VALUE ADDED TAXATION IN INDIA-A CRITICAL OVERVIEW[1]

Introduction

The idea of Value added taxation (hereinafter referred to as "VAT") traces back to the writing of Von Siemens a German businessman in the 1920s. However, not until 1948, the first value added tax was applied in France. At the beginning, France applied the GNP based VAT[2] covering up to the manufacturing level and subsequently replaced with a consumption VAT[3] in 1954.

VAT proves to be an efficient tool for revenue collection; its performance, therefore, has direct impact on fiscal mobilization, macroeconomic stability, and development.

As illustrated in the article, compared with alternatives in indirect taxation, the VAT has revenue potential: it is generally more broad-based and entails a trail of invoices that helps improve tax compliance and enforcement.

In view of its numerous benefits, the VAT has become the sales tax of choice in OECD countries[4]. A similar trend is emerging in developing countries, which typically rely more on sales tax than OECD countries.

The IMF assesses the growing importance and worldwide expansion of the VAT as follows:

"[The VAT has become] a key source of government revenue in over 120 countries. About 4 billion people, 70 percent of the world's population, now live in countries with a VAT, and it raises about $18 trillion in tax revenue—roughly one-quarter of all government revenue. Much of the spread of the VAT, moreover, has taken place over the last ten years. From having been largely the preserve of more developed countries in Europe and Latin America, it has become a pivotal component of the tax systems of both developing and transition economies." [5]

This paper covers the mechanism of the VAT and presents critical issues in the tax design, implementation, and policy implications. The paper consists of five sections.

Section I: Reviews the broad features of VAT introduced in India; also considered are the broad features of the present tax system in India;

Section II: Discusses the rationale for the opposition of VAT as is introduced in India.

Section III: Reviews the experiences of the developed and developing countries with VAT which may provide lessons for effective implementation of VAT in India---Case in point for developed countries is *France; United States*; which represents a federal structure like India is also briefly considered as an illustration for federal structure not adopting VAT;

Case in point for transitional countries is the *Russian Federation*;

Section IV reviews the rationales for the VAT in comparison with other types of indirect taxes. Also considered is the proper system of administration of VAT for India: should VAT be implemented at the state level or at the federal level; Also stated are the authors view on the proper implementation and administration of VAT in India

Section V analyzes critical issues in the VAT design, implementation, and policy implications and provides concluding remarks.

Section I

TAX SYSTEM IN INDIA

The various kinds of Indirect taxes and duties levied in India, at the state and Central level are illustrated hereunder:

Both the Customs and Excise duties are levied and collected by the Central Government. While the Customs duties are levied, collected and retained by the Central Government, the Excise duties are shared by the Central Government with the State Governments.

The State sales tax is levied and collected by the states on all intra state transactions. Central Sales Tax is levied by the Central Government and collected by the states and such levy is restricted to interstate sales originating in the concerned state. The former is regulated by the concerned State Sales Tax Act, while the Central Sales Tax is regulated by the Central Sales Tax Act, 1956.

In the budget for 2003, the Finance Minister of India, after various rounds of consultation with the states of India, proposed the introduction of VAT in India on a nationwide basis, replacing the State Sales Tax Act (India has 28 states and each state has enacted on sales tax).

Broadly stated are the key features of VAT to be introduced in India[6]:

- VAT proposed to be introduced in India is a simple and a transparent tax collected on the sale of goods.

1. ***VAT is to be consumption based*** **and applied on destination principle[7].** Under the consumption type VAT, the base excludes the value of both intermediate inputs and investment items from the gross value of goods and services. The base—as defined—is close to the one in retail sales taxation.

- ***VAT computation*** is to be based on *the invoice-based credit method*. Under this method, a firm at any stage of the production-distribution chain charges its customers the VAT on its output, submits the tax to the treasury, and then claims for the VAT already paid on its input purchase[8].

For illustration, let t1and t2 be the tax rates on output and inputs respectively, then the tax liability based on the invoice based credit method is the difference between (t1*output) and (t2*inputs). The *emphasis* placed on each transaction means that the evidence for each sale or purchase, the invoice, becomes a crucial document to monitor and administer the VAT. Thus, the burden of VAT is not borne by producers or suppliers of taxable goods or services, but rather by the ultimate consumers thereof.

