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INDIRECT TAX REFORMS IN INDIA AND A WAY AHEAD FOR GST

Jaiparkash
PhD. Scholar (Economics)

ABSTRACT

VAT is an improvement over the existing union excise duty at the central level and over the sale tax at the state level while GST is a further improvement over the existing VAT which is yet to be implemented most probably in the coming financial year as promise made by our union finance minister. The new GST will ensure the greater uniformity in the tax rates throughout the country and will end the cascading effects. The objective of this paper is to trace the progress of India's indirect tax reforms from an origin-based CST to a proposed destination based GST.

Key Words: GST, VAT, MODVAT, CENVAT, ITC, TRC, CASCADING EFFECT.

INTRODUCTION

Taxes are not a new phenomenon; they are as old as civilisation itself. The history of Indian taxation goes back to ancient period when we found certain reference about taxes in many old book like Arthshastra written by Kotilya popularly known as Chankya. This book provides very valuable information regarding how to govern and rule. According to Arthshastra, in ancient time taxes were levied and collected in both cash and kind. Taxation Policy has been a widely debated issue all over the world and a large number of studies have been conducted covering different aspects of indirect taxes. Indirect taxes are also known as commodity taxation. The impact and incidence of indirect taxes may be on different persons and that's why the burden of indirect taxes can be shifted. A fixed proportion of the taxes collected by the Centre devolve to the states, based on the recommendations of the Central Finance Commission.

The wave of tax reforms across the world was began in mid1980s, but as far as India is concerned the true and systematic efforts regarding the tax reforms were initiated in 1991 when the government of India appointed a high level committee of experts in August 1991 under the chairmanship of Prof. J.Challiah which is popularly known as (TRC) Tax Reform Committee or Challiah Committee. Most of the recommendation of this committee has been accepted and included in the budget proposal of 1993-94. In 1991 Indian economy was passing through the economic crisis, balance of trade and balance of payment was negative, fiscal deficit and revenue deficit was mounting, inflationary pressure were historically high, foreign exchange were barely sufficient to meet the overnight import requirements of necessity goods and we were losing faith in the international market. In this panic situation to pull the economy out of crisis and to put it on the right path of economic development a wave of liberalisation, privatisation and globalization was initiated which is popularly known as economic reforms. Tax Reforms Committee 1991, chaired by Mr. R. J. Chelliah, was also a step regarding the structural changes initiated by the government of India. Until then, the efficiency of the indirect tax system and compliance levels were severely compromised by very high rates of duty, coupled with a large number of exemptions for meeting a variety of socio-economic objectives. Such a tax structure was not conducive to achieve high economic growth.

Apart from this, the tax reforms 1991 was motivated by a number of factors such as pressing fiscal imbalances, to correct severe budgetary pressures, transition from a planned economy to a market economy, internationalization of economic activities arising from globalization, which emphasized the need to minimize both inefficiencies and compliance costs of the tax system. The tax system in India is mainly a three tier system which is based between the central, state and the local government organizations. In most cases, these local bodies include the local councils and the municipalities. Article 246, of the Indian Constitution, distributes legislative powers including taxation, between the Parliament and the state

legislature. Schedule VII enumerates these subject matters with the use of three lists; Central List- entailing the areas on which only the parliament is competent to makes laws, State List - entailing the areas on which only the state legislature can make laws, Concurrent List - entailing the areas on which both the Parliament and the State Legislature can make laws upon concurrently.

Review of Literature

Reforming the tax system is critical to achieve fiscal consolidation, minimise distortions and to create stable and predictable environment for the market to function. In many developing countries, tax policy was directed to correct fiscal imbalances (Ahmad and Stren, 1991). In other words the transition from centralised planning to market oriented economy required wide ranging tax reforms to replace public enterprise with taxes as principal source of revenue. On the other hand globalisation emphasised the need to minimise both inefficiency and compliance cost of tax system. In the initial years, the tax policy was directed to increase the level of savings, transfer available savings for investment as envisaged by plan strategy and the need to ensure a fair distribution of income, to correct inequalities arising from the oligopolistic market structure, exchange control and administered price determination (Bagchi and Nayak, 1994).

