

Indirect taxes - Vat

Chapter4 VAT (VALUE ADDED TAX)

Vat is indirect tax levied on sale of goods

Vat was introduced primarily as a replacement of existing sales tax in many states in India with effect from 01.04.2005

.The Vat structure has been evolved on the basis of consensus among the states.

•The basic features of Vat will be therefore will be same through the country.

What is Value Added Tax ('VAT')

¬Tax on Value addition

¬Multi-point taxation

¬A state subject

MEANING OF VAT

•Vat is a tax levied on the value added to any product AT EVERY STAGE"

•Provision for input tax credit tax Credit paid at the previous point of purchase.

•The tax paid by a registered dealer is netted. Tax is ultimately borne by the consumer

No VAT

VAT not levied on

•Inter-state sale / Inter-state branch transfer

•Imports/Exports

•Dealers below threshold level

Merits of Vat

•Eliminates multiple taxation of full sale price

•No tax evasion. Because of input tax credit on valid vat invoice

•Neutral on choice of production technique, the vat liability will not vary

•Simple method.

•Lowering tax burden.

•Transparency. – purchase price value addition, vat paid

•Better revenue collection and stability.

•Better accounting systems.- tax paid at earlier stage received back

Demerits of vat

•VAT does not cover services.

•Non integration of central VAT with state VAT. Discourage in purchasing outside state

•Accounting burden.

•Cost of administration for government as the number of dealers will increase

•Exemptions on good, Non applicability of vat, make more cascading effect

METHODS FOR VAT TAXATION (Computation of value added)

Addition method

•Invoice Method

•Subtraction Method

Addition Method

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This method aggregates all the factor payments including profits to arrive at the total value addition on which the rate is applied to calculate the tax. This type of calculation is mainly used with income variant of VAT. Addition method does not easily accommodate exemptions of intermediate dealers.

A drawback of this method is that it does not facilitate matching of invoices for detecting evasion.

Invoice Method

This is the most common and popular method for computing the tax liability under 'VAT' system.

Under this method, tax is imposed at each stage of sales on the entire sale value and the tax paid at the earlier stage is allowed as set-off. In other words, out of tax so calculated, tax paid at the earlier stage i.e., at the stage of purchases is set-off, and at every stage the differential tax is being paid.

The most important aspect of this method is that at each stage, tax is to be charged separately in the invoice.

This method is also called the 'Tax Credit Method' or 'Voucher Method'. From the following illustration, the mode of calculation of tax under this method will become clear:

Subtraction Method

Under this method, the tax is charged only on the value added at each stage of the sale of goods. Since, the total value of goods sold is not taken into account, the question of grant of claim for set-off or tax credit does not arise. This method is normally applied where the tax is not charged separately. Under this method for imposing tax, 'value added' is simply taken as the difference between sales and purchases.

Variants of Vat

The gross product variant

The gross product variant allows deductions for taxes on all purchases of raw materials and components, but no deduction is allowed for taxes on capital inputs. That is, taxes on capital goods such as plant and machinery are not deductible from the tax base in the year of purchase and tax on the depreciated part of the plant and machinery is not deductible in the subsequent years. Capital goods carry a heavier tax burden as they are taxed twice. Modernization and upgrading of plant and machinery is delayed due to this double tax treatment.

The income variant

Income variant of VAT on the other hand allows for deductions on purchases of raw materials and components as well as depreciation on capital goods. This method provides incentives to classify purchases as current expenditure to claim set-off. In practice, however, there are many difficulties connected with the specification of any method of measuring depreciation, which basically depends on the life of an asset as well as on the rate of inflation.

Consumption variant

Consumption of VAT allows for deduction on all business purchases including capital assets. Thus, gross investment is deductible in calculating value added. It neither distinguishes between capital and current expenditures nor specifies the life of assets or depreciation allowances for different assets. This form is neutral between the methods of production; there will be no effect on tax liability due to the method of production (i.e. substituting capital for labour or vice versa). The tax is also neutral between the decision to save or consume.