- ***Who is covered by VAT?*** All business transactions carried on with a state by individuals, partnerships, companies etc. will be covered by VAT.
- ***VAT will not cover*** small businesses with a turnover below a certain limit which will be decided by each state. The turnover limit for eligibility of retailers to opt for payment of tax at compounded rate of tax may be Rs 20-50 lakh (USD 40,000 to 80,000) as may be specified by the respective states. All retail dealers[9] with annual turnover above the limit specified will have to pay VAT even if their entire business is in retail. Retail dealers below a *threshold limit of annual turnover*, as may be specified in the respective State VAT legislation, may opt for payment of tax at a flat rate of 1-2 per cent. The terminology is not uniform in all the States. Presumptive tax,

turnover tax or composition of tax has been used to describe the levy of tax on retailers.

- ***The `sales' not liable to tax under the VAT Act:*** Since the VAT Act applies only to sales within a State, the following sales shall not be governed by the VAT Act: a) sale in the course of inter-state trade or commerce which shall continue to be liable to tax under the Central Sales Tax Act, 1956; b) sale which takes place outside the state; and c) sales in the course of export or import.
- ***The Rates of VAT*:**

There are just four rates under VAT -

- The zero rate (for exports and other essential commodities), 1%[10], 4% [11]and a general rate of 12.5%. These rates will be uniform in all states across the country. The same set of goods will be charged at the same rates in all states. *Most essential commodities are exempt from VAT or fall in the category of 4%.*
- Policy decision has been taken to phase out the Central Sales Tax in 4 year and instead have adoption of uniform classification, etc.

Section II

Present situation regarding implementation of VAT in India

In India, states have exclusive domain to legislate with respect to value added taxation. After a broad consensus among the members of the Empowered Committee of the Finance Ministers of the 28 States of India, the April 1, 2003 budget speech of the Finance Minister of India, Mr. Jaswant Singh, announced implementation of Value Added Tax (VAT) all over the country. But many states subsequently dithered due to intense lobbying by the trader community of the respective states. At present, though 16 states of the Union of India have agreed to introduce VAT, the remaining 12 states have not even passed the necessary legislation for introduction of VAT replacing the local laws governing sales tax.

- **Why is there an opposition to VAT in India**

There has been opposition to VAT on several grounds.

Firstly, the traders lobby is opposed to the introduction of VAT. The traders lobby cites the possibility of harassment by the tax inspectors as the outward reason for their opposition. Under the VAT system, records need to be maintained which according to some trade lobbyists, is very cumbersome and would lead to harassment.

Further, the trade lobbyists claim that VAT is good for manufacturers, but bad for traders[12]. The traders lobbyists contend that the extensive procedural formalities that will have to be followed by traders under the new regime which may result in increased transaction costs.

However the real reason is different. *There is less scope for tax evasion under VAT and there will be stricter compliance.* The traders lobby wants to retain the scope for tax evasion as it exists at present under the sales tax. This being the real underlying reason for their protest there can be no sympathy for their opposition. To exempt small traders from VAT the minimum turnover for VAT has been made Rs.5,00,000. But the traders lobby argues that this limit is too low.

Secondly, some businessmen have expressed apprehensions that introduction of VAT would lead to *inflation*[13].

Thirdly, some states in India have expressed reluctance to introduce VAT because it would reduce the revenue. The Central Government has acknowledged the possibility of reduction in revenue following substitution of sales tax by VAT and had offered to compensate the states for the revenue reduction for three years. Though initially there might be a fall in the revenue, after a period of time the revenue would be buoyant as the compliance would improve[14].

Further, some politicians are opposed to VAT because it would be a negation of the federal principle as it would concentrate more powers at the Central Government and also because it is being introduced at the behest of the World Trade Organization ("*WTO*").

Section III

This Section reviews the experiences of the developed and transitional countries with VAT which may provide lessons for effective implementation of VAT in India---Cases in point for developed countries are *France and United States;* the case in point for the transitional economies is *Russian Federation.*

Box* 1:** The VAT in France **---- *development and key success lesson:

The value added tax (referred to in French as "*taxe sur la valeur ajoutee*" or *TVA*) was instituted in 1955 and is the principal form of indirect taxation in France.

Following are *the broad features of the VAT* as it exists in France[15]:

- The rules applicable to French VAT are notably governed by European Union law (Sixth Directive)[16].
- VAT is *consumption based* and applied on *destination principle*;
- ***VAT computation:*** *Credit invoice type of VAT* is applicable.
- VAT rate is 19.6%;
- *Territorial Application of VAT in France:*

Although subject to certain territorial limitations, the scope of the VAT is very broad: it covers all transactions involving an "*economic activity,*" which term is deemed to include not only industrial, commercial and agricultural activities, but also the rendering of professional services and other activities which are classified as civil.

