BACKDROP FOR STATE LEVEL VAT IN INDIA

- **Meaning:**
  - It is a multi-point tax on value addition
  - VAT is a tax on value added by a dealer.
  - It is collected at different stages of sale
  - With a provision for set-off for tax paid at the previous stage/ tax paid on input before remitting to the Government Account.
  - From 01-04-2005 VAT was introduced in sales tax by all most all the states.
  - VAT prevents cascading effects of taxation by providing set-off/ input –credit of tax paid at earlier stage. Cascading effect means impositions of tax on tax.

- **Basics**:
  - **Power:** As per Entry No. 54 in List (State List) of Schedule VII to constitution of India, States are empowered to levy tax on sale or purchase of goods other than news-paper.
  - **Basic Design:** In order to bring uniformity in VAT, The empowered committee of State Finance was formed. The empowered committee brought out a **white paper**, which provided a base for the preparation of various State VAT Legislations.

    White paper consisted of

    a) Justification of VAT and Background
    b) Design of State level VAT
    c) Steps taken by the states.
  - **State Dependent:** Since VAT is a state subject, the states will have freedom for appropriate variation consistent with the basic design as agreed upon at the Empowered Committee.
  - **VAT** replaced only local Intra state taxes levied at state level like Local Sales tax, Turnover Tax, Additional Taxes and Surcharge.

- **Purpose** :
  - The purpose of introduction of VAT is to bring harmonization in the tax structure of various States and rationalize the overall tax burden
  - With introduction of VAT it is proposed to discontinue CST and compensate state govt. for the loss of revenue suffered by them.

- **Introduction of GST** :
  - Under GST there will be only one central authority administering a uniform goods and service through out country. However, such a development will require constitutional amendment.
  - Under such a uniform tax system, there will no trade barriers like octroi.

Practical Questions

Q.1 X, a manufacturer sells goods to B, a distributor for Rs. 2,000 (excluding of VAT). B sells goods to K, a wholesale dealer for Rs. 2,400. The wholesale dealer sells the goods to a retailer for Rs. 3,000, who ultimately sells to the consumer for Rs. 4,000.

Compute the tax liability, input credit availed and tax payable by the manufacturer, distributor, wholesale dealer and retailer under invoice method assuming VAT rate at 12.5%. [IPCC. November, 2009]

TAXONOMY OF VAT

- **Variants of VAT**:

Variants	Description
Gross Product Variant	1. **Principle:** The gross product variant allows deductions for taxes on **all purchase of raw materials and components. No deduction is allowed for taxes on capital inputs** 2. **Limitation:** a) Capital goods are taxed twice i.e., at the time of purchase and at the time of sale of goods produced using those capital goods. b) Modernization and upgrading of plant and machinery is delayed due to this double tax treatment.
Income Variant	1. **Principle:** a) The income variant of VAT **allows for deductions** on purchase of raw materials and components as well as **depreciation on capital goods.** (i.e.) Credit on Capital purchases are allowed in the ratio of Depreciation over the life of the capital asset. b) This method provides incentives to classify purchase as current expenditure to claim set off. 2. **Limitation:** There are 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	1. **Principle:** **a)** Consumption variant of VAT allows for deduction on **all business purchases including capital assets.** **b)** Gross investment is deductive in calculating value added. **c)** It neither distinguishes **between capital and current expenditures** nor specifies the life of assets or depreciation allowances for different assets. 2. **Merits:** a) 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). b) Convenient from the point of administrative expediency as it simplifies tax administration by obviating the need to distinguish between purchases of intermediate & capital goods and consumption goods . 3. **Limitation:** The system is tax neural from the view point of Government leads to loss of revenues to the Government.

Practical Questions:-

Q.2 A manufacture has purchased raw material for Rs. 1,04,000 (inclusive of 4% VAT) and Plant & Machinery for Rs. 2,25,000 (inclusive of 12.5% VAT). The manufacturing and other expenses (excluding depreciation) are Rs. 3,00,000. He sells the resultant product at 50% above cost (VAT on sales is 4%). The Plant & Machinery is to be depreciate at 50% straight line.
(a) Compute the amount of VAT payable in cash, as per the Gross Product Variant of VAT.
(b) What would be VAT payable in cash, as per the Income Variant
(c) What would be VAT payable in cash, as per the Consumption Variant

- **Computation of VAT**:

1. **Addition Method**
   - ❖ **Suitability** – This method is mainly used with income variant of VAT
   - ❖ **Limitation –**
     - o This method does not easily accommodate exemption of intermediate dealer
     - o It does not facilitate matching of invoice for detecting evasion
   - ❖ **Computation –**
     - o Step 1: Aggregate all the factors payment including profits to arrive at the total value addition
     - o Step 2: Apply the rate on Step 1 to calculate tax

2. **Invoice Method**
   - ❖ **Suitability –** Under Central Excise law this method is followed.
   - ❖ **Salient Feature - .**
     - o 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"
   - ❖ **Computation -**
     - o Step 1: Compute the tax to be imposed at each stage of sales on the entire sale value.
     - o Step 2: Set-off the tax paid at the earlier stage.
     - o Step 3: the difference tax is paid"

3. **Subtraction Method**
   - ❖ **Suitability –** This method is normally applied where the tax is not charged separately.
   - ❖ **Salient Feature**:
     - o Tax is charged only on the value added at each stage of the goods
     - o There is no tax credit as the total value of goods sold is not taken into account.
   - ❖ **Method of determination of value added-**
     - o Direct Subtraction Method:
       Value added = Total value of sale exclusive of tax less Total value of purchase exclusive of tax
     - o Intermediate Subtraction Method:
       Value added = Total value of sale inclusive of tax less total value of purchases inclusive of tax
   - ❖ **Computation -**
     - o Step 1: Compute the value added at under either of the above methods
     - o Step 2: Apply the rate of tax on the amount calculate in step 1

Practical Question

Q.3 A manufacture has purchased raw material for Rs. 1,04,000 (inclusive of 4% VAT) and plant & machinery for Rs. 2,00,000 (VAT nil). The manufacturing and other expense are Rs. 3,00,000 He sells the resultant product at 50% above cost(VAT on sales is 4%). The plant & machinery is to be depreciate at 50% straight line. Compute the amount of VAT payable by addition method.

