SOLUTION TO IPCC TAX PAPER HELD ON 12/5/2010

Q1) Mr. Dinesh Karthik, a resident individual aged 45, furnishes the following information pertaining to the year ended 31/3/2010: **(Marks 16)**

(i) He is the partner in Badrinath & Co., He has received the following amounts from the firm:
a) Interest on capital at 15% Rs.3,00,000
b) Salary as working partner (at 1% of firm's sales) Rs. 90,000

(ii) He is engaged in a business in which he manufactures wheat flour from wheat. The Profit and Loss account pertaining to this business (summarized form) is as under:

Salaries	1,20,000	Gross Profit	12,50,000
Bonus	48,000	Interest on Bank FD (Net of TDS 5,000)	45,000
Car expenses	50,000	Agricultural income	60,000
Machinery repairs	2,34,000	Pension from LIC Jeevandhara	24,000
Advance tax	70,000		
Depreciation Car Machinery	 3,00,000 1,25,000		
Net profit	4,32,000		
Total	**13,79,000**	**Total**	**13,79,000**

(iii) Opening WDV of assets are as under:

	Rs.
Car	3,00,000
Machinery (Used during the year for 170 days)	6,50,000
Additions to machinery New purchased on 23.09.2009 New purchased on 12.11.2009 Old purchased on 12.04.2009 (All assets added during the year were put to use immediately after purchase)	 2,00,000 3,00,000 1,25,000

(iv) Of the total bonus amount, Rs.15,000 was paid on 11/10/2009.
(v) One-fifth of the car expenses are towards estimated personal use of the assessee
(vi) In March, 2008, he had sold a house at Chennai. Arrears of rent relating to this house amounting to Rs.75,000 was received in February, 2010
(vii) Details of his Savings and Investments are as under:
a) Life Insurance premium of Rs. 50,000 paid for policy in the name of his major son who is employed in LMN Ltd. at a salary of Rs.6 lacs pa. Sum assured Rs.2,00,000

b) Rs. 70,000 is the contribution to Pension Fund of National Housing Bank (This was met partially from out of premature withdrawal of deposit in Post Office Time Deposit made on 12/3/2006. Principal component Rs.55,000 and interest Rs.5,000

c) Medical Insurance premium for his father aged 70, who is not dependent on him – Rs. 22,000

You are required to compute the total income of Mr.Dinesh Karthik for the AY 2010-2011 and the tax payable by him. Also indicate whether interest, if any, under sections, 234A and 234B are payable, assuming that the return was filed on 28th September, 2010.

Solution: **Calculation of taxable income of Mr. Dinesh Karthik**

Income under the head of salary		NIL
Income under the head of house property Arrear of rent Less: Deduction of 30% u/s 25B	 75,000 22,500	 52,500
Income under the head of business and profession		8,87,250
Income under the head of capital gains		NIL
Income under the head of other sources		79,000
Gross total income		10,18,750
Less: Deduction u/s 80C a) LIC premium for major son b) Pension fund Less: Deduction u/s 80D – medical insurance for father who is a senior citizen	 50,000 70,000	 1,00,000 (restricted) 20,000
Taxable income		**8,98,750**

Calculation of tax liability of Mr. Dinesh Karthik

Taxable income (calculated)	8,98,750
Net agriculture income given	60,000
Step 1: tax on non agriculture income plus net agriculture income Income-tax on Rs.9,58,750 (Rs.8,98,750 + Rs.60,000)	 **1,91,625**
Step 2: tax on net agriculture income plus basic exemption limit Income-tax on Rs.2,20,000 (1,60,000 + 60,000)	 **6,000**
Step 3: tax of step 1 less tax of step 2 1,91,625 – 6,000 Primary Education Cess of 2% and Secondary & higher education cess 1%	 1,85,625 5,568.75
Tax liability rounded off under section 288B	**1,91,190**
Less: TDS done by bank	5,000
Advance tax liability	1,86,190
Advance tax paid	70,000
Balance payable to the government	**1,16,190**