- **Intra-Community Transactions:** As a result of the single market which became effective in the EU on January 1, 1993, transfers of goods between EU Member States are no longer considered in terms of importations and exportations, but rather in terms of intra-Community acquisitions and intra-Community deliveries. As a general rule, where goods are sent or transported to France from another EU Member State, the EU seller is deemed to perform an intra-Community delivery which is not subject to VAT in the country of the seller. The French buyer then performs an intra-Community acquisition which is subject to French VAT[17]. The French buyer may be entitled to claim a VAT credit as a result of such VAT paid, under the normal rules. The two principal exemptions from VAT relating to certain imported goods, also apply in the case of intra-Community acquisitions.

Where goods are sent or transported from France to another EU Member State, the French seller is deemed to perform an intra-Community delivery which is exonerated from VAT in France. The intra-Community acquisition then performed by the EU buyer is subject to the payment of VAT in the receiving EU Member State. The receiving EU buyer may be entitled to claim a VAT credit as a result of such VAT paid.

However, special rules govern "*triangular transactions*" whereby a company located in a given EU Member State sells goods to a company located in another EU Member State, which resells them to a company located in a third EU Member State, the goods being delivered directly from the first state to the third one. In such case, *the intermediary company* does not need to identify itself in the first or third state, and the final client is subject to VAT on the last sale[18].

Exempt Transactions: The principal activities or persons that are exempted from VAT are: certain insurance, banking and financial activities, certain non-profit activities of non-profit organizations, doctors and other medical professionals, athletes, and lessors of unfurnished premises and certain furnished premises[19] In addition, rentals of agricultural land and buildings are exempt from VAT[20].

Goods and services ***Exonerated from VAT :*** This category includes, *inter alia*, those economic activities which relate to foreign commerce, such as international transportation, the exportation of goods, intra-Community delivery, and the rendering of services relating to goods to be exported or goods which are imported pursuant to the temporary admissions procedure.

An examination of the French VAT system provides some *key lessons for the success* which are illustrated hereunder:

- Strong political commitment from the government;
- Careful planning in all stages, from designing to administration;
- Close cooperation between the business and the government from the embryonic stage of VAT;
- Public and taxpayers' education;
- Selection of capable staff for the administration;
- Adoption of the destination principle VAT as compared to origin principle[21]. In comparison with the origin principle, where the tax is imposed at the point of production: exports are taxed, but imports are not (tax on production), the destination principle promotes production efficiency—as it puts all firms at different jurisdictions on equal footing: they face the same prices on their input purchase.
- VAT is consumption based which is more production efficient as it relieves production from tax burden. In addition, as a general consumption tax, the consumption-typed VAT does not distort the investment and saving behavior.
- The items covered under the exemptions from VAT are limited;

Experience of United States ---- Case study of federal form of government like India, not adopting VAT

The United States has debated the possibility of adopting a VAT on numerous occasions. It has been seen as a way to reduce the budget deficit, finance Social Security, replace the corporate and personal income tax, and finance a health scheme or defense. The Congressional Budget Office[22] estimates that in the United States, a 5 percent VAT, if education, financial services, and all medical care are zero-rated, would yield about US$98 billion in 1998 (about 6.3% of revenues) . This yield is much lower than is common in Europe, and it suggests that to make the administrative costs worthwhile (US$1 billion for government and US$6–10 billion compliance costs for business) the rate might have to move toward the typical worldwide rates of VAT (10 to 20%). The Congressional Budget office in its report further states that a federally administered VAT would be supplemental to the existing sales tax typically levied at 4 to 8 %; Despite the benefits of the VAT regime, a reason that this tax has not been adopted in the United States is that the state governments make heavy use of sales taxes to raise revenue, and they fear that the federal government may eventually seriously undermine the abilities of the state governments to raise revenue if it adopts the VAT. They prefer that the federal government stay away from sales taxes and leave sales taxes to the states. As a result, state governors and legislators have strongly lobbied against all proposals for any sort of federal sales tax in the United States.[23]

Russian Federation--- failure and success lessons

VAT is one of the principal sources of revenue for the Government of Russia, and a cost of doing business there.

