

MODVAT—Howazzaatt ?

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Section F

MODVAT (modified system of added value of taxation) is a new phenomenon in the offing on the Indian economic horizon. Modvat is on the anvil to eliminate the "cascading effect" of our extended system of taxation where both inputs and final products are leviable to duty. Duties are levied both on inputs (raw materials, components and other intermediates) as well as on final products and calculations of duties are made on *ad valorem* basis. When an input is subjected to duties, manufacturer who uses it needs larger amount of working capital to maintain the necessary inventory. In the process, the cost of final product and the requirement of finance go up. Thus, the snow balling effect technically called as cascading effect of taxes raises the cumulative incidence on a final product more than the sum total of the nominal taxes at different stages add upto. So created cascading effect has a number of consequences disfavouring Indian industry and deleting the path leading to the 21st century of necessary friction and thus causing the said-sideways.

Some of those consequences are - cumulative tax burden is worked out substantially higher than the duty at the nominal rates; the difficulty of determining or controlling the incidence of duties on final products; encouragement to vertical integrations of industries which adversely affects ancillarisation; export efforts suffer due to high cost all round.

A number of expert committees have examined the problem of cascading at great length. Some of the measures suggested include a set-off of duties paid on inputs and introduction of MODVAT. Indeed, some progress in the direction of set-off has already been

made. Under the present system of excise taxation relief from input taxation is available in three ways. First, all inputs from Tariff Item 68 are eligible for set-off, provided the inputs are used in the production of excised commodities. Secondly, under Rule 56 A within each Tariff Item duty paid on inputs within the same item is available as proforma credit. Thirdly, there are a number of other provisions granting duty relief for specified inputs used in the production of excisable commodities.

The Indirect Taxation Enquiry Committee of 1978, under the chairmanship of Sh. L. K. Jha, which went into the long term measures for indirect tax reforms, felt that VAT (value added taxation) enabled the country to have an extended system of taxation and yet avoiding cascading. After examining the pros & cons, the Jha Committee felt that a VAT could be applied at the manufacturers' stage in lieu of the present excise system and could be extended to cover inputs.

Advantages of VAT

First, it ensures that the input is taxed only once and as such cascading effect is avoided.

Secondly, it is neutral and does not distort or favour any particular method of production. At the same time, if so required, different VAT rates can accord differential treatment.

Thirdly, VAT is broad based and consequently the rates are relatively lower also due to complete elimination of the hidden spiral element of taxes. This is so because it covers a wide range of commodities and services and is leviable at all stages of production, supply and consumption. At the final stage of consumption it gets completely shifted to the consumer.

Fourthly, VAT provides momentum for the growth of ancillary industries because a well managed large unit will not like to drain out resources by way of tax if it purchases components and services from ancillary or small unit, rather that unit will be tempted to go in for vertical integration of operations as it reduces tax liabilities to a great extent. This factor has contributed much to the economic growth of Japan.

Fifthly, VAT enables identification of tax components separately. As a result, the entire tax, when necessary, can be rebated or refunded, for instance, on export goods etc.

Sixthly, VAT collection cost is substantially lower as compared to the sum of the costs incurred on collection of different type of duties.

Disadvantages of VAT

Hard on the heels of some well earned encomiums showered on VAT for its above mentioned features come the rather disquieting feature that puts the same VAT on the mat

for its dismal feasibility on Centre-State-Local Governments front and some other non-economic hurdles.

First, the problem of accounting and keeping of VAT records particularly in a country like India where the level of literacy is not high.

Secondly, VAT presupposes taxing powers vested in one authority but country like ours where the taxing powers are shared by the Centre, the States and the Local Self Governments, formidable practical considerations of incorporating such tax authorities into centrally administered VAT is really mind boggling.

Thirdly, at a developing stage, a neutral tax cannot be advocated because of the need for directing the investment etc. on national priorities and as such, there would be necessity of having number of VAT rates which can be problematic. Also, when there is a significant exempted sector, there can be problems in availing the tax credits.

Announcing the long term fiscal policy, the Minister for Finance, Mr. V.P. Singh assured of implementing MODVAT programme in a phased manner over a period of years, taking due account of the revenue implications, the need to revise administrative procedures and the lessons from experience gained in the early stages of the reforms.

The Finance Minister further declared, "It must be emphasized that the MODVAT programme is intended to be broadly revenue neutral. It is not the purpose to use MODVAT to give substantial net reliefs on excise. The loss of duty on inputs will be recouped through higher excise taxation on final products. Indeed, shifting the burden of excise taxation away from inputs onto final products is at the heart of the proposed reform. A side from reducing distortionary effects on production and thus increasing the competitiveness of Indian industry, the shifting of excise to final product will help in tailoring excise duty (and countervailing duty) in such a manner that a well off bear a higher proportionate burden than the poor".