Discussion for interest payable u/s 234A and 234B

1) **Interest u/s 234A:** Under this section interest is charged by the government for non filling of income tax return till the due date mentioned under section 139(1). We assume that Mr. Dinesh is liable if file his income tax return on or before 31/7/2010. However he filed his income tax return on 28/9/2010 therefore he is liable to pay interest u/s 234A @ 1% pm on Rs. 1,16,190 for 2 months i.e August and September, 2010
2) **Interest u/s 234B:** Under this section interest is charged by the government if at least 90% of the advance tax due has not been paid till 31/3/PY. In this case Mr. Dinesh is liable to pay advance tax o Rs. 1,86,190 but he has paid only Rs. 70,000, which is less than 90% of Rs. 1,86,190. Therefore , he will be liable to pay interest u/s 234B @ 1% on Rs. 1,16,190 for 6 months i.e. April to September, 2010.

Calculation of income from business and profession

Interest from badrinath & co @ 12%	2,40,000
Salary from badrinath & co	90,000
Income from flour business	5,57,250
Total business income	8,87,250

Calculation of income from the flour business

Wrong profits	4,32,000
Interest of bank FD	(45,000)
Agriculture income	(60,000)
Pension from LIC	(24,000)
Unpaid Bonus	33,000
Personal car expenses	10,000
Advance tax paid	70,000
Wrong depreciation on assets	4,25,000
Correct depreciation u/s 32	(2,83,750)
Corrected Profits	5,57,250

Calculation of depreciation under the block of assets method

Particulars	**Car**	**P & M**
Opening value of the block	3,00,000	6,50,000
Add: Value of asset purchased and put to use a) For more than 180 days b) For less / equal to 180 days	 NIL NIL	 3,25,000 3,00,000
Less: Money received on the sale of the asset	NIL	NIL
Closing value of the block	3,00,000	12,75,000
Depreciation 6,50,000 X 15% = 97,500 2,00,000 X 35% = 70,000	45,000	2,38,750

3,00,000 X 35% / 2 = 52,500 1,25,000 X 15% = 18,750 Total = 2,38,750		
Opening Value for the next year	2,55,000	10,36,250

Calculation of income from other sources

Interest on bank FD (net) Add: TDS done by bank	45,000 5,000	50,000
Agriculture income Less: Exempt u/s 10(1)	60,000 60,000	NIL
Pension from LIC		24,000
Interest on PO time deposits		5,000
Income from other sources		**79,000**

Q2(a) Mr. Tenzingh is engaged in composite business of growing and curing (further processing) Coffee in Coorg, Karnataka. The whole of coffee grown in his plantation is cured. Relevant information pertaining to the year ended 31/3/2010 are given below:

WDV of Car as on 1/4/2009	3,00,000
WDV of machinery as on 31/3/2009 (15% rate)	15,00,000
Expenses incurred for growing coffee	3,10,000
Expenditure for curing Coffee	3,00,000
Sale value of cured Coffee	22,00,000

Besides being used for agricultural operations, the car is also used for personal use; disallowance for personal use; disallowance for personal use may be taken at 20%. The expenses incurred for use running and maintenance are Rs.50,000. The machines were used in coffee curing business operations. Compute the income arising from the above activities for the AY 2010-2011. Show the WDV of the assets as on 31/3/2010. **(Marks 6)**

Q2(b) Mr. Raj Kumar sold a house to his friend Mr. Dhruv on 1/11/2009 for a consideration of Rs.25,00,000. The Sub-Registrar refused to register the document for the said value, as according to him, stamp duty had to be paid on Rs.45,00,000, which was the Government guideline value. Mr. Raj Kumar preferred an appeal to the Revenue Divisional Officer, who fixed the value of the house as Rs.32,00,000 (Rs.22,00,000 for land balance for building portion). The differential stamp duty was paid, accepting the said value determined. Assuming that the fair market value is Rs.32,00,000, what are the tax implications in the hands of Mr. Raj Kumar and Mr. Dhruv for the AY 2010-2011? Mr. Raj Kumar had purchased the land on 1/6/2006 for Rs.5,19,000 and completed the construction of house on 1/10/2007 for Rs.14,00,000. Cost inflation indices may be taken as 519 for the financial year 2006-07, 582 for the financial year 2007-08 and 632 for the financial year 2009-10 **(Marks 6)**

