FOR YOUR INFORMATION

GN (A) 19 (Issued 2005)

Guidance Note on Accounting for State-level Value Added Tax

(The following is the text of the Guidance Note on Accounting for State-level Value Added Tax, issued by the Council of the Institute of Chartered Accountants of India.)

INTRODUCTION

1. The State-level Value Added Tax (hereinafter referred to as 'Value Added Tax' or 'VAT') comes into effect from April 1, 2005, in place of the sales tax structure prevalent in various States. The VAT intends to bring harmonisation in the tax structure of various States and rationalise the overall tax burden. The essence of VAT is that it provides credit/set-off for input tax, i.e., tax paid on purchases, against the output tax, i.e., tax payable on sales.
2. VAT is a State subject, for which the States are independent in taking decisions. The States, through discussion in the Empowered Committee of State Finance Ministers, constituted by the Ministry of Finance, Government of India, have found it in their interest to have certain features of VAT to be common for all the States with a view to avoid unhealthy competition. These features are contained in the 'White Paper on State-Level Value Added Tax' released by the Empowered Committee on January 17, 2005 and constitute the basic design of VAT. At the same time, the States have freedom for making appropriate variations in their respective State laws consistent with this basic design.

OBJECTIVE

3. The objective of this Guidance Note is to provide guidance in respect of accounting for various aspects of State-level Value Added Tax, including accounting for credit/set-off available for input-tax paid on purchases and accounting for VAT payable on sales.

SALIENT FEATURES OF VALUE ADDED TAX (VAT)

4. Salient features of VAT are briefly set out hereinafter. Reference may, however, be made to the respective State Acts, Rules, Notifications and Circulars issued from time to time for details of the provisions of VAT laws prevalent in various States.
5. The nature of VAT, as discussed in this Guidance Note, is based on the White Paper released by the Empowered Committee referred to in paragraph 2 above. Since the VAT laws of the States are to be based on the White Paper, the nature of VAT in all the States would be the same.
6. A trader/manufacturer (hereinafter referred to as a 'dealer') who is registered or is required to be registered under the respective State laws on VAT is entitled to an input tax credit (hereinafter referred to as 'VAT credit') in respect of tax paid on purchases made during the tax period where the purchases arise in the course of his activities as a dealer. The VAT credit is allowed for purchase of inputs/supplies meant for sale or for utilisation in the process of production for such sale, irrespective of when these are utilised/sold, and reduces the immediate tax liability. The VAT is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting VAT credit from tax payable on sales during the tax/payment period (say, a month). If, for example, input worth Rs. 1,00,000/- is purchased and sales are worth Rs. 2,00,000/- in a month, and input tax rate and output tax rate are 4% and 12.5% respectively, VAT credit and calculation of VAT is as shown below:

(a) Input purchased during the month	Rs. 1,00,000
(b) Output sold during the month	Rs. 2,00,000
(c) Input tax paid and available as 'VAT credit' (Rs. 1,00,000 x 4%)	Rs. 4,000
(d) Gross output tax payable (Rs. 2,00,000 x 12.5%)	Rs. 25,000
(e) VAT payable during the month after adjustment of VAT credit [(d) – (c)]	Rs. 21,000

7. VAT credit is given to a dealer for purchase of inputs/supplies in a State meant for sales within the State as well as in other States. Even for stock transfer/consignment sale of goods out of the State, input tax paid in excess of a certain percentage is eligible for VAT credit. VAT credit is available in respect of all purchases made and taxes paid thereon within the State. However, no credit under the VAT laws is allowable in respect of taxes paid on purchases made from other States.
8. If the VAT credit exceeds the tax payable on sales in a month, the excess credit may be carried over to the future month(s). If there is any excess unadjusted VAT credit at the end of the specified period, the same is eligible for refund. The period for which the excess VAT credit can be carried over before becoming eligible for refund is prescribed in the respective State VAT laws.