Firstly, the sale tax is levy on commodities which in most cases, are subject to excise duties Bagchi, (1996). As excise duty and sale tax are levied by the different layers of government, it becomes difficult to determine judiciously the impact of these levies on production, investment and the consumers. No attempt to rationalise commodity tax system can succeed if the centre and the states act independently without co-ordination among themselves. A closely related problem is the taxation of inputs and capital goods, by the central and state governments, through excise duty and sale tax respectively. The taxation of inputs and capital goods contribute to cascading (tax on tax) and vertical integration of firms (Rao and Rao, 2005).

Apart from generating cascading effect, sale taxation of inputs benefits the comparatively richer states at the cost of poorer states. The sale taxation of inputs

also means that its burden falls on consumers outside the state. The tax was refunded if a good was exported outside the country but sale tax on input was not rebated, in consequences the more developed states are able to derive additional resources, by taxing consumers in other states (Report of the Indirect Taxation Enquiry Commission, 1977).

Differential rates of sales tax on the same set of commodities in different states often lead to uneconomic diversion of trade and production centres. It was very common people make purchase from the low tax states and sale them in higher tax states so long as the cost of transporting goods are lower than the tax differential. This distorts natural selection of production centres based on geographical advantage. Such misallocation of resources undermines economic efficiency and thereby retards developmental efforts (Rao and Vaillancourt, 1994). Over all different rate of sale tax in different states (multi-point, double-point and single-point) with different procedures and rules cause difficulty for the traders, consumers and tax authorities and which further lead to corruption and litigation.

True and systematic efforts regarding tax reforms were started in 1991 when market based economic reforms were initiated to pull the economy out of crisis. The Tax Reform Committee (TRC 1991) came forward with a new framework and clear cut road map to bring changes in both direct and indirect taxes as a part of structural reforms by keeping in view the ongoing situation of the economy. The TRC put forward many changes in indirect tax structure like reduction in all major indirect taxes like excise duties, custom duties up to a reasonable extent so that it could not lead to tax evasion. It also recommended that the taxes on domestic production should be fully converted in to a value added tax, and should be implemented throughout the country in consultation with states.

In many ways the reforms since 1991, with emphasis on simplicity and efficiency make marked departure from the past. Lay stress on simplification of rules, regulations and procedures so as to reduce the compliance cost and to ensure a better and transparent tax system. Many changes were introduced to reform the tax administration. As it is one of the well

known fact that Indian tax administration was counted one of the most inefficient system. Corruption, red tapeism, delay and by favouritism are very usual features of Indian tax administration system even today, but the overall situation are far better than before as all these are the results of various tax reforms introduced in India from time to time.

Excise duty is associated with the production of goods in India and is meant for domestic consumption. By the middle of 1970s, the structure of excise duty was highly complex and distortionary and was a mix of specific and Ad-Valorem taxes. On the later alone there were 24 different rates varying from 2% to 100. The tax GDP ratio was quite low which are now in comfortable position. But with the implementation of the recommendations of TRC the regime of excise duties was made simplified and rationalised. Beside reduction in number of tax rates, the tax has been progressively converted from specific to Ad-Valorem levy. In 1999 - 2000 almost eleven tax rates were merged in to three with a handful luxury items. In 2000-01 there were further merged in to a single tax rate to be called (CENVAT) along with three special additional excise duties 8%, 16%, and 24% for few commodities.

A main feature of excise duty is that like corporation tax, a major proportion about 40% of total collection is paid by public sector enterprises and it is of fluctuating nature year after year. The fluctuation is due to the fluctuations in administered price on items such as steel, coal, mineral and petroleum products etc. Contribution from custom duty was not enough in the initial years of independent India due to various quantitative restrictions on imports. The Customs Act was formulated in 1962 to prevent illegal imports and exports of goods.

