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REFORMS IN INDIRECT TAXATION IN INDIA

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ABSTRACT
Tax systems the world over have undergone significant changes during the last twenty years as many countries across the ideological spectrum and with varying levels of development have undertaken reforms The wave of tax reforms that began in the mid-1980s and accelerated in the 1990s was motivated by a number of factors. In many developing countries, pressing fiscal imbalance was the driving force. Tax policy was employed as a principal instrument to correct severe budget deficits. Therefore, the present paper tries to review the indirect tax reforms in India. And also it has made an attempt to analyse evolution of Indian tax structure along with central level as well as state level tax reforms that have changed the present tax system in India.

KEYWORDS
tax systems, reforms, indirect tax, tax policy, budget deficit, fiscal imbalances.

INTRODUCTION
Tax systems the world over have undergone significant changes during the last twenty years as many countries across the ideological spectrum and with varying levels of development have undertaken reforms The wave of tax reforms that began in the mid-1980s and accelerated in the 1990s was motivated by a number of factors. In many developing countries, pressing fiscal imbalance was the driving force. Tax policy was employed as a principal instrument to correct severe budget deficits.

In others, the transition from a planned economy to a market economy necessitated wide ranging tax reforms. Besides efficiency considerations, these tax reforms had to address the issues of replacing public enterprise profits with taxes as a principal source of revenue and of aligning tax policy to change in the development strategy. And apart from that internationalization of economic activities arising from increasing globalization was another motive to undertake tax reforms. On the one hand, globalization lead to significant reduction in tariffs, and replacements had to be found for this important and relatively easily administered revenue source. On the other, globalization emphasized the need to minimize both efficiency and compliance costs of the tax system. The supply-side tax reforms of the Thatcher-Reagan era also had their impact on the tax reforms in developing countries.

The evolution of the Indian tax system was driven by similar concerns and yet, in some ways, it is different and even unique. Unlike most developing countries, which were guided in their tax reforms by multilateral agencies such as the International Monetary Fund, Indian tax reforms have largely borne a domestic brand. They have been calibrated to changes in the development strategy over time while staying in step with the institutional arrangements in the country. Thus, even when the government sought assistance from multilateral financial institutions, the recommendations of these institutions did not directly translate into an agenda for tax reform. Despite this, the tax system reforms were broadly in conformity with international trends and advice proffered by expert groups and was in tune with international best practices. Inevitably tax policy in the country has responded to changing development strategy over the years. In the initial years tax policy was guided by a large number of demands placed on the government. These demands can be summarized as the need to increase the level of savings and investment in the economy and hence the need to stimulate growth and ensure a fair distribution of incomes. That in turn meant an effort to raise taxes from those with an ability to pay, with little regard for the efficiency implications of the chosen instruments for the purpose.

The role of history and institutions was also important in shaping India's tax system. Indeed, the nature of the federal polity, the assignment of tax powers, and tax sharing arrangements have influenced the incentives for revenue mobilization and the structure and administration of the taxes in both central and state governments. The overlapping tax systems have made it difficult to enact and implement comprehensive and coordinated tax reforms. Another legacy of the era of planning is selectivity and discretion both in designing the structure and in implementing the tax system. These contributed to erosion of the tax base, created powerful special interest groups, and introduced the concept of "negotiated settlement" into the tax system.

In a closed economy, inefficiencies did not matter and relative price distortions and disincentives to work, save, and invest did not warrant much consideration. Because of the size of the country, its multilevel fiscal framework, the unique reform experience, and difficulties in calibrating reforms posed by institutional constraints, the Indian tax reform experience can provide useful lessons for many countries. The reforms, by themselves, are important enough reason for a detailed analysis of the tax system in India. Unfortunately, unlike in many developed countries where major tax reform initiatives were followed by detailed analysis of their impact, no serious studies analyzing the economic impact of tax reforms have been conducted in India.