Q 2 (a)

Income from the sale of coffee grown and cured

Sale value of the coffee cured		22,00,000
Less: expenses Expenses for growing coffee Expenses for curing coffee Expenses for car Depreciation on car 3,00,000 X 15% X 80% Depreciation on machinery 15,00,000 X 15%	 3,10,000 3,00,000 40,000 36,000 2,25,000	 9,11,000
Net		12,89,000
Agriculture income	75% of 12,89,000	9,66,750
Business income	25% of 12,89,000	3,22,250

Calculation of depreciation under the block of assets method

Particulars	**Car**	**P & M**
Opening value of the block	3,00,000	15,00,000
Add: Value of asset purchased and put to use a) For more than 180 days b) For less / equal to 180 days	 NIL NIL	 NIL NIL
Less: Money received on the sale of the asset	NIL	NIL
Closing value of the block	3,00,000	15,00,000
Depreciation	45,000	2,25,000
Opening Value for the next year	2,55,000	12,75,000

NOTES:

1) Depreciation on car is Rs. 45000 but only 80% of this would be considered as a business expense.

2) As per latest amendment to section 43(6), where the income of the assessee is derived, partly from agriculture and partly from business and asset are used for both of said purposes then amount of depreciation shall be calculated as if entire income is derived from the business of the assessee under the head of PGBP and depreciation so computed shall be deemed to be the depreciation actually allowed.

Q 2 (b) Tax implication for Mr. Dhruv

1) As per the newly introduced section 56(2)(vii) WEF 1/10/2009, If an immovable property is received for a consideration which is less than the stamp duty value of the property and the difference between the two exceeds Rs.50,000 (inadequate consideration),the difference between the stamp duty value of such property and such consideration shall be taxed as the income of other sources for the recipient.

In this case Stamp duty value fixed has been Rs. 32,00,000 and the consideration given to Mr. raj Kumar has been Rs. 25,00,000. Therefore the difference between the two i.e. Rs. 7,00,000 will be regarded as the income of other sources for Mr. Dhruv.

2) Tax implications for Mr. Raj Kumar

Calculation of capital gains on land and building

Particulars		**Land**	**Building**
Sale consideration under section 50C		22,00,000	10,00,000
Less: Selling expenses		NIL	NIL
Net sale consideration		22,00,000	10,00,000
Less: Indexed cost of acquisition	5,19,000 / 582 X 632	5,63,588	NA
Less: Cost of acquisition		NA	14,00,000
LTCG		16,36,412	NA
STCG u/s 50		NA	(4,00,000)

NOTE: Where land and building are sold and land is a LTCA but building is a STCA then while calculating the taxable capital gains, if the sale consideration can be split up then LTCG shall be calculated on land and STCG will be calculated on building.
For the purposes of land the benefit of indexation will be available since it is LTCA.
For building no indexation shall be done since it is STCA and gains shall be calculated as per section 50. This was decided by Calcutta high court in the case of **Estate of Omprakesh Thenjhunwala.**

Q3) From the following particulars of Income furnishes by Mr. Anirudh pertaining to the year ended 31/3/2010, compute the total income for the AY 2010-2011, if he is: **(Marks 10)**

(i) Resident and ordinary resident;
(ii) Resident but not ordinarily resident;
(iii) Non-resident:

