at different stages and do not treat one sector this way and the other sector the other way. This has been discussed in the Empowered Committee also.

As far as medicines are concerned, given the existence of MRP and given the revenue potential, the States are allowed as they wish on the basis of MRP. That was the decision of the Empowered Committee. As you rightly pointed out, there are two angles to this view. As regards the prices relating to commodities, of daily use appearing in bar-coding are concerned, I have take note of it. In US and Europe, most of the manufactured products have to have a bar-coded pricing system so that there are no exorbitant price charging whereas in our case, if you go to Bangalore or Chennai or even a little corner shop, they are now bar-coding. But, several other Metros have not done it. So, what is the use of uniform bar-coding? Maybe, we have gone a little further. But I thought, even in the bar-coded systems some prices were indicated. I will certainly bring this point to notice of the Empowered Committee. (n/1030/rc)

DR. PARTHASARATHI SHOME: Then Rs.5000 crore issue is mainly to allow for any possibility of revenue fall in a particular State because VAT rates are varying from 12.5 per cent to 4 per cent. As I said, earlier in some States the rates were so high that this rate combination is lower than what they call revenue neutral rate for VAT. In other words, some States have reduced the tax rates and

that is why, they may suffer. Some States are going to make adjustments for the stocks that they are maintaining from 2004 and for that they will be compensated.

QUESTION: Do you think that any State is going to lose due to VAT?

DR. PARTHASARATHI SHOME: Those States that are having the VAT rate structure which is lower than their sales tax rates, will have to be sufficiently compensated.

QUESTION: In Bihar, there is 11 per cent less revenue collection after the introduction of VAT.

DR. PARTHASARATHI SHOME: Last five years average of sales tax was 12.3 per cent a year growth rate. But under the VAT, the growth has been 15.13 per cent. On an average some States are up and some States are down. So, for example, if Karnataka is having a very high rate even in VAT, it will have more collection. You will be pleasantly surprised that the Karnataka's revenue neutral rate was high under VAT structure. One can expect that it will have to cover up at the distribution stage very efficiently. But what is their revenue in the first quarter is not the best indicators because first month of the first quarter is from the previous sales tax regime. Apart from that, some States came in a little later. Some States came in May some in June and so on. We have to see the next quarter to really get a view of that.

You mentioned about Andhra Pradesh. That problem will continue in the sense that till all the States adopt VAT system.

QUESTION: The net result as of now is that the manufacturers of *chappah* are closing their shops. The traders are getting collapsed. We do not know what will happen later on but for the time being, they are being closed. DR.

PARTHASARATHI SHOME: I think I have answered all the questions.

(ADJOURNED)