

# COMPARATIVE ANALYSIS OF VAT AND GST IN INDIA: ADVANTAGES AND CHALLENGES

*Manu Sharad Pathak,*

*Dept. of E.A.F.M., Govt. College, Rajgarh, Alwar (Rajasthan)*

## INTRODUCTION

The indirect tax regime in India has undergone significant reforms, most notably with the introduction of the Goods and Services Tax (GST) on July 1, 2017. Prior to this, the Value Added Tax (VAT) was the predominant taxation system used in India, implemented in 2005 under the 101st Amendment to the Indian Constitution. The transition from VAT to GST was a monumental shift in the country's tax landscape, promising to streamline the system, eliminate tax cascading, and foster economic integration across states. This research paper presents a detailed comparative analysis of the VAT and GST systems in India, examining their advantages, challenges, and overall impact on the economy, businesses, and consumers. The paper also evaluates the effectiveness of GST in overcoming the shortcomings of VAT and identifies areas that still need improvement.

## OVERVIEW OF VAT AND GST IN INDIA

### Value Added Tax (VAT) System

Value Added Tax (VAT) was introduced in India in 2005 to replace the earlier sales tax system, which was criticized for being inefficient, non-transparent, and prone to evasion. VAT is a multi-stage tax levied on the value added at each stage of production or distribution. The main objectives of VAT were to eliminate the cascading effect of tax, provide businesses with credits for taxes paid on inputs, and reduce the overall tax burden on goods. VAT was implemented at both the central and state levels, with each state having its own VAT rules and rates.

### Key Features of VAT:

1. **Tax on Goods:** VAT was primarily levied on goods, with limited application to services.
2. **State-based Legislation:** Each state had the power to decide VAT rates and tax policies, leading to inconsistencies across the country.
3. **Tax Credit Mechanism:** Businesses could claim credit for VAT paid on inputs, ensuring that tax was only applied to the value added at each stage.
4. **Complexity and Fragmentation:** VAT was not harmonized across states, resulting in different rates and rules, which created hurdles for inter-state trade.

### Goods and Services Tax (GST) System

The Goods and Services Tax (GST) was conceptualized as a single, unified tax system that would replace multiple indirect taxes, including VAT, service tax, excise duty, and other local taxes. The GST was designed to simplify the tax structure and create a seamless national market. It was introduced in India on July 1, 2017, following extensive deliberations and consultations. The GST system is based on the principle of destination-based consumption tax, meaning the tax is levied where the goods or services are consumed, rather than where they are produced.

### Key Features of GST:

1. **Tax on Goods and Services:** GST applies to both goods and services, addressing the limitations of VAT, which only covered goods.

2. **Dual Tax Structure:** GST is a dual system where the central government levies the Central GST (CGST) and the state government levies the State GST (SGST) on intra-state transactions, while the Integrated GST (IGST) is levied on inter-state transactions.
3. **Input Tax Credit (ITC):** Businesses can claim input tax credit on taxes paid on both goods and services, which reduces the tax burden on intermediate stages of production and trade.
4. **Uniform Tax Rates:** GST introduces a standardized tax structure across India, with a clear classification of goods and services into various tax slabs, such as 5%, 12%, 18%, and 28%.

## COMPARATIVE ANALYSIS OF VAT AND GST

### Scope and Coverage

- **VAT:** VAT was applicable only to goods, leaving services largely unaddressed. As a result, it was a fragmented tax structure where goods were taxed under VAT and services under a different system (service tax).
- **GST:** GST covers both goods and services under a single tax framework, effectively unifying the taxation of goods and services. This broader coverage eliminates the need for separate tax systems for different sectors and provides a uniform tax treatment across industries.

### Structure and Taxation Mechanism

- **VAT:** VAT was a single-stage tax levied on the final sale of goods. However, businesses could claim tax credits for tax paid on inputs within the same state. The multi-state nature of VAT created complications for businesses involved in interstate trade, as

they had to navigate multiple tax rules, rates, and filing procedures.