The *broad features of the Russian VAT* are illustrated hereunder[24]:

- The *subtraction type VAT* is applicable; Under the subtraction type VAT, the tax liability at any stage is equal to the tax rate multiplied by the tax base or value added measured as the difference between the value of the outputs and the inputs;
- VAT is *consumption type* and based on *destination principle*.
- *VAT Rate*: For the majority of domestic sales of goods and services in Russia, VAT is levied at rate of 20%. Certain basic food products and children's goods are subject to a reduced rate of 10%.
- *Exempted Goods*: Effective January 1, 2001 the list of goods and services exempted from VAT was significantly reduced, compared to previous years. The most significant change has been the abolition of the exemption on the transfer of intellectual property; all taxpayers are allowed to offset immediately VAT included in the costs of capital construction and are not permitted to capitalize such VAT and write it off through depreciation. Further, the mass media concession has been abolished and favorable VAT treatment afforded to healthcare products, goods produced by handicapped persons and some other concessions have been restricted further.

The VAT exemption on education services have been restricted only to sales made by non-commercial educational institutions.

Only specific "technological equipment and spare parts" contributed to the charter capital of Russian entities is exempt from VAT imposed on imported goods.

- **VAT Exoneration:** Services deemed to be supplied outside Russia are outside the scope of VAT with no credit for input tax.
- *Threshold limit for the applicability of VAT*: Taxpayers with monthly revenue over RUR 1 million (approx. $ 35,000) are required to pay VAT and file VAT returns on a monthly basis (by the 20th of the following month). Taxpayers with monthly revenue under RUR 1 million are required to file VAT returns and pay VAT quarterly. Small businesses and individual entrepreneurs are exempted from VAT where their tax base is less than 1 million Rubles over the previous quarter.
- Russia is a unique jurisdiction in applying potentially four separate consumption taxes: a 20% VAT, excise tax which is applied on a unit basis, a 4% turnover tax and a 5% retail sales tax.

Following are the advantages that can be derived from the examination of the Russian VAT:

- The VAT, given its current structure, with exemptions covering a wide range of goods and services is not regressive;
- The ratio of revenue collections to the tax base is almost 17 percent, with a top VAT rate of 20 percent and at such VAT rate, there exists a tax efficiency ratio of 84 percent[25]; Further, the study further pointed out that VAT regime in Russia had no effect on inflation in the economy.
- **Russia**'s standard rate of 20 percent is well within the range of international comparators;[26]
- There exists careful planning in all stages, from designing to administration;
- Compliance rates for income and turnover (sales revenue) in Russia have historically been extremely low, making the job of tax authorities very difficult, to say the least. Therefore, VAT taxes are very attractive to the government, as it puts much of the burden of tax assessment, administration and collection on the business community. Further, it is more broad based and entails a trail of invoices that help improve tax compliance and enforcement;
- By setting a high threshold limit for the applicability of VAT, (for small businesses and individual entrepreneurs the threshold limit is tax base of 1 million Rubles over the previous quarter), it has reduced the compliance and administration problems which are a threat to the sustainability of the VAT system.

Besides the aforementioned advantages, following are the problems associated with the VAT regime in Russia:

- *The subtraction type VAT* applicable in Russia is a cascading tax, which is imposed on each downstream transaction within the Russian Federation.
- The *subtraction method,* requires an explicit estimation of the tax base—this would be fine for a VAT with a single rate structure but would result in serious problems for a multiple-rate VAT regime, which presently exists in Russia. For the purpose of illustration, let us look at a simple case: assume a firm purchases a single type of input (I) subject to a tax rate of ti and produces two types of output subject to different rates of t1and t2, respectively. To properly refund the tax on inputs to the firm, the tax administration needs to know how to apportion the input (I) into the two types of outputs.
- With the application of four consumption taxes in Russia, they are likely to apply to the same tax base, and once their sums are done, taxpayers could end up paying their consumption taxes to as many as four different government bodies. They would also run the risk of being audited for one or more consumption taxes twice in the same fiscal period, once by the State Tax Service (STS) and once by the regional tax authorities of Russia[27].

Section IV

Benefits of VAT in comparison with other indirect taxes

The present sales taxes regime in India is inherently troublesome in terms of both revenue leakage and economic inefficiency. Further there exists problems of cascading; vertical integration of firms (the present tax system distorts trade and production methods i.e. it induces shifting of production bases and/or changes in the constitution of the entity) and the sales tax regime requiring massive registration.

How can VAT address these issues:

The VAT is relatively more advantageous than the alternatives, be it turnover tax or single-stage tax.

First, the VAT is generally more broad-based (it is extended to cover both goods and services).