Till 1990-91 the tariff structure was highly complex varying from 0% to 400%. Peak rate was brought down from 400 to 50% by 1995-96. India has also lifted quantitative restrictions on imports under WTO obligations. The peak rate of import duty has been brought down over the years however the tariff rate is still high and Indian industry is highly protected. With regard to import duty, reforms process required further reduction and unification of rates. Equally important is to face out

most of the concessions and exemptions available along with excise duty and import duty which creates all round complexities and eroded the tax base.

Until 2003 India's constitution did not explicitly recognize and assign to any level of government the power to tax services. However, since all residuary tax powers were assigned to the central government, in 1994, this authority became the basis for levying a tax on selected services.

At the state level, converting the sale tax in to VAT has been completed by allowing for input tax credit not only for intra-state sale and purchase but also for inter-state transactions. The local level tax reforms like abolition of octrio and other surcharges have been abolished as there is no place for these age old practices in the modern tax system. More has been done to reform the tax administration so as to increase the net tax revenue and reduce the compliance costs and to make it more transparent and tax payer friendly. So many new steps like computerisation of tax returns, strengthen the information system, online Tax Accounting System (OLTAS), the Customs e-commerce gateway (ICEGATE), Customs Electronic Data Interchange System (ICES) has helped to improve the information system and speed up clearance process.

Under the constitution the state government has the power to levy and collect taxes on sale or purchase of goods with in its territory according to the rules framed by it. As per the CST (Central Sale Tax) Act 1956, this prevailed prior to the introduction of VAT different states used to levy different rate of tax on wide range of goods with diverse procedure and rules for its collection. However the central government has intervened by preventing the states taxing in the course of inter-state trade and commerce.

Table 1: Tax Revenue of State Governments (in Billion Rs.)

Years	Total Revenue receipts	Tax Revenue	Sales Tax	State Excise Duty	Share in Central Taxes
1990-91	664.67	445.86	176.67		142.42
1991-92	805.36	526.04	210.64	54.39	168.48
1992-93	910.9	604.48	233.49	62.65	205.8
1993-94	1049.97	682.69	272.27	70.09	223.95
1994-95	1203.03	788.32	318.83	74.39	248.85
1995-96	1345.07	908.02	367.04	81.8	290.48
1996-97	1500.41	367.04	421.12	83.58	350.38
1997-98	1668.2	1186.99	468.13	107.56	404.11
1998-99	1727.87	1253.28	510.03	128.61	394.21
1999-00	2029.27	1432.72	599.55	144.66	441.21
2000-01	2325.09	1643.14	699.76	154.79	507.34
2001-02	2494.22	1754.15	731.81	165.04	522.15
2002-03	2736.74	1934.74	821.55	182.68	566.55

2003-04	3091.87	2211.17	931.72	189.28	670.8
2004-05	3635.12	2605.77	1115.54	210.96	785.5
2005-06	4310.21	3063.32	1287.69	250.36	940.24
2006-07	5305.56	3728.41	1535.73	293.16	1202.93
2007-08	6237.48	4379.48	1734.22	341.27	1514.02
2008-09	6946.57	4829.83	1983.27	409.9	1610.52
2009-10	7681.36	5280.75	2206.44	483.75	1650.14
2010-11	9353.47	6801.98	2788.38	591.69	2194.89
2011-12	11414.69	8111.92	3419.85	708.11	2597.37
2012-13	13309.78	9472	4034.02	827.44	3021.88

Source: Budget documents of the State Governments.

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Table: 2 Tax Revenue of Central Governments (in Billion Rs.)

Year	Tax Revenue	Direct Tax	Indirect Tax	% Share of Indirect taxes	Excise Duty	Custom Duty
1990-91	429.78	69.03	360.75	83%	141	206.44
1991-92	500.69	101.03	399.66	80%	160.17	222.57
1992-93	540.44	120.75	419.69	78%	163.67	237.76
1993-94	534.49	125.22	409.27	77%	172.24	221.93
1994-95	674.54	184.09	490.45	73%	210.64	267.89
1995-96	819.39	222.87	596.52	72%	221.76	357.57
1996-97	937.01	253.74	683.27	72%	428.51	325.78
1997-98	956.72	271.72	685	71%	255.16	401.93
1998-99	1046.52	321.2	725.32	69%	285.81	406.68
1999-00	1282.71	414.36	868.36	67%	349.44	484.19
2000-01	1366.58	496.51	870.07	63%	497.58	341.63
2001-02	1335.32	477.03	858.28	64%	544.69	283.4
2002-03	1585.44	616.12	969.32	61%	623.88	318.98