Q.4 The following details have been obtained from the final accounting statement of a dealer for the year 2009-10. Calculate VAT payable assuming rate of VAT is 10%

Input purchased	Rs. 15,00,000
Profit	Rs. 1,00,000
Shop Rent & Salaries	Rs. 2,70,000
Electricity Charges	Rs. 80,000
Other Expenses	Rs. 50,000

- **Advantages of VAT:**

VAT is being implemented in various states in place of the local sales tax payable by the seller. VAT is also expected to be more effective and efficient for every person including Government, manufactures, traders and consumers and hold the following advantages:

1. **Easy to Administer & Transparent**: This system of charging tax is easy to administer because of its simplicity. It also reduces the cost of compliance by the dealers and is transparent, as tax is to be charged in every bill and there will be no local statutory forms.

2. **Less Litigation**: There will be no litigation with respect to allow ability of items, as under VAT no items will be specified in the registration certificate of the dealer. The dealer will be allowed to purchase any of the items of his choice in which he intends to deal. He will also be allowed to purchase any item he requires as raw material for the purpose of manufacturing or for packing.

3. **Tax Credit on purchase of Capital Goods:** The dealer will be allowed to purchase capital goods for manufacturing after paying sale tax and will be entitled to get set off sales tax paid on such purchases from his sales tax liability, which will arise on the sales made by him.

4. **Abolition of Statutory Forms**: There are no forms under VAT. Therefore, all problems related to forms automatically get resolved.

5. **Self Assessment**: Dealers are not required to appear before the Assessing Authority for their yearly assessments, as under VAT there is provision for self assessment. All the cases will be accepted by the department as correct and only a few will be selected for audit as is being done by Income Tax Department and Excise Department at present.

6. **Deterrent against Tax Avoidance:** It will act as deterrent against tax avoidance. Under the present system, tax is charged either on first point basis or at last point basis hence the incentive to evade tax is high because the dealer saves the whole amount of tax due on such transaction, whereas under VAT the incentive to evade tax is low because the dealer saves only a part of tax i.e. (tax amount which he is liable to pay less the amount of tax he has already paid on his purchases).

7. **No Cascading Effect**: It does not have cascading (tax on tax) effect due to system of deduction or credit mechanism. Since VAT does away with cascading, it avoids distorting business decisions; the need for vertical integration is dictated only by the market forces or technical considerations, and not by the tax structure.

8. **Effective Audit & Enforcement Strategies**: The input credit method by generating a trail of invoices is argued to be system that encourages better compliance since the purchaser seeks an invoice to get input tax credit. Further, this trail of invoices supports effective audit and enforcement strategies.

9. **Minimum Exemptions**: The system will be more effective because of minimum exemptions.

10. **Removal of Anomaly of First Point Taxation**: VAT eliminates the limitations of single point tax either at first point or last point. In the case of last point goods, the temptation to evade tax is high.

- **VAT Limitation**

VAT undoubtedly has many advantages but without taking note of the limitation of VAT, one is just looking only at one side of the coin. The limitations of VAT are discussed hereunder.

1. **Detailed Records** :Like any other system VAT is also not free from all evils. Though on record it is said to be the simplest method, however, it is more complicated than a simple first point tax. Many small dealers maintain only primitive accounts and it is very difficult for them to keep proper and detailed records required for VAT purposes.

2. **Cause Inflation**: It is also argued that VAT causes inflation. It's impact will depend on various factors such as inventory holding period, demand supply position of that particular product, number of intermediaries etc. Investment in stock is bound to increase as tax will be paid at the time of purchase, hence one will have to carry tax paid stock.

3. **Refund of Tax**: Credit of tax paid on inputs/capital goods is available to be utilized against tax liability which will be calculated on the sale of final product. VAT credit can not be availed if no tax is payable on final product being exempt or taxable at lower rate.

4. **Functional Problems:** The functional problem of VAT is that input tax credit is allowed on the basis of the invoices issued by the dealer. In respect of invoices where tax at the earlier stage is charged and collected, but not remitted to the State by the concerned dealer, the dealer who has paid the tax and who is entitle to take credit for the tax paid should not be made to suffer. Provisions to protect the interest of the dealers who have paid the tax should be made.

5. **Increase in Investment**: Dealer will be making purchases after paying tax, therefore investment in stock will go up the extent of tax paid. Under old system the dealer was making purchases against statutory forms, hence was not liable to pay tax on it's purchases.

6. **Not Credit for Tax paid on Interstate Purchases**: The biggest problem of introduction of VAT is the non availability of credit for tax paid on interstate purchases in initial years. It will also result in some cascading effect, which goes against the basic spirit of VAT.

7. **Audit under VAT:** Most of the states introduced VAT on 1.4.2005 and they have incorporated audit provisions in the Legislation itself. Audit under VAT is important for better and effective implementation of the VAT system.

INPUT TAX CREDIT & TAX INVOICE

- **Input Tax Credit** :

  1. Eligibility

  - **Dealer:-** 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

  2. Eligible Purchase: Tax paid on purchases which are meant for sale or for utilization in the process of production for such sale.

  3. Tax Payment: The VAT liability of the dealer is calculated by deducting VAT Credit from tax payable on sale during the tax payment period.

  4. VAT Credit for Stock Transfer –

  - VAT Credit is given to a dealer for purchase of inputs/ supplies in a state meant for sales within the date as well as in other states.
  - Even for stock transfer/ Consignment sale of goods out of the stock, input tax credit excess of a certain percentage (i.e. 4 %, now) is eligible for VAT Credit.