STATEMENT OF THE PROBLEM AND NEED FOR THE STUDY
Tax systems world over have undergone major changes during 20th and 21st century. India is one of the forerunners of countries which have implemented tax reforms. Indian tax structure has number of underpinning problem like tax evasion, lack of administrative efficiency, multiplicity of taxes, e.t.c which have created administrative as well as implementing problems for the smooth function of the economy. Therefore, the present study had made an attempt to review indirect reforms in India to analyse whether the tax reforms which were implemented so far in India have reduced the problems encountered in earlier tax system.

OBJECTIVES OF THE STUDY
The present study aimed to achieve the following general as well as specific objectives.
1. To review the evolution of Indian tax structure
2. To review the indirect tax reforms in India.
3. To analyse the share of direct and indirect taxes in combined total tax revenue of centre and states in India.
4. And finally to examine the trends in growth of direct and indirect revenue in combined total tax revenue of centre and states in India.

METHODOLOGY AND DATA SOURCES
The present mainly depends on the secondary data from obtained from various issues of RBI hand book on Indian economy and state finances and the methodology was used in this study includes percentages, figures and trend lines.

EVOLUTION OF INDIAN TAX STRUCTURE
India's tax structure is quite extensive. Now almost every conceivable direct and indirect tax is levied in this country. In terms of the ratios of tax proceeds to GDP, India is one of the modestly taxed countries. And, if today the government feels that its resources are inadequate and it has no choice but to have resources to public debt and deficit financing, it is mainly due to its colossal unproductive expenditure and complete indifference to the canon of economy. As far as tax structure is concerned, the following features are notable in India's tax system.

TAX BUOYANCY

Tax buoyancy is a measure of the responsiveness of tax receipts to GDP. A tax is buoyant when tax revenues increase by more than 1 per cent for a 1 per cent increase in GDP. NIPFP conducted a study on buoyancy of Indian tax system for period 1970-71 to 1983-84. And the study revealed that the buoyancy of total tax revenue was greater than unity (1.21) over the period. As per RBI estimation the tax buoyancy for the period 1981-2001 was 1.19 per cent for direct taxes and when compared with 1.07 per cent of pre- tax reforms period 1981-93. However, the buoyancy of indict taxes was dipped considerably from 0.88 per cent to 1.07 per cent during the period. As per Economic Survey 2012-13 in the post FRBM period (2003-04) both direct and indirect taxes remained buoyant except in crisis period (2008-10) and 2011-12. During 2011-12, both direct and indirect tax revenue grew at slower rate than the budget estimates due to economic slowdown in 2010-11.

EQUITY

India's tax structure as whole is said to be progressive, though it is never disputed that some individual indirect taxes are highly regressive. Small personal incomes are exempted from personal income tax, and as income rises the tax rate also progressively rises. Indirect taxation as a whole is said to be regressive due to its major in public revenue.

ADMINISTRATIVE EFFICIENCY

As far as administrative efficiency is concerned the India's tax system is not so efficient because of its highly complex nature and uncertainty which resulted in tax evasion. And moreover, there are definitional defects in India's tax systems which give elaborate powers to tax authorities to interpret tax laws according to their whims and fancies. This has resulted in wide spread corruption in various departments.

MULTICITY OF TAX LAWS AND LACK OF INTEGRATION

There is multicity of direct and indirect taxes in India. For example, the tax on income and the annual wealth tax may place in the category of direct taxes. It is often suggested that they should be integrated into a single direct tax. Budget for 2009-10 proposed adoption of direct tax code to increase tax GDP ratio and tax compliance and to brought all the direct taxes into a single code, unified compliance procedures, which will eventually pave the way for a single united taxpayer reporting system. There is no integration in indirect taxes too.the excise duties have been levied primarily by central government, the sales taxes by state and Octroi by local bodies. According to the indirect taxation enquiry committee, there is little coordination among them. In its opinion, Octroi is unnecessary and should be abolished and excise duties and sales tax should be replaced by Value Added Tax. The Chelliah Committee had also recommended the introduction of VAT. The government has initiated measures in this direction. At the Central Level Central Value Added Tax (CENVAT), and at the State level State Value Added Tax (SVAT) have been introduced. The central sales tax is also being phased out. It is to be replaced by Goods and Service Tax (GST).

