

The New Economic Policy Vis-a-Vis Excise Law: A Case for VAT

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Introduction

The New Economic Policy (NEP) in India necessitated reform in the sphere of taxation in consonance with the two pronged approach of 'stabilizing' the macro-economic system and of 'adjusting' the market to improve efficiency. In an economy dominated by government intervention and planning, the success of these reforms stand on quicksand.

This article is an attempt to analyse the changing economic scenario and the consequent need for tax reform, particularly excise. A comparison between the existing system of indirect taxation with the suggested VAT¹ has been presented. Due to the inadequacies in the existing system, the VAT has been advocated and examined critically.

The need for VAT

Given the present day objectives of increasing exports, of promoting internationally competitive prices and of increasing the inflow of foreign exchange, the extended system of indirect taxation or VAT is ideal. Any other mode of taxation may be criticized on the ground that at each stage, the mark-up by producers and traders gets inflated because the profits which they seek to earn are related to the total capital which they employ and the amount of capital employed increases, if the costs of inputs are raised on account of the indirect taxes levied on them. This snow balling or pyramiding effect which is also referred to as 'cascading' raises the price of the final product to consumers by more than the sum total of the different taxes levied at intermediate stages. The same amount of revenue may be realised with a smaller rise in the price of the final product and therefore, a lower burden on the consumer, if a non-cumulative type of tax was imposed at the final stage of production, that is, on the finished product.²

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1. Value Added Tax is a tax only on the value added at every stage of manufacture- this method avoids the problem of double counting. The Raj Chelliah Committee on Tax Reforms, 1992-93 has particularly stressed on the importance of VAT.
2. Report of the Raj Chelliah Committee on Tax Reforms, Final Report, part 1, August 1992, p.37.

Implementation of VAT

To facilitate the implementation of VAT the following measures are important:³

1. Most manufactured goods (including certain services) should be brought under the purview of excise duty.
2. The rates on certain commodities should be reduced as the existing rate is too high, e. g., paints and dyes.
3. Extension of MODVAT⁴ credit to all inputs used in the production of taxable commodities.
4. Services used by the productive concerns should be covered by VAT.
5. Gradual reduction in the number of rates moving them towards three rates between 10 and 20 per cent, for all goods that would be covered by the VAT system.

The ideal solution would be to have a single VAT at the central level, reaching down to the retail stage in replacement of most indirect taxes- the Central Excise, the State Sales Tax etc. Proceeds of VAT will be shared among the three levels of government. Having only two major taxes, the income tax and the VAT, would also mean greatly reduced cost of compliance to business and industry as well as lesser obstacles to the fast growth of the economy.⁵

Administrative Efficiency -An Immediate Concern

The implementation of the recommended broad based excise duty would require a 'clean up' in the administrative system. The hurdles identified by the Raj Chelliah Committee⁶ include-

- a complicated code of rules and procedures in the Central Excise and Salt Act and Rules, 1944.
- procedures not keeping pace with changes in the administrative structure.
- inadequate inspection system.
- lack of training of officers and improper placement of officers.

3. *Ibid.*, p.39.

4. MODVAT or Modified Value Added Tax was introduced from 1 March, 1986 in part AA, Chapter V of the Central Excise Rules, 1944. This scheme permistinstant credit on particular inputs used in the manufacture of final products that are liable to excise duty.

5. *Supra* n. 3 at p. 46.

6. Report of the Raj Chelliah Committee on Tax Reforms, Final Report, Part II, January 1993, p. 139.

To establish administrative efficiency, an annual review must be conducted as regards inspection methodology, audit procedures, training etc. Such a review should be carried out in compliance with reforms in the duty structure.

Tax Reforms Till Now -A Review

The impact of the reforms have been adverse in the case of the Centre. Over the years 1991-92, 1992-93 and 1993-94, the Centre's gross tax revenue registered an average growth of 10.2 per cent as against a growth of 15.4 per cent during 1985-86 to 1990-91.

As is evident from Table A, direct taxes in the Centre's revenue have witnessed a growth from 12.1 per cent in the early 1980s and 15.6 per cent in the later half, to 24.8 per cent in the years of reforms. Unfortunately, the revenue from indirect taxes has experienced a decline revenue growth from customs and excise, which together accounted for over 75 per cent of the gross tax revenue of the Centre until recently, has dropped to a mere 3.1 per cent and 9.1 per cent respectively following the reforms as against 16.6 per cent and 14.2 per cent in the immediately preceding five years.⁷ Thus, the tax structure at the Centre has undergone an undesirable change.

Table-A⁸

GROWTH RATES ON MAJOR HEADS OF REVENUE

	Corporation Tax	Personal Income Tax	Customs	Union Excise
1994-95 (over 1993-94 RE) (per cent)	18.9	15.9	12	15.6
Growth observed in the preceding three years:				
1993-94	18.0	20.4	(-)	3
1992-93	13.3	17.2	6.8	9.7
1991-92	47.2	25.2	7.8	14.7

7. Amresh Bagchi, 'India's Tax Reform -A Progress Report', Vol. XXIX, no. 43, EPW, p. 2809, 1994, at p. 2812.

8. *Ibid.*, p.2812.

Tax reforms have been extremely successful in countries such as Bolivia—where its tax revenue increased from a mere 3 per cent in 1983 and 1984 to 13 per cent of Gross Domestic Product (GDP) by 1986 and 17 per cent in 1987. As discussed above, the Indian situation is rather complex—in the light of the domestic resource constraints and the Finance Minister's commitment to the International Monetary Fund (IMF) to bring down the fiscal deficit, the major brunt will have to be borne by excise duties.⁹

Conclusion

With the complex tax structure of the Indian economy, one finds that there has been a prominent shift in the desired direction with a pronounced upward trend in the share of direct taxes in the Centre's revenue. Yet, with the reforms in the background of the NEP, revenue growth as a whole has suffered. There is an urgent need for growth in indirect taxes, particularly excise which, in turn, requires a VAT on a comprehensive basis. The reduction in rate of duty should be offset by the overall benefit of the NEP. That is, the tax net should be wide enough to accommodate such a change by a widening in the tax base.

Thus, the realm of excise law must be harnessed further in compliance with the recommendations of the Raj Chelliah Committee on Tax Reforms to promote the objectives of the NEP in India.

9. Ravinder Goel, "Balance of Payments Problem - Selective Measures hold the key", Vol. XXVII, no.7, EPW, 1992, at p. 323.