Second, it is less risky in terms of revenue leakage (the invoice-based credit mechanism in administering the VAT facilitates collection and enforcement; even if revenues are missed in one stage, they are still collected in other stages). The VAT has, therefore, greater revenue potential than its alternatives.

Thirdly, VAT would not cause cascading. Also, it provides total transparency of the incidence of tax. This is because, VAT is a multi-stage sales tax levied as a proportion of the value added. It is collected at each stage of the production and distribution process, and in principle, its burden may fall on the final consumer depending upon the elasticity of the demand and supply curves. Further a properly designed system of VAT would not cause vertical integration of firms as it does not distort trade and production methods- i.e. it does not induce shifting of production bases, and / or changes in constitution of the entity.

Another feature of VAT regime is discontinuation of the sales tax based incentives to new industrial units. Until now, all the states in India were granting such incentives to new industries in the form of exemption from tax on the purchase of inputs as well as on the sale of finished goods, sales tax loans and/or tax deferral.

Further, from the pure economic efficiency perspective, the VAT generates only distortion on the consumption side, whereas single stage tax / tariff induces distortion on both production and consumption sides. The VAT does not have discriminating effect on savings/investment because savings are essentially excluded from the consumption VAT base.

VAT and Inflation

The argument of opponents to VAT that significant impact on inflation is clearly misplaced. Experience of countries adopting the VAT such as Russia, indicates that the VAT is not inflationary. If the VAT is revenue-enhancing, it will help the government pursue tight monetary policy by contracting the money supply, the rate of growth of the general price level starts to fall and then the VAT may even exert downward pressure on inflation—in this case, the VAT is deflationary rather than inflationary. However, it is important to note that introduction of VAT during high inflation period tends to reduce the chance for its success.

Administration of VAT:

Invoice-based credit VAT, the type of VAT adopted in India is, in principle, self-enforcing and hence a buoyant tax. The description stems from the nature of the invoice-based credit VAT: a taxable business can claim for the refund of the input VAT only if the claim is supported by purchase invoices—the mechanism provides strong incentives for firms to keep invoices of their transactions and is an efficient means for tax authorities to check and cross-check for enforcement enhancement.

Implementation of VAT:

The experience of the United States has shown it has not been able to adopt a federal VAT. This is primarily because of the following reasons:

1. Assigning the responsibility of implementing- Federal government or the State Governments.

2. Harmonization of tax rates by all the States means that States would lose fiscal autonomy in fixing tax rates (according to the ground realities such as extent of industrialization, development, State's financial position etc.) and be influenced by the need to ensure uniformity with other States in tax rates and policies.

3. The VAT system does not ensure Revenue Neutrality for any state (at least in the initial years) with the result that States look for additional sources of revenue outside the VAT system to compensate for the loss of revenue. This gives place to the existence of VAT-able and Non-VAT-able duties or taxes at the same time.

The experiences of various countries have shown that each country has to evolve its own system depending upon the circumstances prevailing in each country.

In India, majority of states have realized that there exist more advantages than disadvantages with the introduction of the VAT regime. In a federal set-up like India, uniform VAT rates will eliminate competition among states to offer tax reduction concessions to attract investment and thereby it prevents reduction of revenues. Once VAT is implemented India will become a common market and sales between states will become totally free. Each producer will have a big common market before him.

As regards to revenue sharing, I feel that there should be an entire field of commodity taxation to the National Government with a proper revenue sharing arrangement among the states. This approach is likely to reduce the possibility of conflicts among the states.

Section V

The VAT in India may become a “money machine,” as the present form presented in the Union Budget for adoption is simple in rate structuring and broad-based. The present VAT rate structure is simply designed as it has only two VAT rates, has few exemptions, and zero rates the exports.

Zero-rating or VAT exoneration generally provides strong incentives for frauds, creates excessive burden on tax administration, and effectively erodes the base. This problem can be handled with the appointment of knowledgeable and competent administrative staff to overview the VAT compliance.

Two major problems related to exemption deserve special attention. *First*, exemption may induce cascading effect and hence makes the system economically inefficient. *Second*, excessive exemption tends to break up the integrity of the VAT regime and hurt its sustainability. As illustrated through the experience of Russia[28], the VAT design should, therefore, minimize—to the extent possible—the number of exemptions. The standard advice by the IMF and the World Bank is that the VAT be structured with a single non-zero rate in addition to zero rate exclusively granted to exports, and few selective exemptions[29].