9. All goods, except liquor, lottery tickets, petrol, diesel, aviation turbine fuel and other motor spirits whose prices are not fully market determined, are covered under VAT and get the benefit of VAT credit. The goods not covered by VAT are taxed under the Sales Tax Act or any other State Act or by making special provisions in the VAT Act itself.
10. Besides prescribing various rates of tax for goods, the State-level VAT laws may also specify (a) certain goods which are exempt, and (b) the sales which are 'zero' rated. The essential difference between the exempt sales and 'zero' rated sales is that while in both the cases, the dealer does not charge VAT, in case of 'zero' rated sales, he is eligible to claim VAT credit for tax paid on purchase of inputs whereas for the exempted sales, he is not eligible to claim VAT credit for the tax paid on the purchase of inputs.
11. Exports sales are 'zero' rated under the VAT laws. This means that the dealer is not required to charge any tax or pay any VAT on the export sales. The dealer, however, is entitled to VAT credit in respect of tax paid within a State on purchase of inputs. The VAT credit is not restricted to only those goods which are meant or used in the manufacture for exports. If, in any tax period, the VAT credit declared in the VAT return exceeds the output tax and the dealer has declared international exports in the same tax period, he can claim refund of the excess VAT credit. The refund will be made within the period prescribed under the State VAT laws. The units located in Special Economic Zones (SEZ) and Export Oriented Units (EOUs) are granted either exemption from payment of input tax or refund of the input tax paid within the prescribed period.
12. In some State VAT laws, industrial units may be granted the facility of deferring output tax net of VAT credit. Such units continue to collect tax on sales from the customers at the time of making sales, but the tax is payable after a certain specified period. The period of eligibility, the method of computing the eligibile amount, the repayment etc., in such cases, shall be in a manner prescribed under the respective State VAT laws.
13. All tax-paid goods purchased on or after April 1, 2004 and still in stock as on April 1, 2005 are eligible to avail VAT credit, subject to submission of requisite documents. Resellers holding tax-paid goods on April 1, 2005 are also eligible. VAT is levied on the goods when sold on and after April 1, 2005 and VAT credit is given for the sales tax already paid in the previous year. This VAT credit is available over a period of 6 months after an interval of 3 months needed for verification. In certain States, however, immediate credit for tax-paid goods lying in stock on April 1, 2005 may be available.
14. VAT credit on all capital goods, except a few capital goods included in the negative list of respective State laws, is also available to dealers. VAT credit on capital goods may be adjusted over a maximum of 36 equal monthly instalments. The States may at their option reduce the number of instalments or may grant full credit in the month of purchase of such capital goods. Some of the State laws on VAT, e.g., the West Bengal Value Added Tax Act, 2003, have defined the term 'Capital Asset' to include components, spare parts, accessories, tools, etc., which are basically of the nature of inventories.
15. Small dealers with gross annual turnover not exceeding the limit specified in White Paper are not liable to pay VAT. However, States have flexibility to fix threshold limit within the specified limit and, therefore, certain States have fixed lower limits in this regard. Small dealers with annual gross turnover not exceeding the specified limit in this respect, who are otherwise liable to pay VAT, however, have the option to pay tax under an alternative scheme known as the 'composition scheme'. The dealers opting for this scheme are required to pay tax at a small percentage, as prescribed, of gross turnover and are not entitled to any VAT credit. Certain States have fixed lower limits of turnover under the composition scheme.
16. In some of the States, the dealers executing works contracts, have been given an option either to pay tax on the value of the goods at the time of incorporation of such goods in the works executed, at the rates applicable to the goods, or they may opt to pay tax by way of composition at applicable rates on a certain percentage of the total consideration received as may be prescribed, and in such a case, they may not be entitled to any VAT credit or may be entitled to a partial VAT credit.
17. The entire design of VAT with input tax credit is mainly based on documentation of tax invoice, cash memo or bill. Every registered dealer, having turnover in excess of the amount specified, issues to the purchaser, serially numbered tax invoice with the prescribed particulars. This tax invoice is required to be signed and dated by the dealer or his regular employee, showing the required particulars. The dealer is required to keep a counterfoil or duplicate of the tax invoice duly signed and dated. Failure to comply with the above attracts penalty. The dealer is also required to keep and maintain a true and correct account of his business transactions, and maintain appropriate records to ascertain his tax liability. Various States have prescribed the records required to be maintained by dealers engaged in various businesses.
18. The State VAT laws also provide for issuance of credit notes/debit notes by the dealer in cases of wrong calculation of tax or return of goods after sales/ purchases are made or in respect of annual discounts and other price adjustments on settlement between the seller and the buyer.