  5. Carry Forward of VAT Credit-

  - 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) and the unadjusted VAT credit at the end of the specified period is eligible for refund.

  6. Exempt and Zero Rated Goods-

  - **Exempt Goods**: Goods on which VAT Credit cannot be claimed
  - Sales which are **Zero rated** : VAT Credit can be claimed in respect of purchase for such sale

  7. VAT Credit On-

  - **Opening Stock**: All tax paid goods still in stock and purchase up to 1 years becomes applicable are eligible for input tax credit. However, the VAT Credit available on opening stock is available over a period of 6 months after an interval of 3 months. Capital goods included in the opening stock are not eligible for input tax credit
  - **Capital Goods**: VAT Credit on all capital goods, except a few included in the negative list in respective state laws may be adjusted over a maximum period of 36 equal monthly installment.

- **Purchase not eligible for input Tax Credit** :

  Input tax credit may not be allowed on the purchase of goods

  1. From unregistered dealers
  2. From registered dealers opting for composition scheme
  3. Notified by the state government
  4. Where purchase invoice is not available
  5. Where purchase invoice does not show tax amount separately
  6. Which are being utilized in the manufacturer of exempted goods.
  7. Which have suffered tax earlier but exempted under VAT
  8. Used for personal use or provided free of charge as gifts.
  9. Imported from outside the territory of India.
  10. From other state/ interstate purchase

- **Eligible Purchases for availing for input Tax Credit** :

  Following are the eligible Purchases
  1. For sales / resale within the state
  2. For interstate sales
  3. To be used as
     A. Containers or packing material
     B. Raw materials or
     C. Consumables stores
     rom unregistered dealers
  4. To be used as capital goods required for manufacturing or resale of taxable goods;
  5. To be used as
     A. Raw Materials
     B. Capital goods
     C. Consumables stores
     D. Packing material/ Containers
  6. For making zero rates sales

- **Refund to Exporters:**

  The White Paper provides for the grant of refund of input tax paid if the goods are exported out of the country. Under the basic design of the White Paper this refund is to be granted **within a period of 3 months** from the end of the period in which the transaction for export took place.

- **Exemption or Refund to SEZ or EOU Units**:

  Units located in Special Economic Zone (SEZ) and Export Oriented Units (EOU) are granted either exemption from payment of input tax or refund of the input tax paid within three months. State Governments may reduce the **time period of 3 months**.

- **VAT Invoice** :

  The whole structure of input tax credit is based on tax invoice, without which credit cannot be claimed. However, in case of small dealer or if the sale is to end consumer, other invoice are permitted without details of tax.

  - **Content of Tax Invoice**
    - The word "Tax Invoice"
    - Name, address and registration number (TIN) of the selling dealer
    - Name & address of the purchasing dealer
    - Registration number of the purchasing dealer (not required under all VAT laws)
    - Pre-printed or self generated serial number with Date of issue
    - Description, quantity and value of goods sold
    - Rate & 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.

  - **Importance of Tax Invoice**
    - Helps in determining the input tax credit
    - Prevents cascading effects of taxes
    - Facilitates multi-point taxation on the value addition
    - Promotes assurance of invoice
    - Assist in performing audit and investigation activities effectively
    - Checks evasion tax.

Practical Question

Q.5 Mr. X, a manufacture, manufactures cloth for the production of which he uses raw material A and raw material A and raw material B. The sale price of raw material A is Rs. 100 and that of raw material B is Rs. 40. He sold cloth to another manufacture Mr. Y for Rs. 300. Mr. Y used this cloth in the manufacture of shirts whose selling price is Rs. 500. Calculate VAT payable at each stage assuming rate of VAT on all the product is 10%.

Q.6 Dinesh purchase raw material from Ram and Shyam for manufacturing goods. Dinesh sells goods to wholesaler Mohan. Mohan sells goods to Trilok, a retailer, who sells goods to consumers.
Calcualte the amount of VAT collected by the government from the following particulars based on the facts that Shyam charges VAT @ 4% and other sellers charges VAT @ 12.5%:

Ram to Dinesh	Rs. 5,000	Shyam to Dinesh	Rs. 8,000
Manufactured goods sold:			
Dinesh to Mohan		Rs. 18,000	
Mohan to Trilok		Rs. 25,000	
Trilok to consumers		Rs. 30,000	

Q.7 Mr. X of Rajasthan started business w.e.f. 01-01-2010 and got himself registered with VAT authorities. He presents the following details for the month of January 2010.

Purchase from Delhi	Rs. 10,00,000
Purchase from Rajasthan	Rs. 4,00,000
Sales within Rajasthan out of purchase from Rajasthan	Rs. 8,00,000
Sales within Rajasthan out of purchase from Delhi	Rs. 1,00,000
Sales to dealer of Maharashtra out of purchases from Rajasthan	Rs. 4,00,000
Sales to dealer of Maharashtra out of purchases from Delhi	Rs. 2,00,000

Compute tax payable by Mr. X. Aforesaid amounts are exclusive of taxes. VAT rate is 4%. CST rate is 2%.

Q.8 Mr. A present following details for March, 2010-

Opening Balance of Input VAT Credit as on 01-03-2010:	Rs. 15,000
Inputs purchased during the month of March	Rs. 15 lakh
Within the state sales of manufactured goods	Rs. 20 lakh.
Inter-state Sales:	Rs. 5 lakh

CST rate is 2%. There is no inventory as on 01-01-2010 or 31-03-2010. The VAT law governing Mr. A provide for the refund of input –VAT credit after the end of the first financial year it self. VAT rate is 12.5% on inputs and 4% on sales. Compute the amount of refund available to Mr. A

Q.9 Mr. K, a manufacture of taxable as well as tax free goods, furnishes the information for the month of March:

(a) Sales of Product A (tax free goods): Rs. 50 lakhs
(b) Sales of Product B (taxable goods): Rs. 100 lakhs (VAT @ 12.5%)
(c) Purchase of Input “X” (used in manufacture of Product A only) Rs. 30 lakhs (VAT @ 4%)
(d) Purchase of Input “Y” (used in manufacture of Product B only) Rs. 75 lakhs (VAT @ 4%)
(e) Purchase of Input “Z” (used in manufacture of Product A & B) Rs. 15 lakhs (VAT @ 20%)

There were no opening or closing inventory. Compute the amount of VAT payable in cash by Mr. K for the month assuming that input “Z” is used in product A & B in ratio of 1:2. Ignore implication under other laws.