Particulars	**Amount**
Profit on sale of shares in Indian Company received in Germany	15,000
Dividend from a Japanese Company received in Japan	10,000
Rent from property in London deposited in a Bank in London, later on remitted to India through approved banking channels	75,000
Dividend from RP Ltd., and Indian Company	6,000
Agricultural income from lands in Gujarat	25,000

Solution:

Computation of Total Income of Mr. Anirudh for the AY 2010-2011

Particulars of Income	**ROR**	**NOR**	**NR**
Profit on the sale of shares in Indian company received in Germany [assumed to be **not** covered u/s10(38)]	15,000	15,000	15,000
Dividend from Japanese company received in Japan	10,000	NIL	NIL
Rent from property in London , deposited in London and then remitted to India	75,000	NIL	NIL

Dividend from an Indian company	Exempt u/s 10(34)	Exempt u/s 10(34)	Exempt u/s 10(34)
Agriculture income from land in Gujarat	Exempt u/s 10(1)	Exempt u/s 10(1)	Exempt u/s 10(1)
Total Income	**1,00,000**	**15,000**	**15,000**

Q 4) Answer the following questions with regard to the provisions of the Income Tax Act.1961:

(Marks 3 x4 =12)

(a) State the concession granted to transport operators from 1/10/2009 onwards in the context of cash payments under section 40A (3) and deduction of tax at source under section 194-C.

(b) What are the conditions to be fulfilled by a charitable Trust under section 12A for applicability of exemption provisions contained in sections 11 and 12?

(c) What are the particulars required to be furnished with the return of income, as per section 139 (6)?

Solution:

Q 4(a) Concessions to transport operators: Latest amendments

1) Under section 40A(3) wef 1/10/2009 payment made to transport operators for incurring expenditure on long haul journeys for plying, hiring or hiring or leasing goods carriages, the limit of payment to such transport operators otherwise than by an account payee cheque or account payee bank draft has been raised to Rs.35,000 from the existing limit of Rs.20,000.

2) Under section 194C wef 1/10/2009, if recipient is a transport contractor (maybe an individual, firm, company or any other person) and he or it furnishes his PAN to the payer of income then such payer shall not do TDS on the payment to such transport operator. Transport operator is a person who is in the business of plying, hiring or leasing of goods carriages.

Q 4(b): Conditions u/s 12A

Following are conditions under section 12A for claiming exemption under section 11 and 12

1. Trust should be registered with the commissioner of Income tax

2. Trust should submit an application for registration in the Form 10A to the commissioner of Income Tax.

3. Such application shall be submitted before the expiry of 1 year from the date of creation of trust.

4. Commissioner can condone the delay if he is satisfied that there were sufficient reasons for not filling application within the time period of 1 year.

Q 4(c): Section 139(6)

The prescribed forms of return referred in

1) Section 139(1)

2) Section 139(3)

3) Section 142(1)

Shall in such cases as may be prescribed, require the assessee to furnish the particulars of

1) Incomes exempt from tax
2) Assets of prescribed nature
3) Value and belongings to him
4) His bank account and Credit card held by him
5) Expenditure exceeding the prescribed limit incurred by him under the prescribed heads and
6) Such other outgoings as may be prescribed.

Q 5) Provide brief answer to the following questions on Service tax: **(Marks 4 x 2 =8)**
(a) Is Service tax payable in respect of services provided in the Indian territorial waters?
(b) Is Service tax leviable on fee collected by Public authorities while performing statutory functions under the provisions of law?
(c) Can an assessee file a revised Service tax return?
(d) Explain the term "Commercial training or coaching centre".

Solution:

Q 5(a) Services in Indian Territorial waters
As per section 3 of the territorial waters, continental shelf, exclusive economic zone and other maritime zones Act, 1976, the sovereignty of India extends and has always extended to the territorial waters of India and to the seabed and subsoil underlying, and the airspace over, such waters.
The limit of the territorial waters is 12 nautical miles from the baseline.
The law of service tax is applicable to the territorial waters of India and it has been extended to installations, structures and vessels in the territorial waters.