INTER-SECTORAL IMBALANCES IN THE TAX STRUCTURE

There are grave inter-sectoral imbalances in India's tax structure as agricultural incomes are virtually tax free. At the time of independence, there were not many people engaged in agriculture whose incomes could be liable to pay income tax. But after land reforms were initiated and new technology was adopted in agriculture, a new class of farmers emerged. Incomes of these people are fairly high, and yet they are tax free. These developments during the past four decades have created inter-sectoral imbalances in the tax structure. Indirect taxation enquiry committee recommended to introduction of agricultural holding tax based on the agricultural productivity. But still the state governments are inclined to introduce this tax duo political lobbying.

THE BURDEN OF TAX EXEMPTIONS

A large number of exemptions have been provided over the years on various grounds like, promoting economic growth, skill up-gradation, distribution of industries etc., this led to huge revenue losses to the government along with distort resource allocation and stunt productivity. For instance, The tax foregone on account of exemptions under personal income tax for the individual taxpayer was estimated at Rs.30, 653 crore and Rs.35, 698 crore respectively in 2010-11 and 2011-12.

TABLE 1.1: COMPOSITION AND SHARE OF DIRECT AND INDIRECT TAXES IN TOTAL TAX REVENUE OF COMBINED CENTRE AND STATES IN INDIA (In Rs. Billion)

Year	Direct Taxes	Indirect Taxes	Total Revenue	Direct Taxes as % of Total Tax Revenue	Indirect Taxes as a % of Total Tax Revenue
1986-87	79.22	415.36	494.58	16.02	83.98
1987-88	86.65	483.85	570.50	15.19	84.81
1988-89	112.65	556.77	669.42	16.83	83.17
1989-90	130.28	644.69	774.97	16.81	83.19
1990-91	142.67	733.60	876.27	16.28	83.72
1991-92	190.47	837.22	1027.69	18.53	81.47
1992-93	224.84	920.78	1145.62	19.62	80.48
1993-94	253.10	964.60	1217.70	20.78	79.22
1994-95	338.68	1124.18	1462.86	23.15	76.85
1995-96	414.76	1312.64	1727.40	24.01	75.99
1996-97	471.79	1501.26	1973.05	23.91	76.09
1997-98	546.26	1597.46	2143.72	25.48	74.52
1998-99	572.44	1727.27	2299.71	24.89	75.11
1999-00	709.37	2006.07	2715.44	26.12	73.88
2000-01	811.63	2198.09	3009.72	26.97	73.03
2001-02	848.76	2240.71	3089.47	27.47	72.53
2002-03	1003.02	2517.16	3520.18	28.49	71.51
2003-04	1253.03	2827.96	4080.99	30.70	69.30
2004-05	1568.28	3285.47	4853.75	32.31	67.69
2005-06	1954.28	3811.66	5765.94	33.89	66.11
2006-07	2690.78	4549.45	7240.23	37.16	62.84
2007-08	3556.89	5218.07	8774.96	40.53	59.47
2008-09	3779.86	5483.18	9263.04	40.80	59.20
2009-10	4248.74	5597.37	9846.11	43.15	56.85
2010-11	5087.19	7413.48	12500.67	40.69	59.31
2011-12	5712.46	8715.05	14427.52	39.59	60.41
2012-13	6512.27	10367.31	16879.58	38.58	61.42
2013-14	7464.51	11744.23	19208.74	38.86	61.14
2014-15	8518.65	13510.20	22028.86	38.67	61.33

Source: RBI Hand Book of Statistics on Indian Economy and RBI hand book on state finances various issues.