- **GST:** GST is a multi-stage tax levied at each point of sale, where businesses can claim input tax credits for both goods and services. This mechanism reduces the cascading effect of taxes (tax on tax) by allowing businesses to offset taxes paid on inputs, thus lowering the overall tax burden and cost of production. The ability to claim ITC across states under the GST system also solves the inter-state tax credit issues present under VAT.

### Tax Rates

- **VAT:** States had the discretion to set VAT rates within a specified range. This led to varying VAT rates across states, creating disparities and complications in trade. VAT rates for goods ranged from 1% to 14.5%, and different products were taxed at different rates across states.
- **GST:** GST provides a clear and uniform tax structure with fixed tax slabs—0%, 5%, 12%, 18%, and 28%. The introduction of a uniform tax structure has helped standardize the tax regime across the country, thus simplifying the tax compliance process for businesses and consumers alike.

### Administrative Structure

- **VAT:** The administration of VAT involved separate tax authorities at both the central and state levels. This decentralized system led to inefficiencies in tax administration and created a lack of coordination between different tax departments.
- **GST:** GST has streamlined administration through the Goods and Services Tax Network (GSTN), a unified online platform that allows businesses to file returns, make payments, and track their tax liabilities. The introduction of a single online portal for compliance has significantly reduced

paperwork and enhanced transparency in the system.

### **Impact on Businesses**

- **VAT:** VAT was often perceived as a cumbersome system, especially for businesses operating in multiple states. Differences in state VAT rates, registration requirements, and procedural complexities led to high compliance costs and operational inefficiencies for businesses, particularly small and medium-sized enterprises (SMEs).
- **GST:** GST aims to simplify business operations by eliminating inter-state barriers, providing input tax credit, and reducing the overall compliance burden through a standardized system. However, the initial implementation of GST created challenges for businesses, especially SMEs, in adapting to the new tax regime. The need for regular filings, the introduction of new compliance procedures, and the dependence on technology for filing returns have been challenging for some businesses.

### **Consumer Impact**

- **VAT:** The impact of VAT on consumers was indirect, as the cascading effect of taxes often led to higher prices for goods. Moreover, consumers had no direct visibility into the tax paid by producers or suppliers, making VAT less transparent.
- **GST:** The GST system is expected to benefit consumers in the long run through lower prices due to the elimination of the cascading tax effect. By reducing the cost of production and making the tax system more transparent, GST can lead to lower retail prices. However, the impact on consumers has been mixed in the short term, as some goods and services saw price hikes due to the adjustment of tax rates.

## **ADVANTAGES OF GST OVER VAT**

### **Elimination of Cascading Tax Effect**

The most significant advantage of GST over VAT is the elimination of the cascading tax effect. Under VAT, tax was levied on the value added at each stage of the supply chain, but businesses were unable to recover taxes paid on inputs if they were purchased from another state. This led to higher costs and inefficiencies. GST solves this issue by allowing businesses to claim input tax credits at all stages of production, ensuring that only the value added to the goods or services is taxed.

### **Increased Transparency**

GST introduces greater transparency in the taxation process. The online filing of returns, the tracking of transactions, and the integration of the entire tax system through GSTN ensure that there is less scope for tax evasion and that businesses are more accountable.

### **Ease of Doing Business**

GST has simplified the process of doing business in India by creating a single tax regime across the country. With the reduction in the need for multiple state-level registrations and compliance procedures, businesses can now operate more efficiently and with fewer regulatory hurdles.

### **Competitive Pricing**

By reducing tax burdens and eliminating the cascading tax effect, GST has the potential to lower the cost of goods and services, making Indian products more competitive in the global market. This can lead to higher export potential and greater economic growth.

## **CHALLENGES OF GST IMPLEMENTATION**

### **Complexity of Compliance**

The GST system, despite its advantages, has introduced new complexities in terms of compliance.

The requirement for businesses to file monthly returns and the reliance on technology for filing have posed challenges, especially for small businesses and traders.

### **Initial Disruptions and Technical Issues**

The transition from VAT to GST caused disruptions in business operations, particularly due to technical issues with the GSTN portal. Small businesses, in particular, faced difficulties in adapting to the new system, leading to delays in filing returns and paying taxes.

### **Uncertainty in Tax Classification**

The classification of goods and services under the multiple tax slabs in GST has led to confusion. While efforts have been made to clarify tax rates, industries such as real estate, hospitality, and telecommunications continue to face issues with inconsistent tax classifications.