Among the three variants of VAT, the consumption variant is widely used. The reasons for preference of this variant are:

Advantages of Consumption variant

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Firstly, it does not affect decisions regarding investment because the tax on capital goods is also set-off against the VAT liability. Hence, the system is tax neutral in respect of techniques of production (labour or capital-intensive).

Secondly, the consumption variant is convenient from the point of administrative expediency as it simplifies tax administration by obviating the need to distinguish between purchases of intermediate and capital goods on the one hand and consumption goods on the other hand.

In practice,, most countries use the consumption variant. Also, most VAT countries include many services in the tax base. Since the business gets set-off for the tax on services, it does not cause any cascading effect.

Input and Output Tax

Input Tax

VAT paid by a registered business dealer on taxable input purchases for business such as raw material, trading goods, capital goods and Consumables

Output Tax

VAT charged by a registered business dealer on sales made by the business to its customers

Input Tax Credit (ITC)

Input tax credit means, credit available on the Purchases made by dealer. Credit of VAT paid will be available only on purchases made within the State. ITC available only to VAT registered **dealer** on purchases made from another VAT registered dealer against a valid VAT invoice, Purchases include raw material, consumables, packing material, capital goods.

Input Tax Credit on Capital goods

- Available and to be adjusted over a period of 24 monthly instalments (2 years)- some states 36 installments.
- States can reduce this period
- No input tax credit on Capital Goods specified in negative list

Use of inputs to avail credit

The purchased inputs can be used for

- For sale/resale with in state or outside state
- As raw material for manufacture of goods for sale inside state or outside state
- As a packing material/consumables in sale of goods
- As goods in execution of works contract.
- For export of goods out of India

The Purchased Capital goods can be used for

For manufacture of taxable goods

Carry forward of Input Tax Credit

- Unutilised Credit will be carried over till the end of the succeeding financial year and if it remains unutilised will be refunded.
- VAT Credit will be refunded within three months in case of exports

Units in SEZ and EOU have an option of either

- Not paying VAT on inputs; or
- Claim full refund within three months
-

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No input tax credit in case of

- Inputs used in the manufacture of exempted goods
- Purchases for other than manufacture/re-sale (Captive Consumption)
- Purchases made inter State/in-transit
- if VAT registered dealer purchases from Unregistered dealer (Output tax payable on full sale price)
- Purchase from a registered dealer who opts of composition scheme.
- Purchased from registered dealer where invoice does not show tax amount separately.

Purchases of goods of negative list for example

- Delhi - Fuel in the form of Petrol, Diesel and Kerosene, LPG, CNG, Coal
- AP - Fuel, Coal and Natural Gas used for power generation
- Jharkhand - Consumables
- Tripura – Credit available in excess of 4% on petroleum products (other than petrol, ATF and diesel) and other fuels

Input tax credit on stock transfers

Inputs used in the manufacture of finished goods which are stock transferred; or purchases of goods which are stock transferred Input tax credit available to the extent of 4% of vat paid on such purchases. In excess of 4% if availed it should be reversed

Utilization of vat Credit

Credit can be utilized towards

- VAT payable on Finished Goods
- CST payable on Inter State Sales
- Any interest or penalty under VAT

Common inputs for exempted sale and taxable sale

- Option 1- maintain separate records for inputs used in exempted sale and taxable sale
- Option 2- Proportionate input tax credit on inputs used in taxable sale

Vat payable

- Vat payable = Output tax – Input Tax credit.

In other words, out of the tax charged on your sales, you will first deduct the tax charged on your purchases, and pay balance to the department.