2003-04	1869.82	765.9	1103.92	59%	702.45	345.86
2004-05	2247.98	959.44	1288.54	57%	772.41	418.11
2005-06	2702.64	1206.92	1495.72	55%	866.42	466.45
2006-07	3511.82	1697.38	1814.44	52%	926.51	628.19
2007-08	4395.47	2315.74	2079.72	47%	961.78	753.82
2008-09	4433.19	2481.52	1951.69	44%	818.72	692.17
2009-10	4565.36	2716.23	1849.13	41%	843.83	602.23
2010-11	5698.69	3135.01	2563.67	45%	1102.22	975.98
2011-12	6297.69	3433.1	2864.54	46%	1162.26	1056.14
2012-13	7421.15	3973.45	3447.69	46%	1378.19	1154.51
2013-14	8840.78	4728.61	4112.17	47%	1572.26	1310.94

Source: Budget documents of the Government of India and Finance Accounts (various issues).

Value Added Tax: Central and the State level

Prior to tax reforms initiated in 1991, sale tax was characterised by a multiplicity of tax rate and exemptions, lack of uniformity across states, large numbers of concessions and exemptions and differing procedure for tax collection. Many states modified their sale tax regime to launch a state level VAT under the scheme prepared by

Empowered Committee for this purpose. VAT is working in more than 150 countries of the world. Keeping in view the importance of VAT and its worldwide acceptance, India too decided to adopt and implement the VAT throughout the country. In India, VAT was first introduced at the Central level for a number of selected commodities in terms of MODVAT with effect from March 1, 1986, and in a step-by-step manner for all commodities in terms of CENVAT in 2002-03. At the state level VAT was introduced in 2005 and Haryana was the first state to adopt and implement the VAT. After overcoming the initial difficulties, all the States and Union Territories have now implemented VAT. Initially most of the states were opposing the adoption and implementation of VAT because of certain economic and political reasons.

Actually the introduction of VAT at the State level has been a more challenging exercise in a federal country like India, where each State, in terms of Constitutional provision, is sovereign in levying and collecting State taxes. Before introduction of VAT, in the sales tax regime there was no harmony in the rates of sales tax on different commodities among the States. Not only were the rates of sales tax numerous (often more than ten in several States), but different from one another for the same commodity in different States. There was also an unhealthy competition among the States in terms of sales tax rates – so-called "rate war" – often resulting in, revenue-wise, a counter-productive situation.

The experience of implementing VAT was quite encouraging and was welcomed by all stake holders. Inspired by the success of VAT the government of India indicated in February 2007 that the country should move towards a national level Goods and Service Tax (GST) at uniform rate throughout the country, covering both goods and services as name suggests. An announcement was made by Sh. P. Chidambaram, the then Union Finance Minister of India, in the Central Budget (2007–2008) to the effect that GST would be introduced from April 1, 2010 and that the Empowered Committee of State Finance Ministers, on his request, would work with the Central Government to prepare a road map for the introduction of

GST in India. After this announcement, the Empowered Committee had set up a Joint Working Group which has submitted its report on a model and road map for GST.

However some states are still opposing GST due to certain economic and political reasons. These are often vocalised by states which has a poor consumption base and who stand to lose on origin-based taxation of resources which they presently receive based on sale to other states. It cannot be denied there will be some losers immediately upon the implementation of the GST and shifting from origin base to destination base. It is therefore, imperative that the centre should come forward with a broad assurance for the provision of compensation for losing states as suggested by the empowered committee. Thus all these issues relating to the implementation of GST need to be addressed adequately.

