Value Added Tax

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What is VAT ?

- VAT is a form of Indirect tax. Indirect tax means tax that is not directly collected by the government. It is always collected through some medium in between. Eg. VAT, Customs, Service Tax.

- VAT is a state level tax levied on sales. Its levy is always on the point of sales and never on the point of purchase.

- When the goods are sold tax is levied on **VALUE ADDITION ONLY.**

- VAT is levied only on intra-state (Maharashtra to Maharashtra) sales. Correspondingly for inter-state (Maharashtra to Goa) sales CST is levied. CST stands for Central Sales Tax and its current rate is 2%.

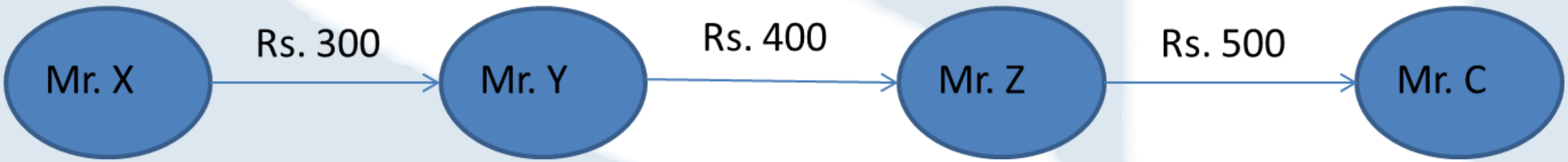
- A new legislation on Goods and Service tax (GST) is about to be brought in wherein all indirect taxes (VAT, Excise, CST, Service tax etc.) will be combined to form a common uniform VAT for the whole country.

Rates of VAT

Rate	Product
Exempt	There are about 50 items here out of which only 10 are decided by individual states and the remaining are common for all the states. Contain natural, unprocessed products in the unorganised sector. Eg Vegetables, pots.
0%	Items whose prices are not fully market determined fall under this category. The states are however allowed to charge VAT on them up to a maximum of 20%. Eg Petrol, ATF, Liquor.
1%	Precious Stones, Gold, Silver, Bullion and Ornaments.
4%	It consists of basic necessities such as medicines, agricultural products, capital goods etc.
12.5%	It consists of most of the luxuries that we use in day to day life.

Features of VAT

- In VAT tax is paid only on the value addition. This is done as every dealer gets Input Tax Credit for the amount of VAT he has paid on the purchase value.
  Thus the amount of tax he pays to the government =
  VAT collected at sales – VAT paid during purchase



- Table showing VAT collected by the government (Assume Rate of VAT to be 1%)

Particulars	**Rs.**
X pays 1% of Rs. 300/-	3
Y pays 1% of Rs. 100/- (400-300)	1
Z pays 1% of Rs. 100/- (500-400)	1
Total Tax received by the government	**5**
Total Tax due to the government @ 1% of Rs. 500/-	**5**

Features of VAT

- The above given table shows that VAT is always paid only on the amount of value added. Eg Y purchases goods from X @ 300. 1% of 300 is Rs. 3.
  He sells the goods to Z @ 400. 1% of 400 is Rs. 4. The value addition done by Y is equal to 400-300 = Rs. 100 and he has paid tax equal to 1% of 100 i.e. Re. 1 to the government.

- Here Re. 1 is also equal to the difference in VAT collected on sale and paid on purchases. Thus it is proved that the amount of tax he pays to the government =
  VAT collected at sales – VAT paid during purchase

- By the introduction of VAT there is no cascading effect of tax. This means no tax is charged on the tax amount. This is because the dealer gets setoff for the amount of input tax credit on purchases and thus this input tax is not added to the cost of the product.

Input Tax Credit

- The credit received for the amount of tax paid on purchases of raw materials and capital goods from dealers in the **same state** is known as Input Tax Credit.
- It is not necessary that the goods purchased should be utilized or sold. Credit can be availed once the tax is actually paid, even on unsold goods.
- There is no credit available if the final goods manufactured from the inputs are exempt goods.
- Normally all goods exported are exempt goods. But input tax credit is available on these goods.
- The credit for the tax paid on capital goods can be availed over a period of maximum 36 months. (time frame is decided by the respective state government).
- When any stock is transferred to some branch or warehouse of ours in some other state the amount of input tax credit we get is reduced by 2%. The 2% is retained by the state government.