SMALL DEALERS & COMPOSITION SCHEME

- **Composition Scheme** :
  - **State Laws to provide for composition Scheme:**

As per white paper VAT Act should be so designed that high taxpayers should not spared and the small dealers should be free from hassies of compliance procedures. Dealer with limited turnover would have an option to pay a lump sum amount based on its turnover at the specified rate as low as 0.25%
Different Schemes may be provided for different classes of dealer.

- **Condition for Composition Scheme:**
  - Turnover of a registered dealer does not exceed Rs. 50 lakhs and

Such a dealer would have an option to pay composite amount of tax based on its annual gross turnover at athe prescribed rates. However, the following are not eligible for the composition scheme:

A. A manufacturer or a dealer who sells goods in course of interstate trade
B. A dealer who sells goods in the course of import or export out of India
C. A dealer transferring goods outside state otherwise than by way of sale or for execution of work contract

Advantage :

Simplifies calculation	Small tax will be payable
Simple return form to cover loner period	Simple records to be maintained

Disadvantages :

No input tax credit can be availed	Cannot issue tax invoice

Practical Questions

Q.10 Mr. K, a retailer who keeps no inventories, presents the following expected information for the year-

1. Purchase of goods :	Rs. 20,00,000 (VAT 4%)
2. Sales (at fixed selling price inclusive of all taxes) :	Rs. 30,00,000 (VAT on sales @ 4%)

Discuss whether he should opt for composition scheme if composite tax is 1% of turnover. Expense of keeping details statutory records required under VAT law will be Rs. 50,000 p.a., which shall get reduced to Rs. 20,000 if composite scheme is opted for. Other expenses are Rs. 3,00,000 p.a.

Q.11 Manufacture A extracted raw product X and raw produce Y from mines at Rs. 15,000 and Rs. 20,000 respectively and sold the same at 150 % margin to manufacture B (VAT 4 % on product X and 12.5% on product Y). Manufacture B is a dealer operating under composition scheme who is also liable to VAT @ 0.40% of turnover. Manufacture B of Surat uses X & Y as raw material added 100% cost of raw material towards manufacturing expenses and profits and sold the resultant product to wholesaler C. C sold the same retailer to D at 25% above cost (VAT rat is 4%). The retailer D sold the same to a consumer at 20% above cost (VAT rate is 4%)
Show the amount of VAT payable by each person.

VAT PRODUCERS

- **Registration** :
  - It is process of obtaining certificate of registration from authorities under VAT Acts.
  - Eligibility :
    1. Gross annual turnover above Rs. 5 lakhs (can be increased to 10 lakhs)
    2. All existing dealer will automatically get registered
    3. A new dealer will be allowed 30 days from the date of liability to get registered.

  - **Compulsory Registration:**
    If an assessee, through required to do so, fails to obtain registration under the VAT Act, he may be compulsorily registered by the commissioner, with the following results-
    (a) The Commissioner may assess the tax due from him on the basis of evidence available with him.
    (b) The assessee shall have to pay such amount of tax forthwith
    (c) He will be liable to penalty for such default and
    (d) He will not be eligible to set-off input tax credit related to period prior to compulsory registsration.

  - **Voluntary Registration:**
    A dealer for whom it is not obligatory to obtain registration may also obtain registration if the commissioner is satisfied that the business of the applicant requires registration.

  - **Cancellation of Registration:**
    The registration is liable for cancellation in any of the following case:
    1. Permanent discontinuance of business
    2. Disposal of business
    3. Transfer of business to a new location or
    4. Annual turnover of a manufacturer or a trader dealing in designated goods or service falling below the specified amount or
    5. Dealer has failed to furnish requisite security or has committed fraud/ misrepresented of facts.

  - **Taxpayers' Identification Number (TIN)**
    TIN is a 11-digit numerical code allotted to every dealer obtaining registration under the VAT-law. It is the registration number, which is intended to identify tax payer.

- **Records** :
  - Following records are mandatory under VAT
    1. Purchase records: Copies of all credit or debit notes issued in chronological order and
    2. Sales records: All invoice in serial no. Copies of all credit or debit notes issued in chronological order and details of amount of tax charged on each sale
    3. VAT Account: Total of the output tax and input tax in each period
       Net total of the tax payable or the excess carried forward as the case may be
  - All theses records should be preserved for the period specified in respective state law (generally 5 years from the end of the year to which they relate)

- **Role of CA in VAT** :
  1. Record keeping
  2. Tax Planning
  3. External audit of VAT records
  4. Dealing with departmental officers

- **Administrative – Procedures under VAT**
  - The major contribution of VAT is simplification. VAT liability will be self assessed by the dealer themselves Voluntary return will be submitted after setting off the tax credit.

  - Under VAT, simplified form of return has been notified. Returns are to be filed monthly/ quarterly as specified in the State Act/ Rules, and will be accompanied with payment challans.

  - Correctness of self assessment will be checked through a system of department audit if evasior is detected on audit, the concerned dealer may be taken up for detailed enquiry.