For example, input worth Rs. 1,00,000/- is purchased and sales are worth Rs. 2,00,000/- in a month, input tax rate and output tax rate are 4% and 12.5% respectively, then input tax credit/set-off and calculation of VAT will be as shown below:

(a)	Input purchased within the month	Rs. 1,00,000/-
(b)	Output sold in the month	Rs. 2,00,000/-
(c)	Input tax paid	Rs. 4,000/-
(d)	Output tax payable	Rs. 25,000/-
(e)	VAT payable during the month	Rs. 21,000/-
	after set-off/input tax credit	
	[(d) – (c)]	

Composition scheme under vat

- Applicable to Every registered dealer who is liable to pay vat and whose turnover does not exceed Rs.50 lakhs in the last financial year
- The scheme is optional. Intimation to Commissioner to exercise option in any whole year or part of year

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- Dealer need not maintain any statutory records as prescribed under the Act. The records for purchase, sales, inventory should be maintained
- Turnover will be taxed at low rate as 0.25%
- No input tax credit on purchases
- Cannot issue tax invoice, the buyer from composition scheme dealer cannot avail input tax credit

Non eligibility of composition scheme

For the following dealers composition scheme not applicable. They cannot avail

- Dealers of importers and exporters
- Dealers having interstate sales
- Dealers having interstate branch /depot/works contract transfers

Rates of VAT

- 0% -36 commodities –Agricultural Products., sea products
- 1%- 3 commodities (Gold, Silver, Precious metals & Stone, etc.)
- 4%-About 340 commodities Industrial, Packing and IT products
- 12.5% (RNR) All other goods (Some states increase it to 13.5%)

RATES OF VAT NOT APPLICABLE

- Non Applicability of VAT on Petrol, Diesel, Aviation Turbine Fuel, Liquor, Lottery Tickets,
- These goods may be taxed under VAT Act or any other Act at higher rates.

Zero rated sale/Exempted sale- Certain sales are 'zero rated' i.e. tax is not payable on final product in certain specified circumstances. In such cases, credit will be available on the inputs i.e. credit will not have to be reversed. Distinction between 'zero rated sale' and 'exempt sale' is that in case of 'zero rated sale', credit is available on tax paid on inputs, while in case of exempt goods, credit of tax paid on inputs is not available. As per para 2.5 of White Paper on State-Level VAT, export sales are zero rated, i.e. though sales tax is not payable on export sales, credit will be available of tax paid on inputs.

Procedures under Vat

Threshold limit on Vat

0-5 Lacs No Vat- Not liable for Registration
5-50 Lacs - can opt for composition at lower rate up to 0.25% (Only for retailers)
50 Lacs Above - Compulsory VAT
Some states the limit is Rs. 10 lakhs instead of 5 lacs

Registration under Vat

Automatic registration under the VAT Act of all the existing dealers

New dealers require to register after vat come in to existence

Dealers who 'Cross the basic threshold limit

Composition scheme dealers

Time limit- within 30 days from the date of commencement of business

TIN will be allotted all dealers. It will be a 11 digit numerical code. First two digits will indicate State Code. TIN will have to be indicated on each invoice issued

Cancellation of registration

- discontinuance of business; or disposal of business
- transfer of business to a new location

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- annual turnover of dealer falling below the specified amount.

Dealer obligation : Inform surrender original RC, pay tax up to date

Records under vat

- Purchase records
- sales records
- VAT account (Input tax credit, utilization, balance)
- Separate record of any exempt sale
- Other documents such as tax invoice, delivery note, bills, credit notes, debit notes

Declaration forms under vat

- No declaration forms
- Old declaration forms under sales tax law dispensed with.
- No concessional sale under vat, Hence no need of forms.

Vat Invoice

- Invoices are important documents for administering VAT.
- In the absence of invoices VAT paid by the dealer earlier cannot be claimed as set off
- Every registered dealer whose turnover of sales exceeds the specified amount shall issue to the purchaser a serially numbered tax invoice, .
- The tax invoice shall be dated and signed showing the required particulars.
- The dealer shall keep a counterfoil or duplicate of such tax invoice duly signed and dated.