Input Tax Credit

However there are various purchases that are ineligible for set-off. These are :-

- Purchase of goods from some other state.
- Purchases from unregistered dealers.
- Purchases from registered dealers who opt for composition scheme.
- Purchase of goods notified by the respective state government.
- Purchase of goods where the invoice is not available, or the amount of tax is not shown separately.
- Where there is evidence that the invoice has not been issued by the seller.
- Purchase of goods which are being utilised in the manufacture of exempted goods.
- Goods imported from other countries or from high sea sales.
- Goods purchased for personal use/consumption or gifted.
- Purchase of goods used in fuel/power generation.

Carry fwd and Refund of Credit

- **SETOFF :**

- The tax credit is always adjusted first against the VAT liability.
- The excess if any should be setoff against the CST collected.

- **CARRY FORWARD AND REFUND :**

- After giving due setoff if there is any Input Tax Credit still lying in account then it will be carried forward to the next year.
- Incase there is any unadjusted Input Tax Credit at the end of the second year, the same shall become eligible for refund. Some states have decided to grant a refund even at the end of the first year itself.
- If, the goods are exported outside the country refund shall be granted on the Input Tax Credit for such goods within 3 months.

Variants of VAT

There are three variants of VAT, namely :-

- Gross Product Variant
- Income Variant
- Consumption Variant

Gross Product Variant

- In this variant deduction is allowed on all purchases of raw materials but no deduction is allowed on Capital Goods. Thus input tax credit is available only on the amount of VAT paid on purchase of Raw Materials.
- By doing this total cascading effect is not prevented as the pro rata cost of the capital goods forms a part of the cost of the product sold and notionally gets taxed again.
- Modernization and upgrading of Plant and Machinery is delayed due to this dual tax treatment.
- **VAT to be remitted to the government = VAT payable on sales – VAT credit allowed on raw materials only.**

Income Variant

- In this variant deduction is allowed for Raw Materials as well as the depreciation portion of the Capital goods. Thus this is a better system than Gross Product Variant.

- The input tax credit is available on the capital asset on a pro rata basis as and when the depreciation is charged on the capital goods.

- Practically there are many difficulties regarding the specification of any method measuring depreciation, which basically depends on the life of the capital asset.

- **VAT to be remitted to the government = VAT payable on sales – VAT credit allowed on raw materials & proportionate VAT Credit allowed on depreciation on Capital goods.**

Consumption Variant

- In this variant deduction is allowed for Raw Materials as well as the Capital goods. Thus this is a better system than Gross Product Variant and Income Variant. Thus Input tax credit is available on all types of purchases.

- This is the universally followed method..

- As credit is available on all types of purchases there is no cascading effect at all plus there is no need to examine whether the goods are capital goods or not.

- **VAT to be remitted to the government = VAT payable on sales – VAT credit allowed on raw materials + Capital goods.**

Methods to Calculate VAT

There are three methods to calculate VAT :-

- Addition Method / Income approach
- Subtraction Method / Product approach
- Invoice Method / Tax Credit approach

Addition Method

- Tax is levied at each stage of sale and value addition is arrived at by aggregating all factor payments and even profit.
- This method is also known as Income Approach.
- In the chain of sales the goods may enjoy certain exemptions at certain point but this method is incapable of accommodating such exemptions. Thus, tax is worked out on exempted goods also. Eg. Electricity is an exempted product but while calculating the cost, the dealer includes pro rate electricity cost in every unit and thus increases his sale price. While collecting VAT he collects it on the amount of electricity expenses also.
- In this method there is no scope for matching of invoices to check tax evasion.

Subtraction Method

- The subtraction method estimates value-added by means of difference between outputs and inputs and is also known as Product Approach.