ACCOUNTING TREATMENT FOR VAT CREDIT IN CASE OF INPUTS/SUPPLIES

19. The accounting treatment for VAT credit recommended in the following paragraphs is required only in situations where the VAT credit is available. Accordingly, accounting treatment recommended hereinafter would not be applicable in cases where no VAT credit is available such as for
    (i) dealers not registered under VAT, or
    (ii) dealers having turnover below the threshold limit as fixed under the State laws on VAT, and opting for composition scheme, or
    (iii) dealers engaged in the works contract and opting to pay tax by way of composition; or
    (iv) purchase of goods from unregistered dealers.

20. In the light of the salient features of VAT discussed above, the VAT is a procedure whereby a dealer can utilise credit for tax paid on inputs/ supplies against tax payable on sales. Under the VAT, credit in respect of purchases made during a period can be set-off against the tax payable on sales during that period, irrespective of when the supplies/inputs purchased are utilised/sold. This implies that VAT credit is a credit on purchase of inputs/supplies and a dealer becomes entitled to it immediately upon making a purchase. This implies that the dealer does not have to wait for the sales to be made or the purchased goods to be used for production to claim VAT credit. Further, there is no relationship between the inputs and the outputs, if all sales are taxable.

21. With a view to recommend appropriate accounting treatment for VAT credit, it would be useful to note the requirements of paragraphs 6 and 7 of Accounting Standard (AS) 2, 'Valuation of Inventories', issued by the Institute of Chartered Accountants of India, dealing with 'cost of inventories' and 'costs of purchase', which are as below:

    "6. The cost of inventories should comprise all costs of purchases, costs of conversion and other costs incurred in bringing the inventories to their present location and condition."

    "7. The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase."

Attention is invited to the paragraph related to 'costs of purchase', according to which, only those taxes have to be included as costs of purchase which are not subsequently recoverable by the enterprise from the taxing authorities. Since the tax paid on inputs is available for set-off against the tax payable on sales or is refundable, it is of the nature of taxes recoverable from taxing authorities and accordingly, input tax paid should not be included in the costs of purchase.

22. In view of the above, the amount of tax paid on purchase of inputs/ supplies and available for VAT credit should be debited to a separate account, say, VAT Credit Receivable (Inputs) Account. As and when VAT credit is actually utilised against VAT payable on sales, appropriate accounting entries will be required to record the adjustment, i.e., VAT Credit Receivable (Inputs) Account should be credited with a corresponding debit to the account maintained for tax payable on sales. The debit balance in VAT Credit Receivable (Inputs) Account, at the year-end, should be shown on the 'Assets' side of the balance sheet under the head 'Loans and Advances'.

23. A dealer may purchase certain common inputs which are to be used for making taxable sales as well as for making exempt sales. In such a case, the dealer, on the date of purchase, should estimate inputs expected to be used for making taxable sales and for making exempt sales. The dealer should recognise VAT credit only in respect of those inputs which are expected to be used for making taxable sales and no VAT credit should be recognised in respect of inputs expected to be used for making exempt sales. Subsequently, in case the actual use is different from the estimated use, the dealer should pass an appropriate adjustment entry for the same. Similarly, in the case of stock transfer/consignment sale of goods out of the State where VAT credit is available only to the extent of a certain portion of input tax paid, the dealer should make an estimate of the expected stock transfers/consignment sales and account for accordingly.

ACCOUNTING TREATMENT FOR VAT CREDIT IN CASE OF CAPITAL GOODS

24. The accounting treatment recommended in the following paragraphs applies only to those capital goods which are eligible for the credit.

25. Paragraph 9.1 of Accounting Standard (AS) 10, Accounting for Fixed Assets, issued by the Institute of Chartered Accountants of India, *inter-alia*, provides as below:

    "9.1 The cost of an item of fixed asset comprises its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. …"

    VAT credit is considered to be of the nature of a refundable tax. Therefore, the tax paid on purchase of capital goods should not be included in the cost of such capital goods.

26. As discussed in paragraph 14, VAT credit on capital goods may or may not be available immediately. To the extent VAT credit is available immediately, the amount

in respect thereof should be debited to an appropriate account, say, 'VAT Credit Receivable (Capital Goods) Account' and the balance which is not available immediately, should be debited to another appropriate account, say, 'VAT Credit Deferred (Capital Goods) Account'. Subsequently, when the balance credit or a part thereof becomes available, the appropriate adjustment for the same should be made, i.e., the amount of credit becoming available should be credited to 'VAT Credit Deferred (Capital Goods) Account' with a corresponding debit to 'VAT Credit Receivable (Capital Goods) Account'. Depreciation should be charged on the original cost of fixed asset excluding VAT credit.