Q 5(b) Services by public authorities
As per section 66 of the Finance Act, 1994 service tax has to be imposed on the taxable services which have been specified in section 65(105) of the Finance Act 1994.
Services provided by public authorities are not covered under section 65(105) therefore no service tax will be imposed on the fees collected by them while performing statutory functions under the provision of any law.

Q 5(c) Revision of service tax return:
As per rule 7B of Service Tax Rules, 1994, a service provider may submit the revised return in form ST-3 in triplicate to correct a mistake or omission, within a period of 90 days from the date of submission of original return.

Q 5(d) Commercial training or coaching centre
Commercial training or coaching centre means any institute or establishment providing commercial training or coaching for imparting knowledge on any subject or field other than the sports, with or without issuance of a certificate and includes coaching or tutorial classes but does not include pre-school coaching and training centre or any institute or establishment which issues any certificate or diploma or degree or any educational qualification recognized by law.

Q 6(a) Virat Kohli & Co., a partnership firm, is providing taxable legal consultancy services, for the second consecutive assessment year. The firm furnishes the following information relating to the services rendered, bills raised, amount received relating to this service, for the year ended 31/3/2010:

(Marks 8)

(i)	Free Service rendered to poor people (Value of the services computed on comparative basis)	40,000
(ii)	Advances received from clients for which no taxable service has been rendered so far	5,00,000
(iii)	Services billed to clients, Gross amount (service tax has been charged separately in all the bills; the firm follows mercantile system of accounting	12,00,000
(iv)	The firm has received the following amounts during the year: Relating to taxable services rendered in March, 2009 (excluding service tax at applicable rates and TDS under section 194-J of the IT Act, 1961 to the Tune of Rs.45,320	5,44,680
(v)	Relating to taxable services rendered in current year 2009 (excluding Service tax at applicable rates and TDS under section 194-J of the IT Act, 9161 to the tune of Rs.1,20,000) (*includes Rs.50,000 for appearance fee before Labour Court received from another firm	9,80,000*

Service tax has been separately received for applicable items in (iv) above. You are required to compute the value of taxable services for the year ended 31/3/2010 and the Service tax payable, briefly explaining the treatment of each item above.

Solution:

Author's Notes:

a) Services of lawyer have been made taxable w.e.f 1/9/2009. Therefore service for the period of April 2009 to August 2009 (5 months) are not taxable and services for the period of September 2009 to March 2010 (7 months) are taxable services.

b) Since there is lack of proper data in the above case, we will assume that data given is for the full financial year 2009-2010 and therefore, data shall be bifurcated into 5 & 7 months accordingly.

Particulars	Total value	Taxable Value of Apr – Aug 2009	Taxable Value of Sep – Mar 2009
Free Service rendered to poor people	40,000	Not taxable	Not taxable since free services
Advances received from clients	5,00,000	Not Taxable	2,91,667
Services billed to clients	12,00,000	Not taxable	Not Taxable, since remuneration not received

Taxable services rendered in March, 2009 **(No service tax will be imposed since services were not taxable when services were rendered.)**	5,90,000	Not taxable	Not taxable
Relating to taxable services rendered in current year. Less: amount received for appearance before Labour Court, not taxable services	11,00,000 (50,000) 10,50,000	Not taxable	6,12,500
Total value of taxable services		NIL	9,04,167
Service tax @ 10 % (assuming that Virat Kohli & co is not small service provider) Add: Primary education cess @ 2% Add: Secondary and higher education cess @ 1% Total service tax (rounded off to multiple of Re. 1)			 90416.7 1,808.34 904.12 93,129

Q 6(b) Answer the following questions on Service Tax: **(Marks 3 x 3 =9)**

(i) What is the scope of taxable service in respect of membership of Clubs or Associations? State the exception to the same.

(ii) Does a service provider have an option to pay Service tax at a rate different from the general rate applicable on gross value of taxable services, in the case of purchase and sale of foreign currency?