- Subtraction method can be further classified into :

a. **Direct Subtraction Method** : Here, tax is levied on the difference between aggregate value of sales excusive of tax and aggregate value of purchases exclusive of tax.
b. **Intermediate Subtraction Method** : Here, tax is levied on the difference between aggregate value of sales inclusive of tax and aggregate value of purchases inclusive of tax.

- Since tax is not on the sale value but confined to value addition only, the question of set-off does not arise only.

- This method is conveniently followed where tax is not charged separately i.e. invoice price represents cum-tax price. Billing will be for Rs. 1100/- instead of 1000 + 100 VAT.

- Formula for calculation of VAT : $\text{Tax} = \dfrac{r}{100+r} \times t$

where : t = Taxable Turnover (Value Added)

r = Rate of VAT

Subtraction Method

- The main problem with this method is that it gives different results for 'uniform rate' and 'varying rates'.

Illustration :

Stage	**Particulars**	**Turnover for VAT**	**VAT @ 1%**
1	First seller to distributor. Price = 10,100/- (Cum-tax price).	10,100	100 [(1/100+1) * 10,100]
2	Distributor to Wholesale trader. Price = 12,120/- (Cum-tax price).	2,020 (12,120 – 10,100)	20 [(1/100+1) * 2,020]
3	Wholesale trader to Retail trader. Price = 14,140/- (Cum-tax price).	2,020 (12,120 – 10,100)	20 [(1/100+1) * 2,020]
4	Retail Trader to consumer. Price = 15,150/- (Cum-tax price).	1,010 (15,150 – 14,140)	10 [(1/100+1) * 1,010]
	TOTAL		**150**

Invoice Method

- This method is also known as Tax Credit Method or Voucher Method.
- In this method the tax on inputs is deducted from the tax on sales to arrive at the VAT payable by the dealer. Thus the quantum of tax is worked out on the total value passed on to the buyer / sale value.
- The seller gets input tax credit on the VAT paid on purchases and thus he pays only the balance to the government.
- In this method it becomes necessary for the dealer to keep proper purchase vouchers to avail the benefit of set-off on the input tax credit paid. Thus he has to maintain proper books of accounts and it even reduces the chances of possible tax evasion.
- Practically, this method is followed in India currently.

Merits of VAT

- **Eliminates multiple Tax:** Set off will be given for the input tax as well as tax paid on previous purchase as well as capital goods. Thus there is no cascading effect of tax.

- **Reduction in Sales price:** As there is no cascading effect of tax, the cost as well as RSP of products stay low.

- **Simplicity:** It is based simply on transactions and not on a base that requires complicated definitions like income or wealth.

- There is certainty in the quantum of tax. **VAT Payable = Tax on sale – Tax on purchase**

- **Tax transparency:** The buyer knows, out of the total consideration paid for purchase of material, what is tax component. Thus, the system ensures transparency.

- **Maintenance of proper books of accounts:** As set-off on Input tax credit is not available unless proper purchase and sale accounts are maintained by the dealer, it is very necessary for the dealer to maintain proper books of accounts.

Demerits of VAT

- **It does not cover goods as well as service:** VAT extends to the retail stage, its base is nor comprehensive enough to compare all goods and services that go into final consumption.
- Neutrality is possible only if the purchases are made within the state. No credit is given in respect of CST purchases. Only when CST is included in the set-off part, total benefit of VAT will be available.
- The amount of focus it gives to the maintenance of books of accounts, it becomes a huge burden for small dealers.
- There are various exemptions and composition schemes available which hinder the total benefit available due to VAT.
- Being a consumption tax, the burden of tax is the same for the poor as well as the rich. In this regards VAT is regressive and not beneficial for the country as a whole.

Role of ICAI and CA's in VAT

- ICAI has prescribed a "Guidance note on accounting for state level VAT".

- In VAT system, the dealer does self assessment. Only 20% of cases are marked for detailed check by the authorities. To enable effective checks, the department needs the expertise of CA's.

- Compulsory VAT audit is there in many states for dealers who have turnover above a certain limit.

- Broadly a CA helps the department in :

a. Going through the books of accounts.
b. Analysing and interpreting the provisions of state-level VAT laws.
c. Reporting any short payment or excess payment of tax that he has come across while conducting the audit.