FIGURE 1.1: TRENDS IN GROWTH OF DIRECT AND INDIRECT TAX REVENUE IN COMBINED CENTRE AND STATES TAX REVENUE IN INDIA

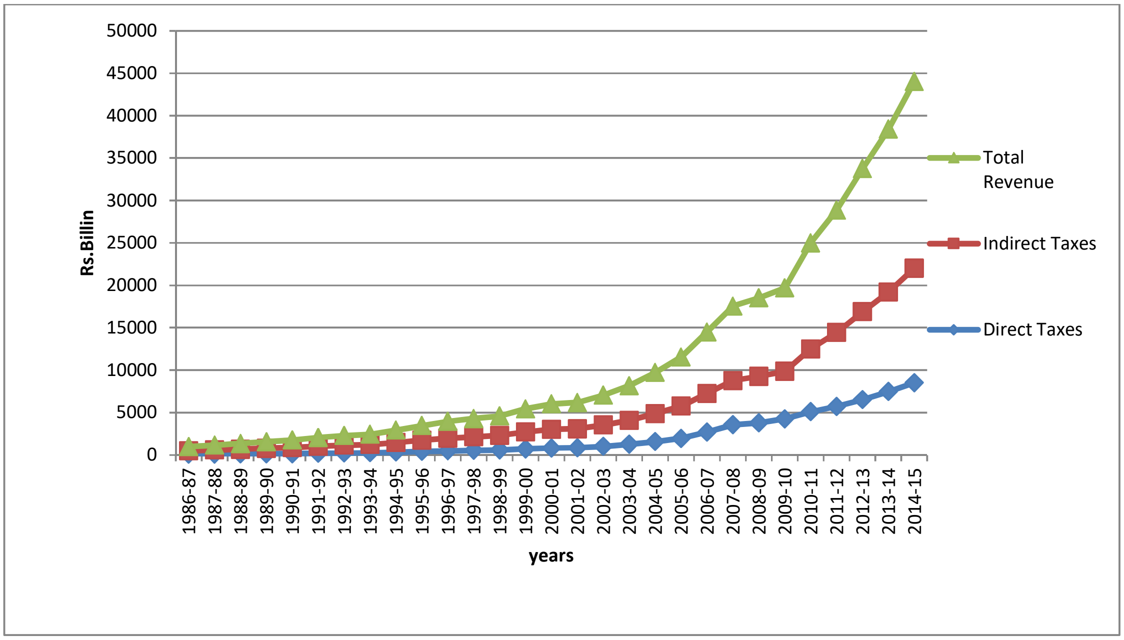
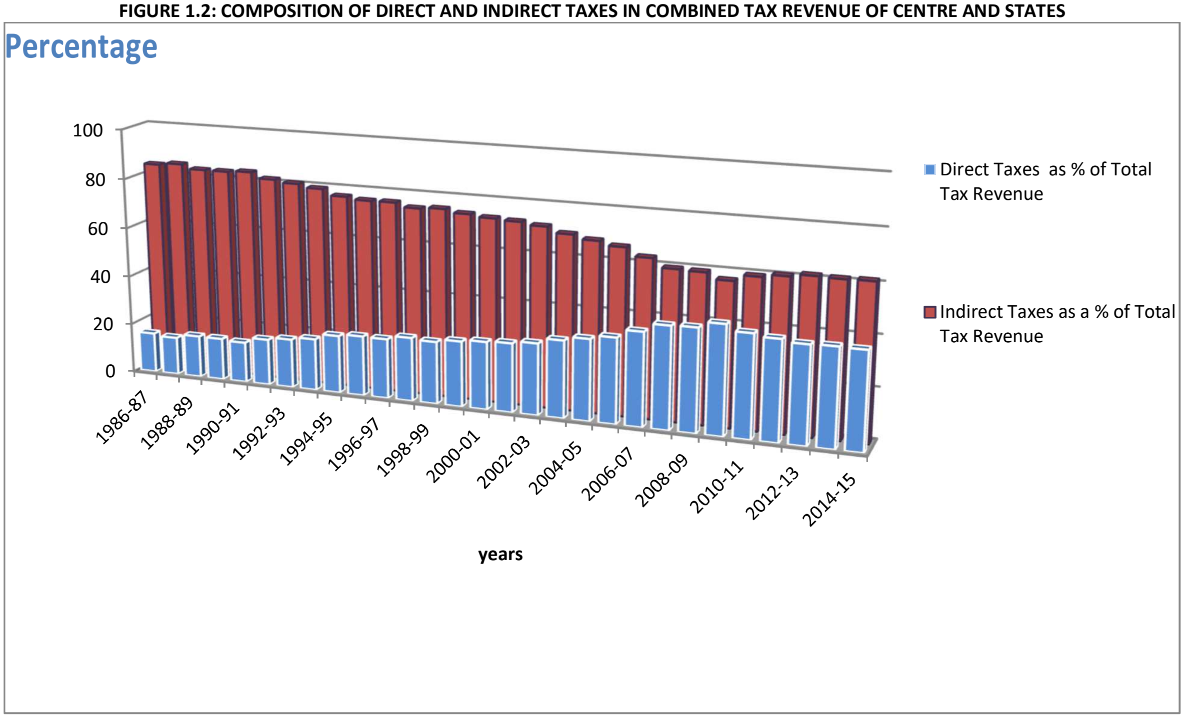