- **Penal Provision**
  - Penal provisions are incorporated by State as per their requirements to discourage evasion of taxes
  - Some of them which attract penalties are –
    1. Failure of keep records
    2. Failure of get registered

- **Tax rates under VAT**
  - There are two basic rate of 4% & 12.5 % Plus
  - VAT rate of 1% for precious stones, gold and silver
  - VAT rate of 20% for Luxury goods
  - A Special category of Zero rated goods included-
    - About 50 commodities of natural and unprocessed product in unrecognized sector
    - Items legally barred from taxation and
    - Items having social implication

- **Goods covered by VAT Law**:
  - All kind of **moveable property**
  - It includes:-
    - All materials, commodities and articles
    - Goods involved in the execution of works contract or those goods to be used in the fitting out, improvement or repair of moveable property.
    - All growing crops, grass or things attached to or forming part of the land which are agreed to be served before sale or under the contract of sale.
  - It **excludes**

    - Newspaper,
    - Stocks
    - Actionable claims
    - Shares & Securities
  - Coverage under VAT: All goods **except liquor, lottery tickets, petrol, diesel, aviation turbine fuel and other motor spirits** whose price are not fully market determined are covered under VAT and get the benefits of VAT Credit.

Common Practical Question

Q.12 Manufacturer A extracted raw produce X and raw produce Y from mines and sold the same to Manufacture B for Rs. 40,000 & Rs. 60,000 respectively. Manufacture B used X and Y as raw material and sold the resultant product to wholesaler C for Rs. 3,00,000. Wholesaler C sold the same to Retailer D for Rs. 4,50,000. The retailer D sold the same to consumer for Rs. 5,00,000.
Compute the VAT payable at each stage under:
(a) Invoice Method. (b) Subtraction Method
Assuming all sales are liable to VAT @ 4% and all the prices given are exculsive of VAT

Q.13 Compute the invoice value to be charged and amount of tax payable under VAT by a dealer who had purchased goods for Rs. 1,20,000 and after adding for expenses of Rs. 10,000 and of profit Rs. 15,000 had sold out the same. The rate of VAT on purchase and sales is 12.5%. [PCC. November, 2007]

Q.14 Compute the VAT amount payable by A who purchase goods from a manufacturer on payment of Rs. 2,25,000 (including VAT) and earn 10% profit on sale to retailers ? VAT rate on purchase and sale is 12.5%
[PCC. June, 2009]

Q.15 X, a trader selling raw material to a manufacturer of finished products. He imports his stock in trade as well purchase the same from the local markets. Following transaction took place during the F.Y. 2009-10. Caluclate VAT and invoice value charged by him to manufactuer. Assume the rate of VAT @ 12.50%

Cost of imported material (from other state) excluding tax	1,00,000
Cost of local material including VAT	2,25,000
Other expenditure including storage, transport, interest & profit earned by him	87,500

[IPCC, June, 2009]

Q.16 Purchase of S & Co., for the month of December are as follow:
Rs. 1,00,000 at 4% VAT & Rs. 5,00,000 at 12.5 % VAT
Sales of S & Co., for the month of December are as follow:
Rs. 3,00,000 at 4% VAT & Rs. 3,00,000 at 12.5% VAT
Compute the eligible input tax credit and VAT payable for the month [Final, June, 2009]

Q.17 Calculate the VAT liability for the period Jan. 1, 2009 to Jan. 31, 2009 from the following particulars :
Input worth Rs. 1,00,000 were purchased within the State. Rs. 2,00,000 worth of finished goods were sold within the State and Rs. 1,00,000 worth of goods were sold in the course of inter-state trade. VAT paid on the procurement of capital goods worth Rs. 1,00,000 during the month was at 12.5%. If the input and output tax rate in the State are 12.5% and 4% respectively and central sales tax rate is 3%, show the total tax liability under the State VAT law and under CST Act. [Final, Nov., 2008]

Q.18 Calculate the tax liability under VAT law and the Central Sales tax Act of the month of March, 2010 from the following particulars:

Input purchased within the state	Rs. 1,70,000
Capital goods used in the manufacturing of the taxable goods	Rs. 50,000
Input purchased from a dealer who opts for composite scheme under the provision of the Act	Rs.10,000
High seas purchases of inputs	Rs. 1,00,000
Finished goods sold within state	Rs. 2,00,000
Finished goods sold in the course of inter state trade	Rs. 2,50,000

Applicability tax rate: VAT rate on capital goods 4%, input tax rate – 4% Output tax rate – 12.5% & CST-2%
[RTP June, 2009]

VAT AND SALES-TAX INCENTIVES

- **Principles laid down in the White Paper**
  The Empowered Committee while allowing the States to decide their own policy for treatment of Incentives had prescribed certain preconditions:
  (i) the quantum as well as the time period allowed for availing the incentives should not be increased or extended.
  (ii) VAT chain should not be affected.

- By and large the incentives are given in three modes as described below:-

(a) Exemption from tax

- Under this mode incentives are given by way of exemption from tax.
- Not required to pay tax on purchase and sales.
- The advantage of this mode is that it making goods cheaper
- The amount of entitlement is to be availed within a specified period.
- The exemption so allowed, ceases either with the expiry of exemption period or the exemption amount whichever occurs first.

(b) Deferment of tax liability

- Under this mode eligible industry is at par with any other normal unit.
- It collects the tax on sale of finished goods and also pays the tax to its vendors on the purchase of raw materials etc.
- However, such eligible unit/industry is not required to pay the collected tax to the Government immediately.
- After that particular period, the liability is required to be paid in prescribed instalments.

(c) Remission of tax

- Under this mode an eligible industry is allowed to collect tax at an appropriate rate but is not required to pay the same.
- The unit is required to file periodical return and show the tax liability.
- After filing the return the department remits the tax liability in full.
- Thus, the tax liability as per return is deemed to have been paid. The input tax paid on purchases by the unit is being given as refund immediately after filing the return.