Registration under VAT

- Registration is the process of obtaining certificate of registration from the VAT authorities of the respective state.

- Such registration is compulsory when the turnover of the dealer exceeds Rs. 10 lakhs. Except for that it is compulsory whenever the dealer :
  - Purchases or sells goods from and to some other states.
  - Is dealing in the Export or Import business.
  - Is liable to pay 20% tax on goods like lottery tickets, liquor, petrol etc.

- The dealer should file an application in specified form along with the prescribed fee and the necessary documents to register himself.

- A dealer can be defined as any person, who consequent to, or in connection with, or incidental to, or in the course of his business, buys or sells goods for a consideration or otherwise.

Registration under VAT

- Dealers whose turnover is less than Rs. 10 lakhs in a year can also register voluntarily. By doing this he can avail the benefit of Input tax credit and even his customers will get input tax credit on their purchases.

- The registration has to be made within 30 days of crossing the turnover limit.

- Registration can be cancelled when :
- Business is transferred to a new location.
- Annual turnover falls below the minimum required for compulsory registration.
- Discontinuance or disposal of the business.
- Dealer has become insolvent.
- There is a change in the constitution if the business.

Composition Scheme

- ➢ This scheme is available for dealers whose annual turnover is below Rs. 50 Lakhs.

- ➢ Under this scheme VAT shall be payable as a small percentage of the gross turnover. The fixing of composite rates of tax is left to the discretion of the respective state.

- ➢ The following dealers are not eligible for the composite scheme:
- Purchases or sells goods from and to some other states.
- Is dealing in the Export or Import business.
- A dealer who transfers his stock to his warehouse or branch in some other state.
- A dealer who wants to issue VAT invoice.

- ➢ The dealer shall exercise this option in writing to the commissioner for a year or a part of the year.

- ➢ Advantages of this scheme :
- It saves the labour and efforts of maintaining a lot of records.
- There is a simple return form to cover a longer return period.

- ➢ Disadvantages of this scheme:
- The dealer cannot avail input tax credit on his purchases and nor can he pass the credit forward to his customers. Thus buyers wont prefer to buy from him.

Records to be maintained

The following records are to be maintained under the VAT law:

- Purchases
- Sales
- Exempted sales
- VAT account
- Copies of all invoices maintained in chronological order.
- Details of output and Input tax paid in each quarter.
- Details of the goods manufactured in the factory.
- Party wise details of every debtor and creditor.

VAT Invoice

- Invoice is a document which contains a list of the goods sold, with the price, tax charged and other details as may be prescribed under the Act.

- The invoices should always be maintained serially numbered. It should be dated and signed by the dealer or his regular employee.

- A VAT invoice is an extremely important document as without the invoice credit cannot be availed.

- It is a tool by which tax evasion is stopped by the authorities and also assists in effective audit of VAT.

- It contains:
  - Name, address and registration number of the seller and the buyer.
  - Pre-printed/ self generated serial number.
  - Date of issue.
  - Description and quantity of the goods.

TIN Number and Return

Taxpayer's identification No.:

- It consists of a 11 digit numerous throughout the country
- First 2 character will be represented the state code by the govt. of India
- Next 9 characters will be different in different states.

Return:

- Returns are to be filed monthly/quarterly as specified in the state acts with payment Challan.
- Every return furnished by dealer will be scrutinized and if any technical mistakes are detected, the dealer will be required to pay the deficit appropriately.

Audit

- Correctness of self-assessment will be checked through a system of departmental audit.
- However if any mistake is detected on audit, the concerned dealer may be taken up for audit for previous periods also.
- The audit team will conduct its work as a time bound manner and audit will be completed within a stipulated period which is 6 months maximum.
- Authorized officers can visit the office of the dealer to verify the correctness and examine the records.
- The audit report will be transparently sent to the dealer also.
- Simultaneously, a cross checking computerized system is being worked out on the basis of co-ordination between central excise & income tax authority.
- This cross-checking system will help to reduce tax evasion and also lead to significantly growth of tax revenue.