(iii) What is the late fee payable for delay in furnishing the Service tax return? Can the same be waived?

Solution:

Q 6(b) (i) Membership of Clubs:

Scope of taxable service shall include any service provided or to be provided to its members, by any club or association in relation to provision of services, facilities or advantages for a subscription or any other amount

Exemption: The taxable services provided or to be provided by resident welfare associations to its members have been exempted from whole of the service tax leviable thereon. However, the exemption is subject to the condition that the total consideration received from an individual member by the said association for providing the said services does not exceed Rs.3,000 per month. This service would otherwise be taxable under the category of membership of clubs or association

Q6(b) (ii) Optional rate of sale of foreign currency:

As per rule 6 of Service Tax Rules, 1994 money changer shall have the option to pay an amount calculated as per 0.25 % of the gross amount of currency exchanged. PEC and SHEC shall be payable in addition to above mentioned rate of service tax.

EXAMPLE: Person exchanged $100 for equivalent rupees from a money changer [Buying rate $US 1 = Rs.38, Selling rate $US 1 = Rs.40]. Service tax liability of money changer shall be as computed below:

a) Normal Assessment = [4,000 (Sale Price) – 3,800 (Purchase Price)] X 10% [PEC & SHEC payable extra]

b) Optional Assessment = 3,800 X 0.25% [PEC & SHEC payable extra]

Q 6(b) (iii) Fees for submitting delayed return:

As per Rule 7C of Service Tax Rules, 1994 the delayed submission of return has been allowed and government has been empowered to fix fees up to Rs. 2000 for that purposes. The details of fee for delayed return are as follows:

1. If delay is up to 15 days from the due date of return: late fees of Rs. 500 are to be paid.
2. If delay is beyond 15 days but up to 30 days from due date: late fees of Rs. 1000 are to be paid.
3. If delay is beyond 30 days from the due date: late fees of Rs. 1000 is to be paid + late fees of Rs. 100 for every day from the 31st day till the date of furnishing of return but subject to the maximum of Rs. 2000 of late fees is to be paid

Further these late fees are mandatory and can't be waived off

Q7) Answer the following questions on VAT: **(Marks 4 x 2 =8)**

(a) What are the items aggregated in the Addition method to calculate the VAT payable? When is this method mainly used?

(b) Is any threshold exemption limit fixed for dealers to obtain VAT registration, as per the White Paper? If yes, why is the same provided?

(c) Is the VAT chain continued when a purchasing dealer opts for VAT composition scheme ? What is the loss to the seller and buyer opting for the composition scheme, and the subsequent buyers?

(d) Can it be said that VAT brings about certainty to a great extent in the matter of interpretational issues? If so, how

Solution:

Q 7 (a) Addition method:

This method aggregates all the factor payments such as wages, rent, interest and profits to arrive at the total value addition on which the rate is applied to calculate the tax. Under this method tax is imposed on exempted goods as well. This method of also known as Income Approach and this type of calculation is mainly used with income variant of VAT.

Q 7(b) Small dealers exempted from VAT:

In order to provide relief to the small dealers, small dealers have been exempted from payment of VAT. Small dealers with annual turnover not exceeding Rs 10 lakhs (earlier, limit was 5 lakhs) will not be liable to VAT. (States shall have the flexibility to fix this threshold limit within Rs 10 lakhs)

Q 7(c) Composite scheme:
If a dealer elects to pay tax under composition scheme then the VAT chain is not continued. Selling dealer who has chosen composite scheme will not be allowed to claim any credit for input tax paid on purchases made by him. Further he will not be entitled to issue tax invoices to the buyer due to which buyer would not be entitled to claim credit of any input tax from his own output tax.

Q7(d) Simple method:
VAT will help in simplification of tax imposition system. Since it is simply based on the transactions and is applied to all sales in the business thus there is no scope of misinterpretation and therefore it is easy to understand. Thus there is no need to go through complicated definition like sales, sales price, turnover of purchases and turnover of sales. The tax is also broad-based and applicable to all sales in business leaving little room for different interpretations. Thus, this system brings certainty to a great extent.