The exemption mode will not be suitable for VAT regime as it would break the VAT chain. The dealers would not be able to issue tax invoices and pass on the credit. However, under deferment and remission mode the VAT invoices showing VAT separately can be issued by the dealer, thereby resulting in continuance of VAT chain. These modes of incentives, therefore appear to be much better option under VAT regime for exempted units as they fulfil the objective of grant of incentives without breaking the VAT chain.

- **VAT & Works Contract**
  - The works contract is a deemed sale, which involves the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract.
  - Earlier the judicial decisions took a view that in the case of composite contracts involving sale of goods and execution of works, no sales tax could be levied at all. However, in order to make the law clear, the 46th amendment to the Constitution provided for the taxation of transfer of materials used in the execution of a works contract as deemed sale. Clause 29A was added to Article 366 of the Constitution of India to cover 'transfer of property in goods involved in execution of works contract'.

  - **Definition of works contract**
    Clause 2(ja) in the Central Sales-tax Act, 1956
    2'(ja) "works contract" means a contract for carrying out any work which, includes assembling, construction, building, altering, manufacturing, processing, fabricating, erection, installation, fitting out, improvement, repair or commissioning of any movable or immovable property".
    Majority of the States have adopted this definition for works contract in their VAT legislations.

Guidelines to ascertain works contract

To ascertain whether a transaction is a works contract as contemplated in Article 366 (29A)(b), the following points should be kept in mind:

1. There must exist an individual works contract; divisible contracts are outside the scope.
2. Goods must be involved in the execution of the works. Transfer of property in goods does qualify as works contract when it is incorporated in the works.
3. Transfer of property in goods must pass as goods or in some other form.
4. Property in goods must pass during the execution of works not before or after the execution of works.
5. Some work has to be done on the property of the contractee by the contractor.
6. In the works contract, transfer of property must be an integral part of its execution.
7. Pure labour contracts or service contracts are outside the purview of the sales tax/VAT law.
8. If during the execution of works contract goods are consumed and their identity is lost then no transfer of property occurs in those goods.

Taxable turnover for works contract

- The **entire contract price** cannot be subjected to VAT but only value of the goods in which the property would pass during execution of works contract can be taxed.
- The amount representing labour & other service charges incurred for such execution should be excluded.
- Where such labour and other service charges are not quantifiable, the sale price shall be the cost of acquisition of the goods + the margin of profit on them prevalent in the trade + the cost of transferring the property in the goods and all other expenses in relation thereto

Tax rates

(a) Schedule Rate

- When the value of each item of material transferred is identifiable, tax is charged on the value of individual items as per schedule of concerned State VAT Law
- Input tax Credit is allowed.

(b) Composition Rate

- The VAT Legislations have provided for composition rates to be applied on the entire contract value of the works contract.
- In such cases, generally the contractor is not entitled to avail of input tax credit on goods procured from within the State. However, in some States (e.g. Maharashtra) partial input tax credit is granted.

Input tax credit on capital goods

Several kinds of works contracts do not involve any manufacturing or processing of goods e.g. contracts for construction of roads, bridges, etc., and yet we find that capital goods of substantial amount are used in the execution of such contracts. Majority of the VAT legislations provide for availing of input tax credit on capital goods **only** where such goods are used in manufacturing or processing of goods.

- **VAT & Lease Transaction**

A lease is a special type of transaction, under which a party owning the asset (called the 'lessor') provides that asset for use over a certain period of time to another party (called the 'lessee') for consideration (called 'rentals').

The legal ownership of the asset remains with the lessor, but the lessee retains the possession and uses the asset over the period of the lease.

Lease as per AS 19

Generally, there are two different types of leases:

Finance lease : The lessor provides finance to the lessee for the purchase of necessary equipments. Machinery and tools, intended to be purchased are purchased in the name of the lessor, but the right to select the assets rests with the lessee.

After the end of lease period the lessee has an option to purchase the leased asset.

A finance lease is a lease that transfers substantially all the risks & rewards incident to the ownership of an asset.

Operating lease : The lessor selects the machinery and equipment required to be purchased and then leases out the same to the customer. The ownership is retained by the lessor but the use of the assets by the lessee is made for a limited period of time.

The AS 19 on Leases defines an operating lease as a lease other than a finance lease.

Taxable event

Taxable event is the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration. Thus, a transfer which is gratuitous is not taxable. Also, transfer of the right to use *immovable property*, like renting a house or factory is not taxable.

Taxable turnover

Normally, the sale price means the amount of valuable consideration paid or payable for any sale made during the given period. It also includes some other charges before delivery thereof. However, certain States have provided for the deduction of interest or finance charges for the purpose of determination of sale price/taxable turnover.

Inter-state leasing

Lease of an asset that is in the course of inter-State or import trade cannot be taxed under a State VAT law. It can be taxed under the Central Sales-tax Act, 1956.

As the definition of "sale" in the Central Sales-tax Act, 1956 has been amended to cover 'deemed sale', therefore deemed sales in the course of inter-State trade will attract tax under the Central Sales Tax Act.

Sub-lease

Transfer of the right to use goods does not require that the goods should be owned by the person effecting such transfer. Accordingly, sub-lease of an asset too can be taxed, unless the State Value Added Tax law has provided for the levy of tax only at one stage.

Sale of leased asset after lease period

Sale of a leased asset after the lease period is over is taxable in the same manner in which normal sale of such asset would have been taxed. Normally, such sale is effected to the same lessee and hence such sale would be a local one exigible to tax under the VAT laws of the State in which the asset is located.

Maintenance of leased asset

The maintenance of the leased asset involving supply of materials for maintenance/repair by the lessor would not amount to works contract, as there would be no transfer of property in such materials to the lessee. Thus, there would be no VAT on the value of the materials supplied during maintenance/repair of the asset. In case of computers, generally the lessor undertakes the maintenance and repair of the leased computers. However, the materials required during such maintenance /repair would be input for sale and input tax credit will be available.

