

CHAPTER 8

VALUE ADDED TAX AND SERVICE TAX

1. Value Added Tax

1.1 The implementation of VAT is intrinsically linked to the administration of the Indirect Taxes, particularly Service Tax, and the tax to GDP ratio on account of these taxes. Therefore, it is necessary to examine the salient features of the proposed dispensation in respect of VAT. The matter assumes importance in view of the limited time now left for the proposed implementation of State VAT, from 1st April 2003. At the same time, it is appreciated that the entire matter of implementation of VAT is currently at a crucial stage and a number of initiatives are under examination by the Empowered Committee, which has made significant progress during last one year. Hence, at this juncture it would not be appropriate or desirable for this Task Force to take a final view on the modalities and implementation of VAT. Therefore, only certain preliminary observations are being made which are considered relevant for the successful introduction of the proposed scheme of VAT.

1.2 Implementation of VAT

1.2.1 There is a strong expectation of the trade and industry that the promised State VAT is implemented from 1st April 2003. At the same time, there is some apprehension that little time is now left and a lot of ground has to be covered. Basically, there is concern about the introduction of uniform legislations, regulatory procedures, registration of dealers, computerisation, training and orientation, designing of forms and documents, simplified assessment procedures etc. No doubt, State Governments are seized of the urgency and steps are being taken for the timely implementation of State VAT. However, it is desirable to clear apprehensions and uncertainty.

1.2.2 It is recommended that the State Governments should announce a time bound action plan for the implementation of VAT by 1st April 2003.

1.3 VAT as a unifying force for all State-level taxes

1.3.1 At present, each State levies multiple taxes on the same item in different names or at different stages e.g. Entry Tax, Luxury Tax, etc. Whereas the Sales Tax is a first-point levy, on a lower value at a relatively lower average rate, the proposed VAT will be a multi-point collection at a much higher RNR (10% or 12.5%) on the last sale, which will be of a higher value. Hence, if States levy over and above VAT any other tax, such as Entry Tax, Luxury Tax, Special Additional Tax, etc. this will only worsen the malady of varying taxes and rates, the avoidance of which is amongst the primary objectives of VAT. In other words, no useful purpose would be served by introducing a multi-point VAT which simply replaces the present single-point Sales Tax alone. Such a VAT will be regressive and make the industry uncompetitive. Therefore, it is necessary that State VAT should be the tax to unify all the State-level taxes i.e. Sales Tax, Purchase Tax, Turnover tax, Works Contract Tax, Entry Tax, Special Additional Tax, etc. should all be covered under State VAT. Same principle should govern Central VAT.

1.3.2 It is recommended that VAT should be one tax to replace all taxes on goods and services.

1.4 Constitutional guarantees regarding implementation

1.4.1 There is an apprehension that unless Constitutional guarantees of any agreement between the Centre and States are provided, long term stability to VAT system may not be ensured. VAT system runs the risk of getting off track on account of levy of multiple taxes by some of the State Governments in future. Therefore, some mechanism backed by Constitutional provision is required to facilitate a binding agreement between States as well as between Centre and States. A suggested formulation is the insertion of an Article (perhaps in the fashion of erstwhile Article 278 in Part XII in the Constitution) on the following lines:

“Notwithstanding anything in this Constitution, the Governments of any number of States, whether amongst themselves or with the Government of India, may enter into any agreement with respect to the levy and collection of any tax or duty leviable by them, and upon the execution of such agreement and during the period in which such agreement is

in force, the power of such States to make any laws to levy any tax or duty shall be subject to the terms of such agreement.”

1.4.2 It is recommended that a constitutional guarantee should be in place for the implementation of State VAT.

1.5 Uniformity of definitions

1.5.1 Reportedly, some of the State VAT legislations are not based upon the model legislation and, as a result, there is variance in the definitions of dealers, distributors, etc. Even the charging section is not uniform. It is expected that this will give rise to disputes.

1.5.2 It is recommended that an attempt should be made for uniformity of legislation. Further, the States must also agree on uniform rates of taxation and uniform classification based upon HSN.

1.6 Compensation to States

1.6.1 One of the issues under discussion is the compensation to be given to the States upon the removal of Sales Tax and the introduction of State VAT, in the event the tax revenue drops due to the change over. Various formulations are being worked out and reportedly a consensus has not been worked out so far. In this regard it is observed that the experience world-wide has been that a move to VAT results in higher revenue realisation. Therefore, there is no cause for concern. Nevertheless if such eventuality arises any compensation should be through revenue mobilization (by the States) from specified services and not through Budgetary support.

1.6.2 It is recommended that issue of compensation, if it arises, must be tackled through mutually acceptable mechanism of additional resource mobilization and not through Budgetary support.

2. Service Tax

2.1 Service sector makes a significant contribution to the GDP and is a potential source of appreciable revenue in the coming years. Linkage of Service Tax with VAT is currently under discussion at various forums, including the Empowered Committee on VAT and a final view is yet to emerge. For this reason, it is desirable to allow a consensus to emerge and, therefore, only few important issues are being addressed.

2.2 Implementation of Service Tax

2.2.1 Keeping in view the necessity to expand the coverage of Service Tax, certain postulates are required at this stage for providing efficient tax administration. Further, the eventual integration of Service Tax with Central Excise is also to be kept in mind. In this background the following recommendations are made :

- (i) Comprehensive Service Tax** - In due course Service Tax should be comprehensive and there should be no selectivity of items. However, it would be in order to identify certain minimum number of services which are not subject to Service Tax. Examples of these services are public utilities, social services (health, education, etc.) and Sovereign services rendered by the State.
- (ii) Credit of duty paid to be allowed to service sector** – A start has been made in allowing tax credit to service providers who can now take credit of the tax paid on the services received. However, the input service and the output service have to be in the same category. It is necessary to expand this scheme to reduce the cascading effect of taxes. Accordingly, the scheme of tax credit should be extended to include all services. In other words, tax credit of services received should be available to a service provider even if the two are not in the same category. At the second stage, the Service Tax credit should be amalgamated into the Cenvat credit scheme on goods. Thus, there should be integration of the Cenvat credit and Service Tax credit schemes.
- (iii) Service Tax as the first E-tax** - In order to facilitate voluntary tax compliance and to eliminate tax payer inconvenience, Service Tax should be implemented as the

first electronic tax (E-tax) with self assessment and on-line web based connectivity between the department and the tax payers.

- (iv) **Separate enactment for Service Tax** – Presently Service tax is levied through the provisions of the Finance Act, 1994 and Service Tax Rules, 1994. With the progressive expansion of the Service Tax coverage it is necessary to enact a specific legislation to administer the tax. Once this is done there would be increased legal clarity and better administration. Eventually, Service Tax legislation and Central Excise legislation must be integrated.