ACCOUNTING TREATMENT FOR LIABILITIES ADJUSTED FROM VAT CREDIT RECEIVABLE BALANCE – INPUTS AND/ OR CAPITAL GOODS

27. A dealer may, normally, utilise the VAT credit receivable balance pertaining either to inputs or to capital goods for adjusting/setting-off the following liabilities:
    (a) Liability in respect of VAT payable on sales.
    (b) Liability in respect of disallowance/withdrawal of VAT credit.
28. All liabilities adjusted out of the VAT credit receivable balance should be credited to the VAT Credit Receivable (Inputs) Account or VAT Credit Receivable (Capital Goods) Account. The corresponding debit for the same should be given to the account maintained for recording VAT liability on sales, say, 'VAT Payable Account', if the liability for VAT payable on sales has been met by using the balance in the said account.
29. If, on the other hand, the amount utilised pertains to disallowance/ withdrawal of VAT credit taken on purchase of inputs made during the year, the same should be added to the cost of inputs. Appropriate adjustment in that case would have to be made while valuing inventory of inputs. If the amount adjusted pertains to disallowance/withdrawal of credit in respect of purchases effected in earlier years, the accounting treatment would depend on whether the said inputs/supplies are available in stock or not. If they are not available, i.e., these have already been sold, the disallowance/withdrawal should be debited to profit and loss account and treated as expense of the current year. If these are still lying in stock, the amount should be added to the cost of inputs.
30. If the amount utilised out of VAT credit receivable balance pertains to any disallowance/withdrawal of VAT credit on capital goods, the same should be added to the cost of the relevant fixed asset. For accounting purposes, depreciation on the revised unamortised depreciable amount should be provided prospectively over the residual useful life of the asset. In case the fixed asset no longer exists, the relevant amount should be written-off in the profit and loss account with an appropriate disclosure. If the amount of VAT credit disallowed on capital goods is standing to the debit of VAT Credit Deferred (Capital Goods) Account and has not been transferred to VAT Credit Receivable (Capital Goods) Account, the account to be credited would be the VAT Credit Deferred (Capital Goods) Account.

ACCOUNTING TREATMENT FOR REFUND OF INPUT TAX

31. Input tax which cannot be adjusted against the VAT payable over the specified period of time and input tax paid on purchases made for exports out of the country are eligible for refund. Any refund of input tax received in this manner should be credited to the VAT Credit Receivable (Inputs) Account or VAT Credit Receivable (Capital Goods) Account, as appropriate.

VALUATION OF INVENTORIES OF INPUTS AND FINAL PRODUCTS

32. The inventory of inputs should be valued net of input tax. In other words, the tax on inputs will not form part of the cost of inventories. Balance in VAT Credit Receivable (Inputs) Account should be shown in the Balance Sheet under the head 'Loans and Advances' on the 'Assets' side.
33. Where inputs/supplies have been obtained from small dealers or other dealers who are exempt from VAT, the actual cost of purchase should be considered as a part of cost of inventory.
34. Where purchases are made from the dealers who are not eligible under the relevant State VAT Laws, e.g., unregistered dealers, to pass VAT credit and, therefore, cannot issue tax invoice in accordance with the applicable law, the inventories of such inputs should be valued at the actual cost inclusive of the input tax.
35. While valuing inventories of final products, the value of inputs should be net of the input tax where VAT credit is available.

VALUATION OF INVENTORIES OF CAPITAL GOODS

36. Inventories of capital goods, such as, components, spare parts, accessories, tools, etc., should be valued net of VAT credit. In other words, input tax paid on such capital goods should not form part of their cost.

ACCOUNTING TREATMENT FOR VAT CREDIT ON GOODS LYING IN STOCK AT THE INCEPTION OF THE VAT SCHEME

37. As mentioned in paragraph 13 above, VAT credit is also

available in respect of tax-paid goods lying in stock at the inception of the VAT scheme. The amount of VAT credit available in respect of opening stock should be credited to 'VAT Credit Available on Opening Stock Account' at the inception of the VAT scheme, if required documents for availing this credit are available with the dealer. The corresponding debit for this amount should be given to 'VAT Credit Receivable (Inputs) Account' if the VAT credit is available immediately. If the VAT credit is not available immediately but is available in future, the corresponding debit for this amount should be given to 'VAT Credit Deferred (Opening Stock) Account'. Subsequently, when this credit becomes actually available, the appropriate adjustment for the same should be made, i.e., the amount of credit becoming available should be credited to 'VAT Credit Deferred (Opening Stock) Account' with a corresponding debit to 'VAT Credit Receivable (Inputs) Account'. In the profit and loss account, the amount of 'VAT Credit Available on Opening Stock Account' should be shown as a deduction from the value of opening stock.