FIGURE 1.2: COMPOSITION OF DIRECT AND INDIRECT TAXES IN COMBINED TAX REVENUE OF CENTRE AND STATES



It is evident from the Table-2.1 that the combined Centre and States total tax revenue has been increased from Rs. 494.58 billion in 1986-87 to Rs. 876.27 billion in 1990-91 and in that revenue from indirect taxes has been occupied more than 80 per cent. This is because agriculture was the predominant sector during pre-reform era. That is why all the governments were mostly depended on indirect taxes than direct taxes to finance their budget along with other objectives like reducing inequalities between rich and poor, controlling consumption and promotion of savings, etc.

But during post-reform period that is from 1991-92 onwards the total combined tax revenue of Centre and States has been increased from Rs. 1027.69 billion in 1991-92 to Rs. 22028.86 billion in 2014-15, during these two decades total revenue of combined centre and states increased more than 21 times. And in that the share of direct taxes was increased from 16.28 per cent in 1990-91 to 38.67 per cent in 2014-15 and at the same time the share of direct taxes was reduced from 82.73 per cent to 61.33 per cent. This is because in post-reform period revenue from personal and corporate income tax has been increased due to growth and development of Industrial and Service sectors. Of course even today also indirect taxes have been occupying larger share in total revenue of combined centre and states that is around 61 per cent. This shows the relative importance of indirect taxes to direct taxes in a developing country like in India.

Figure -2.1, exhibits about the Growth or Trend of direct and indirect tax revenue along with combined tax revenue of Centre and States and it has shown an increasing trend from the beginning. And Figure-2.2, illustrates the composition of direct and indirect taxes in combined total tax revenue of the Centre and States. Though the per cent of indirect tax has decreased from 83 per cent in pre-reform period to 61 per cent in post- reform period, it still occupied larger portion of total tax revenue. And the overall trend has been depicted by the linear trend line in figure-2.2, and that shows there is decreasing share of indirect taxes in total tax revenue of Combined Centre and States. Of course economic reforms are the main cause for the change that taken place in India's tax system that lead to rise in direct tax revenue compared to pre-reform era.

INDIRECT TAX REFORMS IN INDIA

The Indian tax system has undergone major structural changes since independence in 1947. It has become comprehensive and complicated over the years. It has successfully mobilized resources to finance developmental, welfare and administrative activities of public authorities. Besides being the main source of revenue, both for the Central and State Governments, it is an effective instrument to various socio-economic objectives of national policies. However, the tax system has been relying heavily on indirect taxes and suffering extensively from fiscal malady called tax evasion.