Input tax credit

(a) Input tax credit allowed on purchase of the leased asset

Under the VAT legislations tax is to be charged on each stage of sale with the availing of input tax credit of the tax charged on the earlier stages. The tenure of the lease agreements is generally spread over a long period of time and lease rentals are collected over such lease periods. The lessor would pay VAT at the time of procurement of goods. However, liability to pay VAT on lease rentals will be spread over the tenure of the lease. Therefore, some States have provided for utilization of input credit for paying output tax only over the entire period of lease.

This would result in accumulation of input tax credit in the hands of the lessor for a long period of time. Since the tax would eventually be payable by the lessor, he may opt to carry forward the excess input tax credit instead of claiming a refund from the tax authorities.

Consequently, the lessor would have to manage his working capital in order to ensure that carrying of excess input tax credit does not affect his business adversely. However, States like Maharashtra have provided for immediate utilization of such input tax credit against payment of any tax.

(b) Input tax credit as capital goods

The assets given on lease will be generally capitalized by the lessor in his books and will be treated as capital assets. Thus, provision relating to input tax credit on capital goods will apply, e.g. if VAT law provides to give input tax credit on capital goods in 36 months then irrespective of period of lease, input tax credit will be available only for 36 months.

On going leases

In case of the lease agreements entered prior to the introduction of VAT, the lessor would have paid sales tax at the time of procuring the goods. Further, if the lease agreement related to first point goods, the lessor would not have been required to pay any tax on the lease rentals received by him in the sales tax regime.

However, in the VAT regime, the lessor would be required to pay tax on the lease rentals received post introduction of VAT with availability of input tax credit of sales tax paid at the time of procurement of such goods. The availing of input tax credit would be subject to the provisions of the concerned VAT legislations.

VAT & Hire Purchase Transactions

- Hire purchase is a type of instalment credit under which the hire purchaser, called the hirer, agrees to take the goods on hire at a stated rental, which is inclusive of the repayment of principal as well as interest, with an option to purchase.
- Under this transaction, the hirer acquires the property (goods) immediately on signing the hire purchase agreement but the ownership or title of the same is transferred only when the last instalment is paid. The hire purchase system is regulated by the Hire Purchase Act 1972.
- This Act defines a hire purchase as "an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which:
  1. The owner delivers possession of goods thereof to a person on condition that such person pays the agreed amount in periodic instalments.
  2. The property in the goods is to pass to such person on the payment of the last of such instalments,
  3. Such person has a right to terminate the agreement at any time before the property so passes".

Hire purchase should be distinguished from instalment sale wherein property passes to the purchaser with the payment of the first instalment. However, in case of hire purchase (Ownership remains with the seller until the last instalment is paid) buyer gets ownership after paying the last instalment.

Taxable event

The definition of sale under value added tax laws of various States provides that the taxable event will be the delivery of goods on hire purchase or any system of payment by installments. It is implicit that such transaction should be for monetary consideration.

In the case of hire-purchase, property passes in the goods when the hirer exercises his option to purchase the goods subject to the fulfillment of the terms of the agreement and then the transaction fructifies into a concluded (normal) sale.

In the case of delivery of goods on a system of payment by installments, property in the goods passes only where all the installments are paid, which the customer is under an obligation to pay. Such a sale is called 'an installment sale'. Such a transaction is distinct from a credit sale of goods as in the credit sale, the property in the goods immediately passes on delivery of the goods and the buyer is allowed to pay the price by installment or otherwise.

The basic difference in taxation of hire-purchase transaction is that the taxable event has been made the delivery of the goods and not the completed sale on payment of the last installment.

Point of tax

A debatable question which arises is whether in case of hire-purchase or installment sale VAT will have to be paid again at the time when transaction fructifies into a concluded sale, inspite of tax having been deposited on installment (payable as and when due, whether or not recovered). Answer to this problem depends mostly upon the provisions of the VAT laws of the States in which the goods are located when the transaction fructifies into a concluded sale.

One view is that when the transaction fructifies into a concluded sale, tax will not be payable as tax has already been paid on installment. However the other view is that, earlier tax was a tax on delivery of the goods on hire-purchase or installment. Therefore, at that time only the consideration received for hire-purchase or installment was taxed and the consideration receivable at the time of concluded sale does not get taxed. Hence, tax is payable again on the fructified sale on the depreciated value of the asset or its market value. The second view appears to be logical. However, if no consideration is payable on fructified sale then tax is not attracted.

Input tax credit

The hire purchase transaction is at par with normal sale transaction. Therefore normal provisions relating to input tax credit will apply. However, some States have provided for prorate credit.

Finance charges/interest

It is common knowledge that the installment fixed for payment in the case of a hire-purchase arrangement involves an element of interest or finance charges in addition to the price of the goods sold. While some of the State VAT legislations have provided for deduction of such interest or finance charges in arriving at the sale price to be treated as turnover in a hire purchase transaction, some States have not done so.

Goods returned

The VAT is payable on the date of delivery of the goods. If for any reason the goods are returned, then refund of tax will have to be claimed as per the provisions of respective State VAT laws. Many States provide the time limit for granting the claim of goods returned.
Therefore, if the goods are not returned during that specified period, no benefit will be available.

Unpaid installments/ forfeited installments

If for any reason, the transaction of hire purchase fails, then the vendor takes possession of the goods. In substance, this is a sales return. Thus, the provisions of local VAT Act relating to sales return will apply. Normally in such cases the installment received for the intervening period are forfeited.

VAT AND CENTRAL SALES-TAX

CENTRAL SALES TAX

India has a federal structure and the present State-Level value added tax is designed on individual State basis i.e. each State will impose value added tax on the sale/purchase transactions taking place within the State. So far as the trade between various States of India is concerned, the same has been governed by the Central Sales-tax (CST) Act, 1956 which is administered by the State sales-tax departments and the revenue is retained by the State Governments.