ACCOUNTING TREATMENT FOR OUTPUT TAX, i.e., VAT ON SALES

38. Output tax or VAT payable on sales is an indirect tax which is ultimately borne by the final consumer but is collected at each stage of distribution chain. A question may arise as to whether VAT recovered from the customers should be recognised as income in the profit and loss account and, correspondingly, whether VAT payable on sales should be treated as an expense.

39. *The Framework for the Preparation and Presentation of Financial Statements,* issued by the Institute of Chartered Accountants of India, has defined the term 'income' as below:

> "*Income* is increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants."

The Value Added Tax (VAT) is collected from the customers on behalf of the VAT authorities and, therefore, its collection from the customers is not an economic benefit for the enterprise and it does not result in any increase in the equity of the enterprise. Accordingly, it should not be recognised as an income of the enterprise. Similarly, the payment of VAT should not be treated as an expense in the financial statements of the enterprise.

40. In view of the above, it is recommended that the amount of tax collected from customers on sale of goods should be credited to an appropriate account, say, 'VAT Payable Account'. Where the enterprise has not charged VAT separately but has made a composite charge, it should segregate the portion of sales which is attributable to tax and should credit the same to 'VAT Payable Account' at periodic intervals. The amounts of VAT payable adjusted against the VAT Credit Receivable (Inputs) Account or VAT Credit Receivable (Capital Goods) Account and amounts paid in cash will be debited to this account. The credit balance in VAT Payable Account, at the year-end, should be shown on the 'Liabilities' side of the balance sheet under the head 'Current Liabilities'.

41. Where a dealer is enjoying tax holiday and, therefore, his liability to pay output tax is deferred for a period more than one year under the State laws on VAT, the amount in the 'VAT Payable Account' should not be reflected as a current liability. The same should be reflected as a long-term liability.

ILLUSTRATIONS

42. Examples illustrating the accounting treatment of important aspects of VAT are given in the Appendix to this Guidance Note.

Appendix

(This appendix, which is illustrative only and does not form part of the Guidance Note, provides examples to illustrate application of the principles explained in this Guidance Note.)

VAT CREDIT IN CASE OF INPUTS/SUPPLIES

Illustration 1

1. A dealer purchases the following goods in a State during the month of March 20x6:

Particulars	**Total Amount (Rs.)**	**Input Tax Paid (Rs.)**	**Net Amount (Rs.)**
4% VAT Goods	10,40,000	40,000	10,00,000
12.5% VAT Goods	9,00,000	1,00,000	8,00,000
VAT Exempt Goods	2,00,000	-	2,00,000
Total	21,40,000	1,40,000	20,00,000

2. The input tax paid on purchase of goods is eligible for VAT credit.

3. Sales made by the dealer during the month are as below:

Particulars	**Gross Amount (Rs.)**	**Output Tax Collected (Rs.)**	**Net Sales Consideration (Rs.)**
4% VAT Goods	11,44,000	44,000	11,00,000
12.5% VAT Goods	10,12,500	1,12,500	9,00,000
VAT Exempt Goods	2,50,000	-	2,50,000
Total	24,06,500	1,56,500	22,50,000

Suggested Accounting Treatment

1. The dealer passes the following entry to record the goods purchased and input tax paid thereon:

4% VAT Goods Purchase A/c	Dr.	Rs. 10,00,000
12.5 % VAT Goods Purchase A/c	Dr.	Rs. 8,00,000
VAT Exempt Goods Purchase A/c	Dr.	Rs. 2,00,000
VAT Credit Receivable (Inputs) A/c	Dr.	Rs. 1,40,000
To Bank A/c		Rs. 21,40,000

(Being goods purchased and input tax paid)