After independence, various committees have been appointed, from time to time, to review the India's tax system and to make it more suitable to the needs of developing economy. On April 1, 1953, the Government of India appointed the Taxation Enquiry Commission under the chairmanship of Jhon Matthai. The commission presented its landmark report in the following years. Of course Matthai commission was the first to undertake a systematic and comprehensive study of the incidence of Central and State indirect taxes on rural and urban households in different expenditure groups. And also the commission after having studied the then existing excise system, made an important recommendation in terms of commodity coverage.

And later The Indirect Taxation Enquiry Committee was constituted in July 1976, under the chairman ship of L. K. Jha for suggesting reforms in the indirect taxation system. The Jha committee found that the country's indirect tax structure as a whole was progressive, but there was little integration between individual indirect taxes. According to Jha committee, each indirect tax was levied independently of other indirect taxes. Moreover, these taxes lacked build in flexibility and every time when revenue collections had to be increased, upward revision in the tax rate was done. India's indirect tax structure was by and large uncertain and complex and its administration was difficult.

The committee recommended both short-run as well as long run measures to the existing indirect tax system in India. The committee expressed its opinion that the ad valorem taxes are superior to specific taxes duo to their higher income elasticity. Thus it recommended introduction of ad valorem taxes as far as possible. And it was also suggested for exemption of inputs from indirect taxes along with integration of indirect tax structure by replacing excise duties and sales taxes with a single commodity tax. And further the Jha committee opined that, Value Added Tax is the best of all indirect taxes due to its self-monitoring mechanism which assists tax administration and elimination of distortion in decisions by producers that arise from taxation of imports.

REFORMS IN CENTRAL INDIRECT TAXES

Tax reforms have been under taken in India as an integral part of Economic Reforms which were initiated in 1991 by the Tax Reform Committee headed by Raja.J.Chelliah. This is because in the pre-reform era, tax policies in India as in many other countries had retarded growth through creating distortions in the allocation of resources and adversely affecting incentives. The tax system that had evolved over the years had also become complicated, while there was not sufficient modernization of the tax administration. Consequently, tax compliance and tax enforcement had become extremely difficult. Too much of national resources were being used up in compliance as well as enforcement. The present paper tries to bring out indirect tax reforms that have been implemented so far India because of its relative importance in total tax revenue of the government.

The first major indirect tax reform at central level was initiated in 1986 through the introduction of the scheme of Modified Value Added Tax (MODVAT) under central excise, under which manufacturers could get credit for taxes they paid on inputs against the tax payable on output. All goods however, not covered by MODVAT scheme and originally the duties paid on plant and machinery were not eligible for credit.

Further reforms were carried out by the recommendations of Tax Reform Committee in the system of excise taxation. And so, attempts have been made to broaden the tax base, lower the rate structure and simplify the tax administration. The attempt was made to rationalize customs duty in terms of lowering the peak and average tariff rates, and reduction in their dispersion, and of excise duties in terms of the coverage of MODVAT facilities to larger number of commodities and capital goods in the budget for 1994-95 and also service tax was introduced in the same year on telephone services, general insurance and on share broking at 5 per cent. These reforms surely led to improvement in the structure of central taxes. And further, in the budget for 2000-01, the Finance Minister replaced the multiple MODVAT system by a single Central Value Added Tax (CENVAT) to pave the way for eventual adoption of VAT.

It is generally agreed that the Central Sales Tax (CST), being an origin based non rebatable tax, is inconsistent with the concept of VAT and needs to be phased out. After deliberations with the empowered committee of state, the road map for this has been finalized. This provides for a gradual phase out by reducing the CST rate from its level of 4 per cent with effect from April 1, 2007, in phases. One critical issue involved in phasing out of CST is that of compensating the states for revenue losses on account of such phase out. To tackle this problem, the central government has prepared compensation scheme. And it is further proposed to introduce combined national level Goods and Service Tax (GST) to evolve an efficient and harmonized consumption tax system in the country. GST is similar to the concept of State level VAT for goods. It provides for input tax credit at every stage for tax paid till the previous transaction. And also GST will attempt to provide a rational system by subsuming several states and central level indirect taxes on goods and services.