It may be in the interest of the States in India introduce legislation with minimal exemptions and which may probably be limited to hard-to-tax sectors. For example,   France and Russia, with an VAT regime, essentially limits the exemption in some form to education, agriculture, health, and financial services. From the economic efficiency perspective, these services (e.g., public health, and education) generate positive externalities and therefore deserve government subsidies—and therefore they should bear no tax burden.

Taxing agriculture is an acute issue in India as a large populace is dependent on revenue derived from this sector. Despite tempting rationales—technical, political, and social—for sparing the sector from VAT, the sector, in principle, should be brought into the tax net. Exempting agriculture tends to ratchet up to exemption of agricultural inputs and dwarf the benefits of the zero-rating granted to exports of agricultural commodities. The chain of exemptions leading up to the agricultural sector would be a nightmare for the administration: it is always technically hard to distinguish agricultural from non-agricultural inputs. Rather than exempting agriculture and its inputs, the states of India while enacting on VAT should consider providing selective outright fiscal subsidies to agriculture—if necessary—through public funds. Further, taxing agriculture should be accompanied by setting a reasonable threshold, preferably the same as the one applied in other sectors, in order to maintain a manageable number of taxpayers in the net. Further, exemptions from VAT can be limited to critical and pure-for-agriculture inputs such as fertilizer and seeds.

India has set a relatively high threshold level at the beginning—to accommodate the poor tax administration in the initial stage and to quench the nervousness of the public, when the tax is first announced—the aim being to lower the threshold when administration gets improved and the public becomes familiar with the new tax regime. This methodology is useful for successful implementation of VAT.

Further, it is consistent with the methodology adopted by Russia[30]

Limitations of VAT

That the *VAT is inherently regressive* has long been widely held. This is true, if regressivity is defined conventionally on the basis of the tax burden-to-annual gross income ratio. To reduce regressivity, many countries attempt to incorporate in the VAT structure multiple exemptions and/or zero rates. The provisions prove ineffective, however, and yet costly in terms of revenue loss and administration complexity. It is critical that regressivity be studied in an overall context of the applicable fiscal policies including direct, indirect taxes, and public expenditures. The policy makers responsible for introduction of VAT regime in India may need to examine and return to *VAT's main purpose (i.e., collecting revenues effectively and efficiently)*, to strengthen income taxes, and to rationalize pro-poor public expenditures. *Regressivity can be addressed more effectively with sound income taxation and government expenditures.*

There could be cases where the VAT is collected by the dealer, but not paid to the Government. As a result, the set off of such VAT paid by the purchaser may not be allowed to the purchasers. A mechanism has to be devised to tackle such situations.

A *situation of refund* would arise if no VAT is payable on the final sale. As a result, the set off cannot be availed. In such cases, the tax paid becomes the cost or the same has to be claimed as refund. If refunds get delayed—they become "hidden costs" to firms and hurt their financial cash flow. On the other hand, frauds, in various shapes forms, are widespread. Good cooperation between tax and customs agencies would be essential for identifying any unjustified refund claims. In addition, the tax regime should set transparent, severe penalty for refund fraud, specify mandatory time limit for refund processing, and impose interest on the part of refunds outstanding beyond the established mandatory time limit. The establishment of processing time period is critical to protect firms' cash flow and to avoid abuse by the tax administration. Hence, the mechanism of refund has to be framed.

Further, since Central Sales Tax Act (CST) continues to remain in force in India, there can be conflict between the VAT and CST and therefore the VAT council, in charge with the governance of VAT regime in India would need to devise a mechanism to limit the possibility of conflict between the two applicable legislations[31].

An increasing number of countries around the world have switched from various types of consumption tax to the VAT. This trend has set its footprint in almost all recent comprehensive tax reforms. The common form of VAT is consumption-typed, and applied on destination principle with invoice-based credit method. The proposed model of VAT introduced in India incorporates the aforementioned three features of VAT.[32]

Experiences of other countries have shown that for a VAT regime to be successful—apart from being well designed, carefully prepared (from both administration's and taxpayers' perspectives)—the VAT should be introduced in good timing. Therefore, it is essential that VAT should be introduced by all the States in India collectively at a time when the inflation in the economy is low[33]. Further, the need is for close cooperation between businesses and government from the embryonic stage of VAT and selection of capable staff for the administration. Last but not the least, public and taxpayers' education will play a pivotal role in the success of the VAT regime.

With a strong political commitment from the governments at the State level to introduce VAT, India will surely derive benefits from the VAT regime.

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