GST will replace the existing VAT by merging most of indirect taxes under a single name which will be called as GST, goods and service tax which is yet to be implemented most probably in the next coming year. GST is likely to be VAT and will be collected on value addition of every transaction from production to distribution. GST will be levied on a single rate throughout the country on both goods and services. As GST is an indirect tax, the full and final burden of the tax will be on the consumer. One of the distinct feature of GST is that more and more services will be brought under the tax net which were not covered earlier.

Proposed GST model for India

GST is similar to VAT and can be termed as National Level VAT on goods, with one difference, in GST not only goods but services are also included and rate of tax on both goods as well on services will be the same. Most countries have a unified GST system I.e a single rate of tax applicable throughout the country. However in many federal countries like Brazil and Canada a dual GST system is working where GST is levied by both central and state governments. Almost all countries of the Europe have also adopted a dual GST system. Adoption of GST is one of the pre-condition for a country who wants to join the (EU) European Union. As far India is concerned we have adopted a dual GST system because of the federal

nature of our constitution in which the power has been divided between the centre and states. Thus in India under the dual GST system both centre and states will have the power to levy taxes on the sale of goods and services.

Key Features of GST in India

In India the GST will have two components one is levied by the centre, hereafter referred to as (CGST) central goods and service tax and other is levied by the state hereafter referred to as state goods and service tax (SGST). However the rate of CGST and SGST would be decided later on by keeping in view the revenue consideration and acceptability. The combined rate is expected to be 14 to 16 per cent. Currently it is the subject matter of discussion before the empowered committee (committee of state finance ministers). CGST and SGST would be applicable to all transactions of goods and services except a small negative list which are kept outside the purview of GST and the many transactions which are below the prescribe threshold limit. Commodities among negative list are alcohol, cigarettes, cigar, tobacco, LPG, Petrol, and Diesel etc. Alcoholic beverages would be kept out of the purview of GST. Sales Tax/VAT can be continued to be levied on alcoholic beverages as per the existing practice. Excise Duty, which is presently being levied by the States, may not be also affected. Tobacco products would be subjected to GST with ITC. Centre may be allowed to levy excise duty on tobacco products over and above GST without ITC. Although on most of goods and services the rate of tax remains the same but as per the necessity of the nation some goods or services can be declared as "exempted" or zero rated.

Many Taxes has been subsumed under Goods and Service Tax. Central Excise Duty, Additional Excise Duties, CENVAT, Additional Custom Duties popularly known as Countervailing Duty, Service tax, all central cesses and surcharges has been subsumed in to CGST. While VAT, CST, Sale Tax, Purchase tax, Luxury Tax, Lottery Tax, Entertainment Tax, Taxes on betting and gambling, Electricity duty, Octroi , all state cesses and surcharges has been merged in to SGST. Since GST is levied on domestic consumer of final goods and

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services so zero rate of exported goods and services are possible. Similar benefits may be given to Special Economic Zones (SEZs). However, such benefits will only be allowed to the processing zones of the SEZs. No benefit to the sales from an SEZ to Domestic Tariff Area (DTA) will be allowed.

Imports will be levied the same taxes as domestic goods and services adhering to the destination principle. In case of imported goods and services the custom duties will remain outside the purview of GST. Thus the applicable basic custom duties will be continue to be levied on imported goods and services. In addition both CGST and SGST are expected to be levied on imported goods and services. The incidence of tax will follow the destination principle and the tax revenue in case of SGST will accrue to the State where the imported goods and services are consumed. Full and complete set-off will be available on the GST paid on import of goods and services.

In case of intra-state transactions (with in the state) the seller has to collect both CGST & SGST from the purchaser and amount of CGST has to be deposit in the account of central government and the amount of SGST has to be deposit in the account of state government.

In case of inter-state transactions (among different states) centre would levy IGST Inter State Goods and Services Tax which would be equals to the (CGST+SGST) on all inter-State transactions of taxable goods and services. However the amount of SGST would be transfer to the consumer state i.e purchasing state. Presently the inter-state transactions are subject to CST central sale tax which is origin based. However the GST will work under a destination base / consumption based concept and hence tax on inter-state transactions will accrue to the destination state.

Goods and Service Tax is a tax on goods and services, leviable on each point of sale or provision of service, in which at the time of sale the seller or service provider can claim the input credit of tax which he has paid while purchasing the goods or procuring the service.