Q 8 (a) Mr. X, a dealer in Mumbai dealing in consumer goods, submits the following information pertaining to the Month of March, 2010: **(Marks 8)**

1) Exempt goods 'A' purchased for Rs.2,00,000 and sold for Rs.2,50,000.
2) Goods 'B' purchased for Rs.2,25,000 (including VAT) and sold at a margin of 10% profit on purchases (VAT rate 12.5%)
3) Goods 'C' purchased for Rs.1,00,000 (excluding VAT and sold for Rs.1,50,000 (VAT rate 4%).
4) His unutilized balance in VAT input credit on 1/3/2010 was Rs.1,500

Compute the turnover, Input VAT, Output VAT and Net VAT payable by Mr. X.

Q 8(b) Answer the following questions on VAT: **(Marks 3 x 3 = 9)**
(i) What are the merits of VAT in the context of tax evasion, neutrality and transparency?
(ii) State the importance of VAT invoice/ tax invoice in administering VAT.
(iii) Discuss the tax consequences of Stock transfer under the VAT scheme.

Solution:

Q8) (a) Statement showing computation of turnover, input VAT, output VAT and Net VAT

Goods	**Turnover**	**Output VAT**	**Input VAT**	**Net VAT**
A	NIL (since exempted goods)	NIL	NIL	NIL
B	2,00,000 (ex-VAT) + 20,000 (profit) = 2,20,000	27,500 (12.5% of 2,20,000)	25,000 (2,25,000 X 12.5% / 112.5%)	2,500
C	1,50,000	6,000 (4% of 1,50,000)	4,000 (4% of 1,00,000)	2,000
Total	3,50,000	33,500	29,000	4,500
Unutilized VAT credit to be used				1,500

Net VAT to be payable to government				**3,000**

Q8 (b) (i) Merits of VAT:

No tax evasion: Under VAT, credit of tax paid is allowed against the liability on the final product sold. Therefore, unless proper records are kept in respect of various inputs, it is not possible to claim credit. Hence, suppression of purchases or production will be difficult because it will lead to loss of revenue to the dealer, therefore

Transparency: Under a VAT system, the buyer knows, out of the total consideration paid for purchases of material, what is tax component. Thus, the system ensures transparency. This transparency enables the State Government to know as to what is the exact amount of tax coming at each stage. Thus, it is a great aid to the Government while taking decisions with regard to rate of tax etc.

Better revenue collection and stability: The Government will receive its due tax on the final consumer / retail sale price. There will be a minimum possibility of revenue leakage, since the tax credit will be given only if the proof of tax paid at an earlier stage is produced. This means that if the tax is evaded at one stage, full tax will be recoverable from the person at the subsequent stage or from a person unable to produce proof of such tax payment. Thus, in particular, an invoice of VAT will be self enforcing and will induce business to demand invoices from the suppliers.

Q 8(b) (ii) Significance of invoice under VAT

1) VAT credit can be taken by buyer only on the basis of Tax Invoice.
2) The whole system of the VAT with input tax credit is based on the documentation of tax invoice / cash memo / bill.
3) A VAT invoice:
  (i) helps in determining the input tax credit;
  (ii) prevents cascading effect of taxes;
  (iii) facilitates multi-point taxation on the value addition;
  (iv) promotes assurance of invoices;
  (v) assists in performing audit and investigation activities effectively;
  (vi) checks evasion of tax

Q 8(b) (iii) STOCK TRANSFER

Inter-State transfers do not involve sale and, therefore they are not subjected to sales-tax. The same position continues under VAT. However, the tax paid on:

(i) Inputs used in the manufacture of finished goods which are stock transferred; or
(ii) Purchases of goods which are stock transferred

will be available as input tax credit after retention of 4% of such tax by the State Governments.