The Central Sales Tax Act, 1956 is an Act of the Parliament to formulate the principles for determining when sale or purchase of goods takes place in the course of inter-State trade or commerce. It provides for levy and collection of tax on such inter-State sales of goods.

It also formulates principles for determining when a sales or purchase of goods takes place outside a State or in the course of import into or export from India. It also specifies and declares certain goods to be of special importance in inter-State trade and commerce and specifies in relation to them the restrictions and conditions to which the State sales tax laws shall be subject.

A dealer, registered under CST Act, effecting an inter-State-purchase of goods, either for resale, or for use in manufacture or processing of goods, or for mining, or for use in generation and distribution of power or for use in packing for sale/resale can issue form C for availing of the benefit of purchasing at a concession rate (4%) of tax. This form is obtained by the purchasing registered dealer from the concerned sales tax officer.

CST Leads to Cascading of Taxes

India has a purely unbalanced State wise economy as only some of the States are manufacturing States while majority of them are consumer states. Manufacturing States generate considerable revenues from CST.

A lot of goods come into the consuming States with CST imposed on them. When these goods are resold in these States, the tax liability of non-manufacturing States becomes very high on account of VAT and CST. For example, States that do not produce plastic granules (raw material) have to pay 4% CST (against 'C' Form) on import of plastic granules and on value-addition (finished products) it attracts 12.5% tax, the set-off of tax being nil as CST is not vatable (the concept of CST being non-vatable). Thus, the total tax liability is 16.5% but the States where the raw material (plastic granules) is available the total tax liability would be only 12.5%. This shows that VAT with CST leads to cascading effect. Trade will be uncompetitive for the States that are net importers, because in those States consumer prices will be high, while the very objective of the VAT system is the lowering of prices for the consumers. Since, CST is an origin-based tax collected by the exporting
State whereas VAT is a destination based consumption tax, both cannot go together.

CST Is not VATable

The inter-state purchases liable to CST are not eligible for input tax credit. However, the liability for CST can be set off against the input tax credit earned on other eligible purchases.

Let us try to understand this with the help of an example and see why CST is not vatable.

A dealer of Karnataka purchases goods from another dealer of Maharashtra. The
Maharashtra dealer charges CST @ 4% on this sale against the C-form produced by the dealer of Karnataka. The tax is deposited in the treasury of Maharashtra and thus forms part of Maharashtra's revenue. Though its name is central sales tax but the Central Government does not get any part of this revenue and it is totally a revenue receipt of the selling state. The Karnataka dealer later sells these goods in the State of Karnataka to any other dealer or consumer and collects VAT on the same. Now the question arises whether the Karnataka dealer can claim input tax credit of the CST paid by him against his

VAT liability. The answer is no as Karnataka (purchasing State) would not allow set off of a tax paid in Maharashtra (another State) against the tax levied by it as it would result in revenue loss for the Karnataka (purchasing State). This is the main reason why CST is not vatable or why it cannot be made vatable.
However, when liability of CST arises on a inter-state sale, the input tax credit can be used for set off as the revenue in this case the revenue does not go to any other State.

CST After Introduction of VAT
As per the national consensus, the inter-State transactions of purchase and sale will continue to be governed by the CST Act at least for some time till the State-Level Value Added Tax is settled and an alternative system as envisaged in the White Paper is implemented.

VAT and Central-Sales Tax
A decision has been taken by the Empowered Committee for duly phasing out of inter- State sales-tax or CST. The White Paper in this regard states that:
"There is also a need, after introduction of VAT, for phasing out of CST. However, the States are now collecting nearly Rs.15,000 crores every year from CST. There is accordingly a need for compensation from the Government of India for this loss of revenue as CST is phased out. Moreover, while CST is phased out, there is also a critical need for putting in place a regulatory frame-work in terms of Taxation Information Exchange System to give a comprehensive picture of inter-State trade of all commodities. As already mentioned, this process of setting up of Taxation Information Exchange System has already been started by the Empowered Committee, and is expected to be completed within one year. The position regarding CST will be reviewed by the Empowered Committee during 2005-06, and suitable decision on the phasing out of CST will be taken."
The VAT Panel has taken a view that the phase-out would begin from April 1, 2007, with a reduction in CST ceiling rate from 4% to 2% per cent. The VAT Panel had earlier announced that the CST phase out would begin from October 1, 2006 with a reduction in ceiling rate from 4% to 3%, followed by 3% to 2% on April 1, 2007, then a review by December 2007, reduction from 2% to 1% in April 2008 and then from 1% to 0 in the subsequent year.
The move to defer the phase out came in the wake of lack of "convergence" between the States and the Centre over the elements of the compensation package for CST phase out. The CST phase-out would exactly be the same as the previously planned schedule except that the six-month reduction from 4% to 3% (from October 1, 2006 to March 31, 2007) would not take place. After reducing the rate from 4% to 2%, the review would happen as planned by December 2007.

AMENDMENTS IN CST ACT TO FACILITATE INTRODUCTION OF VAT
Amendment in section 15
Finance Act, 2002 had amended section 15(a) of the CST so as to empower States to impose tax at more than one stage in respect of declared goods defined under section 14 of the CST Act. This amendment is basically in response to the suggestions of the Empowered Committee on VAT asking for amendment in the CST Act so as to facilitate smooth introduction of VAT. It is hoped that CST rate for sale against 'C' form would be gradually reduced from 4% to 0%. Once it becomes so, sales-tax will be levied only by the destination State.
Amendment in section 8
Finance Act, 2003 has amended section 8(1) of the CST Act, to provide that with effect from the date to be notified by the Central Government in the Official Gazette, the rate of tax payable by a dealer shall be 2% of his turnover or the State sales tax rate, or as the case may be, the rate applicable under any

enactment of that State imposing value added tax, whichever is lower. However no notification has yet been issued to make the 2% rate effective.