When VAT is introduced in place of Central excise duty, a set-off is given i.e. a deduction is made from the overall tax burden for input tax. In the case of VAT in

place of sales tax system, a set-off is given from tax burden not only for input tax paid but also for tax paid on previous purchases. With VAT, the problem of "tax on tax" and related burden of cascading effect is thus removed. Provision of input tax credit from the overall tax burden has been allowed in case of GST too. Actually prior to the introduction of VAT at the central and state level there was a burden of multiple -taxation. Before any commodity was produce inputs were first taxed and then the commodity got produced with input tax load, output was taxed again. This was causing a burden of multiple taxation i.e. tax on tax with cascading effect. But with the introduction of VAT and now GST a set off was allowed i.e. the deduction can be made from the overall tax burden for input tax. However cross utilization of ITC between the Central GST and the State GST would not be allowed except in the case of inter-State supply of goods and services under the IGST.

The administrative liabilities regarding the CGST will be on central government authorities while in case of SGST will be on the respective state government authorities. The taxpayers would need to submit periodical returns in common format as far as possible to both central and state GST authorities. GST will be equally applicable to the service providers too. Unlike the transactions from the sale tax regime to the VAT, where only business dealings in goods were affected but in case of GST , as the name suggested both goods and services providers would be impacted. Thus even the pure service providers need to plan for the transaction to the GST. India is one of the fastest emerging countries in the service sector and thus trade in services can be improved by rationalisation of taxes.

It is expected that GST regime would lower the prices of goods and services. GST is expected to foster the economic efficiency by lowering the cost of supply of goods and services by way of input credit mechanism and reducing the cascading effects. Further in context of India it is expected that aggregate incidence of dual GST will be lower than the present incidence of the multiple indirect taxes in force. The combined GST is expected to be in the range of 14-16%. Today services are taxed at 10% and the

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combined incidence of indirect taxes on most of goods is around 20%. At present the goods and services are taxed separately but in GST the difference will be vanished.

In our country the goods are taxable since long but the same cannot be said for services. Till 1994 there was no tax on services and this tax was introduced by the then Finance Minister Dr. Manmohan Singh. The logic behind the tax was "if goods are taxable why not services?" There is no separate service tax act and service tax department in India and taxes on services in our country are governed by some of the provision of Finance Act 1994 and service Tax Rules 1994 and the department concerned is Central Excise Department.

The States of Economy and GST

When GST will be introduced it will replace the most of taxes. Till date the centre has the monopoly power to tax services and state have the power to tax the sale of good. Now states will have to surrender their power to tax the goods and share the central tax and certainly this will be a very tough bargaining for them. The states are demanding that they should be given power to tax the services also but in GST they will actually lose their power to tax even the goods. The tax will be collected at the central level and then it will be shared by the states. Thus GST will curtail the power of states to tax the goods and services and this curtailment will affect their economy and autonomy and that's why many states are not in favour of GST. This will be a major hurdle in the way of central government while introducing the GST.

Conclusions

There has been significant progress in the tax regime since implementation of modified value added tax (MODVAT) 1986 and Value added tax (VAT) 2005. Encouraged by the successful implementation of VAT the Government of India now decided to launch GST which would replace a number of indirect taxes presently being levied by centre and state governments and is intended to remove cascading effects of taxes and would provide a common national market for goods and services. The proposed central and state GST would be levied on all

transactions involving supply of goods and services except those that are exempt or kept out of the purview of the GST. If GST is to be a success, there should be uniformity of approach across all states as well as strong disincentives for non-compliance with agreed framework.

The GST at the Central and the State level are expected to give more relief to industry, trade, agriculture and consumers through a more comprehensive and wider coverage of input tax set-off and service tax setoff, subsuming of several taxes in the GST and phasing out of CST. Responses of industry and also of trade have been indeed encouraging. Thus GST offers us the best option to broaden our tax base and we should not miss this opportunities to introduce it when the circumstances are quite favorable and economy is enjoying steady growth with only mild inflation.

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