2. The dealer passes the following entry to record the goods sold and VAT collected thereon:

Bank A/c	Dr. Rs. 24,06,500	
To 4% VAT Goods Sales A/c		Rs. 11,00,000
To 12.5 % VAT Goods Sales A/c		Rs. 9,00,000
To VAT Exempt Goods Sales A/c		Rs. 2,50,000
To VAT Payable A/c		Rs. 1,56,500

(Being goods sold and VAT collected)

3. The dealer passes the following entry to record the liability for VAT payable met by using the balance in the VAT Credit Receivable (Inputs) Account:

VAT Payable A/c	Dr.	Rs. 1,40,000
To VAT Credit Receivable (Inputs) A/c		Rs. 1,40,000

(Being liability for VAT payable met by using the balance in the VAT Credit Receivable (Inputs) Account)

4. Net credit balance of Rs. 16,500 (i.e., Rs. 1,56,500 – Rs. 1,40,000) in VAT Payable A/c is disclosed in the balance sheet as below:

Extracts from the Balance Sheet

Current Liabilities:	Rs.
VAT Payable Account	16,500

5. Accounting Standard (AS) 2, 'Valuation of Inventories', does not require disclosure of components of the cost of inventories as a part of significant accounting policies. However, the dealer may, if he so desires, include the following sentence in the accounting policy regarding valuation of inventories to specify the treatment regarding VAT credit available on purchases:

   'The cost of inventories is net of VAT credit.'

6. The dealer may include the following sentence in the accounting policy regarding revenue recognition to specify the treatment of output tax:

   'Sales are exclusive of VAT.'

7. Suppose the dealer makes payment of outstanding VAT liability at the beginning of the next month. To record the payment, the dealer passes the following entry:

VAT Payable A/c	Dr. Rs. 16,500	
To Bank A/c		Rs. 16,500

(Being payment made for VAT liability)

Illustration 2

1. A dealer purchases the following goods in a State during the month of March 20x6:

Particulars	Total Amount (Rs.)	Input Tax Paid (Rs.)	Net Amount (Rs.)
4% VAT Goods	10,40,000	40,000	10,00,000
12.5% VAT Goods	9,00,000	1,00,000	8,00,000
VAT Exempt Goods	2,00,000	-	2,00,000
Total	21,40,000	1,40,000	20,00,000

2. The other facts of the illustration are as below:
   (a) On March 1, 20x6, there was an opening balance of Rs. 1,00,000 in the VAT Credit Receivable (Inputs) Account.
   (b) During the month, the dealer made a stock transfer of 12.5% VAT goods costing Rs. 2,50,000 out of the State. The stock transfer was an exceptional case for the dealer and, therefore, he had not made an estimate in this regard at the time of purchase. VAT credit to the extent of 4% is not allowed on stock transfer as per the State VAT laws.
   (c) The dealer utilised 4% VAT goods costing Rs. 2,00,000 as input for manufacture of exempted goods. The decision to manufacture the exempted goods was made by the dealer after the purchase of goods and, therefore, he had not made an estimate in this regard at the time of purchase. No VAT credit is available on the inputs used for the manufacture of exempted goods as per the State VAT laws.
   (d) The dealer has received a refund of Rs. 20,000 out of VAT Credit Receivable (Inputs) Account outstanding at the beginning of the month.
   (e) VAT payable on sales made during the month is Rs. 1,15,500.

Suggested Accounting Treatment

1. The entry to record the goods purchased and input tax paid thereon will be the same as in Illustration 1.
2. Since the dealer has recognised full VAT credit at the time of purchase, he is required to reverse the VAT credit to the extent of 4% at the time when the stock transfer takes place. The dealer passes the following entry to record the reversal amounting to Rs. 10,000 (Rs. 2,50,000 x 4%):

12.5 % VAT Goods Purchase A/c	Dr.	Rs. 10,000
To VAT Credit Receivable (Inputs) A/c		Rs. 10,000

(Being VAT Credit reversed to the extent of 4% on stock transfer)

3. The dealer passes entry to record the VAT reversal amounting to Rs.8,000 (Rs. 2,00,000 x 4%) arising because of goods used as input for manufacture of

exempted goods:

4% VAT Goods Purchase A/c Dr. Rs. 8,000
To VAT Credit Receivable (Inputs) A/c Rs. 8,000
(Being VAT credit reversed on the goods used as input for manufacture of exempted goods)

4. The dealer passes the following entry to record the refund of VAT credit received:

Bank A/c Dr. Rs. 20,000
To VAT Credit Receivable (Inputs) A/c Rs. 20,000
(Being refund of VAT Credit Receivable)