•Particulars of Vat Invoice

- the words 'tax invoice' in a prominent place
- name and address of the selling dealer;
- registration number of the selling dealer;
- name and address of the purchasing dealer;
- registration number of the purchasing dealer (not under all VAT legislations);
- pre-printed or self-generated serial number;
- date of issue;
- description, quantity and value of goods sold;
- Rate and amount of tax charged in respect of taxable goods;
- signature of the selling dealer or his regular employee duly authorized by him for such purpose.
- The provisions relating to tax invoice do not apply to a selling dealer who has opted to avail the composition scheme '.

Example on Vat payment

Vat Return

Returns will be filed monthly/quarterly, as prescribed, along with challans. Returns will be scrutinized and if there is technical mistake, it will have to be rectified by dealer

Return normally contains the following particulars

- Name Address and Registration Number of dealer.
- Period of Return.
- Turnover of sales and purchase.
- Claim of Set-off.
- Amount of set-off carried forward.

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- Amount of set-off claimed as refund.
- Calculation of Tax
- Declaration that particulars given in return are true and correct

Assessments under Vat

• Most are the self assessment, where dealer calculate vat liability and pay vat as per law and files monthly returns

• Cross checking by department at the end of year to ensure vat paid correctly.

Audit under vat

- Some states provide vat audit by CA
- Other cases, department do audit on specific selected criteria

Vat in case of special transactions

Vat on Works Contract

- The works contract is a deemed sale
 - Vat is levied on goods involved in works contract (Steel. Cement, paints, fittings etc)
 - Sale price of goods transferred in works contract is the turnover for the purpose of Vat
 - The amount representing labour and other service charges incurred for such execution should be excluded from vat purview.
 - Where such labour and other service charges are not quantifiable, the sale price shall be the cost of acquisition of the goods and the margin of profit + all other expenses in transferring the property
- Tax rates on works Contract
- Option 1- Normal vat schedule rate on goods involved in works contract. Rate applicable for each items is considered Input tax credit is available on Purchases
 - Option 2- Composition scheme rate on the total value of works contract including labour and overheads. No input tax credit is available on Purchases
 - Input credit on Capital goods purchased in works Contract is not available, as the works contract execution is not manufacturing and processing of goods.

Vat on Lease transactions

- Constitution provides power to levy tax on the transfer of the right to use any goods (lease)
- Lease is a deemed sale and vat can be levied
- Taxable event is the transfer of the right to use any goods
- Lease rentals collected by lessor is consideration and treated as turnover. Some states provide deduction of interest and finance charge from lease rentals
- Tax rate applicable on the goods given on lease
- Sub lease is also taxable
- Lessor can get input tax credit on the tax paid on purchase of leased asset

Vat on hire Purchase transactions

- Delivery of goods under hire-purchase or installment sale will be taxable event for vat. And not the completion of sale on exercise of option by hirer or last installment paid by buyer
- VAT laws as applicable to normal sales are equally applicable to hire-purchase and installment sales.
- Hire charges/ Installment amount will be taxed
- When all the hire charges and installments are taxed no vat tax on when the sale was concluded on last installment/when hirer exercise option to buy.

Vat & CST

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- CST levied on Interstate sales where vat levied on local state sales.
- CST paid on outside state purchases is not vatable hence CST have the cascading effect.
- CST is an origin-based tax collected by the exporting State whereas VAT is a destination based consumption tax, both cannot go together
- After vat was introduced it is decided to phased out CST slowly by 2010-2011. Now 2008-09 it is 2% and in 2009-10 it is proposed to 1% and in 2010-2011- 0%

AMENDMENTS IN CST ACT TO FACILITATE INTRODUCTION OF VAT

- CST act sec 15 amended to tax declared goods at more than one stage and Notification u/s 8 to reduce CST to 2% wef 01.06.2008

End of chapter

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