STATE LEVEL TAX REFORMS

With the reforms of central taxes, the focus was shifted to the reform of state taxes, particularly the sales tax. This was because, the sales tax contributes nearly 60 per cent of the State's Own Revenues and almost one third of the domestic trade taxes in the country. The past discussions pointed towards the need to transform the prevailing sales tax system into a consumption type Value Added Tax.

The relevance of State VAT has been under discussion ever since it was proposed by Indirect Taxation Enquiry Committee headed over by L.K.Jha in 1977. And after that, efforts were made to bring the states together to agree for transforming their existing sales tax system to VAT system at the state level. This issue attracted considerable attention. Towards forgoing a consensus, the Union Finance Ministry appointed a Committee of State Finance Ministers from 10 different state governments to work out the rationalization measures and to achieve a co-coordinated structure of sales taxation in the states. The Committees of States' Finance Ministers in 1995 and 1998 respectively and of the Chief Ministers in 1999 have put forth recommendations to replace sales tax by VAT.

The first major breakthrough in the direction of state indirect tax reforms came in the form of an agreement between Union Finance Ministers and the State Chief Ministers on November 16, 1999, with the following objectives.

1. Implementation of floor rates within the existing sales tax regimes.
2. Elimination of the tax based industrial incentives for new and expanding industries.
3. Replacing the existing system of sales tax with a VAT at the state level VAT.

On the basis of the above objectives, Empowered Committee comprising of nine State Finance Ministers was constituted on 17th July 2000 to monitor the decisions taken in Chief Ministers Conference. Empowered Committee further decided to rationalize the rate structure under VAT in the following manner.

1. Nil for certain goods.
2. 1% for gold, silver and precious stones.
3. 4% for certain essential goods and industrial inputs.
4. 20% for liquor and some petroleum products.
5. A Revenue Neutral Rates (RNR) of 10 to 12.5% for other goods.

In the budget 2002, the CST Act was amended and some of these amendments would help in implementation of VAT. The Central government has agreed upon to compensate the states for loss due to implementation of VAT in three consecutive years. And the compensation package for the first year is 100%, for second year is 75% and for third year is 50%.

The Committee recommended adoption of VAT from 1st April 2003. But, Haryana is the only state to introduce VAT from 1st April 2003. The target date for introduction of VAT was rescheduled in the meeting of Empowered Committee on June 18, 2004 with the new target set for April 1, 2005. During this period, the Empowered Committee of State Finance Ministers constituted to monitor the transition to the new tax regime through sustained deliberations, and at last 16 states have agreed to introduce VAT from 1st April 2005. It may be noted that the postponement of introduction of VAT from 1st April, 2002 to 1st April 2005 was due to various reasons such as divergent views on treatment of existing sales tax incentives already granted by states, treatment of Central Sales Tax under VAT, lack of commitment by central government at that time on compensating the states for loss in revenue etc. The important reason for postponement was lack of preparedness by the states. After a lot of persuasion by central government, VAT was introduced from 1st, April 2005.

CONCLUSION

The reforming of Indian tax systems is very essential in view of changes have been taken place in India since its independence. There are number of committees that have been appointed timely by the government of India to study the existing tax system and to give recommendations to increase government revenue, to improve tax compliance and to develop and modify the Indian tax system that suits to the requirements of the society. Of course the committees so far have been appointed suggested number of recommendations like introduction of new taxes, abolition of existing taxes that are more inefficient in terms of revenue generation, etc. the government of India has been implemented those recommendations in selective manner due to some administrative, political and structural problems. But the reforming of any system like Indian tax system is a continuous process which will bring more and more reforms in future too to make Indian tax system more efficient and that system will make India as a developed country.

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