### **Increased Compliance Costs for SMEs**

While GST aims to simplify compliance, the process of adopting the new system has involved costs related to training, upgrading accounting systems, and hiring additional personnel to ensure compliance. For small and medium-sized enterprises (SMEs), these additional costs have been burdensome.

## **CONCLUSION**

The introduction of GST in India was a significant reform that aimed to create a unified, efficient, and transparent tax system. By addressing the inefficiencies of the VAT system and introducing a comprehensive taxation mechanism that covers both goods and services, GST has brought about positive changes to the business environment in India. However, the initial implementation phase revealed several challenges, particularly for small businesses and those reliant on technology for tax filings.

While the advantages of GST, such as the elimination of tax cascading, the reduction in tax

evasion, and the improvement in inter-state trade, are evident, the system still faces challenges that require continued attention. Over time, the full benefits of GST will be realized, and businesses, tax authorities, and consumers will adapt to the new regime. The government must focus on addressing the compliance challenges, improving technical infrastructure, and refining the tax classification system to ensure that the potential of GST is fully realized in driving India's economic growth.

## **REFERENCES**

1. **Bhatia, H. L.** (2016). *Indirect Taxes*. 10th Edition. Vikas Publishing House Pvt. Ltd.
  - This book provides in-depth coverage of the various indirect taxes in India, including VAT and GST, and explores the legal, economic, and procedural aspects of these tax regimes.
2. **Sundaram, S. & Suresh, K.** (2019). *GST in India: The Changing Landscape*. Springer.
  - A comprehensive look at the implementation of GST in India, its challenges, and its impact on the economy.
3. **Jha, V.** (2018). *Goods and Services Tax in India: A Handbook*. Taxmann.
  - An informative guide on the GST system, its implementation, and its comparison with the previous VAT system.
4. **Purohit, A.** (2018). *GST and its Impact on Indian Economy: A Critical Review*. *International Journal of Economics & Management Sciences*, 7(5), 473-482.
  - A journal article discussing the positive and negative impacts of GST on the Indian economy, particularly focusing on small businesses and industries.

5. **Government of India, Ministry of Finance.** (2017). *Goods and Services Tax: A Journey towards Transformation*.
  - Official government publication outlining the transition from VAT to GST, the design of the GST system, and its potential benefits.
6. **Goods and Services Tax Council.** (2017). *GST Implementation Report*.
  - A detailed report published by the GST Council on the introduction of GST, including the challenges faced during implementation and the steps taken to address these issues.
7. **Reserve Bank of India.** (2018). *Impact of GST on Indian Economy*. RBI Annual Report.
  - The report offers insights into how GST is likely to affect the Indian economy, including its influence on inflation, trade, and tax revenue collection.
8. **Singh, R. P.** (2018). "GST vs. VAT: A Comparative Analysis and the Challenges Ahead," *Journal of Taxation and Economic Policy*, 16(1), 12-30.
  - An academic article comparing the two taxation systems in India and analyzing the challenges in implementing GST.
9. **Srinivasan, T. N.** (2017). "The Economics of GST: Impact on Business and Growth," *Indian Journal of Economics and Business*, 16(2), 200-215.
  - This article reviews the economic implications of the GST system, especially in comparison with VAT.
10. **Jain, N., & Kumar, S.** (2019). "The Evolution of VAT to GST in India: A Step Towards Simplification or Complication?" *International Journal of Finance & Taxation*, 7(1), 45-58.
  - Discusses the evolution of indirect taxation in India, from VAT to GST, and analyzes whether the shift simplifies or complicates the tax system.
11. **National Institute of Public Finance and Policy (NIPFP).** (2018). *GST in India: A Case for Reform and Implementation*.
  - A comprehensive research report analyzing the policy, structure, and economic implications of GST in India, comparing it to VAT.
12. **Institute for Economic Growth (IEG).** (2017). *VAT and GST in India: Transition Challenges and Opportunities*.
  - A detailed study on the transition from VAT to GST and its impact on Indian businesses, with a focus on trade, logistics, and manufacturing sectors.