5. VAT Credit Receivable (Inputs) A/c will appear in the books of the dealer as below:

VAT Credit Receivable (Inputs) A/c

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance Dr./Cr.	Balance Amount (Rs.)
March 20x6					
	To Balance b/d	1,00,000		Dr.	1,00,000
	To Bank	1,40,000		Dr.	2,40,000
	By 12.5 % VAT Goods Purchase A/c		10,000	Dr.	2,30,000
	By 4% VAT Goods Purchase A/c		8,000	Dr.	2,22,000
	By Bank		20,000	Dr.	2,02,000
	By VAT Payable A/c		1,15,500	Dr.	86,500
	By Balance c/d		86,500		
	Total	2,40,000	2,40,000		

6. Net debit balance of Rs. 86,500 in the VAT Credit Receivable (Inputs) A/c is disclosed in the balance sheet as below:

Extracts from the Balance Sheet

Assets	Amount (Rs.)
Loans and Advances	
VAT Credit Receivable (Inputs) A/c	86,500

VAT CREDIT IN CASE OF CAPITAL GOODS

Illustration 1

On June 1, 20x6, a dealer purchases one machine in a State for the total cost of Rs. 93,60,000 which includes input tax of Rs. 3,60,000. As per the State VAT laws, input tax paid on purchase of machinery is adjustable as VAT credit over 36 equal monthly instalments beginning July 1, 20x6. Till the end of the year, the dealer has not utilised the VAT credit available on the machine.

Suggested Accounting Treatment

1. The dealer passes the following entry to record the machinery purchased and input tax paid thereon:

Machinery A/c Dr. Rs. 90,00,000
VAT Credit Deferred (Capital Goods) A/c Dr. Rs. 3,60,000
To Bank A/c Rs. 93,60,000
(Being machinery purchased and input tax paid)

2. When the VAT credit becomes actually available, the dealer passes the following entry to recognise the same every month:

VAT Credit Receivable (Capital Goods) A/c Dr. Rs. 10,000
To VAT Credit Deferred (Capital Goods) A/c Rs. 10,000
(Being a portion of VAT credit on purchase of machinery becoming available)

3. The dealer charges depreciation on the cost of machinery excluding VAT credit (i.e., Rs. 93,60,000 – Rs. 3,60,000 = Rs. 90,00,000).

4. Balances in VAT Credit Deferred (Capital Goods) A/c and VAT Credit Receivable (Capital Goods) A/c are disclosed in the balance sheet as on March 31, 20x7 as below:

Extracts from the Balance Sheet

Assets	Amount (Rs.)
Loans and Advances	
VAT Credit Deferred (Capital Goods) A/c	2,70,000
VAT Credit Receivable (Capital Goods) A/c	90,000

Illustration 2

VAT laws of a State come into effect from April 1, 20x5. The laws provide VAT credit for tax paid on capital assets which have been purchased between April 1, 20x3 and March 31, 20x5 and sold on after April 1, 20x5 but before December 31, 20x5.

On April 1, 20x5, a dealer has a machinery which was purchased on December 31, 20x3 for Rs. 12,00,000. The dealer has created provision for depreciation of Rs. 1,50,000 on the machinery till March 31, 20x5. On July 1, 20x5, the dealer sells the said machinery for Rs. 15,00,000. Depreciation on the machinery for the period of April 1, 20x5 to June 30, 20x5 is Rs. 30,000. As per the State VAT laws, the dealer is entitled to VAT credit of Rs. 1,35,000 on sale of the machinery.

Suggested Accounting Treatment

1. As per the Guidance Note, a dealer should recognise VAT credit as soon as he becomes entitled to it. In the present case, as per the State VAT laws, the dealer becomes entitled to VAT credit only when the machinery is sold. Accordingly, he should recognise the VAT credit only on sale of the machinery. To recognise the credit, the dealer passes the following entry:

July 1, 20x5 VAT Credit Receivable (Capital Goods) A/c Dr. Rs. 1,35,000
To Machinery A/c Rs. 1,35,000
(Being VAT credit becoming available on sale of machinery)

2. Machinery A/c will appear in the books of the dealer as below:

Machinery A/c

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance Dr./Cr.	Balance Amount (Rs.)
20x5					
April 1	To Balance b/d (Original Cost)	12,00,000		Dr.	12,00,000
July 1	By Bank (Sale Consideration)		15,00,000	Cr.	3,00,000
July 1	By Provision for Depreciation (Upto March 31, 20x5)		1,50,000	Cr.	4,50,000
July 1	By Depreciation for current year		30,000	Cr.	4,80,000
July 1	By VAT Credit Receivable (Capital Goods) A/c		1,35,000	Cr.	6,15,000
July 1	To Profit on sale	6,15,000			Nil
	Total	18,15,000	18,15,000		

VAT CREDIT IN CASE OF OPENING STOCK AT THE INCEPTION OF VAT SCHEME

Illustration 1

On April 1, 20x5 (the date on which VAT scheme comes into effect), a dealer has an opening stock of Rs. 9,36,000 and the dealer has paid sales tax of Rs. 36,000 on purchase. As per the State VAT laws, these goods are eligible for availing VAT credit in respect of the tax paid. This VAT credit will be available over a period of 6 months after an interval of 3 months needed for verification.

Suggested Accounting Treatment

1. On April 1, 20x5, the dealer passes the following entry to record the VAT credit that will be available in respect of the opening stock:
   VAT Credit Deferred (Opening Stock) A/c Dr. Rs. 36,000
   To VAT Credit Available on Opening Stock A/c Rs. 36,000
   (Being VAT credit in respect of opening stock at the inception of the VAT scheme)
2. On July 1, 20x5, when first instalment of VAT credit becomes actually available, the dealer passes the following entry to recognise the amount becoming available:
   VAT Credit Receivable (Inputs) A/c Dr. Rs. 6,000
   To VAT Credit Deferred (Opening Stock) A/c Rs. 6,000
   (Being a portion of VAT credit on opening stock becoming available)
3. The dealer will repeat the entry mentioned at 2 above for the next 5 months to record the amount of VAT credit becoming available.
4. The dealer discloses opening stock and VAT credit availed in respect thereof in the profit and loss account in the following manner:

Extracts from the Profit and Loss Account

Particulars		*Amount (Rs.)*
Opening Stock	Rs. 9,36,000	
Less: VAT Credit Available on Opening Stock	Rs. 36,000	Rs. 9,00,000

Illustration 2

Continuing Illustration 1, suppose as per the State VAT laws, immediate VAT credit in respect of the tax paid on opening stock is available. In case any part of the opening stock remains unsold upto December 31, 20x5, the dealer is required to reverse VAT credit in respect of unsold stock. The dealer has unsold goods worth Rs. 2,50,000 (net of VAT credit) from the opening stock on December 31, 20x5 and, therefore, he is required to reverse VAT credit to the extent of Rs. 10,000.

Suggested Accounting Treatment

1. On April 1, 20x5, the dealer passes the following entry to record the VAT credit available in respect of the opening stock:
   VAT Credit Receivable (Inputs) A/c Dr. Rs. 36,000
   To VAT Credit Available on Opening Stock A/c Rs. 36,000
   (Being VAT credit in respect of opening stock at the inception of the VAT scheme)
2. On December 31, 20x5, the dealer passes the following entry to reverse the VAT credit in respect of unsold goods:
   VAT Credit Available on Opening Stock A/c Dr. Rs. 10,000
   To VAT Credit Receivable (Inputs) A/c Rs. 10,000
   (Being VAT credit reversed in respect of unsold opening stock)

TREATMENT OF OUTPUT TAX ON A DEBTOR BECOMING INSOLVENT

Illustration

On January 15, 20x6, A Ltd. sells on credit 1,000 units of product 'X' to 'B' for Rs. 100 per unit plus 12.5% VAT. On June 30, 20x6, 'B' becomes insolvent. As per the relevant State VAT laws, in this situation, 'A' Ltd. is not liable to pay VAT.

Suggested Accounting Treatment

1. On January 15, 20x6, 'A' Ltd. passes the following entry:
   B A/c Dr. Rs. 1,12,500
   To Sales Rs. 1,00,000
   To VAT Payable Account Rs. 12,500
   (Being sale of goods on credit to 'B')
2. On June 30, 20x6, 'A' Ltd. passes the following entry:
   VAT Payable A/c Dr. Rs. 12,500
   Bad Debts A/c Dr Rs. 1,00,000
   To B Rs. 1,12,500

(Being bad debts written off on B becoming insolvent) ■